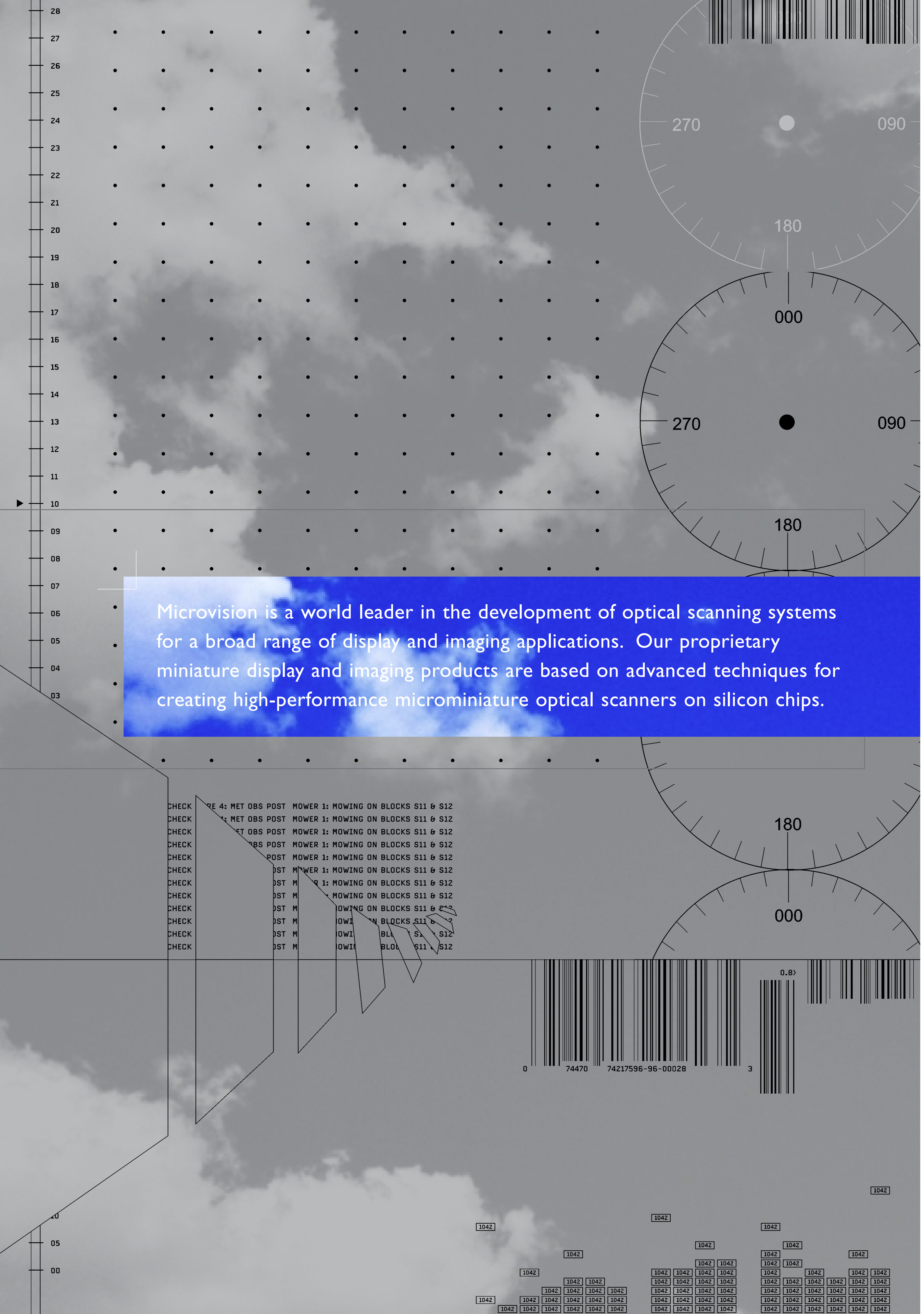
REALIZE POTENTIAL

MICROVISION 2001 ANNUAL REPORT



Microvision is a world leader in the development of optical scanning systems for a broad range of display and imaging applications. Our proprietary miniature display and imaging products are based on advanced techniques for creating high-performance microminiature optical scanners on silicon chips.

FELLOW SHAREHOLDERS

"... transformation of an R&D organization into a commercial enterprise... "

We have just completed the most successful year in Microvision's history, recording record revenue for the year and for the fourth quarter of 2001. As a result of our revenue growth for the last three years, we were awarded a place in Deloitte and Touche's Fast 50 for the state of Washington and the Fast 500 for the United States.

2001 was a year of challenges and commitments, a year of inspiring teamwork and organizational growth. It was a year in which we successfully implemented the operating disciplines that must accompany the transformation of an R&D organization into a commercial enterprise, while staying true to the passions and creative energies that are the essence of innovation and the heart of our entrepreneurial culture.

Microvision completed the development of two unique and compelling products; the recently launched Nomad™ Personal Display System and the soon-to-be-launched Flic™ Personal Bar Code Scanner. The sense of accomplishment that comes with reaching a long prized goal was compounded by a very real sense of historical moment. The Nomad System is not only a tremendous technological achievement, and Microvision's first product; it is also the first display ever based on a scanning micromirror, and the world's only commercial system using a scanned-beam display.

In addition to being technologically distinctive, the Nomad System's performance is unrivaled by any other wearable display. Surgeons, soldiers, emergency workers, technicians, and pilots continue to respond enthusiastically to the product, and as I write this, we are actively developing a team of qualified channel partners to address a variety of exciting market opportunities for the Nomad System, and ramping production to support growing demand. Looking to the future, we believe that these are only the first small steps in the development of a whole new category of unique and powerful mobile information tools that can, over time, become as pervasive as electronic information systems themselves.

The first test marketing introduction of our Flic Personal Bar Code Scanner in November elicited a strong response from channel partners, prospective OEM partners and large potential end-users. Early indications suggest that our mid-year launch of the Flic scanner may be followed with robust sales during the second half of 2002.

Microvision worked hard during the last year to realize the potential of our proprietary scanning technology in our first commercial products, but we also continued to further develop its potential for a broad array of future products.

We made great strides in combining our unique microscanning mirror with low cost light emitting diodes (LEDs) to address the potential for high volume consumer applications of our miniature displays. We demonstrated prototypes that produce

"... passions and creative energies that are the essence of innovation and the heart of our entrepreneurial culture... "

"... with each passing day, we see potential being realized and discover new potentials for Microvision's powerful platform technologies."

extraordinary image quality, and through partnerships with Walsin Lihwa, Cree and others, we believe that we can produce superior quality displays for much lower costs than competing miniature displays.

We continue to progress with the development of laser-scanning cameras for a variety of image capture applications, ranging from two-dimensional bar code readers to machine vision systems and advanced medical scopes.

During the last year our team delivered prototype systems of unique laser-scanning projection systems to leading automobile manufacturers. Our ongoing contract work for the U.S. military has resulted in a helmet mounted display system of unmatched performance. New contracts initiated late in 2001 have broadened the scope of our funded projects to include developments aimed at wearable displays for military surgeons, medics and dismounted troops that build on and leverage our ongoing development of the Nomad System.

Early in the year, we completed a $24 million funding for our Lumera subsidiary with Cisco as lead investor, and we continue to look forward to developments from Lumera in the future as they develop powerful products based on their world leadership in electro-optic polymer technology.

2001 was a time of prolific innovation. We added a substantial number of new patents and applications to our growing portfolio of intellectual property. We now have over 57 issued U.S. patents and nearly 100 pending. We will continue to innovate and to protect our inventions at both Microvision and Lumera.

Indeed 2001 has been the most successful year in Microvision's history, and it is satisfying to reflect on our many achievements during this time, but we believe the coming year holds even more promise. We have introduced our first commercial product and will soon introduce a second. We continue to achieve technological breakthroughs that we believe will enable our product pipeline to broaden steadily for many years to come.

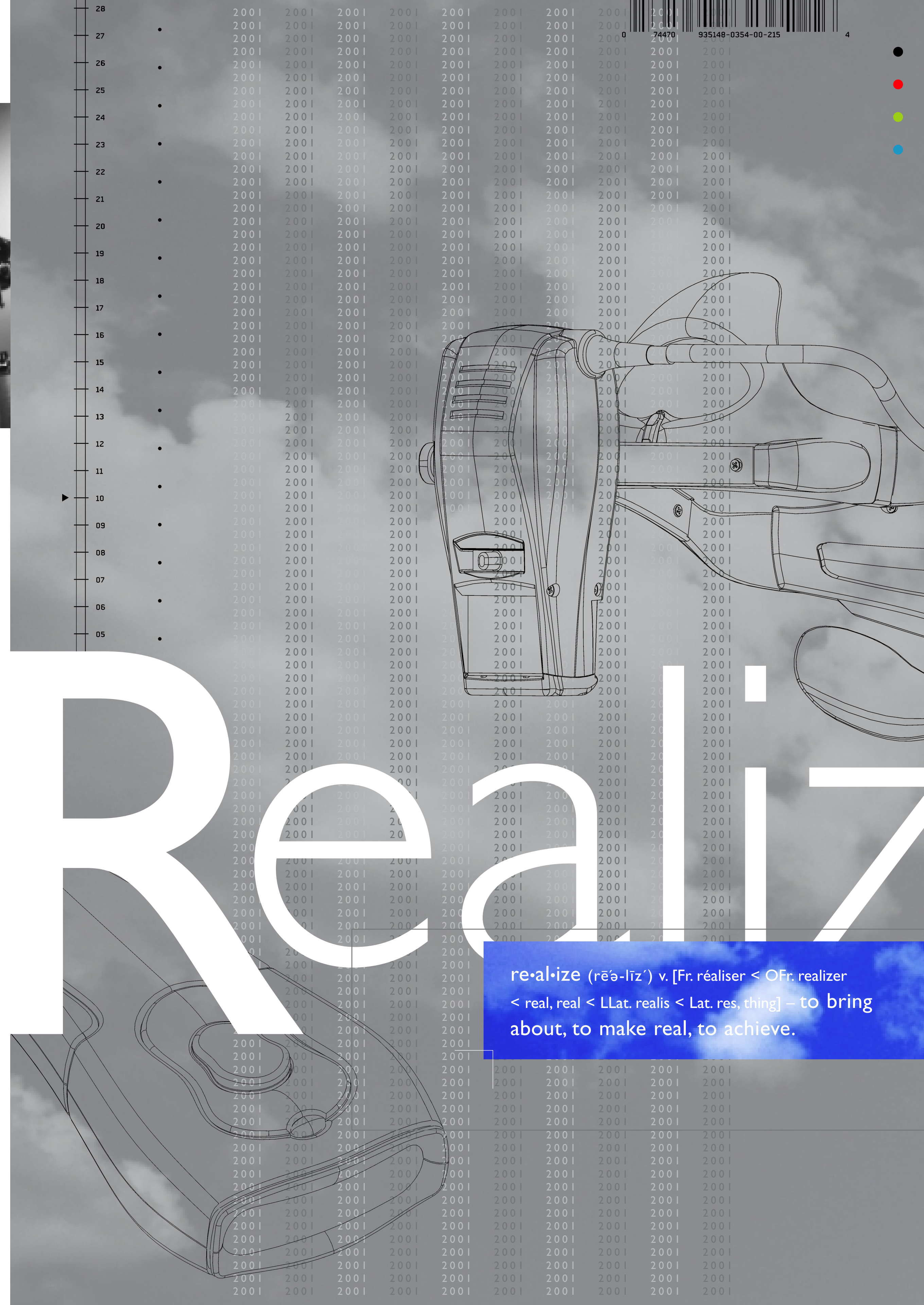
We are working with a growing list of outstanding partners to deliver powerful products and solutions, so that we can translate a position of technological leadership in microscanning systems technology for displays and imaging into market leadership.

One cannot help but feel the gathering momentum and the thrill of a promising future as, with each passing day, we see potential being realized and discover new potentials for Microvision's powerful platform technologies.

We thank you for your support during these exciting times.

Richard F. Rutkowski

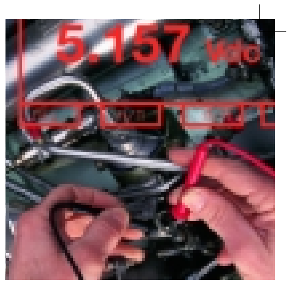
PRESIDENT AND
CHIEF EXECUTIVE OFFICER



"MICROVISION HAS THE CLEAR POTENTIAL TO REVOLUTIONIZE THE WAY IN WHICH VISUAL INFORMATION IS PRESENTED IN WORK AND LEISURE ENVIRONMENTS."

▸ DR. JOHN MARSHALL, FROST PROFESSOR OF OPHTHALMOLOGY, ST THOMAS' HOSPITAL, LONDON

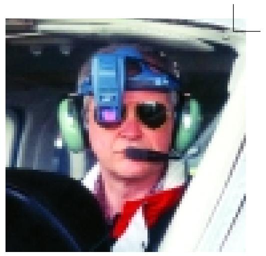
NOMAD



The Nomad System produces a high-contrast, high-resolution (SVGA) image that super-imposes electronic information onto the user's point of task.

The Nomad™ Personal Display System, Microvision's first commercial product, is a 'see-through', high-resolution, daylight-readable, head-worn display that augments the user's natural vision by super-imposing electronic information into the field of view to bring information to the "point of task". The Nomad System enables mobile workers to work hands-free and head-up in any lighting condition, allowing access to information anywhere. As a result, the Nomad System delivers major improvements in situational awareness, productivity, safety and precision, and provides greater versatility for mobile applications than alternative display solutions.

INFORMATION ANYWHERE



Pilots, surgeons, soldiers, technicians, and emergency workers continue to respond enthusiastically to the Nomad System. Production is beginning to ramp up to support growing demand.

FOCUS ON APPLICATIONS, CHANNELS & REFERENCE ACCOUNTS

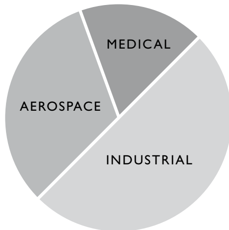
NOMAD'S FIRST CUSTOMERS:

STRYKER LEIBINGER (a division of Stryker Corporation): Nomad will help improve accuracy and decrease orthopedic operative time for surgeons.

EUROCONTROL Nomad will improve visualization for air traffic controllers, potentially reducing stress and workload, reducing delays, and improving airport safety.

ARVIKA (a consortium of companies including Siemens, Volkswagen, Daimler Chrysler, Zeiss, BMW, and Airbus): Using Nomad to improve development, production and servicing of complex technical products.

TELESENSORY Nomad could well improve the ability of people with poor vision to read printed material.



MARKET OPPORTUNITIES

OVER 60 MILLION ON-PREMISE MOBILE WORKERS

LASER PERFORMANCE AT THE PRICE OF A WAND

Flic easily scans, decodes and stores common bar code symbols. The product is expected to become commercially available in mid-2002.

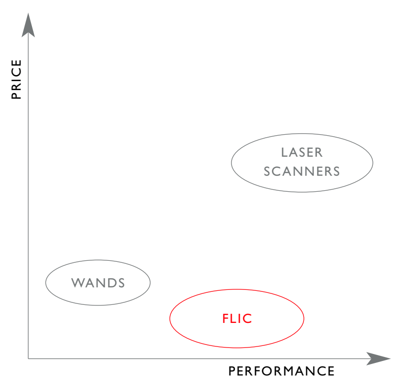
FLIC

BY 2004, THE LINEAR BAR CODE HANDHELD MARKET WILL REACH $1.8 BILLION.

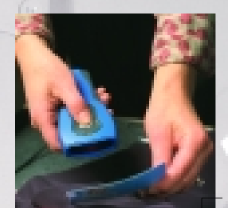
As an outgrowth of its efforts in Retinal Scanning Display technology, Microvision developed capabilities and technologies that resulted in patent-pending breakthroughs in image capture and scanning. The first product (to be delivered in mid-2002) is a revolutionary new bar code scanner. The FLIC™ Personal Bar Code Scanner has performance characteristics that exceed competing scanner solutions — at a cost below current market solutions.

"WE HAVE HAD A VERY POSITIVE RESPONSE BOTH FROM POTENTIAL CHANNEL PARTNERS AND POTENTIAL OEM PARTNERS. SIMILARLY, FORWARD-THINKING END USERS HAVE RESPONDED TO FLIC BY ENVISIONING WHOLLY NEW USE MODELS THAT DISTRIBUTE BAR CODE SCANNING MUCH MORE BROADLY ACROSS THEIR WORKFORCES. WITH A MID-YEAR COMMERCIAL LAUNCH TARGET, EARLY INDICATIONS SUGGEST THAT WE MAY SEE ROBUST SALES ACTIVITY FROM FLIC DURING THE SECOND HALF OF 2002."

▸ CHRIS WIKLOF, MICROVISION, DIRECTOR OF PRODUCT MANAGEMENT



UNLIKE TRADITIONAL SCANNERS, MICROVISION USES A FRESH APPROACH TO CREATE A LOW-COST, HIGH-PERFORMANCE IMAGE CAPTURE DEVICE.



FLIC APPLICATIONS

MANUFACTURING
- order processing
- work-in-process tracking
- materials tracking
- time and attendance

TRANSPORTATION
- shipping and receiving
- cross-docking
- shipment tracking

HEALTH CARE
- bedside transaction processing
- security access
- time and attendance
- medical record maintenance

COMMERCIAL SERVICES
- shipping and receiving
- asset management
- inventory control

WAREHOUSING
- inventory management
- order processing

RETAIL IN STORE
- point of sale (POS)
- customer relationship management (CRM)
- inventory management

GOVERNMENT
- asset tracking
- logistics support
- personnel tracking

CONSUMER
- registry
- shopping lists
- price/product comparison
- catalog shopping
- information retrieval

PRODUCTIVITY

"WE'RE EXTREMELY EXCITED ABOUT OUR NEXT PHASE OF APPLICATION AND INTEGRATION DEVELOPMENT WORK WITH MICROVISION'S DISPLAY. THE IMAGE QUALITY OF THE DISPLAY IS OUTSTANDING AND WE ARE CONFIDENT THAT THE DISPLAY, INTEGRATED WITH OUR SOFTWARE, WILL BE AN IMPORTANT DEMONSTRATION TOOL FOR A VARIETY OF POTENTIAL CUSTOMERS WHO REQUIRE ENHANCED VISUALIZATION AND NAVIGATION CAPABILITIES."

▸ DR. RICHARD EDWARDS, MANAGER OF CREW SYSTEMS TECHNOLOGY, BOEING PHANTOM WORKS

DEFENSE

DEVELOPMENT CONTRACTS

- VIRTUAL COCKPIT OPTIMIZATION PROGRAM
- SPECTRUM
- BIDT & TATRC
- AIRCREW INTEGRATED HELMET

FULL COLOR

BRIGHT
SEE-THROUGH
DAYLIGHT-READABLE
MONOCULAR
BINOCULAR
HI-RESOLUTION

SINGLE COLOR

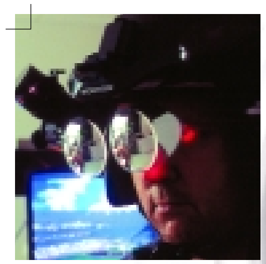
POTENTIAL USERS

- FIXED WING
- GROUND PERSONNEL
- MEDICAL SUPPORT
- GROUND VEHICLES
- ROTARY WING

TECHNOLOGY MATURATION		CONCEPT DEMOS		FIELD TEST	E-MD	PRODUCTION	
FY00	01	02	03	04	05	06	07

MICROVISION CONTINUES TO LEVERAGE DEFENSE CONTRACTS AND PARTNERSHIPS TO COVER KEY TECHNOLOGY AND PRODUCT DEVELOPMENT REQUIREMENTS FOR FUTURE DEFENSE PRODUCTS.

New contracts have broadened the scope of our funded projects to include developments that build on and leverage our ongoing work in the category of wearable displays for military surgeons, medics and dismounted troops, in addition to our work with the Army on helmet mounted displays for rotorcraft.

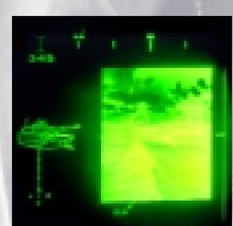


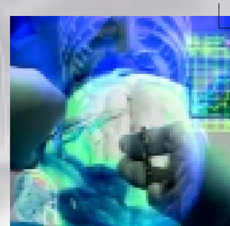
Our on-going contract work for the U.S. military resulted in a helmet-mounted display of unmatched performance. This prototype display system is being tested and evaluated for flight simulators and eventually operational aircraft.

"PEACE-KEEPING HAS BECOME INFORMATION-DRIVEN AND OUR ARMED FORCES MUST BE ABLE TO RECEIVE, INTEGRATE, AND RAPIDLY ASSIMILATE INFORMATION FROM DISPARATE SOURCES. BY PUTTING INFORMATION IN HEAD-UP, SEE-THROUGH MODE, MICROVISION'S RETINAL SCANNING DISPLAY TECHNOLOGY CAN BE A KEY ENABLER IN THIS PROCESS."

▸ BILL SYDNES, MICROVISION, COO

MISSION CRITICAL VISUALIZATION





Current applications in military cockpits and high-end medical equipment allow for continued rapid innovation of retinal scanning displays that produce single or full-color imagery, resulting in broad market opportunities.

"I'M VERY IMPRESSED WITH THE IMAGE QUALITY. THE TECHNOLOGY OFFERS THE EMISSIVE AND UNPIXELATED QUALITIES THAT HAVE ALLOWED CRTS TO DOMINATE DESKTOP AND TELEVISION MARKETS, WHILE OFFERING THE POTENTIAL OF VERY LOW COSTS IN A SUB-MINIATURE PACKAGE. I CAN'T WAIT TO GET A 3G CELL PHONE WITH A MICROVISION DISPLAY INSIDE."

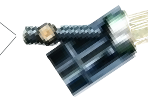
▶ DR ARIS SILZARS, PRESIDENT, SOCIETY FOR INFORMATION DISPLAYS

MOBILITY

Microvision's consumer strategy is to create display products that can have a dominant position in markets where high performance must be combined with very low cost. Our work on microdisplays is intended to generate a "virtual" image that appears close in size and resolution to that of a desktop display. This can be a powerful feature for high-volume applications like digital cameras, gaming systems, handheld wireless devices and portable DVD players.

MICRODISPLAY

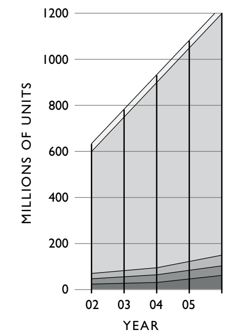
From just three light emitting diodes (LEDs) coupled with a vibrating mirror on a tiny micro-mechanical chip, Microvision's microdisplay platform can be packaged into a broad range of high-volume consumer products.



MICROVISION'S MICRODISPLAY PLATFORM

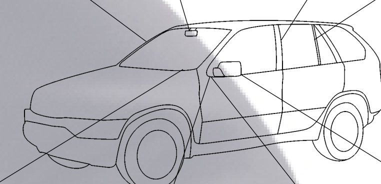
Addressable market: 600-800 million units per year by 2005.

- HANDHELD PCS
- WIRELESS HANDSETS
- DVD PLAYERS
- GAME CONSOLES
- DIGITAL CAMERAS



THE GLOBAL MARKET FOR AUTOMOTIVE TELEMATICS IS EXPECTED TO GROW TO $47.2 BILLION BY 2010 FROM $4.2 BILLION IN 2000.

FUTURE POTENTIAL MICRODISPLAY APPLICATIONS FOR AUTOMOBILES:



Microvision is working with numerous automotive companies to integrate microdisplays into a variety of future automotive applications.

"TODAY'S WIRELESS INTERNET DEVICES ARE LIMITED BY THEIR SMALL DISPLAY SCREENS. A KEY REMAINING INGREDIENT FOR MAKING WIRELESS DATA COMMUNICATION AND MOBILE INTERNET A REALITY IS A VIABLE DISPLAY TECHNOLOGY FOR PORTABLE DEVICES. MICROVISION'S RETINAL SCANNING DISPLAY OFFERS A UNIQUE AND INNOVATIVE SOLUTION TO MEET THE CHALLENGING MIX OF COST, PERFORMANCE AND MINIATURIZATION REQUIRED FOR THIS KIND OF APPLICATION."

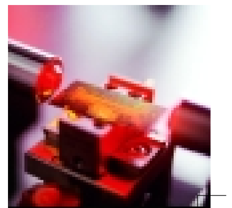
▶ ANDREW VITERBI, CO-FOUNDER, QUALCOMM, PRESIDENT, THE VITERBI GROUP

MICROVISION'S OPTICAL NETWORK COMPONENTS SUBSIDIARY COMPLETED A $24 MILLION ROUND OF FINANCING LED BY CISCO SYSTEMS, INC. IN MARCH 2001.

INTEGRATED OPTICAL SYSTEMS-ON-A-CHIP

LUMERA

As an outgrowth of its ongoing work in photonics, Microvision's majority owned subsidiary, Lumera, builds on patented technology using groundbreaking polymer tehnologies to create electro-optic devices. Devices built out of these polymers act as light gates, or optical switches, and are highly valued by optical equipment manufacturers.



BANDWIDTH

Prototype devices based on materials developed by Lumera's research team have already achieved record-setting bandwidth (in excess of 100 GHz) and operating voltages (below 1 volt) in demonstrations at commercial and government research labs.

"LUMERA'S MATERIAL SCIENTISTS, DEVICE DESIGNERS AND CHARACTERIZATION SPECIALISTS ARE TEAMING WITH THE UNIVERSITY OF WASHINGTON'S POLYMER EXPERTS TO DELIVER THE POTENTIAL OF THIS TECHNOLOGY TO THE ELECTRO-OPTIC MARKET IN 2002."

▸ TOM MINO, LUMERA, CEO

MICROVISION'S UNIQUE BEAM SCANNING TECHNOLOGY CAN BE APPLIED IN MANY DISPLAY AND IMAGE CAPTURE APPLICATIONS ACROSS A RANGE OF MARKETS FROM DEFENSE TO CONSUMER

DISPLAY

CAPTURE

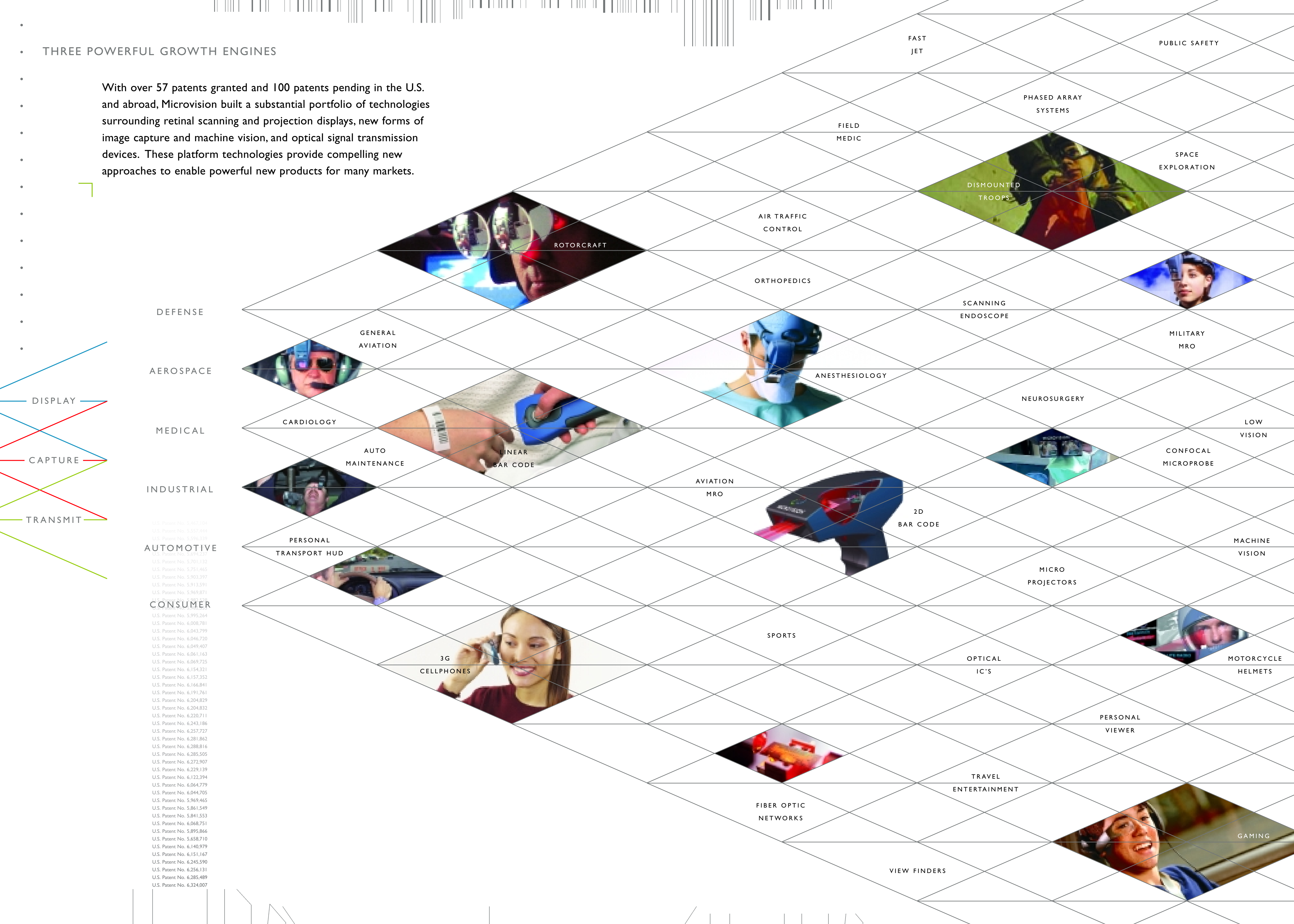
TRANSMIT

Potentia

po•ten•tial (pə-tĕn′shəl) adj. [ME potencial < OFr. < LLat. potentatus < Lat., power < potens, pr.part. of posse, to be able] – the inherent ability or capacity for growth.

THREE POWERFUL GROWTH ENGINES

With over 57 patents granted and 100 patents pending in the U.S. and abroad, Microvision built a substantial portfolio of technologies surrounding retinal scanning and projection displays, new forms of image capture and machine vision, and optical signal transmission devices. These platform technologies provide compelling new approaches to enable powerful new products for many markets.



U.S. Patent No. 5,467,104
U.S. Patent No. 5,557,444
U.S. Patent No. 5,596,339
U.S. Patent No. 5,659,327
U.S. Patent No. 5,694,237
U.S. Patent No. 5,701,132
U.S. Patent No. 5,751,465
U.S. Patent No. 5,903,397
U.S. Patent No. 5,913,591
U.S. Patent No. 5,969,871
U.S. Patent No. 5,982,528
U.S. Patent No. 5,982,555
U.S. Patent No. 5,995,264
U.S. Patent No. 6,008,781
U.S. Patent No. 6,043,799
U.S. Patent No. 6,046,720
U.S. Patent No. 6,049,407
U.S. Patent No. 6,061,163
U.S. Patent No. 6,069,725
U.S. Patent No. 6,154,321
U.S. Patent No. 6,157,352
U.S. Patent No. 6,166,841
U.S. Patent No. 6,191,761
U.S. Patent No. 6,204,829
U.S. Patent No. 6,204,832
U.S. Patent No. 6,220,711
U.S. Patent No. 6,243,186
U.S. Patent No. 6,257,727
U.S. Patent No. 6,281,862
U.S. Patent No. 6,288,816
U.S. Patent No. 6,285,505
U.S. Patent No. 6,272,907
U.S. Patent No. 6,229,139
U.S. Patent No. 6,122,394
U.S. Patent No. 6,064,779
U.S. Patent No. 6,044,705
U.S. Patent No. 5,969,465
U.S. Patent No. 5,861,549
U.S. Patent No. 5,841,553
U.S. Patent No. 6,068,751
U.S. Patent No. 5,895,866
U.S. Patent No. 5,658,710
U.S. Patent No. 6,140,979
U.S. Patent No. 6,151,167
U.S. Patent No. 6,245,590
U.S. Patent No. 6,256,131
U.S. Patent No. 6,285,489
U.S. Patent No. 6,324,007

MVIS

FORWARD LOOKING STATEMENTS

Included in this report are photographic depictions of products and potential applications and products. Actual products and designs may vary prior to commercialization.

The statements in this annual report that relate to future plans, events or performance and potential applications of our technology are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and are subject to the safe harbor created by that section. Actual results might differ materially due to a variety of important factors. These factors involve risks and uncertainties relating to, among other things, market acceptance of and the current developmental stage of the Company's technology; the Company's history of negative cash flows and current expectation of additional losses; change in display technologies; the Company's lack of manufacturing experience and ongoing capital requirements; and the Company's dependence on key personnel. The Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission contains additional information about these and other risk and uncertainties that could cause actual results to differ materially from those in the forward-looking statements.

A summary of selected financial data as of and for the five years ended December 31, 2001 is set forth below:

YEAR ENDED DECEMBER 31,	**2001**	2000	1999	1998	1997
(IN THOUSANDS, EXCEPT PER SHARE DATA)					
STATEMENT OF OPERATIONS DATA					
Revenue	$ 10,762	$ 8,121	$ 6,903	$ 7,074	$ 1,713
Net loss available for common shareholders	(34,794)	(26,601)	(16,700)	(7,328)	(4,945)
Basic and diluted net loss per share	(2.85)	(2.33)	(2.04)	(1.22)	(.85)
Weighted average shares outstanding – basic and diluted	12,200	11,421	8,169	5,994	5,806
BALANCE SHEET DATA					
Cash, cash equivalents and investments available-for-sale	$ 33,652	$ 40,717	$ 32,167	$ 2,269	$ 8,841
Working capital	33,098	40,551	32,802	1,358	8,441
Total assets	54,055	56,172	41,619	6,362	10,741
Long-term obligations	552	714	836	282	92
Mandatorily redeemable preferred stock			1,536		
Total shareholders' equity	32,326	50,042	35,359	2,589	9,164

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

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations, of shareholders' equity, of comprehensive loss and of cash flows present fairly, in all material respects, the financial position of Microvision, Inc. and its subsidiary at December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Seattle, Washington
March 27, 2002

AS OF DECEMBER 31,	2001	2000
DOLLARS IN THOUSANDS		
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 15,587	$ 7,307
Investment securities, available-for-sale	18,065	33,410
Accounts receivable, net of allowances of $109 and $93	1,712	1,033
Costs and estimated earnings in excess of billings on uncompleted contracts	1,584	2,116
Inventory, net	99	—
Current restricted investments	102	1,125
Other current assets	2,302	976
Total current assets	39,451	45,967
Long-term investment, at cost	624	624
Property and equipment, net	8,960	7,516
Restricted investments	1,434	951
Receivables from related parties	2,252	1,000
Other assets	1,334	114
Total assets	$ 54,055	$ 56,172
LIABILITIES, MINORITY INTERESTS AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 1,613	$ 1,974
Accrued liabilities	4,298	2,359
Allowance for estimated contract losses	155	295
Billings in excess of costs and estimated earnings on uncompleted contracts	60	419
Current portion of capital lease obligations	170	317
Current portion of long-term debt	57	52
Total current liabilities	6,353	5,416
Capital lease obligations, net of current portion	61	182
Long-term debt, net of current portion	232	290
Deferred rent, net of current portion	259	242
Total liabilities	6,905	6,130
Commitments and contingencies (Note 13)	—	—
Minority interests	14,824	—
SHAREHOLDERS' EQUITY		
Common stock, no par value, 31,250 shares authorized; 12,998 and 11,884 shares issued and outstanding	135,954	120,506
Deferred compensation	(2,803)	(4,378)
Subscriptions receivable from related parties	(321)	(403)
Accumulated other comprehensive income	427	454
Accumulated deficit	(100,931)	(66,137)
Total shareholders' equity	32,326	50,042
Total liabilities, minority interests and shareholders' equity	$ 54,055	$ 56,172

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

YEAR ENDED DECEMBER 31,	2001	2000	1999
DOLLARS IN THOUSANDS EXCEPT PER SHARE INFORMATION			
Revenue	$ 10,762	$ 8,121	$ 6,903
Cost of revenue	6,109	6,076	4,944
Gross margin	4,653	2,045	1,959
Research and development expense (exclusive of non-cash compensation expense of $865, $7 and $34 for 2001, 2000 and 1999, respectively)	31,899	19,520	10,199
Marketing, general and administrative expense (exclusive of non-cash compensation expense of $1,668, $1,585 and $230 for 2001, 2000 and 1999, respectively)	14,356	10,475	7,205
Non-cash compensation expense	2,533	1,592	264
Total operating expenses	48,788	31,587	17,668
Loss from operations	(44,135)	(29,542)	(15,709)
Interest income	2,523	3,105	1,163
Interest expense	(92)	(164)	(172)
Realized gain on sale of investment securities	316	—	—
Loss before minority interests	(41,388)	(26,601)	(14,718)
Minority interests in loss of consolidated subsidiary	6,594	—	—
Net loss	(34,794)	(26,601)	(14,718)
Less: Preferred dividend	—	—	(228)
Non-cash beneficial conversion feature of Series B Preferred Stock	—	—	(1,754)
Net loss available for common shareholders	$(34,794)	$(26,601)	$(16,700)
Net loss per share – basic and diluted	$ (2.85)	$ (2.33)	$ (2.04)
Weighted-average shares outstanding – basic and diluted	12,200	11,421	8,169

The accompanying notes are an integral part of these financial statements

DOLLARS IN THOUSANDS

	Common Stock Shares	Common Stock Amount	Deferred Compensation	Subscriptions Receivable from Related Parties	Accum. Other Comprehensive (Loss) Income	Accumulated Deficit	Shareholders' Equity
Balance at December 31, 1998	6,065	$ 25,743	$ (239)	$ (79)	$ —	$ (22,836)	$ 2,589
Issuance of stock to board members for services	5	149	(149)				—
Exercise of warrants and options	2,961	33,556		(270)			33,286
Sales of common stock	710	9,738					9,738
Beneficial conversion feature of mandatorily redeemable preferred stock, net of costs		1,754				(1,754)	—
Conversion of preferred stock	400	4,334					4,334
Deferred compensation on stock options		197	(197)				—
Forfeitures of unvested stock options		(108)	108				—
Amortization of deferred compensation			264				264
Dividend on preferred stock		155				(228)	(73)
Other comprehensive loss					(61)		(61)
Net loss						(14,718)	(14,718)
Balance at December 31, 1999	10,141	75,518	(213)	(349)	(61)	(39,536)	35,359
Issuance of stock and options to board members for services	4	623	(623)				—
Exercise of warrants and options	1,108	13,342		(285)			13,057
Sales of common stock	500	23,977					23,977
Issuance of stock for acquisition of license	31	376					376
Conversion of mandatorily preferred stock	100	1,536					1,536
Deferred compensation on warrants and options		6,870	(6,870)				—
Revaluations of warrants		(1,736)	1,736				—
Collection of subscriptions receivable				231			231
Amortization of deferred compensation			1,592				1,592
Other comprehensive income					515		515
Net loss						(26,601)	(26,601)
Balance at December 31, 2000	11,884	120,506	(4,378)	(403)	454	(66,137)	50,042
Issuance of stock and options to board members for services	6	133	(133)				—
Issuance of stock and options to board non-members for services	1	108	(52)				56
Exercise of warrants and options	99	1,177					1,177
Sales of common stock	971	10,355					10,355
Effect of change in interest in subsidiary common stock		3,001					3,001
Issuance of stock for acquisition of license	37	970					970
Revaluations of warrants		(296)	296				—
Collection of subscriptions receivable				82			82
Amortization of deferred compensation			1,464				1,464
Other comprehensive loss					(27)		(27)
Net loss						(34,794)	(34,794)
Balance at December 31, 2001	12,998	$135,954	$(2,803)	$(321)	$427	$(100,931)	$ 32,326

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

YEAR ENDED DECEMBER 31,	**2001**	2000	1999
DOLLARS IN THOUSANDS			
Net loss	$(34,794)	$(26,601)	$(14,718)
Other comprehensive income (loss) – unrealized gain (loss) on investment securities, available-for-sale:			
Unrealized holding gains arising during period	289	515	(61)
Less: reclassification adjustment for gains realized in net loss	(316)	—	—
Net unrealized gain (loss)	(27)	515	(61)
Comprehensive loss	$(34,821)	$(26,086)	$(14,779)

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

YEAR ENDED DECEMBER 31,	**2001**	2000	1999
DOLLARS IN THOUSANDS			
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	$(34,794)	$(26,601)	$(14,718)
ADJUSTMENTS TO RECONCILE NET LOSS TO NET CASH USED IN OPERATIONS			
Depreciation	2,381	1,247	676
Non-cash expenses related to issuance of stock, warrants and options, and amortization of deferred compensation	2,533	1,592	264
Non-cash expenses related to issuance of stock for an exclusive license agreement	970	377	—
Minority interests in loss of consolidated subsidiary	(6,594)	—	—
Non-cash deferred rent	17	27	49
Allowance for estimated contract losses	(140)	295	(228)
CHANGE IN			
Accounts receivable	(679)	(8)	514
Costs and estimated earnings in excess of billings on uncompleted contracts	532	(116)	(1,242)
Inventory	(99)	—	—
Other current assets	(323)	(128)	(565)
Other assets	(59)	37	(32)
Accounts payable	(361)	521	125
Accrued liabilities	1,939	359	972
Billings in excess of costs and estimated earnings on uncompleted contracts	(359)	252	(604)
Net cash used in operating activities	(35,036)	(22,146)	(14,789)
CASH FLOWS FROM INVESTING ACTIVITIES			
Sales of investment securities	23,874	29,686	26,147
Purchases of investment securities	(8,556)	(33,212)	(55,577)
Sales of restricted investment securities	1,748	4,174	1,950
Purchases of restricted investment securities	(1,208)	(4,500)	(3,700)
Collections of receivables from related parties	25	—	—
Advances under receivables from related parties	(1,277)	(1,000)	—
Purchase of long-term investment	—	—	(624)
Purchases of property and equipment	(3,769)	(5,429)	(2,090)
Net cash provided by (used in) investing activities	$ 10,837	$(10,281)	$(33,894)

YEAR ENDED DECEMBER 31,	**2001**	2000	1999
DOLLARS IN THOUSANDS			
CASH FLOWS FROM FINANCING ACTIVITIES			
Principal payments under capital leases	(324)	(280)	(163)
Principal payments under long-term debt	(53)	(47)	(32)
Increase in deferred rent	—	—	166
Increase in long-term debt	—	—	420
Payment of preferred dividend	—	—	(73)
Payments received on subscriptions receivable	82	230	—
Net proceeds from issuance of common stock	11,532	37,033	42,730
Net proceeds from issuance of preferred stock	—	—	6,164
Net proceeds from sale of subsidiary's equity to minority interests	21,242	—	—
Net cash provided by financing activities	32,479	36,936	49,212
Net increase in cash and cash equivalents	8,280	4,509	529
Cash and cash equivalents at beginning of year	7,307	2,798	2,269
Cash and cash equivalents at end of year	$15,587	$ 7,307	$ 2,798
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash paid for interest	$ 92	$ 164	$ 172
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES			
Property and equipment acquired under capital leases	$ 56	$ 279	$ 246
Non-cash charges for Series B Preferred Stock	$ —	$ —	$ 1,908
Conversion of preferred stock to common stock	$ —	$ 1,536	$ 4,334
Effect of change in interest in subsidiary from issuance of subsidiary common stock	$ 3,001	$ —	$ —
Issuance of subsidiary stock and stock options for services rendered	$ 1,013	$ —	$ —

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

NOTE 1 THE COMPANY

Microvision, Inc. ("the Company"), a Washington corporation, was established to acquire, develop, manufacture and market retinal scanning display ("RSD") technology, which projects images onto the retina of the eye. The Company has entered into contracts with commercial and U.S. government customers to develop applications using the RSD technology. As part of these contracts, the Company has produced and delivered several demonstrator units. The Company is working to commercialize the RSD technology for potential defense, aviation, medical, industrial and consumer applications.

Lumera Corporation ("Lumera"), a majority owned subsidiary of Microvision, is a development stage company. Lumera was established to develop, manufacture and market optical devices using organic non-linear electro-optical chromophore materials ("Optical Materials"). Lumera is working to commercialize the devices for potential optical networking applications.

The Company believes that its cash, cash equivalent and investment securities balances totaling $33,700 at December 31, 2001, in addition to the $6,000 raised in March 2002, as described in Note 17, will satisfy its budgeted cash requirements for the next 12 months based on the Company's current operating plan. The Company's operating plan calls for the addition of sales, marketing, technical and other staff and the purchase of additional laboratory and production equipment. The operating plan also provides for the development of strategic relationships with systems and equipment manufacturers that may require additional investments by the Company. There can be no assurance that additional financing will be available to the Company or that, if available, it will be available on terms acceptable to the Company on a timely basis. If adequate funds are not available to satisfy either short-term or long-term capital requirements, the Company may be required to limit its operations substantially. The Company's capital requirements will depend on many factors, including, but not limited to, the rate at which the Company can, directly or through arrangements with OEMs, introduce products incorporating the retinal scanning display technology and the market acceptance and competitive position of such products.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

USE OF ESTIMATES The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Company's management has identified the following areas where significant estimates and assumptions have been made in preparing the financial statements: revenue recognition, allowance for uncollectible receivables, valuation of minority interest in a privately held company and potential losses from litigation.

PRINCIPLES OF CONSOLIDATION The consolidated financial statements include the accounts of the Company and Lumera. As of December 31, 2001 Microvision owns 76% and 11% of the outstanding common stock and mandatorily redeemable convertible preferred stock of Lumera, respectively. The balance of Lumera is owned by public companies and private investors, directors, Microvision employees and the University of Washington ("UW"). Lumera's losses were first allocated to its common shareholders until such losses exceeded its common equity and then to its preferred shareholders pro rata in accordance with their respective ownership interest. All material intercompany accounts and transactions have been eliminated in consolidation.

CASH, CASH EQUIVALENTS AND INVESTMENT SECURITIES The Company considers all investments that mature within 90 days of the date of purchase to be cash equivalents.

Short-term investment securities are primarily debt securities. The Company has classified its entire investment portfolio as available-for-sale. Available-for-sale securities are stated at fair value with unrealized gains and losses included in other comprehensive income (loss). Dividend and interest income are recognized when earned. Realized gains and losses are presented separately on the income statement. The cost of securities sold is based on the specific identification method.

RESTRICTED CASH The current portion of restricted cash represents a certificate of deposit held as collateral for a letter of credit issued to secure payment on a fixed asset purchase.

The long-term portion of restricted cash represents a certificate of deposit held as collateral for letters of credit issued in connection with a lease agreement for the corporate headquarters building. Most of the balance is required to be maintained for the term of the lease.

INVENTORY Inventory consists of raw material, and work in process for the Company's Nomad product. Inventory is recorded at the lower of cost or market with cost determined on the weighted-average method.

LONG-TERM INVESTMENT In December 1999, the Company invested $624 in Gemfire Corporation ("Gemfire"), a privately held corporation. Gemfire is a developer of diode laser components for display applications. The Company accounts for the investment in Gemfire using the cost method.

PROPERTY AND EQUIPMENT Property and equipment is stated at cost and depreciated over the estimated useful lives of the assets (three to five years) using the straight-line method. Leasehold improvements are depreciated over the shorter of estimated useful lives or the lease term.

REVENUE RECOGNITION Revenue has primarily been generated from contracts for further development of the RSD technology and to produce demonstration units for commercial enterprises and the United States government. Revenue on such contracts is recorded using the percentage-of-completion method measured on a cost incurred basis. Changes in contract performance, contract conditions, and estimated profitability, including those arising from contract penalty provisions, and final contract settlements, may result in revisions to costs and revenues and are recognized in the period in which the revisions are determined. Profit incentives are included in revenue when realization is assured.

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

Revenue for product shipments is recognized upon acceptance of the product by the customer or expiration of the contractual acceptance period. There are no rights of return on product shipments. Provision is made for warranties at the time revenue is recorded.

CONCENTRATION OF CREDIT RISK AND SALES TO MAJOR CUSTOMERS Financial instruments that potentially subject the Company to concentrations of credit risk are primarily cash equivalents, investments and accounts receivable. The Company typically does not require collateral from its customers. The Company has a cash investment policy that generally restricts investments to ensure preservation of principal and maintenance of liquidity.

The United States government accounted for approximately 93%, 91% and 82% of total revenue during 2001, 2000 and 1999, respectively. Three commercial enterprises represented 6%, 5% and 16% of total revenues during 2001, 2000, and 1999, respectively.

INCOME TAXES The Company provides for income taxes under the principles of Statement of Financial Accounting Standards ("SFAS") No. 109, which requires that provisions be made for taxes currently due and for the expected future tax effects of temporary differences between book and tax bases of assets and liabilities and for loss and credit carry forwards.

NET LOSS PER SHARE Basic net loss per share is calculated on the basis of the weighted-average number of common shares outstanding during the periods. Net loss per share assuming dilution is calculated on the basis of the weighted-average number of common shares outstanding and the dilutive effect of all potential common stock equivalents and convertible securities. Net loss per share assuming dilution for 2001, 2000 and 1999 is equal to basic net loss per share because the effect of potential common stock equivalents outstanding during the periods, including convertible preferred stock, options and warrants computed using the treasury stock method, is anti-dilutive. The common stock equivalents and convertible securities that were not included in the earnings per share were 5,672,000, 3,517,000 and 3,365,000 at December 31, 2001, 2000 and 1999, respectively.

RESEARCH AND DEVELOPMENT Research and development costs are expensed as incurred. As described in Note 7, Lumera issued shares of its common stock in connection with a research agreement the value of these shares is amortized over the period of the research agreement.

FAIR VALUE OF FINANCIAL INSTRUMENTS The Company's financial instruments include cash and cash equivalents, investment securities, accounts receivable, accounts payable, accrued liabilities, derivative instruments, long-term debt and capital lease obligations. Except for capital leases and long-term debt, the carrying amounts of financial instruments approximate fair value due to their short maturities. The carrying amount of capital leases and long-term debt at December 31, 2001 and 2000 was not materially different from the fair value based on rates available for similar types of arrangements.

DERIVATIVES The Company does not hold or issue derivative financial instruments for trading purposes. The purpose of the Company's hedging activities is to reduce the risk that the eventual cash flows of the underlying assets and liabilities will be adversely affected by changes in exchange rates. Counterparties to derivative financial instruments expose the Company to credit-related losses in the event of nonperformance. However, the Company has entered into these instruments with creditworthy financial institutions and considers the risk of nonperformance to be remote. As of December 31, 2001 the Company has an open contract to purchase 12.7 million Yen (approximately $100) in connection with a firm purchase commitment by the Company. The transaction is accounted for as a foreign currency cash flow hedge as defined by FAS 133. Changes in the fair value of the derivative instrument are (1) initially reported as a component of other comprehensive income outside earnings and (2) later reclassified as earnings in the same period during which the hedged transaction affects earnings. There were no changes in the fair value of its derivative instruments at December 31, 2001.

LONG-LIVED ASSETS The Company periodically evaluates the recoverability of its long-lived assets based on expected undiscounted cash flows and recognizes impairment of the carrying value of long-lived assets, if any, based on the fair value of such assets.

STOCK-BASED COMPENSATION The Company accounts for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" and related amendments and interpretations, including FASB Interpretation Number ("FIN") 44, "Accounting for Certain Transactions Involving Stock Compensation," and complies with the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force Issue No. 96-18.

MVIS NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONT. (DOLLARS IN THOUSANDS EXCEPT PER SHARE INFORMATION) 28
MVIS NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONT. (DOLLARS IN THOUSANDS EXCEPT PER SHARE INFORMATION) 29

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

In July 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations". This statement provides accounting and reporting standards for business combinations initiated subsequent to June 30, 2002. All business combinations in the scope of this statement are to be accounted for under one method, the purchase method.

In July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets". This statement provides accounting and reporting standards for intangible assets acquired individually, with a group of other assets, or as part of a business combination. This statement addresses the treatment of acquired goodwill and other intangible assets after they have been initially recognized in the financial statements. Under this statement, goodwill and other intangibles with indefinite useful lives, on a prospective basis, will no longer be amortized, however will be tested for impairment at least annually, based on a fair value comparison. Intangibles that have finite useful lives will continue to be amortized over their respective useful lives. This statement also requires expanded disclosure for goodwill and other intangible assets. The Company will be required to adopt this statement no later than January 1, 2002. As the Company has no recorded goodwill or intangible assets, there will be no initial effect from adoption of this standard.

In July 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations". This statement provides accounting and reporting standards for costs associated with the retirement of long-lived assets. This statement requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. Adoption of this statement is required no later than January 1, 2003. The Company is currently assessing the impact of this statement on its results of operations, financial position and cash flows.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement replaces SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of". FAS 144 retains the fundamental provisions of SFAS No. 121 for recognition and measurement of the impairment of long-lived assets to be held and used and for measurement of long-lived assets to be disposed of by sale. This statement applies to all long-lived assets, including discounted operations, and replaces the provisions of APB Opinion No. 30, "Reporting Results of Operations-Reporting the Effects of Disposal of a Segment of a Business", for the disposal of segments of a business. This statement requires that those long-lived assets be measured at the lower of carrying amount of fair value less cost to sell, whether reported in continuing operations or in discontinued operations. Microvision will be required to adopt this statement no later than January 1, 2002. The implementation of SFAS 144 will not have a material impact on the Company's results of operations, financial position or cash flows.

NOTE 3 LONG TERM CONTRACTS

Cost and estimated earnings in excess of billings on uncompleted contracts comprises amounts of revenue recognized on contracts that the Company has not yet billed to customers because the amounts were not contractually billable at December 31, 2001 and 2000. The Company will be contractually able to bill 93% and 94% of the balance at December 31, 2001 and 2000, respectively, within 30 days of the respective year-end.

In April 2001, the Company entered into a $2,900 contract modification with the U.S. Army's Aviation Applied Technology Directorate to continue work on an advanced helmet-mounted display and imaging system to be used in the Virtual Cockpit Optimization Program. In addition, the Company entered into a $4,200 contract modification with the U.S. Army's Aircrew Integrated Helmet Systems Program office to further advance the form and functional development of a helmet-mounted display.

In October 2001, the Company entered into a $1,500 subcontract with Concurrent Technologies Corporation in support of the Office of Naval Research's Battlespace Information Display Technology program. The purpose of the program is to develop micro-electrical mechanical systems for use in displaying information on the battlefield.

In December 2001, the Company entered into a $3,300 contract with the U.S. Army's Medical Research Acquisition Activities Telemedicine and Advanced Technology Research Center for the initial phase in the development of a mobile wireless personal display system for medical applications.

The Company's current contracts with the U.S. government are primarily cost plus fixed fee type contracts. Under the terms of a cost plus fixed fee contract the U.S. government reimburses the Company for negotiated actual direct and indirect cost incurred in performing the contracted services. The Company is under no obligation to spend more than the contract value to complete the contracted services. The period of performance is generally one year.

During 2000, the Company entered into a $5.0 million contract with the U.S. Army's Aviation Applied Technology Directorate to continue work on an advanced helmet-mounted display and imaging system to be used in the Virtual Cockpit Optimization Program. In addition, the Company was awarded a $2.8 million contract with the U.S. Army's Aircrew Integrated Helmet Systems Program office to further advance the form and functional development of a helmet-mounted display.

During 2000, the Company entered into a $600,000 contract to provide a Nomad demonstrator unit and a full-color prototype display to the Cleveland Clinic. The Company has sold four additional Nomad demonstration units to customers in the medical and industrial markets during 2000.

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

DECEMBER 31,	2001	2000
Costs incurred on uncompleted contracts	$ 23,587	$ 13,824
Billings on uncompleted contracts	(22,063)	(12,127)
	$ 1,524	$ 1,697
Included in accompanying balance sheets under the following captions		
Costs in excess of billings on uncompleted contracts	$ 1,584	$ 2,116
Billings in excess of costs on uncompleted contracts	(60)	(419)
	$ 1,524	$ 1,697

NOTE 4 INVESTMENTS AVAILABLE-FOR-SALE

The following table summarizes the composition of the Company's available-for-sale investment securities at December 31, 2001 and 2000.

DECEMBER 31,	2001	2000
U.S. corporate debt securities	$15,262	$18,532
U.S. government agency debt securities	2,803	14,878
	$18,065	$33,410

The fair value of the available-for-sale investment securities by contractual maturity at December 31, 2001 is as follows:

	Fair Value
Due in one year or less	$ 8,267
Due in one year through two years	6,145
Due in two years through three years	3,653
	$18,065

NOTE 5 ACCRUED LIABILITIES

Accrued liabilities consist of the following:

DECEMBER 31,	2001	2000
Bonuses	$1,111	$ 657
Payroll and payroll taxes	865	564
Subcontractors	774	470
Compensated absences	371	225
Relocation	329	130
Taxes	324	163
Professional fees	227	80
Other	297	70
	$4,298	$2,359

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MVIS NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONT. (DOLLARS IN THOUSANDS EXCEPT PER SHARE INFORMATION) 31

NOTE 6 PROPERTY AND EQUIPMENT, NET

Property and equipment consist of the following:

DECEMBER 31,	2001	2000
Lab equipment	$ 5,318	$ 3,278
Leasehold improvements	4,356	3,800
Computer hardware and software	3,209	2,214
Office furniture and equipment	1,021	787
	13,904	10,079
Less: Accumulated depreciation	(4,944)	(2,563)
	$ 8,960	$ 7,516

NOTE 7 RECEIVABLES FROM RELATED PARTIES

In 2000, the Board of Directors authorized the Company to provide an unsecured line of credit to each of the Company's three executive directors. The limit of the line of credit is three times the executives' base salary less any amounts outstanding under the Executive Option Exercise Loan Plan. In 2001, the Board of Directors authorized a $500 addition to the limit for one executive, and expanded the group of eligible executives to four. The lines of credit carry interest rates of 5.4% to 6.2%. The lines of credit must be repaid within one year of the earlier of the executive's termination or plan termination. At December 31, 2001, a total of $2,252 and $1,000, respectively, was outstanding under the lines of credit.

In 2000, three executive officers of the Company exercised a total of 128,284 stock options, in exchange for full recourse notes totaling $285. These notes bear interest at 4.6% to 6.2% per annum. Each note is payable in full upon the earliest of (1) a fixed date ranging from January 31, 2001 to December 31, 2004 depending on the expiration of the options exercised; (2) the sale of all of the shares acquired with the note; (3) on a pro rata basis upon the partial sale of shares acquired with the note, or (4) within 90 days of the officer's termination of employment. The notes are included as subscriptions receivable from related parties in shareholders' equity on the consolidated balance sheet.

The interest on both the lines of credit and the full recourse notes is forgiven if the executive is an employee of the Company at December 31 of the respective year. Compensation expense of $116 and $44 was recognized in 2001 and 2000, respectively, for interest forgiven.

NOTE 8 LUMERA SUBSIDIARY EQUITY TRANSACTIONS

In March 2000, Lumera issued 4,700,000 shares of its Class B common stock to the Company for services provided by the Company to Lumera of $94. At the same time, Lumera issued 670,000 shares of its Class B common stock to certain executives of the Company for $12 in cash. Shares of Lumera Class B common stock have ten votes per share.

In January 2001, Lumera issued 802,414 shares of Lumera Class A common stock to the UW at a value of $3.75 per share in connection with a research agreement described in Note 13. Shares of Lumera Class A common stock have one vote per share. The valuation of the shares issued to the UW was more than the per share carrying amount of the Company's interest in Lumera. Although the Company's percentage ownership in Lumera was reduced as a result of this transaction, the increased value of Lumera stock created a gain for the Company on the change in ownership interest. The amount of the gain of $3,001 resulting from the revaluation of the Company's interest in Lumera was credited to paid-in capital.

In March 2001, Lumera issued 2,400,000 shares of its Series A preferred stock at a price of $10.00 per share. Included in this total were 264,000 shares issued to the Company in repayment of intercompany borrowings. The Lumera Series A preferred stock is convertible into shares of Lumera Class A common stock and has voting rights equivalent to the Class A common stock. Holders of the Lumera Series A preferred stock are entitled to receive noncumulative dividends at a rate of $0.60 per share per annum, when and if declared by Lumera's Board of Directors. On any liquidation of Lumera, each holder of Lumera Series A preferred stock is entitled to receive an amount of $10 per share in preference to any distribution to the holders of Lumera common stock. Upon full payment of the Series A preferences, the holders of Lumera preferred and common stock share in any further distributions based on the number of shares of common stock held (on an as converted basis) until the holders of the Lumera Series A preferred stock receive an aggregate of $30.00 per share. Thereafter, any remaining funds and assets of Lumera are distributed pro rata among the holders of the common stock.

Losses in Lumera are first allocated to the holders of the common stock and then to the holders of the preferred shareholders pro rata in accordance with their respective ownership interest. Losses are not allocated to the options and warrants until exercised.

Lumera common stock and Series A preferred stock are eliminated in consolidation with Microvision interests in Lumera common stock and Series A preferred stock and options and warrants to purchase equity in Lumera held by investors other than the Company, and are presented as minority interests on the Company's consolidated balance sheet. A reconciliation of the movements in minority interests is as follows:

		Minority Interests		
	Microvision	Other Common	Other Preferred	Total
Balance at inception	$ 94	$ 13	$ —	$ 107
Loss allocation for 2000	(2,892)	(13)		(2,905)
Balance at December 31, 2000	(2,798)			(2,798)
Issuance of common stock to UW		3,009		3,009
Change in interest	3,001	(3,001)		—
Issuance of preferred stock, net	2,640		21,242	23,882
Options and warrants	719	168		887
Loss allocation for 2001	(3,045)	(8)	(6,586)	(9,639)
Balance at December 31, 2001	$ 517	$ 168	$14,656	$15,341

NOTE 9 PREFERRED STOCK

In January 1999, the Company raised $5,000 (before issuance costs) from the sale of 5,000 shares of Series B-1 convertible preferred stock to a private investor, who was also a director, in a private placement. The preferred stock was immediately convertible into common stock at a rate of $12.50 in preferred stock per common share and carried a cumulative dividend of 4% per annum, payable in cash or additional convertible preferred stock at the election of the Company. The investor also acquired an option to purchase an additional 1,600 shares of Series B-2 convertible preferred stock with an exercise price of $16.00 per share with a six-month maturity and an option to purchase an additional 1,920 shares of Series B-3 convertible preferred stock with an exercise price of $19.20 per share with a nine-month maturity from the closing date of the transaction.

The conversion prices of the Series B-1 and Series B-2 convertible preferred stock were less than the closing prices of the Company's common stock on the dates of commitment to purchase the preferred stock. This beneficial conversion feature was valued at $1,800. This "discount" is treated as a preferred stock dividend and recorded to accumulated deficit over the period between the date of sale and the date on which the preferred stock first becomes convertible. Because the preferred stock was immediately convertible, the entire value of the beneficial conversion feature was recorded as a dividend in 1999.

In October 1999, the Company amended the option to purchase 1,920 shares of the Series B-3 Convertible preferred stock to extend the expiration date of the option to June 30, 2000. In consideration of the extension, the holder waived the right to receive dividends on the outstanding Series B-2 convertible preferred stock. The terms of the option were also amended to an option to purchase 100,000 shares of common stock at a conversion price of $19.20. The amendment was accounted for as a preferred stock dividend with a fair market value of $154.

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

NOTE 10 COMMON STOCK

In April 2000, the Company raised $25,000 (before issuance costs) from the issuance of 500,000 shares of common stock to Cree, Inc. and General Electric Pension Trust. Concurrently, the Company entered into a two-year, $10,000 extension of the development agreement with Cree. The Company was required to pay $4,500 during the first year of the extension in four equal quarterly payments. The first payment was made concurrently with the signing of the extension. During the second year of the extension, the Company is required to pay the remaining $5,500 in four equal quarterly payments.

In June 2000, the Company raised $1,900 (before issuance costs) from the exercise, by an investor, of a warrant to purchase 100,000 shares of common stock at a price of $19.20 per share.

As described in Note 13, in February 2001, the Company issued 37,000 shares of common stock valued at $1,000 to the UW in connection with the purchase of an Exclusive License Agreement. In October 2001, the Company raised $11,000 (before issuance costs) upon issuance of 971,000 shares of common stock to a group of private investors. The investors also acquired fully vested warrants to purchase an aggregate of 146,000 shares of common stock at a price of $14.62 per share for a period of four years.

From 1996 until October 2001, the Company had a stock grant plan for its independent directors ("Directors Stock Plan"). The Directors Stock Plan provided for granting up to a total of 75,000 shares of common stock to non-employee directors of the Company. The Directors Stock Plan was terminated in October 2001 effective as of the vesting date of the annual awards granted as of the June 6, 2001 annual shareholder meeting.

NOTE 11 WARRANTS

In April 1999, the Company issued two fully vested warrants to purchase common stock in connection with a sale of common stock. The first warrant provides the holder the right to purchase up to 418,848 shares of common stock at a price of $17.91 per share until April 1, 2000. The first warrant was exercised in full on April 1, 2000. The second warrant provides the holder the right to purchase up to 145,495 shares of common stock at a price of $19.05 per share until April 1, 2004. The value of the warrants of $3,690 was determined using the Black-Scholes option-pricing model with a dividend yield of zero percent, expected volatility of 83%, risk free interest rate of 5.6% and expected lives of one and 2.3 years for the first and second warrants, respectively. The value of the warrants was accounted for as issuance cost of the common stock and charged directly to common stock.

On April 11, 2000, the Company received $7,500 (before issuance costs) upon exercise of a warrant to purchase 419,000 shares of common stock at a price of $17.91 per share. In December 2000, the Company issued fully vested warrants to purchase 5,000 shares of common stock, for $61.13 per share, to a consultant in payment of fees arising from this transaction.

On August 10, 2000, the Company issued warrants to purchase an aggregate of 200,000 shares of common stock to two consultants in connection with entering into certain consulting agreements with the Company. One of the consultants subsequently became a director. The warrants grant each of the holders the right to purchase up to 100,000 shares of common stock at a price of $34.00 per share. The warrants to purchase an aggregate of 150,000 shares vest over three years and are subject to remeasurement at each balance sheet date during the vesting period. The remaining warrants to purchase an aggregate of 50,000 shares had a measurement date at the time of grant. The deferred compensation related to these warrants is being amortized to non-cash compensation expense over the five-year period of service under the agreements. The total original value of both warrants was estimated at $5,476. Due to stock price fluctuations, the subsequent values for those warrants subject to remeasurement were estimated at $3,441 and $3,740 as of December 31, 2001 and 2000, respectively. Total non-cash amortization expense was $775 and $345 for the years ended December 31, 2001 and 2000, respectively. The fair values of the warrants were estimated at December 31, 2001, 2000, and the issue date, using the Black-Scholes option-pricing model with the following weighted-average assumptions: dividend yield of zero percent; and expected volatility of 83% for all measurement dates; risk-free interest rates of 5.9%, 6.0% and 6.0%; and expected lives of 9.2, 10 and 10 years.

The following table summarizes activity with respect to warrants for the three years ended December 31, 2001:

DOLLARS IN THOUSANDS	Shares (in thousands)	Weighted-average Exercise Price
Outstanding at December 31, 1998	2,606	$11.78
Granted:		
Exercise price greater than fair value	622	18.31
Exercise price less than fair value	31	13.20
Exercised	(2,533)	11.86
Canceled / expired	(22)	11.77
Outstanding at December 31, 1999	704	17.30
Granted:		
Exercise price greater than fair value	255	38.25
Exercise price less than fair value	6	19.20
Exercised	(485)	17.12
Canceled / expired	(17)	15.26
Outstanding at December 31, 2000	463	29.11
Granted:		
Exercise price greater than fair value	158	14.62
Exercise price less than fair value	1	8.00
Exercised	(7)	11.57
Canceled / expired	—	—
Outstanding and exercisable at December 31, 2001	615	$25.55

The following table summarizes information about the weighted-average fair value of warrants granted:

YEAR ENDED DECEMBER 31,	**2001**	2000	1999
Exercise price greater than fair value	$ 5.82	$ 15.43	$ 6.73
Exercise price less than fair value	18.39	36.57	10.24

The following table summarizes information about warrants outstanding and exercisable at December 31, 2001:

	Warrants Outstanding and Exercisable		
RANGE OF EXERCISE PRICES	Number Outstanding at Dec. 31, 2001 (in thousands)	Weighted-avg. Remaining Contractual Life (years)	Weighted-average Exercise Price
$8.00	12	0.02	$ 8.00
$12.50 – $16.00	176	3.55	$14.52
$19.05 – $20.32	172	2.29	$19.21
$34.00	200	8.61	$34.00
$53.00 – $61.13	55	3.32	$53.73
$8.00 – $61.13	615		

The fair value of the warrants granted was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 2001, 2000 and 1999, respectively: dividend yield of zero percent and expected volatility of 83% for all years; risk-free interest rates of 2.9%, 6.2% and 5.5%; and expected lives of 2, 2 and 1 years.

NOTE 12 OPTIONS

The Company has various stock option plans ("Option Plans") which provide for granting incentive stock options ("ISOs") and nonqualified stock options ("NSOs") to employees, directors, officers and certain non-employees of the Company as determined by the Board of Directors, or its designated committee ("Plan Administrator"). The shareholders have authorized issuing options for the purchase of up to a total of 6,504,000 shares of the Company's authorized but unissued common stock. The date of grant, option price, vesting period and other terms specific to options granted under the Option Plans are determined by the Plan Administrator. The Company deems the fair market value of its stock on any given trading day to be the closing price of its stock on the Nasdaq National Market on that date.

Stock options issued under the Option Plans, other than the 2000 Independent Director Stock Option Plan ("the Director Option Plan"), generally have vesting ranges from three years to four years; expiration ranges from five years to 10 years; and exercise prices are set equal to the fair market value of the Company's stock on the date of grant.

The Director Option Plan provides for an annual NSO grant to each independent director to purchase 5,000 shares of the Company's authorized but unissued common stock. A total of 150,000 shares are authorized shares under the plan. Options are granted to new directors on their appointment dates and granted to continuing directors each year on the date of their re-elections to the Board of Directors. The options vest in full no later than the Company's next regularly scheduled annual shareholders' meeting. The exercise price is equal to the average closing price of the Company's common stock as reported on the Nasdaq National Market during the ten trading days prior to the date of grant. The options expire ten years after of the date of grant. Upon leaving the Board, a grant remains exercisable up through its expiration date.

During 2001 and 2000, the Company issued 462,000 and 91,000 options, respectively, outside of its stock option plans to employees who are not executive officers of the Company. The terms and conditions of these options issued are the same as those issued under the Option Plans, except for the vesting provisions of the grants issued in 2001. These grants vest 25% on the grant date, 25% six months from the grant date, 25% one year from grant date and 25% eighteen months from grant date.

In October 2001, the Company granted, subject to shareholder approval, 127,000 options to independent directors. As the issuance of these options is contingent upon shareholder approval no deferred compensation or non-cash compensation amortization expense related to these options has been recorded during the year-ended December 31, 2001.

The following table summarizes activity with respect to options for the three years ended December 31, 2001:

DOLLARS IN THOUSANDS	Shares (in thousands)	Weighted-average Exercise Price
Outstanding at December 31, 1998	2,365	$ 12.75
Granted:		
Exercise price greater than fair value	326	25.90
Exercise price equal to fair value	380	21.33
Exercised	(431)	7.45
Forfeited	(178)	17.90
Outstanding at December 31, 1999	2,462	16.38
Granted:		
Exercise price greater than fair value	5	39.74
Exercise price equal to fair value	1,235	33.94
Exercise price less than fair value	85	35.58
Exercised	(519)	7.49
Forfeited	(214)	29.38
Outstanding at December 31, 2000	3,054	24.65
Granted:		
Exercise price greater than fair value	1,566	18.35
Exercise price equal to fair value	934	19.24
Exercise price less than fair value	70	13.52
Exercised	(92)	11.85
Forfeited	(475)	27.30
Outstanding at December 31, 2001	5,057	$21.52
Exercisable at December 31, 2001	1,980	$18.32

The following table summarizes information about the weighted-average fair value of options granted:

YEAR ENDED DECEMBER 31,	**2001**	2000	1999
Exercise price greater than fair value	$ 8.89	$16.09	$ 9.31
Exercise price equal to fair value	12.84	23.70	14.88
Exercise price less than fair value	8.68	25.81	—

The following table summarizes information about stock options outstanding and exercisable at December 31, 2001:

	Options Outstanding			Options Exercisable	
RANGE OF EXERCISE PRICES	Number Outstanding at Dec. 31, 2001 (in thousands)	Weighted-avg. Remaining Contractual Life (years)	Weighted-average Exercise Price	Number Exercisable at Dec. 31, 2001 (in thousands)	Weighted-average Exercise Price
$6.00 – $8.44	266	2.05	$ 6.73	266	$ 6.73
$8.50 – $16.53	1,854	9.06	$ 14.45	779	$ 14.04
$16.56 – $26.25	1,455	7.96	$21.23	585	$20.48
$26.38 – $40.88	1,442	8.25	$32.83	340	$32.48
$42.94 – $61.13	40	8.29	$50.21	10	$50.39
$6.00 – $61.13	5,057			1,980	

Deferred compensation of $0, $1,840 and $137 was recorded during 2001, 2000 and 1999, respectively, for stock options granted to employees and directors at exercise prices below fair market value.

LUMERA SUBSIDIARY STOCK OPTION PLANS In 2000, Lumera adopted the 2000 Stock Option Plan (the "Lumera Plan"). The Lumera Plan provides for the granting of stock options to employees, consultants and non-employee directors of Lumera. Lumera has reserved 3,000,000 shares of Class A common stock for issuance pursuant to the Lumera Plan. The terms and conditions of any options granted, including date of grant, the exercise price and vesting period are to be determined by the Plan Administrator. Stock options issued under the Lumera Plan generally vest over four years and expire after ten years.

In September 2001, Lumera issued fully vested options to purchase 33,300 shares of Class A common stock at an exercise price of $10.00 per share to a consultant for services completed. The options expire 10 years following the date of issue. The options were valued at $137,000 on the grant date, are not subject to remeasurement and were fully expensed in the period granted. The estimated fair value was determined using the Black-Scholes option-pricing model with the following assumptions: underlying security fair market value of $5.34, dividend yield of zero percent, expected volatility of 80%, risk-free interest rate of 4.0%, expected life of 10 years.

The following table summarizes activity with respect to Lumera options for the two years ended December 31, 2001:

DOLLARS IN THOUSANDS	Shares (in thousands)	Weighted-average Exercise Price
Granted:		
Exercise price greater than fair value	42	$2.00
Exercise price equal to fair value	125	0.68
Exercised	—	—
Forfeited	—	—
Outstanding at December 31, 2000	167	1.01
Granted:		
Exercise price greater than fair value	412	10.00
Exercise price equal to fair value	99	4.23
Exercised	—	—
Forfeited	(43)	0.76
Outstanding at December 31, 2000	635	$7.36
Exercisable at December 31, 2001	65	$5.70

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Lumera options outstanding at December 31, 2001 had a weighted average contractual life of 9.4 years.

FAIR VALUE DISCLOSURES Had compensation cost for options issued been determined using the fair values at the grant dates consistent with the methodology prescribed under SFAS 123, the Company's consolidated net loss available to common shareholders and associated net loss per share would have increased to the pro forma amounts indicated below:

YEAR ENDED DECEMBER 31,	2001	2000	1999
NET LOSS AVAILABLE FOR COMMON SHAREHOLDERS			
As reported	$(34,794)	$(26,601)	$(16,700)
Pro forma	$(53,130)	$(39,449)	$(20,236)
NET LOSS PER SHARE			
As reported	$ (2.85)	$ (2.33)	$ (2.04)
Pro forma	$ (4.35)	$ (3.45)	$ (2.48)

The fair value of the options granted was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 2001, 2000 and 1999, respectively: dividend yield of zero percent; and expected volatility of 83% for all years; risk-free interest rates of 4.1%, 6.1% and 5.5% and expected lives of 4, 5 and 5 years. Actual forfeitures of 15.5% and 8.7% were used for the years ended December 31, 2001 and 2000, respectively. An assumed forfeiture rate of 5% was used for 1999.

The fair value of the options granted by Lumera was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 2001 and 2000, respectively: dividend yield of zero percent and expected volatility of zero percent for all years; risk-free interest rates of 4.5% and 6.0%; and expected lives of 6 and 7 years. Actual forfeitures of 10% and zero percent were used for the years ended December 31, 2001 and 2000, respectively.

NOTE 13 COMMITMENTS AND CONTINGENCIES

AGREEMENTS WITH THE UNIVERSITY OF WASHINGTON In October 1993, the Company entered into a Research Agreement and an exclusive license agreement ("License Agreement") with the UW. The License Agreement grants the Company the rights to certain intellectual property, including the technology subsequently developed under the Microvision research agreement ("Research Agreement"), whereby the Company has an exclusive, royalty-bearing license to make, use and sell or sublicense the licensed technology. In consideration for the license, the Company agreed to pay a one-time nonrefundable license issue fee of $5,134. Payments under the Research Agreement were credited to the license fee. In addition to the nonrefundable fee, which has been paid in full, the Company is required to pay certain on going royalties. In 2000 and 1999 these royalties were not material. Beginning in 2001, the Company is required to pay the UW a nonrefundable license maintenance fee of $10 per quarter, to be credited against royalties due.

In March 1994, the Company entered into an exclusive license agreement ("HALO Agreement") with the UW. This technology involves the projection of data and images onto the inside of a dome that is placed over the viewer's head. The HALO Agreement grants the Company the exclusive right to market the technical information for the purpose of commercial exploitation. Under the agreement, the Company was obligated to pay to the UW $75 and issue 31,250 shares of common stock upon filing of the first patent application and $100 and issue 62,500 shares of common stock upon issuance of the first patent awarded. In 1999, the UW filed a patent application under the HALO Agreement and the Company recorded $452 as an expense based on the value of the 31,250 shares of common stock on the patent filing date and the $75 cash payment, as an expense. The shares of common stock were issued and the cash payment was made in February 2000.

In February 2001, the Company entered into an amendment to the HALO Agreement, whereby it purchased the rights to HALO display technology from the UW for an additional cash payment of $100 and 37,000 shares of Microvision common stock valued at the closing price of the Company's common stock on the date of the amendment. The Company recorded $1,100, the total value of the shares of common stock and the cash payment, as a research and development expense.

In October 2000, Lumera entered into an exclusive license agreement ("Lumera License Agreement") and a Sponsored Research Agreement with the UW. The Lumera License Agreement grants Lumera exclusive rights to certain intellectual property including technology being developed under the Sponsored Research Agreement whereby Lumera has an exclusive royalty-bearing license to make, use, sell or sublicense the licensed technology. In consideration for the Lumera License Agreement, Lumera agreed to pay a one-time nonrefundable license issue fee of $200 to the UW, which was expensed as research and development, as there are no known alternative uses for the technology.

Under the terms of the Sponsored Research Agreement, Lumera issued 802,414 shares of Lumera's Class A common stock. The shares were vested in full by mutual agreement between the UW and Lumera on January 8, 2001. The estimated fair value of the shares issued was $3,009 and has been recorded as prepaid research and development expense, and will be amortized over the term of the research plan. Amortization expense of $844 was recorded in 2001. The balance in prepaid research expenses at December 31, 2001 was $2,165.

In connection with the research plan, Lumera agreed to pay an aggregate of $9,000 in quarterly payments over three years. Lumera has also conditionally committed to provide $300 per year to the UW during the three-year term of the Research Agreement for additional research related to the Optical Materials. The first research payments were made upon Lumera's acceptance of the UW research plan on February 26, 2001, and total payments of $2,550 were made during 2001. These payments are recognized as research expense on a straight-line basis over the term of the Research Agreement. In February 2002, Lumera and the UW restructured the Sponsored Research Agreement to extend quarterly payments and performance through 2005.

The following table reflects the revised payment schedule under the Sponsored Research Agreement:

	Research Plan Annual Payment	Optical Materials Payments	Total
2001	$2,250	$250	$2,500
2002	1,125	300	1,425
2003	3,000	300	3,300
2004	2,250	50	2,300
2005	375		375
Total	$9,000	$900	$9,900

Under the terms of the agreements, Lumera is also required to pay certain costs related to filing and processing of patents and copyrights related to the agreements. Additionally, Lumera will pay certain ongoing royalties.

LITIGATION The Company is subject to various claims and pending or threatened lawsuits in the normal course of business. Management believes that the outcome of any such lawsuits would not have a materially adverse effect on the Company's financial position, results of operations or cash flows.

LEASE COMMITMENTS The Company leases its office space and certain equipment under noncancelable capital and operating leases with initial or remaining terms in excess of one year. The Company entered into a new facility lease that commenced in April 1999, which includes an extension provision and rent escalation provisions over the seven-year term of the lease. Rent expense is recognized on a straight-line basis over the lease term.

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

	Capital Leases	Operating Leases
2002	$189	$1,997
2003	51	2,122
2004	17	1,726
2005	—	1,643
2006	—	406
Thereafter	—	—
Total minimum lease payments	257	$7,894
Less: Amount representing interest	(26)	
Present value of capital lease obligations	231	
Less: Current portion	(170)	
Long-term obligation at December 31, 2001	$ 61	

The capital leases are collateralized by the related assets financed and by security deposits held by the lessors under the lease agreements. The cost and accumulated depreciation of equipment under capital leases was $1,101 and $592 respectively, at December 31, 2001; $1,083 and $396, respectively, at December 31, 2000.

Rent expense was $1,557, $1,255 and $1,008, for 2001, 2000 and 1999, respectively.

LONG-TERM DEBT During 1999, the Company entered into a loan agreement with the lessor of the Company's corporate headquarters to finance $420 in tenant improvements. The loan carries a fixed interest rate of 10% per annum, is repayable over the initial term of the lease and is secured by a letter of credit.

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NOTE 14 INCOME TAXES

A provision for income taxes has not been recorded for 2001, 2000 or 1999 due to taxable losses incurred during such periods. A valuation allowance has been recorded for deferred tax assets because realization is primarily dependent on generating sufficient taxable income prior to expiration of net operating loss carry-forwards.

At December 31, 2001, the Company has net operating loss carry-forwards of approximately $94,200 for federal income tax reporting purposes. In addition the Company has research and development tax credits of $1,826. The net operating losses will expire from 2005 to 2021 if not previously utilized. In certain circumstances, as specified in the Internal Revenue Code, a 50% or more ownership change by certain combinations of the Company's stockholders during any three-year period would result in limitations on the Company's ability to utilize its net operating loss carry-forwards. The Company has determined that such a change occurred during 1995 and the annual utilization of loss carry-forwards generated through the period of that change will be limited to approximately $1,100. An additional change occurred in 1996; and the limitation for losses generated in 1996 is approximately $1,600.

Lumera files a separate tax return. At December 31, 2001, Lumera has net operating loss carry-forwards of approximately $12,300 for federal income tax reporting purposes. The net operating losses will expire from 2020 through 2021 if not previously utilized.

Deferred tax assets are summarized as follows:

DECEMBER 31,	**2001**	2000
Net operating loss carry-forwards – Microvision	$ 32,012	$ 22,293
Net operating loss carry-forwards – Lumera	4,186	—
Research and development credit carry-forwards	1,827	1,060
Other	1,946	502
	39,971	23,855
Less: Valuation allowance	(39,971)	(23,855)
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 will be accounted for as a credit to shareholders' equity.

NOTE 15 RETIREMENT SAVINGS PLAN

The Company has a retirement savings plan ("the Plan") that qualifies under Internal Revenue Code Section 401(k). The Plan covers all qualified employees. Contributions to the Plan by the Company are made at the discretion of the Board of Directors. The Company did not contribute to the Plan in 1999.

In February 2000, the Board of Directors approved a plan amendment to match 50% of employee contributions to the Plan up to 6% of the employee's per pay period compensation, starting on April 1, 2000. During 2001 and 2000, the Company contributed $271 and $134, respectively, to the Plan under the matching program.

NOTE 16 QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The following table presents the Company's unaudited quarterly financial information for the years ending December 31, 2001 and 2000:

YEAR ENDED DECEMBER 31, 2001	December 31	September 30	June 30	March 31
Revenue	$ 4,251	$ 2,402	$ 1,772	$ 2,337
Gross margin	2,123	1,064	691	775
Net loss	(7,809)	(8,198)	(8,567)	(10,220)
Net loss per share – basic and diluted	(.61)	(.68)	(.72)	(.86)

YEAR ENDED DECEMBER 31, 2000	December 31	September 30	June 30	March 31
Revenue	$ 2,865	$ 1,971	$ 1,176	$ 2,110
Gross margin	857	254	292	642
Net loss	(6,913)	(7,683)	(6,932)	(5,073)
Net loss per share – basic and diluted	(.58)	(.65)	(.60)	(.48)

NOTE 17 SEGMENT INFORMATION

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

The accounting policies used to derive reportable segment results are generally the same as those described in Note 2, "Summary of Significant Accounting Policies."

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

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

YEAR ENDED DECEMBER 31, 2001	Microvision	Lumera	Elimination	Total
Revenues from external sources	$ 9,902	$ 860	$ —	$10, 762
Interest income	2,593	377	(447)	2,523
Interest expense	92	447	(447)	92
Depreciation	1,531	850	—	2,381
Segment loss	31,749	9,639	(6,594)	34,794
Segment assets	44,606	15,988	(6,539)	54,055
Purchases of capital assets	1,897	1,872	—	3,769

YEAR ENDED DECEMBER 31, 2000	Microvision	Lumera	Elimination	Total
Revenues from external sources	$ 8,060	$ 61	$ —	$ 8,121
Interest income	3,504	1	(400)	3,105
Interest expense	164	400	(400)	164
Depreciation	1,093	154	—	1,247
Segment loss	23,696	2,905	—	26,601
Segment assets	53,024	3,148	—	56,172
Purchases of capital assets	2,216	3,213	—	5,429

NOTE 18 SUBSEQUENT EVENTS

In March 2002, the Company raised $6,000 before issuance costs from the sale of 524,000 shares of Microvision, Inc. common stock at a price of $11.50 per share to six investors.

OVERVIEW The Company commenced operations in May 1993 to develop and commercialize technology for displaying images and information onto the retina of the eye. In 1993, the Company acquired an exclusive license to the Virtual Retinal Display technology from the University of Washington and entered into a research agreement with the University of Washington to further develop the Virtual Retinal Display technology. The Company has continued to develop the Virtual Retinal Display technology as part of its broader research and development efforts relating to the retinal scanning display technology.

Since the completion of its initial public offering in August 1996, the Company has established and equipped its own in-house laboratory for the continuing development of the retinal scanning display technology and has transferred the research and development work on the Virtual Retinal Display technology from the University of Washington to the Company.

The Company currently has several demonstration versions of the retinal scanning display including monochromatic and color portable units, and full-color tabletop models. The Company expects to continue funding prototype and demonstration versions of products incorporating the retinal scanning display technology at least through 2002. Future revenues, profits and cash flow and the Company's ability to achieve its strategic objectives as described herein will depend on a number of factors, including acceptance of the retinal scanning display technology by various industries and OEMs, market acceptance of products incorporating the retinal scanning display technology and the technical performance of such products.

The Company has incurred substantial losses since its inception and expects to incur a loss during the year ended December 31, 2002.

In 2000, the Company formed a subsidiary, Lumera Corporation ("Lumera"), to develop and commercialize a new class of non-linear optical chromophores ("Optical Materials") and devices that utilize the optical properties of these Optical Materials. Non-linear organic electro-optical chromophore materials are materials that interact with and can be used to change the properties of light waves, including the speed and direction at which light waves travel. In 2001, Lumera acquired an exclusive license to the optical materials technology from the University of Washington and entered into a multi-year Sponsored Research Agreement with the University of Washington to fund continued development work on the Optical Materials.

Lumera, which is a development stage enterprise, has incurred significant net losses since inception. To date Lumera has satisfied its capital requirements principally from the sale of mandatorily redeemable convertible preferred stock and intercompany loans from Microvision.

Lumera has established and built in-house laboratories to develop and characterize new materials, create new device designs and perform small-scale production of new devices and systems based on the Optical Materials. As of December 31, 2001, Microvision owed 76% of the common stock and 11% of the mandatorily redeemable convertible preferred stock of Lumera.

KEY ACCOUNTING POLICIES AND ESTIMATES Microvision's discussions and analysis of its financial condition and results of operations are based upon the Company's 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 the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. On an on-going basis, the Company evaluates its estimates, including those related to revenue recognition, contract losses, bad debts, investments and contingencies and litigation. The Company bases its estimates on historical experience, terms of existing contracts, our evaluation of trends in the display and optical systems components industries, information provided by our current and prospective customers and strategic partners, and information available from other outside sources, and on various other assumptions management believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company believes the following key accounting policies require its more significant judgments and estimates used in the preparation of its consolidated financial statements.

The Company recognizes revenue as work progresses on long-term, cost plus fixed fee and fixed price contracts using the percentage-of-completion method, which relies on estimates of total expected contract revenue and costs. The Company uses this revenue recognition methodology because it can make reasonably dependable estimates of the revenue and costs. Recognized revenues are subject to revisions as the contract progresses to completion and actual revenue and cost become certain. Revisions in revenue estimates are reflected in the period in which the facts that give rise to the revision become known.

The Company maintains allowances for estimated losses resulting from the estimated cost to complete a contract that are in excess of the remaining contract value. The entire estimated loss is recorded in the period in which the loss is first determined.

The Company's product sales generally include acceptance clauses. Acceptance occurs upon the earlier of receipt of a written customer acceptance or expiration of the acceptance period.

The Company maintains a general allowance for uncollectible receivables, including accounts receivable, costs and estimated earnings in excess of billings on uncompleted contracts and receivables from related parties. The Company reviews several factors in determining the allowance including the customer's past payment history and financial condition. If the financial condition of our customers or the related parties who have receivable balances with the Company were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances could be required.

The Company has not recorded an impairment of the minority interest it owns in a privately held company. The value of the minority interest is difficult to determine in the absence of a public trading market. The Company has not recorded an impairment of the minority interest it owns in a privately held company. Microvision records an impairment charge when it believes an investment has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the investments, thereby possibly requiring an impairment charge in the future.

The Company believes that the probability of an unfavorable outcome in its pending litigation is low and therefore has not recorded an accrual for any potential loss. The Company's current estimated range of liability related to pending litigation is based on claims for which our management can estimate the amount and range of potential loss. The Company believes that the probability of an unfavorable outcome in its pending litigation is low and therefore has not recorded an accrual for any potential loss. As additional information becomes available, the Company will assess the potential liability related to its pending litigation and, if appropriate, revise its estimates. Such revisions in the Company's estimates of the potential liability could materially impact our results of operation and financial position.

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 management to apply its judgment or make estimates. There are also areas in which management's judgment in selecting any available alternative would not produce a materially different result to the Company's consolidated financial statements. Additional information about Microvision's accounting policies, and other disclosures required by generally accepted accounting principles, are set forth in the notes to the Company's consolidated financial statements, which begin on page 26 of this Annual Report.

RESULTS OF OPERATIONS

YEAR ENDED DECEMBER 31, 2001 COMPARED TO YEAR ENDED DECEMBER 31, 2000

REVENUE Revenue increased by $2.7 million, or 33%, to $10.8 million in 2001 from $8.1 million in 2000. The increase resulted from a higher level of development contract business in 2001 than that performed in 2000 on contracts entered into in both 2001 and 2000.

To date, substantially all of the Company's revenue has been generated from development contracts. The Company's customers have included both the United States government and commercial enterprises. The United States government accounted for approximately 93% and 91% of revenue during 2001 and 2000, respectively. The Company expects revenue to fluctuate from year to year.

During 2001, the Company entered into several development contracts with both commercial and government entities for further development of the retinal scanning display technology to meet specific customer applications.

In the defense sector, the Company entered into a $2.9 million contract modification with the U.S. Army's Aviation Applied Technology Directorate to continue work on an advanced helmet-mounted display and imaging system to be used in the Virtual Cockpit Optimization Program. In addition, the Company was awarded a $4.2 million contract modification with the U.S. Army's Aircrew Integrated Helmet Systems Program office to further advance the form and functional development of a helmet-mounted display.

In October 2001, the Company entered into a $1.5 million subcontract with Concurrent Technologies Corporation in support of the Office of Naval Research's Battlespace Information Display Technology program. The purpose of the program is to develop improved micro-electrical-mechanical systems for use in displaying information on the battlefield.

In December 2001, the Company entered into a $3.3 million contract with the U.S. Army's Medical Research Acquisition Activities, Telemedicine and Advanced Technology Research Center for the initial phase in the development of a mobile wireless personal display system for medical applications.

In August 2001, Lumera entered into a $1.6 million contract with the U.S. government to design new optical materials appropriate for the fabrication of a wideband optical modulator demonstration system.

During 2001, the Company delivered a full-color demonstration display to the Cleveland Clinic. Cleveland Clinic will use the display to develop and evaluate clinical applications of the retinal scanning display technology.

In December 2001, the Company started production of Nomad, a monochrome head-worn display. The Company has deferred revenue of $50,000 on Nomad units shipped in December 2001 pending customer acceptance. As of December 31, 2001 the Company had received orders for 31 Nomads.

The Company had a backlog of $6.8 million, including approximately $250,000 in Nomad orders, at December 31, 2001. The backlog is composed of development and products contracts, including amendments, and product orders, entered through December 31, 2001. The Company plans to complete all of the backlog contracts during 2002.

COST OF REVENUE Cost of revenue includes both the direct and indirect costs of performing on development contracts and delivering products. Direct costs include labor, materials and other costs incurred directly in performing of specific projects. Indirect costs include labor and other costs associated with operating the Company's research and product development department and building the technical capabilities of the Company. Cost of revenue is determined both by the level of direct costs incurred on development contracts and by the level of indirect costs incurred in managing and building the technical capabilities and capacity of the Company. The cost of revenue can fluctuate substantially from period to period depending on the level of both the direct costs incurred in the performance of projects and the level of indirect costs incurred.

Cost of revenue was $6.1 million in both 2001 and 2000. On a percentage of revenue basis, cost of revenue declined by 24% to 57% in 2001 from 75% in 2000. The decline in cost of revenue as a percentage of sales is due to declines in:

- The allocation of indirect cost to cost of revenue,
- The reduction in losses on uncompleted contracts, and
- The mix of development contracts and product cost.

The lower level of indirect expense in 2001 as compared to 2000 resulted from a higher level of investment the Company made in developing its technologies through work performed on internal research and development projects, which resulted in greater overhead absorption by these research and development projects.

The Company expects that cost of revenue on an absolute dollar basis will increase in the future. This increase will likely result from additional development contract work that the Company expects to perform and planned shipments of commercial products, and commensurate growth in the Company's personnel and technical capacity required for performance on such contracts. The Company expects the cost of contract revenue as a percentage of contract revenue to remain relatively flat over time. The cost of revenue as a percentage of revenue can fluctuate significantly from period to period depending on the contract mix, the cost of future planned products and the level of direct and indirect cost incurred.

RESEARCH AND DEVELOPMENT EXPENSE Research and development expense consists of:

- Compensation related costs of employees and contractors engaged in internal research and product development activities,
- Research fees paid to the University of Washington under the Sponsored Research Agreement,
- Laboratory operations, outsourced development and processing work,
- Fees and expenses related to patent applications, prosecution and protection, and
- Related operating expenses.

Included in research and development expenses are costs incurred in acquiring and maintaining licenses. The Company has charged all research and development costs to cost of revenue or research and development expense.

Research and development expense increased by $12.4 million, or 63%, to $31.9 million from $19.5 million in 2000. The increase reflects continued implementation of the Company's operating plan, which calls for building technical staff and supporting activities, establishing and equipping in-house laboratories, and developing and maintaining its intellectual property portfolio.

In February 2001, the Company made the final payment on a fully paid exclusive license for the "HALO" technology from the University of Washington. This technology involves the projection of data and images onto the inside of a dome that is placed over the viewer's head. The Company issued 37,000 shares of common stock valued at $1.0 million based on the closing stock price on the date of settlement and paid $100,000 to the University of Washington for the final payment for the license. The total value of the final payment of $1.1 million was recorded as research and development expense in 2001 as the technology was deemed to have no alternative future use.

In March 2001, Lumera paid $200,000 to the University of Washington for an exclusive royalty-bearing license relating to the Optical Materials technology. The payment was recorded as an expense as the technology was deemed to have no alternative future use. In addition, during 2001, Lumera made three quarterly payments of $750,000 each to the University of Washington under the Sponsored Research Agreement. Additional quarterly payments totaling $7.7 million are required over the remaining term of the three-year research agreement. Lumera amortized $2.0 million to expense for the cash portion of the payments under the Sponsored Research Agreement during 2001. The remaining $250,000 paid to the University of Washington is recorded as a current asset at December 31, 2001.

Research and development expense for Lumera during 2001, including the payments under the Sponsored Research Agreement, was $6.4 million.

The Company believes that a substantial level of continuing research and development expense will be required to develop commercial products using the retinal scanning display technology and the Optical Materials technology. Accordingly, the Company anticipates that its research and development expenditures will continue to be significant. These expenses will be incurred as a result of:

- Hiring additional technical and support personnel,
- Expanding and equipping in-house laboratories,
- Acquiring rights to additional technologies,
- Subcontracting work to development partners, and
- Incurring related operating expenses.

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

- Continue development of the Company's retinal scanning display technology,
- Develop and commercialize Lumera's Optical Materials technology,
- Accelerate development of microdisplays to meet emerging market opportunities,
- Expand the Company's investment in bar code scanner development, and
- Pursue other potential business opportunities.

MARKETING, GENERAL AND ADMINISTRATIVE EXPENSE Marketing, general and administrative expenses include compensation and support costs for sales, marketing, management and administrative staff, and for other general and administrative costs, including legal and accounting, consultants and other operating expenses.

The Company's marketing activities include corporate awareness campaigns, such as web site development and participation at trade shows; corporate communications initiatives; and working with potential customers and joint venture partners to identify and evaluate product applications in which the Company's technology could be integrated or otherwise used.

Marketing, general and administrative expenses increased by $3.9 million, or 37%, to $14.4 million from $10.5 million in 2000. The increase includes increased compensation and support costs for employees and contractors. The Company expects marketing, general and administrative expenses to increase substantially in future periods as the Company:

- Adds to its sales and marketing staff,
- Makes additional investments in sales and marketing activities, and
- Increases the level of corporate and administrative activity.

Marketing, general and administrative expenses for Lumera during 2001 were $2.8 million.

NON-CASH COMPENSATION EXPENSE Non-cash compensation expense increased by approximately $900,000, or 59%, to $2.5 million from $1.6 million in 2000. Non-cash compensation expense includes the amortization of the value of stock options granted to individuals who are not employees or directors of the Company for services provided to the Company.

In January 2001, Lumera issued 802,414 shares of its Class A Common Stock to the University of Washington pursuant to the Sponsored Research Agreement. The shares were valued at the fair market price of $3.75 per share, as determined by the board of directors. The total value of the stock of $3.0 million was recorded as a prepaid research expense and is being amortized over the three year term of the Sponsored Research Agreement. The total amortization expense relating to the Sponsored Research Agreement during 2001 was $844,000.

In September 2001, Lumera issued options to purchase 33,300 shares of Lumera Class A Common Stock at an exercise price of $10.00 per share to a consultant that provided professional services to Lumera. These options expire 10 years following the date of grant, are fully vested and were exercisable at date of issuance. The options were valued at the date of grant at $137,000 and this amount was recorded as an expense in 2001. The fair value of the options was estimated using the Black-Scholes option pricing model with a stock price of $5.34 per share, dividend yield of zero percent; expected volatility of 80%; risk-free interest rate of 4.0% and expected life of ten years.

In August 2000, the Company entered into five-year consulting agreements with two independent consultants to provide strategic business and financial consulting services to the Company. Under the terms of the agreements, each consultant received a warrant to purchase 100,000 shares of common stock at an exercise price of $34.00 per share. The warrants vest over three years and the unvested shares are subject to remeasurement at each balance sheet date during the vesting period. The original value of the warrants was estimated at $5.5 million. Due to a decrease in the Company stock price, the value at December 31, 2001 was estimated at $3.4 million. In 2001, total non-cash amortization for these agreements was $775,000 compared to $345,000 in 2000. The fair values of the warrants were determined at December 31, 2001, 2000, and the issue date, using the Black-Scholes option-pricing model with the following weighted-average assumptions: dividend yield of zero percent; and expected volatility of 83% for all measurement dates; risk-free interest rates of 5.9%, 6.0% and 6.0%; and expected lives of 9.2, 10 and 10 years.

The following table shows the major components of non-cash compensation expense for 2001 and 2000 respectively.

	2001	2000
Lumera stock issued to the University of Washington	$ 844,000	$ —
Company and Lumera stock options issued to employees	411,000	469,000
Company and Lumera stock options issued to consultants	1,047,000	591,000
Stock and options issued to Independent Directors	231,000	532,000
	$2,533,000	$1,592,000

INTEREST INCOME AND EXPENSE Interest income decreased by $600,000 or 19%, to $2.5 million from $3.1 million in 2000. This decrease resulted primarily from lower average cash and investment securities balances in 2001 than the average cash and investment securities balances in the prior year.

Interest expense was consistent with 2001 because the amount of borrowings did not change significantly.

INCOME TAXES No provision for income taxes has been recorded because the Company has experienced net losses from inception through December 31, 2001. At December 31, 2001, the Company had net operating loss carry-forwards of approximately $94.2 million for federal income tax reporting purposes. In addition the Company has research and development tax credits of $1.8 million. The net operating losses begin expiring in 2008 if not previously utilized. In certain circumstances, as specified in the Internal Revenue Code, a 50% or more ownership change by certain combinations of the Company's shareholders during any three-year period would result in a limitation on the Company's ability to utilize its net operating loss carry-forwards. The

Company has determined that such a change of ownership occurred during 1995 and that the annual utilization of loss carry-forwards generated through the period of that change will be limited to approximately $1.1 million. An additional change of ownership occurred in 1996 and the limitation for losses generated in 1996 is approximately $1.6 million. Lumera has additional net operating loss carry forwards of $12.3 million which are available only to Lumera.

YEAR ENDED DECEMBER 31, 2000 COMPARED TO YEAR ENDED DECEMBER 31, 1999

REVENUE Revenue increased by $1.2 million, or 18%, to $8.1 million in 2000 from $6.9 million in 1999. The increase resulted from a higher level of development contract business in 2000 than that performed in 1999 on contracts entered into in both 2000 and 1999.

Through December 31, 2000, substantially all of the Company's revenue has been generated from development contracts. The Company's customers have included both the United States government and commercial enterprises. The United States government accounted for approximately 91% and 82% of revenue during 2000 and 1999, respectively.

During 2000, the Company entered into several development contracts with both commercial and government entities for further development of the retinal scanning display technology to meet specific customer applications.

- In the defense sector area, the Company entered into a $5.0 million contract with the U.S. Army's Aviation Applied Technology Directorate to continue work on an advanced helmet-mounted display and imaging system to be used in the Virtual Cockpit Optimization Program. In addition, the Company was awarded a $2.8 million contract with the U.S. Army's Aircrew Integrated Helmet Systems Program office to further advance the form and functional development of a helmet-mounted display.
- During 2000, the Company entered into a $600,000 contract to provide a Nomad demonstrator unit and a full-color prototype display to the Cleveland Clinic. The Company has sold four additional Nomad demonstration units to customers in the medical and industrial markets during 2000.

The Company ended the year with a $4.5 million backlog. The backlog is composed of development and products contracts, including amendments entered through December 31, 2000.

COST OF REVENUE Cost of revenue includes both the direct and indirect costs of performing on development contracts and delivering products. Direct costs include labor, materials and other costs incurred directly in performing specific projects. Indirect costs include labor and other costs associated with operating the Company's research and product development department and building the technical capabilities of the Company. Cost of revenue is determined both by the level of direct costs incurred on development contracts and by the level of indirect costs incurred in managing and building the technical capabilities and capacity of the Company. The cost of revenue can fluctuate substantially from period to period depending on the level of both the direct costs incurred in the performance of projects and the level of indirect costs incurred.

Cost of revenue increased by approximately $1.2 million, or 23%, to $6.1 million in 2000, from $4.9 million in 1999. The increase resulted from an increase in the direct costs associated with the Company's performance on development contracts in 2000 from that in 1999.

Cost of revenue in 2000 includes a provision for estimated losses on uncompleted contracts. The Company recognizes any estimated losses on contracts in full as soon as identified. The losses are a result of the Company's decision to invest in strategic projects with our partners. The Company may decide to enter into a loss contract when management believes the project is likely to result in additional contract or product revenue that will have a positive gross margin.

RESEARCH AND DEVELOPMENT EXPENSE Research and development expense consists of:

- Compensation related costs of employees and contractors engaged in internal research and product development activities,
- Laboratory operations, outsourced development and processing work,
- Fees and expenses related to patent applications, prosecution and protection, and
- Related operating expenses.

Included in research and development expenses are costs incurred in acquiring and maintaining technology licenses. The Company has charged all research and development costs to cost of revenue or research and development expense.

Research and development expense increased by $9.3 million, or 91%, to $19.5 million from $10.2 million in 1999. The increase reflects continued implementation of the Company's operating plan, which calls for building technical staff and supporting activities, establishing and equipping in-house laboratories, and developing and maintaining intellectual property.

In April 2000, the Company entered into a $10.0 million extension of an agreement with Cree, Inc. to continue development of semiconductor light emitting diodes and laser diodes. The Company must pay $4.5 million during the first year of the extension in four equal quarterly payments. As of December 31, 2000, the Company had made three payments under this agreement. During the second year of the extension, the Company is required to pay the remaining $5.5 million in four equal quarterly payments.

MARKETING, GENERAL AND ADMINISTRATIVE EXPENSE Marketing, general and administrative expenses include compensation and support costs for sales, marketing, management and administrative staff, and for other general and administrative costs, including legal and accounting, consultants and other operating expenses.

Marketing, general and administrative expenses increased by $3.3 million, or 45%, to $10.5 million from $7.2 million in 1999. The increase includes increased compensation and support costs for employees and contractors.

NON-CASH COMPENSATION EXPENSE Non-cash compensation expense increased by $1.3 million, or 503%, to $1.6 million from $264,000 in 1999. Non-cash compensation expense includes the amortization of the value of stock options granted to individuals who are not employees or directors of the Company for services provided to the Company.

A significant component of the increase is due to a five-year consulting agreement between the Company and two independent consultants, entered into in August 2000, to provide strategic business and financial consulting services. Under the terms of the agreements, each consultant received a warrant to purchase 100,000 shares of common stock at an exercise price of $34.00 per share. The warrants vest over three years and the unvested shares are subject to remeasurement at each balance sheet date during the vesting period. The original value of the warrants was estimated at $5.5 million. Due to a decrease in the Company stock price, the value at December 31, 2000 was estimated at $3.7 million. In 2000, total non-cash amortization for these agreements was $345,000.

The following table shows the major components of non-cash compensation expense:

	2000	1999
Stock options issued to consultants	$ 591,000	$ 66,000
Stock options issued to employees	469,000	34,000
Stock and options issued to Board members	532,000	164,000
	$1,592,000	$264,000

INTEREST INCOME AND EXPENSE Interest income increased by $1.9 million, or 167%, to $3.1 million from $1.2 million in 1999. This increase resulted primarily from higher average cash and investment securities balances in 2000 than the average cash and investment securities balances in the prior year.

Interest expense was consistent with 1999 because the amount of borrowings did not change significantly.

INCOME TAXES No provision for income taxes has been recorded because the Company has experienced net losses from inception through December 31, 2000. At December 31, 2000, the Company had net operating loss carry-forwards of approximately $65.6 million for federal income tax reporting purposes. The net operating losses begin expiring in 2008 if not previously utilized.

LIQUIDITY AND CAPITAL RESOURCES

The Company has funded its operations to date primarily through the sale of common stock and convertible preferred stock and, to a lesser extent, revenues from development contracts and product sales. At December 31, 2001, the Company had $33.7 million in cash, cash equivalents and investment securities.

The Company had the following material changes in assets and liabilities during the year ended December 31, 2001:

"Other current assets" increased by $1.3 million to $2.3 million at December 31, 2001 from $976,000 at December 31, 2000. "Other assets" increased by $1.2 million to $1.3 million at December 31, 2001 from $114,000 at December 31, 2000. The increase in both Other Current Assets and Other Assets was attributable to payments to the University of Washington for continued research under the Sponsored Research Agreement in excess of expense that had been recognized. The Company recognizes the expense on the Sponsored Research Agreement on a straight-line basis over the term of the agreement. The portion of the payments that will be amortized to expense during the next twelve months will be classified as "other current assets," and the portion that will be amortized to expense more than twelve months from the balance sheet date is classified as "other assets." The payments were comprised of both cash and shares of Lumera common stock.

- "Receivables from related parties" increased by $1.3 million to $2.3 million at December 31, 2001 from $1.0 million at December 31, 2000. The increase was attributable to increased borrowings under the Executive Loan Program. In September 2001, the compensation committee of the board of directors approved a $500,000 increase in the loan limit for one executive officer under the plan.
- "Accrued liabilities" increased by $1.9 million to $4.3 million at December 31, 2001 from $2.4 million at December 31, 2000. The reserve for bonuses increased $450,000 to $1.1 million at December 31, 2001 from $650,000 at December 31, 2000. The increase is attributable to shifting the payment of a larger portion of bonuses to after year end. The remaining increase is due to the timing of normal payroll related payments and other liabilities that the Company recognizes when they are probable and the amount of the obligation can be determined.

Cash used in operating activities totaled $35.0 million in 2001 compared to $22.1 million in 2000. Cash used in operating activities for each period resulted primarily from the net loss for the period.

Cash provided by investing activities totaled $10.8 million in 2001 compared to cash used in investing activities of $10.3 million in 2000. The increase in cash provided by investing activities resulted primarily from the sales of investment securities offset by increases in purchases of property and equipment. The increase in sales of investment securities is consistent with the Company's plan to use the cash from the sales of investment securities to fund the Company's operations.

The Company used cash for capital expenditures of $3.8 million in 2001 compared to approximately $5.4 million in 2000. Historically, capital expenditures have been used to make leasehold improvements to leased office space and to purchase computer hardware and software, laboratory equipment and furniture and fixtures to support the Company's growth. Capital expenditures are expected to increase as the Company expands its operations. The Company currently has no material commitments for capital expenditures.

Cash provided by financing activities totaled approximately $32.5 million in 2001 compared to $36.9 million in 2000. The decrease in cash provided by financing activities resulted primarily from decreases in the net proceeds from the issuance of common stock offset by an increase in preferred stock in 2001.

- In March 2001, Lumera raised $21.4 million, before issuance costs, from the issuance of 2,136,000 shares of Lumera mandatorily redeemable convertible preferred stock.
- In October 2001, the Company raised $11.0 million, before issuance costs, from the issuance of 971,496 shares of Microvision common stock and warrants to purchase 145,723 shares of common stock. The warrants have an exercise price of $14.62 per share and a four-year term.

The Company's investment policy restricts investments to ensure principal preservation and liquidity. The Company invests cash that it expects to use within approximately sixty days in U.S. treasury-backed instruments. The Company invests cash in excess of sixty days of its requirements in high quality investment securities. The investment securities portfolio is limited to U.S. government and U.S. government agency debt securities and other high-grade securities generally with maturities of three years or less.

Microvision and Lumera maintain separate cash and investment accounts. Each Company's cash and investments are generally used to fund their business activities.

The Company's future expenditures and capital requirements will depend on numerous factors, including the progress of its research and development program, the progress in commercialization activities and arrangements, the cost of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights, competing technological and market developments and the ability of the Company to establish cooperative development, joint venture and licensing arrangements. In order to maintain its exclusive rights under the Company's license agreement with the University of Washington, the Company is obligated to make royalty payments to the University of Washington with respect to the Virtual Retinal Display technology. If the Company is successful in establishing OEM co-development and joint venture arrangements, the Company expects its partners to fund certain non-recurring engineering costs for technology development and/or for product development. Nevertheless, the Company expects its cash requirements to increase significantly each year as it expands its activities and operations with the objective of commercializing the retinal scanning display and Optical Materials technologies.

The following table lists the Company's material known future cash commitments (in thousands).

YEAR ENDING	**2002**	2003	2004	2005	2006
COMMITMENTS					
Minimum payments under capital leases	$ 189	$ 51	$ 17	$ —	$ —
Minimum payments under operating leases	1,997	2,122	1,726	1,643	406
Minimum payments under research, royalty and licensing agreements	3,248	3,480	2,475	500	—
BUDGETED EXPENDITURES					
Budgeted capital equipment purchase to support planned production	$1,500	$ —	$ —	$ —	$ —

The Company believes that its cash, cash equivalent and investment securities balances totaling $33.7 million, in addition to the $6.0 million raised in March, 2002 will satisfy its budgeted cash requirements for the next 12 months based on the Company's current operating plan. Should expenses exceed the amounts budgeted, the Company may require additional capital earlier to further the development of its technology, for expenses associated with product development, and to respond to competitive pressures or to meet unanticipated development difficulties. In addition, the Company's operating plan calls for the addition of sales, marketing, technical and other staff and the purchase of additional laboratory and production equipment. The operating plan also provides for the development of strategic relationships with systems and equipment manufacturers that may require additional investments by the Company. There can be no assurance that additional financing will be available to the Company or that, if available, it will be available on terms acceptable to the Company on a timely basis. If adequate funds are not available to satisfy either short-term or long-term capital requirements, the Company may be required to limit its operations substantially. The Company's capital requirements will depend on many factors, including, but not limited to, the rate at which the Company can, directly or through arrangements with OEMs, introduce products incorporating the retinal scanning display technology and the market acceptance and competitive position of such products.

NEW ACCOUNTING PRONOUNCEMENTS

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

In July 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations". This statement provides accounting and reporting standards for business combinations initiated subsequent to June 30, 2002. All business combinations in the scope of this statement are to be accounted for under one method, the purchase method.

In July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets". This statement provides accounting and reporting standards for intangible assets acquired individually, with a group of other assets, or as part of a business combination. This statement addresses the treatment of goodwill and other intangible assets after they have been initially recognized in the financial statements. Under this statement, goodwill and other intangibles with indefinite useful lives, on a prospective basis, will no longer be amortized, however will be tested for impairment at least annually, based on a fair value comparison. Intangibles that have finite useful lives will continue to be amortized over their respective useful lives. This statement also requires expanded disclosure for goodwill and other intangible assets. The Company will be required to adopt this statement effective January 1, 2002. As the Company has no recorded goodwill or intangible assets, there will be no initial effect from adoption of this standard.

In July 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations". This statement provides accounting and reporting standards for costs associated with the retirement of long-lived assets. This statement requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. Adoption of this statement is required no later than January 1, 2003. The Company is currently assessing the impact of this statement on its results of operations, financial position and cash flows.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement replaces SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of". FAS 144 retains the fundamental provisions of SFAS No. 121 for recognition and measurement of the impairment of long-lived assets to be held and used and for measurement of long-lived assets to be disposed of by sale. This statement applies to all long-lived assets, including discounted operations, and replaces the provisions of APB Opinion No. 30, "Reporting Results of Operations-Reporting the Effects of Disposal of a Segment of a Business," for the disposal of segments of a business. This statement requires that those long-lived assets be measured at the lower of carrying amount of fair value less cost to sell, whether reported in continuing operations or in discontinued operations. The Company will be required to adopt this statement no later than January 1, 2002. The implementation of SFAS 144 will not have a material impact of this statement on the Company's results of operations, financial position or cash flows.

SUBSEQUENT EVENTS

In March 2002, the Company raised $6.0 million, before issuance costs, from the sale of 524,000 shares of Microvision, Inc. common stock at a price of $11.50 per share to six investors.

FORM 10-K

A copy of the Company's Annual Report on Form 10-k as filed with the Securities and Exchange Commission may be obtained upon request without charge from the Company's headquarters, attention: Investor Relations

MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED SHAREHOLDER MATTERS

The Company's Common Stock trades on the Nasdaq National Market under the symbol "MVIS." As of February 28, 2002, there were 284 holders of record of 13,004,000 shares of Common Stock. The Company has never declared or paid cash dividends on the Common Stock. The Company currently anticipates that it will retain all future earnings to fund the operation of its business and does not anticipate paying dividends on the Common Stock in the foreseeable future.

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

	Common Stock	
QUARTER ENDED	High	Low
March 31, 2000	68.50	25.38
June 30, 2000	56.50	21.75
September 30, 2000	55.13	29.19
December 31, 2000	39.00	13.63
March 31, 2001	29.00	13.00
June 30, 2001	27.50	12.88
September 30, 2001	22.00	9.00
December 31, 2001	16.32	10.92
January 1, 2002 to February 28, 2002	15.45	9.60

On February 28, 2002, the last sale price for the Common Stock was $10.55.

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OFFICERS AND DIRECTORS

BOARD OF DIRECTORS

Richard F. Rutkowski
President & Chief Executive Officer
Microvision, Inc.

Stephen R. Willey
Executive Vice President
Microvision, Inc.

Richard A. Raisig
Chief Financial Officer &
Vice President, Operations
Microvision, Inc.

Jacqueline Brandwynne
Founder & Chief Executive Officer
Brandwynne Corporation

Jacob Brouwer
Chairman & Chief Executive Officer
Brouwer Claims Canada & Co. Ltd.

Richard A. Cowell
Principal
Booz-Allen & Hamilton Inc.

Walter J. Lack
Attorney at Law
Engstrom, Lipscomb & Lack

William Owens
Vice Chairman &
Co-Chief Executive Officer
Teledesic LLC

Robert A. Ratliffe
Vice President & Principal
Eagle River, Inc.

Dennis J. Reimer
Retired, Chief of Staff, U.S. Army,
and Director of the National
Memorial Institute for the Prevention
of Terrorism in Oklahoma City

EXECUTIVE OFFICERS

Richard F. Rutkowski
President & Chief Executive Officer

Stephen R. Willey
Executive Vice President

Richard A. Raisig
Chief Financial Officer &
Vice President, Operations

William L. Sydnes
Chief Operating Officer

Vilakkudi G. Veeraraghaven
Senior Vice President
Research & Product Development

Clarence T. Tegreene
Chief Technology Officer

Richard A. James
Director
Manufacturing Operations

Andrew U. Lee
Vice President
Sales

Todd R. McIntyre
Vice President
Business Development

Thomas E. Sanko
Vice President
Marketing

Jeff T. Wilson
Principal Accounting Officer

ADVISORY BOARD

Dr. Aris Silzars
President
Society for Information Display

Dr. John Marshall
Frost Professor of Ophthalmology
St. Thomas' Hospital

SPECIAL ADVISOR TO BOARD OF DIRECTORS

Dr. Andrew Viterbi
Co-founder, QUALCOMM
President, The Viterbi Group

INDEPENDENT ACCOUNTANTS

PricewaterhouseCoopers LLP

TRANSFER AGENT

American Stock Transfer
and Trust Company
59 Maiden Lane
New York, NY 10038
Shareholder Services
800 937-5449

STOCK LISTING

Microvision, Inc. common stock is traded on The Nasdaq Stock Market under the symbol MVIS.

INVESTOR INQUIRIES

Microvision, Inc.
Attn: Investor Relations
19910 North Creek Parkway
Bothell, WA 98011
425 415-6847
ir@microvision.com

Microvision, Inc. 19910 North Creek Parkway, P.O. Box 3008, Bothell, WA 98011 tel: 425 415-6847 fax: 425 415-6600 http: www.microvision.com