

25 Hendrix Road, Suite A
West Henrietta, New York
(Address of principal executive offices) (Zip Code) **14583**

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, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer
(Do not check if a smaller reporting company)
Smaller reporting company Emerging growth company

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

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

As of August 9, 2018, there were 27,426,402 shares of the registrant's common stock outstanding.

Vuzix Corporation

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

| | (Unaudited) June 30, 2018 | December 31, 2017 |
|---|---------------------------------|----------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and Cash Equivalents | \$29,150,826 | \$14,889,636 |
| Accounts Receivable, Net | 2,044,526 | 974,172 |
| Accrued Project Revenue | — | 497,784 |
| Inventories, Net | 5,273,920 | 3,852,317 |
| Manufacturing Vendor Prepayments | 414,431 | 154,717 |
| Prepaid Expenses | 790,635 | 873,947 |
| Total Current Assets | 37,674,338 | 21,242,573 |
| Long-Term Assets | | |
| Fixed Assets, Net | 4,145,514 | 4,124,466 |
| Patents and Trademarks, Net | 879,206 | 813,774 |
| Software Development Costs, Net | 496,223 | 408,723 |
| Other Assets, Net | 472,154 | 243,717 |
| Total Assets | \$43,667,435 | \$26,833,253 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Accounts Payable | \$2,619,172 | \$3,726,056 |
| Customer Deposits | 229,381 | 73,462 |
| Unearned Revenue | 69,318 | 107,824 |
| Accrued Expenses | 1,595,579 | 1,389,771 |
| Derivative Liability | 172,269 | 152,927 |
| Income and Other Taxes Payable | 20,967 | 3,500 |

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| | | |
|--|---------------|--------------|
| Total Current Liabilities | 4,706,686 | 5,453,540 |
| Total Liabilities | 4,706,686 | 5,453,540 |
| Stockholders' Equity | | |
| Preferred Stock - \$.001 Par Value, 5,000,000 Shares Authorized; 49,626 and 49,626 Shares Issued and Outstanding as of June 30, 2018 and December 31, 2017. | 50 | 50 |
| Common Stock - \$.001 Par Value, 100,000,000 Shares Authorized; 27,337,210 Shares Issued and Outstanding as of June 30, 2018 and 24,276,275 as of December 31, 2017. | 27,337 | 24,276 |
| Additional Paid-in Capital | 146,838,188 | 117,827,839 |
| Accumulated Deficit | (107,904,826) | (96,472,452) |
| Total Stockholders' Equity | 38,960,749 | 21,379,713 |
| Total Liabilities and Stockholders' Equity | \$43,667,435 | \$26,833,253 |

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

VUZIX CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(Unaudited for the six months ended June 30, 2018)

| | Preferred Stock Shares | Preferred Stock Amount | Common Stock Shares | Common Stock Amount | Additional Paid-In Capital | Accumulated Deficit | Total |
|--|---------------------------|---------------------------|------------------------|------------------------|-------------------------------|------------------------|--------------|
| Balance - December 31, 2017 | 49,626 | \$ 50 | 24,276,275 | \$24,276 | \$ 117,827,839 | \$(96,472,452) | \$21,379,713 |
| Cumulative Revenue Adjustment - ASC 606 Adoption | — | — | — | — | — | 81,724 | 81,724 |
| Exercise of Warrants | — | — | 24,928 | 25 | 55,698 | — | 55,723 |
| Exercise of Stock Options | — | — | 8,433 | 9 | (9) | — | — |
| Stock-Based Compensation Expense | — | — | 10,415 | 10 | 832,677 | — | 832,687 |
| Proceeds from Common Stock Offerings | — | — | 3,000,000 | 3,000 | 29,997,000 | — | 30,000,000 |
| Common Stock Issued for Services | — | — | 17,159 | 17 | 99,983 | — | 100,000 |
| Direct Costs of Common Stock Offerings | — | — | — | — | (1,975,000) | — | (1,975,000) |
| Net Loss for the six months ended June 30, 2018 | — | — | — | — | — | (11,514,098) | (11,514,098) |
| Balance - June 30, 2018 | 49,626 | \$ 50 | 27,337,210 | \$27,337 | \$ 146,838,188 | \$(107,904,826) | \$38,960,749 |

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

VUZIX CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|--------------|------------------|--------------|
| | June 30, | 2017 | June 30, | 2017 |
| | 2018 | | 2018 | |
| Sales: | | | | |
| Products | \$2,647,583 | \$904,947 | \$4,010,962 | \$1,864,330 |
| Engineering Services | — | 420,314 | 180,516 | 671,594 |
| Total Sales | 2,647,583 | 1,325,261 | 4,191,478 | 2,535,924 |
| Cost of Sales: | | | | |
| Products | 1,977,410 | 1,397,831 | 3,159,584 | 2,351,734 |
| Engineering Services | — | 356,917 | 184,596 | 464,917 |
| Total Cost of Sales | 1,977,410 | 1,754,748 | 3,344,180 | 2,816,651 |
| Gross Profit (Loss) (exclusive of depreciation shown separately below) | 670,173 | (429,487) | 847,298 | (280,727) |
| Operating Expenses: | | | | |
| Research and Development | 2,564,119 | 1,198,940 | 4,619,910 | 2,867,748 |
| Selling and Marketing | 1,545,160 | 800,329 | 3,079,258 | 1,831,328 |
| General and Administrative | 2,320,151 | 1,308,234 | 3,985,381 | 2,543,417 |
| Depreciation and Amortization | 294,988 | 242,979 | 568,610 | 482,809 |
| Total Operating Expenses | 6,724,418 | 3,550,482 | 12,253,159 | 7,725,302 |
| Loss from Operations | (6,054,245) | (3,979,969) | (11,405,861) | (8,006,029) |
| Other Income (Expense) | | | | |
| Investment Income | 39,986 | 14,944 | 39,986 | 32,844 |
| Other Taxes | (1,316) | (11,600) | (29,858) | (22,150) |
| Foreign Exchange Loss | (5,235) | (26,151) | (9,652) | (25,053) |
| Loss on Asset Disposal | (56,836) | — | (56,836) | — |
| (Loss) Gain on Derivative Valuation | (63,820) | (13,416) | (35,687) | 9,144 |
| Amortization of Term Debt Discounts and Deferred Issuance Costs | — | (29,616) | — | (175,260) |
| Interest Expense | (6,977) | (24,291) | (16,190) | (65,258) |

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| | | | | |
|---|----------------|----------------|-----------------|----------------|
| Total Other Income (Expense) | (94,198) | (90,130) | (108,237) | (245,733) |
| Loss Before Provision for Income Taxes | (6,148,443) | (4,070,099) | (11,514,098) | (8,251,762) |
| Provision for Income Taxes | — | — | — | — |
| Net Loss | (6,148,443) | (4,070,099) | (11,514,098) | (8,251,762) |
| Preferred Stock Dividends | (450,276) | (424,243) | (889,112) | (837,708) |
| Loss Attributable to Common Stockholders | \$(6,598,719) | \$(4,494,342) | \$(12,403,210) | \$(9,089,470) |
| Basic and Diluted Loss per Share | \$(0.24) | \$(0.22) | \$(0.46) | \$(0.45) |
| Weighted-average Shares Outstanding - Basic and Diluted | 27,326,649 | 20,446,824 | 26,814,264 | 20,082,633 |

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

VUZIX CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| | Six Months Ended June 30, | |
|--|---------------------------|---------------|
| | 2018 | 2017 |
| Cash Flows from Operating Activities | | |
| Net Loss | \$(11,514,098) | \$(8,251,762) |
| Non-Cash Adjustments | | |
| Depreciation and Amortization | 568,610 | 482,809 |
| Amortization of Software Development Costs in Cost of Sales - Products | — | 143,225 |
| Stock-Based Compensation Expense | 1,182,687 | 486,602 |
| Common Stock Issued for Services | 100,000 | 100,000 |
| Loss on Disposal of Fixed Assets | 56,836 | — |
| Amortization of Term Debt Discounts and Deferred Issuance Costs | — | 175,260 |
| Loss (Gain) on Derivative Valuation | 35,687 | (9,144) |
| (Increase) Decrease in Operating Assets | | |
| Accounts Receivable | (1,070,354) | (39,216) |
| Accrued Project Revenue | 497,784 | (420,314) |
| Inventories | (1,421,603) | (755,923) |
| Manufacturing Vendor Prepayments | (259,714) | (61,980) |
| Prepaid Expenses and Other Assets | 104,873 | 279,898 |
| Increase (Decrease) in Operating Liabilities | | |
| Accounts Payable | (1,106,884) | 723,632 |
| Accrued Expenses | (217,682) | 56,711 |
| Customer Deposits | 155,919 | (18,753) |
| Unearned Revenue | 43,217 | (370,534) |
| Income and Other Taxes Payable | 17,468 | (9,695) |
| Accrued Compensation | 161,365 | (124,918) |
| Accrued Interest | (87,875) | 65,260 |
| Net Cash Flows Used in Operating Activities | (12,753,764) | (7,548,842) |
| Cash Flows from Investing Activities | | |
| Purchase of Fixed Assets | (603,441) | (662,993) |
| Investments in Licenses, Patents and Trademarks | (108,480) | (92,767) |
| Investments in Other Assets | (250,000) | — |
| Investments in Software Development | (87,500) | (100,000) |
| Net Cash Used in Investing Activities | (1,049,421) | (855,760) |

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| | | |
|--|--------------|--------------|
| Cash Flows from Financing Activities | | |
| Proceeds from Exercise of Warrants | 39,375 | — |
| Proceeds from Common Stock Offerings | 30,000,000 | — |
| Issuance Costs on Common Stock Offerings | (1,975,000) | — |
| Net Cash Flows from Financing Activities | 28,064,375 | — |
| Net Increase (Decrease) in Cash and Cash Equivalents | 14,261,190 | (8,404,602) |
| Cash and Cash Equivalents - Beginning of Period | 14,889,636 | 14,533,944 |
| Cash and Cash Equivalents - End of Period | \$29,150,826 | \$6,129,342 |
| Supplemental Disclosures | | |
| Interest Paid in Cash | \$104,065 | \$39 |
| Conversion of Term Debt and Accrued Interest into Common Stock | \$— | \$1,861,283 |
| Reclassification of Derivative Liability Upon Warrant Exercise | \$16,345 | \$— |
| Cumulative Revenue Adjustment - ASC 606 Adoption | \$81,724 | \$— |
| Accrued Stock-Based Compensation Expense — Not Issued | \$350,000 | \$— |

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

VUZIX CORPORATION

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Vuzix Corporation (“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 Regulation S-X of the Securities and Exchange Commission. Accordingly, the unaudited condensed consolidated financial statements do not include all 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. Certain re-classifications have been made to prior periods to conform with current reporting. The results of the Company’s operations for the six months ended June 30, 2018 are not necessarily indicative of the results of the Company’s operations for the full fiscal year or any other period.

The accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto of the Company as of December 31, 2017, as reported in the Company’s Annual Report.

For the six months ended June 30, 2018, Toshiba Japan represented 94% of engineering revenues and 27% of total revenues as compared to 98% and 26%, respectively, in the comparable 2017 period. As of June 30, 2018 and 2017, Toshiba Japan accounted for 37% and 75% of accounts receivables and accrued project revenue, respectively.

For the six months ended June 30, 2018, AMA SA represented 20% of total revenues as compared to 4% in the comparable 2017 period. As of June 30, 2018 and 2017, AMA SA accounted for 42% and 0% of accounts receivables, respectively.

Note 2 – Revenue Recognition and Contracts with Customers

Adoption

On January 1, 2018, the Company adopted the new guidance on Revenue from Contracts with Customers under Topic 606 using the modified retrospective transition method. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting treatment under Topic 605. We recorded a net decrease to opening accumulated deficit of \$81,724, as of January 1, 2018 due to the cumulative impact of adopting Topic 606, with the impact primarily related to our post contract support (PCS deferred revenue). Refer to the following table for the detailed effect to our consolidated balance sheet upon adoption:

| | Balance at December 31, 2017 | New Revenue Standard Adjustment | Balance at January 1, 2018 |
|-----------------------------|------------------------------------|---------------------------------------|----------------------------------|
| Liabilities | | | |
| Unearned Revenue | \$ 81,724 | \$ (81,724) | \$— |
| Shareholders' Equity | | | |
| Accumulated Deficit | \$(96,472,452) | \$ 81,724 | \$(96,390,728) |

Under the modified retrospective method of adoption, we are required to disclose the impact to revenues had we continued to follow our accounting policies under the previous revenue recognition guidance. We estimate that the impact to revenues for the six months ended June 30, 2018, primarily due to deferrals of PCS amounts for product shipped offset by the amortization of the unearned revenue related to our prior PCS deferred revenue under Topic 605, would have been immaterial.

Disaggregated Revenue

The Company's total revenue was comprised of four major product lines: Smart Glasses and iWear Video Headphones sales, OEM product sales, Waveguide sales, and Engineering services. The following table summarizes the revenue recognized by major product line:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------|------------------|-------------|
| | June 30, 2018 | 2017 | June 30, 2018 | 2017 |
| Revenues | | | | |
| Smart Glasses and iWear Video Headphones Sales | \$1,907,476 | \$788,642 | \$3,120,247 | \$1,748,025 |
| OEM Product Sales | 651,895 | — | 766,065 | — |
| Waveguide Sales | 88,212 | 116,305 | 124,650 | 116,305 |
| Engineering Services | — | 420,314 | 180,516 | 671,594 |
| Total Revenue | 2,647,583 | 1,325,261 | 4,191,478 | 2,535,924 |

Significant Judgments

In applying the new guidance under Topic 606, we performed an assessment of judgments used that could potentially impact both the timing of our satisfaction of performance obligations and our determination of transaction prices used in determining revenue recognized by major product line. Judgments made include variable consideration in determining our transaction prices for our standard product sales that include a 30-day right to return and payment terms are Net 30 - 60 days. For our Engineering Services performance obligations recognized over time using the input method, the estimated costs to complete each project is considered a significant judgment. For the six months ended June 30, 2018 and the year ended December 31, 2017, the significant judgments previously mentioned did not have a material effect on the timing or the amount of revenue recognized under the new guidance.

Performance Obligations

Revenues from our performance obligations satisfied at a point in time are typically for standard goods (Smart Glasses, iWear Video Headphones and Waveguides) and our OEM Products, which are recognized when the customer obtains control, which is generally upon shipment. The Company also records revenue for performance obligations relating to our Engineering Services over time by using either the input method or output method measuring progress

toward satisfying the performance obligations. Satisfaction of our performance obligations related to our Engineering Services are measured using the input method measured by the Company's cost incurred as a percentage of total expected costs to project completion as the inputs of actual costs incurred by the Company are directly correlated with progress of completing the contract. As such, the Company believes that our methodologies for recognizing revenue over time for our Engineering Services correlates directly with the transfer of control of the underlying assets to our customers.

Our standard product sales include a twelve (12) month standard, assurance-type product warranty, not covered by this subtopic. Or in the case of our OEM product and waveguide sales, some may have standard product warranties of up to eighteen (18) months. Our engineering services contracts vary from contract to contract but typically include payment terms of Net 30 days from date of billing, subject to an agreed upon customer acceptance period.

The following table presents a summary of the Company's net sales by revenue recognition method as a percentage of total net sales for the six months ended June 30, 2018:

| | % of Total Net Sales | |
|---------------|-------------------------|---|
| Point in Time | 96 | % |
| Input Method | 4 | % |
| Total | 100 | % |

Remaining Performance Obligations

As of June 30, 2018, the Company had \$228,000 of remaining performance obligations under our OEM product purchase agreement, which represents the transaction price of firm orders less inception to date sales recognized. The Company expects to recognize sales relating to this existing performance obligation of \$228,000 during the remainder of 2018.

Note 3 – Loss Per Share

Basic loss per share is computed by dividing the loss attributable to common stockholders 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 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, 2018 and 2017, 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. As of June 30, 2018 and 2017, there were 8,772,813 and 6,499,941 common stock share equivalents, respectively, potentially issuable under conversion of preferred shares, options, debt, and warrants that could dilute basic earnings per share in the future.

Note 4 – Inventories, Net

Inventories are stated at the lower of cost and net realizable value and consisted of the following:

| | June 30, 2018 | December 31, 2017 |
|--------------------------------|------------------|----------------------|
| Purchased Parts and Components | \$2,826,119 | \$ 1,669,209 |
| Work in Process | — | 25,090 |
| Finished Goods | 3,063,235 | 2,994,342 |
| Less: Reserve for Obsolescence | (615,434) | (836,324) |
| Net | \$5,273,920 | \$ 3,852,317 |

Note 5 – Cost-Method Investment

The Company's cost-method investments consist of the following:

| | June 30, 2018 | December 31, 2017 |
|---------------------|------------------|----------------------|
| Private Corporation | \$250,000 | \$ — |
| Total | \$250,000 | \$ — |

The Company recently invested in a private corporation that is in the low vision near-eye display market. The Company acquired approximately a 1% ownership interest, in the form of preferred stock, in the private company, for a purchase price of \$250,000, and it is valued at cost. As part of this investment, the private entity and the Company entered into a non-binding memorandum of understanding, with the goal of assisting in the Company's development and volume supply of Vuzix display systems to this entity for its low vision products. The Company expects to earn additional equity in the private entity by being compensated for its work in kind and as a result could earn approximately a further 4% equity interest in this firm. This investment was recorded at cost as its fair value is not readily determinable. As of June 30, 2018, the investment is included in Long-Term Other Assets.

Note 6 – Accrued Expenses

Accrued expenses consisted of the following:

| | June 30, 2018 | December 31, 2017 |
|---------------------------------|--------------------------|------------------------------|
| Accrued Wages and Related Costs | \$898,479 | \$ 163,305 |
| Accrued Officer Compensation | 150,853 | 327,469 |
| Accrued Professional Services | 166,260 | 531,728 |
| Accrued Warranty Obligations | 273,095 | 167,503 |
| Accrued Interest | 83,559 | 171,435 |
| Other Accrued Expenses | 23,333 | 28,331 |
| Total | \$1,595,579 | \$ 1,389,771 |

Included in Accrued Wages and Related Costs are provisions for the costs related to the separation of two officers of Vuzix, the Vice President of Sales and its COO. These amounts are expected to be paid over the next six months. Included in the above accrued officer compensation are amounts owed to officers of the Company for services rendered prior to 2016. The amounts are not subject to a fixed repayment schedule and they bear interest at a rate of 8% per year, compounding monthly. Accrued interest at June 30, 2018 and December 31, 2017 is related to interest amounts accrued upon the unpaid officer compensation.

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 for some products. 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, 2018 and the balance as of December 31, 2017 were as follows:

| | |
|--|------------------|
| Accrued Warranty Obligation at December 31, 2017 | \$167,503 |
| Reductions for Settling Warranties | (158,412) |
| Warranties Issued During Period | 264,004 |
| Accrued Warranty Obligations at June 30, 2018 | \$273,095 |

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 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 FASB ASC 815-10-25, we measured the derivative liability using a Monte Carlo Options Lattice pricing model at their issuance date and subsequently re-measured the liability on each reporting date.

Accordingly, at the end of each quarterly reporting date, the derivative fair market value is re-measured and adjusted to current market value. As of June 30, 2018 and December 31, 2017 a total of 33,100 and 38,100 warrants were outstanding that contained a full-ratchet anti-dilution provision, respectively.

The Company has adopted FASB ASC Topic 820 for financial instruments measured at fair value on a recurring basis. FASB 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 three-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 carrying amount of cash, accounts receivable, accounts payable, and accrued expenses approximates their fair value due to their short maturity.

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, 2018:

| | Total | Level 1 | Level 2 | Level 3 |
|--|-----------|---------|---------|-----------|
| Derivative Liability | \$172,269 | \$ — | \$ — | \$172,269 |
| Total liabilities measured at fair value (Current liabilities) | \$172,269 | \$ — | \$ — | \$172,269 |

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, 2017:

| Total | Level 1 | Level 2 | Level 3 |
|-------|---------|---------|---------|
|-------|---------|---------|---------|

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| | | | |
|--|------------|------|-------------|
| Derivative Liability | \$ 152,927 | \$ — | —\$ 152,927 |
| Total liabilities measured at fair value (Current Liabilities) | \$ 152,927 | \$ — | —\$ 152,927 |

Fair value — December 31, 2017 \$ 152,927

Reclassification of warrant exercises to Additional Paid-in Capital (16,345)
Change in fair value for the period of warrant derivative liability 35,687

Fair value — June 30, 2018 \$ 172,269

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

| | June 30, 2018 | | December 31, 2017 | |
|--------------------------------|------------------|---|----------------------|---|
| Assumptions for Pricing Model: | | | | |
| Expected term in years | 0.10 | | 0.59 | |
| Volatility range for years | 128 | % | 143 | % |
| Risk-free interest rate | 2.33 | % | 1.76 | % |
| Expected annual dividends | None | | None | |
| Value of warrants outstanding: | | | | |
| Fair value of warrants | \$172,269 | | \$ 152,927 | |

Note 8 – 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 9 – Capital Stock

Preferred stock

The Board of Directors is authorized to establish and designate different series of preferred stock and to fix and determine their voting powers and other special rights and qualifications. A total of 5,000,000 shares of preferred stock are authorized as of June 30, 2018 and December 31, 2017, 49,626 of which are designated as Series A Preferred Stock. There were 49,626 shares of Series A Preferred Stock issued and outstanding on June 30, 2018 and December 31, 2017.

On January 2, 2015 the Company closed a sale of Series A Preferred Stock to Intel Corporation (the “Series A Purchaser”), pursuant to which we issued and sold 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. Each share of Series A Preferred Stock is convertible, at the option of the Series A holder, into 100 shares of the Company’s common stock

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(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 year, compounded quarterly and payable in cash or in kind, at the Company's sole discretion. As of June 30, 2018, total accumulated and unpaid preferred dividends were \$5,738,176. As of December 31, 2017, total accumulated and unpaid preferred dividends were \$4,849,063. There were no declared preferred dividends owed as of June 30, 2018 or December 31, 2017.

The Series A Purchaser has the right, but not the obligation, to participate in any proposed issuance by the Company of its securities, subject to certain exceptions and 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.

Common Stock

The Company's authorized common stock consists of 100,000,000 shares, par value of \$0.001 as of June 30, 2018 and December 31, 2017. There were 27,337,210 and 24,276,275 shares of common stock issued and outstanding as of June 30, 2018 and December 31, 2017, respectively.

Note 10 – Stock Warrants

A summary of the various changes in warrants during the six-month period ended June 30, 2018 is as follows:

| | Number of Warrants |
|---|-----------------------|
| Warrants Outstanding at December 31, 2017 | 1,184,912 |
| Exercised During the Period | (27,500) |
| Issued During the Period | 1,200,000 |
| Expired During the Period | — |
| Warrants Outstanding, June 30, 2018 | 2,357,412 |

The outstanding warrants as of June 30, 2018 expire from July 31, 2018 to June 18, 2021. The weighted average remaining term of the warrants is 1.6 years. The weighted average exercise price is \$8.29 per share.

Note 11 – Stock Based Compensation Plans

A summary of stock option activity for the six months ended June 30, 2018 is as follows:

| | Number of Options | Weighted Average Exercise Price |
|----------------------------------|------------------------------|--|
| Outstanding at December 31, 2017 | 1,510,244 | \$ 5.04 |
| Granted | 133,500 | 5.55 |
| Exercised | (31,354) | 5.35 |
| Expired or Forfeited | (159,589) | 6.29 |
| Outstanding at June 30, 2018 | 1,452,801 | \$ 4.95 |

The weighted average remaining contractual term for all options as of June 30, 2018 and December 31, 2017 was 7.1 years and 7.6 years, respectively.

As of June 30, 2018, there were 902,305 options that were fully vested and exercisable at a weighted average exercise price of \$4.55 per share. The weighted average remaining contractual term on the vested options is 6.0 years.

As of June 30, 2018, there were 550,496 unvested options exercisable at a weighted average exercise price of \$5.62 per share. The weighted average remaining contractual term on the unvested options is 8.9 years.

For the six months ended June 30, 2018, all options exercised were on a cashless basis.

The weighted average fair value of option grants was calculated using the Black-Scholes-Merton option pricing method. At June 30, 2018, the Company had approximately \$2,784,000 of unrecognized stock compensation expense, which will be recognized over a weighted average period of approximately 2.9 years.

During the year ended December 31, 2017, the Company issued 100,000 shares of non-vested stock to an executive officer which vest over 48 months. The fair market value on the date of grant of the non-vested stock issued was \$5.90, resulting in an aggregate fair value of \$590,000. As of June 30, 2018, the executive officer was no longer with the Company and there was approximately \$430,000 of unrecognized compensation expense remaining. As part of his separation agreement, approximately \$150,000 of this compensation expense was accrued and recognized in the period ending June 30, 2018 and the remaining \$280,000 of unrecognized compensation was forfeited.

During the year ended December 31, 2017, the Company issued 50,000 shares of common stock to its independent board members as part of their annual retainer for services covering the period of July 2017 to June 2018. The fair market value on the date of award of the stock issued was \$6.70, resulting in an aggregate fair value of \$335,000. The fair market value of these awards is expensed over 12 months. As of June 30, 2018, there was no unrecognized expense related to these stock awards.

During the three months ended June 30, 2018, the Company has awarded 105,000 shares of common stock to its board members and members of management. The fair market value of each share awarded was \$6.10 on the date of grant, May 4, 2018, for an aggregate fair market value of \$640,500. The aggregate fair market value of stock awards issued to external directors was \$122,000 and \$518,500 to other members of management, which are vesting over twelve (12) and forty-eight (48) month periods, respectively. As of June 30, 2018, there was approximately \$598,000 of unrecognized expense related to these stock awards.

For the three months ended June 30, 2018 and 2017, the Company recorded total stock-based compensation expense of approximately \$758,000 and \$277,000, respectively. For the six months ended June 30, 2018 and 2017, the Company recorded total stock-based compensation expense of approximately \$1,183,000 and \$487,000, respectively. For the three and six months ended June 30, 2018, stock-based compensation expense includes approximately \$350,000 of one-time compensation expense related to accrued severance.

Note 12 – Litigation

We are not currently involved in any actual or pending legal proceeding or litigation and we are not aware of any such proceedings contemplated by or against us or our property except as follows:

We filed a defamation lawsuit against Ricardo Antonio Pearson (a/k/a Richard Pearson) in the Supreme Court of the State of New York, County of New York on April 5, 2018. The Company's complaint against Mr. Pearson alleges he published false and defamatory articles about the Company. Vuzix is seeking damages in excess of \$80 million, including punitive damages, and money damages.

On July 24, 2018, a purported shareholder class action lawsuit was filed in the United States District Court, Southern District of New York, against the Company, certain of its current and former directors and executive officers and the placement agents of the Company's registered direct offering that was completed in January 2018. The complaint alleges violations of federal securities laws under Sections 11 and 15 of the Securities Act and under Sections 10(b) and 20(a) of the Exchange Act on behalf of a putative class of shareholders that purchased stock between November 9, 2017 and March 20, 2018, or pursuant and/or traceable to the Company's registration statement and prospectus filed in connection with the registered direct offering. The complaint alleges that the Company and certain of its officers and directors made materially false and/or misleading statements and failed to disclose material adverse events about the Company's business, operations and prospects in press releases and public filings. The complaint seeks damages in unspecified amounts, costs and expenses of bringing the action, and other unspecified relief. A similar purported class action was filed against the Company and certain of its current and former executive officers and directors on July 27, 2018, in the United States District Court, Southern District of New York. The Company believes the allegations are false and intends to vigorously defend itself. The Company plans to file a motion to dismiss the complaints.

Note 13 – Contractual Obligations

The Company is party to several lease agreements, with the largest being for its office and manufacturing facility under an operating lease that commenced October 3, 2015 and expires on October 3, 2020. The Company also leases small office spaces in Spain (five-year lease), England (two-year lease) and Japan (two-year lease).

Future minimum payments required under operating lease obligations as of June 30, 2018 are as follows:

| | Total Minimum Lease Payments |
|---------------------------|---|
| 2018 (6 months remaining) | \$ 221,452 |
| 2019 | 442,903 |
| 2020 | 382,813 |
| 2021 | 7,528 |
| 2022 | 8,782 |
| Total | \$ 1,063,478 |

Under the lease agreements described above, the Company is required to pay the pro rata share of the real property taxes and assessments, expenses and other charges associated with these facilities. Rent expense for the three months ended June 30, 2018 and 2017 totaled \$118,900 and \$118,140, respectively. Rent expense for the six months ended June 30, 2018 and 2017 totaled \$231,796 and \$228,509, respectively.

Note 14 – Recent Accounting Pronouncements

Recent Accounting Pronouncements

In July 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2017-11, Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), Derivatives and Hedging (Topic 815). This ASU requires that when determining whether certain financial instruments should be classified as liabilities or equity instruments, an entity should not consider the down round feature. The ASU also re-characterizes as a scope exception the indefinite deferral available to private companies with mandatorily redeemable financial instruments and certain noncontrolling interests, which does not have an accounting effect but addresses navigational concerns within the FASB Accounting Standards Codification. The provisions of the ASU related to down rounds are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. We do not expect the implementation of this standard to have a material effect on our financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). ASU 2016-02 requires lessees to recognize a right-of-use asset and lease liability in the balance sheet for all leases, including operating leases, with terms of more than twelve months. The amendments also require qualitative disclosures along with specific quantitative disclosures.

The new guidance will be effective for fiscal years beginning after December 15, 2018, and interim periods within those years, with early adoption permitted. The amendments must be applied on a modified retrospective basis. We anticipate the adoption of this standard will have a material impact on our financial statements. While we are continuing to assess all the potential impacts of the standard, we currently believe the most significant impact relates to our accounting for our office lease. Under the new guidance, the net present value of the obligation for our office lease will appear on the balance sheet. Currently, it is classified as an operating lease and payments are expensed in the period incurred.

Accounting Pronouncements Adopted in 2018

In June 2017, the FASB issued ASU 2018-07, Compensation — Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting. The amendments in this Update expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. Consistent with the accounting for employee share-based payment awards, award payments issued to nonemployees are measured at grant-date fair value. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. Early adoption is permitted, but no earlier than an entity's adoption date of Topic 606. The Company adopted this standard in the quarter ended June 30, 2018. The adoption of this standard did not have a material impact on our consolidated financial statements and related disclosures.

In May 2017, the FASB issued ASU 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting, which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. The new standard is effective for annual reporting periods, including interim periods within those annual periods, beginning after December 15, 2017. The Company adopted this standard in the quarter ended March 31, 2018. The adoption of this standard did not have a material impact on our consolidated financial statements and related disclosures.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The standard makes eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. The standard is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The new standard requires adoption on a retrospective basis unless it is impracticable to apply, in which case the Company would be required to apply the amendments prospectively as of the earliest date practicable. The Company adopted this standard effective January 1, 2018. Adoption of this standard did not impact our Consolidated Financial Statements for the current or prior periods presented.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The Company adopted this standard effective June 29, 2018, upon the execution of our preferred share equity investment described in Note 5. The Company has elected to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). Topic 606 supersedes the revenue recognition requirements in Topic 605 "Revenue Recognition" (Topic 605) and requires entities to recognize revenues when control of the promised goods or services is transferred to customers at an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. We adopted Topic 606 as of January 1, 2018 using the modified retrospective transition method. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting treatment under Topic 605. We recorded a net decrease to opening accumulated deficit of \$81,724, as of January 1, 2018 due to the cumulative impact of adopting Topic 606, with the impact primarily related to our post contract support (PCS deferred revenue).

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, 2017.

As used in this report, unless otherwise indicated, the terms "Company," "Vuzix", "management," "we," "our," and "us" refer to Vuzix Corporation.

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. We periodically re-evaluate these accounting policies and estimates and make adjustments 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, 2017. There have been no significant changes in our accounting policies other than the adoption of ASC 606, see Note 2 for further discussion, for the six-month period ended June 30, 2018.

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 augmented reality wearable display devices also referred to as head mounted displays (or HMDs, but also known as Video Eyewear, near-eye displays or near-eye virtual displays), in the form of Smart Glasses and Augmented Reality (AR) glasses. Our AR wearable display devices are worn like eyeglasses and contain varying features such as built-in video screens and audio. These devices also often include cameras, sensors, and a computer, that enable the user to view and interact with video and digital content, such as movies, computer data, the Internet or video games. Our AR wearable display products provide virtual large high-resolution screens and present a virtual image to the user through our proprietary optics and projection engines. Using these optics and displays, our AR wearable display devices provide a virtual image that appears to the wearer similar in size ranging from the image from a typical smart phone screen at arm's length away, to models that offer wall-sized home theatre screens. Our virtual imaging products integrate microdisplay technology with our advanced optics to produce compact high-resolution display engines, less than half an inch diagonally, which when viewed through our eyeglasses products create virtual images that appear comparable in size to that of a computer monitor or a large-screen television.

Our Smart Glasses are designed to work standalone or as a peripheral to the smartphone and have many of the same capabilities of the smartphone itself, allowing them to be used as a hands-free wearable computer. Our products can be used as a wearable substitute for large-screen televisions, desktop computer monitors or tablets. Additionally, our Smart Glasses allow users to utilize many smartphone applications while keeping their smartphones in a pocket or purse. Users of mobile devices sometime employ tablets and smartphones to replace their personal computer or console game systems while they are outside their homes or offices. Our wearable display products enable users of these mobile devices to effectively view the entire screen on a small, eyeglass-like device allowing real world interaction while viewing the screen.

Recent Accounting Pronouncements

See Note 14 to the consolidated financial statements.

Results of Operations

Comparison of Three Months Ended June 30, 2018 and June 30, 2017

The following table compares the Company's consolidated statements of operations data for the three months ended June 30, 2018 and 2017:

| | 3 Months Ended June 30, | | Dollar Change | % Increase (Decrease) | |
|----------------------|-------------------------|-----------|------------------|--------------------------|----|
| | 2018 | 2017 | | | |
| Sales: | | | | | |
| Products | \$2,647,583 | \$904,947 | \$1,742,636 | 193 | % |
| Engineering Services | — | 420,314 | (420,314) | (100) |)% |
| Total Sales | 2,647,583 | 1,325,261 | 1,322,322 | 100 | % |
| Cost of Sales: | | | | | |
| Products | 1,977,410 | 1,397,831 | 579,579 | 41 | % |
| Engineering Services | — | 356,917 | (356,917) | (100) |)% |
| Total Cost of Sales | 1,977,410 | 1,754,748 | 222,662 | 13 | % |

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| | | | | | |
|--|---------------|---------------|---------------|--------|---|
| Gross Profit (Loss) (exclusive of depreciation shown separately below) | 670,173 | (429,487) | 1,099,660 | (256) | % |
| Gross Profit % | 25 | % | (32) | % | |
| Operating Expenses: | | | | | |
| Research and Development | 2,564,119 | 1,198,940 | 1,365,179 | 114 | % |
| Selling and Marketing | 1,545,160 | 800,329 | 744,831 | 93 | % |
| General and Administrative | 2,320,151 | 1,308,234 | 1,011,917 | 77 | % |
| Depreciation and Amortization | 294,988 | 242,979 | 52,009 | 21 | % |
| Loss from Operations | (6,054,245) | (3,979,969) | (2,074,276) | 52 | % |
| Other Income (Expense): | | | | | |
| Investment Income | 39,986 | 14,944 | 25,042 | 168 | % |
| Other Taxes | (1,316) | (11,600) | 10,284 | (89) | % |
| Loss on asset disposal | (56,836) | — | (56,836) | NM | |
| Foreign Exchange Loss | (5,235) | (26,151) | 20,916 | (80) | % |
| Loss on Derivative Valuation | (63,820) | (13,416) | (50,404) | 376 | % |
| Amortization of Term Debt Discount and Deferred Issuance Costs | — | (29,616) | 29,616 | (100) | % |
| Interest Expense | (6,977) | (24,291) | 17,314 | (71) | % |
| Total Other Income (Expense) | (94,198) | (90,130) | (4,068) | 5 | % |
| Loss Before Provision for Income Taxes | (6,148,443) | (4,070,099) | (2,078,344) | 51 | % |
| Provision for Income Taxes | — | — | — | 0 | % |
| Net Loss | \$(6,148,443) | \$(4,070,099) | \$(2,078,344) | 51 | % |

Sales. There was an overall increase in total sales for the quarter ended June 30, 2018 over the same period in 2017 of \$1,322,322 or 100%. The following table reflects the major components of our sales:

| | Quarter Ended June 30, 2018 | % of Sales | Quarter Ended June 30, 2017 | % of Sales | Dollar Change | % Increase (Decrease) |
|----------------------------|--------------------------------|---------------|--------------------------------|---------------|---------------------|--------------------------|
| Component of Sales: | | | | | | |
| Smart Glasses | \$ 1,795,723 | 68 % | \$ 707,920 | 53 % | \$ 1,087,803 | 154 % |
| OEM Products | 651,895 | 25 % | — | 0 % | 651,895 | NM |
| iWear Video Headphones | 90,764 | 3 % | 68,988 | 5 % | 21,776 | 32 % |
| Waveguides | 88,212 | 3 % | 116,305 | 9 % | (28,093) | (24)% |
| Freight out | 20,989 | 1 % | 11,734 | 1 % | 9,255 | 79 % |
| Engineering Services | — | 0 % | 420,314 | 32 % | (420,314) | (100)% |
| Total Sales | \$ 2,647,583 | 100 % | \$ 1,325,261 | 100 % | \$ 1,322,322 | 100 % |

The overall increase in total sales was primarily the result of stronger smart glasses sales in the second quarter of 2018 as compared to the same period in 2017. Sales of smart glasses, primarily our M300, in the second quarter of 2018 were \$1,795,723 as compared to \$707,920 in the same period in 2017, a 154% increase. Sales of our original M100 Smart Glasses decreased significantly in 2018 quarter as compared to the 2017 quarterly period, reflecting the sales strength of the new M300. Sales of OEM Products for the 2018 period represent sales to Toshiba of our USB-C smart glasses product as compared to \$-0- in the prior year's period when the product was still under development. Our iWear Video Headphones unit sales rose 32% in the second quarter of 2018 as compared to the same period in 2017. Sales of Waveguide systems for the three months ending June 30, 2018 were \$88,212 versus \$116,305 in the prior year's comparable period.

Sales of engineering services for the three-month period ending June 30, 2018 was \$-0- as compared to \$420,314 in 2017 period. The 2017 period's revenue was comprised primarily of the amounts billed to Toshiba under our development supply agreement, which was completed in March 2018.

Cost of Sales and Gross Profit (Loss). Cost of product revenues and engineering services are 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 of engineering services. The following table reflects the components of our cost of goods sold for products:

| Component of Cost of Sales | Quarter Ended June 30, 2018 | As % Related Product Sales | Quarter Ended June 30, 2017 | As % Related Product Sales | Dollar Change | % Increase (Decrease) |
|----------------------------|--------------------------------|-------------------------------|--------------------------------|-------------------------------|------------------|--------------------------|
| Product Cost of Sales | \$ 1,273,837 | 48 % | \$ 911,191 | 100 % | \$ 362,646 | 40 % |

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| | | | | | | | | | |
|--|--------------|----|---|---------------|-------|---|--------------|--------|---|
| Freight Costs | 172,255 | 7 | % | 128,118 | 14 | % | 44,137 | 34 | % |
| Manufacturing Overhead | 352,509 | 13 | % | 208,599 | 23 | % | 143,910 | 69 | % |
| Warranty Costs | 140,944 | 5 | % | 54,541 | 6 | % | 86,403 | 158 | % |
| Amortization of Software Development Costs | — | 0 | % | 71,613 | 8 | % | (71,613) | (100) | % |
| Software Royalties | 37,864 | 1 | % | 23,769 | 3 | % | 14,095 | 59 | % |
| Total Cost of Sales - Products | \$ 1,977,410 | 75 | % | \$ 1,397,831 | 154 | % | \$ 579,579 | 41 | % |
| Gross Profit (Loss) - Products | \$ 670,173 | 25 | % | \$ (492,884) | (54) | % | \$ 1,163,057 | (236) | % |

For the quarter ended June 30, 2018 we reported an overall gross profit from product sales of \$670,173 as compared to a gross loss of \$492,884 in the prior year's period. On a product cost of sales basis only, product direct costs remained constant at 48% of sales in the 2018. Our overall gross profit for the 2018 period was negatively impacted by the fact that we earn lower margins on OEM sales of Smart Glasses to Toshiba as compared to our Vuzix branded products. In the 2017 period such product cost of sales were approximately 100% of related sales, a period when we recorded inventory obsolescence provisions of \$473,324 related to initial M300 volume production issues and the move from our contract manufacturer's California site to their China facility in spring 2017. There were no such obsolescence provisions in the 2018 period. Manufacturing overhead costs for the 2018 period rose by 69% primarily due to staff additions, but as a percentage of total product sales declined to 13% for the 2018 period from 23% in the 2017 period.

Costs for engineering services for the three months ended June 30, 2018 was \$-0- as compared to \$356,917 in the three-month period ending June 30, 2017. The 2017 year's amounts represented direct project costs as well as the reclassification of \$178,269 of internal research and development wage costs related to the Toshiba engineering program. That program was completed in March 2018 and no new engineering services programs were commenced in the 2018 period. There was \$-0- gross profit from engineering services for the 2018 period versus a gross profit from engineering services of \$63,397 in the same period in 2017.

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. Software development expenses to determine technical feasibility before final development and ongoing maintenance are not capitalized and are included in research and development costs.

| | Quarter Ended June 30, 2018 | % of Sales | Quarter Ended June 30, 2017 | % of Sales | Dollar Change | % Increase (Decrease) |
|--------------------------|--------------------------------|---------------|--------------------------------|---------------|------------------|--------------------------|
| Research and Development | \$ 2,564,119 | 97 % | \$ 1,198,940 | 90 % | \$ 1,365,179 | 114 % |

Comparing our research and development costs for the quarter ended June 30, 2018 versus the same period in 2017, there was an increase in 2018 salary, benefits and stock compensation expenses of \$543,260, primarily the result of additional R&D staff-versus the same period in 2017 when also \$178,269 in such costs were re-classified to Cost of Engineering Services related to the Toshiba project; increased research, development projects and supplies costs of \$442,700; an increase of \$361,406 in consultant advisors on our research programs and contractors on software development for the Blade Smart Glasses; a \$47,469 increase in travel costs; and a \$38,940 increase in hiring expenses.

Selling and Marketing. Selling and marketing costs consist of trade show costs, advertising, sales samples, travel costs, sales staff compensation costs including stock compensation expense, consulting fees, public relations agency fees, website costs and sales commissions paid to full-time staff and outside consultants.

| | Quarter Ended June 30, 2018 | % of Sales | Quarter Ended June 30, 2017 | % of Sales | Dollar Change | % Increase (Decrease) |
|-----------------------|--------------------------------|---------------|--------------------------------|---------------|------------------|--------------------------|
| Selling and Marketing | \$ 1,545,160 | 58 % | \$ 800,329 | 60 % | \$ 744,831 | 93 % |

These costs increased overall as compared to the same period in 2017 primarily due to the following factors: a \$317,946 increase in salary, separation payments, commissions, benefits and stock compensation expenses; an

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increase of \$225,955 in advertising, marketing and trade show costs; an increase of \$126,185 in our app store and website related costs; and an increase of \$89,293 in travel costs.

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.

| | Quarter Ended June 30, 2018 | % of Sales | Quarter Ended June 30, 2017 | % of Sales | Dollar Change | % Increase (Decrease) |
|----------------------------|--------------------------------|---------------|--------------------------------|---------------|------------------|--------------------------|
| General and Administrative | \$ 2,320,151 | 88 % | \$ 1,308,234 | 99 % | \$ 1,011,917 | 77 % |

General and administrative costs rose by 77% or \$1,011,917 for the second quarter of 2018 versus the 2017 period primarily because of: increased salary, separation and stock compensation costs of \$779,133 due to the hiring of new staff as compared to the prior year's period and the separation of the Company's former COO; an increase of \$151,932 in legal fees; an increase in travel expenses of \$48,018; increased bank, credit card fees, consulting fees, office supplies and bad debts totaling \$48,951; a reduction in audit fees of \$20,472, a reduction in hiring fees of \$20,800 and a reduction of \$41,979 in IR and shareholder related expenses.

Depreciation and Amortization. Depreciation and amortization expense for the three months ended June 30, 2018 was \$294,988 as compared to \$242,979 in the same period in 2017, an increase of \$52,009. The increase in depreciation and amortization expense is due to new investments in depreciable assets.

Other Income (Expense). Total other expense was \$94,198 for the three months ended June 30, 2018 as compared to an expense of \$90,130 in the same period in 2017. The overall increase of \$4,068 in these other expenses was primarily the result of an increased loss of \$50,404 on the derivative valuation for the three months ended June 30, 2018 as compared to the same period in 2017; and the elimination of costs for the amortization of senior term debt discounts and deferred financing costs for the three months ended June 30, 2018 as compared to an expense of \$29,616 and a related reduction in interest expense of \$17,314 when such debt was still outstanding.

Provision for Income Taxes. There was not a provision for income taxes in the three-month period ending June 30, 2018 and 2017.

Comparison of Six Months Ended June 30, 2018 and June 30, 2017

The following table compares the Company's consolidated statements of operations data for the six months ended June 30, 2018 and 2017:

| | 6 Months Ended June 30, | | Dollar Change | % | |
|--|-------------------------|-------------|------------------|------------------------|----|
| | 2018 | 2017 | | Increase (Decrease) | |
| Sales: | | | | | |
| Products | \$4,010,962 | \$1,864,330 | \$2,146,632 | 115 | % |
| Engineering Services | 180,516 | 671,594 | (491,078) | (73 |)% |
| Total Sales | 4,191,478 | 2,535,924 | 1,655,554 | 65 | % |
| Cost of Sales: | | | | | |
| Products | 3,159,584 | 2,351,734 | 807,850 | 34 | % |
| Engineering Services | 184,596 | 464,917 | (280,321) | (60 |)% |
| Total Cost of Sales | 3,344,180 | 2,816,651 | 527,529 | 19 | % |
| Gross Profit (Loss) (exclusive of depreciation shown separately below) | 847,298 | (280,727) | 1,128,025 | (402 |)% |
| Gross Profit % | 20 | % (11 |)% | | |
| Operating Expenses: | | | | | |
| Research and Development | 4,619,910 | 2,867,748 | 1,752,162 | 61 | % |
| Selling and Marketing | 3,079,258 | 1,831,328 | 1,247,930 | 68 | % |
| General and Administrative | 3,985,381 | 2,543,417 | 1,441,964 | 57 | % |
| Depreciation and Amortization | 568,610 | 482,809 | 85,801 | 18 | % |

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| | | | | | |
|--|----------------|---------------|---------------|-------|----|
| Loss from Operations | (11,405,861) | (8,006,029) | (3,399,832) | 42 | % |
| Other Income (Expense): | | | | | |
| Investment Income | 39,986 | 32,844 | 7,142 | 22 | % |
| Other Taxes | (29,858) | (22,150) | (7,708) | 35 | % |
| Loss on asset disposal | (56,836) | — | (56,836) | NM | |
| Foreign Exchange Loss | (9,652) | (25,053) | 15,401 | (61) |)% |
| (Loss) Gain on Derivative Valuation | (35,687) | 9,144 | (44,831) | (490) |)% |
| Amortization of Term Debt Discount and Deferred Issuance Costs | — | (175,260) | 175,260 | (100) |)% |
| Interest Expense | (16,190) | (65,258) | 49,068 | (75) |)% |
| Total Other Income (Expense) | (108,237) | (245,733) | 137,496 | (56) |)% |
| Loss Before Provision for Income Taxes | (11,514,098) | (8,251,762) | (3,262,336) | 40 | % |
| Provision for Income Taxes | — | — | — | 0 | % |
| Net Loss | \$(11,514,098) | \$(8,251,762) | \$(3,262,336) | 40 | % |

Sales. There was an overall increase in total revenue for the six months ended June 30, 2018 over the same period in 2017 of \$1,655,554 or 65%. The following table reflects the major components of our sales:

| Component of Sales: | 6 Months Ended June 30, 2018 | % of Sales | 6 Months Ended June 30, 2017 | % of Sales | Dollar Change | % Increase (Decrease) |
|------------------------|---------------------------------|---------------|---------------------------------|---------------|------------------|--------------------------|
| Smart Glasses | \$ 2,857,674 | 69 % | \$ 1,609,368 | 63 % | \$ 1,248,306 | 78 % |
| OEM Products | 766,065 | 18 % | — | 0 % | 766,065 | NM |
| iWear Video Headphones | 208,594 | 5 % | 117,307 | 5 % | 91,287 | 78 % |
| Waveguides | 124,650 | 3 % | 116,305 | 5 % | 8,345 | 7 % |
| Freight out | 53,979 | 1 % | 21,350 | 1 % | 32,629 | 153 % |
| Engineering Services | 180,516 | 4 % | 671,594 | 26 % | (491,078) | (73)% |
| Total Sales | \$ 4,191,478 | 100 % | \$ 2,535,924 | 100 % | \$ 1,655,554 | 65 % |

The overall increase in total sales was primarily the result of stronger smart glasses sales in the first half of 2018 as compared to the same period in 2017. Sales of smart glasses, primarily our M300, in the first half of 2018 were \$2,857,674 as compared to \$1,609,368 in the same period in 2017, a 78% increase. Sales of our original M100 Smart Glasses decreased significantly in 2018 period as compared to the 2017 period, reflecting the sales strength of the new M300. Our iWear Video Headphones unit sales rose 78% in the first half of 2018 as compared to the same period in 2017. Sales of Waveguide systems for the six months ending June 30, 2018 were \$124,650 versus \$116,305 in the prior year's comparable period.

Sales of engineering services for the six-month period ending June 30, 2018 decreased to \$180,516 from \$671,594 in 2017 period. The 2017 period's revenue was comprised primarily of the amounts billed to Toshiba under our development agreement which was completed in March 2018.

Cost of Sales and Gross Profit (Loss). Cost of product revenues and engineering services are 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 of engineering services. The following table reflects the components of our cost of goods sold for products:

| Component of Cost of Sales | 6 Months Ended June 30, 2018 | As % Related Product Sales | 6 Months Ended June 30, 2017 | As % Related Product Sales | Dollar Change | % Increase (Decrease) |
|----------------------------|---------------------------------|-------------------------------|---------------------------------|-------------------------------|------------------|--------------------------|
| Product Cost of Sales | \$ 1,898,724 | 47 % | \$ 1,402,019 | 75 % | \$ 496,705 | 35 % |
| Freight Costs | 320,333 | 8 % | 229,703 | 12 % | 90,630 | 39 % |
| Manufacturing Overhead | 611,352 | 15 % | 433,636 | 23 % | 177,716 | 41 % |
| Warranty Costs | 264,004 | 7 % | 92,189 | 5 % | 171,815 | 186 % |

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| | | | | | | | | |
|--|--------------|----|---|---------------|-----|----|--------------|---------|
| Amortization of Software Development Costs | — | 0 | % | 143,225 | 8 | % | (143,225) | (100)% |
| Software Royalties | 65,171 | 2 | % | 50,962 | 3 | % | 14,209 | 28 % |
| Total Cost of Sales - Products | \$ 3,159,584 | 79 | % | \$ 2,351,734 | 126 | % | \$ 807,850 | 34 % |
| Gross Profit (Loss) - Products | \$ 851,378 | 21 | % | \$ (487,404) | (26 |)% | \$ 1,338,782 | (275)% |

For the six months ended June 30, 2018 we reported an overall gross profit from product sales of \$851,378 as compared to gross loss of \$487,404 in the prior year's period. On a product cost of sales basis only, product direct costs decreased to 47% of sales versus 75% in the prior year's period when we recorded inventory obsolescence provisions of \$473,324 related to initial M300 volume production issues and the move from our contract manufacturer's California site to their China facility in spring 2017. Our overall 2018 improvement in gross profit was negatively impacted by the fact that we earn lower margins earned on OEM sales of Smart Glasses to Toshiba as compared to our Vuzix branded products. As a result of plastics and cabling issues, we have increased our provision rate for possible future warranty costs to 7% of Smart Glasses sales versus 5% in the same period in 2017. Manufacturing overhead costs rose by 41% primarily due to staff additions, but as a percentage of total product sales declined to 15% for the 2018 period from 23% in the 2017 period.

Costs for engineering services for the six months ended June 30, 2018 was \$184,596 as compared to \$464,917 in the prior 2017 period. These amounts represent direct project costs as well as the reclassification of internal research and development wage costs related to the Toshiba engineering program which was completed in March 2018. For the period we incurred a gross loss of \$4,080 for six months ending June 30, 2018, versus a gross profit from engineering services of \$206,677 in the same period in 2017.

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. Software development expenses to determine technical feasibility before final development and ongoing maintenance are not capitalized and are included in research and development costs.

| | 6 Months Ended June 30, 2018 | % of Sales | 6 Months Ended June 30, 2017 | % of Sales | Dollar Change | % Increase (Decrease) |
|--------------------------|---------------------------------|---------------|---------------------------------|---------------|------------------|--------------------------|
| Research and Development | \$ 4,619,910 | 110 % | \$ 2,867,748 | 113 % | \$ 1,752,162 | 61 % |

Comparing our research and development costs for the six months ending June 30, 2018 versus the same period in 2017: there was an increase in 2018 salary, benefits and stock compensation expenses of \$743,812, primarily the result of additional R&D staff versus the same period in 2017 when also \$178,269 in such costs were re-classified to Cost of Engineering Services related to the Toshiba project; increased research, development projects and supplies costs of \$280,409, primarily related to our Blade Smart Glasses; an increase of \$667,228 in consultant advisors on our research programs and on software development for the Blade Smart Glasses; a \$81,376 increase in travel costs; and a \$43,791 increase in hiring expenses.

Selling and Marketing. Selling and marketing costs consist of trade show costs, advertising, sales samples, travel costs, sales staff compensation costs including stock compensation expense, consulting fees, public relations agency

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fees, website costs and sales commissions paid to full-time staff and outside consultants.

| | 6 Months Ended June 30, 2018 | % of Sales | 6 Months Ended June 30, 2017 | % of Sales | Dollar Change | % Increase (Decrease) |
|-----------------------|---------------------------------|---------------|---------------------------------|---------------|------------------|--------------------------|
| Selling and Marketing | \$ 3,079,258 | 73 % | \$ 1,831,328 | 72 % | \$ 1,247,930 | 68 % |

These costs increased overall as compared to the same period in 2017 primarily due to the following factors: an increase of \$468,834 in salary, separation payments, commissions, benefits and stock compensation expenses; an increase of \$416,218 in advertising, marketing and trade show costs; an increase of \$262,579 in our app store and website related costs; and an increase of \$109,392 in travel costs.

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.

| | 6 Months Ended June 30, 2018 | % of Sales | 6 Months Ended June 30, 2017 | % of Sales | Dollar Change | % Increase (Decrease) |
|----------------------------|---------------------------------|---------------|---------------------------------|---------------|------------------|--------------------------|
| General and Administrative | \$ 3,985,381 | 95 % | \$ 2,543,417 | 100 % | \$ 1,441,964 | 57 % |

General and administrative costs rose by 57% or \$1,441,964 for the first half of 2018 versus the 2017 period primarily because of: increased salary, separation and stock compensation costs of \$1,228,340 due to the hiring of new staff as compared to the prior year's period and separation costs of the Company's former COO; an decrease of \$38,243 in legal and audit fees; an increase in travel expenses of \$92,775; and increased bank, credit card fees, consulting fees, office and bad debts totaling \$91,519.

Depreciation and Amortization. Depreciation and amortization expense for the six months ended June 30, 2018 was \$568,610 as compared to \$482,809 in the same period in 2017, an increase of \$85,801. The increase in depreciation and amortization expense is due to new investments in depreciable assets.

Other Income (Expense). Total other expense was \$108,237 for the six months ended June 30, 2018 as compared to an expense of \$245,733 in the same period in 2017. The overall decrease of \$137,496 in these other expenses was primarily the result of \$-0- for the amortization of senior term debt discounts and deferred financing costs for the six months ended June 30, 2018 as compared to a 2017 expense of \$175,260 and a related reduction in interest expense of \$49,068 due to the conversions and maturity of the debt on June 3, 2017. Other items reducing the impact of preceding costs savings were a 44,831 increased loss on the derivative valuation and \$56,836 loss on asset disposals and abandonment.

Provision for Income Taxes. There was not a provision for income taxes in the six-month period ending June 30, 2018 and 2017.

Liquidity and Capital Resources

As of June 30, 2018, we had cash and cash equivalents of \$29,150,826, an increase of \$14,261,190 from \$14,889,636 as of December 31, 2017.

At June 30, 2018, we had current assets of \$37,674,338 compared to current liabilities of \$4,706,686 which resulted in a positive working capital position of \$32,967,652. At December 31, 2017, we had a working capital position of \$15,789,033. Our current liabilities are comprised principally of accounts payable and accrued expenses.

Operating Activities. We used \$12,753,764 of cash for operating activities for the six months ended June 30, 2018 and \$7,548,842 in the same period in 2017. The net cash operating loss after adding back non-cash adjustments for the six months ended June 30, 2018 was \$9,570,278, along with the following changes in operating assets and liabilities for the period: a \$497,784 decrease in accrued revenue, a \$1,421,603 increase in net inventory, a \$1,070,354 increase in accounts receivable, a \$1,106,884 decrease in accounts payable, a \$217,682 decrease in accrued expenses, and a \$161,365 increase in accrued compensation. The major operating items for the six-month period ended June 30, 2017 resulted from a \$6,873,010 loss from operations after non-cash adjustments, and a \$420,314 increase in accrued revenue, a \$755,923 increase in net inventory, a \$279,898 decrease in prepaid expenses, a \$723,632 increase in accounts payable, a \$370,534 reduction in unearned revenue, and a \$124,918 reduction in accrued compensation.

Investing Activities. Cash used in investing activities was \$1,049,421 for the six months ended June 30, 2018 as compared to \$855,760 in the same period in 2017. During the first six months of 2018, \$603,441 was used primarily for the purchase of manufacturing equipment, product mold tooling, and computer equipment as compared to spending of \$662,993 for the same period in 2017. During the six months ending June 30, 2018, a total of \$87,500 in software development costs were capitalized, versus \$100,000 for the same period in 2017. During the 2018 period, the Company invested \$250,000 in a private corporation that is in the low vision near-eye display market. The costs of registering our intellectual property rights and license purchases, included in the investing activities totals described above, were \$108,480 in the six-month period ending June 30, 2018 and \$92,767 in the same period in 2017.

Financing Activities. We generated \$28,064,375 of cash from financing activities for the six months ending June 30, 2018 as compared to \$0 in the same period in 2017. For the 2018 period, financing activities consisted primarily of a public offering of 3,000,000 shares of common stock and warrants to purchase an aggregate of up to 1,200,000 shares of common stock in January 2018, resulting in proceeds after commissions and offering expenses of \$28,025,000. In the same period in 2017, there were no new financing activities.

Capital Resources. As of June 30, 2018, we had a cash balance of \$29,150,826.

We incurred a net loss for the six months ended June 30, 2018 of \$11,514,098 and annual net losses of \$19,633,502 in 2017 and \$19,250,082 in 2016. The Company has an accumulated deficit of \$107,904,826 as of June 30, 2018.

The Company's cash requirements are primarily for funding operating losses, working capital, research and development, and capital expenditures. The Company needs to grow its business significantly to become profitable and self-sustaining on a cash flow basis or it will be required to raise new capital. Our cash requirements related to funding operating losses depend on numerous factors, including new product development activities, our ability to commercialize our products, our products' timely market acceptance, selling prices and gross margins, and other factors. Historically, the Company has met its cash needs by the sale of equity, borrowings under notes, and sales of convertible debt. On January 29, 2018, the Company closed a public offering of 3,000,000 shares of common stock and warrants to purchase an aggregate of up to 1,200,000 shares of common stock resulting in net proceeds of \$28,025,000 after commissions and offering expenses.

We believe our existing cash and cash equivalent balances will be sufficient to meet our working capital and capital expenditure needs for at least the next twelve months. We will continue to invest in our research and development, IP portfolio, and new products offerings. Our future capital requirements may vary materially from those currently planned and will depend on many factors, including our levels of revenue, the timing and extent of spending on research and development efforts and other business initiatives, the expansion of sales and marketing activities, the timing of new product introductions, market acceptance of our products, acquisitions, and overall economic conditions. To the extent that current and anticipated future sources of liquidity are insufficient to fund our future business activities and requirements, we may be required to seek additional equity or debt financing. If the Company raises additional equity funds by these methods, the ownership interests of existing shareholders may be diluted. The amount of such dilution could increase due to the issuance of new warrants or securities with other dilutive characteristics, such as full ratchet anti-dilution clauses or price resets. The incurrence of debt financing would result in debt service obligations and the instruments governing such debt could provide for operating and financing covenants that would restrict our future operations. However, there can be no assurance that we will be able to raise capital in the future or that if we raise additional capital it will be sufficient to execute our business plans 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.

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 annual report on Form 10-K for the year ended December 31, 2017 and other filings we make with the Securities and Exchange Commission 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

We invest our excess cash in high-quality short-term corporate debt instruments, which bear lower levels of relative risk. We believe that the effect, if any, of reasonably possible near-term changes in interest rates on our financial position, results of operations, and cash flows should not be material to our cash flows or income. It is possible that interest rate movements would increase our unrealized gain or loss on interest rate securities. We are exposed to changes in foreign currency exchange rates primarily through transaction gains and losses as a result of non-U.S.

dollar denominated cash flows related to business activities in Japan and Europe. We do not currently hedge our foreign currency exchange rate risk. We estimate that any market risk associated with our international operations is unlikely to have a material adverse effect on our business, financial condition or results of operation.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Management, with the participation of the Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), has performed an evaluation of our disclosure controls and procedures that are defined in Rule 13a-15 of the Exchange Act as of the end of the period covered by this report. This evaluation included consideration of the controls, processes, and procedures that are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Based on this evaluation, our management, including our CEO and CFO, concluded that our disclosure controls and procedures were effective at June 30, 2018.

Changes in Internal Control over Financial Reporting

There have not been any changes in the Company’s internal control over financial reporting (as defined in 13a-15(f) and 15d-15(f) promulgated under the Securities Exchange Act of 1934) that occurred during the Company’s most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

We are not currently involved in any actual or pending legal proceeding or litigation and we are not aware of any such proceedings contemplated by or against us or our property except as follows:

We filed a defamation lawsuit against Ricardo Antonio Pearson (a/k/a Richard Pearson) in the Supreme Court of the State of New York, County of New York on April 5, 2018. The Company's complaint against Mr. Pearson alleges he published false and defamatory articles about the Company. Vuzix is seeking damages in excess of \$80 million, including punitive damages, and money damages.

On July 24, 2018, a purported shareholder class action lawsuit was filed in the United States District Court, Southern District of New York, against the Company, certain of its current and former directors and executive officers and the placement agents of the Company's registered direct offering that was completed in January 2018. The complaint alleges violations of federal securities laws under Sections 11 and 15 of the Securities Act and under Sections 10(b) and 20(a) of the Exchange Act on behalf of a putative class of shareholders that purchased stock between November 9, 2017 and March 20, 2018, or pursuant and/or traceable to the Company's registration statement and prospectus filed in connection with the registered direct offering. The complaint alleges that the Company and certain of its officers and directors made materially false and/or misleading statements and failed to disclose material adverse events about the Company's business, operations and prospects in press releases and public filings. The complaint seeks damages in unspecified amounts, costs and expenses of bringing the action, and other unspecified relief. A similar purported class action was filed against the Company and certain of its current and former executive officers and directors on July 27, 2018, in the United States District Court, Southern District of New York. The Company believes the allegations are false and intends to vigorously defend itself. The Company plans to file a motion to dismiss the complaints.

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, 2017. There have been no material changes from those risk factors. The risks discussed in our 2017 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, 2018, we issued 8,433 shares of common stock upon the exercise of stock options for aggregate exercise price of \$5.35.

During the three months ended June 30, 2018, we issued 27,083 shares of common stock to an employee for their vested stock award.

During the three months ended June 30, 2018, we issued 17,159 shares of common stock for investor relations services.

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

| | |
|-------------|---|
| <u>31.1</u> | <u>Certification of the Chief Executive Officer of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| <u>31.2</u> | <u>Certification of the Chief Financial Officer of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| <u>32.1</u> | <u>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.</u> |
| <u>32.2</u> | <u>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.</u> |
| 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

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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 9, 2018 By: /s/ Paul J. Travers
Paul J. Travers
President, Chief Executive Officer
(Principal Executive Officer)

Date: August 9, 2018 By: /s/ Grant Russell
Grant Russell
Executive Vice President and Chief Financial
Officer
(Principal Financial and Accounting Officer)