IMMERSION CORP
Form 10-Q
May 07, 2010

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

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended March 31, 2010

OR

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

For the transition period from__________to__________

Commission file number 000-27969

IMMERSION CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**94-3180138**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

801 Fox Lane, San Jose, California 95131

(Address of principal executive offices)(Zip Code)

(408) 467-1900

(Registrant s telephone number, including area code)

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 þ No o

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 o No o

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o

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

Yes o No þ

Number of shares of common stock outstanding at April 30, 2010: 28,093,633

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PART I
FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
IMMERSION CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)
(Unaudited)

	March 31, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 20,705	$ 19,828
Short-term investments	43,926	43,900
Accounts receivable (net of allowances for doubtful accounts as of: March 31, 2010 $99 and December 31, 2009 $207)	2,299	2,988
Inventories	644	2,001
Deferred income taxes	250	248
Prepaid expenses and other current assets	4,174	4,474
Total current assets	71,998	73,439
Property and equipment, net	2,734	3,498
Intangibles and other assets, net	11,309	10,897
Total assets	$ 86,041	$ 87,834
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,283	$ 1,382
Accrued compensation	1,292	1,387
Other current liabilities	2,811	3,087
Deferred revenue and customer advances	6,928	6,578
Total current liabilities	12,314	12,434
Long-term deferred revenue	19,172	18,851
Deferred income tax liabilities	250	248
Other long-term liabilities	586	560
Total liabilities	32,322	32,093
Contingencies (Note 15)		
Stockholders equity:		
Common stock and additional paid-in capital $0.001 par value; 100,000,000 shares authorized; shares issued: March 31, 2010 30,876,698 and December 31, 2009 30,786,156; shares outstanding: March 31, 2010 28,090,135 and December 31, 2009 27,999,593	173,275	172,679
Warrants		11
Accumulated other comprehensive income	113	66
Accumulated deficit	(101,280)	(98,626)

Treasury stock at cost: March 31, 2010 and December 31, 2009	2,786,563		(18,389)		(18,389)
Total stockholders equity			53,719		55,741
Total liabilities and stockholders equity		$	86,041	$	87,834

See accompanying Notes to Condensed Consolidated Financial Statements.

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IMMERSION CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended March 31, 2010	2009
Revenues:		
Royalty and license	$ 6,403	$ 3,781
Product sales	2,968	3,279
Development contracts and other	338	446
Total revenues	9,709	7,506
Costs and expenses:		
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	1,369	1,251
Sales and marketing	2,353	4,284
Research and development	2,461	3,929
General and administrative	5,716	4,384
Amortization and impairment of intangibles	235	215
Restructuring costs		646
Total costs and expenses	12,134	14,709
Operating loss	(2,425)	(7,203)
Change in fair value of warrant liability		480
Interest and other income	79	302
Loss from continuing operations before provision for income taxes	(2,346)	(6,421)
Provision for income taxes	(339)	(91)
Loss from continuing operations	(2,685)	(6,512)
Discontinued operations (Note 9):		
Gain on sales of discontinued operations net of provision for income taxes of $0	30	167
Gain from discontinued operations, net of provision for income taxes of $1 and $150 as of March 31, 2010 and 2009, respectively	1	235
Net loss	$ (2,654)	$ (6,110)
Basic and diluted net loss per share		
Continuing operations	$ (0.10)	$ (0.23)
Discontinued operations	0.01	0.01
Total	$ (0.09)	$ (0.22)

Shares used in calculating basic and diluted net loss per share	28,022	27,924

See accompanying Notes to Condensed Consolidated Financial Statements.

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IMMERSION CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(unaudited)

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Cash flows from operating activities:		
Net loss	$ (2,654)	$ (6,110)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	296	390
Amortization and impairment of intangibles	235	215
Stock-based compensation	596	1,404
Change in fair market value of warrant liability		(480)
Allowance for doubtful accounts	(108)	(156)
Loss on disposal of equipment	49	2
Loss on divestiture	45	
Gain on sales of discontinued operations	(30)	(167)
Changes in operating assets and liabilities:		
Accounts receivable	796	2,241
Inventories	385	(818)
Prepaid expenses and other assets	221	44
Accounts payable	(97)	(469)
Accrued compensation and other current liabilities	(420)	(1,295)
Deferred revenue and customer advances	783	1,187
Other long-term liabilities	145	5
Net cash provided by (used in) operating activities	242	(4,007)
Cash flows provided by (used in) investing activities:		
Purchases of short-term investments	(14,978)	(33,962)
Maturities of short-term investments	15,000	11,000
Net proceeds from divestiture	1,434	
Additions to intangibles	(680)	(542)
Proceeds from sale of property and equipment	70	
Purchases of property and equipment	(241)	(580)
Proceeds from sales of discontinued operations	30	167
Net cash provided by (used in) investing activities	635	(23,917)
Cash flows provided by financing activities:		
Issuance of common stock under employee stock purchase plan		134
Exercise of stock options and warrants		70
Net cash provided by financing activities		204
Effect of exchange rates on cash and cash equivalents		(52)

Net increase (decrease) in cash and cash equivalents	877	(27,772)
Cash and cash equivalents:		
Beginning of the period	19,828	64,769
End of the period	$ 20,705	$ 36,997
Supplemental disclosure of cash flow information:		
Cash paid for taxes	$ 7	$
Supplemental disclosure of non-cash investing and financing activities:		
Amounts accrued for property and equipment, and intangibles	$ 89	$ 1,090
Accrued divestiture transaction costs	$ 389	$
Shares issued under company stock plan	$ 413	$ 22

See accompanying Notes to Condensed Consolidated Financial Statements.

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IMMERSION CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2010
(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Immersion Corporation (the Company) was incorporated in 1993 in California and reincorporated in Delaware in 1999 and develops, manufactures, licenses, and supports a wide range of hardware and software technologies and products that enhance digital devices with touch interaction.

Principles of Consolidation and Basis of Presentation

The condensed consolidated financial statements include the accounts of Immersion Corporation and its wholly-owned subsidiaries. All intercompany accounts, transactions, and balances have been eliminated in consolidation.

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all information and footnotes necessary for a complete presentation of the financial position, results of operations, and cash flows, in conformity with accounting principles generally accepted in the United States of America. These condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2009. In the opinion of management, all adjustments consisting of only normal and recurring items necessary for the fair presentation of the financial position and results of operations for the interim period have been included.

The results of operations for the interim periods ended March 31, 2010 are not necessarily indicative of the results to be expected for the full year.

Revenue Recognition

The Company recognizes revenues in accordance with applicable accounting standards, including Accounting Standards Codification (ASC) 605-10-S99, Revenue Recognition (ASC 605-10-S99); ASC 605-25, Multiple Elemen Arrangements (ASC 605-25); and ASC 985-605, Software-Revenue Recognition (ASC 985-605). The Company derives its revenues from three principal sources: royalty and license fees, product sales, and development contracts. As described below, significant management judgments and estimates must be made and used in connection with the revenue recognized in any accounting period. Material differences may result in the amount and timing of revenue for any period based on the judgments and estimates made by management. Specifically, in connection with each transaction involving products, the Company must evaluate whether: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable, and (iv) collectibility is probable. The Company applies these criteria as discussed below.

Persuasive evidence of an arrangement exists: For a license arrangement, the Company requires a written contract, signed by both the customer and the Company. For a stand-alone product sale, the Company requires a purchase order or other form of written agreement with the customer.

Delivery has occurred. The Company delivers software and product to customers physically and delivers software also electronically. For physical deliveries not related to software, the transfer terms typically include transfer of title and risk of loss at the

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Company s shipping location. For electronic deliveries, delivery occurs when the Company provides the customer access codes or keys that allow the customer to take immediate possession of the software.

The fee is fixed or determinable. The Company s arrangement fee is based on the use of standard payment terms which are those that are generally extended to the majority of customers. For transactions involving extended payment terms, the Company deems these fees not to be fixed or determinable for revenue recognition purposes and revenue is deferred until the fees become due and payable.

Collectibility is probable. To recognize revenue, the Company must judge collectibility of the arrangement fees, which is done on a customer-by-customer basis pursuant to the credit review policy. The Company typically sells to customers with whom there is a history of successful collection. For new customers, the Company evaluates the customer s financial condition and ability to pay. If it is determined that collectibility is not probable based upon the credit review process or the customer s payment history, revenue is recognized when payment is received.

Royalty and license revenue The Company recognizes royalty revenue based on royalty reports or related information received from the licensee and when collectibility is deemed reasonably assured. The terms of the royalty agreements generally require licensees to give the Company notification of royalties within 30 to 45 days of the end of the quarter during which the sales occur. The Company recognizes license fee revenue for licenses to intellectual property when earned under the terms of the agreements. Generally, revenue is recognized on a straight-line basis over the expected term of the license.

Product sales The Company recognizes revenue from the sale of products and the license of associated software if any, and expenses all related costs of products sold, once delivery has occurred and customer acceptance, if required, has been achieved. The Company has determined that the license of software for its medical simulation products is incidental to the product as a whole. The Company typically grants to customers a warranty which guarantees that products will substantially conform to the Company s current specifications for generally twelve months from the delivery date pursuant to the terms of the arrangement. Historically, warranty-related costs have not been significant. Separately priced extended warranty contract revenues are recognized ratably over the contractual period.

Development contracts and other revenue Development contracts and other revenue is comprised of professional services (consulting services and/or development contracts). Professional services revenues are recognized under the proportional performance accounting method based on physical completion of the work to be performed or completed performance method. A provision for losses on contracts is made, if necessary, in the period in which the loss becomes probable and can be reasonably estimated. Revisions in estimates are reflected in the period in which the conditions become known. To date, such losses have not been significant.

Multiple element arrangements The Company enters into multiple element arrangements in which customers purchase a time-based license which include a combination of software and/or intellectual property licenses, professional services and in some cases, post contract customer support. For arrangements that include software and professional services, the services are not essential to the functionality of the software, and customers typically purchase consulting services to facilitate the adoption of the Company s technology, but they may also decide to use their own resources or appoint other professional service organizations to perform these services. Contract fees for professional services and post-contract customer support are not frequently sold on a stand-alone basis and as such, the Company does not have sufficient evidence of fair value. For these arrangements, revenue is recognized over the period of the ongoing obligation which is generally consistent with the contractual term of the time-based license.

The Company s revenue recognition policies are significant because revenues are a key component of the Company s results of operations. In addition, the Company s revenue recognition determines the timing of certain expenses, such as commissions and royalties.

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Recent Accounting Pronouncements

In September 2009, the Financial Accounting Standards Board (FASB) ratified Accounting Standards Update (ASU) 2009-13 (update to ASC 605), Revenue Arrangements with Multiple Deliverables (ASU 2009-13 (update to ASC 605)). This guidance addresses criteria for separating the consideration in multiple-element arrangements. ASU 2009-13 (update to ASC 605) requires companies to allocate the overall consideration to each deliverable by using a best estimate of the selling price of individual deliverables in the arrangement in the absence of vendor-specific objective evidence or other third-party evidence of the selling price. ASU 2009-13 (update to ASC 605) will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 and early adoption will be permitted. The Company is currently evaluating the potential impact, if any, of the adoption of ASU 2009-13 (update to ASC 605) on its condensed consolidated results of operations and financial condition.

In September 2009, the FASB ratified ASU 2009-14 (update to ASC 605), Certain Revenue Arrangements That Include Software Elements (ASU 2009-14 (update to ASC 605)). ASU 2009-14 (update to ASC 605) provides guidance to exclude (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product s essential functionally. ASC 2009-14 (update to ASC 605) has an effective date that is consistent with ASU 2009-13 (update to ASC 605) above. The Company is currently evaluating the potential impact, if any, of the adoption of ASC 2009-14 (update to ASC 605) on its condensed consolidated results of operations and financial condition.

In January 2010, the FASB ratified ASU 2010-06 Fair Value Measurements and Disclosures Improving Disclosures about Fair Value Measurements (ASU 2010-06). ASU 2010-06 requires new disclosures for significant transfers in and out of Level 1 and 2 of the fair value hierarchy and the level of disaggregation of assets or liabilities and the valuation techniques and inputs used to measure fair value. The Company adopted the updated guidance which was effective for the Company s annual reporting period at December 31, 2009, with the exception of new Level 3 activity disclosures, which are effective for interim and annual reporting periods beginning after December 15, 2010. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated results of operations and financial condition.

2. FAIR VALUE MEASUREMENTS

Cash Equivalents, Short-term Investments, and Warrant Derivative Liabilities

The financial instruments of the Company measured at fair value on a recurring basis are cash equivalents, short-term investments, and warrant derivative liabilities. The Company s cash equivalents and short-term investments are generally classified within Level 1 or Level 2 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency.

The types of instruments valued based on quoted market prices in active markets include most U.S. government agency securities and most money market securities. Such instruments are generally classified within Level 1 of the fair value hierarchy.

The types of instruments valued based on quoted prices in markets that are less active, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency and include most investment-grade corporate commercial paper. Such instruments are generally classified within Level 2 of the fair value hierarchy.

The types of instruments valued based on unobservable inputs which reflect the reporting entity s own assumptions that market participants would use in pricing the liability include the warrant derivative liability. Such instruments are generally classified within Level 3 of the fair value hierarchy.

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Financial instruments measured at fair value on a recurring basis as of March 31, 2010 and December 31, 2009 are classified based on the valuation technique in the table below:

	March 31, 2010 Fair value measurements using			
	Level 1	Level 2	Level 3	Total
		(In thousands)		
Assets:				
U.S. government agency securities	$ 43,926	$	$	$ 43,926
Money market accounts	15,080			15,080
Total assets at fair value	$ 59,006	$	$	$ 59,006

The above table excludes $5.6 million of cash held in banks.

	December 31, 2009 Fair value measurements using			
	Level 1	Level 2	Level 3	Total
		(In thousands)		
Assets:				
U.S. government agency securities	$ 49,071	$	$	$ 49,071
Money market accounts	11,546			11,546
Total assets at fair value	$ 60,617	$	$	$ 60,617

The above table excludes $3.1 million of cash held in banks.

Short-term Investments

	March 31, 2010			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
		(In thousands)		
U.S. government agency securities	$ 43,914	$ 12	$	$ 43,926
Total	$ 43,914	$ 12	$	$ 43,926

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	December 31, 2009			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
	(In thousands)			
U.S. government agency securities	$ 43,935	$ 2	$ (37)	$ 43,900
Total	$ 43,935	$ 2	$ (37)	$ 43,900

The contractual maturities of the Company s available-for-sale securities on March 31, 2010 and December 31, 2009 were all due in one year or less except for one government agency security of $5 million at December 31, 2009 due in two years.

3. INVENTORIES

	March 31, 2010	December 31, 2009
	(In thousands)	
Raw materials and subassemblies	$ 340	$ 1,653
Work in process	3	45
Finished goods	301	303
Inventories	$ 644	$ 2,001

4. PROPERTY AND EQUIPMENT

	March 31, 2009	December 31, 2009
	(In thousands)	
Computer equipment and purchased software	$ 4,289	$ 4,458
Machinery and equipment	1,345	1,909
Furniture and fixtures	1,253	1,407
Leasehold improvements	1,460	1,458
Total	8,347	9,232
Less accumulated depreciation	(5,613)	(5,734)
Property and equipment, net	$ 2,734	$ 3,498

5. INTANGIBLES AND OTHER ASSETS

	March 31, 2010	December 31, 2009
	(In thousands)	
Patents, technology and trademarks	$ 19,561	$ 19,018
Other assets	223	145
Gross intangibles and other assets	19,784	19,163
Accumulated amortization of patents and technology	(8,475)	(8,266)
Intangibles and other assets, net	$ 11,309	$ 10,897

The Company amortizes its intangible assets related to patents, technology and trademarks, over their estimated useful lives, generally 10 years. The estimated annual amortization expense for intangible assets as of March 31, 2010 is $1.3 million in 2010, $1.4 million in 2011, $1.3 million in 2012, $1.3 million in 2013, $1.2 million in 2014, and $4.9 million in total for all years thereafter.

6. COMPONENTS OF OTHER CURRENT LIABILITIES AND DEFERRED REVENUE AND CUSTOMER ADVANCES

	March 31, 2010	December 31, 2009
	(In thousands)	
Accrued legal	$ 874	$ 509
Income taxes payable	39	40
Other current liabilities	1,898	2,538
Total other current liabilities	$ 2,811	$ 3,087
Deferred revenue	$ 6,850	$ 6,336
Customer advances	78	242
Total deferred revenue and customer advances	$ 6,928	$ 6,578

7. LONG-TERM DEFERRED REVENUE

On March 31, 2010, long-term deferred revenue was $19.2 million and included approximately $17.9 million of deferred revenue from Sony Computer Entertainment. On December 31, 2009, long-term deferred revenue was $18.9 million and included approximately $16.8 million from Sony Computer Entertainment.

8. STOCK-BASED COMPENSATION

Stock Options and Awards

The Company s equity incentive program is a long-term retention program that is intended to attract, retain, and provide incentives for talented employees, consultants, officers, and directors and to align stockholder and employee interests. The Company may grant options, stock appreciation rights, restricted stock, restricted stock units (RSUs), performance shares, performance units, and other stock-based or cash-based awards to employees, directors, and consultants. Under these programs, stock options may be granted at prices not less than the fair market value on the date of grant for stock options. These options generally vest over 4 years and expire 10 years from the date of grant. RSUs generally vest over 3 years. Restricted stock generally vests over one year. On March 31, 2010, 4,307,405 shares of common stock were available for grant, and there were 4,676,054 options to purchase shares of common stock outstanding, as well as 105,055 RSUs and no shares of restricted stock outstanding.

General Stock Option Information

The following table sets forth the summary of option activity under the Company s stock option plans:

	Number of Shares
Outstanding at December 31, 2009 (3,247,607 exercisable at a weighted average price of $9.25 per share)	5,041,235
Granted (weighted average fair value of $2.40 per share)	2,250
Exercised	(3,000)
Forfeited and cancelled	(364,431)
Outstanding at March 31, 2010	4,676,054
Exercisable at March 31, 2010	3,299,061

Restricted Stock Units

Restricted stock unit activity for the three months ended March 31, 2010 is as follows:

	Number of Shares
Beginning balance at December 31, 2009	198,055
Awarded	4,000
Released	(60,542)
Forfeited	(36,458)
Outstanding balance at March 31, 2010	105,055
Expected to vest (1)	74,194

(1) RSUs expected to vest reflect estimated forfeiture rates.

Restricted Stock

Restricted stock activity for the three months ended March 31, 2010 is as follows:

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	Number of Shares
Beginning balance at December 31, 2009	27,000
Awarded	
Released	(27,000)
Forfeited	
Ending balance at March 31, 2010	

The assumptions used to value option grants and shares under the Company s Stock Plans are as follows:

	Three Months Ended March 31,	
Options	**2010**	**2009**
Expected term (in years)	4.9	5.5
Volatility	68%	69%
Interest rate	2.4%	1.8%
Dividend yield		

	Three Months Ended March 31,	
Employee Stock Purchase Plan	**2010**	**2009**
Expected term (in years)		0.5
Volatility		109%
Interest rate		0.4%
Dividend yield		

Total stock-based compensation recognized in the condensed consolidated statements of operations is as follows:

	Three Months Ended March 31,	
	2010	2009
Income Statement Classifications	(In thousands)	
Cost of product sales	$ 10	$ 69
Sales and marketing	166	230
Research and development	196	473
General and administrative	224	632
Total	$ 596	$ 1,404

As of March 31, 2010, there was $7.1 million and $359,000 of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock options and RSUs, respectively, granted to the Company s employees and directors. This cost will be recognized over an estimated weighted-average period of approximately 2.79 years for options and 1.87 years for RSUs. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

Stock Repurchase Program

On November 1, 2007, the Company announced that its board of directors authorized the repurchase of up to $50 million of the Company s common stock. The Company may repurchase its stock for cash in the open market in accordance with applicable securities laws. The timing of and amount of any stock repurchase will depend on share price, corporate and regulatory requirements, economic and market conditions, and other factors. The stock repurchase authorization has no expiration date, does not require the Company to repurchase a specific number of shares, and may be modified, suspended, or discontinued at any time. During the three months ended March 31, 2010 and 2009, there were no stock repurchases under this program.

9. DIVESTITURE, RESTRUCTURING COSTS, AND DISCONTINUED OPERATIONS

Divestiture

On March 30, 2010, the Company entered into and closed an Asset Purchase Agreement, a Transition Services Agreement and a License Agreement (collectively the Transaction) with CAE Healthcare USA (CAE). Under the Asset Purchase Agreement, CAE will acquire certain assets including inventory and fixed assets and certain liabilities including warranty liabilities of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines used in the field of medical training for an approximate amount of $1.6 million subject to purchase price adjustments for final inventory. The agreement also provides for the transfer of certain employees to CAE as well as distribution agreements and customer relationships. Under the transition services agreement, the Company will provide certain back-office services to CAE for up to nine months and will be reimbursed for the expenses incurred for such services. Under the license agreement, the Company has licensed to CAE the Immersion TouchSense patent portfolio within a specific field of use. As such, revenues and costs for the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines have been included in operating income in the accompanying condensed consolidated statements of operations through the date of sale. Although the Company is ceasing to manufacture these three specific product lines, these operating results have not been reported as discontinued operations. The Medical segment will continue with some manufacturing, but the primary focus of the segment s cash flows will change from simulation product sales to licensing fees. During the quarter ended March 31, 2010, the Company recognized a pre-tax loss of approximately $45,000 in continuing operations in connection with this Transaction. The cost reimbursements to be received under the Transition Services Agreement will be recorded as an off-set to

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the related operating expense line items. The Company will receive quarterly payments under the license arrangement starting July 1, 2010. Under the terms of the Company s revenue recognition policy for transactions with extended payment terms such as this, the Company does not recognize revenue until the amounts become due and payable and all other criteria are met. In connection with the transaction, we agreed to indemnify CAE for certain liabilities, claims, and other specified items in the asset purchase agreement.

Restructuring Costs

On March 2, 2009, the Company announced that it was relocating its Medical business operations from Gaithersburg, Maryland to San Jose, California. The Company had workforce reductions that were recorded as Medical segment restructuring charges for the three months ended March 31, 2009. Workforce reduction costs consisted of severance benefits of $166,000 which were included in accrued compensation on the Company s condensed consolidated balance sheet at March 31, 2009. Total costs for the relocation of the Medical business operations and the workforce reductions were $935,000 for the year ended December 31, 2009 and no further costs are expected. All of these restructuring costs were paid by December 31, 2009.

In addition, for the first three months ended March 31, 2009, there were reorganizations in the Company s Touch segment due to business changes causing workforce reductions that resulted in restructuring charges of $480,000. Total costs for these reorganizations were $527,000 for the year ended December 31, 2009 and no further costs are expected. All of these restructuring costs were paid by December 31, 2009.

Results of Discontinued Operations

On November 17, 2008, the Company announced that it would divest its 3D product line which was part of its Touch segment. The Company s 3D product line consisted of a variety of products in the area of 3D digitizing, 3D measurement and inspection, and 3D interaction and included products such as MicroScribe digitizers, the CyberGlove family of products, and a SoftMouse 3D positioning device. In the three months ended March 31, 2009, the Company sold its CyberGlove and SoftMouse 3D positioning device product families including inventory, fixed assets, and intangibles and has recorded a gain on sale of discontinued operations of $167,000. Negotiated consideration for the sale was $900,000 in the form of cash and notes receivable. This consideration will be recognized upon receipt of cash. The Company has abandoned all other 3D operations. Accordingly, the operations of the 3D product line have been classified as discontinued operations, net of income tax, in the condensed consolidated statement of operations. In the three months ended March 31, 2010, the Company recorded a gain on sale of discontinued operations of $30,000 from additional payments from the sale of our 3D family of products.

10. INTEREST AND OTHER INCOME

In 2007, the Company granted a license to Sony Computer Entertainment pursuant to the litigation conclusion agreement with them that required payments of $22.5 million to the Company over the three years ended December 31, 2009. Upon execution of this agreement, the Company recorded the then present value of these installments in the amount of $20.2 million and has recognized the resulting difference as interest income over the payment term.

In January 2009, the Company adopted accounting guidance that provided that an entity should use a two step approach to evaluate whether an equity-linked financial instrument is indexed to its own stock, including evaluating the instrument s contingent exercise and settlement provisions. The Company had warrants to purchase shares that had an adjustment feature that allowed for a change in the number of shares subject to issuance and a change in the exercise price under certain circumstances. Quarterly, the Company recalculated the fair value of its warrants using the Black-Scholes option pricing model. For the three months ending March 31, 2009, the change in the fair value of the warrant liability was $480,000.

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11. INCOME TAXES

For the three months ended March 31, 2010, the Company recorded an income tax provision of $(339,000) on pre-tax loss from continuing operations of $(2.3) million, yielding an effective tax rate of (14.5)%. For the three months ended March 31, 2009, the Company recorded an income tax provision of $(91,000) on a pre-tax loss from continuing operations of $(6.4) million, yielding an effective tax rate of (1.4)%. The effective tax rate differs from the statutory rate primarily due to the valuation allowance, foreign withholding taxes, and unrecognized tax benefits. The income tax provision or benefit for the three months ended March 31, 2010 and 2009, are as a result of applying the estimated annual effective tax rate to loss from continuing operations before taxes, adjusted for certain discrete items which are fully recognized in the period they occur.

As of March 31, 2010, the Company has unrecognized tax benefits of approximately $657,000, including interest of $29,000. The total amount of unrecognized tax benefits that would affect the Company s effective tax rate, if recognized, is $228,000. There were no material changes in the amount of unrecognized tax benefits during the quarter ended March 31, 2010. The Company does not expect any material changes to its liability for unrecognized tax benefits during the next twelve months. The Company s policy is to account for interest and penalties related to uncertain tax positions as a component of income tax provision.

Because the Company has net operating loss and credit carryforwards, there are open statutes of limitations in which federal, state, and foreign taxing authorities may examine the Company s tax returns for all years from 1993 through the current period.

During 2008, the Company recorded a valuation allowance for the entire deferred tax asset as a result of uncertainties regarding the realization of the asset balance due to losses in fiscal 2008, the variability of operating results, and near term projected results. These uncertainties regarding the realization of the asset balance remained through the end of the current quarter. In the event that the Company determines the deferred tax assets are realizable, an adjustment to the valuation allowance may increase income in the period such determination is made. The valuation allowance does not impact the Company s ability to utilize the underlying net operating loss carryforwards.

12. NET LOSS PER SHARE

The following is a reconciliation of the numerators and denominators used in computing basic and diluted net loss per share (in thousands, except per share amounts):

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	Three Months Ended, March 31,	
	2010	**2009**
Numerator:		
Loss from continuing operations	$ (2,685)	$ (6,512)
Gain from discontinued operations	31	402
Net loss	$ (2,654)	$ (6,110)
Denominator:		
Shares used in computation, basic and diluted (weighted average common shares outstanding)	28,022	27,924
Basic and diluted net loss per share:		
Continuing operations	$ (0.10)	$ (0.23)
Discontinued operations	0.01	0.01
Total	$ (0.09)	$ (0.22)

As of March 31, 2010 and 2009, the Company had securities outstanding that could potentially dilute basic earnings per share in the future, but these were excluded from the computation of diluted net loss per share in the periods presented since their effect would have been anti-dilutive. These outstanding securities consisted of the following:

	March 31, 2010	March 31, 2009
Outstanding stock options	4,676,054	7,325,914
Restricted stock and RSUs	105,055	287,787
Warrants		431,243

13. COMPREHENSIVE LOSS

The following table sets forth the components of comprehensive loss:

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	Three Months Ended March 31,	
	2010	2009
	(In thousands)	
Net loss	$ (2,654)	$ (6,110)
Change in unrealized losses on short-term investments	47	(2)
Foreign currency translation adjustment		(67)
Total comprehensive loss	$ (2,607)	$ (6,179)

14. SEGMENT REPORTING

The Company develops, manufactures, licenses, and supports a wide range of hardware and software technologies that more fully engage users sense of touch when operating digital devices. The Company focuses on the following target application areas: automotive, consumer electronics, entertainment, gaming, and commercial and industrial controls; medical; and mobile communications. The Company manages these application areas under two operating and reportable segments: Touch and Medical.

The Company s chief operating decision maker (CODM) is the Chief Executive Officer. The CODM allocates resources to and assesses the performance of each operating segment using information about its revenue and operating income (loss). A description of the types of products and services provided by each operating segment is as follows:

Touch develops and markets touch feedback technologies that enable software and hardware developers to enhance realism and usability in their mobility, computing, entertainment, and industrial applications. Medical develops and markets touch feedback technologies that enable software and hardware developers to recreate realistic healthcare environments.

The following tables display information about the Company s reportable segments:

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	Three Months Ended March 31, 2010	2009
	(In thousands)	
Revenues:		
Touch	$ 6,843	$ 4,475
Medical	2,876	3,066
Intersegment eliminations	(10)	(35)
Total	$ 9,709	$ 7,506
Operating Loss:		
Touch	$ (1,021)	$ (5,016)
Medical	(1,399)	(2,186)
Intersegment eliminations	(5)	(1)
Total	$ (2,425)	$ (7,203)

	March 31, 2010	December 31, 2009
	(In thousands)	
Total Assets:		
Touch	$ 124,134	$ 122,548
Medical	3,728	6,294
Intersegment eliminations	(41,821)	(41,008)
Total	$ 86,041	$ 87,834

15. CONTINGENCIES

In re Immersion Corporation Initial Public Offering Securities Litigation

The Company is involved in legal proceedings relating to a class action lawsuit filed on November 9, 2001 in the U. S. District Court for the Southern District of New York, In re Immersion Corporation Initial Public Offering Securities Litigation, No. Civ. 01-9975 (S.D.N.Y.), related to In re Initial Public Offering Securities Litigation, No. 21 MC 92 (S.D.N.Y.). The named defendants are the Company and three of its current or former officers or directors (the Immersion Defendants), and certain underwriters of its November 12, 1999 initial public offering (IPO). Subsequently, two of the individual defendants stipulated to a dismissal without prejudice.

The operative amended complaint is brought on purported behalf of all persons who purchased the Company s common stock from the date of the Company s IPO through December 6, 2000. It alleges liability under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, on the grounds that the registration statement for the IPO did not disclose that: (1) the underwriters agreed to allow certain customers to purchase shares in the IPO in exchange for excess commissions to be paid to the underwriters; and (2) the underwriters arranged for certain customers to purchase additional shares in the aftermarket at predetermined prices. The complaint also appears to

allege that false or misleading analyst reports were issued. The complaint does not claim any specific amount of damages.

Similar allegations were made in other lawsuits challenging over 300 other initial public offerings and follow-on offerings conducted in 1999 and 2000. The cases were consolidated for pretrial purposes. On February 19, 2003, the District Court ruled on all defendants motions to dismiss. The motion was denied as to claims under the Securities Act of 1933 in the case involving Immersion as well as in all other cases (except for 10 cases). The motion was denied as to the claim under Section 10(b) as to the Company, on the basis that the complaint alleged that the Company had made acquisition(s) following the IPO. The motion was granted as to the claim under Section 10(b), but denied as to the claim under Section 20(a), as to the remaining individual defendant.

In September 2008, all of the parties to the lawsuits reached a settlement, subject to documentation and approval of the District Court. The Immersion Defendants would not be required to contribute to the settlement. Subsequently, an underwriter defendant filed for bankruptcy and other underwriter defendants were acquired. On April 2, 2009, final documentation evidencing the settlement was presented to the District Court for approval. If the settlement is not approved by the District Court, the Company intends to defend the lawsuit vigorously.

Immersion Corporation v. Mentice AB, Mentice SA, Simbionix USA Corp., and Simbionix Ltd.

On April 16, 2008, the Company announced that its wholly owned subsidiary, Immersion Medical, Inc., filed lawsuits for patent infringement in the United States District Court for the Eastern District of Texas against Mentice AB, Mentice SA, Simbionix USA Corp., and Simbionix Ltd (collectively the Defendants), seeking damages and injunctive relief. On July 11, 2008, Mentice AB and Mentice SA (collectively, Mentice) answered the complaint by denying the material allegations and alleging counterclaims seeking a judicial declaration that the asserted patents were invalid, unenforceable, or not infringed. On July 11, 2008, Simbionix USA Corp. and Simbionix Ltd, (collectively, Simbionix) filed a motion to stay or dismiss the lawsuit, and a motion to transfer venue for convenience to the Northern District of Ohio. On September 29, 2009, the court granted Simbionix s motion to transfer the case. On December 7, 2009, the case was transferred to the Northern District of Ohio. The court has not set a trial schedule. On April 15, 2010, Mentice AB, Mentice SA, and Xitact SA (a/k/a Mentice SA) filed a counterclaim against the Company.

In re Immersion Corporation Securities Litigation

In September and October 2009, various putative shareholder class action and derivative complaints were filed in federal and state court against the Company and certain current and former Immersion directors and officers.

On September 2, 2009, a securities class action complaint was filed in the United States District Court for the Northern District of California against the Company and certain of its current and former directors and officers. Over the following five weeks, four additional class action complaints were filed. (One of these four actions was later voluntarily dismissed.) The securities class action complaints name the Company and certain current and former Immersion directors and officers as defendants and allege violations of federal securities laws based on the Company s issuance of allegedly misleading financial statements. The various complaints assert claims covering the period from May 2007 through July 2009 and seek compensatory damages allegedly sustained by the purported class members.

On December 21, 2009, these class actions were consolidated by the court as In Re Immersion Corporation Securities Litigation. On the same day, the court appointed a lead plaintiff and lead plaintiff s counsel. Following our restatement of financial statements, lead plaintiff filed a consolidated complaint on April 9, 2010, as to which Defendants will file a responsive pleading by June 8, 2010.

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In re Immersion Corporation Derivative Litigation

On September 15, 2009, a putative shareholder derivative complaint was filed in the United States District Court for the Northern District of California, purportedly on behalf of the Company and naming certain of its current and former directors and officers as individual defendants. Thereafter, two additional putative derivative complaints were filed in the same court.

The derivative complaints arise from the same or similar alleged facts as the federal securities actions and seek to bring state law causes of action on behalf of the Company against the individual defendants for breaches of fiduciary duty, gross negligence, abuse of control, gross mismanagement, breach of contract, waste of corporate assets, unjust enrichment, as well as for violations of federal securities laws. The federal derivative complaints seek compensatory damages, corporate governance changes, unspecified equitable and injunctive relief, the imposition of a constructive trust, and restitution. On November 17, 2009, the court consolidated these actions as In re Immersion Corporation Derivative Litigation and appointed lead counsel. The court has issued an order staying this action.

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On October 7, 2009, a putative shareholder derivative complaint was filed in the Superior Court of the State of California for the County of Santa Clara, purportedly on behalf of the Company, seeking compensatory damages, equitable and injunctive relief, and restitution. The complaint names certain current and former directors and officers of the Company as individual defendants. This complaint arises from the same or similar alleged facts as the federal securities actions and seeks to bring causes of action on behalf of the Company against the individual defendants for breaches of fiduciary duty, waste of corporate assets and unjust enrichment. The court has issued an order staying this action.

The Company cannot predict the ultimate outcome of the above-mentioned federal and state actions, and it is unable to estimate any potential liability it may incur.

Other Contingencies

From time to time, the Company receives claims from third parties asserting that the Company s technologies, or those of its licensees, infringe on the other parties intellectual property rights. Management believes that these claims are without merit. Additionally, periodically, the Company is involved in routine legal matters and contractual disputes incidental to its normal operations. In management s opinion, the resolution of such matters will not have a material adverse effect on the Company s consolidated financial condition, results of operations, or liquidity.

In the normal course of business, the Company provides indemnifications of varying scope to customers against claims of intellectual property infringement made by third parties arising from the use of the Company s intellectual property, technology, or products. Historically, costs related to these guarantees have not been significant, and the Company is unable to estimate the maximum potential impact of these guarantees on its future results of operations.

As permitted under Delaware law, the Company has agreements whereby it indemnifies its officers and directors for certain events or occurrences while the officer or director is, or was, serving at its request in such capacity. The term of the indemnification period is for the officer s or director s lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company currently has director and officer insurance coverage that limits its exposure and enables it to recover a portion of any future amounts paid. Management believes the estimated fair value of these indemnification agreements in excess of applicable insurance coverage is indeterminable.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The forward-looking statements involve risks and uncertainties. Forward-looking statements are identified by words such as anticipates, believes, expects, intends, may, will, and other similar expressions. However, these words are only way we identify forward-looking statements. In addition, any statements, which refer to expectations, projections, or other characterizations of future events, or circumstances, are forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, including those set forth below in Management s Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors, those described elsewhere in this report, and those described in our other reports filed with the SEC. We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report, and we undertake no obligation to update these forward-looking statements after the filing of this report. You are urged to review carefully and consider our various disclosures in this report and in our other reports publicly disclosed or filed with the SEC that attempt to advise you of the risks and factors that may affect our business.

OVERVIEW

We are a leading provider of haptic technologies that allow people to use their sense of touch more fully when operating a wide variety of digital devices. To achieve this heightened interactivity, we develop and manufacture or license a wide range of hardware and software technologies and products. While we believe that our technologies are broadly applicable, we are currently focusing our marketing and business development activities on the following target application areas: automotive, consumer electronics, entertainment, gaming, and commercial and industrial controls; medical simulation and devices; and mobile communications. We manage these application areas under two operating and reportable segments: 1) Touch and 2) Medical.

In some markets, such as video console gaming, mobile phones, automotive controls, and medical we license our technologies to manufacturers who use them in products sold under their own brand names. In other markets, such as medical simulation we have sold products manufactured under our own brand name through direct sales to end users, distributors, OEMs, or value-added resellers. We are currently shifting from manufacturing products and moving to a licensing model. From time to time, we have also engaged in development projects for third parties.

In the three months ended March 31, 2009, we divested our 3D product line which was part of our Touch segment. We ceased operations of the 3D product line and sold our MicroScribe, CyberGlove and SoftMouse 3D positioning device product families. We have abandoned all other 3D operations. On March 30, 2010, we sold certain assets including inventory and fixed assets and certain liabilities of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines and transferred certain employees to CAE as well as distribution agreements and customer relationships. After that time we stopped shipping and wound down the sales of these lines of medical simulation products. However, we expect to continue to receive revenue due to our licensing agreement with CAE pertaining to haptic-based technology in medical training applications.

Our objective is to drive adoption of our touch technologies across markets and applications to improve the user experience with digital devices and systems. We and our wholly owned subsidiaries hold over 900 issued or pending patents in the U.S. and other countries, covering various aspects of hardware and software technologies.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates and assumptions, including those related to revenue recognition, stock-based compensation, bad debts, inventory reserves, short-term investments, warranty obligations, patents and intangible assets, contingencies, and litigation. We base our estimates and assumptions on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates and assumptions.

We believe the following are our most critical accounting policies as they require our significant judgments and estimates in the preparation of our condensed consolidated financial statements:

Revenue Recognition

We recognize revenues in accordance with applicable accounting standards, including Accounting Standards Codification (ASC) 605-10-S99, Revenue Recognition (ASC 605-10-S99); ASC 605-25, Multiple Element Arrangements (ASC 605-25); and ASC 985-605, Software-Revenue Recognition (ASC 985-605). We derive our revenues from three principal sources: royalty and license fees, product sales, and development contracts. As described below, significant management judgments and estimates must be made and used in connection with the revenue recognized in any accounting period. Material differences may result in the amount and timing of our revenue for any period based on the judgments and estimates made by our management. Specifically, in connection with each transaction involving our products, we must evaluate whether: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable, and (iv) collectibility is probable. We apply these criteria as discussed below.

Persuasive evidence of an arrangement exists: For a license arrangement, we require a written contract, signed by both the customer and us. For a stand-alone product sale, we require a purchase order or other form of written agreement with the customer.

Delivery has occurred. We deliver software and product to our customers physically and deliver software also electronically. For physical deliveries not related to software, our transfer terms typically include transfer of title and risk of loss at our shipping location. For electronic deliveries, delivery occurs when we provide the customer access codes or keys that allow the customer to take immediate possession of the software.

The fee is fixed or determinable. Our arrangement fee is based on the use of standard payment terms which are those that are generally extended to the majority of customers. For transactions involving extended payment terms, we deem these fees not to be fixed or determinable for revenue recognition purposes and revenue is deferred until the fees become due and payable.

Collectibility is probable. To recognize revenue, we must judge collectibility of the arrangement fees, which we do on a customer-by-customer basis pursuant to our credit review policy. We typically sell to customers with whom we have a history of successful collection. For new customers, we evaluate the customer s financial condition and ability to pay. If we determined that collectibility is not probable based upon our credit review process or the customer s payment history, we recognize revenue when payment is received.

Royalty and license revenue We recognize royalty revenue based on royalty reports or related information received from the licensee and when collectibility is deemed reasonably assured. The terms of the royalty agreements generally require licensees to give us notification of royalties within 30 to 45 days of the end of the quarter during which the sales occur. We recognize license fee revenue for licenses to our intellectual property when earned under the terms of the agreements. Generally, revenue is recognized on a straight-line basis over the expected term of the license.

Product sales We recognize revenue from the sale of products and the license of associated software if any, and expense all related costs of products sold, once delivery has occurred and customer acceptance, if required, has been achieved. We have determined that the license of software for the medical simulation products is incidental to the product as a whole. We typically grant our customers a warranty which guarantees that our products will substantially conform to our current specifications for generally twelve months from the delivery date pursuant to the terms of the arrangement. Historically, warranty-related costs have not been significant. Separately priced extended warranty contract revenues are recognized ratably over the contractual period.

Development contracts and other revenue Development contracts and other revenue is comprised of professional services (consulting services and/or development contracts). Professional services revenues are recognized under the proportional performance accounting method based on physical completion of the work to be performed or completed performance method. A provision for losses on contracts is made, if necessary, in the period in which the loss becomes probable and can be reasonably estimated. Revisions in estimates are reflected in the period in which the conditions become known. To date, such losses have not been significant.

Multiple element arrangements We enter into multiple element arrangements in which customers purchase a time-based license which include a combination of software and/or intellectual property licenses, professional services and in some cases, post contract customer support. For arrangements that include software and professional services, the services are not essential to the functionality of the software, and customers typically purchase consulting services to facilitate the adoption of our technology, but they may also decide to use their own resources or appoint other professional service organizations to perform these services. Contract fees for professional services and post-contract customer support are not frequently sold on a stand-alone basis and as such, we do not have sufficient evidence of fair value. For these arrangements, revenue is recognized over the period of the ongoing obligation which is generally consistent with the contractual term of the time-based license.

Our revenue recognition policies are significant because our revenues are a key component of our results of operations. In addition, our revenue recognition determines the timing of certain expenses, such as commissions and royalties.

Stock-based Compensation Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period.

Valuation and amortization method We use the Black-Scholes model, single-option approach to determine the fair value of stock options and ESPP shares. All share-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include actual and projected employee stock option exercise behaviors that impact the expected term and forfeiture rates, our expected stock price volatility over the term of the awards, risk-free interest rate, and expected dividends.

If factors change and we employ different assumptions for estimating stock-based compensation expense in future periods, or if we decide to use a different valuation model, the future periods may differ significantly from what we have recorded in the current period and could materially affect our operating results.

The Black-Scholes model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable, characteristics not present in our option grants and ESPP shares. Existing valuation models, including the Black-Scholes and lattice binomial models, may not provide reliable measures of the fair values of our stock-based compensation. Consequently, there is a risk that our estimates of the fair values of our stock-based compensation awards on the grant dates may bear little resemblance to the actual values realized upon the exercise, expiration, early termination, or forfeiture of those stock-based payments in the future. Certain stock-based payments, such as employee stock options, may expire and be worthless or otherwise result in zero intrinsic value as compared to the fair values originally estimated on the grant date and reported in our financial statements. Alternatively, value may be realized from these instruments that are significantly higher than the fair values originally estimated on the grant date and reported in our financial statements. There currently is no market-based mechanism or other practical application to verify the reliability and accuracy of the estimates stemming from these valuation models, nor is there a means to compare and adjust the estimates to actual values.

See Note 8 to the condensed consolidated financial statements for further information regarding stock compensation disclosures.

Accounting for Income Taxes

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized and are reversed at such time that realization is believed to be more likely than not.

Our judgments, assumptions, and estimates relative to the current provision for income tax take into account current tax laws, our interpretation of current tax laws, and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. We have established reserves for income taxes to address potential exposures involving tax positions that could be challenged by tax authorities. Although we believe our judgments, assumptions, and estimates are reasonable, changes in tax laws or our interpretation of tax laws and any future tax audits could significantly impact the amounts provided for income taxes in our condensed consolidated financial statements.

Our assumptions, judgments, and estimates relative to the value of a deferred tax asset take into account predictions of the amount and category of future taxable income, such as income from operations or capital gains income. Actual operating results and the underlying amount and category of income in future years could render inaccurate our current assumptions, judgments, and estimates of recoverable net deferred tax assets. Any of the assumptions, judgments, and estimates mentioned above could cause our actual income tax obligations to differ from our estimates, thus materially impacting our financial position and results of operations.

Short-term Investments

Our short-term investments consist primarily of highly liquid commercial paper and government agency securities purchased with an original or remaining maturity of greater than 90 days on the date of purchase. We classify all debt securities with readily determinable market values as available-for-sale . Even though the stated maturity dates of these debt securities may be one year or more beyond the balance sheet date, we have classified all debt securities as short-term investments as they are available for current operations and reasonably expected to be realized in cash or sold within one year. These investments are carried at fair market value with unrealized gains and losses considered to be temporary in nature reported as a separate component of other comprehensive income (loss) within stockholders equity.

In April 2009, new accounting guidance revised the impairment model for debt securities by modifying the current intent and ability indicator in determining whether a debt security is other-than-temporary impaired. For debt securities in an unrealized loss position, we are required to assess whether (i) we have the intent to sell the debt security or (ii) it is more likely than not that we will be required to sell the debt security before its anticipated recovery. If either of these conditions is met, an other-than-temporary impairment on the security must be recognized in earnings equal to the entire difference between its fair value and amortized cost basis.

For debt securities in an unrealized loss position which are deemed to be other-than-temporary where neither of the criteria in the paragraph above are present, the difference between the security s then-current amortized cost basis and fair value is separated into (i) the amount of the impairment related to the credit loss (i.e. the credit loss component) and (ii) the amount of the impairment related to all other factors (i.e., the non-credit loss component). The credit loss component is recognized in earnings. The non-credit loss component is recognized in accumulated other comprehensive loss. The credit loss component is the excess of the amortized cost of the security over the best estimate of the present value of the cash flows expected to be collected from the debt security. The non-credit component is the residual amount of the other-than-temporary impairment. Prior to the new accounting guidance, in all cases, if an impairment was determined to be other-than-temporary, then an impairment loss was recognized in earnings in an amount equal to the entire difference between the security s amortized cost basis and its fair value.

When calculating the present value of expected cash flows to determine the credit loss component of the other-than-temporary impairment, we estimate the amount and timing of projected cash flows on a security-by-security basis. These calculations reflect our expectations of the performance of the underlying collateral and of the issuer to meet payment obligations as applicable. The expected cash flows are discounted using the effective interest rate of the security prior to any impairment. The amortized cost basis of a debt security is adjusted for credit losses recorded to earnings. The difference between the cash flows expected to be collected and the new cost basis is accreted to investment income over the remaining expected life of the security.

Further information about short-term investments may be found in Note 2 to the condensed consolidated financial statements.

Recovery of Accounts Receivable

We maintain allowances for doubtful accounts for estimated losses resulting from our review and assessment of our customers ability to make required payments. If the financial condition of one or more of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances might be required.

Inventory Valuation

We reduce our inventory value for estimated obsolete and slow moving inventory in an amount equal to the difference between the cost of inventory and the net realizable value based upon assumptions about future demand and market conditions. If actual future demand and market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Intangible Assets

We have acquired patents and other intangible assets. In addition, we capitalize the external legal and filing fees associated with patents and trademarks. We assess the recoverability of our intangible assets, and we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets that affect our condensed consolidated financial statements. If these estimates or related assumptions change in the future, we may be required to record impairment charges for these assets. We amortize our intangible assets related to patents and trademarks, once they are issued, over their estimated useful lives, generally 10 years. Future changes in the estimated useful life could affect the amount of future period amortization expense that we will incur. During the first three months of 2010, we capitalized costs associated with patents and trademarks of $569,000. Our total amortization expense for the same period was $215,000.

Restructuring Costs

We calculate our restructuring costs based upon our estimate of workforce reduction costs, asset impairment charges, and other appropriate charges resulting from a restructuring. Based on our assumptions, judgments, and estimates, we determine whether we need to record an impairment charge to reduce the value of the asset carried on our balance sheet to its estimated fair value. Assumptions, judgments and estimates about future values are complex and often subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in our business strategy.

The above listing is not intended to be a comprehensive list of all of our accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP, with no need for management s judgment in its application. There are also areas in which management s judgment in selecting any available alternative would not produce a materially different result.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009

The following discussion and analysis includes our results of operations from continuing operations for the three months ended March 2010 and 2009. A separate discussion of the 3D product line under discontinued operations has been presented following our analysis of continuing operations. Accordingly, the sales, gross profit, sales and marketing expense, and income tax provision from our discontinued operations have been aggregated and reported as loss from discontinued operations and are not a component of the aforementioned continuing operations discussion. The operating results for the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines have been included in continuing operations in the accompanying condensed consolidated financial statements. Although the Company is ceasing to manufacture these three specific product lines, these operating results have not been reported as discontinued operations. The Medical segment will continue with some manufacturing, but the primary focus of the segment s cash flows will change from simulation product sales to licensing fees.

Overview

We had a 29% increase in revenues from continuing operations during the three months ended March 31, 2010 as compared to the three months ended March 31, 2009. The first quarter revenue increase was primarily due to a 69% increase in royalty and license revenue primarily due to increased royalty and license fees from our mobility, gaming, touchscreen, integrated circuit, automotive, and medical licensees, partially offset by a 9% decrease in product sales and a 24% decrease in development contract revenues. With increased gross margin from our increased licensing revenue and reduced expenses, our net loss from continuing operations was $2.7 million for the three months ended March 31, 2010 compared to a loss from continuing operations of $6.5 million for the three months ended March 31, 2009.

In February, 2010, we announced plans to focus primarily on a licensing model in the future. On March 30, 2010 we entered into an agreement with CAE and sold certain assets of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines for approximately $1.6 million and had a loss on the transaction of $45,000. The agreement also provided for the transfer of approximately 34 employees and contractors to CAE as well as distribution agreements and customer relationships. We also entered into a licensing agreement with CAE for the Immersion TouchSense patent portfolio for use in the field of Medical Training.

With the divestiture of these product lines, and the plan to pursue the medical segment via a licensing approach, the manufacturing and selling of simulator products to the medical training industry will be significantly reduced, and therefore, we hope to achieve certain cost reductions in 2010. Revenue in 2009 for these product lines was approximately $6 million. In 2010, we also expect to continue to focus on the execution of plans in our established businesses to increase revenue and make selected investments for longer-term growth areas. Our success could be limited by several factors, including the current macro-economic climate, the timely release of our new technology and our licensees products, continued market acceptance of our technology and our licensee s products, the introduction of new products by existing or new competitors, and the cost of ongoing litigation. For a further discussion of these and other risk factors, see Item 1A Risk Factors.

Three Months Ended March 31, 2010 Compared to Three Months Ended March 31, 2009

REVENUES	**March 31, 2010**	**2009**	**Change**
	($ In thousands)		
Three months ended:			
Royalty and license	$ 6,403	$ 3,781	69%
Product sales	2,968	3,279	(9)%
Development contracts and other	338	446	(24)%
Total Revenue	$ 9,709	$ 7,506	29%

Total Revenue Our total revenue from continuing operations for the first quarter of 2010 increased by $2.2 million or 29% from the first quarter of 2009.

Royalty and license revenue Royalty and license revenue is comprised of royalties earned on sales by our TouchSense licensees and license fees charged for our intellectual property portfolio. Royalty and license revenue for the three months ended March 31, 2010 was $6.4 million, an increase of $2.6 million or 69% from the three months ended March 31, 2009. The increase in royalty and license revenue was primarily due to increases in royalty and license revenue from our Touch and Medical segments including that from mobility, gaming, touchscreen, integrated circuit, automotive, and medical licensees. We expect royalty revenue to be a significant component of our revenue as our technology continues to be included in more products.

Based on our litigation conclusion and business agreement entered into with Sony Computer Entertainment in March 2007, we are recognizing a minimum of $30.0 million as royalty and license revenue from March 2007 through March 2017, which amounts to approximately $750,000 per quarter.

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Product sales Product sales for the three months ended March 31, 2010 were $3.0 million, a decrease of $311,000 or 9% as compared to the three months ended March 31, 2009. The decrease in product sales was mainly due to a decrease in medical product sales of $304,000. Decreased medical product sales was primarily due to decreased sales of our Virtual IV product. On March 30, 2010 we entered into an agreement with CAE and sold certain assets and divested the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines. With the divestiture of these product lines, and the plan to pursue the medical segment via a licensing approach, the sales of simulator products to the medical training industry will be significantly reduced. Revenue for the year ended December 31, 2009 and for the quarter ended March 31, 2010 for these product lines were approximately $6 million and $2 million, respectively.

Development contract and other revenue Development contract and other revenue is comprised of revenue on commercial contracts and extended support contracts. Development contract and other revenue was $338,000 during the three months ended March 31, 2010, a decrease of $108,000 or 24% compared to the three months ended March 31, 2009. The decrease was mainly attributable to a decrease in Touch contract revenue. We continue to transition our engineering resources from certain commercial development contract efforts to technology and product development efforts that focus on leveraging our existing sales and channel distribution capabilities.

We categorize our geographic information into four major regions: North America, Europe, Far East, and Rest of the World. In the first three months of 2010, revenue generated in North America, Europe, Far East, and Rest of the World represented 30%, 25%, 43%, and 2%, respectively, compared to 48%, 25%, 25%, and 2%, respectively, for the first three months of 2009. The shift in revenues among regions was mainly due to an increase in Touch royalty revenue and Medical product sales in the Far East offset by a decrease in Medical product sales in North America. The increase in revenue in the Far East was due primarily to increased royalty and license revenue from licensees of mobile devices, licensees of automotive products, manufacturers of integrated circuits, and manufacturers of other electronic devices.

COST OF PRODUCT SALES	March 31, 2010	2009	Change
	($ In thousands)		
Three months ended:			
Cost of product sales	$1,369	$1,251	9%
% of total product revenue	46%	38%	

Cost of Product Sales Our cost of product sales (exclusive of amortization of intangibles) consists primarily of materials, labor, and overhead. There is no cost of product sales associated with royalty and license revenue or development contract revenue. Cost of product sales from continuing operations was $1.4 million, an increase of $118,000 or 9% for the first three months of 2010 as compared to the first three months of 2009. The increase in cost of product sales was primarily due to increased direct material costs and production costs of $355,000, increased obsolescence expense and scrap of $79,000, and increased freight costs of $53,000, partially offset by reduced overhead costs of $256,000 and reduced physical inventory adjustment expense of $115,000. The increase in direct material costs was mainly the result of one-time lower margin product sales and changes in the product mix. Overhead costs decreased mainly as a result of reduced salary expense from decreased headcount. Cost of product sales increased as a percentage of product revenue to 46% in the first three months of 2010 from 38% in the first three months of 2009. This increase is mainly due to the result of a change in the sales mix of products sold and direct product cost increases mentioned above. With the divestiture of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines, and the plan to pursue the medical segment via a licensing approach, cost of product sales for medical products are expected to decline in absolute dollars in the future since we will have only one product line remaining, the Virtual IV product line.

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OPERATING EXPENSES AND OTHER	March 31, 2010	2009	Change
	($ In thousands)		
Three months ended:			
Sales and marketing	$2,353	$4,284	(45)%
% of total revenue	24%	57%	
Research and development	$2,461	$3,929	(37)%
% of total revenue	25%	52%	
General and administrative	$5,716	$4,384	30%
% of total revenue	59%	58%	
Amortization of intangibles	$ 235	$ 215	9%
% of total revenue	2%	3%	
Restructuring costs	$	$ 646	*%
% of total revenue	*%	9%	

* Not meaningful

Sales and Marketing Our sales and marketing expenses are comprised primarily of employee compensation and benefits costs, advertising, public relations, trade shows, brochures, market development funds, travel, and an allocation of facilities costs. Sales and marketing expenses from continuing operations were $2.4 million, a decrease of $1.9 million or 45% in the first three months of 2010 compared to the comparable period in 2009. The decrease was primarily due to decreased compensation, benefits, and overhead of $1.2 million primarily due to decreased sales and marketing headcount, decreased marketing, advertising, and public relations costs of $380,000, decreased sales and marketing travel expense of $252,000 due to decreased sales and marketing headcount, decreased consulting of $135,000, decreased office and supplies expense of $127,000 partially offset by increased bad debt expense of $87,000. We are taking steps to continue to reduce our sales and marketing expenses. We expect to continue to focus our sales and marketing efforts on mobile device, touchscreen, and medical market opportunities to build greater market acceptance for our touch technologies.

Research and Development Our research and development expenses are comprised primarily of employee compensation and benefits costs, consulting fees, tooling and supplies, and an allocation of facilities costs. Research and development expenses from continuing operations were $2.5 million, a decrease of $1.5 million or 37% in the first three months of 2010 compared to the same period in 2009. The decrease was primarily due to decreased compensation, benefits, and overhead of $1.0 million, decreased consulting costs of $345,000 that supplements our engineering staff, decreased lab and prototyping costs of $64,000, and reduced engineering travel costs of $21,000. The decreased compensation, benefits, and overhead expense was primarily due to decreased research and development headcount. We expect our headcount-related research and development expenses to decrease in 2010 compared to the levels in 2009.

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General and Administrative Our general and administrative expenses are comprised primarily of employee compensation and benefits, legal and professional fees, office supplies, travel, and an allocation of facilities costs. General and administrative expenses from continuing operations were $5.7 million, an increase of $1.3 million or 30% in the first three months of 2010 compared to the same period in 2009. The increase was primarily due to increased legal and professional expenses of $2.1 million, partially offset by decreased compensation benefits and overhead of $702,000, and decreased administrative travel of $89,000. The increased legal and professional expenses were primarily due to increased accounting, audit, and legal costs resulting from our internal investigation and restatement costs of $1.6 million along with increased litigation costs. The decreased compensation benefits and overhead was primarily due to decreased general and administrative headcount. We expect that the dollar amount of general and administrative expenses will continue to be a significant component of our operating expenses. We will continue to incur costs related to litigation as we continue to assert our intellectual property and contractual rights and defend lawsuits brought against us. We are taking steps to continue to reduce our general and administrative expenses.

Amortization and impairment of Intangibles Our amortization and impairment of intangibles is comprised primarily of patent amortization and trademark amortization along with impairment and write off of intangibles. Amortization and impairment of intangibles increased by $20,000 or 9% in the first three months of 2010 compared to the same period in 2009. The increase was primarily attributable to a write off of certain patents.

Restructuring There were no restructuring charges incurred in the first three months of 2010. Restructuring costs for the first three months of 2009 consisted primarily of severance benefits occurring from the reduction of workforce due to the relocation of the Maryland medical business operations to San Jose of $166,000 and severance benefits from the reduction of workforce due to business changes in our Touch segment of $480,000.

Change in fair value of warrant liability In January 2009, we adopted ASC 815-40. ASC 815-40 provides that an entity should use a two step approach to evaluate whether an equity-linked financial instrument is indexed to its own stock, including evaluating the instrument s contingent exercise and settlement provisions. Quarterly we recalculated the fair value of our warrants using the Black-Scholes option pricing model. For the first three months of 2009, the gain from the change in fair value of the warrant liability was $480,000. There is no impact for 2010 or future periods because the warrants expired in December 2009.

Interest and Other Income Interest and other income consist primarily of interest income and dividend income from cash and cash equivalents and short-term investments and gains on sales of short-term investments. Interest and other income decreased by $223,000 in the first three months of 2010 compared to the same period in 2009. This was primarily the result of decreased interest income due to a reduction of accreted interest income from Sony Computer Entertainment as this interest accretion was complete as the final payment was received at the beginning of the current quarter, decreased cash equivalents and short-term investments, and reduced interest rates on cash equivalents and short-term investments.

Provision for Income Taxes We recorded a provision for income taxes for the three months ended March 31, 2010 of $339,000 on pre-tax loss from continuing operations of $2.3 million, yielding an effective tax rate of (14.5)%. For the three months ended March 31, 2009, we recorded a provision for income taxes of $91,000 on pre-tax loss from continuing operations of $6.4 million, yielding an effective tax rate of (1.4)%. The income tax provision for the first three months of 2010 and 2009 are primarily due to foreign withholding tax expense.

Discontinued Operations In the three months ended March 31, 2010, we recorded a gain on sale of discontinued operations of $30,000 from additional payments received from the sale of our 3D family of products.

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This was a decrease of $137,000 from what was recorded in the three months ended March 31, 2009. Loss from discontinued operations, net of tax, decreased by $234,000 to $1,000 in the three months of 2010 compared to the same period in 2009, primarily due to the decrease in activity due to the ceasing of 3D operations in the quarter ended March 31, 2009 resulting in reduced sales volumes and costs and expenses associated with 3D operations during subsequent periods.

SEGMENT RESULTS FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009

We have two operating and reportable segments. One segment, Touch, develops and markets touch feedback technologies that enable software and hardware developers to enhance realism and usability in their mobility, computing, entertainment, and industrial applications. The second segment, Medical, develops and markets touch feedback technologies that enable software and hardware developers to manufacture medical simulation equipment and recreate realistic healthcare environments.

	Three Months Ended March 31,	
	2010	2009
	(In thousands)	
Revenues:		
Touch	$ 6,843	$ 4,475
Medical	2,876	3,066
Intersegment eliminations	(10)	(35)
Total	$ 9,709	$ 7,506
Operating loss:		
Touch	$ (1,021)	$ (5,016)
Medical	(1,399)	(2,186)
Intersegment eliminations	(5)	(1)
Total	$ (2,425)	$ (7,203)

* Note: Segment information may not be indicative of the financial position or results of operations that would have been achieved had these segments operated as unaffiliated entities.

Touch segment Revenues from the Touch segment were $6.8 million, an increase of $2.4 million or 53% in the first three months of 2010 compared to the same period in 2009. Royalty and license revenues increased by

$2.5 million mainly due to increases in royalty and license revenue from mobility, gaming, touchscreen, integrated circuit, and automotive licensees. We expect royalty revenue to be a significant component of our revenue as our technology continues to be included in more products along all lines of our Touch business. Development contract revenue decreased by $109,000 primarily due to decreased development contracts and support mainly from our mobility and automotive customers. Operating loss for the first three months of 2010 was $1.0 million, a decrease of $4.0 million compared to the same period in 2009. The decrease was primarily due to increased gross margin of $2.5 million mainly due to increased royalty and license revenue; a decrease in sales and marketing expenses of $745,000 mainly due to decreased headcount and decreased marketing, advertising, and public relations costs; a decrease in research and development costs of $594,000 mainly due to decreased compensation, benefits, and overhead; and decreased Touch restructuring costs of $480,000. The decreases to the operating loss were partially offset by an increase in general and administrative expenses of $330,000 mainly due to increased accounting, tax, and audit expense partially offset by decreased general and administrative compensation, benefits, and overhead expense due to decreased headcount.

Medical segment Revenues from the Medical segment were $2.9 million, a decrease of $190,000 or 6%, for the first three months of 2010 compared to the same period in 2009. The decrease was primarily due to reduced product sales of $304,000 primarily due to decreased sales of our Virtual IV product. This was partially offset by increases in royalty and license revenue of $112,000 from medical licensees. Operating loss for the first three months of 2010 was $1.4 million, a decrease of $787,000 compared to the same period in 2009. The decrease was mainly due to decreased sales and marketing expenses of $1.2 million mainly due to decreased headcount, decreased research and development expenses of $874,000 mainly due to decreased headcount, and decreased restructuring costs of $166,000. The decreases to the operating loss were partially offset by an increase in general and administrative expenses of $1.0 million and decreased gross margin of $436,000. The increase in general and administrative expenses was mainly due to increased legal, professional, and license fee expenses resulting from our internal investigation and restatement, partially offset by decreased compensation, benefits, and overhead expense due to decreased headcount. The decreased gross margin was due to decreased sales and the change in the sales mix of products sold.

LIQUIDITY AND CAPITAL RESOURCES

Our cash, cash equivalents, and short-term investments consist primarily of money market funds and highly liquid commercial paper and government agency securities. All of our short-term investments are classified as available-for-sale. The securities are stated at market value, with unrealized gains and losses reported as a component of accumulated other comprehensive income, within stockholders equity.

On March 31, 2010, our cash, cash equivalents, and short-term investments totaled $64.6 million, an increase of $902,000 from $63.7 million on December 31, 2009.

In March 2007, we concluded our patent infringement litigation against Sony Computer Entertainment and we received $97.3 million. Furthermore, we entered into a new business agreement under which, we were to receive twelve quarterly installments of $1.875 million for a total of $22.5 million beginning on March 31, 2007 and ending on December 31, 2009. As of March 31, 2010, we have received all twelve of these installments.

Net cash provided by operating activities during the three months ended March 31, 2010 was $242,000, a change of $4.2 million from the $4.0 million used during the three months ended March 31, 2009. Cash provided by operations during the three months ended March 31, 2010 was primarily the result of a $796,000 increase due to a change in accounts receivable, a $783,000 increase due to a change in deferred revenue and customer advances, an increase of $385,000 due to a change in inventories, a $221,000 increase due to changes in prepaid expenses and other assets, and an increase of $145,000 due to a change in other liabilities. These increases were offset by a net loss of $2.7 million and a decrease of $420,000 due to a change in accrued compensation and other current liabilities. Cash provided by operations during the three months ended March 31, 2010 was also impacted by noncash charges and credits of $1.1 million, including $596,000 of noncash stock-based compensation, $296,000 in depreciation and amortization, and $235,000 in amortization and impairment of intangibles.

Net cash provided by investing activities during the three months ended March 31, 2010 was $635,000, compared to the $23.9 million used in investing activities during the three months ended March 31, 2009, an increase of $24.5 million. Net cash provided by investing activities during the period consisted of maturities or sales of short-term investments of $15.0 million and proceeds from divestiture of certain medical lines of business of $1.4 million, partially offset by $15.0 million of purchases of short-term investments; a $680,000 increase in intangibles, primarily due to capitalization of external patent filings and application costs; and an increase of $241,000 used to purchase property and equipment.

There was no net cash provided by or used in financing activities during the three months ended March 31, 2010 compared to $204,000 provided during the three months ended March 31, 2009.

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With our plan to focus on a licensing approach, we hope to achieve certain cost reductions in 2010. We anticipate that capital expenditures for the year ended December 31, 2010 will total less than $1,500,000 in connection with anticipated maintenance and upgrades to operations and infrastructure. Cash flows from our discontinued operations have been included in our condensed consolidated statement of cash flows with continuing operations within each cash flow category. The absence of cash flows from discontinued operations is not expected to affect our future liquidity or capital resources. Additionally, if we acquire one or more businesses, patents, or products, our cash or capital requirements could increase substantially. In the event of such an acquisition, or should any unanticipated circumstances arise that significantly increase our capital requirements, we may elect to raise additional capital through debt or equity financing. Any of these events could result in substantial dilution to our stockholders. There is no assurance that such additional capital will be available on terms acceptable to us, if at all.

SUMMARY DISCLOSURES ABOUT CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The following table reflects a summary of our contractual cash obligations and other commercial commitments as of December 31, 2009 (in thousands):

Contractual Obligations	**Total**	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**More Than 5 Years**
Operating Leases	$ 3,266	$ 737	$ 2,036	$ 493	$

As of March 31, 2010, we had a liability for unrecognized tax benefits totaling $657,000 including interest of $29,000, of which approximately $228,000 could be payable in cash. Due to the uncertainties related to these tax matters, we are unable to make a reasonably reliable estimate when cash settlement with a taxing authority will occur. Settlement of such amounts could require the utilization of working capital.

RECENT ACCOUNTING PRONOUNCEMENTS

See Note 1 to the condensed consolidated financial statements for information regarding the effect of new accounting pronouncements on our financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to financial market risks, including changes in interest rates and foreign currency exchange rates. Changes in these factors may cause fluctuations in our earnings and cash flows. We evaluate and manage the exposure to these market risks as follows:

Cash Equivalents and Short-term Investments We have cash equivalents and short-term investments of $64.6 million as of March 31, 2010. These securities are subject to interest rate fluctuations. An increase in interest rates could adversely affect the market value of our cash equivalents and short-term investments. A hypothetical 100 basis point increase in interest rates would result in an approximately $290,000 decrease in the fair value of our cash equivalents and short-term investments as of March 31, 2010.

We limit our exposure to interest rate and credit risk by establishing and monitoring clear policies and guidelines for our cash equivalents and short-term investment portfolios. The primary objective of our policies is to preserve principal while at the same time maximizing yields, without significantly increasing risk. Our investment policy limits the maximum weighted average duration of all invested funds to 12 months. Our policy s guidelines also limit exposure to loss by limiting the sums we can invest in any individual security and restricting investment to securities that meet certain defined credit ratings. We do not use derivative financial instruments in our investment portfolio to manage interest rate risk.

Foreign Currency Exchange Rates A substantial majority of our revenue, expense, and capital purchasing activities are transacted in U.S. dollars. However, we do incur certain operating costs for our foreign operations in other currencies but these operations are limited in scope and thus we are not materially exposed to foreign currency fluctuations. Additionally we have some reliance on international and export sales that are subject to the risks of fluctuations in currency exchange rates. Because a substantial majority of our international and export revenues, as well as expenses, are typically denominated in U.S. dollars, a strengthening of the U.S. dollar could cause our products to become relatively more expensive to customers in a particular country, leading to a reduction in sales or profitability in that country. We have no foreign exchange contracts, option contracts, or other foreign currency hedging arrangements.

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Our management, with the participation of our Chief Executive Officer and Interim Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act as of March 31, 2010. The purpose of these controls and procedures is to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC s rules, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Interim Chief Financial Officer, to allow timely decisions regarding required disclosures.

Our management with the participation of our Chief Executive Officer and Interim Chief Financial Officer evaluated our disclosure controls and procedures and determined that there were material weaknesses in our internal control over financial reporting as of March 31, 2010, as more fully described in Management s Report on Internal Control over Financial Reporting in our Annual Report on Form 10-K for the year ended December 31, 2009. A material weakness is a deficiency, or combination of deficiencies, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. Based on this evaluation and because of the material weaknesses described in our Form 10-K for the year ended December 31, 2009, which have not been remediated, our Chief Executive Officer and Interim Chief Financial Officer have concluded that certain disclosure controls and procedures were not effective as of March 31, 2010.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

Other than the remedial efforts to address our material weaknesses as described further below, that took place or that were ongoing during the three months ended March 31, 2010, there were no changes in our internal control over financial reporting during the three months ended March 31, 2010 that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

Plans for Remediation

We will not be able to assess whether the steps we are taking will fully remedy the material weaknesses in our internal control over financial reporting until we have fully implemented them and sufficient time passes in order to evaluate their effectiveness.

We have undertaken the following remedial efforts to address the material weakness in our internal control over financial reporting with respect to income taxes as initially reported in our Annual Report on Form 10-K for the year ended December 31, 2007:

> We have hired consultants to assist with the preparation of our quarterly and annual tax calculations and the related financial disclosures including the rationale for recognizing the benefits of certain tax positions in the financial statements with oversight responsibility remaining with the Corporate Controller. We continue to evaluate additional steps to remediate this material weakness.

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We have undertaken the following remedial efforts to address the material weaknesses in our internal control over financial reporting with respect to revenue recognition as initially reported in Amendment No.1 to our Annual Report on Form 10-K/A for the year ended December 31, 2008 filed on February 8, 2010:

- We improved our documentation of existing revenue recognition policies, including policies involving non-standard terms and conditions, multiple element arrangements, modifications to shipping terms and requests for pre-release products;
- We have restructured our finance department such that the individuals responsible for the recognition of revenue are all located at our headquarters and report directly to the Interim CFO with clearly delineated responsibilities;
- We have held training sessions on revenue recognition policies with the sales personnel and will continue to implement training and oversight of executive, finance, sales and operational personnel and new hires to ensure compliance with revenue recognition policies;
- We have redesigned the quarterly sub-certification process to cover a wider variety of topics that could affect the financial statements and added more employees to this certification process;
- We have implemented a process of obtaining quarterly certifications from all sales personnel certifying that they are not aware of any side agreements modifying our standard terms of contracts;
- We have implemented a process of obtaining, on an annual basis, signed acknowledgments from each employee that he or she has read and is in compliance with our code of ethics and employee handbook;
- We have improved our legal and financial review process of all sales order packages for all terms and conditions prior to shipment; and
- We are in the process of automating the approval process for the release of all products in development to production. The approval process now requires the approval of finance personnel.

In addition, we continue to take the steps set forth in the remedial plan approved by the Audit Committee as further discussed in the Explanatory Note and Item 9 in Amendment No. 1 to our Annual Report on Form 10-K/A for 2008.

We have undertaken the following remedial efforts to address the material weakness in our internal control over financial reporting with respect to the calculation of stock-based compensation, accounting for warrants and inventory control and fixed asset management as initially described in Evaluation of Disclosure Controls and Procedures in Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2009 and in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2009, both filed on February 8, 2010:

- We have added a control procedure to test the calculation of the third-party stock-based compensation reports on a quarterly basis, and upon upgrading to new versions of the software, and to ensure timely review of the technical updates to the software;
- We have added a control procedure to test the review and implementation of all applicable new accounting pronouncements with the appropriate review by finance personnel to ensure compliance;
- We are in the process of implementing control procedures to ensure capitalization and tracking of all demonstration and customer loaner equipment; and
- We are in the process of reviewing our physical inventory management procedures including cycle counts to ensure proper control of inventory with appropriate review by operations and finance personnel.

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PART II
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In re Immersion Corporation Initial Public Offering Securities Litigation

We are involved in legal proceedings relating to a class action lawsuit filed on November 9, 2001 in the U. S. District Court for the Southern District of New York, *In re Immersion Corporation Initial Public Offering Securities Litigation*, No. Civ. 01-9975 (S.D.N.Y.), related to In re Initial Public Offering Securities Litigation, No. 21 MC 92 (S.D.N.Y.). The named defendants are Immersion and three of our current or former officers or directors (the Immersion Defendants), and certain underwriters of our November 12, 1999 initial public offering (IPO). Subsequently, two of the individual defendants stipulated to a dismissal without prejudice.

The operative amended complaint is brought on purported behalf of all persons who purchased our common stock from the date of our IPO through December 6, 2000. It alleges liability under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, on the grounds that the registration statement for the IPO did not disclose that: (1) the underwriters agreed to allow certain customers to purchase shares in the IPO in exchange for excess commissions to be paid to the underwriters; and (2) the underwriters arranged for certain customers to purchase additional shares in the aftermarket at predetermined prices. The complaint also appears to allege that false or misleading analyst reports were issued. The complaint does not claim any specific amount of damages.

Similar allegations were made in other lawsuits challenging over 300 other initial public offerings and follow-on offerings conducted in 1999 and 2000. The cases were consolidated for pretrial purposes. On February 19, 2003, the District Court ruled on all defendants motions to dismiss. The motion was denied as to claims under the Securities Act of 1933 in the case involving us as well as in all other cases (except for 10 cases). The motion was denied as to the claim under Section 10(b) as to us, on the basis that the complaint alleged that we had made acquisition(s) following the IPO. The motion was granted as to the claim under Section 10(b), but denied as to the claim under Section 20(a), as to the remaining individual defendant.

In September 2008, all of the parties to the lawsuits reached a settlement, subject to documentation and approval of the District Court. The Immersion Defendants would not be required to contribute to the settlement. Subsequently, an underwriter defendant filed for bankruptcy and other underwriter defendants were acquired. On April 2, 2009, final documentation evidencing the settlement was presented to the District Court for approval. If the settlement is not approved by the District Court, we intend to defend the lawsuit vigorously.

Immersion Corporation v. Mentice AB, Mentice SA, Simbionix USA Corp., and Simbionix Ltd.

On April 16, 2008, we announced that our wholly owned subsidiary, Immersion Medical, Inc., filed lawsuits for patent infringement in the United States District Court for the Eastern District of Texas against Mentice AB, Mentice SA, Simbionix USA Corp., and Simbionix Ltd (collectively the Defendants), seeking damages and injunctive relief. On July 11, 2008, Mentice AB and Mentice SA (collectively, Mentice) answered the complaint by denying the material allegations and alleging counterclaims seeking a judicial declaration that the asserted patents were invalid, unenforceable, or not infringed. On July 11, 2008, Simbionix USA Corp. and Simbionix Ltd, (collectively, Simbionix) filed a motion to stay or dismiss the lawsuit, and a motion to transfer venue for convenience to the Northern District of Ohio. On September 29, 2009, the court granted Simbionix s motion to transfer the case. On December 7, 2009, the case was transferred to the Northern District of Ohio. The court has not set a trial schedule. On April 15, 2010, Mentice AB, Mentice SA, and Xitact SA (a/k/a Mentice SA) filed a counterclaim against us.

In re Immersion Corporation Securities Litigation

In September and October 2009, various putative shareholder class action and derivative complaints were filed in federal and state court against us and certain current and former Immersion directors and officers.

On September 2, 2009, a securities class action complaint was filed in the United States District Court for the Northern District of California against us and certain of our current and former directors and officers. Over the following five weeks, four additional class action complaints were filed. (One of these four actions was later voluntarily dismissed.) The securities class action complaints name us and certain current and former Immersion directors and officers as defendants and allege violations of federal securities laws based on our issuance of allegedly misleading financial statements. The various complaints assert claims covering the period from May 2007 through July 2009 and seek compensatory damages allegedly sustained by the purported class members.

On December 21, 2009, these class actions were consolidated by the court as *In Re Immersion Corporation Securities Litigation.* On the same day, the court appointed a lead plaintiff and lead plaintiff s counsel. Following our restatement of financial statements, lead plaintiff filed a consolidated complaint on April 9, 2010, as to which Defendants will file a responsive pleading by June 8, 2010.

In re Immersion Corporation Derivative Litigation

On September 15, 2009, a putative shareholder derivative complaint was filed in the United States District Court for the Northern District of California, purportedly on behalf of us and naming certain of our current and former directors and officers as individual defendants. Thereafter, two additional putative derivative complaints were filed in the same court.

The derivative complaints arise from the same or similar alleged facts as the federal securities actions and seek to bring state law causes of action on behalf of us against the individual defendants for breaches of fiduciary duty, gross negligence, abuse of control, gross mismanagement, breach of contract, waste of corporate assets, unjust enrichment, as well as for violations of federal securities laws. The federal derivative complaints seek compensatory damages, corporate governance changes, unspecified equitable and injunctive relief, the imposition of a constructive trust, and restitution. On November 17, 2009, the court consolidated these actions as *In re Immersion Corporation Derivative Litigation* and appointed lead counsel. The court has issued an order staying this action.

Shaw v. Richardson et al.

On October 7, 2009, a putative shareholder derivative complaint was filed in the Superior Court of the State of California for the County of Santa Clara, purportedly on behalf of us, seeking compensatory damages, equitable and injunctive relief, and restitution. The complaint names certain current and former directors and officers of us as individual defendants. This complaint arises from the same or similar alleged facts as the federal securities actions and seeks to bring causes of action on behalf of us against the individual defendants for breaches of fiduciary duty, waste of corporate assets and unjust enrichment. Plaintiff will file an amended complaint in this action following our restatement of financial statements, to which defendants will have the opportunity to file responsive pleadings.

We cannot predict the ultimate outcome of the above-mentioned federal and state actions, and we are unable to estimate any potential liability we may incur.

ITEM 1A. RISK FACTORS

Company Risks

IF WE FAIL TO ESTABLISH AND MAINTAIN PROPER AND EFFECTIVE INTERNAL CONTROLS AND IF WE FAIL TO REMEDIATE EXISTING INTERNAL CONTROL DEFICIENCIES, OUR ABILITY TO PRODUCE ACCURATE FINANCIAL STATEMENTS ON A TIMELY BASIS COULD BE IMPAIRED, WHICH WOULD ADVERSELY AFFECT OUR CONDENSED CONSOLIDATED OPERATING RESULTS, OUR ABILITY TO OPERATE OUR BUSINESS AND OUR STOCK PRICE.

In connection with the internal investigation conducted by the audit committee into revenue recognition of certain transactions in our Medical line of business, we determined that we did not have adequate internal financial and accounting controls to produce accurate and timely financial statements. Among the material weaknesses identified in our review, we determined that we had material weaknesses with respect to revenue recognition. In addition, as set forth in 2007, we determined that we had a material weakness in controls over accounting for income taxes. In reviewing our financial statements in preparation for the restatement we determined that we also had material weaknesses in our controls over accounting for stock-based compensation, the adoption of new accounting standards, inventory control management and accounting for fixed assets. For a further discussion of these material weaknesses, see Item 4 of our Annual Report on Form 10-K for the year ended December 31, 2009. Although we have begun implementing new processes and procedures to improve our internal controls, our Chief Executive Officer and Interim Chief Financial Officer determined that as of March 31, 2010, our internal controls over financial reporting were not effective to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external reporting in accordance with generally accepted accounting principles in the United States.

Ensuring that we have adequate internal financial and accounting controls and procedures in place to produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. Any failure on our part to remedy identified material weaknesses, or any additional delays or errors in our financial reporting, whether or not resulting from the identified material weakness relating to revenue recognition or any other material weaknesses, could cause our financial reporting to be unreliable and could have a material adverse effect on our business, results of operations, or financial condition and could have a substantial adverse impact on the trading price of our common stock.

We do not expect that our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system s objectives will be met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within our company will have been detected. As discussed in this Form 10-Q, management has identified material weaknesses in the past and may identify additional material weaknesses in the future.

We cannot be certain that the actions we have taken and are taking to improve our internal controls over financial reporting will be sufficient or that we will be able to implement our planned processes and procedures in a timely manner. In addition, we may be unable to produce accurate financial statements on a timely basis. Any of the foregoing could cause investors to lose confidence in the reliability of our condensed consolidated financial statements, which could cause the market price of our common stock to decline and make it more difficult for us to finance our operations and growth.

OUR CURRENT LITIGATION IS EXPENSIVE, DISRUPTIVE, AND TIME CONSUMING, AND WILL CONTINUE TO BE, UNTIL RESOLVED, AND REGARDLESS OF WHETHER WE ARE ULTIMATELY SUCCESSFUL, COULD ADVERSELY AFFECT OUR BUSINESS.

We are currently a party to various legal proceedings. Due to the inherent uncertainties of litigation, we cannot accurately predict how these cases will ultimately be resolved. In addition, it is possible that as a result of our internal investigation described elsewhere in this report, we may be subject to additional litigation and investigations by government authorities such as the SEC. We anticipate that currently pending litigation will continue to be costly and that future litigation or investigations will result in

additional legal expenses, and there can be no assurance that we will be successful or able to recover the costs we incur in connection with litigation or investigations. We expense litigation and investigatory costs as incurred, and only accrue for costs that have been incurred but not paid to the vendor as of the financial statement date. Litigation and investigations have diverted, and are likely to continue to divert, the efforts and attention of some of our key management and personnel. As a result, until such time as it is resolved or concluded, litigation and investigations could adversely affect our business. Further, any unfavorable outcome could adversely affect our business. For additional background on this and our other litigation, please see Note 15 to the condensed consolidated financial statements in Item I and Item 1 Legal Proceedings of Part II.

THE UNCERTAIN GLOBAL ECONOMIC ENVIRONMENT COULD REDUCE OUR REVENUES AND COULD HAVE AN ADVERSE EFFECT ON OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The current global economic recession could materially hurt our business in a number of ways including, longer sales and renewal cycles, delays in adoption of our products or technologies, increased risk of competition, increased risk of inventory obsolescence, higher overhead costs as a percentage of revenue, delays in signing or failing to sign customer agreements, or signing customer agreements at reduced purchase levels. In addition, our suppliers, customers, potential customers, and business partners are facing similar challenges, which could materially and adversely affect the level of business they conduct with us or in the level of sales of products that include our technology. The current economic downturn may lead to a reduction in corporate, university, or government budgets for research and development in sectors including the automotive, aerospace, mobility, and medical sectors, which use our products. Sales of our products or technology may be adversely affected by cuts in these research and development budgets. Furthermore, a prolonged tightening of the credit markets could significantly impact our ability to liquidate investments or reduce the rate of return on investments.

WE HAD AN ACCUMULATED DEFICIT OF $101 MILLION AS OF MARCH 31, 2010, HAVE A HISTORY OF LOSSES, EXPECT TO EXPERIENCE LOSSES IN THE FUTURE, AND MAY NOT ACHIEVE OR MAINTAIN PROFITABILITY IN THE FUTURE.

Since 1997, we have incurred losses in all but four quarters. We need to generate significant ongoing revenue to return to profitability. We anticipate that we will continue to incur expenses as we:

- continue to develop our technologies;
- increase our sales and marketing efforts;
- attempt to expand the market for touch-enabled technologies and products and change our business;
- protect and enforce our intellectual property;
- pursue strategic relationships;
- incur costs related to pending litigation;
- acquire intellectual property or other assets from third-parties; and
- invest in systems and processes to manage our business.

If our revenues grow more slowly than we anticipate or if our operating expenses exceed our expectations, we may not achieve or maintain profitability.

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WE HAVE LITTLE OR NO CONTROL OR INFLUENCE ON OUR LICENSEES DESIGN, MANUFACTURING, PROMOTION, DISTRIBUTION, OR PRICING OF THEIR PRODUCTS INCORPORATING OUR TOUCH-ENABLING TECHNOLOGIES, UPON WHICH WE GENERATE ROYALTY REVENUE.

A key part of our business strategy is to license our intellectual property to companies that manufacture and sell products incorporating our touch-enabling technologies. Sales of those products generate royalty and license revenue for us. For the quarters ended March 31, 2010, and 2009, 66% and 50%, respectively, of our total revenues were royalty and license revenues. We do not control or influence the design, manufacture, quality control, promotion, distribution, or pricing of products that are manufactured and sold by our licensees, nor can we control consolidation within an industry which could either reduce the number of licensing products available or reduce royalty rates for the combined licensees. In addition, we generally do not have commitments from our licensees that they will continue to use our technologies in current or future products. As a result, products incorporating our technologies may not be brought to market, achieve commercial acceptance, or otherwise generate meaningful royalty revenue for us. For us to generate royalty revenue, licensees that pay us per-unit royalties must manufacture and distribute products incorporating our touch-enabling technologies in a timely fashion and generate consumer demand through marketing and other promotional activities. If our licensees products fail to achieve commercial success or if products are recalled because of quality control problems, our revenues will not grow and could decline.

Peak demand for products that incorporate our technologies, especially in the video console gaming and computer gaming peripherals market, typically occurs in the fourth calendar quarter as a result of increased demand during the year-end holiday season. If our licensees do not ship products incorporating our touch-enabling technologies in a timely fashion or fail to achieve strong sales in the fourth quarter of the calendar year, we may not receive related royalty and license revenue.

DUE TO RECENT TURNOVER, OUR EXECUTIVE MANAGEMENT TEAM HAS LIMITED EXPERIENCE WORKING TOGETHER AND IF THERE ARE DIFFICULTIES WITHIN THIS TEAM, IT COULD IMPEDE THE EXECUTION OF OUR BUSINESS STRATEGY.

Recently, we have experienced a number of changes in our executive team. Our success will depend to a significant extent on the management team s ability to implement a successful strategy, to successfully lead and motivate our employees, and to work effectively together and with the board of directors. If this leadership team is not successful, our ability to execute our business strategy would be impeded.

WE HAVE EXPERIENCED SIGNIFICANT CHANGE IN OUR BUSINESS, AND WE CANNOT ASSURE YOU THAT THESE CHANGES WILL RESULT IN INCREASED REVENUE OR PROFITABILITY.

Our business has undergone significant changes in recent periods, including the divestiture of our 3D business, new management, consolidation of our medical business and sale of assets and certain liabilities of our medical simulation product lines, and focus on additional target markets. These changes have required, and will likely in the future require, significant investments of cash and other resources, as well as management s time and attention and have placed significant strains on our managerial, financial, engineering, or other resources. We cannot assure you that these efforts will result in growing our business successfully or in increased operating performance.

WE MAY NOT BE ABLE TO CONTINUE TO DERIVE SIGNIFICANT REVENUES FROM MAKERS OF PERIPHERALS FOR POPULAR VIDEO GAMING PLATFORMS.

A significant portion of our gaming royalty revenues come from third-party peripheral makers who make licensed gaming products designed for use with popular video game console systems from Microsoft, Sony, and Nintendo. Video game console systems are closed, proprietary systems, and video game console system makers typically impose certain requirements or restrictions on third-party peripheral makers who wish to make peripherals that will be compatible with a particular video game console system. If third-party peripheral makers cannot or are not allowed to obtain or satisfy these requirements or restrictions, our gaming royalty revenues could be significantly reduced. Furthermore, should a significant video game console maker choose to omit touch-enabling capabilities from its console system or somehow restrict or impede the ability of third parties to make touch-enabling peripherals, it may very well lead our gaming licensees to stop making products with touch-enabling capabilities, thereby significantly reducing our gaming royalty revenues.

Under the terms of our agreement with Sony, Sony receives a royalty-free license to our worldwide portfolio of patents. This license permits Sony to make, use, and sell hardware, software, and services covered by our patents in its PS1, PS2, and PS3 systems for a fixed license payment. The PS3 console system was launched in late 2006 in the United States and Japan without force feedback capability. Sony has since released new PS3 controllers with vibration feedback. We do not know to what extent Sony will allow third-party peripheral makers to make licensed PS3 gaming products with vibration feedback to interface with the PS3 console. To the extent Sony selectively limits their licensing to leading third-party controller makers to make PS3 controllers with vibration feedback, our licensing revenue from third-party PS3 peripherals will continue to be severely limited. Sony continues to sell the PS2, and our third party licensees continue to sell licensed PS2 peripherals. However, U.S. sales of PS2 peripherals continue to decline as more consumers switch to the PS3 console system and other next-generation console systems like the Nintendo Wii and Microsoft Xbox 360.

Both the Microsoft Xbox 360 and Nintendo Wii include touch-enabling capabilities. For the Microsoft Xbox 360 video console system launched in November 2005, Microsoft has, to date, not yet broadly licensed third parties to produce peripherals for its Xbox 360 game console. To the extent Microsoft does not fully license third parties, Microsoft s share of all aftermarket Xbox 360 game controller sales will likely remain high or increase, which we expect will limit our gaming royalty revenue. Additionally, Microsoft is now making touch-enabled steering wheel products covered by their royalty-free, perpetual, irrevocable license to our worldwide portfolio of patents that could compete with our licensees current products for which we earn per unit royalties.

BECAUSE WE HAVE A FIXED PAYMENT LICENSE WITH MICROSOFT, OUR ROYALTY REVENUE FROM LICENSING IN THE GAMING MARKET AND OTHER CONSUMER MARKETS HAS PREVIOUSLY DECLINED AND MAY FURTHER DO SO IF MICROSOFT INCREASES ITS VOLUME OF SALES OF TOUCH-ENABLED GAMING PRODUCTS AND CONSUMER PRODUCTS AT THE EXPENSE OF OUR OTHER LICENSEES.

Under the terms of our present agreement with Microsoft, Microsoft receives a royalty-free, perpetual, irrevocable license to our worldwide portfolio of patents. This license permits Microsoft to make, use, and sell hardware, software, and services, excluding specified products, covered by our patents. We will not receive any further revenues or royalties from Microsoft under our current agreement with Microsoft. Microsoft has a significant share of the market for touch-enabled console gaming computer peripherals and is pursuing other consumer markets such as mobile phones, PDAs, and portable music players. Microsoft has significantly greater financial, sales, and marketing resources, as well as greater name recognition and a larger customer base than some of our other licensees. In the event that Microsoft increases its share of these markets, our royalty revenue from other licensees in these market segments might decline.

WE GENERATE REVENUES FROM TOUCH-ENABLING COMPONENTS THAT ARE SOLD AND INCORPORATED INTO THIRD-PARTY PRODUCTS. WE HAVE LITTLE OR NO CONTROL OR INFLUENCE OVER THE DESIGN, MANUFACTURE, PROMOTION, DISTRIBUTION, OR PRICING OF THOSE THIRD-PARTY PRODUCTS.

Part of our business strategy is to sell components that provide touch feedback capability in products that other companies design, manufacture, and sell. Sales of these components generate product revenue. However, we do not control or influence the design, manufacture, quality control, promotion, distribution, or pricing of products that are manufactured and sold by those customers that buy these components. In addition, we generally do not have commitments from customers that they will continue to use our components in current or future products. As a result, products incorporating our components may not be brought to market, meet quality control standards, or achieve commercial acceptance. If the customers fail to stimulate and capitalize upon market demand for their products that include our components, or if products are recalled because of quality control problems, our revenues will not grow and could decline.

THE TERMS IN OUR AGREEMENTS MAY BE CONSTRUED BY OUR LICENSEES IN A MANNER THAT IS INCONSISTENT WITH THE RIGHTS THAT WE HAVE GRANTED TO OTHER LICENSEES, OR IN A MANNER THAT MAY REQUIRE US TO INCUR SUBSTANTIAL COSTS TO RESOLVE CONFLICTS OVER LICENSE TERMS.

We have entered into, and we expect to continue to enter into, agreements pursuant to which our licensees are granted rights under our technology and intellectual property. These rights may be granted in certain fields of use, or with respect to certain market sectors or product categories, and may include exclusive rights or sublicensing rights. We refer to the license terms and restrictions in our agreements, including, but not limited to, field of use definitions, market sector, and product category definitions, collectively as License Provisions.

Due to the continuing evolution of market sectors, product categories, and licensee business models, and to the compromises inherent in the drafting and negotiation of License Provisions, our licensees may, at some time during the term of their agreements with us, interpret License Provisions in their agreements in a way that is different from our interpretation of such License Provisions, or in a way that is in conflict with the rights that we have granted to other licensees. Such interpretations by our licensees may lead to claims that we have granted rights to one licensee which are inconsistent with the rights that we have granted to another licensee.

In addition, after we enter into an agreement, it is possible that markets and/or products, or legal and/or regulatory environments, will evolve in a manner that we did not foresee or was not foreseeable at the time we entered into the agreement. As a result, in any agreement, we may have granted rights that will preclude or restrict our exploitation of new opportunities that arise after the execution of the agreement.

IF WE ARE UNABLE TO ENTER INTO NEW LICENSING ARRANGEMENTS WITH OUR EXISTING LICENSEES AND WITH ADDITIONAL THIRD-PARTY MANUFACTURERS FOR OUR TOUCH-ENABLING TECHNOLOGIES, OUR ROYALTY REVENUE MAY NOT GROW.

Our revenue growth is significantly dependent on our ability to enter into new licensing arrangements. Our failure to enter into new or renewal of licensing arrangements will cause our operating results to suffer. We face numerous risks in obtaining new licenses on terms consistent with our business objectives and in maintaining, expanding, and supporting our relationships with our current licensees. These risks include:

- the lengthy and expensive process of building a relationship with potential licensees;
- the competition we may face with the internal design teams of existing and potential licensees;
- difficulties in persuading product manufacturers to work with us, to rely on us for critical technology, and to disclose to us proprietary product development and other strategies;
- difficulties with persuading potential licensees who may have developed their own intellectual property or licensed intellectual property from other parties in areas related to ours to license our technology versus continuing to develop their own or license from other parties;
- challenges in demonstrating the compelling value of our technologies in new applications like mobile phones, portable devices, and touchscreens;
- difficulties in persuading existing and potential licensees to bear the development costs and risks necessary to incorporate our technologies into their products;

difficulties in obtaining new licensees for yet-to-be commercialized technology because their suppliers may not be ready to meet stringent quality and parts availability requirements;

inability to sign new gaming licenses if the video console makers choose not to license third parties to make peripherals for their new consoles; and

reluctance of content developers, mobile phone manufacturers, and service providers to sign license agreements without a critical mass of other such inter-dependent supporters of the mobile phone industry also having a license, or without enough phones in the market that incorporate our technologies.

OUR CONSOLIDATION OF AND TRANSITION FROM OUR MEDICAL OPERATIONS AND OTHER RESTRUCTURINGS MAY NOT BE SUCCESSFUL, AND MAY NEGATIVELY IMPACT OUR BUSINESS.

In May 2009, we moved the operations of our Medical line of business from Maryland to our headquarters in San Jose, California and we have also reduced our workforce in recent periods. In March, 2010, we sold certain assets including inventory and fixed assets and certain liabilities of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines and transferred certain employees to CAE as well as distribution agreements and customer relationships. We also have entered into a licensing agreement with CAE for the Immersion TouchSense patent portfolio for use in the field of Medical Training. Consolidations and business restructurings involve numerous risks and uncertainties, including, but not limited to: the potential loss of key employees, customers and business partners; market uncertainty related to our future business plans; the incurrence of unexpected expenses or charges; diversion of management attention from other key areas of our business; negative impacts on employee morale; and other potential dislocations and disruptions to the business. In addition, if our business expands, it may be more difficult for us to attract additional personnel and develop the resources we would need to support a larger customer base.

For the quarters ended March 31, 2010 and 2009, 30% and 41%, respectively, of our total revenues were from our medical line of business. Accordingly, if we are unable to manage the consolidation and transition effectively, our overall business and operating results could be materially and adversely affected.

LITIGATION REGARDING INTELLECTUAL PROPERTY RIGHTS COULD BE EXPENSIVE, DISRUPTIVE, AND TIME CONSUMING; COULD RESULT IN THE IMPAIRMENT OR LOSS OF PORTIONS OF OUR INTELLECTUAL PROPERTY; AND COULD ADVERSELY AFFECT OUR BUSINESS.

Intellectual property litigation, whether brought by us or by others against us, has caused us to expend, and may cause us to expend in future periods, significant financial resources as well as divert management s time and efforts. From time to time, we initiate claims against third parties that we believe infringe our intellectual property rights. We intend to enforce our intellectual property rights vigorously and may initiate litigation against parties that we believe are infringing our intellectual property rights if we are unable to resolve matters satisfactorily through negotiation. Litigation brought to protect and enforce our intellectual property rights could be costly, time-consuming, and difficult to pursue in certain venues, and distracting to management and potential customers and could result in the impairment or loss of portions of our intellectual property. In addition, any litigation in which we are accused of infringement may cause product shipment delays, require us to develop non-infringing technologies, or require us to enter into royalty or license agreements even before the issue of infringement has been decided on the merits. If any litigation were not resolved in our favor, we could become subject to substantial damage claims from third parties and indemnification claims from our licensees. We could be enjoined from the continued use of the technologies at issue without a royalty or license agreement. Royalty or license agreements, if required, might not be available on acceptable terms, or at all. If a third party claiming infringement against us prevailed, and we may not be able to develop non-infringing technologies or license the infringed or similar technologies on a timely and cost-effective basis, our expenses could increase and our revenues could decrease.

While we attempt to avoid infringing known proprietary rights of third parties, third parties may hold, or may in the future be issued, patents that could be infringed by our products or technologies. Any of these third parties might make a claim of infringement against us with respect to the products that we manufacture and the technologies that we license. From time to time, we have received letters from companies, several of which have significantly greater financial resources than we do, asserting that some of our technologies, or those of our licensees, infringe their intellectual property rights. Certain of our licensees may receive similar letters from these or other companies from time to time. Such letters or subsequent litigation may influence our licensees decisions whether to ship products incorporating our technologies. In addition, such letters may cause a dispute between our licensees and us over indemnification for the infringement claim. Any of these notices, or additional notices that we or our licensees could receive in the future from these or other companies, could lead to litigation against us, either regarding the infringement claim or the indemnification claim.

We have acquired patents from third parties and also license some technologies from third parties. We must rely upon the owners of the patents or the technologies for information on the origin and ownership of the acquired or licensed technologies. As a result, our exposure to infringement claims may increase. We generally obtain representations as to the origin and ownership of acquired or licensed technologies and indemnification to cover any breach of these representations. However, representations may not be accurate and indemnification may not provide adequate compensation for breach of the representations. Intellectual property claims against our licensees, or us, whether or not they have merit, could be time-consuming to defend, cause product shipment delays, require us to pay damages, harm existing license arrangements, or require us or our licensees to cease utilizing the technologies unless we can enter into licensing agreements. Licensing agreements might not be available on terms acceptable to us or at all. Furthermore, claims by third parties against our licensees could also result in claims by our licensees against us for indemnification.

The legal principles applicable to patents and patent licenses continue to change and evolve. Legislation and judicial decisions that make it easier for patent licensees to challenge the validity, enforceability, or infringement of patents, or make it more difficult for patent licensors to obtain a permanent injunction, obtain enhanced damages for willful infringement, or to obtain or enforce patents, may adversely affect our business and the value of our patent portfolio. Furthermore, our prospects for future revenue growth through our royalty and licensing based businesses could be diminished.

PRODUCT LIABILITY CLAIMS COULD BE TIME-CONSUMING AND COSTLY TO DEFEND AND COULD EXPOSE US TO LOSS.

Our products or our licensees products may have flaws or other defects that may lead to personal or other injury claims. If products that we or our licensees sell cause personal injury, property injury, financial loss, or other injury to our or our licensees customers, the customers or our licensees may seek damages or other recovery from us. From our transition from the medical products business, we could face product liability claims for products that we have sold or that any of our successors may sell in the future. Defending any claims against us, regardless of merit, would be time-consuming, expensive to defend, and distracting to management, and could result in damages and injure our reputation, the reputation of our technology and services, and/or the reputation of our products, or the reputation of our licensees or their products. This damage could limit the market for our and our licensees products and harm our results of operations. In addition, if our business liability insurance coverage proves inadequate or future coverage is unavailable on acceptable terms or at all, our business, operating results and financial condition could be adversely affected.

In the past, manufacturers of peripheral products including certain gaming products such as joysticks, wheels, or gamepads, have been subject to claims alleging that use of their products has caused or contributed to various types of repetitive stress injuries, including carpal tunnel syndrome. While we have not experienced any product liability claims to date, we could face such claims in the future, which could harm our business and reputation. Although our license agreements typically contain provisions designed to limit our exposure to product liability claims, existing or future laws or unfavorable judicial decisions could limit or invalidate the provisions.

OUR PRODUCTS ARE COMPLEX AND MAY CONTAIN UNDETECTED ERRORS, WHICH COULD HARM OUR REPUTATION AND FUTURE PRODUCT SALES.

Any failure to provide high quality and reliable products, whether caused by our own failure or failures of our suppliers or OEM customers, could damage our reputation and reduce demand for our products. Our products have in the past contained, and may in the future contain, undetected errors or defects. Some errors in our products may only be discovered after a product has been shipped to customers. Any errors or defects discovered in our products after commercial release could result in loss of revenue, loss of customers, and increased service and warranty costs, any of which could adversely affect our business.

THE NATURE OF SOME OF OUR PRODUCTS MAY ALSO SUBJECT US TO EXPORT CONTROL REGULATION BY THE U.S. DEPARTMENT OF STATE AND THE DEPARTMENT OF COMMERCE. VIOLATIONS OF THESE REGULATIONS CAN RESULT IN MONETARY PENALTIES AND DENIAL OF EXPORT PRIVILEGES.

Our sales to customers in some areas outside the United States could be subject to government export regulations or restrictions that prohibit us from selling to customers in some countries or that require us to obtain licenses or approvals to export such products internationally. Delays or denial of the grant of any required license or approval, or changes to the regulations, could make it difficult or impossible to make sales to foreign customers in some countries and could adversely affect our revenue. In addition, we could be subject to fines and penalties for violation of these export regulations if we were found in violation. Such violation could result in penalties, including prohibiting us from exporting our products to one or more countries, and could materially and adversely affect our business.

COMPLIANCE WITH DIRECTIVES THAT RESTRICT THE USE OF CERTAIN MATERIALS MAY INCREASE OUR COSTS AND LIMIT OUR REVENUE OPPORTUNITIES.

Our products and packaging must meet all safety, electrical, labeling, marking, or other requirements of the countries into which we ship products or our resellers sell our products. We have to assess each product and determine whether it complies with the requirements of local regulations or whether they are exempt from meeting the requirements of the regulations. If we determine that a product is not exempt and does not comply with adopted regulations, we will have to make changes to the product or its documentation if we want to sell that product into the region once the regulations become effective. Making such changes may be costly to perform and may have a negative impact on our results of operations. In addition, there can be no assurance that the national enforcement bodies of the regions adopting such regulations will agree with our assessment that certain of our products and documentation comply with or are exempt from the regulations. If products are determined not to be compliant or exempt, we will not be able to ship them in the region that adopts such regulations until such time that they are compliant, and this may have a negative impact on our revenue and results of operations.

BECAUSE PERSONAL COMPUTER PERIPHERAL PRODUCTS THAT INCORPORATE OUR TOUCH-ENABLING TECHNOLOGIES CURRENTLY WORK WITH MICROSOFT S OPERATING SYSTEM SOFTWARE, OUR COSTS COULD INCREASE AND OUR REVENUES COULD DECLINE IF MICROSOFT MODIFIES ITS OPERATING SYSTEM SOFTWARE.

Our hardware and software technologies for personal computer peripheral products that incorporate our touch-enabling technologies are currently compatible with Microsoft s Windows 2000, Windows Me, Windows XP, and Windows Vista operating systems, including DirectX, Microsoft s entertainment API. Modifications and new versions of Microsoft s operating system and APIs (including DirectX and Windows 7) may require that we and/or our licensees modify the touch-enabling technologies to be compatible with Microsoft s modifications or new versions, and this could cause delays in the release of products by our licensees. If Microsoft modifies its software products in ways that limit the use of our other licensees products, our costs could increase and our revenues could decline.

In addition, Microsoft announced that its new product, Windows 7, will feature a new multi-touch input function, allowing users to use multiple fingers simultaneously to interact with touch surfaces. Enabling multi-location touch-feedback will require us to innovate hardware and software, enable Windows 7 API s with multi-touch output support, and work with our licensees and third parties to integrate such features. There are feasibility risks with both hardware and software, and there may be potential delays in the revenue growth of haptically-enabled multi touch surfaces.

IF WE ARE UNABLE TO DEVELOP OPEN SOURCE COMPLIANT PRODUCTS, OUR ABILITY TO LICENSE OUR TECHNOLOGIES AND GENERATE REVENUES WOULD BE IMPAIRED.

We have seen, and believe that we will continue to see, an increase in customers requesting that we develop products that will operate in an open source environment. Developing open source compliant products, without imperiling the intellectual property rights upon which our licensing business depends, may prove difficult under certain circumstances, thereby placing us at a competitive disadvantage for new product designs. As a result, our revenues may not grow and could decline.

THE MARKET FOR CERTAIN TOUCH-ENABLING TECHNOLOGIES AND TOUCH-ENABLED PRODUCTS IS AT AN EARLY STAGE AND IF MARKET DEMAND DOES NOT DEVELOP, WE MAY NOT ACHIEVE OR SUSTAIN REVENUE GROWTH.

The market for certain of our touch-enabling technologies and certain of our licensees touch-enabled products is at an early stage. If we and our licensees are unable to develop demand for touch-enabling technologies and touch-enabled products, we may not achieve or sustain revenue growth. We cannot accurately predict the growth of the markets for these technologies and products, the timing of product introductions, or the timing of commercial acceptance of these products.

Even if our touch-enabling technologies and our licensees touch-enabled products are ultimately widely adopted, widespread adoption may take a long time to occur. The timing and amount of royalties and product sales that we receive will depend on whether the products marketed achieve widespread adoption and, if so, how rapidly that adoption occurs.

We expect that we will need to pursue extensive and expensive marketing and sales efforts to educate prospective licensees, component customers, and end users about the uses and benefits of our technologies and to persuade software developers to create software that utilizes our technologies. Negative product reviews or publicity about our company, our products, our licensees products, haptic features, or haptic technology in general could have a negative impact on market adoption, our revenue, and/or our ability to license our technologies in the future.

IF WE FAIL TO PROTECT AND ENFORCE OUR INTELLECTUAL PROPERTY RIGHTS, OUR ABILITY TO LICENSE OUR TECHNOLOGIES AND GENERATE REVENUES WOULD BE IMPAIRED.

Our business depends on generating revenues by licensing our intellectual property rights and by selling products that incorporate our technologies. We rely on our significant patent portfolio to protect our proprietary rights. If we are not able to protect and enforce those rights, our ability to obtain future licenses or maintain current licenses and royalty revenue could be impaired. In addition, if a court or the patent office were to limit the scope, declare unenforceable, or invalidate any of our patents, current licensees may refuse to make royalty payments, or they may choose to challenge one or more of our patents. It is also possible that:

- our pending patent applications may not result in the issuance of patents;

- our patents may not be broad enough to protect our proprietary rights; and

- effective patent protection may not be available in every country, particularly in Asia, in which we or

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our licensees do business.

We also rely on licenses, confidentiality agreements, other contractual agreements, and copyright, trademark, and trade secret laws to establish and protect our proprietary rights. It is possible that:

- laws and contractual restrictions may not be sufficient to prevent misappropriation of our technologies or deter others from developing similar technologies; and

- policing unauthorized use of our patented technologies, trademarks, and other proprietary rights would be difficult, expensive, and time-consuming, within and particularly outside of the United States of America.

CERTAIN TERMS OR RIGHTS GRANTED IN OUR LICENSE AGREEMENTS OR OUR DEVELOPMENT CONTRACTS MAY LIMIT OUR FUTURE REVENUE OPPORTUNITIES.

While it is not our general practice to sign license agreements that provide exclusive rights for a period of time with respect to a technology, field of use, and/or geography, or to accept similar limitations in product development contracts, we have entered into such agreements and may in the future. Although additional compensation or other benefits may be part of the agreement, the compensation or benefits may not adequately compensate us for the limitations or restrictions we have agreed to as that particular market develops. Over the life of the exclusivity period, especially in markets that grow larger or faster than anticipated, our revenue may be limited and less than what we could have achieved in the market with several licensees or additional products available to sell to a specific set of customers.

IF WE FAIL TO DEVELOP NEW OR ENHANCED TECHNOLOGIES FOR NEW APPLICATIONS AND PLATFORMS, WE MAY NOT BE ABLE TO CREATE A MARKET FOR OUR TECHNOLOGIES OR OUR TECHNOLOGIES MAY BECOME OBSOLETE, AND OUR ABILITY TO GROW AND OUR RESULTS OF OPERATIONS MIGHT BE HARMED.

Our initiatives to develop new and enhanced technologies and to commercialize these technologies for new applications and new platforms may not be successful or timely. Any new or enhanced technologies may not be favorably received by consumers and could damage our reputation or our brand. Expanding our technologies could also require significant additional expenses and strain our management, financial, and operational resources.

Moreover, technology products generally have relatively short product life cycles and our current products may become obsolete in the future. Our ability to generate revenues will be harmed if:

- we fail to develop new technologies or products;

- the technologies we develop infringe on third-party patents or other third-party rights;

- our new technologies fail to gain market acceptance; or

- our current products become obsolete or no longer meet new regulatory requirements.

Our ability to achieve revenue growth also depends on our continuing ability to improve and reduce the cost of our technologies and to introduce these technologies to the marketplace in a timely manner. If our development efforts are not successful or are significantly delayed, companies may not incorporate our technologies into their products and our revenue growth may be impaired.

WE HAVE LIMITED ENGINEERING, CUSTOMER SERVICE, TECHNICAL SUPPORT, QUALITY ASSURANCE AND MANUFACTURING RESOURCES TO DESIGN AND FULFILL FAVORABLE PRODUCT DELIVERY SCHEDULES AND SUFFICIENT LEVELS OF QUALITY IN SUPPORT OF OUR DIFFERENT PRODUCT AREAS. PRODUCTS AND SERVICES MAY NOT BE DELIVERED IN

A TIMELY WAY, WITH SUFFICIENT LEVELS OF QUALITY, OR AT ALL, WHICH MAY REDUCE OUR REVENUE.

Engineering, customer service, technical support, quality assurance, and manufacturing resources are deployed against a variety of different projects and programs to provide sufficient levels of quality necessary for channels and customers. Success in various markets may depend on timely deliveries and overall levels of sustained quality and customer service. Failure to provide favorable product and program deliverables and quality and customer service levels, or provide them at all, may disrupt channels and customers, harm our brand, and reduce our revenues.

THE HIGHER COST OF PRODUCTS INCORPORATING OUR TOUCH-ENABLING TECHNOLOGIES MAY INHIBIT OR PREVENT THEIR WIDESPREAD ADOPTION.

Personal computer and console gaming peripherals, mobile devices, touchscreens, and automotive and industrial controls incorporating our touch-enabling technologies can be more expensive than similar competitive products that are not touch-enabled. Although major manufacturers, such as ALPS Electric Co., BMW, LG Electronics, Logitech, Microsoft, Nokia, Samsung, and Sony have licensed our technologies, the greater expense of development and production of products containing our touch-enabling technologies, together with the higher price to the end customer, may be a significant barrier to their widespread adoption and sale.

THE MARKETS IN WHICH WE PARTICIPATE OR MAY TARGET IN THE FUTURE ARE INTENSELY COMPETITIVE, AND IF WE DO NOT COMPETE EFFECTIVELY, OUR OPERATING RESULTS COULD BE HARMED.

Our target markets are rapidly evolving and highly competitive. Many of our competitors and potential competitors are larger and have greater name recognition, much longer operating histories, larger marketing budgets, and significantly greater resources than we do, and with the introduction of new technologies and market entrants, we expect competition to intensify in the future. We believe that competition in these markets will continue to be intense and that competitive pressures will drive the price of our products and our licensees products downward. These price reductions, if not offset by increases in unit sales or productivity, will cause our revenues to decline. If we fail to compete effectively, our business will be harmed. Some of our principal competitors offer their products or services at a lower price, which has resulted in pricing pressures. If we are unable to achieve our target pricing levels, our operating results would be negatively impacted. In addition, pricing pressures and increased competition generally could result in reduced sales, reduced margins, losses, or the failure of our application suite to achieve or maintain more widespread market acceptance, any of which could harm our business.

We face competition from internal design teams of existing and potential OEM customers. In addition, as a result of their licenses to our patent portfolios, we could face competition from Microsoft and Sony. Our licensees or other third parties may also seek to develop products using our intellectual property or develop alternative designs that attempt to circumvent our intellectual property or that they believe do not require a license under our intellectual property. These potential competitors may have significantly greater financial, technical, and marketing resources than we do, and the costs associated with asserting our intellectual property rights against such products and such potential competitors could be significant. Moreover, if such alternative designs were determined by a court not to require a license under our intellectual property rights, competition from such unlicensed products could limit or reduce our revenues.

Additionally, if haptic technology gains market acceptance, more research by universities and/or corporations or other parties may be performed potentially leading to strong intellectual property positions by third parties in certain areas of haptics or the launch of haptics products before we commercialize our own technology.

Many of our current and potential competitors, including Microsoft, are able to devote greater resources to the development, promotion, and sale of their products and services. In addition, many of our competitors have established marketing relationships or access to larger customer bases, distributors, and other business partners. As a result, our competitors might be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or customer requirements. Further, some potential customers, particularly large enterprises, may elect to develop their own internal solutions. For all of these reasons, we may not be able to compete successfully against our current and future competitors.

WINNING BUSINESS IS SUBJECT TO A COMPETITIVE SELECTION PROCESS THAT CAN BE LENGTHY AND REQUIRES US TO INCUR SIGNIFICANT EXPENSE, AND WE MAY NOT BE SELECTED.

Our primary focus is on winning competitive bid selection processes, known as design wins, so that haptics will be included in our customers equipment. These selection processes can be lengthy and can require us to incur significant design and development expenditures. We may not win the competitive selection process and may never generate any revenue despite incurring significant design and development expenditures. Because we typically focus on only a few customers in a product area, the loss of a design win can sometimes result in our failure to get haptics added to new generation products. This can result in lost sales and could hurt our position in future competitive selection processes because we may not be perceived as being a technology leader.

After winning a product design for one of our customers, we may still experience delays in generating revenue from our products as a result of the lengthy development and design cycle. In addition, a delay or cancellation of a customer s plans could significantly adversely affect our financial results, as we may have incurred significant expense and generated no revenue. Finally, if our customers fail to successfully market and sell their equipment it could materially adversely affect our business, financial condition, and results of operations as the demand for our products falls.

AUTOMOBILES INCORPORATING OUR TOUCH-ENABLING TECHNOLOGIES ARE SUBJECT TO LENGTHY PRODUCT DEVELOPMENT PERIODS, MAKING IT DIFFICULT TO PREDICT WHEN AND WHETHER WE WILL RECEIVE AUTOMOTIVE ROYALTIES.

The product development process for automobiles is very lengthy, sometimes longer than four years. We may not earn royalty revenue on our automotive technologies unless and until automobiles featuring our technologies are shipped to customers, which may not occur until several years after we enter into an agreement with an automobile manufacturer or a supplier to an automobile manufacturer. Throughout the product development process, we face the risk that an automobile manufacturer or supplier may delay the incorporation of, or choose not to incorporate, our technologies into its automobiles, making it difficult for us to predict the automotive royalties we may receive, if any. After the product launches, our royalties still depend on market acceptance of the vehicle or the option packages if our technology is an option (for example, a navigation unit), which is likely to be determined by many factors beyond our control.

A LIMITED NUMBER OF CUSTOMERS ACCOUNT FOR A SIGNIFICANT PORTION OF OUR REVENUE, AND THE LOSS OF MAJOR CUSTOMERS COULD HARM OUR OPERATING RESULTS.

Our 3 largest customers accounted for approximately 39% of our total net revenue for the first quarter of 2010. We cannot be certain that customers that have accounted for significant revenue in past periods, individually or as a group, will, continue to generate revenue in any future period. If we lose a major customer or group of customers, our revenue could decline if we are unable to replace revenue from other sources.

OUR INTERNATIONAL EXPANSION EFFORTS SUBJECT US TO ADDITIONAL RISKS AND COSTS.

We intend to expand international activities. International operations are subject to a number of difficulties and special costs, including:

- compliance with multiple, conflicting and changing governmental laws and regulations;
- laws and business practices favoring local competitors;
- foreign exchange and currency risks;
- difficulty in collecting accounts receivable or longer payment cycles;
- import and export restrictions and tariffs;
- difficulties staffing and managing foreign operations;
- difficulties and expense in enforcing intellectual property rights;
- business risks, including fluctuations in demand for our products and the cost and effort to conduct international operations and travel abroad to promote international distribution and overall global economic conditions;
- multiple conflicting tax laws and regulations; and
- political and economic instability.

Our international operations could also increase our exposure to international laws and regulations. If we cannot comply with foreign laws and regulations, which are often complex and subject to variation and unexpected changes, we could incur unexpected costs and potential litigation. For example, the governments of foreign countries might attempt to regulate our products and services or levy sales or other taxes relating to our activities. In addition, foreign countries may impose tariffs, duties, price controls, or other restrictions on foreign currencies or trade barriers, any of which could make it more difficult for us to conduct our business.

WE MIGHT BE UNABLE TO RETAIN OR RECRUIT NECESSARY PERSONNEL, WHICH COULD SLOW THE DEVELOPMENT AND DEPLOYMENT OF OUR TECHNOLOGIES.

Our ability to develop and deploy our technologies and to sustain our revenue growth depends upon the continued service of our management and other key personnel, many of whom would be difficult to replace. Furthermore, we believe that there are a limited number of engineering and technical personnel that are experienced in haptics. Management and other key employees may voluntarily terminate their employment with us at any time upon short notice. The loss of management or key personnel could delay product development cycles or otherwise harm our business.

We believe that our future success will also depend largely on our ability to attract, integrate, and retain sales, support, marketing, and research and development personnel. Competition for such personnel is intense, and we may not be successful in attracting, integrating, and retaining such personnel. Given the protracted nature of if, how, and when we collect royalties on new design contracts, it may be difficult to craft compensation plans that will attract and retain the level of salesmanship needed to secure these contracts. Additionally some of our executive officers and key employees hold stock options with exercise prices above the current market price of our common stock or that are largely vested. Each of these factors may impair our ability to retain the services of our executive officers and key employees. Our technologies are complex and we rely upon the continued service of our existing personnel to support licensees, enhance existing technologies, and develop new technologies.

IF OUR FACILITIES WERE TO EXPERIENCE CATASTROPHIC LOSS, OUR OPERATIONS WOULD BE SERIOUSLY HARMED.

Our facilities could be subject to a catastrophic loss such as fire, flood, earthquake, power outage, or

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terrorist activity. A substantial portion of our research and development activities, manufacturing, our corporate headquarters, and other critical business operations are located near major earthquake faults in San Jose, California, an area with a history of seismic events. An earthquake at or near our facilities could disrupt our operations, delay production and shipments of our products or technologies, and result in large expenses to repair and replace the facility. While we believe that we maintain insurance sufficient to cover most long-term potential losses at our facilities, our existing insurance may not be adequate for all possible losses. In addition, California has experienced problems with its power supply in recent years. As a result, we have experienced utility cost increases and may experience unexpected interruptions in our power supply that could have a material adverse effect on our sales, results of operations, and financial condition.

Investment Risks

OUR QUARTERLY REVENUES AND OPERATING RESULTS ARE VOLATILE, AND IF OUR FUTURE RESULTS ARE BELOW THE EXPECTATIONS OF PUBLIC MARKET ANALYSTS OR INVESTORS, THE PRICE OF OUR COMMON STOCK IS LIKELY TO DECLINE.

Our revenues and operating results are likely to vary significantly from quarter to quarter due to a number of factors, many of which are outside of our control and any of which could cause the price of our common stock to decline.

These factors include:

- the establishment or loss of licensing relationships;
- the timing and recognition of payments under fixed and/or up-front license agreements;
- the timing of work performed under development agreements;
- the timing of our expenses, including costs related to litigation, stock-based awards, acquisitions of technologies, or businesses;
- the timing of introductions and market acceptance of new products and product enhancements by us, our licensees, our competitors, or their competitors;
- our ability to develop and improve our technologies;
- our ability to attract, integrate, and retain qualified personnel;
- seasonality in the demand for our products or our licensees products; and
- our ability to build or ship products on a timely basis.

CHANGES IN FINANCIAL ACCOUNTING STANDARDS OR PRACTICES MAY CAUSE ADVERSE, UNEXPECTED FINANCIAL REPORTING FLUCTUATIONS AND AFFECT OUR REPORTED RESULTS OF OPERATIONS.

A change in accounting standards or practices can have a significant effect on our reported results and may even affect our reporting of transactions completed before the change is effective. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

OUR STOCK PRICE MAY FLUCTUATE REGARDLESS OF OUR PERFORMANCE.

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The stock market has experienced extreme volatility that often has been unrelated or disproportionate to the performance of particular companies. These market fluctuations may cause our stock price to decline regardless of our performance. The market price of our common stock has been, and in the future could be, significantly affected by factors such as: actual or anticipated fluctuations in operating results; announcements of technical innovations; announcements regarding litigation in which we are involved; changes by game console manufacturers to not include touch-enabling capabilities in their products; new products or new contracts; sales or the perception in the market of possible sales of large number of shares of our common stock by insiders or others; stock repurchase activity; changes in securities analysts recommendations; changing circumstances regarding competitors or their customers; governmental regulatory action; developments with respect to patents or proprietary rights; inclusion in or exclusion from various stock indices; and general market conditions. In the past, following periods of volatility in the market price of a company s securities, securities class action litigation has been initiated against that company.

PROVISIONS IN OUR CHARTER DOCUMENTS AND DELAWARE LAW COULD PREVENT OR DELAY A CHANGE IN CONTROL, WHICH COULD REDUCE THE MARKET PRICE OF OUR COMMON STOCK.

Provisions in our certificate of incorporation and bylaws may have the effect of delaying or preventing a change of control or changes in our board of directors or management, including the following:

- our board of directors is classified into three classes of directors with staggered three-year terms;
- only our chairperson of the board of directors, a majority of our board of directors or 10% or greater stockholders are authorized to call a special meeting of stockholders;
- our stockholders can only take action at a meeting of stockholders and not by written consent;
- vacancies on our board of directors can be filled only by our board of directors and not by our stockholders;
- our restated certificate of incorporation authorizes undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval; and
- advance notice procedures apply for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders.

In addition, certain provisions of Delaware law may discourage, delay, or prevent someone from acquiring or merging with us. These provisions could limit the price that investors might be willing to pay in the future for shares.

WE MAY ENGAGE IN ACQUISITIONS THAT COULD DILUTE STOCKHOLDERS INTERESTS, DIVERT MANAGEMENT ATTENTION, OR CAUSE INTEGRATION PROBLEMS.

As part of our business strategy, we have in the past and may in the future, acquire businesses or intellectual property that we feel could complement our business, enhance our technical capabilities, or increase our intellectual property portfolio. The pursuit of potential acquisitions may divert the attention of management and cause us to incur various expenses in identifying, investigating, and pursuing suitable acquisitions, whether or not they are consummated.

IF WE CONSUMMATE ACQUISITIONS THROUGH THE ISSUANCE OF OUR SECURITIES, OUR STOCKHOLDERS COULD SUFFER SIGNIFICANT DILUTION. ACQUISITIONS COULD ALSO CREATE RISKS FOR US, INCLUDING:

As part of our business strategy, we have in the past and may in the future, acquire businesses or

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intellectual property that we feel could complement our business, enhance our technical capabilities, or increase our intellectual property portfolio. The pursuit of potential acquisitions may divert the attention of management and cause us to incur various expenses in identifying, investigating, and pursuing suitable acquisitions, whether or not they are consummated.

If we consummate acquisitions through the issuance of our securities, our stockholders could suffer significant dilution. Acquisitions could also create risks for us, including:

- unanticipated costs associated with the acquisitions;
- use of substantial portions of our available cash to consummate the acquisitions;
- diversion of management s attention from other business concerns;
- difficulties in assimilation of acquired personnel or operations
- failure to realize the anticipated benefits of acquired intellectual property or other assets;
- charges associated with amortization of acquired assets or potential charges for write-down of assets associated with unsuccessful acquisitions;
- potential intellectual property infringement claims related to newly-acquired product lines; and
- potential costs associated with failed acquisition efforts.

Any acquisitions, even if successfully completed, might not generate significant additional revenue or provide any benefit to our business.

AS OUR BUSINESS GROWS, SUCH GROWTH MAY PLACE A SIGNIFICANT STRAIN ON OUR MANAGEMENT AND OPERATIONS AND, AS A RESULT, OUR BUSINESS MAY SUFFER.

We plan to continue expanding our business, and any significant growth could place a significant strain on our management systems, infrastructure and other resources. We recently transitioned the preparation of all of our internal reporting to upgraded management information systems and are in the process of considering implementing additional automated system functionality. If we go forward with these system enhancements, we may encounter problems with the implementation of these systems or we may have difficulties preparing or tracking internal information which could adversely affect our financial results. We will need to continue to invest the necessary capital to upgrade and improve our operational, financial and management reporting systems. If our management fails to manage our growth effectively, we could experience increased costs, declines in product quality, or customer satisfaction, which could harm our business.

ITEM 6. EXHIBITS

The following exhibits are filed herewith:

Exhibit Number	**Description**
10.1	Form of 2010 Executive Incentive Plan.
31.1	Certification of Victor Viegas, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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Exhibit Number	Description
31.2	Certification of Henry Hirvela, Interim Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Victor Viegas, Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Henry Hirvela, Interim Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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.

Date: May 7, 2010

IMMERSION CORPORATION

By /s/ Henry Hirvela
Henry Hirvela
Interim Chief Financial Officer

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