IMMERSION CORP
Form 10-Q
November 07, 2011
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

[**X**] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2011

OR

[ ] 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	*(I.R.S. Employer Identification No.)*
incorporation or organization)	

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 [X] No [ ]

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

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 [ ] Accelerated filer [X]

Non-accelerated filer [ ] (Do not check if a smaller reporting company) Smaller Reporting Company [ ]

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

Yes [ ] No [X]

Number of shares of common stock outstanding at October 31, 2011: 28,863,334.

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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)

	September 30, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 14,509	$ 12,243
Short-term investments	48,979	48,961
Accounts and other receivables (net of allowances for doubtful accounts as of: September 30, 2011 $25 and December 31, 2010 $97)	779	815
Inventories	579	406
Deferred income taxes	342	342
Prepaid expenses and other current assets	704	3,821
Total current assets	65,892	66,588
Property and equipment, net	1,279	1,931
Intangibles and other assets, net	13,771	12,356
Total assets	$ 80,942	$ 80,875
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 550	$ 393
Accrued compensation	2,722	3,507
Other current liabilities	1,129	1,488
Deferred revenue and customer advances	4,459	4,429
Total current liabilities	8,860	9,817
Long-term deferred revenue	14,010	16,494
Deferred income tax liabilities	342	342
Other long-term liabilities	455	538
Total liabilities	23,667	27,191
Commitments and Contingencies (Notes 9 and 16)		
Stockholders equity:		
Common stock and additional paid-in capital $0.001 par value; 100,000,000 shares authorized; shares issued: September 30, 2011 31,760,085 and December 31, 2010 31,016,812; shares outstanding: September 30, 2011 28,940,662 and December 31, 2010 28,228,603	181,609	176,515
Accumulated other comprehensive income	139	120
Accumulated deficit	(105,887)	(104,553)

Treasury stock at cost: September 30, 2011 2,819,423 shares and December 31, 2010 2,788,209 shares		(18,586)		(18,398)
Total stockholders equity		57,275		53,684
Total liabilities and stockholders equity	$	80,942	$	80,875

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 September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Revenues:				
Royalty and license	$ 5,875	$ 5,141	$ 20,110	$ 17,848
Product sales	345	1,217	1,892	6,035
Development contracts and other	275	189	943	848
Total revenues	6,495	6,547	22,945	24,731
Costs and expenses:				
Cost of revenues (exclusive of amortization, impairment, and abandonment of intangibles shown separately below)	192	457	913	2,587
Sales and marketing	1,643	1,813	5,402	6,077
Research and development	2,183	2,007	6,525	6,473
General and administrative	3,195	3,008	9,367	11,808
Amortization and impairment or abandonment of intangibles	324	211	1,016	650
Total costs and expenses	7,537	7,496	23,223	27,595
Operating loss	(1,042)	(949)	(278)	(2,864)
Interest and other income	58	70	172	212
Loss from continuing operations before provision for income taxes	(984)	(879)	(106)	(2,652)
Provision for income taxes	(428)	(336)	(1,289)	(1,098)
Loss from continuing operations	(1,412)	(1,215)	(1,395)	(3,750)
Discontinued operations (Note 11) :				
Gain on sales of discontinued operations net of provision for income taxes of $0, $18, $39 and $18	0	82	61	143
Net loss	$ (1,412)	$ (1,133)	$ (1,334)	$ (3,607)
Basic and diluted net loss per share				
Continuing operations	(0.05)	(0.04)	(0.05)	(0.13)
Discontinued operations	0.00	0.00	0.00	0.00
Total	$ (0.05)	$ (0.04)	$ (0.05)	$ (0.13)
Shares used in calculating basic and diluted net loss per share	28,918	28,134	28,595	28,087

See accompanying Notes to Condensed Consolidated Financial Statements.

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IMMERSION CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) (unaudited)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Cash flows from operating activities:		
Net loss	$ (1,334)	$ (3,607)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization of property and equipment	717	842
Amortization and impairment or abandonment of intangibles	1,016	650
Stock-based compensation	2,705	2,430
Allowance (recovery) for doubtful accounts	(25)	(120)
Loss on disposal of equipment	3	90
Loss on divestiture	0	43
Gain on sales of discontinued operations	(61)	(143)
Changes in operating assets and liabilities:		
Accounts and other receivables	61	2,259
Inventories	(173)	860
Prepaid expenses and other current assets	3,117	53
Other assets	(89)	0
Accounts payable	32	(315)
Accrued compensation and other current liabilities	(1,282)	(829)
Deferred revenue and customer advances	(2,454)	(3,583)
Other long-term liabilities	(56)	121
Net cash provided by (used in) operating activities	2,177	(1,249)
Cash flows used in investing activities:		
Purchases of available-for-sale investments	(44,910)	(34,880)
Proceeds from maturities of available-for-sale investments	45,000	30,000
Net proceeds from divestiture	0	964
Additions to intangibles	(2,406)	(1,584)
Proceeds from sale of property and equipment	0	160
Purchases of property and equipment	(84)	(336)
Proceeds from sales of discontinued operations	100	142
Net cash used in investing activities	(2,300)	(5,534)
Cash flows provided by financing activities:		
Issuance of common stock under employee stock purchase plan	145	0
Exercise of stock options	2,244	83
Net cash provided by financing activities	2,389	83
Net increase in cash and cash equivalents	2,266	(6,700)
Cash and cash equivalents:		
Beginning of the period	12,243	19,828

End of the period	$ 14,509	$ 13,128
Supplemental disclosure of cash flow information:		
Cash paid (received) for taxes	$ (3,302)	$ 6
Supplemental disclosure of non-cash investing and financing activities:		
Amounts accrued for property and equipment, and intangibles	$ 636	$ 377
Shares issued under company stock plan	$ 1,305	$ 34

See accompanying Notes to Condensed Consolidated Financial Statements.

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IMMERSION CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

(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, Immersion Canada Inc., Immersion International, LLC, Immersion Medical, Inc., Immersion Japan K.K., Immersion Taiwan, and Haptify, Inc. 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, 2010. 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 periods presented have been included.

The results of operations for the interim periods ended September 30, 2011 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 Element Arrangements (ASC 605-25); and ASC 985-60 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, 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 also delivers software 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 probable. 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, which is generally recognized when all deliverables including services are completed or recognized on a straight-line basis over the expected term of the license.

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 limited cases, post contract customer support. For arrangements that are software based and include software and professional services, the services are generally not essential to the functionality of the software, and customers may 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. For these arrangements, including those with post contract customer support, revenue is recognized either over the period of the ongoing obligation which is generally consistent with the contractual term, or when all deliverables including services have been completed.

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.

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 adopted ASU 2009-13 (update to ASC 605) as of January 1, 2011, and its application had no impact on the Company s condensed consolidated financial statements as no material new agreements or materially modified contracts in the nine months ended September 30, 2011 came under this guidance.

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 adopted ASC 2009-14 (update to ASC 605) as of January 1, 2011, and its application had no impact on the Company s condensed consolidated financial statements as no material new agreements or materially modified contracts in the nine months ended September 30, 2011 came under this guidance.

In June 2011, the FASB ratified ASU 2011-05 Comprehensive Income (Topic 220): Presentation of Comprehensive Income. ASU 2011-05 requires that all nonowner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements, eliminating the option to present other comprehensive income in the statement of changes in equity. Under either choice, items that are reclassified from other comprehensive income to net income are required to be presented on the face of the financial statements where the components of net income and the components of other comprehensive income are presented. This amendment is effective for reporting periods beginning after December 15, 2011, and will be applied retrospectively. This amendment will change the manner in which the Company presents comprehensive income.

2. FAIR VALUE MEASUREMENTS

Cash Equivalents and Short-term Investments

The financial instruments of the Company measured at fair value on a recurring basis are cash equivalents and short-term investments. The Company s cash equivalents and short-term investments are 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 Company did not have any transfers between Level 1 and Level 2 fair value measurements during the periods presented.

The types of instruments valued based on quoted market prices in active markets include most U.S. treasury 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 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 or data that market participants would use in valuing an instrument are generally classified within Level 3 of the fair value hierarchy.

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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 was adopted January 1, 2011. The adoption of this guidance did not have a material impact on its condensed consolidated results of operations and financial condition.

Financial instruments measured at fair value on a recurring basis as of September 30, 2011 and December 31, 2010 are classified based on the valuation technique in the table below:

	September 30, 2011 Fair value measurements using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	(In thousands)			
Assets:				
U.S. Treasury securities	$ 48,979	$ 0	$ 0	$ 48,979
Money market accounts	11,423	0	0	11,423
Total assets at fair value	$ 60,402	$ 0	$ 0	$ 60,402

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

	December 31, 2010 Fair value measurements using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	(In thousands)			
Assets:				
U.S. Treasury securities	$ 48,961	$ 0	$ 0	$ 48,961
Money market accounts	7,356	0	0	7,356
Total assets at fair value	$ 56,317	$ 0	$ 0	$ 56,317

The above table excludes $4.9 million of cash held in banks.

Short-term Investments

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	September 30, 2011			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
	(In thousands)			
U.S. Treasury securities	$ 48,949	$ 30	$ 0	$ 48,979
Total	$ 48,949	$ 30	$ 0	$ 48,979

	December 31, 2010			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
	(In thousands)			
U.S. Treasury securities	$ 48,942	$ 19	$ 0	$ 48,961
Total	$ 48,942	$ 19	$ 0	$ 48,961

The contractual maturities of the Company s available-for-sale securities on September 30, 2011 and December 31, 2010 were all due within one year.

3. ACCOUNTS AND OTHER RECEIVABLES

	September 30, 2011	December 31, 2010
	(In thousands)	
Trade accounts receivable	$ 337	$ 459
Receivables from vendors and other	442	356
Accounts and other receivables	$ 779	$ 815

4. INVENTORIES

	September 30, 2011	December 31, 2010
	(In thousands)	
Raw materials and subassemblies	$ 310	$ 281
Finished goods	269	125
Inventories	$ 579	$ 406

5. PROPERTY AND EQUIPMENT

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	September 30, 2011	December 31, 2010
	(In thousands)	
Computer equipment and purchased software	$ 3,681	$ 3,807
Machinery and equipment	711	815
Furniture and fixtures	634	630
Leasehold improvements	886	881
Total	5,912	6,133
Less accumulated depreciation	(4,633)	(4,202)
Property and equipment, net	$ 1,279	$ 1,931

6. INTANGIBLES AND OTHER ASSETS

	September 30, 2011	December 31, 2010
	(In thousands)	
Patents and trademarks	$ 23,122	$ 21,074
Other assets	286	295
Gross intangibles and other assets	23,408	21,369
Accumulated amortization of patents and trademarks	(9,637)	(9,013)
Intangibles and other assets, net	$ 13,771	$ 12,356

The Company amortizes its intangible assets related to patents and trademarks, over their estimated useful lives, generally 10 years from the date of issuance of the patents and trademarks. Amortization of intangibles excluding impairments or abandonments was as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2011	2010	2011	2010
	(In thousands)		(In thousands)	
Amortization of Intangibles - excluding impairments or abandonments	$ 333	$ 211	$ 747	$ 630

The table below includes estimated remaining annual amortization expense for intangible assets as of September 30, 2011. The table includes patents which are in process and the amounts are subject to change based on management s estimate.

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	Estimated Amortization Expense (In thousands)
Remainder of 2011	$ 267
2012	1,118
2013	1,326
2014	1,394
2015	1,496
Thereafter	7,884
Total	$ 13,485

Patents in process included in patents and trademarks were as follows:

	September 30, 2011	December 31, 2010
	(In thousands)	
Patents in process	$ 8,119	$ 7,382

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

	September 30, 2011	December 31, 2010
	(In thousands)	
Accrued legal	$ 380	$ 543
Income taxes payable	31	55
Other current liabilities	718	890
Total other current liabilities	$ 1,129	$ 1,488
Deferred revenue	$ 4,392	$ 4,390
Customer advances	67	39
Total deferred revenue and customer advances	$ 4,459	$ 4,429

8. LONG-TERM DEFERRED REVENUE

Long-term deferred revenue consisted of the following:

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	September 30, 2011	December 31, 2010
	(In thousands)	
Deferred revenue for Sony Computer Entertainment	$ 13,384	$ 15,632
Other deferred revenue	626	862
Long-term deferred revenue	$ 14,010	$ 16,494

9. COMMITMENTS

The Company leases several of its facilities under noncancelable operating lease arrangements that expire at various dates through 2016.

On September 16, 2011, the Company entered into a Lease Termination Agreement effective as of December 31, 2011 with respect to the lease of its primary facilities of approximately 48,000 square feet in San Jose, California which was set to expire in June 2014. Pursuant to that agreement, the Company will be paid $350,000, subject to the Company vacating the premises by December 31, 2011. On September 19, 2011, the Company entered into a new lease agreement for its primary facilities of approximately 33,000 square feet in San Jose, California which expires in December 2016 and can be extended to December 2021.

Minimum future lease payments and non-cancellable unconditional purchase obligations are as follows:

	Operating Leases	Purchase Obligations
	(In thousands)	
2011 (remainder)	$ 185	$ 255
2012	362	-
2013	499	-
2014	513	-
2015	507	-
Thereafter	422	-
Total	$ 2,488	$ 255

10. 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, officers, 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 from 5 to 10 years from the date of grant. Restricted stock generally vests over one year. RSUs generally vest over 3 years. On June 3, 2011, the Company s stockholders approved the 2011 Equity Incentive Plan (the 2011 Plan) in which 2,300,000 shares were authorized. In addition, 400,000 shares were transferred from the Company s 2007 Equity Incentive Plan (the 2007 Plan) and 2,279,263 shares were transferred from the Company s 2008 Equity Incentive Plan (the 2008 Plan) for a total of 4,979,263 originally available for grant under the 2011 Plan. Under the 2011 Plan, any award other than an option or stock appreciation right shall reduce the common stock shares available for grant by 1.75 shares for every share issued. The 2007 Plan and 2008 Plan have been terminated.

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	September 30, 2011
Common stock shares available for grant	4,860,638
Common stock options outstanding	3,584,975
Restricted stock awards outstanding	18,000
Restricted stock units outstanding	448,540

Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan (ESPP). Under the ESPP, eligible employees may purchase common stock through payroll deductions at a purchase price of 85% of the lower of the fair market value of the Company s stock at the beginning of the offering period or the purchase date. Participants may not purchase more than 2,000 shares in a six-month offering period or purchase stock having a value greater than $25,000 in any calendar year as measured at the beginning of the offering period. A total of 1,000,000 shares of common stock are reserved for issuance under the ESPP. As of September 30, 2011, 456,891 shares had been purchased since the inception of the ESPP in 1999. Under ASC 718-10, the ESPP is considered a compensatory plan and the Company is required to recognize compensation cost related to the fair value of common stock purchased under the ESPP. Shares purchased under the ESPP for the nine months ended September 30, 2011 are listed below. No shares were purchased under the ESPP for the nine months ended September 30, 2010. The intrinsic value listed below is calculated as the difference between the market value on the date of purchase and the purchase price of the shares.

	Nine months Ended September 30, 2011
Shares purchased under ESPP	28,702
Average price of shares purchased under ESPP	$ 5.04
Intrinsic value of shares purchased under ESPP	$ 74,566

Summary of Stock Options

The following table sets forth the summary of option activity under the Company s stock option plans for the nine months ended September 30, 2011 and year ended December 31, 2010:

	Nine Months Ended September 30, 2011	Year Ended December 31, 2010
Beginning outstanding balance	4,000,526	5,041,235
Granted	387,163	662,185
Exercised	(537,520)	(130,135)
Forfeited and cancelled	(265,194)	(1,572,759)
Ending outstanding balance	3,584,975	4,000,526
Aggregate intrinsic value of options exercised	$ 2,399,000	$ 308,000
Weighted average fair value of options granted	4.18	3.11

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Information regarding stock options outstanding at September 30, 2011 and December 31, 2010 is summarized below:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (In millions)
September 30, 2011				
Options outstanding	3,584,975	$ 6.53	6.02	$ 2.6
Options vested and expected to vest using estimated forfeiture rates	3,445,690	6.54	5.92	2.5
Options exercisable	2,426,104	7.00	4.92	1.5
December 31, 2010				
Options outstanding	4,000,526	$ 6.26	6.39	$ 5.5
Options vested and expected to vest using estimated forfeiture rates	3,798,092	6.32	6.25	5.1
Options exercisable	2,541,701	6.80	5.03	2.9

Summary of Restricted Stock Units

RSU activity for the nine months ended September 30, 2011 and year ended December 31, 2010 was as follows:

	Nine Months Ended September 30, 2011	Year Ended December 31, 2010
Beginning outstanding balance	417,923	198,055
Awarded	243,908	363,928
Released	(156,051)	(69,021)
Forfeited	(57,240)	(75,039)
Ending outstanding balance	448,540	417,923
Weighted average grant date fair value of RSUs granted	$ 6.61	$ 5.58
Total fair value of RSUs released	1,146,000	315,000
Total fair value of RSUs remaining unvested	2,682,000	2,804,000

Information regarding RSUs outstanding at September 30, 2011 and December 31, 2010 is summarized below:

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	Number of Shares	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (In millions)
September 30, 2011			
RSUs outstanding	448,540	1.19	$ 2.7
RSUs vested and expected to vest using estimated forfeiture rates	361,439	1.16	2.2
December 31, 2010			
RSUs outstanding	417,923	1.13	$ 2.8
RSUs vested and expected to vest using estimated forfeiture rates	330,038	1.00	2.2

Summary of Restricted Stock Awards

Restricted stock award activity for the nine months ended September 30, 2011 and year ended December 31, 2010 was as follows:

	Nine Months Ended September 30, 2011	Year Ended December 31, 2010
Beginning outstanding balance	18,000	27,000
Awarded	30,000	22,500
Released	(21,000)	(31,500)
Forfeited	(9,000)	0
Ending outstanding balance	18,000	18,000
Weighted average grant date fair value of restricted stock awarded	$ 6.61	$ 5.59
Total fair value of restricted stock awards released	159,000	147,000

Stock Plan Assumptions

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
Options	**2011**	**2010**	**2011**	**2010**
Expected life (in years)	4.5	5.2	5.0	5.2
Volatility	70%	67%	69%	67%
Interest rate	0.9%	1.5%	1.7%	2.0%
Dividend yield	0.0%	0.0%	0.0%	0.0%

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	Three Months Ended September 30,		Nine Months Ended September 30,	
Employee Stock Purchase Plan	**2011**	**2010**	**2011**	**2010**
Expected life (in years)	0.5	N/A	0.5	N/A
Volatility	40%	N/A	45%	N/A
Interest rate	0.2%	N/A	0.2%	N/A
Dividend yield	0.0%	N/A	0.0%	N/A

Compensation Costs

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
	(In thousands)		(In thousands)	
Statement of Operations Classifications				
Cost of product sales	$ 0	$ 0	$ 0	$ 10
Sales and marketing	132	155	376	546
Research and development	201	199	639	597
General and administrative	607	542	1,690	1,277
Total	$ 940	$ 896	$ 2,705	$ 2,430

As of September 30, 2011, there was $5.4 million related to stock options, restricted stock awards, and RSUs of unrecognized compensation cost, adjusted for estimated forfeitures, granted to the Company s employees and directors. This cost will be recognized over an estimated weighted-average period of approximately 2.48 years for options, 1.90 years for RSUs, and 0.45 years for restricted stock awards. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

Stock Repurchase Program

On November 1, 2007, the Company announced 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 twelve months ended December 31, 2008, the Company repurchased 2,786,563 shares for approximately $18.4 million at an average cost of $6.60 per share net of transaction costs through open market repurchases. During the three and nine months ended September 30, 2011, the Company repurchased 31,214 shares for $188,000 at an average cost of $6.02 net of transaction costs through open market repurchases. These amounts are classified as treasury stock on the Company s condensed consolidated balance sheet.

11. DIVESTITURE AND DISCONTINUED OPERATIONS

Divestiture

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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 acquired certain assets including inventory, fixed assets, and certain liabilities which included warranty liabilities of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines used in the field of medical training for approximately $1.6 million subject to purchase price adjustments for final inventory levels. The agreement also provided for the transfer of certain employees to CAE as well as distribution agreements and customer relationships. Under the transition services agreement, the Company provided certain back-office services to CAE for up to nine months and was being reimbursed for the expenses incurred for such services. Under the license agreement, the Company 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 (loss) in the accompanying condensed consolidated statements of operations through the date of sale. Although the Company has ceased manufacturing these three specific product lines, these operating results have not been reported as discontinued operations. The Company continues to manufacture Virtual IV products, another medical product line, but the primary focus of the Company s business has changed from simulation product sales to licensing fees. During the nine months ended September 30, 2010, the Company recognized a pre-tax loss of approximately $43,000 in continuing operations in connection with the asset purchase agreement and the transition services agreement. There was no cost in 2011 related to the CAE transaction. The cost reimbursements received under the Transition Services Agreement were recorded as an off-set to the related operating expense line items. The Company s license agreement with CAE includes quarterly revenue under the license arrangement which started in July 2010. Under the terms of the Company s revenue recognition policy for transactions with extended payment terms such as this, the Company recognizes revenue as amounts become due and payable and all revenue recognition criteria are met. In connection with the transaction, the Company agreed to indemnify CAE for certain liabilities, claims, and other specified items in the asset purchase agreement.

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. During 2009, the Company sold all of its 3D product line including inventory, fixed assets, and intangibles and recorded gains on the sale of discontinued operations of $187,000 at the time of the sales. Negotiated consideration for the sales was $2.7 million in the form of cash of $320,000 and notes receivable of $2.4 million payable through 2013, for which the proceeds are being recognized when they are received. 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 for all periods presented. The assets sold consisted primarily of intangible assets that had no carrying value on the Company s books at the time of sale. In the three and nine months ended September 30, 2011 the Company recorded a gain on sales of discontinued operations net of tax of $0 and $61,000 respectively, from payments on notes from the sale of the 3D product line. In the three and nine months ended September 30, 2010 the Company recorded a gain on sale of discontinued operations net of tax of $82,000 and $143,000 respectively, from payments on notes from the sale of the 3D product line.

12. INCOME TAXES

Income tax provisions from continuing operations consisted of the following:

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands)		(In thousands)	
Loss from continuing operations before provision for income taxes	$ (984)	$ (879)	$ (106)	$ (2,652)
Provision for income taxes	(428)	(336)	(1,289)	(1,098)
Effective tax rate	(43.5)%	(38.2)%	(1216.0)%	(41.4)%

The effective tax rates differ from the statutory rate primarily due to the valuation allowance, foreign withholding taxes, and unrecognized tax benefits. The income tax provision for the three months and nine months ended September 30, 2011 and 2010 are primarily as a result of foreign withholding tax expense.

As of September 30, 2011, the Company had unrecognized tax benefits under ASC 740 Income Taxes of approximately $673,000 including interest of $45,000. The total amount of unrecognized tax benefits that would affect the Company s effective tax rate, if recognized, was $244,000. There were no material changes in the amount of unrecognized tax benefits during the nine months ended September 30, 2011. 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 had 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.

The Company maintains a valuation allowance for its entire deferred tax assets at September 30, 2011 and December 31, 2010 as a result of uncertainties regarding the realization of the asset balance due to past losses, the variability of operating results, and near term projected results. 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.

13. NET LOSS PER SHARE

Basic and diluted net loss per share is computed using the weighted average number of common shares outstanding for the period, excluding unvested restricted stock and RSUs. 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 September 30,				Nine Months Ended September 30,			
	2011		2010		2011		2010	
Numerator:								
Loss from continuing operations	$	(1,412)	$	(1,215)	$	(1,395)	$	(3,750)
Gain from discontinued operations, net of tax		0		82		61		143
Net loss used in computing basic and diluted net loss per share	$	(1,412)	$	(1,133)	$	(1,334)	$	(3,607)
Denominator:								
Shares used in computation of basic and diluted net loss per share		28,918		28,134		28,595		28,087
Basic and diluted net loss per share from:								
Continuing operations	$	(0.05)	$	(0.04)	$	(0.05)	$	(0.13)
Discontinued operations		0.00		0.00		0.00		0.00
Total	$	(0.05)	$	(0.04)	$	(0.05)	$	(0.13)

As of September 30, 2011 and 2010, 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 for the three and nine months ended September 30, 2011 and 2010, since their effect would have been anti-dilutive. These outstanding securities consisted of the following (in thousands):

	September 30, 2011	September 30, 2010
Outstanding stock options	3,585	4,176
Unvested restricted stock awards	18	18
Unvested RSUs	449	424

14. COMPREHENSIVE LOSS

The following table sets forth the components of comprehensive loss:

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	Three Months Ended September 30, 2011	2010	Nine Months Ended September 30, 2011	2010
	(In thousands)		(In thousands)	
Net loss	$ (1,412)	$ (1,133)	$ (1,334)	$ (3,607)
Change in unrealized losses on short-term investments	(3)	(7)	19	66
Total comprehensive loss	$ (1,415)	$ (1,140)	$ (1,315)	$ (3,541)

15. 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: mobile communications and consumer electronics, automotive, gaming, commercial and industrial controls, and medical. Through March 31, 2010, the Company managed these application areas under two operating and reportable segments: Touch and Medical. As discussed in Note 11 of the condensed consolidated financial statements, on March 30, 2010 the Company divested its Endoscopy, Endovascular, and Laparoscopy product lines. Management continues to manufacture a limited amount of product, but the primary focus from this part of the business has changed from simulation product sales to primarily a licensing model under which the Company develops and licenses a wide range of haptic-related software and patented technologies and will collect license and royalty revenue. As of April 1, 2010, the Company reorganized into one segment and there is no longer management, development, operations, or administrative personnel specifically for medical operations or product lines.

The Company s chief operating decision maker (CODM) is the Chief Executive Officer. The CODM allocates resources to and assesses the performance of the Company using information about its revenue and operating loss. Beginning April 1, 2010, there is only one segment that is reported to management.

As the Company has changed its internal structure which caused the Company s reportable segments to change, the Company has restated its previously reported separate segment information from Medical and Touch into only one segment. As such, separate segment information has been eliminated.

16. 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

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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.

In September 2008, all of the parties to the lawsuits reached a settlement, subject to documentation and approval of the District Court. 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. On October 6, 2009, the District Court approved the settlement, and the Court subsequently entered a judgment of dismissal. Under the judgment, the Immersion Defendants are not required to contribute to the settlement. Several notices of appeal have been filed by putative class members challenging the settlement. Subsequently, the District Court determined that none of the objectors had standing to appeal. One of the putative objectors has filed a notice of appeal of the determination as to him. The Company intends to defend the lawsuit vigorously.

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 the Company s restatement of its financial statements, lead plaintiff filed a consolidated complaint on April 9, 2010. Defendants moved to dismiss the action on June 15, 2010 and that motion was granted on March 11, 2011. Lead plaintiff filed an amended complaint on April 29, 2011. Defendants moved to dismiss the amended complaint on July 1, 2011.

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.

Kasmer v. Immersion Corporation

On May 5, 2010, an action was filed in Delaware Chancery Court by a shareholder seeking to enforce a demand to inspect certain of the Company s records pursuant to Section 220 of the Delaware General Corporation Law, as a possible prelude to the shareholder bringing a derivative action. The Company filed an answer on June 14, 2010, questioning whether a proper purpose for the records inspection had been stated and raising other defenses concerning the scope of the demand, among other deficiencies. Following a one-day trial on December 2, 2010, the Court significantly narrowed the scope of the demand and the Company responded accordingly. On October 24, 2011, the shareholder filed a motion seeking to compel further responses to the demand. The Company believes that its responses complied with the Court s ruling and therefore will be opposing the shareholder s motion.

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 condensed 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 reduces 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 expr However, these words are not the 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 and other devices. To achieve this heightened interactivity, we develop and license or manufacture a wide range of 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 lines of business: mobile communications and consumer electronics, automotive, gaming, commercial and industrial, and medical. As of April 1, 2010, we reorganized from two segments and now we manage these application areas under one operating and reportable segment (See Note 15 to the condensed consolidated financial statements).

In most all of our markets, such as mobile communications and consumer electronics, automotive, gaming, commercial and industrial, and medical, we primarily license our technologies to manufacturers who use them in products sold under their own brand names. In a few markets, such as medical simulation, we have sold products manufactured under our own brand name through direct sales to end users, distributors, or OEMs. From time to time, we have also engaged in development projects for third parties.

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. Since 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 agreements with medical licensees, and we continue to ship Virtual IV medical products.

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 more than 1,200 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, short-term investments, warranty obligations, patents and intangible assets, income taxes, 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

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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-Reve 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, 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 also deliver software 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 probable. 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, which is generally recognized when all deliverables including services are completed or recognized on a straight-line basis over the expected term of the license.

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 limited cases, post contract customer support. For arrangements that are software based and include software and professional services, the services are generally not essential to the functionality of the software, and customers may 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. For these arrangements, including those with post contract customer support, revenue is recognized either over the period of the ongoing obligation which is generally consistent with the contractual term, or when all deliverables including services have been completed.

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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.

Cost of Revenues Cost of revenues includes both cost of product sales and cost of development contract revenues. Cost of product sales consists primarily of contract manufacturing and other overhead costs. Cost of development contract revenue includes primarily labor related costs relating to these contracts.

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, stock awards, 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. Stock-based compensation expense recognized at fair value includes the impact of estimated forfeitures. We estimate future forfeitures at the date of grant and revise the estimates if necessary, in subsequent periods if actual forfeitures differ from these estimates. 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, 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 10 to the condensed consolidated financial statements for further information regarding stock-based compensation.

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,

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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 U.S. treasury bills 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, and using the specific identification method, any unrealized gains and losses considered to be temporary in nature are 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-temporarily 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, historical losses, and existing economic conditions. 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, filing, and maintenance 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 nine months ended September 30, 2011, we capitalized costs associated with patents and trademarks of $2.4 million. Our total amortization expense (exclusive of impairments or abandonments) for the same period was $747,000.

RESULTS OF OPERATIONS FOR THE THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010

The following discussion and analysis includes our results of operations from continuing operations for the three months and nine months ended September 30, 2011 and 2010. Accordingly, any gain or loss on sale or income tax provision from discontinued operations have been aggregated and reported as a gain or 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 we have ceased manufacturing these three specific product lines, these operating results have not been reported as discontinued operations. From our medical product lines, we continue to manufacture our Virtual IV product line, but the primary focus from this part of our business has changed from simulation product sales to royalty and license revenue.

Overview

Our revenues decreased by 1% during the third quarter ended September 30, 2011 as compared to the third quarter ended September 30, 2010. The third quarter revenue decrease was primarily due to a 72% decrease in product sales, partially offset by a 14% increase in royalty and license revenue. The decrease in

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product sales was primarily due to a softer market for our products in the medical line of business as well as inventory rebalancing by a specific customer. The increase in royalty and license revenue was mainly due to increased revenue primarily from our gaming and mobility licensees. Our revenues decreased by 7% during the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. The revenue decrease for the nine months ended September 30, 2011 was primarily due to a 69% decrease in product sales primarily due to the divestiture of certain medical product lines to CAE. Partially offsetting this, there was a 13% increase in royalty and license revenue mainly due to increased royalty and license fees primarily from our mobility and gaming lines of business.

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 to CAE for approximately $1.6 million and had a loss on the transaction of $43,000 in 2010. The agreement also provided for the transfer of approximately 34 employees and contractors to CAE as well as distribution agreements and customer relationships. Our divestiture of our medical simulation product lines was completed during 2010. However, we expect to continue to receive revenue due to our licensing agreement with CAE and other companies pertaining to haptic-based technology in medical training applications, and we continue to ship Virtual IV medical products.

Our loss from continuing operations was $1.4 million during the third quarter ended September 30, 2011 as compared to a loss of $1.2 million for the third quarter ended September 30, 2010. The increased loss was primarily due to higher operating expenses which include an increase in research and development expenses and an increase in foreign withholding taxes resulting from higher royalty revenue from some Asian countries. Our loss from continuing operations was $1.4 million during the nine months ended September 30, 2011 as compared to a loss from continuing operations of $3.8 million for the nine months ended September 30, 2010. The decreased loss was primarily due to reduced ongoing expenses from the transfer of product lines to CAE, reductions in personnel, and other cost savings measures.

During the remainder of 2011, we expect royalty and licensing revenues to be the major component of our revenues as our technology continues to be included in more products. Our first quarter revenue is typically higher than all other quarters due to the reporting of holiday sales by our customers in the prior quarter and we expect this seasonality to continue. Also, we expect to continue to make investments in research and developments that are critical to support future growth. 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 licensees 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 Part II, Item 1A Risk Factors.

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REVENUES	September 30, 2011	September 30, 2010	Change	% Change
	(In thousands)			
Three months ended:				
Royalty and license	$ 5,875	$ 5,141	$ 734	14%
Product sales	345	1,217	(872)	(72)%
Development contracts and other	275	189	86	46%
Total Revenues	$ 6,495	$ 6,547	$ (52)	(1)%
Nine months ended:				
Royalty and license	$ 20,110	$ 17,848	$ 2,262	13%
Product sales	1,892	6,035	(4,143)	(69)%
Development contracts and other	943	848	95	11%
Total Revenues	$ 22,945	$ 24,731	$ (1,786)	(7)%

Three Months Ended September 30, 2011 Compared to Three Months Ended September 30, 2010

Royalty and license revenue Royalty and license revenue is comprised of royalties earned on sales by our licensees and license fees charged for our intellectual property portfolio. The increase in royalty and license revenue for the three months ended September 30, 2011 compared to the three months ended September 30, 2010 was primarily due to increases in royalty and license revenue from our mobility, gaming, and medical licensees partially offset by decreases from our other licensees.

Royalty and license revenue increased by 38% for gaming customers mainly due to increases in royalties from new and existing customers due to increased units shipped by licensees.

Royalty and license revenue increased by 21% for mobility customers primarily due to increases in mobility units shipped by our licensees. The increase was due to the fact that our technology continues to be included in more phone models and other devices.

We expect royalty and license revenue to be the major component of our future revenue as we focus on our licensing model and as our technology continues to be included in more products.

Product sales Product sales are comprised primarily of medical products, actuators, design kits, and integrated circuits. The decrease in product sales was due mainly to a $862,000 decrease in medical product sales due primarily to a reduction in sales of our Virtual IV medical simulator product arising from reduced demand in this market as well as inventory rebalancing by a specific customer. We expect product sales will remain at reduced levels in 2011 primarily as a result of softer demand in this market.

Development contracts and other revenue Development contracts and other revenue is comprised of revenue on commercial contracts. Development contracts and other revenue increased mainly due to increased engineering contract revenue from our mobility customers. We continue to focus our engineering resources on development efforts that focus on leveraging our existing sales and channel distribution capabilities. Accordingly, we do not expect development contract revenue to be a significant part of total revenues in the future.

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We categorize our geographic information into four major regions: North America, Europe, Far East, and Rest of the World. In the third quarter ended September 30, 2011, revenue generated in North America, Europe, Far East, and Rest of the World represented 40%, 13%, 47%, and 0% of total revenue, respectively, compared to 41%, 14%, 45%, and 0% of total revenue, respectively, for the third quarter ended September 30, 2010. The shift in revenues among regions was mainly due to a decrease in product sales in North America and Europe as a result of a reduction in sales of our Virtual IV and other medical simulator products. This was partially offset by an increase in royalty and license revenue in North America and Europe. The increase in North American royalty and license revenue was primarily from gaming licensees. The increase in European royalty and license revenue was primarily due to increased mobile device revenue. In addition, there was an increase in royalty and license revenue in the Far East. The increase in Far Eastern royalty and license revenue was primarily due to increased royalty and license revenue from licensees of mobile devices, gaming devices, and automotive products offset by a decrease in royalty and license revenue from other licensees.

Nine months Ended September 30, 2011 Compared to Nine months Ended September 30, 2010

Royalty and license revenue The increase in royalty and license revenue was due to increases in royalty and license revenue generated primarily from mobility, gaming, and medical licensees, partially offset by decreases from our other licensees.

Royalty and license revenue increased by 22% for gaming customers mainly due to increases in royalties from new and existing customers due to increased units shipped by licensees, partially offset by decreases in certain true ups and other one-time payments occurring primarily in the second quarter of 2010. We experience seasonally higher revenue from our gaming customers due to the reporting of holiday sales in the first calendar quarter.

Royalty and license revenue increased by 19% for mobility customers primarily due to increases in units shipped.

Product sales 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 to CAE resulting in reduced medical product sales subsequent to that date. The decrease in product sales was due primarily to a $4.0 million decrease in medical product sales primarily due to the divesture of these medical simulation product lines in the three months ended March 2010. Revenue for the nine months ended September 30, 2010 for the divested product lines was approximately $3 million which did not recur in 2011. The decrease in medical product sales was also caused by a reduction in other medical product sales of $928,000 primarily a decrease in sales of our Virtual IV medical simulator product arising from inventory rebalancing by a specific customer and reduced demand in this market.

Development contracts and other revenue Development contracts and other revenue increased mainly due to an increase in contracted engineering services mainly from medical customers.

In the nine months ended September 30, 2011, revenue generated in North America, Europe, Far East, and Rest of the World represented 42%, 15%, 43%, and 0% of total revenue, respectively, compared to 37%, 17%, 44%, and 2% of total revenue, respectively, for the nine months ended September 30, 2010. The shift in revenues among regions was mainly due to a decrease in product sales in Europe, the Far East, and Rest of the World as a result of the divestiture of the medical simulation product lines and a decrease in mobile device royalty and license revenue in Europe due to the timing of revenue recognized. These decreases were partially offset by an increase in royalty and license revenue in the Far East. The increase in Far Eastern royalty and license revenue was primarily due to increased royalty and license revenue from licensees of mobile devices partially offset by a decrease in royalty and license revenue from other licensees. In addition, there was an increase in royalty and license revenue in North America partially offset by a decrease in product revenue in North America. The increase in North American royalty and license revenue was primarily due to increased royalty and license revenue from gaming and medical licensees. The decrease in North American product revenue was due to a decrease in sales of our Virtual IV and other medical simulator products.

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COST OF REVENUES	September 30, 2011	2010	Change	% Change
	(In thousands)			
Three months ended:				
Cost of revenues	$ 192	$ 457	$ (265)	(58)%
% of total revenues	3%	7%	(4)%	
Nine months ended:				
Cost of revenues	$ 913	$ 2,587	$ (1,674)	(65)%
% of total revenues	4%	10%	(6)%	

Cost of Revenues Our cost of revenues (exclusive of amortization and impairment or abandonment of intangibles) consists primarily of direct materials, contract manufacturing, and other overhead costs for product sales, and labor related costs for development contracts and other. The reduced product sales was the major contributor to the overall reduction of cost of revenues for the third quarter ended September 30, 2011 as compared to the third quarter ended September 30, 2010. Specifically, the decrease in cost of revenues for 2011 as compared to 2010 was primarily due to decreased direct material costs, contract manufacturing costs, and related costs of $254,000. The decrease in direct material, contract manufacturing, related costs, and freight expense of approximately 63% was mainly due to a decrease in related product sales. We expect cost of revenues will remain at reduced levels for the remainder of 2011 primarily as a result of expected continued reduced demand for medical product sales in 2011.

The divestiture of certain medical simulation product lines in 2010 was a major contributor to the overall reduction of cost of revenues for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. Specifically, the decrease in cost of revenues for 2011 as compared to 2010 was primarily due to decreased direct material costs, contract manufacturing, and related costs of $1.4 million and decreased freight costs of $174,000. The decrease in direct material, contract manufacturing, related costs, and freight expense of approximately 69% was mainly due to a similar decrease in product sales.

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OPERATING EXPENSES	**September 30, 2011**	**2010**	**Change**	**% Change**
	($ In thousands)			
Three months ended:				
Sales and marketing	$ 1,643	$ 1,813	$ (170)	(9)%
% of total revenue	25%	28%	(3)%	
Research and development	$ 2,183	$ 2,007	$ 176	9%
% of total revenue	34%	31%	3%	
General and administrative	$ 3,195	$ 3,008	$ 187	6%
% of total revenue	49%	46%	3%	
Amortization and impairment or abandonment of intangibles	$ 324	$ 211	$ 113	54%
% of total revenue	5%	3%	2%	
Nine months ended:				
Sales and marketing	$ 5,402	$ 6,077	$ (675)	(11)%
% of total revenue	24%	25%	(1)%	
Research and development	$ 6,525	$ 6,473	$ 52	1%
% of total revenue	28%	26%	2%	
General and administrative	$ 9,367	$ 11,808	$ (2,441)	(21)%
% of total revenue	41%	48%	(7)%	
Amortization and impairment or abandonment of intangibles	$ 1,016	$ 650	$ 366	56%
% of total revenue	4%	3%	1%	

Sales and Marketing Our sales and marketing expenses are comprised primarily of employee compensation and benefits, advertising, public relations, trade shows, market development funds, travel, and an allocation of facilities costs. The decrease in sales and marketing expense for the third quarter ended September 30, 2011 as compared to the third quarter ended September 30, 2010 was primarily due to decreased compensation, benefits, and other related costs of $240,000 due to decreased sales and marketing headcount and benefits, partially offset by increased marketing, advertising, and public relations costs of $64,000 due to current marketing initiatives. We expect that sales and marketing expenses will continue to be significant as we continue to invest in sales and marketing to further our focus on building greater market acceptance for our touch technologies.

The decrease in sales and marketing expense for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010 was primarily due to the divestiture of the medical simulation product lines, resulting in reduced ongoing expenses. Specifically, the decrease in overall sales and marketing expenses was mainly due to decreased compensation, benefits, and other related costs of $871,000 primarily due to decreased sales and marketing headcount and decreased travel expense of $155,000 also due to decreased sales and marketing headcount, partially offset by increased marketing, advertising, and public relations costs of $386,000.

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Research and Development Our research and development expenses are comprised primarily of employee compensation and benefits, consulting fees, tooling and supplies, and an allocation of facilities costs. The increase in research and development expenses for the third quarter ended September 30, 2011 as compared to the third quarter ended September 30, 2010 was primarily due to increased compensation, benefits, and other related costs of $204,000 and increased travel expense of $43,000 mainly due to increased headcount, partially offset by decreased lab and prototyping expense of $84,000. We believe that continued significant investment in research and development efforts are critical to our future success, and we expect to make increased investments in areas of research and technology development to support future growth.

The increase in research and development expense for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010 was primarily due to increased compensation, benefits, and other related costs of $142,000 mainly due to increased headcount, partially offset by decreased lab and prototyping expense of $78,000 and a decreased loss on disposition of fixed assets of $22,000.

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. The increase in general and administrative expenses for the third quarter ended September 30, 2011 as compared to the third quarter ended September 30, 2010 was primarily due to increased compensation, benefits, and other related costs of $232,000, partially offset by decreased legal, professional, and license fee expenses of $117,000. The increased compensation, benefits, and other related costs was mainly due to increased headcount and increased severance costs for terminated employees. The decreased legal and professional expenses were primarily due to reduced litigation expenses as certain lawsuits were settled during 2010 along with reduced audit, tax, and accounting expenses. We expect that 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 any lawsuits brought against us.

The decrease in general and administrative expenses for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010 was primarily due to decreased legal, professional, and license fee expenses of $3.3 million, partially offset by increased compensation, benefits, and other related costs of $918,000. The decreased legal and professional expenses were primarily due to decreased accounting, audit, legal and consulting costs resulting from our internal investigation which was concluded in 2010. A decrease in litigation expenses as certain lawsuits have been settled during 2010 also contributed to the overall reduction in legal and professional expenses. The increased compensation, benefits, and other related costs was primarily due to increased stock compensation expense mainly due to the timing of the expense of stock options granted, increased headcount, and increased severance costs for terminated employees.

Amortization and impairment or abandonment of Intangibles Our amortization and impairment or abandonment of intangibles is comprised primarily of patent amortization and other intangible amortization along with impairment and write off of abandoned and expired patents. Amortization and impairment or abandonment of intangibles increased for the third quarter ended September 30, 2011 as compared to the third quarter ended September 30, 2010 mainly due to increased amortization due to the increased number of patents. Amortization and impairment or abandonment of intangibles increased for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010 mainly due to the write off of abandoned and expired patents along with increased amortization due to the increased number of patents.

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INTEREST AND OTHER INCOME	September 30, 2011	2010	Change	% Change
	(In thousands)			
Three months ended:				
Interest and other income	$ 58	$ 70	$ (12)	(17)%
% of total revenue	1%	1%	(0)%	
Nine months ended:				
Interest and other income	$ 172	$ 212	$ (40)	(19)%
% of total revenue	1%	1%	0%	

Interest and Other Income Interest and other income consist primarily of interest income from cash and cash equivalents and short-term investments, interest on notes receivable, gains on sales of short-term investments, and other income. Interest and other income decreased for the third quarter and nine months ended September 30, 2011 as compared to the third quarter and nine months ended September 30, 2010, primarily as a result of decreased interest income due to reduced interest rates on cash, cash equivalents, and short-term investments.

PROVISION FOR TAXES	September 30, 2011	2010	Change	% Change
	(In thousands)			
Three months ended:				
Provision for income taxes	$ (428)	$ (336)	$ (92)	27%
Loss from continuing operations before income taxes	$ (984)	$ (879)		
Effective tax rate	(43.5)%	(38.2)%		
Nine months ended:				
Provision for income taxes	$ (1,289)	$ (1,098)	$ (191)	17%
Loss from continuing operations before income taxes	$ (106)	$ (2,652)		
Effective tax rate	(1216.0)%	(41.4)%		

Provision for Income Taxes The income tax provision increased for the third quarter and nine months ended September 30, 2011 compared to the third quarter and nine months ended September 30, 2010 primarily due to increased foreign withholding tax expense as a result of increased revenues in certain Asian countries.

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DISCONTINUED OPERATIONS	September 30, 2011	September 30, 2010	Change	% Change
	(In thousands)			
Three months ended:				
Gain on sales from discontinued operations (net of provision for income taxes)	$ 0	$ 82	$ (82)	(100)%
% of total revenue	0%	1%		
Nine months ended:				
Gain on sales from discontinued operations (net of provision for income taxes)	$ 61	$ 143	$ (82)	(57)%
% of total revenue	0%	1%		

Discontinued Operations Gain on sales of discontinued operations net of taxes is primarily comprised of additional payments received from the sale in 2009 of our 3D family of products. The decrease in the gain on sales of discontinued operations net of taxes for the third quarter and nine months ended September 30, 2011 compared to the third quarter and nine months ended September 30, 2010 is primarily due to decreased payments received from the sale of our 3D family of products.

LIQUIDITY AND CAPITAL RESOURCES

Our cash, cash equivalents, and short-term investments consist primarily of money market funds and highly liquid commercial paper and U.S. Treasury 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 (loss), within stockholders equity.

On September 30, 2011, our cash, cash equivalents, and short-term investments totaled $63.5 million, an increase of $2.3 million from $61.2 million on December 31, 2010.

Cash provided by (used in) operating activities

Net cash provided by operating activities during the nine months ended September 30, 2011 was $2.2 million, an increase of $3.4 million from the $1.2 million used in operating activities during the nine months ended September 30, 2010. This reflects an increase of $3.0 million from a net loss adjusted for non-cash items, including $2.7 million of non-cash stock-based compensation, $1.0 million in amortization and impairment or abandonment of intangibles, and $717,000 in depreciation and amortization of property and equipment. Offsetting this increase, cash decreased by $844,000 from changes in other operating assets and liabilities including a decrease of $2.5 million due to a change in deferred revenue and customer advances mainly due to recognition of deferred revenue, a decrease of $1.3 million due to a change in accrued compensation and other current liabilities, and a decrease of $173,000 due to a change in inventories. These were offset by an increase in cash from a change in prepaid expenses and other current assets of $3.1 million primarily reflecting a tax refund received.

Cash used in investing activities

Net cash used in investing activities during the nine months ended September 30, 2011 was $2.3 million, compared to the $5.5 million used in investing activities during the nine months ended September 30, 2010, a decreased use of cash of $3.2 million. Net cash used in investing activities during the current period consisted of purchases of short-term investments of $44.9 million and a $2.4 million increase in intangibles primarily due to capitalization of external patent filings and application costs offset by maturities of short-term investments of $45.0 million.

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Cash provided by financing activities

Net cash provided by financing activities during the nine months ended September 30, 2011 was $2.4 million compared to the $83,000 provided during the nine months ended September 30, 2010. Cash provided by financing activities during the nine months ended September 30, 2011 was due to the exercise of stock options and the issuance of common stock under the employee stock purchase plan.

We believe that our cash, cash equivalents, and short-term investments will be sufficient to meet our working capital needs for at least the next twelve months. We expect that there will likely be fewer needs of our working capital in 2011 compared to 2010 due to the divestiture of the medical simulation product lines. Our Board has approved commencing repurchases of our shares of common stock under the previously authorized Stock Repurchase Program which currently has $31.4 million remaining. We will continue to protect and defend our extensive intellectual property portfolio, which also could result in increased use of cash. We anticipate that capital expenditures for property and equipment for the full year ended December 31, 2011 will be less than $500,000. We anticipate that capitalization of external patent filing and application costs for the year ended December 31, 2011 will be approximately $3 million. Cash flows from our discontinued operations have been included in our 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

On September 16, 2011, we entered into a Lease Termination Agreement effective as of December 31, 2011 with respect to the lease of our primary facilities of approximately 48,000 square feet in San Jose, California which was set to expire in June 2014. Pursuant to that agreement, we will be paid $350,000, subject to our vacating the premises by December 31, 2011. On September 19, 2011, we entered into a new lease agreement for our primary facilities of approximately 33,000 square feet in San Jose, California which expires in December 2016 and can be extended to December 2021.

The following table reflects a summary of our contractual cash obligations and other commercial commitments as of September 30, 2011 (in thousands):

Contractual Obligations	**Total**	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**More Than 5 Years**
Operating Leases	$ 2,488	$ 425	$ 1,005	$ 952	$ 106
Purchase Obligations	255	255	0	0	0
Total	$ 2,743	$ 680	$ 1,005	$ 952	$ 106

As of September 30, 2011, we had a liability for unrecognized tax benefits totaling $673,000 including interest of $45,000, of which approximately $244,000 could be payable in cash. Due to the uncertainties related to these tax matters, we are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur. Settlement of such amounts could require the utilization of working capital.

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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 $60.4 million as of September 30, 2011, which 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 a decrease of approximately $345,000 in the fair value of our cash equivalents and short-term investments as of September 30, 2011.

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 policy s guidelines also limit exposure to loss by limiting the sums we can invest in any individual security and restricting investments 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 and we do not expect to have such arrangements in the foreseeable future.

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Based on their evaluation as of September 30, 2011, our management with the participation of our Chief Executive Officer and Chief Financial Officer, have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective to ensure that the information required to be disclosed by us in this quarterly report on Form 10-Q was (i) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and regulations and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

There were no changes to internal controls over financial reporting that occurred during the quarter ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no

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evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any within Immersion, have been detected.

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.

In September 2008, all of the parties to the lawsuits reached a settlement, subject to documentation and approval of the District Court. 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. On October 6, 2009, the District Court approved the settlement, and the Court subsequently entered a judgment of dismissal. Under the judgment, the Immersion Defendants are not required to contribute to the settlement. Several notices of appeal have been filed by putative class members challenging the settlement. Subsequently, the District Court determined that none of the objectors had standing to appeal. One of the putative objectors has filed a notice of appeal of the determination as to him. We intend to defend the lawsuit vigorously.

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. Defendants moved to dismiss the action on June 15, 2010 and that motion was granted on March 11, 2011. Lead plaintiff filed an amended complaint on April 29, 2011. Defendants moved to dismiss the amended complaint on July 1, 2011.

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.

Kasmer v. Immersion Corporation

On May 5, 2010, an action was filed in Delaware Chancery Court by a shareholder seeking to enforce a demand to inspect certain of our records pursuant to Section 220 of the Delaware General Corporation Law, as a possible prelude to the shareholder bringing a derivative action. We filed our answer on June 14, 2010, questioning whether a proper purpose for the records inspection had been stated and raising other defenses concerning the scope of the demand, among other deficiencies. Following a one-day trial on December 2, 2010, the Court significantly narrowed the scope of the demand and we responded accordingly. On October 24, 2011, the shareholder filed a motion seeking to compel further responses to the demand. We believe that our responses complied with the Court s ruling and therefore will be opposing the shareholder s motion.

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

As previously discussed, our actual results could differ materially from our forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to those discussed below. These and many other factors described in this report could adversely affect our operations, performance and financial condition.

Company Risks

The uncertain economic environment could reduce our revenues and could have an adverse effect on our financial condition and results of operations.

The current economic conditions 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, higher overhead costs as a percentage of revenue, delays in signing or failing to sign customer agreements, or signing customer agreements with reduced royalty rates. In addition, our customers,

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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. Adverse economic conditions can 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.

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 partially 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 intellectual property or license intellectual property 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 or if video console makers no longer require peripherals to play video games; 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.

A limited number of customers account for a significant portion of our revenue, and the loss of major customers could harm our operating results.

Three customers accounted for approximately 45% and 39% of our total revenues for the third quarter ended September 30, 2011 and 2010, respectively. Three customers accounted for approximately 44% and 34% of our total revenues for the nine months ended September 30, 2011 and 2010, respectively. We cannot be certain that customers that have accounted for significant revenue in past periods, individually or

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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.

We had an accumulated deficit of $106 million as of September 30, 2011, have a history of losses, and may not achieve or maintain profitability in the future.

Since 1997, we have incurred losses in all but six quarters. As of September 30, 2011, we had an accumulated deficit of $106 million. We need to generate significant ongoing revenue to achieve and maintain consistent 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.

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 third quarter ended September 30, 2011 and 2010, 90% and 79%, respectively, of our total revenues were royalty and license revenues. For the nine months ended September 30, 2011 and 2010, 88% and 72%, 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 may fluctuate from quarter to quarter for products that incorporate our technologies, especially in the video console gaming and computer gaming peripherals market. If our licensees do not ship products incorporating our touch-enabling technologies in a timely fashion or fail to achieve strong sales, we may not receive related royalty and license revenue.

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We have limited engineering, customer service, technical support, quality assurance and operations 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 operations 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.

Catastrophic events, such as natural disasters (including the recent earthquake and tsunami in Japan and the extensive flooding in Thailand), war, and acts of terrorism could disrupt the business of our customers, which could harm our business and results of operations.

The production processes and operations of our customers are susceptible to the occurrence of catastrophic events, such as natural disasters (including the recent earthquake and tsunami in Japan), war, and acts of terrorism, all of which are outside of our control. Any such events could cause a serious business disruption to our customers ability to manufacture, distribute and sell products incorporating our touch-enabling technologies upon which we generate royalty revenue, which disruption may adversely affect our business and results of operation.

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. 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.

Our business depends in part on access to third-party platforms or technologies, and if the access is withdrawn, denied, or is not available on terms acceptable to us, or if the platforms or technologies change without notice to us, our business and operating results could be adversely affected.

Our product portfolio includes current and future products designed for use with third-party platforms or software. Our business in these categories relies on our access to the platforms of third parties, which can be withdrawn, denied or not be available on terms acceptable to us.

Our access to third-party platforms may require paying a royalty, which lowers our product margins, or may otherwise be on terms that are not acceptable to us. In addition, the third-party platforms or technologies used to interact with our product portfolio can be delayed in production or can change without prior notice to us, which can result in our having lower margins.

If we are unable to access third-party platforms or technologies, or if our access is withdrawn, denied, or is not available on terms acceptable to us, or if the platforms or technologies are delayed or change without notice to us, our business and operating results could be adversely affected.

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.

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 our 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.

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Our business depends on generating revenues by licensing our intellectual property rights and by customers 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 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.

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

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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.

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 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.

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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, to improve their ease of integration in both hardware and software, 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.

The higher cost of products incorporating our touch-enabling technologies may inhibit or prevent their widespread adoption.

Mobile devices, touchscreens, personal computer and console gaming peripherals, 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. Accordingly, we may not receive a material amount of royalties from more expensive products.

Our customers may have difficulties obtaining the components necessary to manufacture haptic-based products, which could harm our business and results of operations.

In order to manufacture haptic-based products, our customers require components such as actuators and amplifiers. The inability of suppliers to deliver adequate supplies of these components could disrupt our customers production processes which would harm our business and results of operations. In addition, our newer products require new types of components that we expect will be developed and sold by our ecosystem partners. Failure of our ecosystem partners to bring these products to market in a timely fashion and at attractive price points may affect our ability to secure customers for these newer products which could harm our business and results of operations.

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.

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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.

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.

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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 and medical devices incorporating our touch-enabling technologies are subject to lengthy product development periods, making it difficult to predict when and whether we will receive automotive and medical devices royalties.

The product development process for automobiles and medical devices is very lengthy, sometimes longer than four years. We may not earn royalty revenue on our automotive/medical devices technologies unless and until automobiles/medical devices featuring our technologies are shipped to customers, which may not occur until several years after we enter into an agreement with manufacturer or a supplier to a manufacturer. Throughout the product development process, we face the risk that a manufacturer or supplier may delay the incorporation of, or choose not to incorporate, our technologies into its automobiles/medical devices, making it difficult for us to predict the 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.

Our international expansion efforts subject us to additional risks and costs.

We currently have sales personnel in Finland, Japan, Korea, Switzerland, and Taiwan and we intend to expand our 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;

- political and economic instability; and

- an outbreak of hostilities in markets where major customers are located, including Korea.

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 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 technologies are complex and we rely upon the continued service of our existing personnel to support licensees, enhance existing technologies, and develop new technologies. Accordingly, 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 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. 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 could 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 16 to the condensed consolidated financial statements and Item 1 Legal Proceedings of Part II.

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. In addition, even though we have transitioned from the medical products business,

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we could face product liability claims for products that we have sold or that 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 or sales by our customers to their end customers in some areas outside the United States could be subject to government export regulations or restrictions that prohibit us or our licensees 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,

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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.

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 terrorist activity. A substantial portion of our research and development activities, operations, 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 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.

We use contract manufacturers and may have difficulties obtaining the products that we need. This could harm our ability to meet our customers demand for our products.

We rely on a limited number of contract manufacturers and suppliers for our products. The inability of such contract manufacturers or suppliers to deliver adequate inventory could make it difficult to ship products ordered by our customers. We also have limited influence on contract manufacturers operations. There is risk that the manufacture, quality control, operations, controls, and distribution might not be up to our standards. The occurrence of any of these could harm our business and results of operations.

If we fail to establish and maintain proper and effective internal controls, our ability to produce accurate financial statements on a timely basis could be impaired, which would adversely affect our consolidated operating results, our ability to operate our business and our stock price.

We have in the past had material weaknesses in our internal control over financial reporting. 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, 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.

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;

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- the timing and recognition of payments under fixed and/or up-front license agreements;
- seasonality in the demand for our products or our licensees products;
- the timing of our expenses, including costs related to litigation, stock-based awards, acquisitions of technologies, or businesses;
- development in any pending litigation;
- the timing of introductions and market acceptance of new products and product enhancements by us, our licensees, our competitors, or their competitors; and
- the timing of work performed under development agreements.

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 business is subject to changing regulations regarding corporate governance and other compliance areas that will increase both our costs and the risk of noncompliance.

As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, or the Exchange Act, the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, and the rules and regulations of The NASDAQ Stock Market. The requirements of these rules and regulations have increased and we expect will continue to increase our legal, accounting and financial compliance costs, will make some activities more difficult, time-consuming and costly and may also place undue strain on our personnel, systems and resources.

Our stock price may fluctuate regardless of our performance.

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.

Our stock repurchase program could affect our stock price and add volatility.

Any repurchases pursuant to our stock repurchase program could affect our stock price and add volatility. There can be no assurance that any repurchases will actually be made under the program, nor is

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there any assurance that a sufficient number of shares of our common stock will be repurchased to satisfy the market s expectations. Furthermore, there can be no assurance that any repurchases conducted under the plan will be made at the best possible price. The existence of a stock repurchase program could also cause our stock price to be higher than it would be in the absence of such a program and could potentially reduce the market liquidity for our stock. Additionally, we are permitted to and could discontinue our stock repurchase program at any time and any such discontinuation could cause the market price of our stock to decline.

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:

- 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;

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- 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 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 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Below is a summary of stock repurchases for the quarter ending September 30, 2011. See Note 10 of our condensed consolidated financial statements for information regarding our stock repurchase program.

Program/Period (1)	**Shares Repurchased (2)**	**Average Price Per Share**	**Approximate Dollar Value that May Yet Be Purchased Under the Program**
Beginning approximate dollar value available to be repurchased as of June 30, 2011			$31,610,649
July 1 July 31, 2011	0	$ 0.00	
August 1 August 31, 2011	0	0.00	
September 1 September 30, 2011	31,214	6.02	
Total shares repurchased	31,214	$ 6.02	187,777
Ending approximate dollar value that may be repurchased under the Program as of September 30, 2011			$31,422,872

(1) On November 1, 2007, our Board of Directors authorized a share repurchase program of up to $50,000,000. This share repurchase authorization has no expiration date and does not require us to repurchase a specific number of shares. The timing and amount of any share

repurchase will depend on the share price, corporate and regulatory requirements, economic and market conditions, and other factors. The repurchase authorization may be modified, suspended, or discontinued at any time.

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(2) All shares were repurchased on the open market as part of the plan publicly announced on November 1, 2007. The repurchases were effected by a single broker in market transactions at prevailing market prices net of transaction costs pursuant to a trading plan designed to satisfy the conditions of Rule 10b5-1 under the Securities and Exchange Act of 1934, as amended.

ITEM 6. EXHIBITS

The exhibits listed in the accompanying Exhibit Index are filed or incorporated by reference as part of this Form 10-Q.

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: November 7, 2011

IMMERSION CORPORATION

By /s/ Shum Mukherjee
Shum Mukherjee
Chief Financial Officer and Principal Accounting Officer

EXHIBIT INDEX

Exhibit Number	**Description**
10.1	Lease Termination agreement between Super Micro Computer, Inc. and Immersion Corporation dated September 15, 2011.
10.2	Office Lease between Carr NP Properties, L.L.C., and Immersion Corporation dated September 15, 2011.
31.1	Certification of Victor Viegas, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Shum Mukherjee, 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 Shum Mukherjee, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.1	Part 1, Item 1 of this Form 10-Q formatted in XBRL.