IMMERSION CORP
Form 10-Q
November 05, 2010
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

[**X**] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2010

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________.

Commission file number 000-27969

IMMERSION

CORPORATION

(Exact name of registrant as specified in its charter)

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

801 Fox Lane, San Jose, California 95131

(Address of principal executive offices) (Zip Code)

(408) 467-1900

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer [ ] Accelerated filer [X]

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

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

Yes [ ] No [X]

Number of shares of common stock outstanding at October 29, 2010: 28,175,759.

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IMMERSION CORPORATION

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PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

IMMERSION CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share amounts)

(Unaudited)

	September 30, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 13,128	$ 19,828
Short-term investments	48,962	43,900
Accounts receivable (net of allowances for doubtful accounts as of: September 30, 2010 $86 and December 31, 2009 $207)	849	2,988
Inventories	259	2,001
Deferred income taxes	250	248
Prepaid expenses and other current assets	4,158	4,474
Total current assets	67,606	73,439
Property and equipment, net	2,164	3,498
Intangibles and other assets, net	12,153	10,897
Total assets	$ 81,923	$ 87,834
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,273	$ 1,382
Accrued compensation	2,261	1,387
Other current liabilities	1,140	3,087
Deferred revenue and customer advances	4,319	6,578
Total current liabilities	8,993	12,434
Long-term deferred revenue	17,415	18,851
Deferred income tax liabilities	250	248
Other long-term liabilities	563	560
Total liabilities	27,221	32,093
Contingencies (Note 15)		
Stockholders equity:		
Common stock and additional paid-in capital $0.001 par value; 100,000,000 shares authorized; shares issued: September 30, 2010 30,928,552 and December 31, 2009 30,786,156; shares outstanding: September 30, 2010 28,140,343 and December 31, 2009	175,201	172,679

27,999,593				
Warrants		-		11
Accumulated other comprehensive income		132		66
Accumulated deficit		(102,233)		(98,626)
Treasury stock at cost: September 30, 2010 - 2,788,209 and December 31, 2009 2,786,563		(18,398)		(18,389)
Total stockholders equity		54,702		55,741
Total liabilities and stockholders equity	$	81,923	$	87,834

See accompanying Notes to Condensed Consolidated Financial Statements.

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IMMERSION CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Revenues:				
Royalty and license	$ 5,141	$ 2,841	$ 17,848	$ 10,202
Product sales	1,217	3,467	6,035	9,518
Development contracts and other	189	285	848	1,061
Total revenues	6,547	6,593	24,731	20,781
Costs and expenses:				
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	457	3,293	2,587	6,856
Sales and marketing	1,813	2,653	6,077	10,953
Research and development	2,007	2,690	6,473	10,031
General and administrative	3,008	6,673	11,808	15,899
Amortization and impairment of intangibles	211	243	650	682
Restructuring costs	-	181	-	1,532
Total costs and expenses	7,496	15,733	27,595	45,953
Operating loss	(949)	(9,140)	(2,864)	(25,172)
Change in fair value of warrant liability	-	146	-	490
Interest and other income	70	163	212	673
Loss from continuing operations before provision for income taxes	(879)	(8,831)	(2,652)	(24,009)
Provision for income taxes	(336)	(186)	(1,098)	(577)
Loss from continuing operations	(1,215)	(9,017)	(3,750)	(24,586)
Discontinued operations (Note 9) :				
Gain on sales of discontinued operations net of provision for income taxes of $18, $0, $18, and $0	82	20	142	207
Gain (loss) from discontinued operations, net of provision (benefit) for income taxes of $0, $76, $1, and $178	-	(17)	1	384
Net loss	$ (1,133)	$ (9,014)	$ (3,607)	$ (23,995)
Basic and diluted net loss per share				
Continuing operations	(0.04)	(0.32)	(0.13)	(0.88)
Discontinued operations	-	-	-	0.02
Total	$ (0.04)	$ (0.32)	$ (0.13)	$ (0.86)

Shares used in calculating basic and diluted net loss per share	28,134	27,994	28,087	27,962

See accompanying Notes to Condensed Consolidated Financial Statements.

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IMMERSION CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) (unaudited)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Cash flows from operating activities:		
Net loss	$ (3,607)	$ (23,995)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	842	1,208
Amortization and impairment of intangibles	650	682
Stock-based compensation	2,430	3,749
Change in fair market value of warrant liability	-	(490)
Allowance for doubtful accounts	(120)	(253)
Loss on disposal of equipment	90	711
Loss on divestiture	43	-
Gain on sales of discontinued operations	(142)	(207)
Changes in operating assets and liabilities:		
Accounts receivable	2,259	3,951
Inventories	860	1,109
Prepaid expenses and other assets	52	1,023
Accounts payable	(315)	(540)
Accrued compensation and other current liabilities	(829)	(1,582)
Deferred revenue and customer advances	(3,583)	1,595
Other long-term liabilities	121	8
Net cash used in operating activities	(1,249)	(13,031)
Cash flows used in investing activities:		
Purchases of short-term investments	(34,880)	(68,990)
Maturities of short-term investments	30,000	46,000
Net proceeds from divestiture	964	-
Additions to intangibles	(1,584)	(1,944)
Proceeds from sale of property and equipment	160	-
Purchases of property and equipment	(336)	(1,509)
Proceeds from sales of discontinued operations	142	207
Net cash used in investing activities	(5,534)	(26,236)
Cash flows provided by financing activities:		
Issuance of common stock under employee stock purchase plan	-	134
Exercise of stock options and warrants	83	143
Tax withholding payment related to vested and restricted stock units	-	(7)
Net cash provided by financing activities	83	270
Net decrease in cash and cash equivalents	(6,700)	(38,997)
Cash and cash equivalents:		

Beginning of the period	19,828	64,769
End of the period	$ 13,128	$ 25,772
Supplemental disclosure of cash flow information:		
Cash paid (received) for taxes	$ 6	$ (54)
Supplemental disclosure of non-cash investing and financing activities:		
Amounts accrued for property and equipment, and intangibles	$ 377	$ 538
Shares issued under company stock plan	$ 34	$ 60

See accompanying Notes to Condensed Consolidated Financial Statements.

IMMERSION CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES

Description of Business

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

Principles of Consolidation and Basis of Presentation

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

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

The results of operations for the interim periods ended September 30, 2010 are not necessarily indicative of the results to be expected for the full year.

Revenue Recognition

The Company recognizes revenues in accordance with applicable accounting standards, including Accounting Standards Codification (ASC) 605-10-S99, Revenue Recognition (ASC 605-10-S99); ASC 605-25, Multiple Element 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, the Company must evaluate whether: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable, and (iv) collectibility is probable. The Company applies these criteria as discussed below.

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

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

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

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

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

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

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

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

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

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Recent Accounting Pronouncements

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

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

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

2. FAIR VALUE MEASUREMENTS

Cash Equivalents and Short-term Investments

The financial instruments of the Company measured at fair value on a recurring basis are cash equivalents, short-term investments, and warrant derivative liabilities. The Company s cash equivalents and short-term investments are generally classified within Level 1 or Level 2 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The Company did not have any transfers between Level 1 and Level 2 fair value measurements during the periods presented.

The types of instruments valued based on quoted market prices in active markets include most U.S. 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 include most investment-grade corporate commercial paper. Such instruments are generally classified within Level 2 of the fair value hierarchy.

The types of instruments valued based on unobservable inputs which reflect the reporting entity s own assumptions that market participants would use in valuing an instrument are generally classified within Level 3 of the fair value hierarchy.

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Financial instruments measured at fair value on a recurring basis as of September 30, 2010 and December 31, 2009 are classified based on the valuation technique in the table below:

	September 30, 2010 Fair value measurements using			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Assets:				
U.S. government agency securities	$ 48,962	$ -	$ -	$ 48,962
Money market accounts	8,334	-	-	8,334
Total assets at fair value	$ 57,296	$ -	$ -	$ 57,296

The above table excludes $4.8 million of cash held in banks.

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

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

Short-term Investments

	September 30, 2010			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
	(In thousands)			
U.S. government agency securities	$ 48,932	$ 30	$ -	$ 48,962
Total	$ 48,932	$ 30	$ -	$ 48,962

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

The contractual maturities of the Company s available-for-sale securities on September 30, 2010 and December 31, 2009 were all due in one year or less except for one government agency security of $5 million at December 31, 2009 due in two years.

3. INVENTORIES

	September 30, 2010	December 31, 2009
	(In thousands)	
Raw materials and subassemblies	$ 195	$ 1,653
Work in process	-	45
Finished goods	64	303
Inventories	$ 259	$ 2,001

4. PROPERTY AND EQUIPMENT

	September 30, 2010	December 31, 2009
	(In thousands)	
Computer equipment and purchased software	$ 3,786	$ 4,458
Machinery and equipment	932	1,909
Furniture and fixtures	630	1,407
Leasehold improvements	881	1,458
Total	6,229	9,232
Less accumulated depreciation	(4,065)	(5,734)
Property and equipment, net	$ 2,164	$ 3,498

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5. INTANGIBLES AND OTHER ASSETS

	September 30, 2010	December 31, 2009
	(In thousands)	
Patents, technology, and trademarks	$ 20,778	$ 19,018
Other assets	292	145
Gross intangibles and other assets	21,070	19,163
Accumulated amortization of patents, technology, and trademarks	(8,917)	(8,266)
Intangibles and other assets, net	$ 12,153	$ 10,897

The Company amortizes its intangible assets related to patents, technology and trademarks, over their estimated useful lives, generally 10 years. The estimated remaining annual amortization expense for intangible assets as of September 30, 2010 is as follows:

	Estimated Amortization Expense (In thousands)
2010	$ 297
2011	1,479
2012	1,410
2013	1,376
2014	1,305
Thereafter	5,994
Total	$ 11,861

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

	September 30, 2010	December 31, 2009
	(In thousands)	
Accrued legal	$ 441	$ 509
Income taxes payable	44	40
Other current liabilities	655	2,538
Total other current liabilities	$ 1,140	$ 3,087
Deferred revenue	$ 4,277	$ 6,336
Customer advances	42	242
Total deferred revenue and customer advances	$ 4,319	$ 6,578

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7. LONG-TERM DEFERRED REVENUE

Long-term deferred revenue consisted of the following:

	September 30, 2010	December 31, 2009
	(In thousands)	
Deferred revenue for Sony Computer Entertainment	$ 16,382	$ 16,755
Other deferred revenue	1,033	2,096
Long-term deferred revenue	$ 17,415	$ 18,851

8. STOCK-BASED COMPENSATION

Stock Options and Awards

The Company s equity incentive program is a long-term retention program that is intended to attract, retain, and provide incentives for talented employees, consultants, officers, and directors and to align stockholder and employee interests. The Company may grant options, stock appreciation rights, restricted stock, restricted stock units (RSUs), performance shares, performance units, and other stock-based or cash-based awards to employees, officers, directors, and consultants. Under these programs, stock options may be granted at prices not less than the fair market value on the date of grant for stock options. These options generally vest over 4 years and expire 10 years from the date of grant. RSUs generally vest over 3 years. Restricted stock generally vests over one year. On September 30, 2010, 3,263,593 shares of common stock were available for grant, and there were options to purchase 4,175,510 shares of common stock outstanding, as well as 424,173 RSUs and 18,000 shares of restricted stock outstanding.

General Stock Option Information

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

	Number of Shares
Outstanding at December 31, 2009 (3,247,607 exercisable at a weighted average price of $9.25 per share)	5,041,235
Granted (weighted average fair value of $3.10 per share)	626,835
Exercised	(41,875)
Forfeited and cancelled	(1,450,685)
Outstanding at September 30, 2010	4,175,510
Exercisable at September 30, 2010	2,619,382
Vested and expected to vest at September 30, 2010 using estimated forfeiture rates	4,001,229

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Restricted Stock Units

Restricted stock unit activity for the nine months ended September 30, 2010 is as follows:

	Number of Shares
Beginning balance at December 31, 2009	198,055
Awarded	363,928
Released	(69,021)
Forfeited	(68,789)
Outstanding balance at September 30, 2010	424,173
Vested and expected to vest at September 30, 2010 using estimated forfeiture rates	322,568

Restricted Stock

Restricted stock activity for the nine months ended September 30, 2010 is as follows:

	Number of Shares
Beginning balance at December 31, 2009	27,000
Awarded	22,500
Released	(31,500)
Forfeited	-
Ending balance at September 30, 2010	18,000

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
Options and Awards	**2010**	**2009**	**2010**	**2009**
Expected term (in years)	5.2	5.5	5.2	5.5
Volatility	67%	68%	67%	69%
Interest rate	1.5%	2.4%	2.0%	1.9%
Dividend yield	-	-	-	-

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Employee Stock Purchase Plan	Three Months Ended September 30, 2010	2009	Nine Months Ended September 30, 2010	2009
Expected term (in years)	0.5	-	0.5	0.5
Volatility	80%	-	80%	109%
Interest rate	0.6%	-	0.6%	0.4%
Dividend yield	-	-	-	-

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

	Three Months Ended September 30, 2010	2009	Nine Months Ended September 30, 2010	2009
	(In thousands)		(In thousands)	
Income Statement Classifications				
Cost of product sales	$ -	$ 27	$ 10	$ 129
Sales and marketing	155	219	546	661
Research and development	199	232	597	945
General and administrative	542	620	1,277	2,014
Total	$ 896	$ 1,098	$ 2,430	$ 3,749

As of September 30, 2010, there was $10.4 million related to stock options and $2.2 million related to restricted stock awards and RSUs of unrecognized compensation cost, adjusted for estimated forfeitures, granted to the Company s employees and directors. This cost will be recognized over an estimated weighted-average period of approximately 2.92 years for options and 2.29 years for RSUs. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

Stock Repurchase Program

On November 1, 2007, the Company announced that its board of directors authorized the repurchase of up to $50 million of the Company s common stock. The Company may repurchase its stock for cash in the open market in accordance with applicable securities laws. The timing of and amount of any stock repurchase will depend on share price, corporate and regulatory requirements, economic and market conditions, and other factors. The stock repurchase authorization has no expiration date, does not require the Company to repurchase a specific number of shares, and may be modified, suspended, or discontinued at any time. During the three and nine months ended September 30, 2010 and 2009, there were no stock repurchases under this program.

9. DIVESTITURE, RESTRUCTURING COSTS, AND DISCONTINUED OPERATIONS

Divestiture

On March 30, 2010, the Company entered into and closed an Asset Purchase Agreement, a Transition Services Agreement and a License Agreement (collectively the Transaction) with CAE Healthcare USA (CAE). Under the Asset Purchase Agreement, CAE acquired certain assets including inventory, fixed assets, and certain liabilities which included warranty liabilities of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines used in the field of medical training for an approximate amount of $1.6 million subject to purchase price adjustments for final inventory levels. The agreement also provided for the transfer of certain employees to CAE as well as distribution agreements and customer relationships. Under the transition services agreement, the Company provides certain back-office services to CAE for up to nine months and is being reimbursed for the expenses incurred for such services. Under the license agreement, the Company has licensed to CAE the Immersion TouchSense patent portfolio within a specific field of use. As such, revenues and costs for the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines have been included in operating income in the accompanying condensed consolidated statements of operations through the date of sale. Although the Company has ceased manufacturing these three specific product lines, these operating results have not been reported as discontinued operations. The Company continues to manufacture Virtual IV products, another medical product line, but the primary focus from this part of the Company s business has changed from simulation product sales to licensing fees. During the nine months ended September 30, 2010, the Company recognized a pre-tax loss of approximately $43,000 in continuing operations in connection with the asset purchase agreement and the transition services agreement. The cost reimbursements to be received under the Transition Services Agreement are recorded as an off-set to the related operating expense line items. The Company s agreement with CAE includes quarterly revenue under the license arrangement starting July, 2010. Under the terms of the Company s revenue recognition policy for transactions with extended payment terms such as this, the Company does not recognize revenue until the amounts become due and payable and all revenue recognition criteria are met. In connection with the transaction, the Company agreed to indemnify CAE for certain liabilities, claims, and other specified items in the asset purchase agreement.

Restructuring Costs

On March 2, 2009, the Company announced that it was relocating its Medical business operations from Gaithersburg, Maryland to San Jose, California. The Company had workforce reductions that were recorded as Medical segment restructuring charges of $187,000 and $998,000 for the three months and nine months ended September 30, 2009, respectively. Total costs for the relocation of the Medical business operations and the workforce reductions were $935,000 for the year ended December 31, 2009 and no further costs were expected beyond December 31, 2009. All of these restructuring costs were paid by December 31, 2009.

In addition, for the three months and nine months ended September 30, 2009, there were reorganizations in the Company s Touch segment due to business changes causing workforce reductions that resulted in a credit of $6,000 and charges of $534,000, respectively. Total costs for these reorganizations were incurred by December 31, 2009 and no further costs were expected beyond December 31, 2009. All of these restructuring costs were paid by December 31, 2009.

Results of Discontinued Operations

On November 17, 2008, the Company announced that it would divest its 3D product line which was part of its Touch segment. The Company s 3D product line consisted of a variety of products in the area of 3D digitizing, 3D measurement and inspection, and 3D interaction and included products such as MicroScribe digitizers, the CyberGlove family of products, and a SoftMouse 3D positioning device. In the three months ended March 31, 2009, the Company sold its CyberGlove and SoftMouse 3D positioning device product families including inventory, fixed assets, and intangibles and has recorded a gain on sale of discontinued operations of $167,000. Negotiated consideration for the sale was $900,000 in the form of cash and notes receivable to be paid through 2013. This consideration has been and will continue to be recognized upon receipt of cash. In the three months ended June 30, 2009, the Company sold its MicroScribe device product family including inventory, fixed assets and intangibles and has recorded a gain on sale of discontinued operations of $20,000. Negotiated consideration for the sale was $1.8 million in the form of cash and notes receivable to be paid through 2013, and the proceeds will be recognized when they are received. Revenues included in discontinued operations of the 3D product line were $1.2 million and $3.5 million for the three months and nine months ended September 30, 2009, respectively. The Company has abandoned all other 3D operations. Accordingly, the operations of the 3D product line have been classified as discontinued operations, net of income tax, in the condensed consolidated statement of operations. In the three months and nine months ended September 30, 2010, the Company recorded a gain on sale of discontinued operations of $82,000 and $142,000 respectively, from cash received from the sale of our 3D family of products.

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10. INTEREST AND OTHER INCOME

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

In January 2009, the Company adopted accounting guidance that provided that an entity should use a two step approach to evaluate whether an equity-linked financial instrument is indexed to its own stock, including evaluating the instrument s contingent exercise and settlement provisions. The Company issued warrants to a third party to purchase shares that had an adjustment feature that allowed for a change in the number of shares subject to issuance and a change in the exercise price under certain circumstances. Quarterly, the Company recalculated the fair value of its warrants using the Black-Scholes option pricing model. For the three months and nine months ended September 30, 2009, the change in the fair value of the warrant liability was a credit of $146,000 and a charge of $491,000 respectively. There was no impact in 2010 as the warrants expired at the end of 2009.

11. INCOME TAXES

Income tax provisions consisted of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
	(In thousands)		**(In thousands)**	
Loss from continuing operations before provision for income taxes	$ (879)	$ (8,831)	$ (2,652)	$ (24,009)
Provision for income taxes	336	186	1,098	577
Effective tax rate	(38.2)%	(2.1)%	(41.4)%	(2.4)%

The effective tax rates differ from the statutory rate primarily due to the valuation allowance, foreign withholding taxes, and unrecognized tax benefits. The income tax provision for the nine months ended September 30, 2010 and 2009, are primarily a result of foreign withholding tax expense.

As of September 30, 2010, the Company has unrecognized tax benefits under ASC 740 Income Taxes of approximately $661,000 including interest of $34,000. The total amount of unrecognized tax benefits that would affect the Company s effective tax rate, if recognized, is $233,000. There were no material changes in the amount of unrecognized tax benefits during the nine months ended September 30, 2010. The Company does not expect any material changes to its liability for unrecognized tax benefits during the next twelve months. The Company s policy is to account for interest and penalties related to uncertain tax positions as a component of income tax provision.

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

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The Company maintains a valuation allowance for its entire deferred tax assets at September 30, 2010 and December 31, 2009 as a result of uncertainties regarding the realization of the asset balance due to past losses, the variability of operating results, and near term projected results. In the event that the Company determines the deferred tax assets are realizable, an adjustment to the valuation allowance may increase income in the period such determination is made. The valuation allowance does not impact the Company s ability to utilize the underlying net operating loss carryforwards.

12. NET LOSS PER SHARE

Basic and diluted net loss per share is computed using the weighted average number of common shares outstanding for the period, excluding unvested restricted stock and RSUs. The following is a reconciliation of the numerators and denominators used in computing basic and diluted net loss per share (in thousands, except per share amounts):

	Three Months Ended September 30		Nine Months Ended September 30	
	2010	**2009**	**2010**	**2009**
Numerator:				
Loss from continuing operations	$ (1,215)	$ (9,017)	$ (3,750)	$ (24,586)
Gain from discontinued operations, net of tax	82	3	143	591
Net loss used in computing basic and diluted net loss per share	$ (1,133)	$ (9,014)	$ (3,607)	$ (23,995)
Denominator:				
Shares used in computation of basic and diluted net loss per share (weighted average common shares outstanding)	28,134	27,994	28,087	27,962
Basic and diluted net loss per share from:				
Continuing operations	$ (0.04)	$ (0.32)	$ (0.13)	$ (0.88)
Discontinued operations	-	-	-	0.02
Net loss	$ (0.04)	$ (0.32)	$ (0.13)	$ (0.86)

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As of September 30, 2010 and 2009, the Company had securities outstanding that could potentially dilute basic earnings per share in the future, but these were excluded from the computation of diluted net loss per share for the three and nine months ended September 30, 2010 and 2009, since their effect would have been anti-dilutive. These outstanding securities consisted of the following:

	September 30, 2010	September 30, 2009
Outstanding stock options	4,175,510	5,353,723
Restricted stock and RSUs	424,173	229,749
Warrants	-	428,567

13. COMPREHENSIVE LOSS

The following table sets forth the components of comprehensive loss:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands)		(In thousands)	
Net Loss	$ (1,133)	$ (9,014)	$ (3,607)	$ (23,995)
Change in unrealized losses on short-term investments	(7)	3	66	3
Foreign currency translation adjustment	-	4	-	9
Total comprehensive loss	$ (1,140)	$ (9,007)	$ (3,541)	$ (23,983)

14. SEGMENT REPORTING

The Company develops, manufactures, licenses, and supports a wide range of hardware and software technologies that more fully engage users sense of touch when operating digital devices. The Company focuses on the following target application areas: automotive, consumer electronics, entertainment, gaming, and commercial and industrial controls, medical, and mobile communications. Through March 31, 2010, the Company managed these application areas under two operating and reportable segments: Touch and Medical. As discussed in Note 9 of the condensed consolidated financial statements, at March 30, 2010 the Company divested its Endoscopy, Endovascular, and Laparoscopy product lines. Management continues to manufacture a limited amount of product, but the primary focus from this part of the business has changed from simulation product sales to primarily a licensing model under which the Company develops and licenses a wide range of haptic-related software and patented technologies and will collect license and royalty revenue. As of April 1, 2010, the Company has reorganized into one segment and there is no longer management, development, operations, or administrative personnel specifically for medical operations or product lines.

The Company s chief operating decision maker (CODM) is the Chief Executive Officer. The CODM allocates resources to and assesses the performance of the Company using information about its revenue and operating loss. As of April 1, 2010, there is only one segment that is reported to management. The Company develops and markets touch feedback technologies that enable software and hardware developers to enhance realism and usability in their mobility, computing, entertainment, medical, and industrial applications.

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

15. CONTINGENCIES

In re Immersion Corporation Initial Public Offering Securities Litigation

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

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

Similar allegations were made in other lawsuits challenging over 300 other initial public offerings and follow-on offerings conducted in 1999 and 2000. The cases were consolidated for pretrial purposes.

In September 2008, all of the parties to the lawsuits reached a settlement, subject to documentation and approval of the District Court. Subsequently, an underwriter defendant filed for bankruptcy and other underwriter defendants were acquired. On April 2, 2009, final documentation evidencing the settlement was presented to the District Court for approval. On October 6, 2009, the District Court approved the settlement, and the Court subsequently entered a judgment of dismissal. Under the judgment, the Immersion Defendants are not required to contribute to the settlement. If the settlement is reversed on appeal, the Company intends to defend the lawsuit vigorously.

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

On April 16, 2008, the Company announced that its wholly owned subsidiary, Immersion Medical, Inc., filed lawsuits for patent infringement in the United States District Court for the Eastern District of Texas against Mentice AB, Mentice SA, Simbionix USA Corp., and Simbionix Ltd (collectively the Defendants), seeking damages and injunctive relief. On July 11, 2008, Mentice AB and Mentice SA (collectively, Mentice) answered the complaint by denying the material allegations and alleging counterclaims seeking a judicial declaration that the asserted patents were invalid, unenforceable, or not infringed. On July 11, 2008, Simbionix USA Corp. and Simbionix Ltd, (collectively, Simbionix) filed a motion to stay or dismiss the lawsuit, and a motion to transfer venue for convenience to the Northern District of Ohio. On September 29, 2009, the court granted Simbionix s motion to transfer the case. On December 7, 2009, the case was transferred to the Northern District of Ohio. On April 15, 2010, Mentice AB, Mentice SA, and Xitact SA (a/k/a Mentice SA) filed a counterclaim against the Company. On June 3, 2010, the Company entered into a Settlement, Release, and Patent License Agreement with Simbionix and, on June 11, 2010, the case against Simbionix was dismissed.

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In re Immersion Corporation Securities Litigation

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

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

On December 21, 2009, these class actions were consolidated by the court as In Re Immersion Corporation Securities Litigation. On the same day, the court appointed a lead plaintiff and lead plaintiff s counsel. Following the Company s restatement of its financial statements, lead plaintiff filed a consolidated complaint on April 9, 2010. Defendants filed a motion to dismiss the action on June 15, 2010. The motion is pending.

In re Immersion Corporation Derivative Litigation

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

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

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 the Company, seeking compensatory damages, equitable and injunctive relief, and restitution. The complaint names certain current and former directors and officers of the Company as individual defendants. This complaint arises from the same or similar alleged facts as the federal securities actions and seeks to bring causes of action on behalf of the Company against the individual defendants for breaches of fiduciary duty, waste of corporate assets and unjust enrichment. The court has issued an order staying this action.

Kasmer v. Immersion Corporation

On May 5, 2010, an action was filed in Delaware Chancery Court by a purported shareholder seeking to enforce a demand to inspect certain of the Company s records pursuant to Section 220 of the Delaware General Corporation Law, as a possible prelude to the shareholder bringing a derivative action. The Company filed an answer on June 14, 2010, questioning whether a proper purpose for the records inspection had been stated and raising other defenses concerning the scope of the demand, among other deficiencies. The enforceability of the demand and the scope of the resulting inspection, if any, have not yet been determined. A one-day trial to determine the enforceability of the demand is currently scheduled for December 2, 2010.

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

Other Contingencies

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

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

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

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

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

OVERVIEW

We are a leading provider of haptic technologies that allow people to use their sense of touch more fully when operating a wide variety of digital devices. To achieve this heightened interactivity, we develop and manufacture or license a wide range of hardware and software technologies. While we believe that our technologies are broadly applicable, we are currently focusing our marketing and business development activities on the following target application areas: automotive, consumer electronics, entertainment, gaming, and commercial and industrial controls; medical; and mobile communications. We reorganized from two segments and now we currently manage these application areas under one operating and reportable segment (See Note 14 to the condensed consolidated financial statements).

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In most all of our markets, such as video console gaming, mobile phones, automotive controls, touch screens, and medical we now license our technologies to manufacturers who use them in products sold under their own brand names. In a few markets, such as medical simulation, we sold products manufactured under our own brand name through direct sales to end users, distributors, or OEMs. We have shifted the majority of our business from manufacturing products to primarily a licensing model. From time to time, we have also engaged in development projects for third parties.

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

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

Revenue Recognition

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

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

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

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

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

Royalty and license revenue We recognize royalty revenue based on royalty reports or related information received from the licensee and when collectibility is deemed 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, which is generally recognized on a straight-line basis over the expected term of the license.

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

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

Multiple element arrangements We enter into multiple element arrangements in which customers purchase a time-based license which include a combination of software and/or intellectual property licenses, professional services and in some cases, post contract customer support. For arrangements that include software and professional services, the services are not essential to the functionality of the software, and customers typically purchase consulting services to facilitate the adoption of our technology, but they may also decide to use their own resources or appoint other professional service organizations to perform these services. For these arrangements, including those with post contract customer support 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 paid to suppliers.

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

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

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

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

Accounting for Income Taxes

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

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

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

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Short-term Investments

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

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

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

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

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

Recovery of Accounts Receivable

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

Inventory Valuation

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

Intangible Assets

We have acquired patents and other intangible assets. In addition, we capitalize the external legal and filing fees associated with patents and trademarks. We assess the recoverability of our intangible assets, and we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets that affect our condensed consolidated financial statements. If these estimates or related assumptions change in the future, we may be required to record impairment charges for these assets. We amortize our intangible assets related to patents and trademarks, once they are issued, over their estimated useful lives, generally 10 years. Future changes in the estimated useful life could affect the amount of future period amortization expense that we will incur. During the first nine months of 2010, we capitalized costs associated with patents and trademarks of $1.8 million. Our total amortization expense for the same period was $630,000.

Restructuring Costs

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

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

RESULTS OF OPERATIONS FOR THE THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009

The following discussion and analysis includes our results of operations from continuing operations for the three months and nine months ended September 2010 and 2009. A separate discussion of the 3D product line under discontinued operations has been presented following our analysis of continuing operations. Accordingly, any sales, gross profit, sales and marketing expense, or income tax provision from discontinued operations have been aggregated and reported as a gain or loss from discontinued operations and are not a component of the aforementioned continuing operations discussion. The operating results for the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines have been included in continuing operations in the accompanying condensed consolidated financial statements. Although the Company has ceased manufacturing these three specific product lines, these operating results have not been reported as discontinued operations. From our medical products, we are continuing to manufacture our Virtual IV product line, but the primary focus from this part of our business is changing from simulation product sales to royalty and license revenue.

Overview

We had a 1% decrease in revenues from continuing operations during the third quarter of 2010 as compared to the third quarter of 2009. The third quarter revenue decrease was primarily due to a 65% decrease in product sales and a 34% decrease in development contract revenues, partially offset by an 81% increase in royalty and license revenue primarily due to increased royalty and license fees from our mobility, integrated circuit, and gaming licensees. We had a 19% increase in revenues from continuing operations during the first nine months of 2010 as compared to the same period of 2009. The nine month

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revenue increase was primarily due to a 75% increase in royalty and license revenue primarily due to increased royalty and license fees from our mobility, gaming, and integrated circuit licensees, partially offset by a 37% decrease in product sales and a 20% decrease in development contract revenues.

On March 30, 2010 we entered into an agreement with CAE and sold certain assets of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines to CAE for approximately $1.6 million and had a loss on the transaction of $43,000. The agreement also provided for the transfer of approximately 34 employees and contractors to CAE as well as distribution agreements and customer relationships. We also entered into a licensing agreement with CAE for the Immersion TouchSense patent portfolio for use in the field of Medical Training.

Our loss from continuing operations was $1.2 million for the third quarter of 2010 compared to a loss from continuing operations of $9.0 million for the third quarter of 2009. The decreased loss was primarily due to increased gross margin from our increased licensing revenue; reduced ongoing expenses from the transfer of product lines to CAE and reductions in personnel; and reduced one-time costs comprised of restructuring costs, inventory write offs, and our internal investigation which was completed in the first quarter of 2010. Our net loss from continuing operations was $3.8 million for the nine months ended September 30, 2010 compared to a net loss from continuing operations of $24.0 million for the nine months ended September 30, 2009. The decrease in net loss was primarily due to the same reasons noted above.

The manufacture and sales of simulator products to the medical training industry has been and will be reduced with the transfer of certain medical product lines to CAE. Revenue for the year ended 2009 for these product lines was approximately $6 million. Due in part to this divestiture, we have achieved certain cost reductions in 2010. For the remainder of 2010, we also expect to continue to focus on the execution of plans in our established businesses. Our success could be limited by several factors, including the current macro-economic climate, the timely release of our new technology and our licensees products, continued market acceptance of our technology and our licensee s products, the introduction of new products by existing or new competitors, and the cost of ongoing litigation. For a further discussion of these and other risk factors, see Part II, Item 1A Risk Factors.

REVENUES	**September 30, 2010**	**2009**	**Change**	**% Change**
	(In thousands)			
Three months ended:				
Royalty and license	$ 5,141	$ 2,841	$ 2,300	81 %
Product sales	1,217	3,467	(2,250)	(65)%
Development contracts and other	189	285	(96)	(34)%
Total Revenues	$ 6,547	$ 6,593	$ (46)	(1)%
Nine months ended:				
Royalty and license	$ 17,848	$ 10,202	$ 7,646	75 %
Product sales	6,035	9,518	(3,483)	(37)%
Development contracts and other	848	1,061	(213)	(20)%
Total Revenues	$ 24,731	$ 20,781	$ 3,950	19 %

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Three Months Ended September 30, 2010 Compared to Three Months Ended September 30, 2009

Royalty and license revenue Royalty and license revenue is comprised of royalties earned on sales by our TouchSense licensees and license fees charged for our intellectual property portfolio. The increase in royalty and license revenue was due to increases in per unit royalties generated primarily from mobility, integrated circuit, and gaming licensees and also increases in license contracts signed. We expect royalty revenue to be a significant component of our revenue as our technology continues to be included in more products, but we expect to see lower growth rates in the future than we have experienced in the first nine months of 2010.

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

Product sales Product sales are comprised primarily of medical products, actuators, design kits, and integrated circuits. The decrease in product sales was due primarily to a $2.2 million decrease in medical product sales arising mainly from the divesture of certain medical simulation product lines in the period ending March 31, 2010. On March 30, 2010 we entered into an agreement with CAE and sold certain assets and divested the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines to CAE resulting in reduced medical product sales subsequent to that date. Sales of our Virtual IV medical simulator product also declined compared to the same period in the prior year. We expect medical product sales will continue to decrease for the remainder of 2010 compared to 2009 primarily as a result of the divestiture of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines. Revenue for the three months ended September 30, 2010 and 2009 for the three divested product lines were $0 and $1.8 million, respectively.

Development contracts and other revenue Development contracts and other revenue is comprised of revenue on commercial contracts and extended support contracts. The decrease in development contracts and other revenue was mainly attributable to a decrease in contracted engineering services. We continue to transition our engineering resources from certain commercial development contract efforts to technology and product development efforts that focus on leveraging our existing sales and channel distribution capabilities.

We categorize our geographic information into four major regions: North America, Europe, Far East, and Rest of the World. In the third quarter of 2010, revenue generated in North America, Europe, Far East, and Rest of the World represented 41%, 14%, 45%, and 0% of total revenue, respectively, compared to 35%, 12%, 51%, and 2% of total revenue, respectively, for the third quarter of 2009. The shift in revenues among regions was mainly due to a decrease in product sales in all regions as a result of the divestiture of certain medical simulation product lines in the first quarter of 2010. This was offset by an increase in royalty and license revenue in North America. Product sales decreases in the Far East were also partially offset by an increase in royalty and license revenue in the Far East. The increase in royalty and license revenue in the North America and the Far East was primarily due to increased royalty and license revenue from licensees of mobile devices, manufacturers of integrated circuits and gaming licensees.

Nine Months Ended September 30, 2010 Compared to Nine Months Ended September 30, 2009

Royalty and license revenue The increase in royalty and license revenue was due to increases in per unit royalties primarily from mobility, integrated circuit and gaming licensees and also increases in license contracts signed. In addition, during the second quarter we benefitted from true-up payments in accordance with provisions of our contracts with certain customers in the gaming market.

Product sales The decrease in product sales was primarily due to a $2.2 million decrease resulting from the divestiture of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines and $1.0 million decrease in sales of our Virtual IV medical simulators. Revenue for the nine months ended September 30, 2010 and 2009 for the three divested product lines was $2.7 million and $5.3 million, respectively.

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Development contracts and other revenue Development contracts and other revenue decreased mainly due to a decrease in the number of individual development contracts and due to a decrease in contracted engineering services.

In the first nine months of 2010, revenue generated in North America, Europe, Far East, and Rest of the World represented 37%, 17%, 44%, and 2%, respectively, compared to 46%, 17%, 36%, and 1%, respectively, for the first nine months of 2009. The shift in revenues among regions was mainly due to a decrease in product sales in North America, Europe and the Far East as a result of the divestiture of certain medical simulation product lines. This was offset by an increase in royalty and license revenue in the Far East and Europe. Product sales decreases in North America were also partially offset by an increase in royalty and license revenue in North America. The increase in royalty and license revenue in Europe was primarily due to increased royalty and license revenue from licensees of mobile devices. The increase in royalty and license revenue in the Far East was primarily due to increased royalty and license revenue from licensees of mobile devices, manufacturers of integrated circuits, automotive licensees, gaming licensees, and touchscreen licensees. The increase in royalty and license revenue in North America was primarily due to increased royalty and license revenue from licensees of gaming licensees, medical licensees, and touchscreen licensees.

COST OF PRODUCT SALES	September 30, 2010	2009	Change	% Change
	(In thousands)			
Three months ended:				
Cost of product sales	$ 457	$ 3,293	$ (2,836)	(86)%
% of total product revenue	38%	95%	(57)%	
Nine months ended:				
Cost of product sales	$ 2,587	$ 6,856	$ (4,269)	(62)%
% of total product revenue	43%	72%	(29)%	

Cost of Product Sales Our cost of product sales (exclusive of amortization of intangibles) consists primarily of materials, labor, and overhead. The decrease in cost of product sales for the third quarter of 2010 as compared to the third quarter of 2009 was primarily due to decreased direct material costs and production costs of $1.0 million, decreased obsolescence expense of $472,000, decreased inventory scrap costs of $457,000, reduced warranty and repair expense of $286,000, reduced overhead costs of $240,000 and decreased freight costs of $181,000. The decrease in direct material, production costs, and freight expense of approximately 77% was mainly due to a similar decrease in product sales. The decrease in obsolescence expense and inventory scrap costs was mainly due to a write-off of medical product parts that did not recur in 2010. The decrease in warranty and repair costs was mainly due to costs relating to medical products that did not recur in 2010. Overhead costs decreased mainly as a result of reduced salary expense from the elimination of operations personnel. Cost of product sales decreased as a percentage of product revenue to 38% in the third quarter of 2010 from 95% in the third quarter of 2009. This decrease is mainly due to the result of the reduced write off of medical inventory parts. With the divestiture of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines, cost of product sales for medical products are expected to decline in absolute dollars in the future.

The decrease in cost of product sales for the nine months ended September 30, 2010 as compared to the nine months ended September 30, 2009 was primarily due to decreased direct material costs and production costs of $1.0 million, reduced overhead costs of $766,000, decreased obsolescence expense of $758,000, decreased physical inventory write off costs of $620,000, decreased inventory scrap costs of $437,000, reduced warranty and repair expense of $330,000, and decreased freight costs of $201,000. The decrease in direct material, production costs, and freight expense of approximately 34% was mainly due to a similar decrease in product sales. Overhead costs decreased mainly as a result of reduced salary expense from the elimination of operations personnel in the second quarter of 2010. The decrease in obsolescence expense and inventory scrap costs was mainly due to a write-off of medical product parts that did not recur in 2010. The reduction of physical inventory write off costs consisted primarily of physical count to book adjustments of medical demonstration equipment inventory in the second quarter of 2009 that did not recur in 2010. The decrease in warranty and repair costs was mainly due to costs relating to medical products that did not recur in 2010. Year to date, cost of product sales decreased as a percentage of product revenue to 43% in the third quarter of 2010 from 72% in the third quarter of 2009. This decrease is mainly due to the result of the reduced medical physical inventory adjustment expense and the decreased inventory write off of medical inventory parts.

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OPERATING EXPENSES AND OTHER	September 30, 2010	2009	Change	% Change
	($ In thousands)			
Three months ended:				
Sales and marketing	$ 1,813	$ 2,653	$ (840)	(32)%
% of total revenue	28%	40%	(13)%	
Research and development	$ 2,007	$ 2,690	$ (683)	(25)%
% of total revenue	31%	41%	(10)%	
General and administrative	$ 3,008	$ 6,673	$ (3,665)	(55)%
% of total revenue	46%	101%	(55)%	
Amortization and impairment of intangibles	$ 211	$ 243	$ (32)	(13)%
% of total revenue	3%	4%	(0)%	
Restructuring Costs	$ -	$ 181	$ (181)	(100)%
% of total revenue	*%	3%	*%	
Nine months ended:				
Sales and marketing	$ 6,077	$ 10,953	$ (4,876)	(45)%
% of total revenue	25%	53%	(28)%	
Research and development	$ 6,473	$ 10,031	$ (3,558)	(35)%
% of total revenue	26%	48%	(22)%	
General and administrative	$ 11,808	$ 15,899	$ (4,091)	(26)%
% of total revenue	48%	77%	(29)%	
Amortization and impairment of intangibles	$ 650	$ 682	$ (32)	(5)%
% of total revenue	3%	3%	(1)%	
Restructuring Costs	$ -	$ 1,532	$ (1,532)	(100)%
% of total revenue	*%	7%	*%	

* Not meaningful

Sales and Marketing Our sales and marketing expenses are comprised primarily of employee compensation and benefits costs, advertising, public relations, trade shows, market development funds, travel, and an allocation of facilities costs. The divestiture of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines was a major contributor to the overall reduction of sales and marketing expenses in the third quarter of 2010 compared to the comparable period in 2009. Specifically, the decrease in overall sales and marketing expenses was mainly due to decreased compensation, benefits, and overhead of $433,000 primarily due to decreased sales and marketing headcount, decreased travel expense of $194,000 also due to decreased sales and marketing headcount, and decreased marketing, advertising, and public relations costs of $156,000. We expect to continue to focus our sales and marketing efforts on mobile device, touchscreen, and medical market opportunities to build greater market acceptance for our touch technologies.

The decrease in sales and marketing expense for the nine months ended September 30, 2010 as compared to the nine months ended September 30, 2009 was primarily due to the divestiture of the medical simulation product lines. Specifically, the decrease in sales and marketing expenses was due to decreased compensation, benefits, and overhead of $2.2 million primarily due to decreased sales and marketing headcount. In addition we had decreased marketing, advertising, and public relations costs of $852,000, decreased sales and marketing travel expense of $733,000 mainly due to decreased sales and marketing headcount, a reduction in the loss on disposal of fixed assets of $658,000 primarily relating to the write-off of demonstration equipment in the second quarter of 2009 that did not recur in 2010, and decreased consulting of $450,000 that was primarily used to supplement our sales and marketing staff.

Research and Development Our research and development expenses are comprised primarily of employee compensation and benefits costs, consulting fees, tooling and supplies, and an allocation of facilities costs. The divestiture of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines was a major contributor to the overall reduction of research and development expenses in the third quarter of 2010 compared to the comparable period in 2009. Specifically, the decrease in overall research and development expenses was primarily due to decreased compensation, benefits, and overhead of $591,000 and decreased consulting costs that supplement our engineering staff of $154,000, partially offset by increased lab and prototyping costs of $68,000 mainly to build new prototypes. The decreased compensation, benefits, and overhead expense was primarily due to decreased research and development headcount. Although we have reduced our research and development expenses, we believe that continued significant investment in research and development is critical to our future success, and we expect to make investments in areas of research and technology development to support future growth.

The decrease in research and development expense for the nine months ended September 30, 2010 as compared to the nine months ended September 30, 2009 was primarily due to the divestiture of the medical simulation product lines. Specifically, the decrease in overall research and development expenses was primarily due to decreased compensation, benefits, and overhead of $2.5 million mainly due to decreased headcount. In addition, we had decreased consulting costs of $855,000, decreased lab, demonstration, and prototyping costs of $68,000, and reduced engineering travel costs of $67,000.

General and Administrative Our general and administrative expenses are comprised primarily of employee compensation and benefits, legal and professional fees, office supplies, travel, and an allocation of facilities costs. The decrease in general and administrative expenses in the third quarter of 2010 compared to the comparable period in 2009 was primarily due to decreased legal and professional expenses of $3.5 million and decreased compensation, benefits, and overhead of $167,000. The decreased legal and professional expenses were primarily due to decreased accounting, audit, and legal costs resulting from our internal investigation in 2009 which was concluded in the first quarter of 2010. A decrease in litigation expenses also contributed to the overall reduction in legal and professional expenses. The decreased compensation benefits and overhead was primarily due to decreased general and administrative headcount. We expect that the dollar amount of general and administrative expenses will continue to be a significant component of our operating expenses. We will continue to incur costs related to litigation as we continue to assert our intellectual property and contractual rights and defend lawsuits brought against us.

The decrease in general and administrative expenses for the nine months ended September 30, 2010 as compared to the nine months ended September 30, 2009 was primarily due to decreased legal, professional, and license fee expenses of $2.1 million and decreased compensation, benefits, and overhead of $1.7 million. The decreased legal and professional expenses were primarily due to decreased accounting, audit, and legal costs resulting from our internal investigation in 2009 which was concluded in the first quarter of 2010. A decrease in litigation expenses also contributed to the overall reduction in legal and professional expenses. The decreased compensation, benefits, and overhead expense was primarily due to decreased general and administrative headcount.

Amortization and impairment of Intangibles Our amortization and impairment of intangibles is comprised primarily of patent amortization and trademark amortization along with impairment and write

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off of intangibles. Amortization and impairment of intangibles decreased in the third quarter of 2010 compared to the comparable period in 2009 primarily due to a decrease in write off of intangibles in 2010. Amortization and impairment of intangibles decreased in the first nine months of 2010 compared to the same period in 2009 primarily due to certain patents becoming fully amortized.

Restructuring There were no restructuring charges incurred in the third quarter of 2010, nor are any currently anticipated. Restructuring costs of $181,000 in the third quarter of 2009 consisted primarily of severance benefits and costs paid to close down certain facilities in connection with the reduction of workforce of Medical personnel in Montreal Canada.

There were no restructuring charges incurred during the first nine months of 2010. Restructuring costs of $1.5 million in the first nine months of 2009 consisted 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 also included severance benefits paid as the result of the reduction of workforce due to changes in our Touch business.

Change in fair value of warrant liability In January 2009, we adopted accounting guidance that provided that an entity should use a two step approach to evaluate whether an equity-linked financial instrument is indexed to its own stock, including evaluating the instrument s contingent exercise and settlement provisions. We issued warrants to a third party to purchase shares that had an adjustment feature that allowed for a change in the number of shares subject to issuance and a change in the exercise price under certain circumstances. Quarterly, we recalculated the fair value of our warrants using the Black-Scholes option pricing model. For the three months and nine months ended September 30, 2009, the gain from the change in fair value of the warrant liability was $146,000 and $490,000, respectively. There is no impact for 2010 or future periods because the warrants expired in December 2009.

Interest and Other Income Interest and other income consist primarily of interest income from cash and cash equivalents and short-term investments, interest on notes receivable, and gains on sales of short-term investments. Interest and other income decreased by $93,000 in the third quarter of 2010 compared to the same period in 2009. Interest and other income decreased by $461,000 in the first nine months of 2010 compared to the same period in 2009. These decreases were primarily the result of decreased interest income due to a reduction of accreted interest income from Sony Computer Entertainment as this interest accretion was complete as the final payment was received at the beginning of 2010, decreased cash equivalents and short-term investments, and reduced interest rates on cash equivalents and short-term investments.

Provision for Income Taxes We recorded a provision for income taxes for the third quarter of 2010 of $336,000 on pre-tax loss from continuing operations of $879,000, yielding an effective tax rate of (38.2)%. We recorded a provision for income taxes for the third quarter of 2009 of $186,000 on pre-tax loss from continuing operations of $8.8 million, yielding an effective tax rate of (2.1)%. The income tax provision for the third quarters of 2010 and 2009 are primarily due to foreign withholding tax expense which increased as a result of increased revenue in Asia.

For the nine months ended September 30, 2010, we recorded a provision for income taxes of $1.1 million on pre-tax loss from continuing operations of $2.7 million, yielding an effective tax rate of (41.4)%. We recorded a provision for income taxes for the nine months ended September 30, 2009 of $577,000 on pre-tax loss from continuing operations of $24.0 million, yielding an effective tax rate of (2.4)%. The income tax provision for the nine months ended September 30, 2010 and 2009 are primarily due to foreign withholding tax expense.

Discontinued Operations In the three months ended September 30, 2010, we recorded a gain on the sales of discontinued operations net of tax of $82,000 from additional payments received from the sale of our 3D family of products. This was an increase of $62,000 from what was recorded in the three months ended September 30, 2009. Loss from discontinued operations, net of tax, decreased by $17,000 to $0 in the three months ended September 30, 2010 compared to the same period in 2009, primarily due to the

decrease in activity due to the ceasing of 3D operations in the quarter ended March 31, 2009 resulting in reduced sales volumes and costs and expenses associated with 3D operations during subsequent periods.

Gain from sales of discontinued operations, net of tax, decreased by $65,000 in the nine months ended September 30, 2010 compared to the same period in 2009 due to a reduction in payments received from the sale of our 3D family of products. In the nine months ended September 30, 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 a gain on sale of discontinued operations of $207,000. Accordingly, the operations of the 3D product line has been classified as discontinued operations in the condensed consolidated statement of operations. Gain from discontinued operations, net of tax, decreased by $383,000 in the nine months ended September 30, 2010 compared to the same period in 2009, primarily due to the decrease in activity due to the ceasing of 3D operations in the quarter ended March 31, 2009 resulting in reduced sales volumes and costs and expenses associated with 3D operations during that period.

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

Through March 31, 2010, we managed our business under two operating and reportable segments: Touch and Medical. As discussed in Notes 9 and 14 of the condensed consolidated financial statements, at March 30, 2010 we had divested our Endoscopy, Endovascular, and Laparoscopy product lines. Management continues to manufacture a limited amount of product, but the primary focus for this part of our business has changed from simulation product sales to primarily a licensing model under which we develop and licenses a wide range of haptic-related software and patented technologies and will collect license and royalty revenue.

As of April 1, 2010, we have reorganized into one segment and there is no longer separate management, development, operations, or administrative personnel specifically for medical operations or product lines. Our business is to develop, manufacture, license, and support a wide range of hardware and software technologies that more fully engage users sense of touch when operating digital devices.

As we have changed our internal structure which caused our reportable segments to change, we have restated our previously reported separate segment information from Medical and Touch into only one segment. As such, separate segment information has been eliminated and all discussion of our business is included in discussions of our company as a whole.

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 September 30, 2010, our cash, cash equivalents, and short-term investments totaled $62.1 million, a decrease of $1.6 million from $63.7 million on December 31, 2009.

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

Cash used in operating activities

Net cash used in operating activities during the nine months ended September 30, 2010 was $1.2 million, a change of $11.8 million from the $13.0 million used during the nine months ended September 30, 2009. Cash used in operations during the nine months ended September 30, 2010 was primarily the result of a net loss of $3.6 million, a decrease of $3.6 million due to a change in deferred revenue and customer advances mainly due to the recognition of previously deferred revenue, a decrease of $829,000 due to a change in accrued compensation and other current liabilities, and a $315,000 decrease in accounts payable

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resulting from the divestiture of certain medical product lines and the timing of payments to vendors. These decreases were offset by $2.3 million increase due to a change in accounts receivable reflecting the divestiture of certain medical product lines along with successful collection efforts. In addition, there was an increase due to a change in inventories of $860,000 reflecting the divestiture of certain medical product lines and streamlining operations. Cash provided by operations during the nine months ended September 30, 2010 was also impacted by noncash charges and credits of $3.8 million, including $2.4 million of noncash stock-based compensation, $842,000 in depreciation and amortization and $650,000 in amortization and impairment of intangibles.

Cash used in investing operations

Net cash used in investing activities during the nine months ended September 30, 2010 was $5.5 million, compared to the $26.2 million used in investing activities during the nine months ended September 30, 2009, a decrease of $20.7 million. Net cash used in investing activities during the current period consisted of purchases of short-term investments of $34.9 million and offset by maturities of short-term investments of $30.0 million; $1.6 million increase in intangibles primarily due to capitalization of external patent filings and application costs, and an increase of $336,000 used to purchase property and equipment, partially offset by net proceeds from the divestiture of certain medical product lines totaling $964,000.

Cash provided by financing operations

Net cash provided by financing activities during the nine months ended September 30, 2010 was $83,000, a change of $187,000 from the $270,000 provided during the nine months ended September 30, 2009. Cash provided by financing activities during the nine months ended September 30, 2010 was due to the exercise of stock options and warrants.

We anticipate that capital expenditures for the full year ended December 31, 2010 will total less than $1.0 million in connection with anticipated maintenance and upgrades to operations and infrastructure. Cash flows from our discontinued operations have been included in our condensed consolidated statement of cash flows with continuing operations within each cash flow category. The absence of cash flows from discontinued operations is not expected to affect our future liquidity or capital resources. We believe our existing cash, cash equivalents and short term investments and currently available resources will be sufficient to meet our working capital and capital expenditure needs over the next 12 months. Our future capital requirements will depend on many factors, including our rate of revenue growth, future acquisitions, the level of our sales and marketing activities, the timing and extent of spending to support product development efforts and expansion into new territories, the timing of general and administrative expenses, and the continuing market acceptance of our technology. To the extent that existing cash and cash from operations are not sufficient to fund our future activities, we may need to raise additional funds through public or private equity or debt financing. There can be no assurance that such funds would be available on terms acceptable to us or at all.

SUMMARY DISCLOSURES ABOUT CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

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

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

As of September 30, 2010, we had a liability for unrecognized tax benefits totaling $661,000 including interest of $34,000, of which approximately $233,000 could be payable in cash. Due to the uncertainties related to these tax matters, we are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur. Settlement of such amounts could require the utilization of working capital.

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RECENT ACCOUNTING PRONOUNCEMENTS

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Cash Equivalents and Short-term Investments We have cash equivalents and short-term investments of $62.1 million as of September 30, 2010. These securities are subject to interest rate fluctuations. An increase in interest rates could adversely affect the market value of our cash equivalents and short-term investments. A hypothetical 100 basis point increase in interest rates would result in a decrease of approximately $234,356 in the fair value of our cash equivalents and short-term investments as of September 30, 2010.

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

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

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act as of September 30, 2010. The purpose of these controls and procedures is to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC s rules, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, to allow timely decisions regarding required disclosures.

Our management with the participation of our Chief Executive Officer and Chief Financial Officer evaluated our disclosure controls and procedures and determined that the controls put in place for remediating the previously identified material weaknesses with respect to calculation of stock based compensation, inventory control, and fixed asset management have operated effectively for a period of time sufficient to conclude that such material weaknesses have been remediated. In addition, management is continuing the process of remediating the previously identified material weaknesses related to taxes, revenue reporting and adoption of new accounting standards and believes that the Company s disclosure controls and procedures were not effective as of September 30, 2010.

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A material weakness is a deficiency, or combination of deficiencies, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

Other than the remedial efforts to address our material weaknesses as described further below, that took place or that were ongoing during the three months ended September 30, 2010, there were no changes in our internal control over financial reporting during the three months ended September 30, 2010 that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

Plans for Remediation

We will not be able to assess whether the steps we are taking will fully remedy the material weaknesses in our internal control over financial reporting with respect to taxes, revenue reporting, and adoption of new accounting standards until we have fully implemented them and sufficient time passes in order to evaluate their effectiveness, which we expect to occur at the end of the year at the earliest.

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

- We have hired consultants to assist with the preparation of our quarterly and annual tax calculations and the related financial disclosures including the rationale for recognizing the benefits of certain tax positions in the financial statements with oversight responsibility remaining with the Corporate Controller. During the three months ended June 30, 2010, the Chief Financial Officer was also assigned oversight responsibility in addition to the Corporate Controller.

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

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

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We have undertaken the following remedial efforts to address the material weakness in our internal control over financial reporting with respect to adoption of new accounting standards as initially described in Evaluation of Disclosure Controls and Procedures in Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2009 filed on February 8, 2010:

We have added a control procedure to test the review and implementation of all applicable new accounting pronouncements with the appropriate review by finance personnel to ensure compliance.

PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In re Immersion Corporation Initial Public Offering Securities Litigation

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

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

Similar allegations were made in other lawsuits challenging over 300 other initial public offerings and follow-on offerings conducted in 1999 and 2000. The cases were consolidated for pretrial purposes.

In September 2008, all of the parties to the lawsuits reached a settlement, subject to documentation and approval of the District Court. Subsequently, an underwriter defendant filed for bankruptcy and other underwriter defendants were acquired. On April 2, 2009, final documentation evidencing the settlement was presented to the District Court for approval. On October 6, 2009, the District Court approved the settlement, and the Court subsequently entered a judgment of dismissal. Under the judgment, the Immersion Defendants are not required to contribute to the settlement. If the settlement is reversed on appeal, 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

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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. On April 15, 2010, Mentice AB, Mentice SA, and Xitact SA (a/k/a Mentice SA) filed a counterclaim against us. On June 3, 2010, we entered into a Settlement, Release, and Patent License Agreement with Simbionix and, on June 11, 2010, the case against Simbionix was dismissed.

In re Immersion Corporation Securities Litigation

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

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

On December 21, 2009, these class actions were consolidated by the court as *In Re Immersion Corporation Securities Litigation.* On the same day, the court appointed a lead plaintiff and lead plaintiff s counsel. Following our restatement of financial statements, lead plaintiff filed a consolidated complaint on April 9, 2010. Defendants filed a motion to dismiss the action on June 15, 2010. The motion is pending.

In re Immersion Corporation Derivative Litigation

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

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

Shaw v. Richardson et al.

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

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Kasmer v. Immersion Corporation

On May 5, 2010, an action was filed in Delaware Chancery Court by a purported shareholder seeking to enforce a demand to inspect certain of our records pursuant to Section 220 of the Delaware General Corporation Law, as a possible prelude to the shareholder bringing a derivative action. We filed our answer on June 14, 2010, questioning whether a proper purpose for the records inspection had been stated and raising other defenses concerning the scope of the demand, among other deficiencies. The enforceability of the demand and the scope of the resulting inspection, if any, have not yet been determined. A one-day trial to determine the enforceability of the demand is currently scheduled for December 2, 2010.

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

ITEM 1A. RISK FACTORS

Company Risks

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

In connection with the internal investigation conducted by the audit committee into revenue recognition of certain transactions in our Medical line of business, we determined that we did not have adequate internal financial and accounting controls to produce accurate and timely financial statements. Among the material weaknesses identified in our review were material weaknesses related to revenue recognition. In addition, as set forth in our Annual Report on Form 10-K for the year ended December 31, 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, some of which have been remediated as of September 30, 2010. For a further discussion of these material weaknesses, see Item 9A of our Annual Report on Form 10-K for the year ended December 31, 2009 and Part I, Item 4 of this Form 10-Q. Although we have begun implementing new processes and procedures to improve our internal controls, our Chief Executive Officer and Chief Financial Officer determined that as of September 30, 2010, our internal controls over financial reporting were not effective to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external reporting in accordance with generally accepted accounting principles in the United States.

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

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

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

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

The current economic conditions could materially hurt our business in a number of ways including, longer sales and renewal cycles, delays in adoption of our products or technologies, increased risk of competition, 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.

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

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

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

Three customers accounted for approximately 39% of our total net revenue for the third quarter of 2010 and approximately 34% for the nine months ended September 30, 2010. We cannot be certain that customers that have accounted for significant revenue in past periods, individually or as a group, will, continue to generate revenue in any future period. If we lose a major customer or group of customers, our revenue could decline if we are unable to replace revenue from other sources.

WE HAD AN ACCUMULATED DEFICIT OF $102 MILLION AS OF SEPTEMBER 30, 2010, HAVE A HISTORY OF LOSSES, EXPECT TO EXPERIENCE LOSSES IN THE FUTURE, AND MAY NOT ACHIEVE OR MAINTAIN PROFITABILITY IN THE FUTURE.

Since 1997, we have incurred losses in all but five 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 third quarter of 2010 and 2009, 79% and 43%, respectively, of our total revenues were royalty and license revenues. For the nine months ended September 30, 2010 and 2009, 72%

and 49%, respectively, of our total revenues were royalty and license. We do not control or influence the design, manufacture, quality control, promotion, distribution, or pricing of products that are manufactured and sold by our licensees, nor can we control consolidation within an industry which could either reduce the number of licensing products available or reduce royalty rates for the combined licensees. In addition, we generally do not have commitments from our licensees that they will continue to use our technologies in current or future products. As a result, products incorporating our technologies may not be brought to market, achieve commercial acceptance, or otherwise generate meaningful royalty revenue for us. For us to generate royalty revenue, licensees that pay us per-unit royalties must manufacture and distribute products incorporating our touch-enabling technologies in a timely fashion and generate consumer demand through marketing and other promotional activities. If our licensees products fail to achieve commercial success or if products are recalled because of quality control problems, our revenues will not grow and could decline.

Peak demand may fluctuate from quarter to quarter for products that incorporate our technologies, especially in the video console gaming and computer gaming peripherals market. If our licensees do not ship products incorporating our touch-enabling technologies in a timely fashion or fail to achieve strong sales, we may not receive related royalty and license revenue.

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.

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

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license third parties, Microsoft s share of all aftermarket Xbox 360 game controller sales will likely remain high or increase, which we expect will limit our gaming royalty revenue. Additionally, Microsoft is now making touch-enabled steering wheel products covered by their royalty-free, perpetual, irrevocable license to our worldwide portfolio of patents that could compete with our licensees current products for which we earn per unit royalties.

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

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

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

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

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

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

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

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

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

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

- effective patent protection may not be available in every country, particularly in Asia, in which we or our licensees do business.

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

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

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

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

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

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

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

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

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

We are currently a party to various legal proceedings. Due to the inherent uncertainties of litigation, we cannot accurately predict how these cases will ultimately be resolved. In addition, it is possible that as a result of our internal investigation described elsewhere in this report, we may be subject to additional litigation and investigations by government authorities such as the SEC. We anticipate that currently pending litigation will continue to be costly and that future litigation or investigations will result in additional legal expenses, and there can be no assurance that we will be successful or able to recover the costs we incur in connection with litigation or investigations. We expense litigation and investigatory costs as incurred, and only accrue for costs that have been incurred but not paid to the vendor as of the financial statement date. Litigation and investigations have diverted, and are likely to continue to divert, the efforts and attention of some of our key management and personnel. As a result, until such time as it is resolved or concluded, litigation and investigations could adversely affect our business. Further, any unfavorable outcome could adversely affect our business. For additional background on this and our other litigation, please see Note 15 to the condensed consolidated financial statements in Item 1 and Item 1 Legal Proceedings of Part II.

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

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

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

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

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

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.

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.

OUR CUSTOMERS MAY HAVE DIFFICULTIES OBTAINING THE COMPONENTS NECESSARY TO MANUFACTURE HAPTIC-BASED PRODUCTS, WHICH COULD HARM OUR BUSINESS AND RESULTS OF OPERATIONS.

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

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, Windows Vista, and Windows 7 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.

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.

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

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

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

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

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

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

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

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

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.

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;
- political and economic instability; and
- an outbreak of hostilities in markets where major customers are located, including Korea.

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

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

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

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

OUR TRANSITION TO PRIMARILY A LICENSING MODEL MAY NOT BE SUCCESSFUL, AND MAY NEGATIVELY IMPACT OUR BUSINESS.

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In March, 2010, we sold certain assets including inventory and fixed assets and certain liabilities of the Endoscopy, Endovascular, and Laparoscopy medical simulation product lines and transferred certain employees to CAE as well as distribution agreements and customer relationships. We also have entered into a licensing agreement with CAE for the Immersion TouchSense patent portfolio for use in the field of Medical Training. 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. Accordingly, if we are unable to manage the transition effectively, our overall business and operating results could be materially and adversely affected.

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

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

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.

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

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

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

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

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

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

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

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

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

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.

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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;
- development in any pending litigation;
- the timing of introductions and market acceptance of new products and product enhancements by us, our licensees, our competitors, or their competitors;
- our ability to develop and improve our technologies;
- our ability to attract, integrate, and retain qualified personnel; and
- seasonality in the demand for our products or our licensees products.

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

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

OUR BUSINESS IS SUBJECT TO CHANGING REGULATIONS REGARDING CORPORATE GOVERNANCE AND OTHER COMPLIANCE AREAS THAT WILL INCREASE BOTH OUR COSTS AND THE RISK OF NONCOMPLIANCE.

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

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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 considering implementing additional automated system functionality. If we go forward with these system enhancements, we may encounter problems with the implementation of these systems or we may have difficulties preparing or tracking internal information which could adversely affect our financial results. We will need to continue to invest the necessary capital to upgrade and improve our operational, financial and management reporting systems. If our management fails to manage our growth effectively, we could experience increased costs, declines in product quality, or customer satisfaction, which could harm our business.

ITEM 6. EXHIBITS

The following exhibits are filed herewith:

Exhibit Number	*Description*
10.1*	Offer Letter dated October 1, 2010 by and between Craig Vachon and the Company.
31.1	Certification of Victor Viegas, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Shum Mukherjee, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Victor Viegas, Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Shum Mukherjee, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Indicates management contract or compensatory plan or arrangement.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 5, 2010

IMMERSION CORPORATION

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

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