

Vuzix Corp  
Form 10-Q  
August 13, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the Quarterly Period Ended June 30, 2015**

**OR**

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

**Commission file number 001-35955**

**VUZIX CORPORATION**

**(Exact name of registrant as specified in its charter)**

|                                       |                            |
|---------------------------------------|----------------------------|
| <b>Delaware</b>                       | <b>04-3392453</b>          |
| <b>State or other jurisdiction of</b> | <b>(I.R.S. Employer</b>    |
| <b>incorporation or organization</b>  | <b>Identification No.)</b> |

**2166 Brighton Henrietta Townline Rd**  
**14623**  
**Rochester, New York**  
**(Address of principal executive offices) (Zip Code)**

**Registrant's telephone number, including area code: (585) 359-5900**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Non-accelerated filer

Large accelerated filer  Accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in rule 12b-2 of the Exchange Act). Yes  No

As of August 13, 2015, there were 16,031,434 shares of the registrant's common stock outstanding.

**Vuzix Corporation**

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**Part 1: FINANCIAL INFORMATION****Item 1: Condensed Consolidated Financial Statements (Unaudited)****VUZIX CORPORATION****CONSOLIDATED BALANCE SHEETS****(Unaudited)**

|   | June 30,<br>2015     | December 31,<br>2014 |
|---|----------------------|----------------------|
| <b>ASSETS</b>   |                      |                      |
| Current Assets  |                      |                      |
| Cash and Cash Equivalents                             | \$ 15,047,989        | \$ 84,967            |
| Accounts Receivable                                   | 84,380               | 383,533              |
| Marketable Securities                                 | 5,000,000            | —                    |
| Inventories, Net                                      | 1,086,838            | 911,949              |
| Prepaid Manufacturing Vendor Payments                 | 843,772              | 156,091              |
| Prepaid Expenses and Other Assets                     | 536,373              | 422,909              |
| <b>Total Current Assets</b>                           | <b>22,599,352</b>    | <b>1,959,449</b>     |
| Tooling and Equipment, Net                            | 486,190              | 416,965              |
| Patents and Trademarks, Net                           | 514,295              | 423,489              |
| Software Development Costs, Net                       | 644,513              | 787,738              |
| Debt Issuance Costs, Net                              | 89,488               | 112,521              |
| <b>Total Assets</b>                                   | <b>\$ 24,333,838</b> | <b>\$ 3,700,162</b>  |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b> |                      |                      |
| Current Liabilities                                   |                      |                      |
| Accounts Payable                                      | \$ 688,397           | \$ 2,183,565         |
| Line of Credit  | —                    | 112,500              |
| Notes Payable   | —                    | 37,038               |
| Current Portion of Long-term Debt, Net of discount    | 82,464               | 128,425              |
| Current Portion of Capital Leases                     | 6,009                | 16,882               |
| Customer Deposits                                     | 21,872               | 120,550              |
| Unearned Revenue                                      | 68,591               | 53,403               |
| Accrued Expenses                                      | 719,837              | 699,067              |
| Income and Other Taxes Payable                        | 6,732                | 35,158               |

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|  |              |              |
|--|--------------|--------------|
| Total Current Liabilities  | 1,593,902    | 3,386,588    |
| Long-Term Liabilities  |              |              |
| Long-Term Derivative Liability   | 169,027      | 13,541,138   |
| Long-Term Portion of Term Debt, Net of discount  | 1,077,552    | 1,088,996    |
| Long-Term Portion of Accrued Interest  | 125,405      | 81,451       |
| Total Long-Term Liabilities  | 1,371,984    | 14,711,585   |
| Total Liabilities  | 2,965,886    | 18,098,173   |
| Stockholders' Equity (Deficit)   |              |              |
| Preferred Stock — \$.001 Par Value, 5,000,000 Shares Authorized; 49,626 Shares Issued and Outstanding June 30, 2015, and 0 Shares Outstanding on December 31, 2014 | 50           | —            |
| Common Stock — \$.001 Par Value, 100,000,000 Shares Authorized; 16,001,434 Shares Issued and Outstanding June 30, 2015 and 11,295,387 on December 31, 2014         | 16,000       | 11,296       |
| Additional Paid-in Capital   | 73,006,471   | 29,752,083   |
| Accumulated Deficit  | (51,654,569) | (44,161,390) |
| Total Stockholders' Equity (Deficit)   | 21,367,952   | (14,398,011) |
| Total Liabilities and Stockholders' Equity (Deficit)   | \$24,333,838 | \$3,700,162  |

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

**VUZIX CORPORATION****CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)****For the Six Months Ended June 30, 2015****(Unaudited)**

|  | Common Stock |           | Additional<br>Paid-In<br>Capital | Accumulated<br>Deficit | Preferred Stock |        | Total          |
|--|--------------|-----------|----------------------------------|------------------------|-----------------|--------|----------------|
|  | Shares       | Amount    |                                  |                        | Shares          | Amount |                |
| <b>Balance — December 31, 2014</b>   | 11,295,387   | \$ 11,296 | \$ 29,752,083                    | \$(44,161,390 )        | —               | \$ —   | \$(14,398,011) |
| Stock Compensation Expense   |              |           | 252,331                          |                        |                 |        | 252,331        |
| Conversion of Note Payable   | 210,000      | 210       | 472,290                          |                        |                 |        | 472,500        |
| Stock Issued for Services  | 100,337      | 100       | 583,564                          |                        |                 |        | 583,664        |
| Common Stock Awards to Officers, Directors and Law Firm  | 295,000      | 295       | 1,474,705                        |                        |                 |        | 1,475,000      |
| Warrants Issued for Services   |              |           | 260,373                          |                        |                 |        | 260,373        |
| Exercise of Warrants   | 4,092,254    | 4,091     | 1,213,535                        |                        |                 |        | 1,217,626      |
| Reclass Fair Value of Warrant Derivative Liability upon Exercise                                   |              |           | 2,855,463                        |                        |                 |        | 2,855,463      |
| Reclass Fair Value of Warrant Derivative Liability Upon Waiver of Certain Anti-Dilutive Provisions |              |           | 8,736,412                        |                        |                 |        | 8,736,412      |
| Reclass Fair Value of Note Derivative Liability Upon Waiver of Certain Anti-Dilutive Provisions    |              |           | 2,806,942                        |                        |                 |        | 2,806,942      |
| Proceeds from Preferred Stock Offering   |              |           | 24,812,950                       |                        | 49,626          | 50     | 24,813,000     |
| Direct costs of preferred stock Offering   |              |           | (214,169 )                       |                        |                 |        | (214,169 )     |
|  | 8,456        | 8         | (8 )                             |                        |                 |        | —              |

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|   |            |           |               |                 |        |       |               |
|---|------------|-----------|---------------|-----------------|--------|-------|---------------|
| Exercise of Stock<br>Options<br>Net Loss for the Six<br>Months Ended June 30,<br>2015 |            |           |               | (7,493,179 )    |        |       | (7,493,179 )  |
| Balance — June 30, 2015   | 16,001,434 | \$ 16,000 | \$ 73,006,471 | \$(51,654,569 ) | 49,626 | \$ 50 | \$ 21,367,952 |

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

## VUZIX CORPORATION

## CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

|  | For Three Months<br>Ended June 30, |            | For Six Months<br>Ended June 30, |              |
|--|------------------------------------|------------|----------------------------------|--------------|
|  | 2015                               | 2014       | 2015                             | 2014         |
| Sales of Products                                      | \$427,812                          | \$609,887  | \$1,123,386                      | \$1,259,305  |
| Sales of Engineering Services                          | —                                  | 113,371    | 113,581                          | 262,371      |
| <b>Total Sales</b>                                     | 427,812                            | 723,258    | 1,236,967                        | 1,521,676    |
| Cost of Sales — Products                               | 392,548                            | 416,808    | 977,938                          | 807,457      |
| Cost of Sales — Engineering Services                   | —                                  | 45,432     | 45,432                           | 105,032      |
| <b>Total Cost of Sales</b>                             | 392,548                            | 462,240    | 1,023,370                        | 912,489      |
| <b>Gross Profit</b>                                    | 35,264                             | 261,018    | 213,597                          | 609,187      |
| Operating Expenses:                                    |                                    |            |                                  |              |
| Research and Development                               | 732,491                            | 295,552    | 1,247,198                        | 692,974      |
| Selling and Marketing                                  | 345,262                            | 256,767    | 702,809                          | 621,322      |
| General and Administrative                             | 1,023,244                          | 532,561    | 3,958,149                        | 1,012,197    |
| Depreciation and Amortization                          | 78,548                             | 101,438    | 138,187                          | 201,143      |
| <b>(Loss) from Operations</b>                          | (2,144,281 )                       | (925,300 ) | (5,832,746 )                     | (1,918,449 ) |
| <b>Other Income (Expense)</b>                          |                                    |            |                                  |              |
| Other Taxes  | (2,290 )                           | (25,093 )  | (14,065 )                        | (46,535 )    |
| Foreign Exchange Gain (Loss)                           | (4,223 )                           | 3,713      | 1,048                            | (237 )       |
| Gain (Loss) on Derivative Valuation                    | (23,279 )                          | 1,248,556  | (1,026,706 )                     | 3,823,818    |
| Amortization of Senior Term Debt Discount              | (178,981 )                         | (33,889 )  | (519,941 )                       | (40,214 )    |
| Amortization of Deferred Financing Costs               | (11,580 )                          | (3,405 )   | (23,032 )                        | (3,405 )     |
| Interest Expenses                                      | (37,693 )                          | (25,472 )  | (77,737 )                        | (63,962 )    |
| <b>Total Other Income (Expense)</b>                    | (258,046 )                         | 1,164,410  | (1,660,433 )                     | 3,669,465    |
| <b>Income (Loss) Before Provision for Income Taxes</b> | (2,402,327 )                       | 239,110    | (7,493,179 )                     | 1,751,016    |
| Provision (Benefit) for Income Taxes                   | —                                  | —          | —                                | —            |
| <b>Net Income (Loss)</b>                               | (2,402,327 )                       | \$239,110  | (7,493,179 )                     | 1,751,016    |
| Preferred Stock Dividends                              | (376,545 )                         | —          | (735,483 )                       | —            |
| <b>Earnings Available to Common Shareholders</b>       | \$(2,778,872 )                     | \$239,110  | \$(8,228,662 )                   | \$1,751,016  |

**Earnings (Loss) per Share**

|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Basic                                     | \$(0.17    | ) \$0.02   | \$(0.56    | ) \$0.17   |
| Diluted                                   | \$(0.17    | ) \$0.02   | \$(0.56    | ) \$0.15   |
| Weighted-average Shares Outstanding Basic | 15,934,279 | 10,285,453 | 14,754,298 | 10,135,387 |
| Diluted                                   | 15,934,279 | 11,226,921 | 14,754,298 | 11,395,405 |

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

**VUZIX CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

|  | For the Six Months Ended<br>June 30, |             |
|--|--------------------------------------|-------------|
|  | 2015                                 | 2014        |
| Cash Flows from Operating Activities                                 |                                      |             |
| Net Income (Loss)  | \$(7,493,179 )                       | \$1,751,016 |
| Non-Cash Adjustments   |                                      |             |
| Depreciation and Amortization  | 138,187                              | 201,143     |
| Amortization of Software Development Costs in cost of sales products | 143,225                              | —           |
| Common Stock Awards Compensation Expense                             | 1,475,000                            | —           |
| Stock-Based Option Compensation Expense                              | 252,331                              | 38,694      |
| Amortization of Term Debt Discount                                   | 519,941                              | 40,214      |
| Amortization of Debt Issuance Costs                                  | 23,032                               | 3,405       |
| Common Stock and Warrants Issued for Services                        | 821,121                              | —           |
| (Gain) Loss on Derivative Valuation                                  | 1,026,706                            | (3,823,818) |
| (Increase) Decrease in Operating Assets                              |                                      |             |
| Accounts Receivable  | 299,153                              | 48,783      |
| Inventories  | (174,889 )                           | 36,801      |
| Vendor Prepayments   | (687,681 )                           | —           |
| Prepaid Expenses and Other Assets                                    | (90,547 )                            | 140,200     |
| Increase (Decrease) in Operating Liabilities                         |                                      |             |
| Accounts Payable   | (1,495,169 )                         | (327,655 )  |
| Accrued Expense  | 20,770                               | 28,427      |
| Customer Deposits  | (98,678 )                            | (103,671 )  |
| Unearned Revenue   | 15,188                               | —           |
| Income and Other Taxes Payable                                       | (28,426 )                            | (37,051 )   |
| Accrued Interest   | 43,954                               | 24,513      |
| Net Cash Flows Used in Operating Activities                          | (5,289,961 )                         | (1,978,999) |
| Cash Flows from Investing Activities                                 |                                      |             |
| Purchases of Tooling and Equipment                                   | (171,243 )                           | (83,619 )   |
| Purchases of Marketable Securities                                   | (5,000,000 )                         | —           |
| Investments in Software  | —                                    | (482,196 )  |
| Investments in Patents and Trademarks                                | (126,975 )                           | (43,821 )   |
| Net Cash Used in Investing Activities                                | (5,298,218 )                         | (609,636 )  |
| Cash Flows from Financing Activities                                 |                                      |             |
| Proceeds from Exercise of Warrants                                   | 1,217,626                            | 1,586,691   |

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|  |                  |                 |
|--|------------------|-----------------|
| Repayment of Capital Leases  | (10,873 )        | (15,171 )       |
| Repayment of Long-Term Debt and Notes Payable  | (141,883 )       | (183,624 )      |
| Proceeds from Senior Convertible Debt  | —                | 3,000,000       |
| Issuance Costs on Senior Convertible Debt  | —                | (138,090 )      |
| Proceeds from Preferred Stock Offering   | 24,813,000       | —               |
| Issuance Costs on Preferred Stock Offering   | (214,169 )       | —               |
| Net Change in Lines of Credit  | (112,500 )       | —               |
| <br>Net Cash Flows Provided by Financing Activities  | <br>25,551,201   | <br>4,249,806   |
| <br>Net Increase in Cash and Cash Equivalents  | <br>14,963,022   | <br>1,661,171   |
| Cash and Cash Equivalents — Beginning of Period  | 84,967           | 310,140         |
| <br>Cash and Cash Equivalents — End of Period  | <br>\$15,047,989 | <br>\$1,979,311 |
| Supplemental Disclosures   |                  |                 |
| Interest Paid  | \$25,495         | \$42,854        |
| Common Stock and Warrants Issued for Services, Classified as Prepaid Expense   | \$843,937        | —               |
| Conversion of Long-Term Debt   | \$427,500        | —               |
| Discount on Senior Convertible Debt attributed to embedded Conversion Price Adjustment Option  | —                | \$1,938,988     |
| Reclassification of Derivative Liability to Paid-In Capital upon Waiver of Certain Anti-Dilutive Provisions of Warrants and Convertible Debt | \$11,543,354     | —               |
| Reclassification of Derivative Liability Upon Warrant Exercises  | \$2,855,463      | —               |

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

## **VUZIX CORPORATION AND SUBSIDIARIES**

### **NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

#### **Note 1 — Basis of Presentation**

The accompanying unaudited Condensed Consolidated Financial Statements of Vuzix Corporation and Subsidiaries ("the Company") have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X of the Securities and Exchange Commission. Accordingly, the unaudited Condensed Consolidated Financial Statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. The condensed consolidated balance sheet as of December 31, 2014 was derived from the audited Consolidated Financial Statements in Form 10-K.

The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements of the Company as of December 31, 2014, as reported in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission.

The results of the Company's operations for any interim period are not necessarily indicative of the results of the Company's operations for any other interim period or for a full fiscal year.

#### **Note 2 – Earnings (Loss) Per Share**

Basic earnings (loss) per share is computed by dividing net income or loss by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution from the assumed exercise of stock options and warrants, and the conversion of any convertible debt and convertible preferred shares. During periods of net loss, all common stock equivalents are excluded from the diluted EPS calculation because they are antidilutive. Since the Company reported a net loss for the three and six months ended June 30, 2015, the calculation for basic and diluted earnings per share is considered to be the same, as the impact of potential common shares is anti-dilutive. Since the Company reported net income for the three and six months ended June 30, 2014, a total of 941,467 and 1,260,019 additional shares have been included respectively for these diluted calculations. As of June 30, 2015 and December 31, 2014, there were 7,283,036 and 7,012,767 respectively, common stock share equivalents potentially issuable under convertible debt agreements, conversion of preferred shares, options, and

warrants that could potentially dilute basic earnings per share in the future.

**Note 3 — Marketable Securities**

Marketable securities consists of highly liquid, highly rated, short term commercial paper with original maturities of more than three months and less than twelve months. These investments are classified as available-for-sale with a fair value determinable based on level 1 inputs. As of June 30, 2015, the contractual maturities of these investments totaled \$5,000,000 which approximated their fair value. The Company held no such investments as of December 31, 2014.

**Note 4 — Inventories**

Inventories are stated at the lower of cost (determined on the first-in, first-out or specific identification method) or market and consisted of the following as at June 30, 2015 and December 31, 2014:

|                                | June 30,<br>2015 | December 31, 2014 |
|--------------------------------|------------------|-------------------|
| Purchased Parts and Components | \$1,031,521      | \$ 1,251,224      |
| Work in Process                | 10,895           | 25,974            |
| Finished Goods                 | 329,494          | 300,889           |
| Less: Reserve for Obsolescence | (285,072 )       | (666,138 )        |
| Net                            | \$1,086,838      | \$ 911,949        |

**Note 5 — Notes Payable**

Notes payable represent promissory notes payable by the Company.

|   | June<br>30,<br>2015 | December 31,<br>2014 |
|---|---------------------|----------------------|
| Notes payable to officers and shareholders of the Company. The notes bear interest at 18.5% and secured by all the assets of the Company. Paid in full during 2015. | \$—                 | \$ 37,038            |
|   | \$—                 | \$ 37,038            |

**Note 6 — Accrued Expenses**

Accrued expenses consisted of the following:

|                                 | June 30,<br>2015 | December 31, 2014 |
|---------------------------------|------------------|-------------------|
| Accrued Wages and Related Costs | \$107,474        | \$ 101,445        |
| Accrued Compensation            | 417,286          | 428,786           |
| Accrued Professional Services   | 52,000           | 45,000            |
| Accrued Warranty Obligations    | 46,663           | 39,624            |
| Accrued Interest                | 96,414           | 75,471            |
| Other Accrued Expenses          | —                | 8,741             |
| Total                           | \$719,837        | \$ 699,067        |

Included in the above accrued compensation are amounts owed to officers of the Company for services rendered that remain outstanding. These amounts are not subject to a fixed repayment schedule and they bear interest at a rate of 8% per annum, compounding monthly. The related interest amounts included in Accrued Interest were \$71,076 and \$62,801 respectively as of June 30, 2015 and December 31, 2014. The related interest expense amounts for the six months ended June 30, 2015 and 2014 were \$18,171 and \$8,994 respectively.

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The Company has warranty obligations in connection with the sale of certain of its products. The warranty period for its products is generally one year except in certain European countries where it is two years. The costs incurred to provide for these warranty obligations are estimated and recorded as an accrued liability at the time of sale. The Company estimates its future warranty costs based on product-based historical performance rates and related costs to repair. The changes in the Company's accrued warranty obligations for the six months ended June 30, 2015 were as follows:

|   |          |
|---|----------|
| Accrued Warranty Obligations at December 31, 2014 | \$39,624 |
| Reductions for Settling Warranties                | (38,032) |
| Warranties Issued During Period                   | 45,071   |
| Accrued Warranty Obligations at June 30, 2015     | \$46,663 |

## Note 7 – Derivative Liability and Fair Value Measurements

The Company recognized a derivative liability for the warrants to purchase shares of its common stock issued in connection with the public equity offering and related debt conversions on August 5, 2013. These warrants have a cashless exercise provision and an exercise price that is subject to adjustment in the event of subsequent equity sales at a lower purchase price (subject to certain exceptions) along with full-ratchet anti-dilution provisions. In accordance with ASC 815-10-25, we measured the derivative liability using a Monte Carlo Options Lattice pricing model at their issuance date and subsequently remeasured the liability on each reporting date.

Accordingly, at the end of each quarterly reporting date the derivative fair market value is remeasured and adjusted to current market value. As at June 30, 2015 a total of 45,100 of these warrants were outstanding and as at December 31, 2014 a total of 4,730,992 warrants were outstanding that contained a full-ratchet anti-dilution provision. In connection with the Series A Private Placement on January 2, 2015 (see Note 10), holders of approximately 86% of outstanding warrants issued by the Company in its public offering and in connection with the conversion by certain holders of the Company's outstanding debt in connection with the Company's public offering (collectively, the "Public Offering Warrants") agreed to irrevocably waive their rights to anti-dilution protection under Section 2(b) of the Public Offering Warrants in the event the Company issues additional securities at a per share price lower than the exercise price of the Public Offering Warrants (the "Public Offering Warrant Waiver"). As a result the related derivative liability was reversed to Nil and reclassified into stockholders equity under Additional Paid-In Capital.

The Company recognized a derivative liability during the year ended December 31, 2014 for the \$3,000,000 of senior convertible notes with a conversion price that is subject to adjustment in the event of subsequent equity sales at a lower purchase price (subject to certain exceptions). In accordance with FASB ASC 815-10-25, we measured the derivative liability of this embedded conversion option using a Monte Carlo Options Lattice pricing model at the June 3, 2014 issuance date as \$1,938,988. The value of the derivative liability at issuance was recorded as a discount against the notes in the Long-Term Liabilities section of the balance sheet which is amortized into interest expense over the term of the related note. At the end of each quarterly reporting date the derivative fair market value is remeasured and adjusted to current market value through earnings.

In connection with the Series A Private Placement on January 2, 2015, each of the holders of notes issued by the Company on June 3, 2014 (the "June 2014 Notes") agreed to irrevocably waive their rights to anti-dilution protection under Section 5(b) of the June 2014 Notes in the event the Company issues additional securities at a per share price lower than the conversion price of the June 2014 Notes (the "June 2014 Note Waiver"). As a result this derivative liability was reversed to Nil and reclassified into stockholders equity under Additional Paid-In Capital. For period ending December 31, 2014, the Monte Carlo Options Lattice pricing model was used to estimate the fair value of the embedded conversion option on the convertible notes issued during this period.

The Company has adopted FASB ASC Topic 820 for financial instruments measured at fair value on a recurring basis. ASC Topic 820 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States and expands disclosures about fair value measurements.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FASB ASC Topic 820 establishes a six-tier fair value hierarchy which prioritizes the inputs used in measuring fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). These tiers include:

- Level 1, defined as observable inputs such as quoted prices for identical instruments in active markets;
- Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable such as quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active; and
- Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions, such as valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

The Company's financial instruments primarily consists of cash and cash equivalents, marketable securities, accounts receivable, accounts payable, lines of credit, long-term debt and capital leases, customer deposits, accrued expenses, and income taxes payable.

As of the consolidated balance sheet dates, the estimated fair values of the financial instruments were not materially different from their carrying values as presented due to both the short maturities of these instruments and that the interest rates on borrowing approximate those that would have been available for loans for similar remaining maturity and risk profiles.

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We measure certain financial instruments at fair value on a recurring basis. Assets and liabilities measured at fair value on a recurring basis are as follows at June 30, 2015:

|  | Total       | Level 1     | Level 2 | Level 3   |
|--|-------------|-------------|---------|-----------|
| Marketable Securities                                | \$5,000,000 | \$5,000,000 | \$ —    | \$—       |
| Total assets measured at fair value                  | 5,000,000   | 5,000,000   | —       | —         |
| Liabilities  |             |             |         |           |
| Warrant Liability                                    | 169,027     | —           | —       | 169,027   |
| Total liabilities measured at fair value (Long-Term) | \$169,027   | \$—         | \$ —    | \$169,027 |

We measure certain financial instruments at fair value on a recurring basis. Assets and liabilities measured at fair value on a recurring basis are as follows at December 31, 2014:

|  | Total        | Level 1 | Level 2 | Level 3      |
|--|--------------|---------|---------|--------------|
| Assets   | \$—          | \$ —    | \$ —    | \$—          |
| Total assets measured at fair value                  | —            | —       | —       | —            |
| Liabilities  |              |         |         |              |
| Note Conversion Feature Liability                    | 2,806,942    | —       | —       | 2,806,942    |
| Warrant Liability                                    | 10,734,196   | —       | —       | 10,734,196   |
| Total liabilities measured at fair value (Long-Term) | \$13,541,138 | \$ —    | \$ —    | \$13,541,138 |

|   |              |
|---|--------------|
| Fair value – December 31, 2014  | \$13,541,138 |
| Reclassification of warrant exercises to Additional Paid-in Capital   | (2,855,463 ) |
| Change in fair value for the period of warrant derivative liability   | 1,026,706    |
| Reclassification of embedded debt conversion price adjustment provision liability to Additional Paid-in Capital upon waiver of certain anti-dilutive provisions | (2,806,942 ) |
| Reclassification of warrant exercise price adjustment provision liability to Additional Paid-in Capital upon waiver of certain anti-dilutive provisions         | (8,736,412 ) |
| Fair value – June 30, 2015  | \$169,027    |

The Monte Carlo Options Lattice pricing model was used to estimate the fair value of the derivative liability outstanding:

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|                                | June 30, 2015 | December 31,<br>2014 |
|--------------------------------|---------------|----------------------|
| Assumptions for Pricing Model: |               |                      |
| Expected term in years         | 3.10 to 3.29  | 3.59 to 3.78         |
| Volatility range for years     | 94 to 104%    | 81 to 89%            |
| Risk-free interest rate        | 0.86 to 1.01% | 0.83 to 1.11%        |
| Expected annual dividends      | None          | None                 |

**Note 8 — Long-Term Debt**

Long-term debt consisted of the following:

|   | June 30,<br>2015 | December<br>31, 2014 |
|---|------------------|----------------------|
| Note payable for research and development equipment. The principal is subject to a fixed semi-annual repayment schedule commencing October 31, 2013 over 48 months. The note carries a 0% interest rate.  | \$98,243         | \$186,131            |
| The note carries a 0% interest, but imputed interest has been accrued based on a 12% discount rate and is reflected as a reduction in the principal.  | (33,748 )        | (46,399 )            |
| Note payable for which the principal and interest is subject to a fixed blended repayment schedule of 36 months, commencing July 15, 2013. The loan bears interest at 12% per annum and is secured by a subordinated position in all the assets of the Company.   | 33,916           | 50,874               |
| Convertible, Senior Secured Notes payable. The principal is due June 3, 2017 and no principal payments are required prior to maturity. The notes carry 5% interest, payable upon the note's maturity. Both the principal plus accrued interest is convertible into shares of the Company's common shares at \$2.25, subject to normal adjustments. The notes are secured by a first security position in all the assets of the Company. | 1,902,500        | 2,375,000            |
| Unamortized debt discount related to derivative liability associated with above notes' conversion price that is subject to adjustment in the event of subsequent equity sales at a lower purchase price (subject to certain exceptions). Upon issuance on June 3, 2014 the discount was \$1,938,988.  | (840,895 )       | (1,348,185)          |
|   | 1,160,016        | 1,217,421            |
| Less: Amount Due Within One Year  | (82,464 )        | (128,425 )           |
| Amount Due After One Year   | \$1,077,552      | \$1,088,996          |

The calendar year aggregate maturities for all long-term borrowings exclusive of discounts as of June 30, 2015 are as follows:

| Total Aggregate Maturity For Period                           | Amounts    |
|---|------------|
| 2015  | \$107,766  |
| 2016  | 24,393     |
| 2017  | 1,902,500  |
| Total Required Principal Payments Exclusive of Debt Discounts | 2,034,659  |
| Total Unamortized Debt Discounts                              | (874,643 ) |

|  |             |
|--|-------------|
| Total Net Long-Term Borrowings as of June 30, 2015 | \$1,160,016 |
|--|-------------|

## Note 9 — Income Taxes

The Company's effective income tax rate is a combination of federal, state and foreign tax rates and differs from the U.S. statutory rate due to taxes on foreign income, permanent differences including tax-exempt interest, and the resolution of tax uncertainties, offset by a valuation allowance against U.S. deferred income tax assets.

## Note 10 — Preferred Stock

The Company may issue shares of undesignated preferred stock in one or more series. The Board of Directors is authorized to establish and designate the different series and to fix and determine the voting powers and other special rights and qualifications. A total of 5,000,000 shares of preferred stock are authorized as of June 30, 2015 and December 31, 2014.

On January 2, 2015 (the "Series A Closing Date"), we entered into and closed a Series A Preferred Stock Purchase Agreement (the "Series A Purchase Agreement") with Intel Corporation (the "Series A Purchaser"), pursuant to which we issued and sold to the Series A Purchaser, an aggregate of 49,626 shares of the Company's Series A Preferred Stock, at a purchase price of \$500 per share, for an aggregate purchase price of \$24,813,000 (the "Series A Private Placement"). Each share of Series A Preferred Stock is convertible, at the option of the Series A Purchaser, into 100 shares of the Company's common stock (determined by dividing the Series A Original Issue Price of \$500 by the Series A Conversion Price. The Series A Conversion Price is \$5.00, subject to adjustment in the event of stock splits, dividends or other combinations). Total costs incurred connection with this offering were approximately \$214,000.

Each share of Series A Preferred Stock is entitled to receive dividends at a rate of 6% per annum, compounded quarterly and payable in cash or in kind, at the Company's sole discretion. As of June 30, 2015, total accrued and unpaid preferred dividends were \$735,483. In the event of the liquidation, dissolution or winding up of the Company, each share of Series A Preferred Stock is entitled to a liquidation preference equal to one times (1x) the Series A Purchaser's original per share purchase price, plus a right to receive an additional liquidation distribution together with the common stock holders pro rata on an as converted basis, but not in excess of \$1,000 per share in the aggregate (subject to adjustment for accrued but unpaid dividends and in the event of stock splits, dividends or other combinations). Each share of Series A Preferred Stock is entitled to vote with the holders of the Company's common stock on matters presented to its stockholders, and is entitled to cast such number of votes equal to the whole number of shares of common stock into which such shares of Series A Preferred Stock are convertible. The holders of record of the Series A Preferred Stock are entitled to nominate and elect 2 directors to the Company's Board of Directors (the "Board Election Right"), at least one of whom will be required to qualify as an "independent" director, as that term is used in applicable exchange listing rules. The Board Election Right with respect to the independent director will terminate on such date as the number of shares of Series A Preferred Stock then outstanding is less than 40% of the original amount purchased by the Series A Purchaser. The Board Election Right with respect to the second director shall terminate on such date as the number of shares of Series A Preferred Stock then outstanding is less than 20% of the

original amount purchased by the Series A Purchaser. The Company also granted the Series A Purchaser the right to have a board observer at meetings of the Company's Board of Directors and committees thereof.

For as long as at least 25% (or 12,406 shares) of the Series A Preferred Stock is outstanding, the Company may not, without the consent of holders of at least 60% of the then outstanding shares of Series A Preferred Stock, take certain actions, including but not limited to: (i) liquidate, dissolve, or wind up the business and affairs of the Company; (ii) amend, alter or repeal any provision of its charter or bylaws in a manner that adversely effects the rights of the Series A Preferred Stock; (iii) create or issue any capital stock that is equal to or senior to the Series A Preferred Stock with respect to preferences; (iv) create or issue any debt security, subject to certain exceptions; (v) pay off any debt obligation prior to its stated maturity date; or (vi) enter into any stockholders rights plan or similar arrangement or take other actions that may limit actions that holders of a majority of the Series A Preferred Stock can take under Section 203 ("Section 203") of the Delaware General Corporation Law, as well as such other customary provisions protecting the rights of the holder of the Series A Preferred Stock, as are outlined in the Certificate of Designation.

The Series A Purchaser has the right to participate in any proposed issuance by the Company of its securities, subject to certain exceptions (the "Participation Right"). In the event the Series A Purchaser is not afforded the opportunity to exercise its Participation Right, the Series A Purchaser will have the right, but not the obligation, up to two times per calendar year, to acquire additional securities from the Company in such amount as is sufficient to maintain the Series A Purchaser's ownership percentage in the Company, calculated immediately prior to such applicable financing, at a purchase price equal to the per share price of the Company's securities in such applicable financing.

In connection with the Series A Private Placement, the Company entered into an investor's rights agreement with the Series A Purchaser, pursuant to which the Company agreed to file a "resale" registration statement with the Securities and Exchange Commission (the "SEC") covering all shares of common stock issuable upon conversion of the Series A Preferred Stock sold in the Series A Private Placement on or before February 14, 2015. The Company filed the registration statement on February 12, 2015 and the registration statement was declared effective by the SEC on February 17, 2015.

**Note 11 — Stock Warrants**

A summary of the various changes in warrants during the six-month period ended June 30, 2015 is as follows.

|   | Number of<br>Shares |
|---|---------------------|
| Warrants Outstanding at December 31, 2014 | 5,236,660           |
| Exercised During the Period               | (4,706,517)         |
| Issued During the Period                  | 60,000              |
| Expired During the Period                 | (14,814 )           |
| Warrants Outstanding, June 30, 2015       | 575,329             |

The outstanding warrants as of June 30, 2015 expire from December 31, 2015 to August 5, 2018. The weighted average remaining term of the warrants is 2.7 years. The weighted average exercise price is \$2.40 per share. During the six months ending June 30, 2015 a total 4,168,267 warrants were exercised on a cashless basis resulting in the issuance of 3,554,004 shares.

The Black-Scholes-Merton pricing model was used to estimate the fair value of share-based awards under FASB ASC Topic 718. The Black-Scholes-Merton pricing model incorporates various and highly subjective assumptions, including expected term and expected volatility.

The following summary table shows the assumptions used to compute the fair value of warrants granted during the six period ended June 30, 2015 for investor relations services and their estimated value:

|                                 |                  |
|---------------------------------|------------------|
| · Expected term in years        | 2.8 to 3.0 years |
| · Volatility                    | 122.8 to 122.9%  |
| · Risk-free interest rate       | 0.90 to 0.99%    |
| · Expected annual dividends     | None             |
| · Fair value of warrants issued | \$260,373        |

The entire fair value amount of the warrants issued was recognized during the six-month period ended June 30, 2015.

**Note 12 — Stock Option Plans**

A summary of stock option activity for the six months ended June 30, 2015 is as follows:

|                                  | Number<br>of<br>Shares | Weighted<br>Average<br>Exercise<br>Price |
|----------------------------------|------------------------|--|
| Outstanding at December 31, 2014 | 720,551                | \$ 4.46                                  |
| Granted                          | 229,000                | \$ 5.36                                  |
| Exercised                        | (15,833 )              | \$ 2.60                                  |
| Expired or Forfeited             | (34,167 )              | \$ 3.38                                  |
| Outstanding at June 30, 2015     | 899,551                | \$ 4.76                                  |

As of June 30, 2015, there were 347,222 options that were fully vested and exercisable at a weighted average exercise price of \$6.48 per share. The weighted average remaining contractual term on the vested options is 7.0 years.

As of June 30, 2015 there were 552,329 unvested options exercisable at a weighted average exercise price of \$3.69 per share. The weighted average remaining contractual term on the unvested options is 9.8 years.

The following summary table shows the assumptions used to compute the fair value of options granted during the six period ended June 30, 2015 and their estimated value:

|                               |             |
|-------------------------------|-------------|
| ·Expected term in years       | 6.0 years   |
| ·Volatility                   | 111.1%      |
| ·Risk-free interest rate      | 1.74%       |
| ·Expected annual dividends    | None        |
| ·Fair value of options issued | \$1,026,243 |

No cash was received from option exercises for the six months ended June 30, 2015 and 2014. During the quarter ended June 30, 2015 the Company issued a total of 8,456 shares of common stock as the result of the cashless exercise of 15,833 options.

The weighted average fair value of option grants was calculated using the Black-Scholes-Merton option pricing method. At June 30, 2015, the Company had approximately \$1,843,903 of unrecognized stock compensation expense, which will be recognized over a weighted average period of approximately 2.2 years.

#### **Note 13 — Litigation**

We are not currently involved in any pending legal proceeding or litigation.

#### **Note 14 — Contractual Obligations**

The Company leases office and manufacturing space under operating leases that expire on September 30, 2015 through to March 1, 2016. The Company's total contractual payment obligations for operating leases as of June 30, 2015 total \$40,000.

The Company signed a lease agreement for new office and manufacturing space under an operating lease that is contemplated to commence any time after October 1, 2015, subject to completion. The lease is cancellable by the Company upon 30 days-notice if the premises are not ready for possession by November 30, 2015. The base rent contractual payment obligations under this operating lease will be \$335,248 per year, once the lease commences. The lease has an original 5 year term with an option by the Company to renew for two 3 year terms at pre-agreed to lease rates.

#### **Note 15 — Recent Accounting Pronouncements**

FASB ASU 2015-1, Income Statement—Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items. This FASB ASU eliminates from GAAP the concept of extraordinary items. FASB ASU 2015-1 is effective for the annual period ending after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption.

FASB ASU 2015-03—Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. This FASB ASU requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability (same treatment as debt discounts). FASB ASU 2015-3 is effective for the annual periods beginning after December 15, 2015. Early adoption is permitted for financial statements that not have been previously issued.

FASB ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. This ASU requires inventory within the scope of the guidance be measured at the lower of cost or net realizable value. FASB ASU 2015-11 is effective for annual and interim periods beginning after December 15, 2016, with prospective application required. Early adoption is permitted. The Company is evaluating the potential impact of this FASB ASU on the condensed consolidated financial statements.

There are no other recent accounting pronouncements that are expected to have a material impact on the condensed consolidated financial statements.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*You should read the following discussion and analysis of financial condition and results of operations in conjunction with the financial statements and related notes appearing elsewhere in this quarterly report and in our annual report on Form 10-K for the year ended December 31, 2014*

*As used in this report, unless otherwise indicated, the terms “Company,” “Vuzix” “management,” “we,” “our,” and “us” refer to Vuzix Corporation and its subsidiary.*

***Critical Accounting Policies and Significant Developments and Estimates***

The discussion and analysis of our financial condition and results of operations are based on our unaudited condensed consolidated financial statements and related notes appearing elsewhere in this quarterly report. The preparation of these statements in conformity with generally accepted accounting principles requires the appropriate application of certain accounting policies, many of which require us to make estimates and assumptions about future events and their impact on amounts reported in our financial statements, including the statement of operations, balance sheet, cash flow and related notes. We continually evaluate our estimates used in the preparation of our financial statements, including those related to revenue recognition, bad debts, inventories, warranty reserves, product warranty, carrying value of long-lived assets, fair value measurement of financial instruments and embedded derivatives, valuation of stock compensation awards, and income taxes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying values of assets and liabilities that are not apparent from other sources. Since future events and their impact cannot be determined with certainty, the actual results will inevitably differ from our estimates. Such differences could be material to the financial statements.

We believe that our application of accounting policies, and the estimates inherently required therein, are reasonable. These accounting policies and estimates are periodically reevaluated, and adjustments are made when facts and circumstances dictate a change. Historically, we have found our application of accounting policies to be appropriate, and actual results have not differed materially from those determined using necessary estimates.

Management believes certain factors and trends are important in understanding our financial performance. The critical accounting policies, judgments and estimates that we believe have the most significant effect on our financial statements are:

- valuation of inventories;
- carrying value of long-lived assets;
- software development costs;
- revenue recognition;
- product warranty;
- fair value measurement of financial instruments and embedded derivatives;
- stock-based compensation; and
- income taxes.

Our accounting policies are more fully described in the notes to our condensed consolidated financial statements included in this quarterly report and in our annual report on Form 10-K for the year ended December 31, 2014. There have been no significant changes in our accounting policies for the six month period ended June 30, 2015.

### ***Off Balance Sheet Arrangements***

We do not have any off-balance sheet arrangements that have, or are reasonably likely to have, an effect on our financial condition, financial statements, revenues or expenses.

### ***Business Matters***

We are engaged in the design, manufacture, marketing and sale of wearable display devices that are worn like eyeglasses and feature built-in video screens that enable the user to view video and digital content, such as movies, computer data, the Internet or video games. Our wearable display products, known commercially as Video Eyewear (also referred to as head mounted displays (or HMDs), Smart Glasses, wearable displays, video glasses, personal viewers, near-eye virtual displays, and near-eye displays or NEDs) contain micro video displays that offer users a portable high-quality viewing experience. Our Video Eyewear products provide virtual large high-resolution screens, fit in a user's pocket or purse and can be viewed practically anywhere, anytime. They can also be used for virtual and augmented reality applications, in which the wearer is either immersed in a computer generated world or has their real world view augmented with computer generated information or graphics. Our recent Smart Glasses products, a new category of Video Eyewear have much of the capabilities of a smartphone including wireless internet access but that are like glasses. We produce both monocular and binocular Video Eyewear devices. Video Eyewear are designed to work with mobile electronic devices, such as cell phones, laptop computers, tablets, portable media players and gaming systems.

Our Video Eyewear products feature high performance miniature display modules, low power electronics and related optical systems. We produce both monocular and binocular Video Eyewear devices that we believe are excellent solutions for many mobile computer or video viewing requirements. With respect to our Video Eyewear products, we focus on the consumer markets for gaming and mobile video while our Virtual and Augmented Reality products are also sold in the consumer, industrial, commercial, academic and medical markets. The consumer electronics and mobile phone accessory markets in which we compete has been subject to rapid technological change including the rapid adoption of tablets and most recently larger screen sizes and display resolutions along with declining prices on mobile phones, and as a result we must continue to improve our products' performance and lower our costs. We believe our intellectual property portfolio gives us a leadership position in microdisplay electronics, waveguides, ergonomics, packaging, motion tracking and optical systems.

### ***Recent Accounting Pronouncements***

FASB ASU 2015-1, Income Statement—Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items. This ASU eliminates from GAAP the concept of extraordinary items. FASB ASU 2015-1 is effective for the annual period ending after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption.

FASB ASU 2015-03—Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. This ASU requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability (same treatment as debt discounts). FASB ASU 2015-3 is effective for the annual periods beginning after December 15, 2015. Early adoption is permitted for financial statements that not have been previously issued.

FASB ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. This ASU requires inventory within the scope of the guidance be measured at the lower of cost or net realizable value. FASB ASU 2015-11 is effective for annual and interim periods beginning after December 15, 2016, with prospective application required. Early adoption is permitted. The Company is evaluating the potential impact of this ASU on the condensed consolidated financial statements.

There are no other recent accounting pronouncements that are expected to have a material impact on the condensed consolidated financial statements.

### ***Results of Operations***

**Comparison of Three Months Ended June 30, 2015 and June 30, 2014**

The following table compares the Company's consolidated statements of operations data for the three months ended June 30, 2015 and 2014.

|  | 3 Months Ended June 30, |                   | Dollar Change         | % Increase<br>(Decrease) |           |
|--|-------------------------|-------------------|-----------------------|--------------------------|-----------|
|  | 2015                    | 2014              |                       |                          |           |
| Sales of Products                                      | \$427,812               | \$609,887         | \$ (182,075 )         | (30                      | )%        |
| Sales of Engineering Services                          | —                       | 113,371           | (113,371 )            | (100                     | )%        |
| <b>Total Sales</b>                                     | <b>427,812</b>          | <b>723,258</b>    | <b>(295,446 )</b>     | <b>(41</b>               | <b>)%</b> |
| Cost of Sales — Products                               | 392,548                 | 416,808           | (24,260 )             | (6                       | )%        |
| Cost of Sales — Engineering Services                   | —                       | 45,432            | (45,432 )             | (100                     | )%        |
| <b>Total Cost of Sales</b>                             | <b>392,548</b>          | <b>462,240</b>    | <b>(69,692 )</b>      | <b>(15</b>               | <b>)%</b> |
| Gross Profit   | 35,264                  | 261,018           | (225,754 )            | (86                      | )%        |
| Gross Margin %   | 8                       | % 36              | %                     |                          |           |
| <b>Operating Expenses:</b>                             |                         |                   |                       |                          |           |
| Research and Development                               | 732,491                 | 295,552           | 436,939               | 148                      | %         |
| Selling and Marketing                                  | 345,262                 | 256,767           | 88,495                | 34                       | %         |
| General and Administrative                             | 1,023,244               | 532,561           | 490,683               | 92                       | %         |
| Depreciation and Amortization                          | 78,548                  | 101,438           | (28,890 )             | (23                      | )%        |
| <b>Loss from Operations</b>                            | <b>(2,144,281)</b>      | <b>(925,300 )</b> | <b>(1,218,981 )</b>   | <b>132</b>               | <b>%</b>  |
| <b>Other Income (Expense)</b>                          |                         |                   |                       |                          |           |
| Other Taxes  | (2,290 )                | (25,093 )         | 22,803                | (91                      | )%        |
| Foreign Exchange (Gain) Loss                           | (4,223 )                | 3,713             | (7,936 )              | (214                     | )%        |
| (Loss) Gain on Derivative Valuation                    | (23,279 )               | 1,248,556         | (1,271,835 )          | (102                     | )%        |
| Amortization of Senior Term Debt Discount              | (178,981 )              | (33,889 )         | (145,092 )            | 428                      | %         |
| Amortization of Deferred Financing Costs               | (11,580 )               | (3,405 )          | (8,175 )              | 240                      | %         |
| Interest Expense                                       | (37,693 )               | (25,472 )         | (12,221 )             | 48                       | %         |
| <b>Total Other Income (Expense)</b>                    | <b>(258,046 )</b>       | <b>1,164,410</b>  | <b>(1,422,456 )</b>   | <b>(122</b>              | <b>)%</b> |
| <b>(Loss) Income Before Provision for Income Taxes</b> | <b>(2,402,327)</b>      | <b>239,110</b>    | <b>(2,641,437 )</b>   | <b>(1105</b>             | <b>)%</b> |
| Provision for Income Taxes                             | —                       | —                 | —                     | —                        |           |
| <b>Net (Loss) Income</b>                               | <b>\$(2,402,327)</b>    | <b>\$239,110</b>  | <b>\$(2,641,437 )</b> | <b>(1105</b>             | <b>)%</b> |



*Sales.* The decrease in product sales for the three months ended June 30, 2015 over the same period in 2014 was primarily the result of the phase out of our Wrap 1200 series of products. The Wrap Video Eyewear products are used for Video Viewing, Augmented Reality, and Virtual Reality applications. All these Wrap 1200 product models were phased out early in the period due to planned product changes to higher resolution versions and as a consequence we had very limited quantities left for sale as compared to the 2014 period. As a result sales of Video Eyewear, AR, and VR products decreased by 74% over the comparative period in 2014 and represented just 16% of revenues for the 2015 period. Sales of M100 Smart Glasses were virtually flat for the quarter as compared to the prior year and they represented 84% of total product revenues as compared to 60% in the 2014 period.

Sales from our engineering services for the three months ended June 30, 2015, was Nil compared to \$113,371 or 16% of total sales in the same period in 2014. We have no open orders for further engineering services and are focusing on our own product and technology development activities.

*Cost of Sales and Gross Margin.* Cost of product revenues and engineering services is comprised of materials, components, labor, warranty costs, freight costs, manufacturing overhead, software royalties, and the non-cash amortization of software development costs related to the production of our products and rendering engineering services. The decreased gross margin percentage earned in the three months ended June 30, 2015 as compared to the same period in 2014 was primarily the result of amortization of software development costs of \$71,612 in the three months ending June 30, 2015, a \$32,163 increase in manufacturing overhead as the result of increased wage costs, and \$43,750 in minimum software royalties related to a new software bundle on the M100 Smart Glasses in the 2015 period. The following table reflects the components of our cost of goods sold for products:

| Component of Cost of Sales               | 3 Months<br>Ending June<br>30, 2015 | As %<br>Related<br>Sales | 3 Months<br>Ending June<br>30, 2014 | As % of<br>Related<br>Sales | Dollar<br>Change |
|--|-------------------------------------|--------------------------|-------------------------------------|-----------------------------|------------------|
| Product Cost of Sales                    | \$ 151,017                          | 35.3 %                   | \$ 322,802                          | 52.9 %                      | \$(171,785)      |
| Manufacturing Overheads                  | 126,169                             | 29.5 %                   | 94,006                              | 15.4 %                      | 32,163           |
| Amortization of Software Costs           | 71,612                              | 16.7 %                   | —                                   | —                           | 71,612           |
| Software Royalties (Minimum for Quarter) | 43,750                              | 10.2 %                   | —                                   | —                           | 43,750           |
| Total Cost of Sales – Products           | \$ 392,548                          | 91.8 %                   | \$ 416,808                          | 68.3 %                      | \$(24,260 )      |

*Research and Development.* Our research and development expenses consist primarily of compensation costs for personnel, related stock compensation expenses, third party services, purchase of research supplies and materials, and consulting fees related to research and development costs. Software development expenses to determine technical feasibility before final development and ongoing maintenance that are not capitalized are included in research and development costs. Comparing research and development costs for the three months ending June 30, 2015 versus the same period in 2014, there was an increase in 2015 salary and stock compensation expenses of \$254,720 versus the same period in 2014 when \$62,500 of salaries related to software development costs were capitalized, a reduction of \$47,034 in consulting fees, an increase in project development costs of \$165,154 primarily related to the new iWear Video Headphones product scheduled for introduction in the fall of 2015, and an \$18,804 increase in travel costs, primarily to and from Asia.

*Selling and Marketing.* Selling and marketing costs consist of trade show costs, advertising, travel costs, sales staff compensation costs including stock compensation expense, consulting fees and sales commissions paid to full-time staff and outside consultants. These costs increased overall for the three months ended June 30, 2015 as compared to the same period in 2014 primarily due to the following main factors: higher trade show costs of \$23,732; higher travel costs of \$11,895; and an increase in salary and stock compensation costs of \$52,030.

*General and Administrative.* General and administrative costs include professional fees, investor relations (IR) costs including shares and warrants issued for IR services, salaries and related stock compensation, travel costs, office and rental costs. These costs increased for the three months ended June 30, 2015 as compared to the same period in 2014 primarily because of higher investor relations costs totaling \$325,337, inclusive of a non-cash expense of \$248,763 for shares of common stock and warrants awarded to consultants; \$45,137 increase in professional and consulting fees; \$142,725 increase in salary and stock compensation costs; \$10,571 increase in stock exchange listing fees; partially offset by \$4,986 decreased travel costs; \$10,241 decrease in insurance costs; and a \$5,955 decrease in bank charges.

*Depreciation and Amortization.* Depreciation and amortization expense for the three months ended June 30, 2015 was \$78,548 as compared to \$101,438 in the same period in 2014, a decrease of \$22,890 or 23%. The reduction in depreciation and amortization expense is due to assets that have become fully depreciated and lower capital expenditures over the last 2 fiscal years.

*Other Income (Expense).* Other income and expenses was primarily attributable to two items. The Company recorded a loss of \$23,279 on the derivative liability valuation mark-to-market revaluation for 2015 versus income of \$1,248,556 in 2014, a reduction of \$1,271,835. Secondly, we incurred \$178,981 in expenses for the amortization term debt discounts in 2015 as compared to \$33,889 in 2014, a period prior to when the June 2014 Notes (discussed below) were issued. The provision for other taxes for 2015 was \$2,290 compared to \$25,093 for 2014. The composition of each year's other taxes provision was primarily for franchise taxes payable to the State of Delaware, our state of incorporation, which has decreased due to the reduction in authorized capital effected in June 2014.

*Provision for Income Taxes.* There were no provisions for income taxes for the three months ended June 30, 2015 or 2014.

*Net Income (Loss) and Income (Loss) per Share.* As the result of the foregoing, our net loss was \$2,402,327 or \$0.17 basic and diluted per share for the three months ended June 30, 2015, versus net income of \$239,110 or \$0.02 basic and diluted income per share for the same period in 2014.

**Comparison of Six Months Ended June 30, 2015 and June 30, 2014**

The following table compares the Company's consolidated statements of operations data for the six months ended June 30, 2015 and 2014.

|   | 6 Months Ended June 30, |             | Dollar Change  | % Increase<br>(Decrease) |   |
|---|-------------------------|-------------|----------------|--------------------------|---|
|   | 2015                    | 2014        |                |                          |   |
| Sales of Products                               | \$1,123,386             | \$1,259,305 | \$ (135,919 )  | (11 )                    | % |
| Sales of Engineering Services                   | 113,581                 | 262,371     | (148,790 )     | (57 )                    | % |
| Total Sales                                     | 1,236,967               | 1,521,676   | (284,709 )     | (19 )                    | % |
| Cost of Sales — Products                        | 977,938                 | 807,457     | 170,481        | 21                       | % |
| Cost of Sales — Engineering Services            | 45,432                  | 105,032     | (59,600 )      | (57 )                    | % |
| Total Cost of Sales                             | 1,023,370               | 912,489     | 110,881        | 12                       | % |
| Gross Profit                                    | 213,597                 | 609,187     | (395,590 )     | (65 )                    | % |
| Gross Margin %                                  | 17 %                    | 40 %        |                |                          |   |
| Operating Expenses:                             |                         |             |                |                          |   |
| Research and Development                        | 1,247,198               | 692,974     | 554,224        | 80                       | % |
| Selling and Marketing                           | 702,809                 | 621,322     | 81,487         | 13                       | % |
| General and Administrative                      | 3,958,148               | 1,012,197   | 2,945,951      | 291                      | % |
| Depreciation and Amortization                   | 138,187                 | 201,143     | (62,956 )      | (31 )                    | % |
| Loss from Operations                            | (5,832,746)             | (1,918,449) | (3,914,297 )   | 204                      | % |
| Other Income (Expense)                          |                         |             |                |                          |   |
| Other Taxes                                     | (14,065 )               | (46,535 )   | 32,470         | (70 )                    | % |
| Foreign Exchange (Gain) Loss                    | 1,048                   | (237 )      | 1,285          | (542 )                   | % |
| (Loss) Gain on Derivative Valuation             | (1,026,706)             | 3,823,818   | (4,850,524 )   | (127 )                   | % |
| Amortization of Senior Term Debt Discount       | (519,941 )              | (40,214 )   | (479,727 )     | 1193                     | % |
| Amortization of Deferred Financing Costs        | (23,032 )               | (3,405 )    | (19,627 )      | (576 )                   | % |
| Interest Expense (combine with above)           | (77,737 )               | (63,962 )   | (13,775 )      | (22 )                    | % |
| Total Other Income (Expense)                    | (1,660,433)             | 3,669,465   | (5,329,898 )   | (145 )                   | % |
| (Loss) Income Before Provision for Income Taxes | (7,493,179)             | 1,751,016   | (9,244,195 )   | (528 )                   | % |
| Provision for Income Taxes                      | —                       | —           | —              | —                        |   |
| Net (Loss) Income                               | \$(7,493,179)           | \$1,751,016 | \$(9,244,195 ) | (528 )                   | % |

*Sales.* The decrease in product sales for the six months ended June 30, 2015 over the same period in 2014 was primarily the result of the phase out of our Wrap 1200 series of products. The Wrap Video Eyewear products are used for Video Viewing, Augmented Reality, and Virtual Reality applications. All these Wrap 1200 product models were phased out early in the period due to planned product changes to higher resolution versions and as a consequence we had very limited quantities left for sale as compared to the 2014 period. As a result sales of Video Eyewear, AR, and VR products decreased by 65% over the comparative period in 2014 and represented just 15% of revenues for the six month period ending June 30, 2015 as compared to 39% of revenues in 2014. Sales of M100 Smart Glasses rose 28% for the six month period ended June 30, 2015 and represented 83% of product revenues as compared to 58% in the 2014 period.

Sales from our engineering services for the six months ended June 30, 2015, was \$113,581 compared to \$262,371 or 17% of total sales in the same period in 2014. We had no engineering services revenues in the second quarter of 2015 and have no open orders for further engineering services and are focusing on our own product and technology development activities.

*Cost of Sales and Gross Profit.* Cost of product revenues and engineering services is comprised of materials, components, labor, warranty costs, freight costs, manufacturing overhead, software royalties, and the non-cash amortization of software development costs related to the production of our products and rendering engineering services. Gross profit decreased to \$213,597 for the six months ended June 30, 2015 from \$609,187 for the same period in 2014, a decrease of \$395,590 or 65%. The reduction was principally the result of lower product sales and the fact that nearly 40% of the composition of our cost of goods are generally fixed in nature. As a percentage of net sales, gross profit decreased to 17% for the six month period ended June 30, 2015 compared to 40% for the same period in 2014. This decrease was primarily the result of increased manufacturing overhead costs, minimum software royalties related to a new software bundle on the M100 Smart Glasses in March 2015, and commencement of amortization of software development costs that were capitalized in the comparative 2014 period. The following table reflects the components of our cost of goods sold related to products.

| Component of Cost of Sales               | 6 Months<br>Ending<br>June<br>30, 2015 | As %<br>Related<br>Sales |          | 6 Months<br>Ending<br>June<br>30, 2014 | As % of<br>Related<br>Sales | Dollar<br>Change   |
|--|--|--------------------------|----------|--|-----------------------------|--------------------|
| Product Cost of Sales                    | \$530,110                              | 47.2                     | %        | \$603,532                              | 47.9                        | %(73,422)          |
| Manufacturing Overheads                  | 254,602                                | 22.7                     | %        | 203,925                                | 16.2                        | % 50,678           |
| Amortization of Software Costs           | 143,225                                | 12.7                     | %        | —                                      | —                           | 143,225            |
| Software Royalties (Minimum for Quarter) | 50,000                                 | 4.5                      | %        | —                                      | —                           | 50,000             |
| <b>Total Cost of Sales - Products</b>    | <b>\$977,938</b>                       | <b>87.1</b>              | <b>%</b> | <b>\$807,457</b>                       | <b>64.1</b>                 | <b>% \$170,481</b> |

*Research and Development.* Our research and development expenses consist primarily of compensation costs for personnel, related stock compensation expenses, third party services, purchase of research supplies and materials, and consulting fees related to research and development costs. Software development expenses to determine technical feasibility before final development and ongoing maintenance that are not capitalized are included in research and development costs. Comparing the research and development costs for the six months ending June 30, 2015 versus the same period in 2014, there was an increase in 2015 salary and stock compensation expenses of \$350,957 versus the same period in 2014 when \$125,000 of salaries related to software development costs were capitalized; a reduction of \$80,640 in consulting fees; an increase in project development costs of \$210,117 primarily related to the new iWear Video Headphones product scheduled for introduction in the fall of 2015' and a \$26,466 increase in travel costs, primarily to and from Asia.

*Selling and Marketing.* Selling and marketing costs consist of trade show costs, advertising, travel costs, sales staff compensation costs including stock compensation expense, consulting fees and sales commissions paid to full-time staff and outside consultants. These costs increased overall for the six months ended June 30, 2015 to \$702,809 as compared to the same period in 2014 of \$621,322 primarily due to the following main factors: higher trade show and advertising costs of \$40,609; higher travel costs of \$11,406; increases in salary and stock compensation costs of \$74,207; partially offset by a \$43,788 reduction in consulting expenses.

*General and Administrative.* General and administrative costs include professional fees, investor relations (IR) costs including shares and warrants issued for IR services, salaries and related stock compensation, travel costs, office and rental costs. These costs increased for the six months ended June 30, 2015 as compared to the same period in 2014 primarily because of higher non-cash compensation expense related to stock awards totaling \$1,375,000 our officers and directors; increased IR activities of \$1,093,174, inclusive of a non-cash expense of \$796,969 for stock and warrants awarded to consultants; \$199,927 increase in professional fees, of which \$100,000 was for a stock award to our attorneys; \$47,452 in increased travel costs; \$56,550 increase in fees paid to our external board members; increased salary and benefits costs of \$44,002; and \$23,784 in increased stock exchange listing fees. Of the overall \$2,945,951 increase in 2015 over 2014, a total of approximately \$2,394,473 was non-cash share and warrant compensation expense, leaving a net increase of approximately \$551,478 as the result of cash general and administrative expenses described above.

*Depreciation and Amortization.* Depreciation and amortization expense for the six months ended June 30, 2015 was \$138,187 as compared to \$201,143 in the same period in 2014, a decrease of \$62,956 or 31%. The reduction in depreciation and amortization expense is due to assets that have become fully depreciated and lower capital expenditures over the last 2 fiscal years

*Other Income (Expense).* Total other expense was \$1,660,433 for the six month period ended June 30, 2015 compared to income of \$3,669,465 in the same period in 2014. The largest expense for the 2015 period was the loss \$1,026,706 on the derivative liability valuation mark-to-market revaluation for the 2015 period versus a gain of \$3,823,818, with the overall change being driven by a reduction in our stock price during the mark-to-market revaluation periods in 2014. We incurred \$519,941 in expenses for the amortization term debt discounts in 2015 as compared to \$40,214 in 2014, when the June 2014 Notes were only issued late in that comparative period. The provision for other taxes for the first six months of 2015 was \$14,065 compared to \$46,535 for 2014. The composition of each year's other taxes provision was primarily for franchise taxes payable to the State of Delaware, our state of incorporation, which has decreased due to the reduction in authorized capital effected in June 2014.

*Provision for Income Taxes.* There were no provisions for income taxes for the respective six month periods ending June 30, 2015 and 2014. The reported income for the six months ended June 30, 2014 was fully offset by the Company's large loss carry-forwards for tax purposes.

*Net Income (Loss) and Income (Loss) per Share.* As a result of the foregoing, we incurred a net loss of \$7,493,179 or \$0.56 basic and diluted per share for the six months ended June 30, 2015, versus a net income of \$1,751,016 or \$0.17 basic and diluted income per share for the same period in 2014.

## **Liquidity and Capital Resources**

As of June 30, 2015, we had cash and cash equivalents of \$15,047,989, an increase of \$14,963,022 from \$84,967 as of December 31, 2014. As of June 30, 2015, we also had \$5,000,000 in short-term marketable securities.

At June 30, 2015 we had current assets of \$22,599,352 compared to current liabilities of \$1,593,902 which resulted in a positive working capital position of \$21,005,450. At December 31, 2014, we had current liabilities of \$3,386,588 compared to current assets of \$1,959,449 which resulted in a negative working capital position of \$1,427,139. Our current liabilities are comprised principally of accounts payable, accrued expenses and notes payable.

*Operating Activities.* We used \$5,289,961 of cash for operating activities for the six months ending June 30, 2015 and \$1,978,999 in the same period in 2014. Total non-cash adjustments for the six months ending June 30, 2015 were \$4,399,543 reflecting a net loss adjusted for non-cash items of \$3,093,636 as compared to a net loss adjusted for non-cash items of \$1,789,346 after non-cash adjustments of \$3,540,362 for the same period in 2014. The major cash operating items for the six months ending June 30, 2015 resulted from a \$1,495,169 decrease in accounts payable, a \$98,678 decrease in customer deposits and a \$174,889 increase in inventory, net of reserves, and vendor prepayments for components of \$687,681, offset by a \$299,153 reduction in accounts receivable. The major cash operating items for the six month period ending June 30, 2014 were a \$327,655 decrease in accounts payable, a \$140,200 reduction in prepaid expenses, and a \$103,671 decrease customer deposits.

*Investing Activities.* Cash used in investing activities was \$5,298,218 for the six months ending June 30, 2015 as compared to \$609,636 in the same period in 2014. During the first six months of 2015, \$5,000,000 was used to purchase marketable securities consisting of highly rated commercial paper due within 6 months, \$171,243 was used primarily for new product tooling and the purchase of computer equipment additions, as compared to spending of \$83,619 for the same period in 2014, primarily for the purchase of manufacturing equipment and mold tooling computer equipment additions. During the six months ending June 30, 2014, a total of \$482,196 in software development costs related to our M100 product was capitalized, versus \$-0- for the same period in 2015 when no amounts were capitalized. The costs of registering our intellectual property rights and third party patent purchases, included in the investing activities totals described above, were \$126,975 in the six month period ending June 30, 2015 and \$43,821 in the same period in 2014.

*Financing Activities.* Cash provided by financing activities was \$25,551,201 for the six months ending June 30, 2015, whereas in the same period in 2014, our net financing activities provided \$4,249,806. During the six month period ending June 30, 2015, the primary sources of cash from financing activities were the proceeds of \$24,813,000 from the sale of Series A Preferred Stock on January 2, 2015 to Intel Corporation (discussed below), less direct offering costs of \$214,169 and the cash proceeds of \$1,217,626 from warrant exercises. During the six month period ending June 30, 2014, the primary sources of cash from financing activities were proceeds of \$1,586,691 from warrant exercises, the \$3,000,000 issuance of senior convertible notes, less direct offering costs of \$138,090, less payments on notes and capital leases of \$198,795.

*Capital Resources.* As of June 30, 2015, we had a cash and cash equivalents balance of \$15,047,989 and \$5,000,000 in short-term marketable securities.

On January 2, 2015 (the “Series A Closing Date”), we entered into and closed a Series A Preferred Stock Purchase Agreement (the “Series A Purchase Agreement”) with Intel Corporation (the “Series A Purchaser”), pursuant to which we issued and sold to the Series A Purchaser, an aggregate of 49,626 shares of the Company’s Series A Preferred Stock, at a purchase price of \$500 per share, for an aggregate purchase price of \$24,813,000 (the “Series A Private Placement”). Each share of Series A Preferred Stock is convertible, at the option of the Series A Purchaser, into 100 shares of the Company’s common stock (determined by dividing the Series A Original Issue Price of \$500 by the Series A Conversion Price. The Series A Conversion Price is \$5.00, subject to adjustment in the event of stock splits, dividends or other combinations).

Each share of Series A Preferred Stock is entitled to receive dividends at a rate of 6% per annum, compounded quarterly and payable in cash or in kind, at the Company’s sole discretion. In the event of the liquidation, dissolution or winding up of the Company, each share of Series A Preferred Stock is entitled to a liquidation preference equal to one times (1x) the Series A Purchaser’s original per share purchase price, plus a right to receive an additional liquidation distribution together with the common stock holders pro rata on an as converted basis, but not in excess of \$1,000 per share in the aggregate (subject to adjustment for accrued but unpaid dividends and in the event of stock splits, dividends or other combinations). Each share of Series A Preferred Stock is entitled to vote with the holders of the Company’s common stock on matters presented to its stockholders, and is entitled to cast such number of votes equal to the whole number of shares of common stock into which such shares of Series A Preferred Stock are convertible. The holders of record of the Series A Preferred Stock will be entitled to nominate and elect 2 directors to the Company’s Board of Directors (the “Board Election Right”), at least one of whom will be required to qualify as an “independent” director, as that term is used in applicable exchange listing rules. The Board Election Right with respect to the independent director will terminate on such date as the number of shares of Series A Preferred Stock then outstanding is less than 40% of the original amount purchased by the Series A Purchaser. The Board Election Right with respect to the second director shall terminate on such date as the number of shares of Series A Preferred Stock then outstanding is less than 20% of the original amount purchased by the Series A Purchaser. The Company also granted the Series A Purchaser the right to have a board observer at meetings of the Company’s Board of Directors and committees thereof. As of the date of the filing of this Quarterly Report, the Series A Purchaser has not requested the appointment of its 2 directors nor asked to have its observer attend board meetings.

For as long as at least 25% (or 12,406 shares) of the Series A Preferred Stock is outstanding, the Company may not, without the consent of holders of at least 60% of the then outstanding shares of Series A Preferred Stock, take certain actions, including but not limited to: (i) liquidate, dissolve, or wind up the business and affairs of the Company; (ii) amend, alter or repeal any provision of its charter or bylaws in a manner that adversely effects the rights of the Series A Preferred Stock; (iii) create or issue any capital stock that is equal to or senior to the Series A Preferred Stock with respect to preferences; (iv) create or issue any debt security, subject to certain exceptions; (v) pay off any debt obligation prior to its stated maturity date; or (vi) enter into any stockholders rights plan or similar arrangement or take other actions that may limit actions that holders of a majority of the Series A Preferred Stock can take under Section 203 (“Section 203”) of the Delaware General Corporation Law, as well as such other customary provisions protecting the rights of the holder of the Series A Preferred Stock, as are outlined in the Certificate of Designation.

The Series A Purchaser has the right to participate in any proposed issuance by the Company of its securities, subject to certain exceptions (the “Participation Right”). In the event the Series A Purchaser is not afforded the opportunity to exercise its Participation Right, the Series A Purchaser will have the right, but not the obligation, up to two times per calendar year, to acquire additional securities from the Company in such amount as is sufficient to maintain the Series A Purchaser’s ownership percentage in the Company, calculated immediately prior to such applicable financing, at a purchase price equal to the per share price of the Company’s securities in such applicable financing.

Additionally, the Company’s Board of Directors approved the Offering for purposes of Section 203, which prohibits transactions with interested stockholders under Delaware state law. The Board of Directors approved the exemption of the Series A Purchaser from Section 203 with respect to any future business combinations or other transactions covered by Section 203 and, for such purposes, the Series A Purchaser will not be deemed an “interested stockholder”. Furthermore, the Board of Directors has waived any claims based on the corporate opportunity doctrine under Delaware state law or with respect to any duty of the Series A Purchaser, the directors appointed pursuant to the Board Election Right or the board observer, to disclose any information regarding the Series A Purchaser that may be of interest to the Company or permit the Company to participate in any projects or investments based on such information.

In connection with the Series A Private Placement, the Company entered into an investor’s rights agreement with the Series A Purchaser, pursuant to which the Company agreed to file a “resale” registration statement with the Securities and Exchange Commission (the “SEC”) covering all shares of common stock issuable upon conversion of the Series A Preferred Stock sold in the Series A Private Placement. The Company filed the registration statement on February 12, 2015 and the registration statement was declared effective by the SEC on February 17, 2015.

In connection with the Series A Private Placement, each of the holders of notes issued by the Company on June 3, 2014 (the “June 2014 Notes”) agreed to irrevocably waive their rights to anti-dilution protection under Section 5(b) of the June 2014 Notes in the event the Company issues additional securities at a per share price lower than the conversion price of the June 2014 Notes (the “June 2014 Note Waiver”). The obligations of the holder of the June 2014 Notes under the June 2014 Note Waiver will be binding on all assignees of the June 2014 Notes. Additionally, holders of the June 2014 Notes waived their rights of participation with respect to the June 2014 Private Placement and agreed

to subordinate their participation rights to the Series A Purchaser's Participation Right.

In connection with the Series A Private Placement, holders of approximately 86% of outstanding warrants issued by the Company in its public offering on August 5, 2013 and in connection with the conversion by certain holders of the Company's outstanding debt in connection with the Company's public offering (collectively, the "Public Offering Warrants") agreed to irrevocably waive their rights to anti-dilution protection under Section 2(b) of the Public Offering Warrants in the event the Company issues additional securities at a per share price lower than the exercise price of the Public Offering Warrants (the "Public Offering Warrant Waiver"). The obligations of the holder of the Public Offering Warrants under the Public Offering Warrant Waiver will be binding on all assignees of the July 2013 Warrants.

During the first six months of 2015, the Company received exercise notices with respect to an aggregate of 4,673,392 warrants issued pursuant to the Company's public offering at an exercise price of \$2.25 per share. A total of 512,000 of these warrants were exercised for cash along with 26,250 underwriter cash warrant exercises related to that same offering, netting total proceeds of \$1,217,626 to the Company. A further 4,161,392 of these public offering warrants and 6,875 underwriter warrants were exercised on a cashless basis resulting in the issuance of 3,549,624 and 4,380 common shares, respectively. All but 7,500 of these warrant exercises occurred in the first quarter of 2015. There are currently 57,600 investor and 70,125 underwriter warrants outstanding from the August 2013 public offering.

Additionally, \$427,500 in convertible notes were converted to common stock during the first six months of 2015. Total convertible notes outstanding as of June 30, 2015, excluding accrued interest is \$1,902,500, which is convertible into 845,556 shares.

We will need to continue to increase our product sales to achieve positive cash flow from operations. We have developed an operating plan which includes the expansion of our existing premises and personnel resources. As part of this plan we will be relocating our corporate offices, research and development facilities and manufacturing to a facility approximately 4 times our existing facility by the end of 2015. This relocation will include the installation of new cleanroom space to meet the expanded production needs of our waveguide optics. Most of the new personnel resources will be focused on research and development staff and select marketing and sales personnel as well as some finance head count increases to improve the Company's financial reporting controls. We intend to introduce several new products over the next year including our award winning iWear (formerly named the V720) Video Headphones, successor models of the M100 Smart Glasses and new Smart Glasses products based on our waveguide optics technologies. Such expenditures, along with further future net operating losses, product tooling expenses, and related working capital investments, will be the principal use of our cash.

We believe our existing cash and cash equivalent balances and cash flow from future operations will be sufficient to meet our working capital and capital expenditure needs for the foreseeable future even with continued operating losses similar in size to the amounts reported for the six months ending June 30, 2015 and for the year ended December 31, 2014. There can however be no assurance that we will be able to generate positive cash flows from operations in the future.

## Forward Looking Statements

This quarterly report includes forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are based on our management's beliefs and assumptions and on information currently available to our management. Forward-looking statements include statements concerning:

- Our cash needs and financing plans;
- Our possible or assumed future results of operations;
- Our business strategies;
- Our ability to attract and retain customers;
- Our ability to sell additional products and services to customers;
- Our competitive position;
- Our industry environment;
- Our potential growth opportunities;
- Expected technological advances by us or by third parties and our ability to leverage them;
- The effects of future regulation; and
- The effects of competition.

All statements in this quarterly report that are not historical facts are forward-looking statements. We may, in some cases, use terms such as "anticipates," "believes," "could," "estimates," "expects," "intends," "may," "plans," "potential," "pre-

“projects,” “should,” “will,” “would” or similar expressions that convey uncertainty of future events or outcomes to identify forward-looking statements.

The outcome of the events described in these forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. These important factors include our financial performance and the other important factors set forth in our annual report on Form 10-K for the year ended December 31, 2014 and in other filings with the Securities and Exchange Commission.

All such forward-looking statements are subject to certain risks and uncertainties and should be evaluated in light of important risk factors. These risk factors include, but are not limited to, those that are described in “Risk Factors” under Item 1A and elsewhere in our 2014 annual report on Form 10-K and the following: business and economic conditions, rapid technological changes accompanied by frequent new product introductions, competitive pressures, dependence on key customers, inability to gauge order flows from customers, fluctuations in quarterly and annual results, the reliance on a limited number of third party suppliers, limitations of our manufacturing capacity and arrangements, the protection of our proprietary technology, the effects of pending or threatened litigation, the dependence on key personnel, changes in critical accounting estimates, potential impairments related to investments, foreign regulations, liquidity issues, and potential material weaknesses in internal control over financial reporting. Further, during weak or uncertain economic periods, customers may delay the placement of their orders. These factors often result in a substantial portion of our revenue being derived from orders placed within a quarter and shipped in the final month of the same quarter.

Any of these factors could cause our actual results to differ materially from our anticipated results. We caution readers to carefully consider such factors. Many of these factors are beyond our control. In addition, any forward-looking statements represent our estimates only as of the date they are made, and should not be relied upon as representing our estimates as of any subsequent date. While we may elect to update forward-looking statements at some point in the future, except as may be required under applicable securities laws, we specifically disclaim any obligation to do so, even if our estimates change.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Not required for a smaller reporting company.

### **Item 4. Controls and Procedures**

#### Disclosure Controls and Procedures

We maintain a system of disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in reports that we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's (SEC) rules and forms. Disclosure controls are also designed to reasonably assure that such information is accumulated and communicated to management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), as appropriate to allow timely decisions regarding required disclosure. Disclosure controls include components of internal control over financial reporting, which consists of control processes designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP.

As reported in our 2014 Annual Report on Form 10-K (the "2014 Form 10-K"), as of December 31, 2014, our management identified material weaknesses in our internal control over financial reporting that have a direct impact on our financial reporting. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim consolidated financial statements will not be prevented or detected on a timely basis. Due to these material weaknesses in internal control over financial reporting, our management concluded in our 2014 Form 10-K that our disclosure controls and procedures were ineffective as of December 31, 2014. The control deficiencies that constituted the material weaknesses were listed in our Form 10-K, as of December 31, 2014.

Our management, with the participation of our CEO and CFO, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 30, 2015. As part of its evaluation, our management has evaluated whether the control deficiencies related to the reported material weakness in internal control over financial reporting continue to exist. During the quarter ending June 30, 2015, we had a detailed review and assessment of our controls and procedures currently in place prepared by external consultants. Our management is now preparing plans for making changes in our controls and procedures as a result. As of June 30, 2015, we have not completed the development, assessment, implementation and testing of all the changes in controls and procedures that we believe are necessary to conclude that the material weakness has been remediated and, therefore, our management has concluded that we cannot assert that the control deficiencies relating to the reported material weakness have been effectively remediated. As a result, our CEO and CFO have concluded that our disclosure controls and procedures were ineffective as of June 30, 2015.

In light of the foregoing conclusion, we undertook additional procedures in order that management could conclude that reasonable assurance exists regarding the reliability of financial reporting and the preparation of the consolidated financial statements contained in this filing. Accordingly, management believes that our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for the period ended June 30, 2015 fairly present, in all material respects, our financial position, results of operations and cash flows for the periods presented.

### **Changes in internal control over financial reporting**

During the three months ended June 30, 2015, there were no changes in our internal controls that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **Part II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

We are not currently involved in any pending legal proceeding or litigation and we are not aware of any such proceedings contemplated by or against us or our property. To our knowledge, there are no material legal proceedings to which any our directors, officers or affiliates, or any beneficial owner of more than five percent of our common stock, or any associate of any of the foregoing, is a party adverse to us or any of our subsidiaries or has a material interest adverse to us or any of our subsidiaries.

## **Item 1A. Risk Factors**

In addition to the other information set forth in this report you should carefully consider the factors discussed in Part I, Item 1A. “Risk Factors” in our annual report on Form 10-K for the year ended December 31, 2014. There have been no material changes from those risk factors. The risks discussed in our 2014 annual report could materially affect our business, financial condition and future results.

## **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Sale of Unregistered Securities –

During the three months ended June 30, 2015 we issued 60,337 shares of common stock for investor relations services.

During the three months ended June 30, 2015 we issued 8,456 shares of common stock upon the exercise of stock options to an employee of the Company.

During the three months ended June 30, 2015, we issued 60,000 shares of common stock upon conversion of convertible notes in the principal amount of \$135,000.

In connection with the foregoing, we relied upon the exemption from registration provided by Section 4(a)(2) under the Securities Act of 1933, as amended, for transactions not involving a public offering.

Purchase of Equity Securities – none

## **Item 3. Defaults Upon Senior Securities**

None

## **Item 4. Mine Safety Disclosures**

Not Applicable

**Item 5. Other Information**

None

**Item 6. Exhibits**

**Exhibit No. Description**

- |         |  |
|---------|--|
| 31.1    | Certification of the Chief Executive Officer of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2    | Certification of the Chief Financial Officer of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1    | Certification of the Chief Executive Officer of the Registrant pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2    | Certification of the Chief Financial Officer of the Registrant pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document   |
| 101.SCH | XBRL Taxonomy Extension Schema Document  |
| 101.CAL | XBRL Taxonomy Extension Calculation Link base Document   |
| 101.DEF | XBRL Taxonomy Extension Definition Link base   |
| 101.LAB | XBRL Taxonomy Extension Label Link base Document   |
| 101.PRE | XBRL Taxonomy Extension Presentation Link base Document  |

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**VUZIX CORPORATION**

Date: August 13, 2015 By: /s/ Paul J. Travers  
Paul J. Travers  
President, Chief Executive Officer  
(Principal Executive Officer)

Date: August 13, 2015 By: /s/ Grant Russell  
Grant Russell  
Executive Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)