IMMERSION CORP
Form 10-K/A
July 14, 2010

Table of Contents

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

Form 10-K/A
(Amendment No. 1 to Form 10-K)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2009

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission File Number 000-27969

Immersion Corporation
(Exact name of registrant as specified in its charter)

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

801 Fox Lane
San Jose, California 95131
(Address of principal executive offices, zip code)

(408) 467-1900
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.001 par value	The Nasdaq Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

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

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

The aggregate market value of the registrant s common stock held by non-affiliates of the registrant on June 30, 2009, the last business day of the registrant s most recently completed second fiscal quarter, was $108,261,883 (based on the closing sales price of the registrant s common stock on that date). Shares of the registrant s common stock held by each officer and director and each person whom owns 5% or more of the outstanding common stock of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. Number of shares of common stock outstanding at March 3, 2010: 27,999,593

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2010 Annual Meeting are incorporated by reference into Part III hereof.

IMMERSION CORPORATION

2009 FORM 10-K ANNUAL REPORT

TABLE OF CONTENTS

Table of Contents

Explanatory Note

Immersion Corporation (the Company) is filing this Amendment No. 1 to Form 10-K to its Annual Report on Form 10-K for the year ended December 31, 2009, originally filed March 30, 2010 (the Original Filing) (i) to clarify that the Chief Financial Officer of the Company is executing this Annual Report on Form 10-K in his capacity as Chief Financial Officer and Principal Accounting Officer of the Company, and (ii) to correct references included in the power of attorney section. Unless the context otherwise requires, all references to the Form 10-K contained herein shall refer to this Amendment No. 1 to Form 10-K.

Except as set forth above, the content of the Original Filing has not been amended, updated or otherwise modified.

Forward-looking Statements

In addition to historical information this Annual Report on Form 10-K 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 Exchange Act). The forward-looking statements involve risks and uncertainties. Forward-looking statements are identified by words such as anticipates, believes, expects, intends, may, will, other similar expressions. 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 Risk Factors and those described elsewhere in this report , and those described in our other reports filed with the Securities and Exchange Commission (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.

PART I

Item 1. *Business*

Overview

Immersion Corporation is a leading provider of haptic technologies that allow people to use their sense of touch more fully when operating a wide variety of digital devices. To achieve this heightened interactivity, we develop and market or license a wide range of hardware and software technologies and products. While we believe that our technologies are broadly applicable, we are currently focusing our marketing and business development activities on the following target application areas: automotive, consumer electronics, gaming, and commercial and industrial devices and controls; medical simulation; and mobile communications. We manage these application areas under two operating and reportable segments: 1) the Touch Line of Business and 2) the Medical Line of Business. See Management s Discussion and Analysis of Financial Condition and Results of Operations as well as the notes to the consolidated financial statements for financial information for these segments for the past three years.

In some markets, such as video console gaming, consumer electronics, mobile phones, and automotive controls, we license our technologies to manufacturers who use them in products sold under their own brand names. In other markets, such as medical simulation, we sell products manufactured under our own brand name through direct sales to end users, distributors, original equipment manufacturers (OEMs), or value-added resellers. From time to time, we also engage in development projects for third parties.

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 800 issued or pending patents in the U.S. and other countries, covering various aspects of hardware and software technologies.

Immersion Corporation was incorporated in 1993 in California and reincorporated in Delaware in 1999. We consummated our initial public offering on November 12, 1999.

Table of Contents

Haptics and Its Benefits

In the world of computers, consumer electronics, and digital devices and controls, meaningful haptic (touch) information is limited or missing. For example, when dialing a number or entering text on a conventional touchscreen, users feel only the touchscreen surface, without the subtle, yet confirming sensation we expect from mechanical switches and keyboards.

To supply richer, more meaningful haptic feedback also known as force feedback, touch feedback, or tactile feedback electronic input/output devices can be made to generate physical forces. Our programmable haptic technologies embedded in many types of devices can give users physical sensations appropriate to the situation. Users can feel as though they are interacting with different textures and mass, compliant springs, solid barriers, deep or shallow detents. They can feel the force or resistance as they push a virtual button, scroll through a list, or encounter the end of a menu. In a video or mobile game, users can feel the gun recoil, the engine rev, or the crack of the bat meeting the ball. When simulating the placement of cardiac pacing leads, a user can feel the forces that would be encountered when navigating the leads through a beating heart, providing a more realistic experience of performing this procedure. These forces are created by actuators, such as motors, which are built into devices such as joysticks, steering wheels, gamepads, personal music players, mobile phones, and medical training simulators. Actuators can also be designed into devices used in automotive, industrial, medical, or retail kiosk and point-of-sale systems, such as digital switches, rotary controls, touchscreens, and touch surfaces.

We believe the programmability of our haptic products is a key differentiator over purely electro-mechanical systems and can drive the further adoption of cost effective and more reliable digital devices. A programmable device can supply a tactile response appropriate to the context of operation for systems and devices of many types. These tactile cues can help users operate more intuitively or realize a more enjoyable or natural experience. Used in combination with sight and sound cues, haptic feedback adds a compelling, engaging, meaningful multimodal aspect to the user interface. Our haptic products and technologies can also add a tactile quality to interactions that have been devoid of tactile confirmation, such as when using a touchpad or touchscreen. Independent research shows that the confirmation and navigational cues obtained by programmable haptics can aid in performance and accuracy and increase user satisfaction. The addition of programmable haptics can help in the conversion from purely mechanical rotary controls to digital devices or from a mechanical keyboard, switch, or button interface to an electronic touchscreen.

Programmability also supplies more flexibility in the types of responses that are possible, in upgradeability, in consistent performance that will not degrade over time, and in the potential for personalized settings. Multiple mechanical controls can be consolidated into one versatile programmable control that can save space and improve ergonomics. Conversely, one programmable control device can be implemented as many different types of controls with context-appropriate touch feedback, which can simplify inventory.

Our Solutions

Our goal is to improve the way people interact with digital devices by engaging their sense of touch. Our core competencies include our understanding of how interactions should feel and our knowledge of how to use technology to achieve that feeling. Our strength in both of these areas has resulted in many novel applications.

We believe that our touch-enabled products and technologies give users a more complete, intuitive, enjoyable, and realistic experience. Our patented designs include software elements such as real-time software algorithms and authoring tools, and specialized hardware elements, such as motors, sensors, transmissions, and control electronics. Together, these software and hardware elements enable tactile sensations that are context-appropriate within the application.

We have developed haptic systems for many types of hardware input/output devices such as gamepads, joysticks, mobile phones, rotary controls, touchscreens, and flexible and rigid endoscopy devices for medical simulations.

We have developed many mechanisms to convey forces to the user s hands or body. These include vibro-tactile actuators, direct-, belt-, gear-, or cable-driven mechanisms and other proprietary devices that supply textures and vibration, resistance, and damping forces to the user.

Table of Contents

To develop our real-time electronic actuator controllers, we had to address challenges such as size, accuracy, resolution, frequency, latency requirements, power consumption, and cost. Our control solutions include both closed-loop and open-loop control schemes. In closed-loop control, the firmware reads inputs from the input/output devices, and then calculates and applies the output forces in real time based on the input data. In open-loop control, a triggering event will activate the firmware to calculate and send the output signal to the actuator in real time.

We have developed many software solutions for various operating systems and computing platforms including Windows-based and Apple personal computers, automotive, and mobile handset operating systems. Our inventions include control algorithms for efficiently driving relevant families of actuators (such as spinning mass actuators, linear actuators, and piezo-electric systems) as well as several generations of authoring tools for creating, visualizing, modifying, archiving, and experiencing haptic feedback.

Licensed Solutions

In some markets, such as video console gaming, consumer electronics, mobile phones, and automotive controls, we license our technologies to OEMs or their suppliers who then include our technologies in products sold under their own brand names.

We offer our expertise to our licensees to help them design and integrate touch effects into their products. This expertise includes turn-key engineering and integration services, design kits for prototyping, authoring tools, application programming interfaces, and the development of hardware and software technologies that are compatible with industry standards.

Turn-key Engineering and Integration Services We offer engineering assistance, including technical and design assistance and integration services that allow our licensees to incorporate our touch-enabling products and technologies into their products at a reasonable cost and in a shortened time frame. This allows them to get to market quickly by using our years of haptic development and solution deployment expertise. We offer product development solutions including product software libraries, design, prototype creation, technology transfer, actuator selection, component sourcing, development/integration kits, sample source code, comprehensive documentation, and other engineering services. In addition, we help ensure a quality end-user experience by offering testing and certification services to a number of licensees.

Design Kits for Prototyping We offer several design kits for customers to use for technology evaluation, internal evaluation, usability testing, and focus group testing. The kits include components and documentation that designers, engineers, and system integrators need for prototyping TouchSense touch feedback into an existing or sample product.

Authoring Tools We license authoring tools that enable haptic designers and software developers to quickly design and incorporate custom touch feedback into their own applications. Authoring tools allow designers to create, modify, experience, and save or restore haptic effects for a haptic device. The tools are the equivalent of a computer-aided design application for haptics. Our authoring tools support vibro-tactile haptic devices (such as mobile phones, touchscreens, and vibro-tactile gaming peripherals), as well as kinesthetic haptic devices (such as rotary devices, 2D devices, and joysticks). Various haptic effect parameters can be defined and modified, and the result immediately experienced. Our authoring tools run on mainstream operating systems such as Microsoft Windows.

Application Programming Interfaces or (APIs) Our APIs provide haptic-effect generation capability. This allows designers and software programmers to focus on adding haptic effects to their applications instead of struggling with the mechanics of programming real-time algorithms and handling communications between computers and devices. Some of our haptic APIs are device independent (for example, they work with scroll wheels, rotary knobs, 2D joysticks, and other devices) to allow flexibility and reusability. Others are crafted to meet the needs of a particular customer or industry.

Compatible with Industry Standards We have designed our hardware and software technologies for our licensees to be compatible with industry hardware and software standards. Our technologies operate across multiple platforms and comply with such standards as Microsoft s entertainment application programming interface, DirectX, and a standard communications interface, Universal Serial Bus known as (USB). More generally,

Table of Contents

our software driver and API technology has been designed to be easily ported to a variety of operating systems including Windows, Windows CE, Mac OS X, BREW/REX (from QUALCOMM), Java (J2SE), various Linux platforms including Android, Maemo and VxWorks.

Manufactured Product Solutions

We produce our products using both contracted and in-house manufacturing. We manufacture and sell some of our products under the Immersion brand name through a combination of direct sales, distributors, and value-added resellers. These products include:

medical and surgical simulation systems used for training medical professionals in minimally invasive medical and surgical procedures including endoscopy, laparoscopy, and endovascular;

components used in our haptic touchscreen and touch surface solutions;

programmable rotary control technology and reference design for operating a wide range of devices; and

electronic control boards for wheels and joysticks used in arcade games, research, and industrial applications.

We also manufacture some products on a private-label basis for customers. In addition, we may resell another manufacturer s product into our customer base such as certain types of medical simulators.

As we previously announced in late 2008, we divested our line of 3D products in 2009. These products included our:

MicroScribe® digitizers;

a 3D interaction product line; and

SoftMouse® 3D positioning device.

Touch Line of Business

Products and Markets

Gaming Devices We have licensed our TouchSense intellectual property to Microsoft for use in its gaming products, to Apple Computer for use in its operating system, and to Sony Computer Entertainment for use in its legacy and current PlayStation console gaming products. We have also licensed our TouchSense intellectual property to over a dozen gaming peripheral manufacturers and distributors, including Logitech and Mad Catz, to bring haptic technology to PC platforms including both Microsoft Windows and Apple operating systems, as well as to video game consoles.

In the video game console peripheral market, we have licensed our intellectual property for use in hundreds of spinning mass tactile feedback devices and force feedback devices such as steering wheels and joysticks to various manufacturers including dreamGear, Gemini, Griffin, Hori, i-CON, Intec, Katana, Logitech, Mad Catz, Microsoft, NYKO, Performance Designed Products or (PDP) (formerly Electro Source LLC), Radica, and Sony. These products are designed to work with one or more video game consoles including the Xbox and Xbox 360 from Microsoft; the PlayStation, PlayStation 2, and PlayStation 3 from Sony; and the N64, GameCube, and Wii from Nintendo. Currently, products sold to consumers using TouchSense technology include PC joysticks, steering wheels, and gamepads from various licensees.

For the years ended December 31, 2009, 2008, and 2007, respectively 19%, 30%, and 24% of our total revenues were generated from PC and console gaming revenues.

In the arcade entertainment market, our products include steering wheel and joystick control electronics that provide industrial strength and quality force feedback that enable very realistic simulations.

In the casino and bar-top amusement market, we signed an agreement with 3M Touch Systems in 2005 that allows them to manufacture and distribute its MicroTouch touch screens with our TouchSense technology. 3M Touch Systems and seven system integrators demonstrated this technology in pre-production touchscreen monitors at the 2008 Global Gaming Expo.

Table of Contents

Mobile Communications and Portable Devices We developed TouchSense solutions for the mobile phone market and a variety of portable devices.

The TouchSense Solution for Mobile Phones for handset OEMs, operators, and application developers includes a TouchSense Player, a lightweight and powerful vibration playback system that is embedded in the phone, and a TouchSense software toolkit, including a PC-based composition tool for creating haptic effects for inclusion in content and applications. Haptic effects can be used in alerts, e-mail, games, messages, ringtones, touchscreen interactions, and other user interface features to add information or identification, signal status or message arrival, and heighten interest or fun. With a TouchSense-enabled phone, users can send and receive a wide range of vibro-tactile haptic effects independently from or in synchronicity with audio, video, and application program content.

Our licensees currently include the top three makers of mobile phones by volume in the world: Nokia, Samsung, and LG Electronics plus others such as Pantech Co., Ltd. and KTF Technologies Inc. In 2009, approximately 75 million handsets with TouchSense technology were shipped by our licensees. Since its launch in the first handset in 2005, our TouchSense technology has shipped in over 100 million handsets. In December 2009, we worked with Synaptics and other market leaders to present a mobile concept phone that demonstrates new usage models and user experience with integrated haptics. We intend to expand applications for TouchSense technologies in new user experiences in mobile phones.

For the years ended December 31, 2009, 2008, and 2007, respectively 29%, 17%, and 8% of our total revenues were generated from mobile communications.

TouchSense components include technologies for haptic touchscreens and programmable haptic rotary controls. In early 2009, Samsung launched its new dual touchscreen Digital Still Cameras (TL220 and TL225) and P3 personal media player with Immersion haptic feedback technology for touchscreen interactions. In 2008 Cue Acoustics announced and began shipping a premium AM/FM radio and iPod docking station that includes a TouchSense rotary control module as its primary control mechanism. In 2007, CTT-Net of Korea launched the world s first personal navigation devices, (PNDs) to use Immersion s TouchSense technology to provide tactile feedback for touchscreen interactions in a global positioning system, (GPS). We intend to expand applications for TouchSense technologies into a broader range of portable devices, including remote controls for home entertainment systems, medical diagnostic and therapeutic equipment, test and measurement equipment, portable terminals, game devices, and media players.

Automotive We have developed TouchSense technology for rotary controls, touchscreens, and touch surfaces appropriate for use in automobiles. TouchSense rotary technology can consolidate the control of multiple systems into a single module that provides the appropriate feel for each function. This allows the driver convenient access to many systems and supplies context-sensitive cues for operation. TouchSense touchscreen and touch surface technology provides tactile feedback for an otherwise unresponsive surface such as an all digital switch or touchscreen. Programmable haptic touchscreen, touch surface, and rotary controls of many types can be used to provide a space-saving, aesthetic look and a confirming response for the driver that can help reduce glance time.

We have also conducted various funded development efforts and provided tools and evaluation licenses to several major automobile manufacturers and suppliers interested in touch-enabled automobile controls.

We have licensed our TouchSense rotary technology for use in vehicle controls since 2002. Siemens VDO Automotive (now Continental) has licensed our technology for use in the high-end Volkswagen Phaeton sedan and Bentley cars. ALPS Electric, also a licensee, has produced a haptic rotary control that has been included in the Mercedes-Benz S-Class sedan. ALPS also produced a two-dimensional haptic control module called the Remote Touch controller in the Lexus RX 350 and 450h. These 2010 Lexus models were announced in November 2008 and launched in the U.S. in February 2009. Other licensees of TouchSense technology in the automotive industry include:

Methode Electronics, Inc., a global designer and manufacturer of electronic component and subsystem devices; Visteon Corporation, a leading global automotive supplier that designs, engineers, and manufactures innovative climate, interior, electronic and lighting products for vehicle manufacturers; Volkswagen, Europe s largest automaker; and SMK Corporation of Tokyo, a global manufacturer of electromechanical components. Since its launch in the first vehicle in 2001 our TouchSense technology has shipped in over 2.4 million vehicles.

For the years ended December 31, 2009, 2008, and 2007, respectively 6%, 9%, and 12% of our total revenues were from automotive customers.

3D and Mechanical CAD Design During 2008, we sold three-dimensional and mechanical computer-aided design products that allow users to create three-dimensional computer models directly from physical objects and also to precisely measure manufactured parts. We also manufactured and sold the CyberGlove system. In addition, we manufactured and sold specialized products such as computer peripherals that incorporate advanced computer peripheral technologies. We divested these product lines by the second quarter of 2009.

Sales and Distribution

Sales of our products generally do not experience seasonal fluctuations, except that royalties from gaming peripherals, tend to be higher during the year-end holiday shopping season. However, there may be variations in the timing of revenue recognition from development contracts depending on numerous factors including contract milestones and operations scheduling. Our products typically incorporate readily available commercial components.

In the PC and video console gaming, consumer electronics, mobility, and automotive markets, we establish licensing relationships through our business development efforts.

In mobility, sales relationships must be established with operators, handset manufacturers, and content developers worldwide. We have signed license agreements with mobile handset manufacturers for the incorporation of TouchSense technology into certain mobile phone handsets. We have established relationships with CDMA platform developer QUALCOMM, Incorporated and with smartphone operating system developer Symbian, Ltd.

We employ a direct sales force in the United States, Europe, and Asia to license our TouchSense software products. In gaming, our sales force is also augmented through co-marketing arrangements. As part of our strategy to increase our visibility and promote our touch-enabling technology, our consumer-products licensees may also require our licensees to display the TouchSense technology logo on their end products.

We sell our touchscreen and touch surface products to OEMs and system integrators using a worldwide direct sales force. In addition, the technology is licensed to large system integrators and OEMs in automotive and other markets.

In the automotive market, we use a worldwide direct sales force to work with vehicle manufacturers and component suppliers. We have licensed our technology to leading automotive component suppliers including Methode, ALPS Electric, SMK, and Visteon as part of our strategy to speed adoption of our TouchSense technologies across the automotive industry.

In 2009, we began implementing a strategy to broaden and expand market penetration by licensing our TouchSense technology into several chip manufacturers, including Atmel, Cypress and IDT, with the goal that these licensees will broaden their product offerings with the addition of haptics.

Competition

With respect to touch-enabled consumer products, we are aware of several companies that claim to possess touch feedback technology applicable to the consumer market. In addition, we are aware of several companies that currently market unlicensed touch feedback products in consumer markets.

In the Touch line of business, the principal competitive factors are the strength of the intellectual property underlying the technology, the technological expertise and design innovation and the use, reliability and cost-effectiveness of the products. We believe we compete favorably in all these areas.

Several companies also currently market touch feedback products that are competitive to ours in non-consumer markets. These companies could also shift their focus to the consumer market. In addition, our licensees or other companies may develop products that compete with products employing our touch-enabling technologies, but are based on alternative technologies, or develop technologies that are similar or superior to our technologies, duplicate our technologies, or design around our patents. Many of our licensees, including Microsoft, LG Electronics,

Table of Contents

Logitech, Nokia, Samsung, and others have greater financial and technical resources upon which to draw in attempting to develop computer peripheral or mobile phone technologies that do not make use of our touch-enabling technologies.

For licensed applications, our competitive position is partially dependent on the competitive positions of our licensees that pay a license and/or royalty. Our licensees markets are highly competitive. We believe that the principal competitive factors in our licensees markets include price, performance, user-centric design, ease-of-use, quality, and timeliness of products, as well as the manufacturer s responsiveness, capacity, technical abilities, established customer relationships, retail shelf space, advertising, promotional programs, and brand recognition. Touch-related benefits in some of these markets may be viewed simply as enhancements and compete with nontouch-enabled technologies.

Medical Line of Business

Products and Markets

We have developed numerous simulation technologies that can be used for medical training and testing. By enabling a medical simulator to more fully engage users sense of touch, our technologies can support realistic simulations that are effective in teaching medical students, doctors, and other health professionals what it feels like to perform a given procedure. The use of our simulators allows these professionals to perfect their practice in an environment that poses no risks to patients, where mistakes have no dire consequences, and where animal or cadaver use is unnecessary.

In addition, organizations wanting to train customers or sales staff on medical procedures and on the use of new tools and medical devices engage us to develop special simulators. Examples of projects we have completed include simulation of venous access, minimally invasive vein harvesting, hysteroscopy, and aortic valve and pacemaker lead placement.

We have four medical simulation product lines: the Virtual IV system, which simulates needle-based procedures such as intravenous catheterization and phlebotomy; the Endoscopy AccuTouch® System, which simulates endoscopic procedures, including bronchoscopy and lower and upper GI procedures; the CathLabVR System, which simulates endovascular interventions including cardiac pacing, angiography, angioplasty, and carotid and coronary stent placement; and the LapVR System, which simulates minimally invasive procedures involving abdominal and pelvic organs. In addition, we sell an arthroscopy surgical simulator for certain arthroscopic surgical procedures on knees and shoulders based on GMV s insightArthroVR system.

These systems are used for training and educational purposes to enable health professionals to feel simulated forces that they would experience during actual medical procedures, such as encountering an arterial obstruction. The systems are designed to provide a realistic training environment augmented by real-time graphics that include anatomic models developed from actual patient data and high-fidelity sound that includes simulated patient responses.

All of our medical products are comprised of a hardware system, an interface device, and software modules that include several cases of increasing difficulty, allowing users to develop their skills by experiencing a broad range of pathologies in differing anatomical conditions.

We design each product line to maximize the number of procedures that can be simulated with minimal additional customer hardware investment. These systems then enable potential additional sales of software to the installed base of hardware systems. We currently have over 25 software modules available that replicate a range of medical procedures, such as intravenous catheterization, laparoscopy, bronchoscopy, colonoscopy, cardiac pacing, and carotid and coronary angioplasty.

In 2009, we entered the robotic surgical market by licensing our TouchSense technology to MAKO Surgical. We intend to pursue additional licensees to further expand our licensing business into this market.

In February 2010, we announced our intention to focus our medical line of business on licensing opportunities in medical simulation, robotic surgical devices, and other medical surgical devices. In March 2010 we entered into

Table of Contents

an agreement to sell certain assets of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines. See Note 19 of the consolidated financial statements.

Sales and Distribution

Sales of these products may experience seasonal fluctuations related to teaching hospitals summer residency programs. The latter may depend on numerous factors including contract milestones and timing of work performed against the contract.

With respect to medical simulation products, we employ a direct sales force and a network of international distributors that sell simulation systems to hospitals, colleges and universities, nursing schools, medical schools, emergency medical technician training programs, the military, medical device companies, and other organizations involved in procedural medicine. During 2009, we signed agreements with additional distributors for sales of our products in Europe, and Asia Pacific regions.

In the robotic surgical market and other medical licensing markets, we establish licensing relationships through our business development efforts.

For the years ended December 31, 2009, 2008, and 2007, respectively 41%, 40%, and 52%, of our total revenues were generated from the medical line of business. For the year ended December 31, 2007, 12% of our total revenues consisting of licensing, product revenue, or development revenues were from one customer.

Competition

There are several companies that currently sell simulation products to medical customers. Some simulators target the same minimally invasive procedures as do ours, while others sell mannequin-based systems for emergency response training. All simulators compete at some level for the same funding in medical institutions. Competitors include Simbionix USA Corporation, Mentice Corporation, Medical Education Technologies, Inc., and Medical Simulation Corporation. The principal competitive factors are the quality of the simulation for the type of medical procedure being simulated, technological sophistication, and price. We believe we compete favorably on all three.

Research and Development

Our success depends on our timely ability to invent, improve, and reduce the cost of our technologies in a timely manner; to design and develop products to meet specifications based on research and our understanding of customer needs and expectations; and to collaborate with our licensees who are integrating our technologies into theirs.

Immersion Engineering We have assembled a multi-disciplinary team of highly skilled engineers and scientists with the experience required for development of touch-enabling technology. The team s experience includes skills related to mechanical engineering, electrical engineering, embedded systems and firmware, control techniques, software, quality control, haptic content design, and project and process management. For medical simulations, we have assembled a team of experts who are skilled at modeling the anatomy and physiology of various medical cases, creating graphical renderings, designing haptic feedback, and devising advanced control algorithms to simulate realistic navigation for medical procedures, such as through the body s blood vessels.

Application Engineering & Technical Support We may provide application engineering and technical support during integration of our touch-enabling technology into customer products. To facilitate the validation and adoption of touch-enabling technology, we have developed various design kits. These kits may include actuators, mounting suggestions, controller boards, software libraries, programming examples, and documentation. Our application engineers support customer use of these design kits, including through phone and e-mail technical support and onsite training. Our application engineers and technical support staff may also help install our products, train customers on their use, and provide ongoing product support, particularly for medical training simulators.

Licensee Interaction Typically, collaborative development efforts are structured using a four-phase approach including Product Definition, Concept Development, Detail Design, and Production Design phases.

Table of Contents

This four-phase design process is typically used for designing new systems when the solution is not known beforehand. Each phase includes formal design reviews and documentation. The continuation of our development effort is contingent upon successful completion and acceptance of prior phases. This method helps ensure that the customer s financial risk is minimized and that project deliverables remain consistent with the goals established in the Product Definition phase.

Product Development Process For product development, we follow a product design process based on ISO 9001 guidance. This process starts with the typical marketing and product requirement stages, and once approved, typically moves on to product planning and design, prototyping, then alpha, beta, and first-run production development and testing stages. All of these stages are typically supported by documentation procedures and tools, design reviews, revision management, and other quality criteria. This careful, step-wise process helps us meet our design and quality requirements and to help make business decisions to continue, modify, or end product development. For our medical simulation products, we may add stages to help ensure our systems are very realistic and closely emulate the real medical procedures.

Research We have a dedicated team of experts in haptics and multimodal systems focused on investigating the next generations of haptic products for existing and new markets. The team has expertise in actuator design, mounting, control software, and human factors. We are also actively seeking and establishing worldwide research collaborations to reinforce our technical leadership and expand our innovative advancements. In addition, we have entered into numerous contracts with corporations and government agencies that help fund advanced research and development. Our government contracts permit us to retain ownership of the technology developed under the contracts, provided that we supply the applicable government agency a license to use the technology for noncommercial purposes.

For the years ended December 31, 2009, 2008, and 2007, research and development expenses were \$12.5 million, \$13.1 million, and \$10.4 million respectively.

Intellectual Property

We believe that intellectual property protection is crucial to our business. We rely on a combination of patents, copyrights, trade secrets, trademarks, nondisclosure agreements with employees and third parties, licensing arrangements, and other contractual agreements with third parties to protect our intellectual property.

Our failure to obtain or maintain adequate protection for our intellectual property rights for any reason could hurt our competitive position. There is no guarantee that patents will be issued from the patent applications that we have filed or may file. Our issued patents may be challenged, invalidated, or circumvented, and claims of our patents may not be of sufficient scope or strength, or issued in the proper geographic regions, to provide meaningful protection or any commercial advantage.

We and our wholly owned subsidiaries hold more than 800 issued or pending patents in the U.S. and other countries that cover various aspects of our hardware and software technologies. Some of our U.S. patents have begun to expire starting in 2007. We amortize our patents over their estimated useful lives, generally 10 years.

Where we believe it is appropriate, we will protect our intellectual property rights through the legal system. For example, we filed a complaint against Sony Computer Entertainment, Inc. and Sony Computer Entertainment of America, Inc. (collectively Sony Computer Entertainment) on February 11, 2002 in the U.S. District Court for the Northern District Court of California. On March 1, 2007, Immersion and Sony Computer Entertainment announced that the patent litigation at the U.S. Court of Appeals for the Federal Circuit was concluded. See Item 3. Legal Proceedings for further details and discussion of the litigation proceedings and conclusion.

On April 16, 2008, we announced that our wholly owned subsidiary, Immersion Medical, Inc., filed lawsuits for patent infringement in the United States District Court for the Eastern District of Texas against Mentice AB, Mentice SA, Simbionix USA Corp., and Simbionix Ltd. We intend to vigorously prosecute this lawsuit.

Table of Contents

Investor Information

You can access financial and other information in the Investor Relations section of our Web site at www.immersion.com. We make available, on our Web site, free of charge, copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after filing such material electronically or otherwise furnishing it to the SEC.

The charters of our audit committee, our compensation committee, and our nominating/corporate governance committee, and our Code of Business Conduct and Ethics (including code of ethics provisions that apply to our principal executive officer, principal financial officer, controller, and senior financial officers) are also available at our Web site under Corporate Governance. These items are also available to any stockholder who requests them by calling +1 408.467.1900.

The SEC maintains an Internet site that contains reports, proxy, and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov.

Employees

As of December 31, 2009, we had 124 full-time employees, including 54 in research and development, 29 in sales and marketing, and 41 in legal, finance, administration, and operations. As of that date, we also had 17 independent contractors. None of our employees are represented by a labor union, and we consider our employee relations to be positive.

Executive Officers

The following table sets forth information regarding our executive officers as of March 9, 2010.

Name	Position with the Company	Age
Victor Viegas	Interim Chief Executive Officer and member of the Board of Directors	53
Henry Hirvela	Interim Chief Financial Officer	58
G. Craig Vachon	Senior Vice President and General Manager, Touch Line of Business	46

Mr. Viegas has served as Interim Chief Executive Officer since October 2009 and as a member of the Board of Directors since October 2002. Mr. Viegas was the Company s Chief Executive Officer from October 2002 through April 2008, and President from February 2002 through April 2008. Mr. Viegas was also Chairman of the Board of Directors from October 2007 to February 2009. Mr. Viegas also served as Chief Financial Officer until February 2005, having joined the Company in August 1999 as Chief Financial Officer, Vice President, Finance. From June 1996 to August 1999, he served as Vice President, Finance and Administration and Chief Financial Officer of Macrovision Corporation, a developer and licensor of video and software copy protection technologies. From October 1986 to June 1996, he served as Vice President of Finance and Chief Financial Officer of Balco Incorporated, a manufacturer of advanced automotive service equipment. He holds a B.S. in Accounting and an M.B.A. from Santa Clara University. Mr. Viegas is also a Certified Public Accountant (inactive) in the State of California.

Mr. Hirvela has been serving as Interim Chief Financial Officer since October 2009 and as a consultant to the Company since August 2009. From May 2008 to November 2008, Mr. Hirvela served as executive vice president and Chief Financial Officer of BRE Properties, Inc., a real estate investment trust, where he was responsible for all financial functions including investor relations, SEC and internal reporting, internal controls, cost accounting, and budgeting and planning. Prior to that time, Mr. Hirvela served as Chief Financial Officer of VistaCare, Inc., a medical services company, from March 2006 to February 2008. Prior to this engagement, Mr. Hirvela founded Phoenix Management Partners, LLC in September 2002, during which time he served as President and CEO of Vigilant Systems, Inc. and served as Chairman and Director for Three-Five Systems, Inc., an electronic manufacturing services company, from February 2003 to September 2006. From 1996 to 2000, Mr. Hirvela served as Vice President and Chief Financial Officer for Scottsdale-based Allied Waste Industries, Inc. Prior to this, Mr. Hirvela held a variety of management positions with Bank of America, Texas Eastern Corporation and Browning-Ferris Industries. He holds a bachelor s degree from the United States International University and an M.B.A. from the Johnson Graduate School of Management at Cornell University.

Table of Contents

G. Craig Vachon joined Immersion in September 2008 as Vice President and General Manager, Mobility Group. Effective January 12, 2009. Mr. Vachon was promoted to Senior Vice President and General Manager of the Touch Line of Business. From February 2006 to September 2008, Mr. Vachon served as Vice President of Corporate Development of Atrua Technologies, Inc. where he was charged with identifying and evaluating organic and inorganic opportunities to expand the business and enhance shareholder value. From March 2004 to February 2006, Mr. Vachon served as the CEO and President of Varatouch Technology, Inc., which was acquired by Atrua Technologies, Inc. in February 2006. From November 2001 to November 2003, he served as CEO and Chairman of Sirenic, Inc. Mr. Vachon holds a B.S. in Communication and an M.S. in Business Communication from Emerson College.

Item 1A. *Risk Factors*

You should carefully consider the following risks and uncertainties, as well as other information in this report and our other SEC filings, in considering our business and prospects. If any of the following risks or uncertainties actually occurs, our business, financial condition, or results of operations could be materially adversely affected. The following risks and uncertainties are not the only ones facing us. Additional risks and uncertainties of which we are unaware or that we currently believe are immaterial could also materially adversely affect our business, financial condition, or results of operations. In any case, the trading price of our common stock could decline, and you could lose all or part of your investment. See also the Forward-looking Statements discussion in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

Company Risks

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

In connection with the internal investigation conducted by the audit committee into revenue recognition of certain transactions in our Medical line of business, we determined that we did not have adequate internal financial and accounting controls to produce accurate and timely financial statements. Among the material weaknesses identified in our review, we determined that we had material weaknesses with respect to revenue recognition. In addition, as set forth in 2007, we determined that we had a material weakness in controls over accounting for income taxes. In reviewing our financial statements in preparation for the restatement we determined that we also had material weaknesses in our controls over accounting for stock-based compensation, the adoption of new accounting standards, inventory control management and accounting for fixed assets. For a further discussion of these material weaknesses, see Item 9A of this Report. Although we have begun implementing new processes and procedures to improve our internal controls, our Interim Chief Executive Officer and Interim Chief Financial Officer determined that as of December 31, 2009, our internal controls over financial reporting were not effective to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external reporting in accordance with generally accepted accounting principles in the United States.

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

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

We are required to comply with Section 404 of the Sarbanes Oxley Act of 2002. We have expended significant resources in developing the necessary documentation and testing procedures required by Section 404 of the Sarbanes Oxley Act. Our management has concluded that we did not maintain effective control over financial reporting as of December 31, 2009 based on the criteria in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. We cannot be certain that the actions we have taken and are taking to improve our internal controls over financial reporting will be sufficient or that we will be able to implement our planned processes and procedures in a timely manner. In addition, we may be unable to produce accurate financial statements on a timely basis. Any of the foregoing could cause investors to lose confidence in the reliability of our consolidated financial statements, which could cause the market price of our common stock to decline and make it more difficult for us to finance our operations and growth.

Our current litigation is expensive, disruptive, and time consuming, and will continue to be, until resolved, and regardless of whether we are ultimately successful, could adversely affect our business.

We are currently a party to various legal proceedings. Due to the inherent uncertainties of litigation, we cannot accurately predict how these cases will ultimately be resolved. In addition, it is possible that as a result of our internal investigation described elsewhere in this report, we may be subject to additional litigation and investigations by government authorities such as the SEC. We anticipate that currently pending litigation will continue to be costly and that future litigation or investigations will result in additional legal expenses, and there can be no assurance that we will be successful or able to recover the costs we incur in connection with litigation or investigations. We expense litigation and investigatory costs as incurred, and only accrue for costs that have been incurred but not paid to the vendor as of the financial statement date. Litigation and investigations have diverted, and are likely to continue to divert, the efforts and attention of some of our key management and personnel. As a result, until such time as it is resolved or concluded, litigation and investigations could adversely affect our business. Further, any unfavorable outcome could adversely affect our business. For additional background on this and our other litigation, please see Notes 11 and 16 to the consolidated financial statements in Part I and Item 3. Legal Proceedings of this Part I.

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

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

We had an accumulated deficit of $99 million as of December 31, 2009, have a history of losses, expect to experience losses in the future, and may not achieve or maintain profitability in the future.

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

- continue to develop our technologies;
- increase our sales and marketing efforts;

attempt to expand the market for touch-enabled technologies and products and change our business;

protect and enforce our intellectual property;

pursue strategic relationships;

incur costs related to pending litigation;

acquire intellectual property or other assets from third-parties; and

invest in systems and processes to manage our business.

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

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 years ended December 31, 2009, 2008 and 2007, 51%, 51% and 39%, respectively, of our total revenues were royalty and license revenues. We do not control or influence the design, manufacture, quality control, promotion, distribution, or pricing of products that are manufactured and sold by our licensees, nor can we control consolidation within an industry which could either reduce the number of licensing products available or reduce royalty rates for the combined licensees. In addition, we generally do not have commitments from our licensees that they will continue to use our technologies in current or future products. As a result, products incorporating our technologies may not be brought to market, achieve commercial acceptance, or otherwise generate meaningful royalty revenue for us. For us to generate royalty revenue, licensees that pay us per-unit royalties must manufacture and distribute products incorporating our touch-enabling technologies in a timely fashion and generate consumer demand through marketing and other promotional activities. If our licensees products fail to achieve commercial success or if products are recalled because of quality control problems, our revenues will not grow and could decline.

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

Due to recent turnover, our executive management team has limited experience working together and if there are difficulties within this team, it could impede the execution of our business strategy.

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

We have experienced significant change in our business, and we cannot assure you that these changes will result in increased revenue or profitability.

Our business has undergone significant changes in recent periods, including the divestiture of our 3D business, new management, consolidation of our medical business and personnel changes and focus on additional target markets. In addition, we recently announced our intention to transition from the medical simulation products business. These changes have required, and will likely in the future require, significant investments of cash and other resources, as well as management s time and attention and have placed significant strains on our managerial, financial, engineering, or other resources. We cannot assure you that these efforts will result in growing our business successfully or in increased operating performance.

Table of Contents

We may not be able to continue to derive significant revenues from makers of peripherals for popular video gaming platforms.

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

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

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

Because we have a fixed payment license with Microsoft, our royalty revenue from licensing in the gaming market and other consumer markets has declined and may further do so if Microsoft increases its volume of sales of touch-enabled gaming products and consumer products at the expense of our other licensees.

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

We generate revenues from touch-enabling components that are sold and incorporated into third-party products. We have little or no control or influence over the design, manufacture, promotion, distribution, or pricing of those third-party products.

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

The terms in our agreements may be construed by our licensees in a manner that is inconsistent with the rights that we have granted to other licensees, or in a manner that may require us to incur substantial costs to resolve conflicts over license terms.

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

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

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

If we are unable to enter into new licensing arrangements with our existing licensees and with additional third-party manufacturers for our touch-enabling technologies, our royalty revenue may not grow.

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

- the lengthy and expensive process of building a relationship with potential licensees;
- the competition we may face with the internal design teams of existing and potential licensees;
- difficulties in persuading product manufacturers to work with us, to rely on us for critical technology, and to disclose to us proprietary product development and other strategies;
- difficulties with persuading potential licensees who may have developed their own intellectual property or licensed intellectual property from other parties in areas related to ours to license our technology versus continuing to develop their own or license from other parties;

challenges in demonstrating the compelling value of our technologies in new applications like mobile phones, portable devices, and touchscreens;

difficulties in persuading existing and potential licensees to bear the development costs and risks necessary to incorporate our technologies into their products;

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

inability to sign new gaming licenses if the video console makers choose not to license third parties to make peripherals for their new consoles; and reluctance of content developers, mobile phone manufacturers, and service providers to sign license agreements without a critical mass of other such inter-dependent supporters of the mobile phone industry also having a license, or without enough phones in the market that incorporate our technologies.

Our consolidation of and transition from our Medical operations and other restructurings may not be successful, and may negatively impact our business.

In May 2009, we moved the operations of our Medical line of business from Maryland to our headquarters in San Jose, California and we have also reduced our workforce in recent periods. Consolidations and business restructurings involve numerous risks and uncertainties, including, but not limited to: the potential loss of key employees, customers and business partners; market uncertainty related to our future business plans; the incurrence of unexpected expenses or charges; diversion of management attention from other key areas of our business; negative impacts on employee morale; and other potential dislocations and disruptions to the business. In addition, if our business expands, it may be more difficult for us to attract additional personnel and develop the resources we would need to support a larger customer base.

We also intend to transition from our medical simulation products business which could continue to disrupt our overall business. For the years ended December 31, 2009, 2008 and 2007, 41%, 40% and 52%, respectively, of our total revenues were from our medical line of business. Accordingly, if we are unable to manage this consolidation and transition effectively, our overall business and operating results could be materially and adversely affected.

Litigation regarding intellectual property rights could be expensive, disruptive, and time consuming; could result in the impairment or loss of portions of our intellectual property; and could adversely affect our business.

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

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

Table of Contents

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

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

Product liability claims could be time-consuming and costly to defend and could expose us to loss.

Our products or our licensees products may have flaws or other defects that may lead to personal or other injury claims. If products that we or our licensees sell cause personal injury, property injury, financial loss, or other injury to our or our licensees customers, the customers or our licensees may seek damages or other recovery from us. Although we intend to transition from the medical products business, we could face product liability claims for products that we have sold or that any successor 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.

Table of Contents

The nature of some of our products may also subject us to export control regulation by the U.S. Department of State and the Department of Commerce. Violations of these regulations can result in monetary penalties and denial of export privileges.

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

Compliance with directives that restrict the use of certain materials may increase our costs and limit our revenue opportunities.

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

Because personal computer peripheral products that incorporate our touch-enabling technologies currently work with Microsoft s operating system software, our costs could increase and our revenues could decline if Microsoft modifies its operating system software.

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

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

If we are unable to develop open source compliant products, our ability to license our technologies and generate revenues would be impaired.

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

The market for certain touch-enabling technologies and touch-enabled products is at an early stage and if market demand does not develop, we may not achieve or sustain revenue growth.

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

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

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

If we fail to protect and enforce our intellectual property rights, our ability to license our technologies and generate revenues would be impaired.

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

- our pending patent applications may not result in the issuance of patents;
- our patents may not be broad enough to protect our proprietary rights; and
- effective patent protection may not be available in every country 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.

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

Table of Contents

what we could have achieved in the market with several licensees or additional products available to sell to a specific set of customers.

If we fail to develop new or enhanced technologies for new applications and platforms, we may not be able to create a market for our technologies or our technologies may become obsolete, and our ability to grow and our results of operations might be harmed.

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

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

- we fail to develop new technologies or products;
- the technologies we develop infringe on third-party patents or other third-party rights;
- our new technologies fail to gain market acceptance; or
- our current products become obsolete or no longer meet new regulatory requirements.

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

We have limited engineering, customer service, technical support, quality assurance and manufacturing resources to design and fulfill favorable product delivery schedules and sufficient levels of quality in support of our different product areas. Products and services may not be delivered in a timely way, with sufficient levels of quality, or at all, which may reduce our revenue.

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

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

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

Medical licensing and certification authorities may not recommend or require use of our technologies for training and/or testing purposes and certain legislation that may encourage the use of simulators may not become law, significantly slowing or inhibiting the market penetration of our medical simulation technologies.

Several key medical certification bodies, including the American Board of Internal Medicine (ABIM), the American Board of Surgery (ABS), and the American College of Cardiology (ACC), have great influence in recommending particular medical methodologies, including medical training and testing methodologies, for use by

22

medical professionals. In the event that the ABIM and the ACC, as well as other, similar bodies, do not endorse medical simulation products in general, or our products or products incorporating our technology in particular, as a training and/or testing tool, and in addition in the event that the Enhancing Simulation Act of 2009 does not pass into law, market penetration for our products or products incorporating our technology in the medical market could be significantly and adversely affected.

The markets in which we participate or may target in the future are intensely competitive, and if we do not compete effectively, our operating results could be harmed.

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

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

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

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

Winning business is subject to a competitive selection process that can be lengthy and requires us to incur significant expense, and we may not be selected.

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

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

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

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

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

Our 3 largest customers accounted for approximately 34% of our total net revenue for 2009. We cannot be certain that customers that have accounted for significant revenue in past periods, individually or as a group, will, continue to generate revenue in any future period. If we lose a major customer or group of customers, our revenue could decline if we are unable to replace revenue from other sources.

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

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

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

- multiple conflicting tax laws and regulations; and
- political and economic instability.

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

Table of Contents

We might be unable to retain or recruit necessary personnel, which could slow the development and deployment of our technologies.

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

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

If our facilities were to experience catastrophic loss, our operations would be seriously harmed.

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

Investment Risks

Our quarterly revenues and operating results are volatile, and if our future results are below the expectations of public market analysts or investors, the price of our common stock is likely to decline.

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

These factors include:

- the establishment or loss of licensing relationships;
- the timing and recognition of payments under fixed and/or up-front license agreements;
- the timing of work performed under development agreements;

the timing of our expenses, including costs related to litigation, stock-based awards, acquisitions of technologies, or businesses;

the timing of introductions and market acceptance of new products and product enhancements by us, our licensees, our competitors, or their competitors;

our ability to develop and improve our technologies;

Table of Contents

our ability to attract, integrate, and retain qualified personnel;

seasonality in the demand for our products or our licensees products; and

our ability to build or ship products on a timely basis.

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.

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

failure to realize the anticipated benefits of acquired intellectual property or other assets;

charges associated with amortization of acquired assets or potential charges for write-down of assets associated with unsuccessful acquisitions;

potential intellectual property infringement claims related to newly acquired product lines; and

potential costs associated with failed acquisition efforts.

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

As our business grows, such growth may place a significant strain on our management and operations and, as a result, our business may suffer.

We plan to continue expanding our business, and any significant growth could place a significant strain on our management systems, infrastructure and other resources. We recently transitioned the preparation of all of our internal reporting to upgraded management information systems and are in the process of implementing this system for all of our subsidiaries. If we encounter problems with the implementation of these systems, 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 1B. *Unresolved Staff Comments*

None.

Item 2. *Properties*

We lease a facility in San Jose, California of approximately 48,000 square feet, which serves as our corporate headquarters and includes our sales, marketing, administration, research and development, manufacturing, and distribution functions for the Touch operating segment. Products produced in San Jose include several of our touch interface products, including rotary encoders, components to enable tactile feedback in touchscreens, and various arcade gaming products. The facility is also used for the Medical operating segment including the sales, marketing, administration, research and development, manufacturing, and distribution functions for the Endoscopy AccuTouch System, the CathLab VR System, Virtual IV System, the Lap VR System, and the insightArthroVR arthroscopy surgical simulator. The lease for this property expires in June 2014 and can be extended to June 2018.

We lease a facility in Montreal, Quebec, Canada of approximately 6,416 square feet, for our subsidiary, Immersion Canada, Inc. The facility is used for research and development and administration functions. The lease for this property expires in October 2015.

We lease office space in Seocho-gu, Seoul, Korea. The facility is used for sales and marketing support and research and development functions. This lease expires in November 2011.

We lease office space in Espoo, Finland for use by our sales and technical support function. The lease agreement is cancelable upon a three month notice.

We believe that our existing facilities are adequate to meet our current needs.

Item 3. ***Legal Proceedings***

In re Immersion Corporation Initial Public Offering Securities Litigation

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

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

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

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

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

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

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. The lead plaintiff will file a consolidated complaint following our restatement of financial statements to which defendants will then have an opportunity to file responsive pleadings.

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. Plaintiffs will file a consolidated derivative complaint following our restatement of financial statements, to which defendants will then have the opportunity to file responsive pleadings.

Shaw v. Richardson et al.

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

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.

PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Our common stock is traded on the Nasdaq Global Market under the symbol IMMR. The following table sets forth, for the periods indicated, the high and low sales prices for our common stock on such market.

	High	Low
Fiscal year ended December 31, 2009		
Fourth Quarter	$ 4.96	$ 3.42
Third Quarter	$ 4.66	$ 3.41
Second Quarter	$ 5.17	$ 2.80
First Quarter	$ 6.10	$ 2.31
Fiscal year ended December 31, 2008		
Fourth Quarter	$ 6.35	$ 2.72
Third Quarter	$ 7.92	$ 5.22
Second Quarter	$ 11.82	$ 6.43
First Quarter	$ 13.38	$ 6.61

On March 3, 2010, the closing price was $4.53 and there were 142 holders of record of our common stock. Because many of such shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

Issuer Repurchases of Equity Securities

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. We have currently stopped repurchasing shares under this share repurchase program.

Dividend Policy

We have never declared or paid any cash dividends on our common stock and we do not anticipate paying cash dividends in the foreseeable future. We currently intend to retain any earnings to fund future growth, product development, and operations.

Table of Contents

Item 6. *Selected Financial Data*

The following selected consolidated financial data is qualified in its entirety by, and should be read in conjunction with, Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto included elsewhere in this Annual Report on Form 10-K.

	Years Ended December 31,				
	2009	**2008(2)**	**2007(2)**	**2006(2)**	**2005(2)**
	(In thousands, except per share data)				
CONSOLIDATED STATEMENTS OF OPERATIONS DATA:					
Revenues	$ 27,725	$ 27,981	$ 30,140	$ 22,959	$ 19,683
Costs and expenses(1)	58,181	77,075	(93,138)	32,937	32,686
Operating income (loss)	(30,456)	(49,094)	123,278	(9,978)	(13,003)
Income tax benefit (provision) from continuing operations	310	(5,088)	(12,850)	218	298
Income (loss) from continuing operations	(28,856)	(50,258)	116,027	(11,087)	(13,732)
Gain (loss) from discontinued operations (net of tax)	577	(732)	1,059	505	647
Net income (loss)	(28,279)	(50,990)	117,086	(10,582)	(13,085)
Basic net income (loss) per share					
Continuing operations	$ (1.03)	$ (1.70)	$ 4.19	$ (0.45)	$ (0.57)
Discontinued operations	$ 0.02	$ (0.02)	$ 0.04	$ 0.02	$ 0.03
Total	$ (1.01)	$ (1.72)	$ 4.23	$ (0.43)	$ (0.54)
Diluted net income (loss) per share					
Continuing operations	$ (1.03)	$ (1.70)	$ 3.68	$ (0.45)	$ (0.57)
Discontinued operations	$ 0.02	$ (0.02)	$ 0.03	$ 0.02	$ 0.03
Total	$ (1.01)	$ (1.72)	$ 3.71	$ (0.43)	$ (0.54)
Shares used in calculating net loss per share					
Basic	27,973	29,575	27,662	24,556	24,027
Diluted	27,973	29,575	31,667	24,556	24,027

			December 31,		
	2009	**2008**	**2007**	**2006**	**2005**
			(In thousands)		
CONSOLIDATED BALANCE SHEET DATA:					
Cash, cash equivalents, and short-term investments	$ 63,728	$ 85,743	$ 138,112	$ 32,012	$ 28,171
Working capital	61,005	82,972	143,160	33,557	28,885
Total assets	87,834	113,587	167,931	49,623	44,760
Long-term debt, less current portion				18,122	17,490
				15,000	15,000

Long-term customer advance from Microsoft					
Total stockholders equity (deficit)	55,741	79,778	142,177	(23,385)	(16,795)

(1) Results include litigation settlements, conclusions,and patent license income (expense) of $(20.8) million, $134.9 million, and $1.7 million for 2008, 2007, and 2006, respectively.

(2) Information has been retrospectively restated to present the results of our 3D product line as a discontinued operation. See Note 12 Restructuring and Discontinued Operations in the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Form 10K.

31

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto.

This Management s Discussion and Analysis of Financial Condition and Results of Operations 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, will, and other similar expressions. 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 in Item 1A, 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 release the results of any revisions to these forward-looking statements that could occur after the filing of this report.

Critical Accounting Policies and Estimates

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

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

Revenue Recognition

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

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

written agreement with the customer.

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

32

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 position and ability to pay. If we determined that collectibility is not probable based upon our credit review process or the customer s payment history, we recognize revenue when payment is received.

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

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

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

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

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

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

Valuation and amortization method We use the Black-Scholes model, single-option approach to determine the fair value of stock options, and ESPP shares. All share-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These

33

Table of Contents

variables include actual and projected employee stock option exercise behaviors that impact the expected term and forfeiture rates, our expected stock price volatility over the term of the awards, risk-free interest rate, and expected dividends.

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

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

See Note 10 to the consolidated financial statements for further information regarding stock compensation disclosures.

Accounting for Income Taxes

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

Our judgments, assumptions, and estimates relative to the current provision for income tax take into account current tax laws, our interpretation of current tax laws, and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. We have established reserves for income taxes to address potential exposures involving tax positions that could be challenged by tax authorities. Although we believe our judgments, assumptions, and estimates are reasonable, changes in tax laws or our interpretation of tax laws and any future tax audits could significantly impact the amounts provided for income taxes in our 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 taxes. Any of the assumptions, judgments, and estimates mentioned above could cause our actual income tax obligations to differ from our estimates, thus materially impacting our financial position and results of operations.

Short-term Investments

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

Table of Contents

We follow the accounting guidance to assess whether our investments with unrealized loss positions are other than temporarily impaired. Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and are reported in the consolidated statement of operations. Factors considered in determining whether a loss is temporary include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

Effective January 1, 2008, we adopted the provisions of ASC 820, Fair Value Measurements and Disclosures (ASC 820), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements required under other accounting pronouncements. ASC 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. ASC 820 also requires that a fair value measurement reflect the assumptions market participants would use in pricing an asset or liability based on the best information available. Assumptions include the risks inherent in a particular valuation technique (such as a pricing model) and/or the risks inherent in the inputs to the model.

In February 2008, the FASB revised ASC 820, that delays the effective date of ASC 820 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) until fiscal years beginning after November 15, 2008. The delay is intended to allow the FASB and constituents additional time to consider the effect of various implementation issues that have arisen, or that may arise, from the application of ASC 820. The adoption of this guidance did not have a material impact on the Company s consolidated results of operations, financial position or cash flows. Further information about short-term investments may be found in Note 2 to the consolidated financial statements.

Recovery of Accounts Receivable

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

Inventory Valuation

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

Intangible Assets

We have acquired patents and other intangible assets. In addition, we capitalize the external legal and filing fees associated with patents and trademarks. We assess the recoverability of our intangible assets, and we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets that affect our 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 year ended December 31, 2009, we capitalized costs associated with patents and trademarks of $2.3 million. Our total amortization expense for the same period was $829,000.

Restructuring Costs

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

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

Results of Operations

Overview of 2009

We continued to invest in research, development, sales, and marketing in our key business segments. Key events in the year were as follows:

We believe that our haptics technology is included in 100 million phones worldwide.

We completed the divestiture of our 3D product line. Operations of our 3D product line have been retrospectively classified as discontinued operations in our consolidated statement of operations.

In conjunction with moving our medical operating segment to San Jose, our reduction of workforce from our Montreal medical business operations, and other workforce reductions in our Touch segment, we had restructuring costs of $1.5 million. We had physical inventory write offs of $593,000 primarily consisting of physical count to book adjustments of medical equipment parts. We also recognized fixed asset write offs of demo equipment of $682,000 primarily resulting from a reconciliation of the fixed asset records to the physical inventory at the time of the move. In addition we had inventory obsolescence and scrap expenses of $1.3 million primarily of medical equipment parts.

In February, 2010, we announced plans to focus primarily on a licensing model in the future. In March 2010 we entered into an agreement to sell certain assets of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines. Correspondingly, we plan to pursue the medical segment via a licensing approach. Under a licensing approach, we anticipate that the manufacturing and selling of simulator products to the medical training industry will not be an ongoing focus for us, and therefore, we hope to achieve certain cost reductions in 2010. Revenue in 2009 for these product lines was approximately $6 million. In 2010, we also expect to continue to focus on the execution of plans in our established businesses to increase revenue and make selected investments for longer-term growth areas. Our success could be limited by several factors, including the current macro-economic climate, the timely release of our new products and our licensees products, continued market acceptance of our products and technology, the introduction of new products by existing or new competitors, and the cost of ongoing litigation. For a further discussion of these and other risk factors, see Item 1A Risk Factors.

Table of Contents

The following table sets forth our statement of operations data as a percentage of total revenues:

	Years Ended December 31, 2009	2008	2007
Revenues:			
Royalty and license	51.2%	50.9%	39.4%
Product sales	43.0	39.7	46.9
Development contracts and other	5.8	9.4	13.7
Total revenues	100.0	100.0	100.0
Costs and expenses:			
Cost of product sales (exclusive of amortization of intangibles shown separately below)	29.9	26.9	24.1
Sales and marketing	48.1	55.3	34.1
Research and development	45.1	46.7	34.5
General and administrative	78.3	68.8	42.1
Amortization and impairment of intangibles	3.2	3.2	3.8
Litigation settlements, conclusions, and patent license		74.1	(447.6)
Restructuring costs	5.3	0.5	
Total costs and expenses	209.9	275.5	(309.0)
Operating income (loss)	(109.9)	(175.5)	409.0
Change in fair value of warrant liability	1.9		
Interest and other income	2.8	15.0	22.0
Interest and other expense		(0.9)	(3.4)
Income (loss) from continuing operations before provision for income taxes	(105.2)	(161.4)	427.6
Benefit (provision) for income taxes	1.1	(18.2)	(42.6)
Income (loss) from continuing operations	(104.1)	(179.6)	385.0
Discontinued operations, net of provision for income taxes	2.1	(2.6)	3.5
Net income (loss)	(102.0)%	(182.2)%	388.5%

Comparison of Years Ended December 31, 2009, 2008, and 2007

Revenues

	2009	% Change	2008 ($ in thousands)	% Change	2007

Royalty and license	$ 14,202	0%	$ 14,254	20%	$ 11,881
Product sales	11,924	7%	11,110	(21)%	14,138
Development contracts and other	1,599	(39)%	2,617	(36)%	4,121
Total revenue	$ 27,725	(1)%	$ 27,981	(7)%	$ 30,140

Fiscal 2009 Compared to Fiscal 2008

Total Revenue Our total revenue for the year ended December 31, 2009 decreased by $256,000, or 1%, to $27.7 million, from $28.0 million in 2008.

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. Royalty and license revenue decreased by $52,000 or less than 0.5% from 2008 to 2009. The decrease in royalty and license revenue was primarily due to a

Table of Contents

decrease in royalty and license revenue from gaming and automotive licensees partially offset by increased revenue from licensees of mobile and medical devices. Revenues from gaming customers in 2008 which did not recur in 2009 included previously deferred revenues from ISLLC totaling $1.1 million which was recognized after we concluded our litigation with it. In addition, BMW has removed our technology from certain controller systems, which also caused automotive royalties to decline in 2009 compared to 2008. We plan on focusing most of our future business on a licensing model for both the touch and medical segments.

Based on our litigation conclusion and business agreement entered into with Sony Computer Entertainment in March 2007, we are recognizing a minimum of $30.0 million as royalty and license revenue from March 2007 through March 2017, which amount to approximately $750,000 per quarter. The revenue from our third-party peripheral licensees included in royalty and license revenue has generally continued to decline primarily due to i) the reduced sales of past generation video console systems due to the launches of the next-generation console models from Microsoft Xbox 360, Sony PlayStation 3 (PS3), and Nintendo Wii, and ii) the decline in third-party market share of aftermarket game console controllers due to the launch of next-generation peripherals by manufacturers of console systems.

Sony has, to date, not yet broadly licensed third parties to produce peripherals of the PS3 system. To the extent Sony discourages or impedes third-party controller makers from making more PS3 controllers with vibration feedback, our licensing revenue from third-party PS3 peripherals will continue to be severely limited.

For the Microsoft Xbox 360 video console system launched in November 2005, Microsoft has, to date, not broadly licensed third parties to produce game controllers. Because our gaming royalties come mainly from third-party manufacturers, unless Microsoft broadens its licenses to third-party controller makers, particularly with respect to wireless controllers for Xbox 360, our gaming royalty revenue may decline. Additionally, Microsoft is now making touch-enabled wheels covered by its royalty-free, perpetual, irrevocable license to our worldwide portfolio of patents that could compete with our licensees current or future products for which we earn per unit royalties. For the Nintendo Wii video console system launched in December 2006, Nintendo has, to date, not yet broadly licensed third parties to produce game controllers for its Wii game console. Because our gaming royalties come mainly from third-party manufacturers, unless Nintendo broadens its licenses to third-party controller makers, our gaming royalty revenue may decline.

Product sales Product sales increased by $814,000 or 7% from 2008 to 2009. The increase in product sales was primarily due to an increase in medical product sales of $983,000 partially offset by a decrease in touch product sales of $169,000. Increased medical product sales were mainly due to the recognition of $1.0 million in revenue from an international medical customer for whom revenues could not be recognized until the agreement with the customer was terminated in the third quarter of 2009 partially offset by decreases of other medical product sales. Touch interface product sales decreased primarily due to reduced sales of touchscreen and touch panel components and arcade entertainment products. In March 2010 we entered into an agreement to sell certain assets of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines. See Note 19 of the consolidated financial statements. Revenue in 2009 for these product lines was approximately $6 million. Medical product sales are expected to significantly decline in the future since we will be transitioning to a license model and will have only one product line remaining, the Virtual IV product line.

Development contracts and other revenue Development contracts and other revenue decreased by $1.0 million or 39% from 2008 to 2009. Development contracts and other revenue is comprised of revenue on commercial contracts. The decrease was mainly attributable to a decrease in medical contract revenue of $916,000 due to a lower volume of work performed under medical contracts in 2009 compared to 2008. We continue to transition our engineering resources from certain commercial development contract efforts to development efforts that focus on leveraging our existing sales and channel distribution capabilities. Accordingly, we do not expect development contract revenue to grow significantly in the future.

For the year ended December 31, 2009, revenues generated in North America, Europe, Far East, and Rest of the World represented 47%, 14%, 37%, and 2%, respectively, compared to 67%, 15%, 15%, and 3%, respectively, for the year ended December 31, 2008. The shift in revenues among regions was mainly due to an increase in Touch royalty revenue and Medical product sales in the Far East; a decrease in Touch royalty revenue, medical product revenue, and medical contract revenue in North America; a decrease in Touch royalty revenue from Europe; and a decrease in medical product sales from the Rest of the World. We mainly attribute the increase in revenue in the Far East to increased shipments by licensees of mobile devices, partially due to the addition of increased international sales and support personnel in 2008, and recognition of $1.0 million from an international medical customer as discussed above. The decrease in Touch royalty revenue in North America is partially attributable to previously deferred revenues from ISLLC totaling $1.1 million which was recognized in 2008 after we concluded our litigation with them. Three customers accounted for 34% of our sales in 2009 and two customers accounted for 22% of our sales in 2008. As medical product sales are expected to decline in the future since these offerings will no longer be a core strategy, we may see our sales concentrated in fewer large customers in the future.

Fiscal 2008 Compared to Fiscal 2007

Total Revenue Our total revenue for the year ended December 31, 2008 decreased by $2.1 million, or 7%, to $28.0 million, from $30.1 million in 2007.

Royalty and license revenue Royalty and license revenue increased by $2.4 million or 20% from 2007 to 2008 and was all from our Touch segment. The increase in royalty and license revenue was primarily a result of an increase in mobile device license and royalty revenue of $2.1 million and an increase in gaming royalties of $1.2 million, offset in part by a decrease in royalties for touch interface products of $942,000.

Mobile device license and royalty revenue increased primarily due to the increase in the shipment of TouchSense enabled phones by LG Electronics that began in the second quarter of 2007, the signing of a new license contract with mobile device manufacturer Nokia at the end of the second quarter of 2007, and the shipment of additional TouchSense enabled phones by our licensees in 2008.

The increase in gaming royalties compared to 2007 was mainly due to previously deferred royalty revenues from ISLLC totaling $1.0 million which was recognized after we concluded our litigation with them. There was also an increase in royalty and license revenue from an increase in sales of new steering wheel products from Logitech. In addition, there was a full year of royalty and license revenue from first-party gaming licensee Sony Computer Entertainment that increased revenue year over year. Although the revenue from our third-party peripheral licensees had generally continued to decline primarily due to i) the reduced sales of past generation video console systems due to the launches of the next-generation console models from Microsoft (Xbox 360), Sony (PlayStation 3), and Nintendo (Wii), and ii) the decline in third-party market share of aftermarket game console controllers due to the launch of next-generation peripherals by manufacturers of console systems, we saw the decline begin to stabilize, as manifested by the release of new steering wheel products from Logitech for the PlayStation 3.

Touch interface product royalties decreased mainly due to the recognition of certain automotive royalty payments in the second quarter of 2007 that did not recur. In addition, BMW has begun to remove our technology from certain controller systems, that also caused automotive royalties to decline.

Product sales Product sales decreased by $3.0 million or 21% from 2007 to 2008. The decrease in product sales was primarily due to decreased medical product sales of $3.1 million, mainly due to decreased sales of our endoscopy, endovascular, laparoscopy, and Virtual IV simulator platforms partially offset by increases in our arthroscopy simulators. These decreases were primarily due to decreased international sales and delays in new product introductions. Touch interface products increased by $96,000 due to additional sales of touchscreen and touch panel components, rotary modules, and arcade entertainment products.

Development contracts and other revenue Development contracts and other revenue decreased by $1.5 million or 36% from 2007 to 2008. The decrease was mainly attributable to a decrease in medical contract revenue of $1.3 million due to the completion of work performed under medical contracts that occurred in 2007 through the first six months of 2008, and decreased touch interface product contract revenue of $564,000 primarily due to contracts being completed during the year. Partially offsetting this, there was increased revenue recognized on mobile device development contracts and support of $370,000.

Table of Contents

Cost of Product Sales

	2009	% Change	2008	% Change	2007
			($ in thousands)		
Cost of product sales	$ 8,289	10%	$ 7,516	3%	$ 7,272
% of product sales	70%		68%		51%

Our cost of product sales consists primarily of materials, labor, and overhead. It excludes amortization and impairment of intangibles. There is no cost of product sales associated with royalty and license revenue or development contract revenue. Cost of product sales increased by $773,000 or 10% from 2008 to 2009. The increase in cost of product sales was primarily due to an increase in excess and obsolete inventory provisions and scrap expense of $873,000, increased physical inventory write off costs of $601,000, an increase of material and production costs of $363,000, and increased freight costs of $103,000, partially offset by decreased overhead costs of $1.3 million. The increase in obsolescence and inventory scrap expense was mainly due to additional excess and obsolescence write-off and inventory scrap mainly from medical product parts. The physical inventory write off costs primarily consisted of physical count to book adjustments of medical equipment parts in the second quarter of 2009. The increase in direct material costs was mainly a result of increased product sales. Overhead costs decreased mainly as a result of reduced salary expense from decreased headcount. Cost of product sales increased as a percentage of product revenue to 70% in 2009 from 68% in 2008. This increase is mainly due to the increased costs mentioned above, partially offset by the reduced overhead costs from decreased headcount mentioned above. In March 2010 we entered into an agreement to sell certain assets of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines. See Note 19 of the consolidated financial statements. Cost of product sales for medical products are expected to decline in the future since we will have only one product line remaining, the Virtual IV product line.

Cost of product sales increased by $244,000 or 3% from 2007 to 2008. The increase in cost of product sales was primarily due to an increase of overhead costs of $383,000, an increase in excess and obsolete inventory provisions of $235,000, increased provision for warranty and repair costs of $177,000, and increased royalties of $137,000 partially offset by decreased material and production costs of $666,000. Overhead costs increased, in part, as a result of increased salary expense from additional headcount and other costs of programs to improve quality processes within our manufacturing operations. The decrease in direct material costs was mainly a result of decreased product sales. Royalty costs increased due to increased sales of certain medical products with associated royalty costs. Cost of product sales increased as a percentage of product revenue to 68% in 2008 from 51% in 2007. This increase is mainly due to reduced sales and the increased overhead and other costs mentioned above.

Expenses

	2009	% Change	2008	% Change	2007
			($ in thousands)		
Sales and marketing	$ 13,324	(14)%	$ 15,472	51%	$ 10,272
Research and development	12,493	(4)%	13,058	26%	10,389
General and administrative	21,719	13%	19,249	52%	12,683
Amortization and impairment of intangibles	894	1%	888	(23)%	1,146

Litigation conclusions and patent license		(100)%	20,750	*%	(134,900)
Restructuring costs	1,462	930%	142	*%	

* Percentage not meaningful.

Sales and Marketing Our sales and marketing expenses are comprised primarily of employee compensation and benefits, sales commissions, advertising, trade shows, brochures, market development funds, travel, and an allocation of facilities costs. Sales and marketing expenses decreased by $2.1 million or 14% in 2009 compared to 2008. The decrease was primarily due to decreased compensation, benefits, and overhead of $1.3 million primarily due to decreased sales and marketing headcount; decreased marketing, advertising, and public relations costs of $520,000; decreased employee recruitment expense of $394,000; a decrease in bad debt expense of $371,000; and decreased sales and marketing travel expense of $89,000; partially offset by increased write offs of fixed assets of

$506,000 primarily demo equipment resulting from a reconciliation of fixed asset records to the physical inventory at the time of the move of our Medical line of business from Maryland to San Jose. In March 2010 we entered into an agreement to sell certain assets of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines which will cause some of our sales and marketing expenses to decrease in the future. See Note 19 of the consolidated financial statements. We are taking steps to reduce our sales and marketing expenses, although we expect to continue to focus our sales and marketing efforts on mobile device, touchscreen, and medical market licensing opportunities to build greater market acceptance for our touch technologies.

Sales and marketing expenses increased by $5.2 million or 51% in 2008 compared to 2007. The increase was primarily due to increased compensation, benefits, and overhead of $2.2 million, increased marketing, advertising, and public relations costs of $1.1 million, increased sales and marketing travel expense of $622,000, increased consulting costs of $551,000 to supplement our sales and marketing staff, increased office and facilities expenses of $307,000, an increase in bad debt expense of $236,000, and increased employee recruiting costs of $163,000. The increased sales and marketing expenses were primarily due to an increase in sales and marketing headcount and the expanding of our sales and marketing efforts internationally. In addition, the increased compensation, benefits, and overhead expense was mainly due to an increase in sales and marketing headcount, increased compensation for sales and marketing personnel, and increased non-cash stock based compensation charges.

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. Research and development expenses decreased by $565,000 or 4% in 2009 compared to 2008. The decrease was primarily due to decreased lab and prototyping expenses of $282,000, decreased employee recruiting expenses of $179,000, and decreased compensation, benefits, and overhead expense of $125,000. The decreased compensation, benefits, and overhead expense was primarily due to decreased research and development headcount. We are taking steps to reduce our research and development expenses.

Research and development expenses increased by $2.7 million or 26% in 2008 compared to 2007. The increase was primarily due to increased compensation, benefits, and overhead expense of $1.7 million, increased professional and consulting expense of $585,000 to supplement our engineering staff, and an increase in lab and prototyping expenses of $277,000 in support of sales efforts. The increased compensation, benefits, and overhead expense was primarily due to increased research and development headcount and increased non-cash stock-based compensation charges.

General and Administrative Our general and administrative expenses are comprised primarily of employee compensation and benefits, legal and professional fees, office supplies, travel, and an allocation of facilities costs. General and administrative expenses increased by $2.5 million or 13% in 2009 compared to 2008. The increase was primarily due to increased legal, professional, and license fee expense of $1.5 million, increased compensation, benefits, and overhead of $864,000, and loss on fixed assets of $108,000 partially offset by decreased travel costs of $48,000. The increased legal, professional, and license fee expenses were primarily due to increased accounting, audit and legal costs resulting from our internal investigation and restatement costs incurred in 2009, offset by reduced litigation costs of $2.7 million, mainly Microsoft litigation which was settled in 2008. The increased compensation, benefits, and overhead expense was primarily due to changes in executive personnel that resulted in additional costs and increased non-cash stock-based compensation charges. We expect that the dollar amount of general and administrative expenses will continue to be a significant component of our operating expenses. We continued to incur costs related to the restatement of our historical financial statements in the first quarter of 2010 and will continue to incur litigation costs as we assert our intellectual property and contractual rights and defend lawsuits brought against us.

General and administrative expenses increased by $6.6 million or 52% in 2008 compared to 2007. The increase was primarily due to increased legal, professional, and license fee expense of $3.4 million, increased compensation, benefits, and overhead of $2.5 million, increased travel costs of $274,000, and increased supplies and office and facilities expense of $183,000. The increased legal, professional, and license fee expenses were primarily due to increased litigation and other activities that we were engaged in, mainly the litigation with Microsoft; increased consulting costs; and increased recruiting costs due to management changes. The increased compensation, benefits, and overhead expense was primarily due to changes in executive personnel that resulted in additional costs, increased general and administrative headcount, increased compensation for general and administrative personnel, and increased non-cash stock-based compensation charges.

Amortization and impairment of Intangibles Our amortization impairment of intangibles is comprised primarily of patent amortization and other intangible amortization along with impairment or write off of abandoned and expired patents. Amortization and impairment of intangibles increased slightly by $6,000 or 1% from 2008 to 2009. The increase was primarily attributable to an increase from the cost and number of new patents being amortized along with the impairment of certain patents partially offset by some intangible assets reaching full amortization. Amortization and impairment of intangibles decreased by $258,000 or 23% from 2007 to 2008. The decrease was primarily attributable to some intangible assets reaching full amortization partially offset by an increase from the cost and number of new patents being amortized.

Litigation Settlements, Conclusions, and Patent License There were no litigation settlements, conclusions, and patent license expenses in the year ended December 31, 2009, which was a decrease of $20.8 million compared to 2008, all of which related to our settlement with Microsoft. Litigation settlements, conclusions, and patent license was $20.8 million of expense for 2008, compared to income of $134.9 million for the same period in 2007, a change of $155.7 million. For 2007, the $134.9 million was comprised of $119.9 million related to Sony Computer Entertainment and $15.0 million related to the release of the Microsoft long-term customer advance.

Restructuring Restructuring costs increased by $1.3 million from 2008 to 2009. Restructuring costs of $1.5 million for the year ended December 31, 2009 consist primarily of severance benefits and move and close down of facility costs paid in connection with the reduction of workforce from our Montreal medical business operations and relocation of the Maryland medical business operations to San Jose. Restructuring costs in 2009 also included severance benefits paid as the result of the reduction of workforce due to business changes in our Touch segment. Restructuring costs for the year ended December 31, 2008 consist primarily of severance benefits paid as the result of the reduction of workforce due to business changes in our Touch segment of $142,000. There were no restructuring charges incurred for the year ended 2007.

Interest and Other Income / Expense

	2009	% Change	2008	% Change	2007
			($ in thousands)		
Change in fair value of warrant liability	$ 517	*%	$	*%	$
Interest and other income	777	(81)%	4,174	(37)%	6,623
Interest and other expense	(4)	(98)%	(250)	(76)%	(1,024)

* Percentage not meaningful.

Change in fair value of warrant liability In January 2009, we adopted ASC 815-40, Contracts in Entity s own Equity . For the year ended December 31, 2009, we had a gain from the change in fair value of the warrant liability of $517,000. There was no gain or loss from the change in fair value of the warrant liability for the years ended December 31, 2008 or 2007. We do not expect to have any further charges for a change in the fair value of the warrant liability since the warrants expired in December 2009.

Interest and Other Income Interest and other income consist primarily of interest income and dividend income from cash and cash equivalents and short-term investments and gain on sale of short-term investments. Interest and other income decreased by $3.4 million from 2008 to 2009. This was primarily the result of decreased interest income due to a reduction in cash equivalents and short-term investments and reduced interest rates on cash, cash equivalents, and short-term investments. In addition, interest income included the accretion of interest income from Sony Computer Entertainment of $377,000 in 2009 compared to $904,000 in 2008. This interest accretion was complete at the end of 2009.

Interest and other income decreased by $2.4 million from 2007 to 2008. This was primarily the result of decreased interest income due to a reduction in cash equivalents and short-term investments and reduced interest rates on cash, cash equivalents, and short-term investments.

Table of Contents

Interest and Other Expense Interest and other expense consists primarily of interest and accretion expense on our 5% Senior Subordinated Convertible Debentures (5% Convertible Debentures) and accretion and dividend expense on our long-term customer advance from Microsoft along with impairment losses on long term notes receivable. Interest and other expense decreased by $246,000 from 2008 to 2009 primarily due to the reduction of impairment losses on long term notes receivable.

Interest and other expense decreased by $774,000 from 2007 to 2008 due to the elimination of interest expense from the conversion and redemption of our 5% Convertible Debentures during the third quarter of 2007 partially offset by impairment losses on long term notes receivable.

Benefit (Provision) for Taxes

	2009	% Change	2008	% Change	2007
			($ in thousands)		
Benefit (provision) for income taxes	$ 310	106%	$ (5,088)	60%	$ (12,850)

Benefit (Provision) for Income Taxes For the year ended 2009, we recorded a benefit for income taxes of $310,000 yielding an effective tax rate of 1.1%. The current year tax benefit is reflective of the recording of a benefit for the alternative minimum tax and net operating loss carrybacks, R&D monetization, valuation allowance on specific deferred tax assets, and foreign withholding tax expense. Accordingly, the effective tax rate differs from the statutory rate. For the year ended 2008, we recorded a provision for income taxes of $5.1 million yielding an effective tax rate of 11.3%. The tax provision for the year ended 2008 is reflective of the recording of a full valuation allowance against our entire deferred tax asset balance in the period due to losses in fiscal 2008, the variability of operating results, and near term projected losses. Accordingly, the effective tax rate differs from the statutory rate. For the year ended 2007, we recorded a provision for income taxes of $12.9 million yielding an effective tax rate of 10.0%. The 2007 tax provision is primarily reflective of federal and state tax expense as a result of our pre-tax income of $128.9 million mainly due to the litigation conclusions and patent license from Sony Computer Entertainment, see Note 13 to the consolidated financial statements. The effective tax rate differs from the statutory rate primarily due to the significant reduction in our valuation allowance against deferred tax assets as we used the majority of our net operating loss carryforwards against current year taxable income.

Discontinued Operations

	2009	% Change	2008	% Change	2007
			($ in thousands)		
Gain on sale of discontinued operations	$ 237	*%	$	*%	$
Gain (loss) from discontinued operations	$ 340	146%	$ (732)	(169)%	$ 1,059

* Percentage not meaningful.

Discontinued Operations In the year ended December 31, 2009, we ceased operations of the 3D product line and sold our CyberGlove family of products, SoftMouse 3D positioning device family of products, and our Microscribe family of products, and recorded gains on sales of discontinued operations of $237,000. Accordingly, the operations of the

3D product line have been classified as discontinued operations in the consolidated statement of operations. Gain from discontinued operations, net of tax, increased by $1.1 million for the year ended December 31, 2009 compared to the same period in 2008, primarily due to the decrease in activity due to the ceasing of 3D operations in the quarter ended March 31, 2009. This resulted in reduced sales volumes and reduced costs and expenses including inventory and asset impairment charges associated with 3D operations during 2008. Loss from discontinued operations increased for the year ended December 31, 2008 compared to 2007, primarily due to increased costs and expenses, including inventory and asset impairment charges associated with 3D operations during 2008 offset by a reduction in income tax provision.

Segment Results for the Years Ended December 31, 2009, 2008, and 2007 are as follows:

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

	2009	% Change	2008	% Change	2007
			($ in thousands)		
Revenues:					
Touch	$ 16,374	(3)%	$ 16,912	16%	$ 14,590
Medical	11,386	2%	11,180	(29)%	15,639
Intersegment eliminations	(35)		(111)		(89)
Total	$ 27,725	(1)%	$ 27,981	(7)%	$ 30,140
Operating Income (Loss)*:					
Touch	$ (15,678)	61%	$ (40,289)	(133)%	$ 122,771
Medical	(14,777)	(68)%	(8,808)	(1765)%	529
Intersegment eliminations	(1)		3		(22)
Total	$ (30,456)	38%	$ (49,094)	(140)%	$ 123,278

* Segment expenses relating to our corporate operations are not allocated but are included in the Touch segment as that is how they are considered for management evaluation purposes. As a result, the segment information may not be indicative of the financial position or results of operations that would have been achieved had these segments operated as unaffiliated entities.

Fiscal 2009 Compared to Fiscal 2008

Touch segment Revenues from the Touch segment decreased by $538,000, or 3% in 2009 compared to 2008. Royalty and license revenues decreased by $190,000, mainly due to decreased revenue from gaming and automotive licensees partially offset by increased revenue from licensees of mobile devices. Revenues from gaming customers in 2008 which did not recur in 2009 included previously deferred revenues from ISLLC totaling $1.1 million which was recognized after we concluded our litigation with it. In addition, BMW has removed our technology from certain controller systems, which also caused automotive royalties to decline in 2009 compared to 2008. Product sales decreased by $246,000 primarily due to a decrease in product sales from touch interface products, mainly due to decreased sales of touchscreen and touch panel components and decreased sales of commercial gaming products, partially offset by increased integrated circuit chip sales. Development contract revenue decreased by $102,000 primarily due to decreased development contracts and support mainly from our mobility customers. The segment s operating loss decreased by $24.6 million in 2009 as compared to 2008. The change was primarily due to the Microsoft settlement expense in 2008 of $20.8 million; a decrease in general and administrative expenses of $1.9 million; a decrease in sales and marketing expenses of $1.5 million; and increased gross margin of $1.5 million partially offset by an increase in research and development expenses of $568,000 and increased restructuring charges of $427,000. General and administrative expense decreased primarily due to reduced litigation costs, mainly Microsoft litigation which was settled in 2008. The decreased sales and marketing expenses were primarily due to reduced salary expense from a decrease in sales and marketing headcount. Increased margin was mainly a result of reduced salary expense from decreased operations headcount.

Medical segment Revenues from Medical increased by $206,000 or 2%, from 2008 to 2009. Increased revenues were primarily due to increased product sales of $983,000 and increased royalty and license revenue of $140,000, partially offset by decreased development contract revenue of $916,000. Increased medical product sales were mainly due to the recognition of $1.0 million in revenue from an international medical customer for whom revenues could not be recognized until the agreement with the customer was terminated in the third quarter of 2009, partially offset by decreases of other medical product sales. The decrease in medical contract revenue was mainly attributable to a lower volume of work performed under medical contracts in 2009 compared to 2008. The segment s operating loss increased by $6.0 million in 2009 as compared to 2008. The increased operating loss was mainly due to a decrease in gross margin of $2.5 million primarily due to increased obsolescence and scrap expense and physical inventory write off; increased general and administrative expenses of $4.4 million; and increased restructuring costs of $893,000, partially offset by decreased research and development expenses of $1.1 million and decreased sales and marketing expenses of $657,000. The increase in obsolescence and inventory scrap expense was mainly due to additional excess and obsolescence write-off and inventory scrap mainly from medical product parts. The physical inventory write off costs primarily consisted of physical count to book adjustments of medical equipment parts in the second quarter of 2009. General and administrative expense increased primarily due to increased accounting, audit and legal costs resulting from our internal investigation and restatement costs incurred in 2009. The increased restructuring costs were mainly due to the reduction of workforce of Montreal medical personnel and relocation of the Maryland medical business operations to San Jose. The decreased research and development and sales and marketing expenses were primarily due to reduced salary expense from a decrease in related headcount. In March 2010 we entered into an agreement to sell certain assets of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines. See Note 19 of the consolidated financial statements. Revenue in 2009 for these product lines was approximately $6 million. Segments results are expected to decline significantly in the future since we will be transitioning to a license model and will have only one product line remaining, the Virtual IV product line.

Fiscal 2008 Compared to Fiscal 2007

Touch segment Revenues from the Touch segment increased by $2.3 million, or 16% in 2008 compared to 2007. Royalty and license revenues increased by $2.4 million, mainly due to an increase in mobile device license and royalty revenue primarily due to the shipment of additional TouchSense enabled phones, and an increase in gaming royalties mainly due to the recognition of previously deferred revenues from ISLLC and the increase in sales of new steering wheel products from Logitech offset by a decrease in touch interface product royalties mainly due to the recognition of certain automotive royalty payments in the second quarter of 2007 that did not recur. Product sales increased by $134,000 primarily due to an increase in product sales from touch interface products, mainly due to increased sales of touchscreen and touch panel components and increased sales of commercial gaming products. Development contract revenue decreased by $180,000, primarily due to reduced touch interface product contract revenue, partially offset by increased revenue on mobile device development contracts and support. The segment s operating income changed by $163.1 million to an operating loss in 2008 as compared to an operating profit in 2007. The change was primarily due to increased litigation settlements, conclusions, and patent license income of $134.9 million ($119.9 million from Sony Computer Entertainment and $15.0 million related to the release of the Microsoft long-term customer advance) occurring in 2007 and the Microsoft settlement expense in 2008 of $20.8 million; an increase in general and administrative expenses of $4.5 million; an increase in sales and marketing expenses of $2.9 million; an increase of research and development expenses of $1.9 million, and increased restructuring charges of $142,000. The change from income in 2007 to a loss in 2008 was partially offset by increased gross margin of $1.8 million mainly from increased royalty and license revenue and decreased amortization and impairment of intangibles of $255,000.

Medical segment Revenues from Medical decreased by $4.5 million or 29%, from 2007 to 2008. The decrease was primarily due to a decrease in medical product sales of $3.1 million mainly due to decreased sales of our endoscopy, endovascular, laparoscopy, and Virtual IV simulator platforms partially offset by increases in our arthroscopy simulators; and a decrease of $1.3 million in medical development contract revenue due to work completed under medical contracts in 2007. The decrease in medical contracts also represents continued efforts to move away from development work during the period and concentrate on product sales and licensing. The decrease in product sales was primarily due to decreased international sales and delays in new product introductions. The segment s operating income changed by $9.3 million to a loss in 2008 as compared to a profit in 2007. The loss was mainly due to a decrease in gross margin of $4.2 million primarily due to decreased sales and a change in product sales mix, increased sales and marketing expenses of $2.3 million primarily due to international sales and marketing efforts, increased general and administrative expenses of $2.1 million, mainly litigation and legal costs, and increased research and development expenses of $756,000.

Liquidity and Capital Resources

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

On December 31, 2009, our cash, cash equivalents, and short-term investments totaled $63.7 million, a decrease of $22.0 million from $85.7 million on December 31, 2008.

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

On June 18, 2007, Microsoft filed a complaint against us in the U.S. District Court for the Western District of Washington alleging one claim for breach of a contract. After conducting discovery and filing various motions, on August 25, 2008 the parties agreed to settle all claims. Under the terms of the settlement, we paid Microsoft $20.8 million in October 2008.

Net cash used in operating activities during 2009 was $18.3 million, a change of $12.1 million from the $30.4 million used in operating activities during 2008. Cash used in operations during 2009 was primarily the result of a net loss of $28.3 million, a decrease of $1.7 million due to a change in accrued compensation and other current liabilities due to the timing of payments and a decrease of $1.4 million due to a change in accounts payable due to the timing of payments. These decreases were offset by an increase of $3.4 million due to a change in accounts receivable, an increase of $1.4 million due to a change in inventories and an increase of $1.4 million due to a change in deferred revenue and customer advances. Accounts receivable decreased primarily due to the timing of sales during the year and increased collection efforts. Inventory decreased primarily due to the changed forecasts affecting inventory purchases and inventory obsolescence and scrapping. Cash provided by operations during 2009 was also impacted by noncash charges and credits of $6.7 million, including $4.5 million of noncash stock-based compensation, $1.6 million in depreciation and amortization, $894,000 in amortization and impairment of intangibles, an increase to loss on disposal of equipment of $726,000, partially offset by a credits from the change in market value of warrant liability of $517,000 and gain on sales of discontinued operations of $237,000.

Net cash used in operating activities during 2008 was $30.4 million, a change of $115.0 million from the $84.6 million provided by operating activities during 2007. Cash used in operations during 2008 was primarily the result of a net loss of $51.0 million, a decrease of $1.5 million due to a change in other long-term liabilities, a decrease of $1.3 million due to a change in prepaid expenses and other current assets, a decrease of $1.0 million due to a change in accounts receivable, and a decrease of $415,000 due to a change in income taxes payable. These decreases were offset by an increase of $7.3 million due to a change in deferred income taxes, a $6.1 million increase due to a change in deferred revenue and customer advances and long-term customer advance from Microsoft, an increase of $2.4 million due to a change in accrued compensation and other current liabilities, and an increase of $1.5 million due to a change in accounts payable. Cash provided by operations during 2008 was also impacted by noncash charges and credits of $7.6 million, including $5.3 million of noncash stock-based compensation, $1.2 million in depreciation and amortization, $888,000 in amortization and impairment of intangibles, an increase to allowance for doubtful accounts of $351,000, partially offset by a credit of $220,000 from excess tax benefits from stock-based compensation.

Net cash used in investing activities during 2009 was $26.9 million, compared to the $25.3 million provided by investing activities during 2008, a decrease of $52.2 million. Net cash used in investing activities during 2009 consisted of an increase in proceeds from maturities of available -for- sale investments of $75.0 million, offset by purchases of available -for- sale investments of $98.0 million; $2.6 million used to purchase intangibles, primarily due to capitalization of external patent filing and application costs, and a $1.6 million increase in purchases of property and equipment. Net cash provided by investing activities during 2008 was $25.3 million, compared to the $55.2 million used in investing activities during 2007, an increase of $80.5 million. Net cash provided by investing activities during the period consisted of an increase in maturities or sales of short-term investments of $90.0 million, partially offset by purchases of short-term investments of $59.2 million; $3.1 million used to purchase property and equipment, and a $2.4 million increase in intangibles, primarily due to capitalization of external patent filing and application costs.

Net cash provided by financing activities during 2009 was $278,000 compared to $16.6 million used during 2008, or a $16.9 million decrease from the prior year. Net cash provided by financing activities for 2009 consisted of issuances of common stock and exercises of stock options and warrants. Net cash used in financing activities during 2008 was $16.6 million compared to $25.2 million provided by financing activities during 2007, or a $41.8 million

Table of Contents

increase from the prior year. Net cash used in financing activities for the period consisted primarily of treasury stock repurchases of $18.4 million, partially offset by issuances of common stock and exercises of stock options and warrants in the amount of $1.6 million, and an increase of $220,000 from excess tax benefits from tax deductible stock-based compensation.

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

Summary Disclosures about Contractual Obligations and Commercial Commitments

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

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

As discussed in Note 13 to the consolidated financial statements we adopted new accounting requirements for uncertain tax benefits on January 1, 2007. At December 31, 2009, we had a liability for unrecognized tax benefits totaling $654,000 including interest of $26,000, of which approximately $225,000 could be payable in cash. Due to the uncertainties related to these tax matters, we are unable to make a reasonably reliable estimate when cash settlement with a taxing authority will occur. Settlement of such amounts could require the utilization of working capital.

Recent Accounting Pronouncements

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

Item 7A. ***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, Short-term Investments, and Long-Term Investments We have cash equivalents, short-term investments, and long-term investments of $60.6 million as of December 31, 2009. These securities are subject to interest rate fluctuations. An increase in interest rates could adversely affect the market value of our fixed income securities. A hypothetical 100 basis point increase in interest rates would result in an approximate $345,000 decrease in the fair value of our cash equivalents, short-term investments, and long-term investments as of December 31, 2009.

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 limit exposure to loss by limiting the sums we can invest in any individual security and restricting

Table of Contents

investment to securities that meet certain defined credit ratings. We do not use derivative financial instruments in our investment portfolio to manage interest rate risk.

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

Item 8. ***Financial Statements and Supplementary Data***

IMMERSION CORPORATION

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Immersion Corporation:

We have audited the accompanying consolidated balance sheets of Immersion Corporation and subsidiaries (the Company) as of December 31, 2009 and 2008, and the related consolidated statements of operations, stockholders equity (deficit), and cash flows for each of the three years in the period ended December 31, 2009. Our audits also included the financial statement schedule listed in the Index at Item 15 (a) 2. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Immersion Corporation and subsidiaries as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of December 31, 2009, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 30, 2010 expressed an adverse opinion on the effectiveness of the Company s internal control over financial reporting because of material weaknesses.

/s/ DELOITTE & TOUCHE LLP

San Jose, California
March 30, 2010

Table of Contents

IMMERSION CORPORATION

CONSOLIDATED BALANCE SHEETS

	December 31, 2009	December 31, 2008
	(In thousands, except share and per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 19,828	$ 64,769
Short-term investments	43,900	20,974
Accounts receivable (net of allowances for doubtful accounts of: 2009 $207; 2008 $436)	2,988	6,114
Inventories, net	2,001	3,757
Deferred income taxes	248	311
Prepaid expenses and other current assets	4,474	4,344
Total current assets	73,439	100,269
Property and equipment, net	3,498	3,827
Intangibles and other assets, net	10,897	9,491
Total assets	$ 87,834	$ 113,587
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,382	$ 2,842
Accrued compensation	1,387	2,920
Other current liabilities	3,087	3,493
Deferred revenue and customer advances	6,578	8,042
Total current liabilities	12,434	17,297
Long-term deferred revenue	18,851	15,989
Deferred income tax liabilities	248	311
Other long-term liabilities	560	212
Total liabilities	32,093	33,809
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: December 31, 2009- 30,786,156 and December 31, 2008 - 30,674,045; shares outstanding: December 31, 2009 27,999,593 and December 31, 2008 27,887,482	172,679	167,870
Warrants	11	1,731

Accumulated other comprehensive income	66	109
Accumulated deficit	(98,626)	(71,543)
Treasury stock at cost: December 31, 2009 and 2008 2,786,563 shares	(18,389)	(18,389)
Total stockholders equity	55,741	79,778
Total liabilities and stockholders equity	$ 87,834	$ 113,587

See notes to consolidated financial statements.

Table of Contents

IMMERSION CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31,		
	2009	**2008**	**2007**
	(In thousands, except per share amounts)		
Revenues:			
Royalty and license	$ 14,202	$ 14,254	$ 11,881
Product sales	11,924	11,110	14,138
Development contracts and other	1,599	2,617	4,121
Total revenues	27,725	27,981	30,140
Costs and expenses:			
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	8,289	7,516	7,272
Sales and marketing	13,324	15,472	10,272
Research and development	12,493	13,058	10,389
General and administrative	21,719	19,249	12,683
Amortization and impairment of intangibles	894	888	1,146
Litigation settlements, conclusions, and patent license		20,750	(134,900)
Restructuring costs	1,462	142	
Total costs and expenses	58,181	77,075	(93,138)
Operating income (loss)	(30,456)	(49,094)	123,278
Change in fair value of warrant liability	517		
Interest and other income	777	4,174	6,623
Interest and other expense	(4)	(250)	(1,024)
Income (loss) from continuing operations before provision for income taxes	(29,166)	(45,170)	128,877
Benefit (provision) for income taxes	310	(5,088)	(12,850)
Income (loss) from continuing operations	(28,856)	(50,258)	116,027
Discontinued operations (Note 12) :			
Gain on sales of discontinued operations, net of provision for income taxes of $0	237		
Gain (loss) from discontinued operations, net of provision for income taxes of $216, $0, and $752	340	(732)	1,059
Net income (loss)	$ (28,279)	$ (50,990)	$ 117,086
Basic net income (loss) per share:			
Continuing operations	$ (1.03)	$ (1.70)	$ 4.19
Discontinued operations	0.02	(0.02)	0.04

Total	$	(1.01)	$	(1.72)	$	4.23
Shares used in calculating basic net income (loss) per share		27,973		29,575		27,662
Diluted net income (loss) per share:						
Continuing operations	$	(1.03)	$	(1.70)	$	3.68
Discontinued operations		0.02		(0.02)		0.03
Total	$	(1.01)	$	(1.72)	$	3.71
Shares used in calculating diluted net income (loss) per share		27,973		29,575		31,667

See notes to consolidated financial statements.

Table of Contents

IMMERSION CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)

	Common Stock and Additional Paid-In Capital			Accumulated Other Comprehensive	Accumulated	Treasury Stock		Total Stockholders Equity	To Compr Inc
	Shares	Amount	Warrants	Income	Deficit	Shares	Amount	(Deficit)	(Lo
	(In thousands, except share amounts)								
es at January 1,	24,797,572	$ 110,501	$ 3,686	$ 67	$ (137,639)		$	$ (23,385)	
ome					117,086			117,086	$ 11
currency ion adjustment				88				88	
zed gain (loss) lable-for-sale es, net of taxes				(18)				(18)	
ehensive income									$ 11
sion of long-term common stock	2,656,677	17,257						17,257	
e of stock for urchase	56,516	317						317	
e of stock	2,609,573	12,707						12,707	
e of warrants	269,512	832	(801)					31	
ion of warrants		1,154	(1,154)						
ased nsation		3,446						3,446	
nefits from ased nsation		14,648						14,648	
es at ber 31, 2007	30,389,850	$ 160,862	$ 1,731	$ 137	$ (20,553)		$	$ 142,177	
s					(50,990)			(50,990)	$ (5
currency ion adjustment				(39)				(39)	
zed gain (loss) lable-for-sale es, net of taxes				11				11	
ehensive loss									$ (5

e of stock for urchase	47,158	330						330	
e of stock	237,037	1,253						1,253	
ased nsation		5,327						5,327	
nefits from ased nsation		98						98	
y stock es						2,786,563	(18,389)	(18,389)	
es at ber 31, 2008	30,674,045	$ 167,870	$ 1,731	$ 109	$ (71,543)	2,786,563	$ (18,389)	$ 79,778	
tive effect of in accounting e			(1,713)		1,196			(517)	
s					(28,279)			(28,279)	$ (2
currency ion adjustment				11				11	
zed gain (loss) lable-for-sale es, net of taxes				(54)				(54)	
ehensive loss									$ (2
e of stock for urchase	30,376	134						134	
e of stock	71,207	145						145	
of Restricted Units	10,528	64						64	
ion of warrants		7	(7)						
ased nsation		4,459						4,459	
es at ber 31, 2009	30,786,156	$ 172,679	$ 11	$ 66	$ (98,626)	2,786,563	$ (18,389)	$ 55,741	

See notes to consolidated financial statements.

Table of Contents

IMMERSION CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2009	2008	2007
	(In thousands)		
Cash flows from operating activities:			
Net income (loss)	$ (28,279)	$ (50,990)	$ 117,086
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,563	1,210	911
Amortization and impairment of intangibles	894	888	1,146
Stock-based compensation	4,524	5,327	3,446
Excess tax benefits from stock-based compensation		(220)	(13,556)
Realized gain on short-term investments		(81)	
Change in fair market value of warrant liability	(517)		
Allowance (recovery) for doubtful accounts	(229)	351	(54)
Interest expense accretion on 5% Convertible Debenture			535
Fair value adjustment of Put Option and Registration Rights			(15)
Loss on disposal of equipment	726	93	15
Gain on sales of discontinued operations	(237)		
Changes in operating assets and liabilities:			
Accounts receivable	3,355	(1,012)	(388)
Inventories	1,395	(1)	(943)
Deferred income taxes	63	7,295	(7,297)
Prepaid expenses and other current assets	(131)	(1,310)	(1,840)
Other assets	11	12	(62)
Accounts payable	(1,441)	1,473	(618)
Accrued compensation and other current liabilities	(1,702)	2,384	620
Income taxes payable	4	(415)	15,211
Deferred revenue and customer advances and long-term customer advance from Microsoft	1,398	6,140	(30,607)
Other long-term liabilities	285	(1,508)	960
Net cash provided by (used in) operating activities	(18,318)	(30,364)	84,550
Cash flows provided by (used in) investing activities:			
Purchases of available-for-sale investments	(97,980)	(59,242)	(96,719)
Proceeds from maturities of available-for-sale investments	75,000	89,978	45,110
Additions to intangibles	(2,589)	(2,394)	(2,199)
Purchases of property and equipment	(1,569)	(3,090)	(1,438)
Proceeds from sales of discontinued operations	237		
Net cash provided by (used in) investing activities	(26,901)	25,252	(55,246)

Cash flows provided by (used in) financing activities:						
Issuance of common stock under employee stock purchase plan		134		330		317
Exercise of stock options and warrants		144		1,253		12,738
Excess tax benefits from stock-based compensation				220		13,556
Payment on long-term debt						(1,400)
Purchases of treasury stock				(18,389)		
Net cash provided by (used in) financing activities		278		(16,586)		25,211
Effect of exchange rates on cash and cash equivalents				(26)		(34)
Net increase (decrease) in cash and cash equivalents		(44,941)		(21,724)		54,481
Cash and cash equivalents:						
Beginning of year		64,769		86,493		32,012
End of year	$	19,828	$	64,769	$	86,493
Supplemental disclosure of cash flow information:						
Cash paid (received) for taxes	$	(54)	$	(1,586)	$	6,882
Cash paid for interest	$		$		$	572
Supplemental disclosure of noncash investing and financing activities:						
Issuance of common stock in connection with the conversion of the 5% Convertible Debentures	$		$		$	17,257
Amounts accrued for property and equipment, and intangibles	$	351	$	605	$	
Shares issued upon vesting of restricted stock units	$	64	$		$	

See notes to consolidated financial statements.

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 consolidated financial statements include the accounts of Immersion Corporation and its majority-owned subsidiaries. All intercompany accounts, transactions, and balances have been eliminated in consolidation. The Company has prepared the accompanying consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP).

Cash Equivalents

The Company considers all highly liquid instruments purchased with an original or remaining maturity of less than three months at the date of purchase to be cash equivalents.

Short-term Investments

The Company s short-term investments consist primarily of highly liquid commercial paper and government agency securities purchased with an original or remaining maturity of greater than 90 days on the date of purchase. The Company classifies 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, the Company has classified all debt securities as short-term investments as they are reasonably expected to be realized in cash or sold within one year. These investments are carried at fair market value with unrealized gains and losses considered to be temporary in nature reported as a separate component of other comprehensive income (loss) within stockholders equity.

The Company follows the guidance provided by ASC 320 to assess whether our investments with unrealized loss positions are other than temporarily impaired. Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and are reported in the consolidated statement of operations. Factors considered in determining whether a loss is temporary include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts for estimated losses resulting from its review and assessment of its customers ability to make required payments. The Company reviews its trade receivables by aging categories to identify significant customers with known disputes or collection issues. For accounts not specifically identified, the Company provides reserves based on historical levels of credit losses and reserves.

Inventories

Inventories are stated at the lower of cost (principally on a standard cost basis which approximates FIFO) or market. The Company reduces its 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.

Table of Contents

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Property and Equipment

Property is stated at cost and is generally depreciated using the straight-line method over the estimated useful life of the related asset. The estimated useful lives are as follows:

Computer equipment and purchased software	3 years
Machinery and equipment	3-5 years
Furniture and fixtures	5 years

Leasehold improvements are amortized over the shorter of the lease term or their useful life.

Intangible Assets

Intangible assets with finite useful lives are amortized and intangible assets with indefinite lives are not amortized but rather are tested at least annually for impairment.

In addition to purchased intangible assets, the Company capitalizes the external legal and filing fees associated with its patents and trademarks. These costs are amortized utilizing the straight-line method, which approximates the pattern of consumption over the estimated useful lives of the respective assets, generally ten years.

Long-lived Assets

The Company evaluates its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of that asset may not be recoverable. An impairment loss would be recognized when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Measurement of an impairment loss for long-lived assets and certain identifiable intangible assets that management expects to hold and use is based on the fair value of the asset.

Product Warranty

The Company sells its products with warranties ranging from three to sixty months. The Company records the estimated warranty costs when the revenue is recognized. Historically, warranty-related costs have not been significant.

Revenue Recognition

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

(ii) delivery has occurred, (iii) the fee is fixed or determinable, and (iv) collectibility is probable. The Company applies these criteria as discussed below.

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

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

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 position and ability to pay. If it is determined that collectibility is not probable based upon the credit review process or the customer s payment history, revenue is recognized when payment is received.

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

Product sales The Company recognizes revenue from the sale of products and the license of associated software if any, and expense 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 the 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. Extended warranty contract revenues are recognized ratably over the contractual period.

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

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

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Advertising

Advertising costs (including obligations under cooperative marketing programs) are expensed as incurred and included in sales and marketing expense. Advertising expense was $78,000, $229,000, and $102,000 in 2009, 2008, and 2007, respectively.

Research and Development

Research and development costs are expensed as incurred. The Company has generated revenues from development contracts with the United States government and other commercial customers that have enabled it to accelerate its own product development efforts. Such development revenues have only partially funded the Company s product development activities, and the Company generally retains ownership of the products developed under these arrangements. As a result, the Company classifies all development costs related to these contracts as research and development expenses.

Income Taxes

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

Software Development Costs

Certain of the Company s products include software. Costs for the development of new software products and substantial enhancements to existing software products are expensed as incurred until technological feasibility has been established, at which time any additional costs would be capitalized. The Company considers technological feasibility to be established upon completion of a working model of the software and the related hardware. Because the Company believes its current process for developing software is essentially completed concurrently with the establishment of technological feasibility, no costs have been capitalized to date.

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. See Note 10 for further information regarding the Company s stock-based compensation assumptions and expenses.

Table of Contents

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Comprehensive Income (Loss)

Comprehensive income (loss) includes net income (loss) as well as other items of comprehensive income. The Company s other comprehensive income consists of foreign currency translation adjustments and unrealized gains and losses on available-for-sale securities. The components of accumulated other comprehensive income are as below.

	December 31, 2009	December 31, 2008	December 31, 2007
	(In thousands)		
Net unrealized losses on short-term investments	$ (35)	$ 19	$ 7
Foreign currency translation adjustment	101	90	130
Accumulated other comprehensive income	$ 66	$ 109	$ 137

Use of Estimates

The preparation of consolidated financial statements and related disclosures in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include valuation of short-term investments, income taxes including uncertain tax provisions, revenue recognition, stock-based compensation, contingent liabilities from litigation, and accruals for other liabilities. Actual results could differ from those estimates.

Concentration of Credit Risks

Financial instruments that potentially subject the Company to a concentration of credit risk principally consist of cash, cash equivalents, short term investments, and accounts receivable. The Company invests primarily in money market accounts and highly liquid instruments purchased with an original or remaining maturity of greater than 90 days on the date of purchase. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand. The Company sells products primarily to companies in North America, Europe, and the Far East. To reduce credit risk, management performs periodic credit evaluations of its customers financial condition. The Company maintains reserves for estimated potential credit losses, but historically has not experienced any significant losses related to individual customers or groups of customers in any particular industry or geographic area.

Certain Significant Risks and Uncertainties

The Company operates in a dynamic industry and, accordingly, can be affected by a variety of factors. For example, management of the Company believes that changes in any of the following areas could have a negative effect on the Company in terms of its future financial position and results of operations: the mix of revenues; the loss of significant customers; fundamental changes in the technology underlying the Company s products; market acceptance of the Company s and its licensees products under development; the availability of contract manufacturing capacity;

development of sales channels; litigation or other claims in which the Company is involved; the ability to successfully assert its patent rights against others; the impact of the global economic downturn; the hiring, training, and retention of key employees; successful and timely completion of product and technology development efforts; and new product or technology introductions by competitors.

Fair Value of Financial Instruments

Financial instruments consist primarily of cash equivalents, short-term investments, accounts receivable and accounts payable. Cash equivalents and short term investments are stated at fair value based on quoted market

Table of Contents

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

prices. The recorded cost of accounts receivable and accounts payable approximate the fair value of the respective assets and liabilities.

Foreign Currency Translation

The functional currency of the Company s foreign subsidiary is U.S. dollars. Accordingly, gains and losses from the translation of the financial statements of the foreign subsidiary are reported as a separate component of accumulated other comprehensive income. Foreign currency transaction gains and losses are included in earnings.

Recent Accounting Pronouncements

In April 2008, the FASB issued ASC 350-30, Determination of the Useful Life of Intangible Assets. (ASC 350-30). ASC 350-30 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. ASC 350-30 is effective for fiscal years beginning after December 15, 2008. The adoption of this guidance did not have a material impact on the Company s consolidated results of operations, financial position or cash flows.

In April 2009, the FASB issued ASC 320-10, Recognition and Presentation of Other-Than-Temporary Impairments (ASC 320-10). This ASC amends the other-than temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments in the financial statements. The most significant change the guidance brings is a revision to the amount of other-than-temporary loss of a debt security recorded in earnings. ASC 320-10 is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of this guidance did not have a material impact on the Company s consolidated results of operations, financial position or cash flows.

In April 2009, the FASB issued ASC 820-10, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (ASC 820-10). ASC 820-10 provides guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. This ASC also includes guidance on identifying circumstances that indicate a transaction is not orderly. This guidance emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. ASC 820-10 is effective for interim and annual reporting periods ending after June 15, 2009, and is applied prospectively. The adoption of this guidance did not have a material impact on the Company s consolidated results of operations, financial position or cash flows.

In April 2009, the FASB issued ASC 825-10, Interim Disclosures about Fair Value of Financial Instruments. (ASC 825-10). This guidance requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This guidance also requires those disclosures in summarized financial information at interim reporting periods. ASC 825-10 is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of this guidance did not have a material impact on the Company s consolidated results of operations, financial position or cash flows.

In May 2009, the FASB issued ASC 855-10, Subsequent Events (ASC 855-10). ASC 855-10 provides guidance on management s assessment of subsequent events and incorporates this guidance into accounting literature. It also requires entities to disclose the date through which they have evaluated subsequent events and whether the date corresponds with the release of their financial statements. This guidance is effective for all interim and annual periods ending after June 15, 2009. The adoption of this guidance did not have a material impact on the Company s consolidated results of operations or financial position. In February 2010, the FASB issued Accounting Standards Update 2010-09 which eliminates the requirement to disclose the date through which subsequent events

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

have been evaluated for SEC filers. This guidance, effective upon issuance, did not have a material impact on the Company s results of operations, financial position, or cash flows.

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

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

2. Fair Value Disclosures

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

The financial instruments of the Company measured at fair value on a recurring basis are cash equivalents, short-term investments, and warrant derivative liabilities. The Company s cash equivalents and short-term investments are 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 s warrant derivative liabilities are classified within Level 3 of the fair value hierarchy because they are valued using unobservable inputs which reflect the reporting entity s own assumptions that market participants would use in pricing the liability. Unobservable inputs are developed based on the best information available in the circumstances and also include the Company s own data.

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

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

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

Table of Contents

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Financial instruments measured at fair value on a recurring basis as of December 31, 2009 and December 31, 2008 are classified based on the valuation technique in the table below: