

SIERRA BANCORP
Form 10-Q
May 12, 2008
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES

EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2008

Commission file number: 000-33063

SIERRA BANCORP

(Exact name of Registrant as specified in its charter)

California
(State of Incorporation)

33-0937517
(IRS Employer Identification No)

86 North Main Street, Porterville, California 93257

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(Address of principal executive offices) (Zip Code)
(559) 782-4900

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock, no par value, 9,573,138 shares outstanding as of April 30, 2008

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Table of Contents**PART I - FINANCIAL INFORMATION****Item 1****SIERRA BANCORP****CONSOLIDATED BALANCE SHEETS**

(dollars in thousands)

	March 31, 2008 (unaudited)	December 31, 2007 (audited)
<u>ASSETS</u>		
Cash and due from banks	\$ 43,100	\$ 43,972
Interest-bearing deposits in other banks	50	50
Federal funds sold	1,000	
Total Cash & Cash Equivalents	44,150	44,022
Investment securities available for sale	235,664	184,917
Loans and leases:		
Gross loans and leases	921,044	924,633
Allowance for loan and lease losses	(12,478)	(12,276)
Deferred loan and lease fees, net	(2,818)	(3,045)
Net Loans and Leases	905,748	909,312
Premises and equipment, net	18,240	18,255
Other assets	77,960	77,229
TOTAL ASSETS	\$ 1,281,762	\$ 1,233,735
<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>		
LIABILITIES		
Deposits:		
Non-interest bearing	\$ 225,318	\$ 243,764
Interest bearing	698,230	606,383
Total Deposits	923,548	850,147
Federal funds purchased and repurchase agreements	35,894	39,082
Short-term borrowings	137,000	193,000
Long-term borrowings	35,000	5,000
Other liabilities	18,031	16,114
Junior subordinated debentures	30,928	30,928
TOTAL LIABILITIES	1,180,401	1,134,271
SHAREHOLDERS' EQUITY		
Common stock, no par value; 24,000,000 shares authorized; 9,521,273 and 9,576,388 shares issued and outstanding at March 31, 2008 and December 31, 2007, respectively	19,055	18,757
Additional paid in capital	883	797
Retained earnings	80,384	80,125
Accumulated other comprehensive income (loss)	1,039	(215)
TOTAL SHAREHOLDERS' EQUITY	101,361	99,464

TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 1,281,762	\$ 1,233,735
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The accompanying notes are an integral part of these consolidated financial statements

Table of Contents**SIERRA BANCORP****CONSOLIDATED STATEMENTS OF INCOME**

(dollars in thousands, except per share data, unaudited)

	For the Quarter Ended March 31, 2008	For the Quarter Ended March 31, 2007
Interest income:		
Interest and fees on loans	\$ 18,222	\$ 19,639
Interest on investment securities:		
Taxable	1,592	1,552
Tax-exempt	578	547
Interest on Federal funds sold and interest-bearing deposits	6	7
Total interest income	20,398	21,745
Interest expense:		
Interest on deposits	4,426	5,158
Interest on short-term borrowings	1,504	1,838
Interest on long-term borrowings	91	207
Interest on mandatorily redeemable trust preferred securities	515	566
Total interest expense	6,536	7,769
Net Interest Income	13,862	13,976
Provision for loan losses	2,270	900
Net Interest Income after Provision for Loan Losses	11,592	13,076
Non-interest revenue:		
Service charges on deposit accounts	2,468	1,575
Gains on investment securities available-for-sale	45	5
Other	1,735	1,410
Total other operating income	4,248	2,990
Other operating expense:		
Salaries and employee benefits	4,498	4,664
Occupancy expense	1,486	1,466
Other	2,559	2,854
Total other operating expenses	8,543	8,984
Income before income taxes	7,297	7,082
Provision for income taxes	2,338	2,329
Net Income	\$ 4,959	\$ 4,753
PER SHARE DATA		
Book value	\$ 10.65	\$ 9.49
Cash dividends	\$ 0.17	\$ 0.15
Earnings per share basic	\$ 0.52	\$ 0.49
Earnings per share diluted	\$ 0.51	\$ 0.47
Average shares outstanding, basic	9,558,161	9,729,627
Average shares outstanding, diluted	9,801,531	10,149,351

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

Table of Contents**SIERRA BANCORP****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(dollars in thousands, unaudited)

	Three Months Ended March 31,	
	2008	2007
Cash Flows from Operating Activities		
Net income	\$ 4,959	\$ 4,753
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on investment securities	\$ (45)	\$ (5)
Gain on sales of loans	(1)	(17)
Gain on disposal of fixed assets	(82)	
Loss on sale on foreclosed assets	32	
Writedown on foreclosed assets		
Share-based compensation expense	86	96
Provision for loan losses	2,270	900
Depreciation and amortization	722	799
Net amortization on securities premiums and discounts	29	101
(Increase) Decrease in unearned net loan fees	(226)	44
Increase in cash surrender value of life insurance policies	(160)	(358)
Proceeds from sales of loans held for sale		1,169
Originations of loans held for sale		(1,152)
Decrease in interest receivable and other assets	811	1,184
Increase (Decrease) in other liabilities	172	(597)
Excess tax benefit from share-based payment arrangements	(113)	(727)
Net cash provided by operating activities	8,454	6,190
Cash Flows from Investing Activities		
Maturities of securities available for sale	1,200	
Proceeds from sales/calls of securities available for sale	6,000	830
Purchases of securities available for sale	(61,205)	(6,576)
Principal paydowns on securities available for sale	5,438	5,892
Decrease in loans receivable, net	(1,094)	(18,081)
Purchases of premises and equipment, net	(844)	(881)
Proceeds from sales of foreclosed assets	1,264	
Net cash used in investing activities	(49,241)	(18,816)
Cash Flows from Financing Activities		
Increase in deposits	73,401	33,677
(Decrease) Increase in federal funds purchased	(7,000)	20,000
Decrease in borrowed funds	(26,000)	(52,400)
Increase (Decrease) in repurchase agreements	3,812	(1,599)
Cash dividends paid	(1,630)	(1,466)
Stock repurchased	(2,080)	(2,972)
Stock options exercised	299	752
Excess tax benefit from share-based payment arrangements	113	727
Net cash (used in) provided by financing activities	40,915	(3,281)
Increase (Decrease) in cash and due from banks	128	(15,907)

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Cash and Cash Equivalents			
Beginning of period		44,022	59,015
End of period		\$ 44,150	\$ 43,108

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

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SIERRA BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

Note 1 The Business of Sierra Bancorp

Sierra Bancorp (the Company), headquartered in Porterville, California, is a California corporation registered as a bank holding company under the Bank Holding Company Act of 1956, as amended. The Company was incorporated in November 2000 and acquired all of the outstanding shares of Bank of the Sierra (the Bank) in August 2001. The Company's principal subsidiary is the Bank, and the Company exists primarily for the purpose of holding the stock of the Bank and of such other subsidiaries it may acquire or establish. The Company's main source of income is dividends from the Bank, but the Company intends to explore supplemental sources of income in the future. The expenditures of the Company, including (but not limited to) the payment of dividends to shareholders, if and when declared by the Board of Directors, the cost of servicing debt, audit costs, and shareholder expenses will generally be paid from dividends remitted to the Company by the Bank.

At the present time, the Company's only other direct subsidiaries are Sierra Statutory Trust II and Sierra Capital Trust III, which were formed in March 2004 and June 2006, respectively, solely to facilitate the issuance of capital trust pass-through securities. Pursuant to Financial Accounting Standards Board (FASB) Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46), these trusts are not reflected on a consolidated basis in the financial statements of the Company. References herein to the Company include Sierra Bancorp and its consolidated subsidiary, the Bank, unless the context indicates otherwise.

The Bank is a California state-chartered bank headquartered in Porterville, California. It was incorporated in September 1977, opened for business in January 1978, and has grown to be the largest independent bank headquartered in the South San Joaquin Valley. The Bank is an independent multi-community bank that offers a full range of retail and commercial banking services primarily in the central and southern sections of the San Joaquin Valley. On the southern end, our footprint extends east through the Tehachapi plateau and into the northwestern tip of the Mojave Desert. We currently operate 21 full service branch offices throughout this geographic footprint, in addition to an internet branch which provides the ability to open deposit accounts online. The Bank's two newest brick and mortar branches commenced operations in Delano in March 2007 and Bakersfield in February 2006. Our next office is expected to be another branch in the city of Bakersfield, with an anticipated opening in the second quarter of 2008. We have also executed a lease for a pre-existing branch building in the Sunnyside area of South Fresno. Renovation activities have commenced, and that branch could be operational as early as Summer 2008. In addition to these full-service branches, the Bank has an agricultural credit unit and an SBA lending unit with staff located at our corporate headquarters, eight offsite ATMs, and a virtual branch through which customers can open deposit accounts and submit certain loan applications online. The Bank's deposit accounts are insured by the Federal Deposit Insurance Corporation (FDIC) up to maximum insurable amounts.

Note 2 Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in a condensed format, and therefore do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The information furnished in these interim statements reflects all adjustments that are, in the opinion of management, necessary for a fair statement of the results for such period. Such adjustments are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q. The results of operations in the interim statements are not necessarily indicative of the results that may be expected for any other quarter, or for the full year. Certain amounts reported for 2007 have been reclassified to be consistent with the reporting for 2008. The interim financial information should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2007 as filed with the Securities and Exchange Commission.

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Note 3 Current Accounting Developments

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (FAS 157). This statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position (FSP) No. FAS 157-2, Effective Date of FASB Statement No. 157. This FSP delays the effective date of FAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The impact of adoption was not material to the Company.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (FAS 159). The standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new standard is effective for the Company on January 1, 2008. The Company did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008.

FAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate fair value:

Securities: The fair values of trading securities and securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities relationship to other benchmark quoted securities.

Loans held for sale: Since loans designated by the Company as available-for-sale are typically sold shortly after making the decision to sell them, realized gains or losses are usually recognized within the same period and fluctuations in fair values are thus not relevant for reporting purposes. If available for sale loans exist on gn: center">13

The stockholders are being asked to ratify the audit committee’s appointment of Freed Maxick CPAs, P.C. for the year ending December 31, 2016. If the stockholders fail to ratify this appointment, the audit committee may, but is not required to, reconsider whether to retain that firm. Even if the appointment is ratified, the audit committee in its discretion may direct the appointment of a different accounting firm at any time during the year if it determines that such a change would be in the best interests of the Company and its stockholders. A representative of Freed Maxick, CPAs, P.C. will be present at the annual meeting and will be given the opportunity to make a statement if he or she so desires and will be available to respond to appropriate questions.

Fees Paid to Freed Maxick CPAs, P.C.

The following table shows the fees that were billed by Freed Maxick CPAs, P.C. for professional services rendered in 2015 and 2014.

	2015	2014
Audit Fees ⁽¹⁾	\$ 124,770	\$ 96,000
Audit-Related Fees ⁽²⁾	3,500	4,043
Tax Fees	17,920	0
All Other Fees ⁽³⁾	0	0
Total Freed Maxick CPAs, P.C. Fees	\$ 146,190	\$ 100,043

(1) Audit fees primarily represent amounts billed for the audit of our annual consolidated financial statements for such fiscal year and quarterly reviews of our consolidated financial statements.

(2) Audit-related fees represent fees for services rendered in connection with reviewing our SEC filings.

Fees Paid to EFPR Group, LLP

The following table shows the fees that were billed by EFPR Group, LLP for professional services rendered in 2015 and 2014.

	2015	2014
Audit Fees ⁽¹⁾	\$0	\$30,170
Audit-Related Fees ⁽²⁾	8,000	5,652
Tax Fees	0	6,500
All Other Fees ⁽³⁾	0	4,434
Total EFP Rotenberg, LLP Fees	\$8,000	\$46,756

(1) Audit fees primarily represent amounts billed for the quarterly reviews of our consolidated financial statements and fees for consents and comfort letters.

(2) Audit-related fees represent fees for services rendered in connection with consents and comfort letters and with our August 5, 2013 public stock offering and subsequent registration statements.

(3) All other fees in 2014 consisted of interest charged.

Pre-Approval of Fees by Audit Committee

In accordance with applicable laws, rules and regulations, our audit committee charter and pre-approval policies established by the audit committee require that the audit committee review in advance and pre-approve all audit and permitted non-audit fees for services provided to us by our independent registered public accounting firm. The services performed by, and the fees to be paid to, Freed Maxick CPAs, P.C. in 2015 and 2014 were approved by the audit committee. The services performed by, and the fees to be paid to, EFPR Group, LLP in 2015 and 2014 were approved by the audit committee.

Independence Analysis by Audit Committee

The audit committee has considered whether the provision of the services described above was compatible with maintaining the independence of Freed Maxick CPAs, P.C. and determined that the provision of such services was compatible with such firm's independence. For 2015 and 2014, Freed Maxick CPAs, P.C. provided no services other than those services described above.

The audit committee has considered whether the provision of the services described above was compatible with maintaining the independence of EFP Rotenberg, LLP and determined that the provision of such services was compatible with such firm's independence. For each of 2015 and 2014, EFP Rotenberg, LLP provided no services other than those services described above.

Required Vote

The affirmative vote of the holders of a majority of the shares of common stock and Series A Preferred Stock (on an as-converted basis) present in person or represented by proxy at the Annual Meeting and entitled to vote on the matter is needed to ratify the appointment of Freed Maxick CPAs, P.C. as our independent registered public accounting firm for the year ending December 31, 2016. An abstention will have the same legal effect as a vote against the ratification of Freed Maxick CPAs, P.C., and broker non-votes will have no effect on the outcome of the ratification of the independent registered public accounting firm.

Our Board of Directors unanimously recommend that the

stockholders vote FOR ratification of the appointment of FREED MAXICK CPAS, P.C. as our independent registered public accounting firm for the year ending December 31, 2016.

AUDIT COMMITTEE REPORT¹

Membership and Role of Audit Committee

The audit committee of our board is responsible for providing independent, objective oversight and review of our accounting functions, internal controls and financial reporting process. Currently, the audit committee is comprised of Messrs. Scott, Ruckdaeschel, and our recent board appointee, Edward Kay, effective April 2016. The audit committee operates pursuant to a written charter adopted by the board of directors in December 2009 which may be found on our website www.vuzix.com under the “Investors-Corporate Governance” section. We believe that each of the members of the audit committee is independent as defined by applicable laws and regulations.

Management has the primary responsibility for the financial statements and the reporting process, including our system of internal controls, and for the preparation of the consolidated financial statements in accordance with generally accepted accounting principles. Our independent accountants are responsible for performing an independent audit of those financial statements in accordance with generally accepted auditing standards and to issue a report thereon. The audit committee’s responsibility is to monitor and oversee these processes on behalf of the board. Three of the four members of the audit committee are not professional accountants or auditors and their functions are not intended to duplicate or certify the activities of management and the independent auditors. Edward Kay, a professional accountant is chair of the audit committee.

Review of our Audited Financial Statements

In fulfilling its oversight responsibilities, the audit committee reviewed the audited financial statements in our Annual Report on Form 10-K with management and discussed the quality and acceptability of our accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in our financial statements.

The audit committee reviewed with the independent auditors, who are responsible for expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles, their judgments as to the quality and acceptability of our accounting principles and such other matters as are required to be discussed with the committee under generally accepted auditing standards, including Auditing Standard No. 16 (Communications with Audit Committees). In addition, the audit committee has discussed with the independent auditors the auditors’ independence from management and us, including the matters in the written disclosures required by Independence Standards Board Standard No. 1 (Independent Discussions with Audit Committees), which were submitted to us, and considered the compatibility of non-audit services with the auditors’ independence.

¹ *The material in this report is not deemed to be “soliciting material,” or to be “filed” with the Securities and Exchange Commission and is not to be incorporated by reference in any of our filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof and irrespective of any general incorporation language in any such filings.*

The audit committee discussed with our independent auditors the overall scope and plans for their audit. The audit committee met with the independent auditors, with and without management present, to discuss the results of their examination, their evaluation of our internal controls, and the overall quality of our financial reporting.

In reliance on these reviews and discussions, the audit committee recommended to our board of directors (and our board has approved) that our audited financial statements for the year ended December 31, 2015 be included in the Annual Report on Form 10-K for the year ended December 31, 2015 for filing with the Securities and Exchange Commission.

The audit committee selects the Company's independent registered public accounting firm annually and has submitted such selection for the year ending December 31, 2016 for ratification by stockholders at the Company's annual meeting.

The Audit Committee currently consists of Edward Kay, Michael Scott and Alexander Ruckdaeschel.

COMPENSATION AND OTHER INFORMATION CONCERNING NAMED EXECUTIVE OFFICERS AND DIRECTORS

Named Executive Officers

This proxy statement contains information about the compensation paid to our Named Executive Officers ("NEOs") during 2015. For 2015, we determined that the following officers were our named executive officers for purposes of this proxy statement:

Paul J. Travers - chief executive officer and president
Grant Russell – chief financial officer and executive vice president

Compensation Philosophy

We believe that the products and technology of the Company that are critical to our future growth, such as our smart glasses, wearable computing and waveguide optics, are still evolving rapidly and accordingly we attempt to strike a balance between longer term strategic initiatives and short-term financial metrics as performance indicators. As such, we believe it is important to reward not just financial achievement but progress in our strategic initiatives such as the development of new products and/or technology. As a result, we strive to counterbalance our employee retention objectives and pay-for-performance objectives. Historically we believe we have accomplished this by compensating our executives with a combination of base salary, performance bonus awards and long-term equity-based retention compensation. In addition, we periodically use benchmarks and peer group comparisons to assist us in determining whether our executive compensation is appropriate in light of our compensation objectives and philosophy. We currently have no pre-established policy for the allocation between either cash or non-cash compensation but we do emphasize long term results over annual achievements.

Role of the Compensation Committee

The Compensation Committee of our board of directors sets our executive compensation policies and determines the amounts and elements of compensation for our executive officers. As set forth in the Compensation Committee's written charter, its responsibilities include establishing compensation policies for our directors and executive officers; reviewing and approving the CEO's and CFO's annual compensation; approving employment agreements or arrangements with executive officers; administering our 2014 Equity Incentive Plan and approving grants under this Incentive Plan; and making recommendations regarding any other incentive compensation or equity-based plans. The Compensation Committee may delegate certain authority with respect to compensation matters to our executive officers.

For all executive officers other than our CEO and CFO, the Compensation Committee establishes and approves the base salary compensation based on recommendations from the CEO. With respect to compensation of our CEO and CFO, the Compensation Committee establishes and approves the compensation determinations based on the Compensation Committee's evaluation and performance reviews of our CEO and CFO.

A copy of the Compensation Committee charter is posted on our website, www.vuzix.com, under the heading "Investors: Corporate Governance."

The Role of Management

At the request of the Compensation Committee, the Name Executive Officers of the Company may be present at Compensation Committee meetings for discussion purposes. However, they have no involvement in the decisions made by the Committee, nor do they have a vote on any matters brought before the Committee. The Compensation Committee meets with the CEO to discuss his performance and compensation package, but ultimately decisions regarding his package are made solely based upon the Committee's deliberations, as well as input from the compensation consultant, as requested. The Compensation Committee considers recommendations from the CEO, as well as input from the compensation consultant as requested, to make decisions regarding any other NEOs.

Role of the Compensation Consultant

The Compensation Committee is comprised exclusively of independent outside directors. In making its determinations with respect to executive compensation, the Compensation Committee has the authority to engage its own advisors to assist in carrying out its responsibilities. The engagement of services from the compensation consultant provides input on trends in executive compensation and an outside perspective on our executive compensation practices and assists with our peer group benchmarking analysis. The Compensation Committee uses the consultant to assist in the identification and selection of peer companies for purposes of comparing compensation practices, to provide guidance regarding the amount and types of compensation that we provide to our executives and board of directors, and other compensation-related matters.

Elements of Executive Compensation

The compensation level of our executives generally reflects their level of experience and is designed to provide an incentive to positively affect our future operating performance and shareholder value.

In making determinations with respect to amounts and elements of executive compensation, the Compensation Committee evaluates our overall performance during the year against annual budgets; evaluates the Chief Executive Officer's achievements against the Board's expectations; obtains input from the Chief Executive Officer on the performance reviews of the other executive officers; evaluates the potential for future contributions by each executive to our long-term success; and periodically compares our executive compensation against a benchmarking analysis of a group of peer companies.

Salary. Base salary is the primary fixed element in the Company's compensation program and is intended to provide an element of certainty and security to the Company's executive officers on an ongoing basis. Two of the Company's executive officers had employment agreements with the Company as of December 31, 2014 and their initial salaries are set by contract. Salaries are based on the executive's level of experience, specialty and responsibility. Executive salaries are reviewed on an annual basis by the Compensation Committee. Any increases in salary are based on an evaluation of the individual's performance, level of responsibility and, when such information is available, the level of pay compared to the salaries paid to persons in similar positions in the Company's peer group or as shown in survey data.

The Compensation Committee approves all option grants with input and recommendations from the CEO, with the exception that the CEO and CFO have been delegated authority to approve initial grants made to newly hired employees. New employees may receive a stock option grant when hired in order to immediately align their interests with us and may be eligible for additional option grants going forward.

Bonus. Any short term bonuses or cash incentive awards to executive officers are tied to achieving performance metrics established by the Compensation Committee at the beginning of each year, with input from the CEO, which are not re-set during the year, regardless of Company performance or economic conditions. The program creates incentive for the executive officers to direct their efforts toward achieving specified company goals and individual goals. To measure our 2015 performance, the Compensation Committee established goals related to the Company's financial performance and attainment of strategic milestones and approved individual goals for executives. In 2015, we fell short of reaching the Company's financial performance goals. Other strategic milestones related to the development of certain technologies and attaining certain production milestones and certain individual milestones were not achieved.

Compensation Setting Process

The Compensation Committee compared the total direct compensation of the Company's executive officers with the total direct compensation paid to the top executive officers at the companies in the peer group, as well as to compensation levels revealed in survey data provided by PM&P, for purposes of establishing 2015 salaries for our NEOs.

The compensation consultant reports directly to the Compensation Committee and carries out responsibilities as assigned by the Committee. The Compensation Committee has the sole authority to retain and terminate the compensation consultant and to approve the compensation consultant's fees and all other terms of the engagement. The Committee exercised this authority to engage Pearl Meyer & Partners (PM&P) as its independent compensation consultant in February 2015 and has direct access to the compensation consultant throughout the year. PM&P serves as an advisor to the Compensation Committee on topics primarily related to Board and executive compensation. PM&P reports directly to the Compensation Committee Chair, takes direction from the Compensation Committee, and does not provide us with any services other than the services provided at the request of the Compensation Committee.

The Compensation Committee regularly reviews the services provided by its outside consultants and believes that PM&P is independent in providing executive compensation consulting services. The Compensation Committee conducted a specific review of its relationship with PM&P in 2015 and determined that PM&P's work for the Compensation Committee did not raise any conflicts of interest, consistent with the guidance provided under the Dodd-Frank Wall Street Reform and Consumer Protection Act, and by the SEC and the NASDAQ National Market, or Nasdaq.

Compensation Determinations

Peer Group Benchmarking

In 2015 the Compensation Committee engaged PM&P to assist in selecting a peer group. The companies were selected as peers based on their being in a similar industry, primarily manufacturers of electronic components or electronic equipment and instruments, and of a generally similar size, based mainly on market capitalization revenue that approximated ours. A total of 13 companies were selected.

The Compensation Committee compared the total direct compensation of the Company's executive officers with the total direct compensation paid to the named executive officers at the companies in the peer group, as well as to compensation levels revealed in survey data provided by PM&P, for purposes of establishing 2015 salaries, which had previously been established back in 2007 and before our Company went public. The Compensation Committee set Mr. Travers's base salary under his amended employment contract at \$425,000, which represents approximately a 41.6% increase over the salary of \$300,000 that he had previously been earning since January 2010. The Compensation Committee set Mr. Russell's base salary under his amended employment contract at \$350,000, which represents approximately a 27.3% increase over the salary of \$275,000 that he had previously been earning since January 2010. Both these increases became effective May 1, 2015. The Compensation Committee evaluated each of these executive officers' performance and recognized their achievements since the Company first went public in 2009 and the progress the Company has made.

Compensation Discussion and Analysis

The Compensation Committee believes that the Company's "NEOs" play a critical role in the operational and financial performance of the Company that creates long-term value for our stockholders. Accordingly, the Company's executive compensation philosophy is to reward our executives for individual performance and for contributions to our performance. The Compensation Committee believes that new products and IP of the Company are critical to the Company's future growth, such as upcoming and new wearable technology products and smart glasses, including waveguide optics models and accordingly wants to strike a reasonable balance between lead (strategic initiatives) and lag (financial metrics) performance indicators. And as the Company's shares are now traded on NASDAQ it is important that the management team implement Sarbanes Oxley, or SOX and greatly reduce the deficiencies in the areas of financial reporting. As such, the Committee believes it is important to reward not just the achievement of financial goals but also progress in the Corporation's strategic initiatives such as the development of new products and/or technology as well as improved financial reporting controls.

Accordingly, the Compensation Committee implemented a short-term incentive plan for the two NEOs for the Company's 2015 fiscal year. This incentive plan was developed in consultation with the PM&P for 2015 and the following performance targets for each NEO:

Paul Travers – target incentive amount is 60% of base salary. Seventy-five percent (75%) of Mr. Travers' target performance bonus will be based on the Company's operating results and twenty-five percent (25%) related to new product introductions and technology objectives.

Grant Russell - target incentive amount is 50% of base salary. Seventy-five percent (75%) of Mr. Russell's target performance bonus will be based on the Company's operating results and twenty-five percent (25%) related to implementing and verifying full SOX controls at the Company.

In 2015, while we were successful in advancing new products, key technologies, and in securing a major financing from key industry entity, neither NEO achieved their and the Company's targets and as a result no short-term cash incentives were paid in 2015.

In 2013, our stockholders voted on our executive compensation program (also known as "Say on Pay") for the first time and of the 1,842,079 votes present at the meeting, 1,490,824, or 80.2% approved it. The Committee considered the stockholders' endorsement of the Committee's decisions and policies for our overall executive compensation program in continuing the pay-for-performance program that is currently in place.

SUMMARY COMPENSATION TABLE

The following table sets forth information concerning total compensation earned or paid to our named executive officers for 2015 and 2014. More detailed information is presented in the other tables and in the footnotes to the tables.

Name and Principal Position	Year	Salary Paid (\$)	Bonus or Commission (\$)(3)	Option Awards (\$)(4)	Stock Award (\$)(5)	All Other Compensation (\$)	Total (\$)
Paul J. Travers, President and Chief Executive Officer	2015	\$383,333 ⁽¹⁾	\$ —	\$ —	\$500,000 ⁽⁵⁾	9,278 ⁽⁶⁾	\$892,612 ⁽⁶⁾
	2014	300,000 ⁽¹⁾	—	93,090	—	9,276 ⁽⁶⁾	402,366 ⁽⁶⁾
Grant Russell, Chief Financial Officer and Executive Vice President	2015	325,000 ⁽²⁾	—	—	500,000 ⁽⁵⁾	19,700 ⁽⁷⁾	844,700 ⁽⁷⁾
	2014	275,000 ⁽²⁾	—	151,271	—	20,376 ⁽⁷⁾	446,647 ⁽⁷⁾

(1) Mr. Travers's contract provides for an annual salary of \$425,000 in 2015 and \$300,000 in 2014.

(2) Mr. Russell's contract provides for an annual salary of \$350,000 in 2015 and \$275,000 in 2014.

(3) There were no bonuses paid in 2015 and 2014.

Represents the total fair market of stock options granted in 2014, which vest over 4 years, in accordance with (4) FASB ASC Topic 718. See Notes 1 and 15 of the consolidated financial statements included in our Form 10-K for the year ended December 31, 2015, regarding assumptions underlying valuation of equity awards.

Represents the total fair market of stock awards granted in 2015, and was determined by multiplying the number (5) of shares of restricted common stock granted upon the closing of the Series A Preferred Stock offering on January 2, 2015, which was valued at its conversion price of \$5.00 per share.

(6) Consists of amounts paid to Mr. Travers as a car allowance (as per his employment contract).

(7) Consists of amounts paid to Mr. Russell in reimbursement for the rental of an automobile and direct travel to and from his primary residence in Vancouver, Canada to Rochester, New York.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR END

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The following table sets forth information concerning exercisable and unexercisable stock options held by the named executive officers at December 31, 2015.

Name	Option Awards		Equity Incentive Plan Awards:		
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Exercised Options (#) Unexercisable	Number of Securities Underlying Unexercised Options (#)	Option Exercise Price (\$)	Option Expiration Date
Paul Travers ⁽¹⁾	18,426	21,574	—	\$ 2.70	8/18/2024
Grant Russell ⁽¹⁾	29,942	35,058	—	2.70	8/18/2024
Grant Russell ⁽²⁾	2,666	—	—	11.25	5/01/2019

(1) This option granted under our 2014 option plan vests in equal monthly installments over four years from the date of grant.

(2) This option was granted under our 2009 option plan and it vested in equal monthly installments over four years from the date of grant.

Equity Compensation Plan Information

The Company has adopted the Vuzix 2007 Stock Option Plan (the “2007 Plan”), the Vuzix 2009 Stock Plan (the “2009 Plan”) and the Vuzix 2014 Incentive Stock Plan (the “2014 Plan” and, together with the 2007 and 2009 Plan, the “Plans”). Under the 2007 Plan, we have 37,447 options outstanding and none available for future use. Under the 2009 Plan, we have 120,842 options outstanding and none available for future use. The maximum number of shares of common stock that may be issued under the 2014 Plan was initially set at 1,000,000 and thereafter will automatically be increased each time the Company issues additional shares of common stock so that the total number of shares issuable thereunder will at all times equal 10% of the then outstanding shares of stock, unless in any case the Board of Directors adopts a resolution providing that the number of shares issuable under this Plan will not be so increased. The Board of Directors have not adopted any resolution stating that the shares issuable will not be increased. As of April 29, 2016, the maximum number shares issuable under the 2014 Plan is 1,613,303. Under the 2014 Plan, we have 872,000 options outstanding and 741,303 options available for future issuance.

The purpose of the Plans is to retain executives and selected employees and consultants and reward them for making contributions to our success. These objectives are accomplished by making long-term incentive awards under thereby providing participants with a proprietary interest in our growth and performance. Each of the plans are administered by our board of directors.

The following table summarizes information as of the close of business on December 31, 2015 concerning the Plans and the options outstanding.

Plan category	Number of securities to be issued upon exercise of outstanding options (a)	Weighted-average exercise price of outstanding options (b)	Securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	1,022,789	\$ 4.59	744,295
Equity compensation plans not approved by security holders	—	—	—
Total	1,022,789	\$ 4.59	744,295

Employment Agreements

Paul J. Travers

On August 1, 2007, we entered into an employment agreement with Paul J. Travers providing for his continued service as our Chief Executive Officer and President. Under the agreement, Mr. Travers is entitled to an initial annual base salary of \$300,000 or such greater amount as shall be determined by the board of directors. Effective May 1, 2015, the Compensation Committee agreed to increase Mr. Travers' annual base salary to \$425,000. He is also eligible to receive such periodic, annual or other bonuses as the board of directors in its sole discretion shall determine and to participate in all bonus plans established for our senior executives. The agreement also provides that Mr. Travers may be awarded, in the sole discretion of the board of directors, stock options and other awards under any plan or arrangement for which our senior executives are eligible. The level of his participation in any such plan or arrangement shall be determined by the board of directors in its sole discretion. To the greatest extent permissible under the Internal Revenue Code (the Code) and the regulations thereunder, options granted to Mr. Travers shall be incentive stock options within the meaning Section 422 of the Code. He is also eligible to participate in all employee benefit plans which are generally available to our senior executives and entitled to receive fringe benefits and perquisites comparable to those of our other senior executives.

Under his agreement, we are obligated to reimburse Mr. Travers for the costs of an automobile at the rate of \$750 per month and for all actual, reasonable and customary expenses incurred in the course of his employment in accordance with our policies as then in effect. Mr. Travers is subject to certain restrictive covenants under the agreement, including a covenant not to compete for 24 months after his termination for any reason other than by him for good reason or by us without cause and for 48 months after his termination if such termination results in our obligation to pay him the change of control payment described below.

Grant Russell

On August 1, 2007, we entered into an employment agreement with Grant Russell providing for his continued service as our Chief Financial Officer and Executive Vice President. Under the agreement, Mr. Russell is entitled to an initial annual base salary of \$275,000 or such greater amount as shall be determined by the board of directors. Effective May 1, 2015, the Compensation Committee agreed to increase Mr. Russell's annual base salary to \$350,000. He is also eligible to receive such periodic, annual or other bonuses as the board of directors in its sole discretion shall determine and to participate in all bonus plans established for our senior executives. The agreement also provides that Mr. Russell may be awarded, in the sole discretion of the board of directors, stock options and other awards under any plan or arrangement for which our senior executives are eligible. The level of his participation in any such plan or arrangement shall be determined by the board of directors in its sole discretion. To the greatest extent permissible under the Code and the regulations thereunder, options granted to Mr. Russell shall be incentive stock options within the meaning of Section 422 of the Code. He is also eligible to participate in all employee benefit plans which are generally available to our senior executives and entitled to receive fringe benefits and perquisites comparable to those of our other senior executives.

Under his agreement, we are obligated to either reimburse Mr. Russell for the costs of an automobile at the rate of \$750 per month or to bear all expenses associated with his lease of an automobile for his use while in Rochester, New York, to reimburse him for the costs of travel between Rochester, New York and his primary residence in Vancouver, British Columbia, Canada and to reimburse him for all actual, reasonable and customary expenses incurred in the course of his employment in accordance with our policies as then in effect. We provide Mr. Russell the option to receive a portion of his salary in the form of a housing allowance, at the rate prescribed by the Internal Revenue Service, for the maintenance of a second residence in Rochester, New York. Payment of such allowance is deductible by us for federal income tax purposes in the same manner as cash compensation. Mr. Russell is subject to certain restrictive covenants under the agreement, including a covenant not to compete for 24 months after his termination for any reason other than by him for good reason or by us without cause and for 48 months after his termination if such termination results in our obligation to pay him the change of control payment described below.

Potential Payments upon Termination or Change in Control

This section sets forth information regarding compensation and benefits that each of the named executive officers would receive in the event of a change in control (as defined in the applicable employment agreement) or in the event of termination of employment under several different circumstances, including: (1) termination by Vuzix for cause (as defined in the applicable employment agreement); (2) a voluntary termination by the named executive officer; (3) termination by the named executive officer for good reason (as defined in the applicable employment agreement); (4) involuntary termination by Vuzix without cause; (5) death; or (6) disability (as defined in the applicable employment agreement).

Under the agreements of both Mr. Travers and Russell: (a) we shall have “cause” to terminate them as a result of their: (i) willfully engaging in conduct which is materially injurious to us; (ii) willful fraud or material dishonesty in connection with their performance as an employee; (iii) deliberate or intentional failure to substantially perform their duties as employees that results in material harm to us; or (iv) conviction for, or plea of nolo contendere to a charge of, commission of a felony; (b) they shall have “good reason” to terminate their employment upon: (i) a material diminution during the term of the agreements in their duties, responsibilities, position, office or title; (ii) a breach by us of the compensation and benefits provisions of their agreements; (iii) a material breach by us of any other terms of their agreements; or (iv) the relocation of their principal place of business at our request beyond 30 miles from its current location; and (c) they shall be deemed to be “disabled” if they shall be rendered incapable of performing their duties to us by reason of any medically determined physical or mental impairment that can be expected to result in death or that can reasonably be expected to last for a period of either (i) five or more consecutive months from the first date of their absence due to the disability or (ii) nine months during any 12-month period. Any termination by us for cause or by them for good reason is subject to a 30-day notice period and opportunity to cure.

Under their employment agreements, “change of control” means: (i) the approval by our stockholders, and the completion of the transaction resulting from such approval, of (A) the sale or other disposition of all or substantially all our assets or (B) our complete liquidation or dissolution; (ii) the sale, in a single transaction or in a series of related transactions, of all or substantially all of the outstanding shares of our capital stock; (iii) the approval by our stockholders, and the completion of the transaction resulting from such approval, of a merger, consolidation, reorganization or similar corporate transaction, whether or not we are the surviving corporation in such transaction, in which the outstanding shares of common stock are converted into (A) shares of stock of another company, other than a conversion into shares of voting common stock of the successor corporation (or a holding company thereof) representing fifty percent (50%) or more of the voting power of all capital stock thereof outstanding immediately after the merger or consolidation or (B) other securities (either ours or those of another company) or cash or other property; (iv) pursuant to an affirmative vote of a holder or holders of seventy five percent (75%) of our capital stock of the entitled to vote on such a matter, the removal of a majority of the individuals who are at that time members of the board of directors; or (v) the acquisition by any entity or individual of one hundred percent of our capital stock.

The actual amounts that would be payable in such circumstances can only be determined at the date of termination or upon the change in control. The amounts included below are based on the following:

- We have assumed that the termination event occurred effective as of December 31, 2015, the last day of 2015; We have assumed that the value of our common stock was \$7.59 per share, the US dollar closing market price of our common stock on December 31, 2015, the last trading day of our common stock, and that all unvested options were exercised on December 31, 2015; and
- Health benefits are included at the estimated value of continuation of this benefit.

Paul J. Travers

If Mr. Travers's employment is terminated (i) by the Company without cause or (ii) by Mr. Travers for good reason or (iii) as a result of disability, Mr. Travers would be entitled to receive:

· two times his annual base salary, payable in 24 equal monthly installments	\$ 850,000
· his annual incentive bonus, payable within 60 days of termination	\$-
Total cash compensation upon termination	\$ 850,000

If Mr. Travers's employment is terminated within one year of a change of control for any reason other than by us for cause, or if he elects to terminate his employment (whether or not for good reason) during the period beginning 121 days after a change of control and ending on the second anniversary thereof, Mr. Travers would be entitled to receive:

· four times his annual base salary, payable in 48 equal monthly installments	\$ 1,700,000
· his annual incentive bonus, then in effect, payable within 60 days of termination	\$-
Total cash compensation upon change of control	\$ 1,700,000

Additionally, in either case Mr. Travers would also be entitled to:

· continuation of medical benefits throughout the 24 or 48-month period during which severance payments are made or until he becomes eligible to receive medical benefits from subsequent employer	\$12,457 (for 24 months) or \$24,914 (for 48 months)
· value of all unvested options, which would vest immediately	\$0
· any accrued amounts owing to him	
· additionally in the event any severance payments under those existing agreements become subject in the future to IRS Section 280G excise taxes that lower the net amounts after tax those officers would otherwise receive, then the Company shall gross up such payments to these "disqualified individuals" (IRS definition) for the 20 percent excess tax if their currently existing severance arrangements are deemed excess parachute payment amounts	

If Mr. Travers's employment is terminated for cause or by Mr. Travers voluntarily, he will be entitled to receive only any accrued amounts owing him and will forfeit all unvested equity and unearned incentive payments.

Grant Russell

If Mr. Russell’s employment is terminated (i) by the Company without cause or (ii) by Mr. Russell for good reason or (iii) as a result of disability, Mr. Russell would be entitled to receive:

·two times his annual base salary, payable in 24 equal monthly installments	\$ 700,000
·his annual incentive bonus, payable within 60 days of termination	\$-
Total cash compensation upon termination	\$ 700,000

If Mr. Russell’s employment is terminated within one year of a change of control for any reason other than by us for cause, or if he elects to terminate his employment (whether or not for good reason) during the period beginning 121 days after a change of control and ending on the second anniversary thereof, Mr. Russell would be entitled to receive:

·four times his annual base salary, payable in 48 equal monthly installments	\$ 1,400,000
·his annual incentive bonus, then in effect, payable within 60 days of termination	\$-
Total cash compensation upon change of control	\$ 1,400,000

Additionally, in either case Mr. Russell would also be entitled to:

·continuation of medical benefits throughout the 24 or 48-month period during which severance payments are made or until he becomes eligible to receive medical benefits from subsequent employer	\$4,321 (for 24 months) or \$8,643 (for 48 months)
·value of all unvested options, which would vest immediately	\$0
·any accrued amounts owing to him	
·additionally in the event any severance payments under those existing agreements become subject in the future to IRS Section 280G excise taxes that lower the net amounts after tax those officers would otherwise receive, then the Company shall gross up such payments to these “disqualified individuals” (IRS definition) for the 20 percent excess tax if their currently existing severance arrangements are deemed excess parachute payment amounts	

If Mr. Russell's employment is terminated for cause or by Mr. Russell voluntarily, he will be entitled to receive only any accrued amounts owing him and will forfeit all unvested equity and unearned incentive payments.

Director Compensation

How Directors are Compensated

Employee directors do not receive additional compensation for serving on the board beyond the compensation they received for serving as our officers, as described under "Executive Compensation."

We use a combination of cash and stock-based incentive compensation to attract and retain qualified candidates to serve on the board. In setting non-employee director compensation the board considers the amount of time that directors expend in fulfilling their duties as members of our board and the skill-level we require of members of our board.

DIRECTOR COMPENSATION — YEAR ENDED DECEMBER 31, 2015

Name	Fees Earned or Paid in				Total
	Cash (\$)	Stock Awards (\$) ⁽¹⁾	Option Awards (\$)	All Other Compensation (\$)	
William Lee	48,550	189,900	—	—	238,450
Michael Scott	46,550	189,900	—	—	236,450
Alexander Ruckdaeschel	46,550	189,900	—	—	236,450

(1) Represents the total fair market of stock awards granted in 2015, and was determined by multiplying the number of shares of restricted common stock granted by the closing price of our common stock as listed on NASDAQ on the day of grant. Two stock awards were made in 2015, the first of 25,000 shares to each external director upon the closing of the Series A Preferred Stock offering in January 2015, which was valued at its conversion price of \$5.00 per share. A further 10,000 shares on July 15, 2015, when our closing price of our stock was \$6.49, was granted to each external director upon their election to the Board of Directors at our 2015 Annual Meeting to serve until our

2016 Annual Meeting.

During 2015 cash director fees were paid to non-management members of the board of directors and board committee chairs. Further the nonemployee directors were reimbursed for ordinary expenses incurred in connection with attendance at meetings of the board of directors.

For the period from January 1 to March 31, 2015, the non-management members of the board of directors were paid a monthly retainer of \$1,200 per month and \$1,250 per calendar quarter for non-management board of director members who were also a chairperson of a board committee, with the chair of the audit committee receiving \$2,500 per quarter.

Effective April 1, 2015 the Company's external board members receive annual retainer fees of \$45,000. Further the chairpersons of the Company's external Board Committees also began receiving the following annual retainer fees:

▲Audit Committee - \$10,000.

●Compensation Committee - \$9,000.

♣Nomination Committee - \$9,000

The Company will not pay any cash fees for any regular meetings of the Board or Committee meetings. In the event there are special circumstances that require the formation of any Special Committees and related special meetings the Board may consider further cash consideration for the external directors on such Special Committees.

TRANSACTIONS WITH RELATED PERSONS

Since January 1, 2014, we have entered into the following transactions in which our directors, executive officers or holders of more than 5% of our capital stock had or will have a direct or indirect material interest. The following transactions do not include compensation, termination and change-in-control arrangements, which are described under "COMPENSATION AND OTHER INFORMATION CONCERNING NAMED EXECUTIVE OFFICERS AND DIRECTORS." We believe the terms obtained or consideration that we paid or received, as applicable, in connection with the transactions described below were comparable to terms available or the amounts that would be paid or received, as applicable, in arm's-length transactions.

Warrant Exercises

On February 25, 2015, Grant Russell, our chief financial officer, exercised 364,080 warrants on a cashless basis for 313,885 shares of common stock. Also on February 25, 2015, Paul Travers, our chief executive officer, exercised 809,655 warrants on a cashless basis for 698,029 shares of common stock.

Indemnification Agreements

We have entered into indemnification agreements with each of our directors and executive officers. Under these agreements we are obligated to indemnify the indemnitee to the fullest extent permitted by applicable law for all reasonable expenses (including attorneys' fees and disbursements), judgments, fines (including excise taxes and penalties) and amounts paid in settlement actually and reasonably incurred by the indemnitee arising out of or connected with the indemnitee's service as a director or officer and indemnitee's service in another capacity at our request or direction. We are also obligated to advance all reasonable and actual expenses incurred by the indemnitee in connection with any action, suit, proceeding or appeal with respect to which he is entitled to be indemnified upon our receipt of an invoice for such expenses. Our obligation to advance expenses is subject to the indemnitee's execution, upon our request, of an agreement to repay all such amounts if it is ultimately determined that he is not entitled to be indemnified by us under applicable law. If a claim for indemnification under this agreement may not be paid to the indemnitee under applicable law, then in any action in which we are jointly liable with the indemnitee, we are obligated to contribute to the amount of reasonable expenses (including attorneys' fees and disbursements) actually and reasonably incurred by the indemnitee in proportion to the relative benefits received by us and the indemnitee from the transaction from which such action arose, and our relative fault and that of the indemnitee in connection with the events which resulted in such expenses. The rights of an indemnitee under the form of indemnification agreement are in addition to any other rights that the indemnitee may have under our certificate of incorporation or bylaws, any agreement, or any vote of our stockholders or directors. We are not obligated to make any payment under the form of indemnification agreement to the extent payment is actually made to the indemnitee under an insurance policy or any other method outside of the agreement.

PROPOSAL 3

ADVISORY VOTE ON EXECUTIVE COMPENSATION

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") requires the Company's stockholders to have the opportunity to cast a non-binding advisory vote regarding the approval of the compensation disclosed in this Proxy Statement of the Company's executive officers who are named above in the Summary Compensation Table (the "named executive officers"). The Company has disclosed the compensation of the named executive officers pursuant to rules adopted by the SEC.

We believe that our compensation policies for the named executive officers are designed to attract, motivate and retain talented executive officers and are aligned with the long-term interests of the Company's stockholders. This advisory stockholder vote, commonly referred to as a "say-on-pay vote," gives you as a stockholder the opportunity to approve or not approve the compensation of the named executive officers that is disclosed in this Proxy Statement by voting for or against the following resolution (or by abstaining with respect to the resolution):

RESOLVED, that the stockholders of Vuzix Corporation approve all of the compensation of the Company's executive officers who are named in the Summary Compensation Table of the Company's 2016 Proxy Statement, as such compensation is disclosed in the Company's 2016 Proxy Statement pursuant to Item 402 of Regulation S-K, which disclosure includes the Proxy Statement's Summary Compensation Table and other executive compensation tables and related narrative disclosures.

In 2013, our stockholders voted on our executive compensation program (also known as "Say on Pay") for the first time and of the 1,842,079 votes present at the meeting, 1,490,824, or 80.2% approved it. The Committee considered the stockholders endorsement of the Committee's decisions and policies for our overall executive compensation program in continuing the pay-for-performance program that is currently in place.

Because your vote is advisory, it will not be binding on either the Board of Directors or the Company. However, the Company's Compensation Committee will take into account the outcome of the stockholder vote on this proposal at the Annual Meeting when considering future executive compensation arrangements. In addition, your non-binding advisory votes described in this Proposal 3 and below in Proposal 4 will not be construed: (1) as overruling any decision by the Board of Directors, any Board committee or the Company relating to the compensation of the named executive officers, or (2) as creating or changing any fiduciary duties or other duties on the part of the Board of Directors, any Board committee or the Company.

The Dodd-Frank Act requires the Company's stockholders to have the opportunity to cast a non-binding advisory vote regarding how frequently the Company should seek from its stockholders a non-binding advisory vote (similar to this Proposal 3) on the compensation disclosed in the Company's proxy statement of its executive officers who are named in the proxy statement's summary compensation table for the year in question (the "named executive officers").

The Board of Directors has determined that an advisory vote by the Company's stockholders on executive compensation that occurs every three years is the most appropriate alternative for the Company and this frequency was approved by our stockholders in their advisory vote at the Company's 2013 Annual Meeting. The Board of Directors may subsequently decide that it is in the best interests of the Company and its stockholders to hold an advisory vote on executive compensation that differs in frequency from every three years in the future.

RECOMMENDATION OF THE BOARD FOR PROPOSAL NO. 3:

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE TO APPROVE THE COMPENSATION DISCLOSED IN THIS PROXY STATEMENT OF THE COMPANY'S EXECUTIVE OFFICERS WHO ARE NAMED IN THIS PROXY STATEMENT'S SUMMARY COMPENSATION TABLE.

OTHER MATTERS

The board of directors knows of no other matters that will be presented for consideration at the annual meeting, but if other matters properly come before the meeting, the persons named as proxies in the enclosed proxy will vote according to their best judgment. Stockholders are requested to date and sign the enclosed proxy and to mail it promptly in the enclosed postage-paid envelope. If you attend the annual meeting, you may revoke your proxy at that time and vote in person, if you wish. Otherwise your proxy will be voted for you.

By Order of the Board of Directors

Steven D. Ward,
Secretary

Dated: April 29, 2016

Rochester, New York

We will make available at no cost, upon your written request, a copy of our annual report on Form 10-K for the year ended December 31, 2015 (without exhibits) as filed with the Securities and Exchange Commission. Copies of exhibits to our Form 10-K will be made available, upon your written request and payment to us of the reasonable costs of reproduction and mailing. Written requests should be made to: Corporate Secretary, Vuzix Corporation, 25 Hendrix Road, Suite A, West Henrietta, New York 14586.

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