

IMMERSION CORP  
Form 10-Q  
November 07, 2012  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(MARK ONE)

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

For the quarterly period ended September 30, 2012

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**  
(State or other jurisdiction of

**94-3180138**  
(I.R.S. Employer

incorporation or organization)

Identification No.)

**30 Rio Robles, San Jose, California 95134**

(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 ☒ 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 ☒

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 ☒

Number of shares of common stock outstanding at October 26, 2012: 27,273,391.

**Table of Contents**

**IMMERSION CORPORATION**

**INDEX**

	<b>Page</b>
<b><u>PART I</u></b>	
<b><u>FINANCIAL INFORMATION</u></b>	
Item 1. <u>Financial Statements</u>	
<u>Unaudited Condensed Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011</u>	3
<u>Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss for the Three Months and Nine Months Ended September 30, 2012 and 2011</u>	4
<u>Unaudited Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2012 and 2011</u>	5
<u>Unaudited Notes to Condensed Consolidated Financial Statements</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	35
Item 4. <u>Controls and Procedures</u>	36
<b><u>PART II</u></b>	
<b><u>OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	37
Item 1A. <u>Risk Factors</u>	38
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	54
Item 6. <u>Exhibits</u>	55
<u>SIGNATURES</u>	56

**Table of Contents**

**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, 2012	December 31, 2011
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 13,889	\$ 7,298
Short-term investments	33,985	48,987
Accounts and other receivables (net of allowances for doubtful accounts as of: September 30, 2012 \$134 and December 31, 2011 \$21)	1,402	1,487
Inventories	359	423
Deferred income taxes	215	215
Prepaid expenses and other current assets	773	479
Total current assets	50,623	58,889
Property and equipment, net	1,426	1,737
Intangibles and other assets, net	15,447	14,053
Total assets	\$ 67,496	\$ 74,679
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 1,717	\$ 365
Accrued compensation	2,412	2,830
Other current liabilities	2,478	2,054
Deferred revenue and customer advances	4,651	4,120
Total current liabilities	11,258	9,369
Long-term deferred revenue	10,999	13,229
Deferred income tax liabilities	215	215
Other long-term liabilities	584	245
Total liabilities	23,056	23,058
Contingencies (Note 13)		
Stockholders' equity:		
Common stock and additional paid-in capital \$0.001 par value; 100,000,000 shares authorized; shares issued: September 30, 2012 32,256,135 and December 31, 2011 31,786,030; shares outstanding: September 30, 2012 27,359,441 and December 31, 2011 27,857,824	185,950	182,508
Accumulated other comprehensive income	107	118
Accumulated deficit	(111,521)	(106,157)
	(30,096)	(24,848)

## Edgar Filing: IMMERSION CORP - Form 10-Q

Treasury stock at cost: September 30, 2012 4,896,694 shares and December 31, 2011 3,928,206 shares

Total stockholders' equity	44,440	51,621
Total liabilities and stockholders' equity	\$ 67,496	\$ 74,679

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents**

**IMMERSION CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**AND COMPREHENSIVE LOSS**

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Revenues:				
Royalty and license	\$ 6,371	\$ 5,875	\$ 21,386	\$ 20,110
Product sales	529	345	1,145	1,892
Development contracts and other	242	275	778	943
Total revenues	7,142	6,495	23,309	22,945
Costs and expenses:				
Cost of revenues (exclusive of amortization, impairment, and abandonment of intangibles shown separately below)	273	192	802	913
Sales and marketing	1,632	1,643	5,072	5,402
Research and development	2,088	2,183	6,406	6,525
General and administrative	5,750	3,195	14,882	9,367
Amortization, impairment, and abandonment of intangibles	337	324	1,071	1,016
Total costs and expenses	10,080	7,537	28,233	23,223
Operating loss	(2,938)	(1,042)	(4,924)	(278)
Interest and other income	66	58	144	172
Loss from continuing operations before provision for income taxes	(2,872)	(984)	(4,780)	(106)
Provision for income taxes	(118)	(428)	(737)	(1,289)
Loss from continuing operations	(2,990)	(1,412)	(5,517)	(1,395)
Discontinued operations (Note 10) :				
Gain on sales of discontinued operations net of provision for income taxes of \$0, \$0, \$97, and \$39	0	0	153	61
Net loss	\$ (2,990)	\$ (1,412)	\$ (5,364)	\$ (1,334)
Basic and diluted net loss per share				
Continuing operations	(0.11)	(0.05)	(0.20)	(0.05)
Discontinued operations	0.00	0.00	0.01	0.00
Total	\$ (0.11)	\$ (0.05)	\$ (0.19)	\$ (0.05)
Shares used in calculating basic and diluted net loss per share	27,658	28,918	27,885	28,595
Other Comprehensive Income (loss)				
Change in unrealized gains (losses) on short-term investments	6	(3)	(11)	19

## Edgar Filing: IMMERSION CORP - Form 10-Q

Total Other Comprehensive Income (loss)	6	(3)	(11)	19
Total Comprehensive loss	\$ (2,984)	\$ (1,415)	\$ (5,375)	\$ (1,315)

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents****IMMERSION CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands) (unaudited)**

	<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>
Cash flows from operating activities:		
Net loss	\$ (5,364)	\$ (1,334)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization of property and equipment	490	717
Amortization, impairment, and abandonment of intangibles	1,071	1,016
Stock-based compensation	2,346	2,705
Allowance (recovery) for doubtful accounts	113	(25)
Loss on disposal of equipment	27	3
Gain on sales of discontinued operations	(153)	(61)
Changes in operating assets and liabilities:		
Accounts and other receivables	(28)	61
Inventories	64	(173)
Prepaid expenses and other current assets	(294)	3,117
Other assets	(45)	(89)
Accounts payable	1,214	32
Accrued compensation and other current liabilities	622	(1,282)
Deferred revenue and customer advances	(1,699)	(2,454)
Other long-term liabilities	339	(56)
Net cash provided by (used in) operating activities	(1,297)	2,177
Cash flows provided by (used in) investing activities:		
Purchases of available-for-sale investments	(29,956)	(44,910)
Proceeds from maturities of available-for-sale investments	45,000	45,000
Additions to intangibles	(2,323)	(2,406)
Purchases of property and equipment	(931)	(84)
Proceeds from sales of discontinued operations	250	100
Net cash provided by (used in) investing activities	12,040	(2,300)
Cash flows provided by (used in) financing activities:		
Issuance of common stock under employee stock purchase plan	122	145
Exercise of stock options	974	2,244
Purchase of treasury stock	(5,248)	0
Net cash provided by (used in) financing activities	(4,152)	2,389
Net increase in cash and cash equivalents	6,591	2,266
Cash and cash equivalents:		
Beginning of the period	7,298	12,243
End of the period	\$ 13,889	\$ 14,509
Supplemental disclosure of cash flow information:		
Cash paid (received) for taxes	\$ 21	\$ (3,302)



## Edgar Filing: IMMERSION CORP - Form 10-Q

Supplemental disclosure of non-cash operating, investing, and financing activities:

Amounts accrued for property and equipment, and intangibles	\$ 647	\$ 636
---	--------	--------

Issuance of shares from Employee Stock Purchase Plan and Release of Restricted Stock Units and Awards under company stock plan	\$ 1,298	\$ 1,305
--	----------	----------

See accompanying Notes to Condensed Consolidated Financial Statements.

---

**Table of Contents**

**IMMERSION CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2012**

**(Unaudited)**

**1. SIGNIFICANT ACCOUNTING POLICIES**

*Description of Business*

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

*Principles of Consolidation and Basis of Presentation*

The condensed consolidated financial statements include the accounts of Immersion Corporation and its wholly-owned subsidiaries: Immersion Canada Inc.; Immersion International, LLC; Immersion Medical, Inc.; Immersion Japan K.K.; Immersion Ltd.; Immersion Software Ireland Ltd.; and Haptify, Inc. All intercompany accounts, transactions, and balances have been eliminated in consolidation.

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all information and footnotes necessary for a complete presentation of the financial position, results of operations, and cash flows, in conformity with GAAP. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements included in the Company's Annual Report on Form 10-K, for the fiscal year ended December 31, 2011. 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, 2012 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, 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



## **Table of Contents**

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.

*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 licenses its portfolio of patents to customers in a variety of industries such as mobility, gaming, automotive, and medical devices. A majority of these are variable fee arrangements where the royalties earned by the Company are based on unit or sales volumes of the respective licensees. The Company also enters into fixed license fee arrangements. However, the terms of the royalty agreements generally require licensees to give notification of royalties due to the Company within 30-45 days of the end of the quarter during which their related sales occur. As the Company is unable to estimate the licensees' sales in any given quarter to determine the royalties due to it, the Company recognizes royalty revenues based on royalties reported by licensees during the quarter and when all revenue recognition criteria are met. The Company recognizes fixed license fee revenue for licenses to intellectual property when earned under the terms of the agreements, which is generally recognized when all deliverables including services are completed or recognized on a straight-line basis over the expected term of the license. Certain royalties are based upon customer shipments or revenues and could be subject to change and may result in out of period adjustments.

*Development contracts and other revenue* Development contracts and other revenue are 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 time-based licenses, which include a combination of software and/or intellectual property licenses, professional services and in limited cases, post contract customer support. For arrangements that are software based and include software and professional services, the services are generally not essential to the functionality of the software, and customers may purchase consulting services to facilitate the adoption of the Company's technology, but they may also decide to use their own resources or appoint other professional service organizations to perform these services. For these arrangements, including those with post contract customer support, revenue is recognized either over the period of the ongoing obligation which is generally consistent with the contractual term, or when all deliverables including services have been completed.

Also affecting revenue recognition for contracts that have multiple element arrangements are two Accounting Standards Updates (ASU). In September 2009, the Financial Accounting Standards Board (FASB) ratified 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

## **Table of Contents**

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) was effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company adopted ASU 2009-13 (update to ASC 605) as of January 1, 2011, and its application has had no impact on the Company's condensed consolidated financial statements to date. 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 functionality. ASU 2009-14 (update to ASC 605) had an effective date that is consistent with ASU 2009-13 (update to ASC 605) above. The Company adopted ASU 2009-14 (update to ASC 605) as of January 1, 2011, and its application has had no impact on the Company's condensed consolidated financial statements to date.

*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 three to twelve months from the delivery date pursuant to the terms of the arrangement. Historically, warranty-related costs have not been significant.

### *Recent Accounting Pronouncements*

In June 2011, the FASB ratified ASU 2011-05 *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. ASU 2011-05 requires that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements, eliminating the option to present other comprehensive income in the statement of changes in equity. Under either choice, items that are reclassified from other comprehensive income to net income are required to be presented on the face of the financial statements where the components of net income and the components of other comprehensive income are presented. In December 2011 the FASB ratified ASU 2011-12 *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. ASU 2011-12 defers those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments. These amendments are effective for reporting periods beginning after December 15, 2011, and have been applied retrospectively. These amendments have changed the manner in which the Company presents comprehensive income by reporting comprehensive income information in the condensed consolidated statements of operations and comprehensive loss.

## **2. FAIR VALUE MEASUREMENTS**

### *Cash Equivalents and Short-term Investments*

The financial instruments of the Company measured at fair value on a recurring basis are cash equivalents and short-term investments.

The Company's fixed income available-for-sale securities consist of high quality, investment grade securities. The Company values these securities based on pricing from pricing vendors, who may use quoted prices in active markets for identical assets (Level 1) or inputs other than quoted prices that are observable either directly or indirectly (Level 2) in determining fair value.

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

**Table of Contents**

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 are generally classified within Level 2 of the fair value hierarchy and include most U.S. treasury securities and most investment-grade corporate commercial paper.

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

In May 2011, FASB issued ASU No. 2011-04, Fair Value Measurements (Topic 820). This ASU provides additional guidance on fair value disclosures. This guidance contains certain updates to the measurement guidance as well as enhanced disclosure requirements. The most significant change in disclosures is an expansion of the information required for Level 3 measurements including enhanced disclosure for: (1) the valuation processes used by the reporting entity; and (2) the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs, if any. This guidance is effective for interim and annual periods beginning on or after December 15, 2011, with early adoption prohibited. The Company adopted the updated guidance which was effective for the Company on January 1, 2012. The adoption of this new guidance did not have a material impact on the Company's condensed consolidated financial statements.

Financial instruments measured at fair value on a recurring basis as of September 30, 2012 and December 31, 2011 are classified based on the valuation technique in the table below:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	September 30, 2012 Fair value measurements using		Total		
Assets:		Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)			
					(In thousands)	
U.S. Treasury securities	\$ 0	\$ 38,985	\$ 0	\$ 38,985		
Money market accounts	4,628	0	0	4,628		
Total assets at fair value	\$ 4,628	\$ 38,985	\$ 0	\$ 43,613		

The above table excludes \$4.3 million of cash held in banks.

	Quoted Prices in Active Markets for Identical Assets (Level 1)	December 31, 2011 Fair value measurements using		Total
		Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
(In thousands)				
Assets:				
U.S. Treasury securities	\$ 0	\$ 48,987	\$ 0	\$ 48,987
Money market accounts	3,617	0	0	3,617

Edgar Filing: IMMERSION CORP - Form 10-Q

Total assets at fair value	\$ 3,617	\$ 48,987	\$ 0	\$ 52,604
----------------------------	----------	-----------	------	-----------

**Table of Contents**

The above table excludes \$3.7 million of cash held in banks.

*Short-term Investments*

	Amortized Cost	September 30, 2012 Gross Unrealized Holding Gains (In thousands)	September 30, 2012 Gross Unrealized Holding Losses (In thousands)	Fair Value
U.S. Treasury securities	\$ 38,979	\$ 6	\$ 0	\$ 38,985
Total	\$ 38,979	\$ 6	\$ 0	\$ 38,985

	Amortized Cost	December 31, 2011 Gross Unrealized Holding Gains (In thousands)	December 31, 2011 Gross Unrealized Holding Losses (In thousands)	Fair Value
U.S. Treasury securities	\$ 48,970	\$ 17	\$ 0	\$ 48,987
Total	\$ 48,970	\$ 17	\$ 0	\$ 48,987

The contractual maturities of the Company's available-for-sale securities on September 30, 2012 and December 31, 2011 were all due within one year.

**3. ACCOUNTS AND OTHER RECEIVABLES**

	September 30, 2012 (In thousands)	December 31, 2011 (In thousands)
Trade accounts receivable	\$ 903	\$ 525
Receivables from vendors, lessor, and other	499	962
Accounts and other receivables	\$ 1,402	\$ 1,487

**4. INVENTORIES**

	September 30, 2012 (In thousands)	December 31, 2011 (In thousands)
Raw materials and subassemblies	\$ 218	\$ 167
Finished goods	141	256
Inventories	\$ 359	\$ 423





## Table of Contents

### 5. PROPERTY AND EQUIPMENT

	September 30, 2012	December 31, 2011
	(In thousands)	
Computer equipment and purchased software	\$ 3,753	\$ 3,696
Machinery and equipment	654	882
Furniture and fixtures	546	533
Leasehold improvements	905	837
<b>Total</b>	<b>5,858</b>	<b>5,948</b>
Less accumulated depreciation	(4,432)	(4,211)
<b>Property and equipment, net</b>	<b>\$ 1,426</b>	<b>\$ 1,737</b>

### 6. INTANGIBLES AND OTHER ASSETS

	September 30, 2012	December 31, 2011
	(In thousands)	
Patents and trademarks	\$ 25,754	\$ 23,617
Other assets	196	204
<b>Gross intangibles and other assets</b>	<b>25,950</b>	<b>23,821</b>
Accumulated amortization of patents and trademarks	(10,503)	(9,768)
<b>Intangibles and other assets, net</b>	<b>\$ 15,447</b>	<b>\$ 14,053</b>

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Amortization of Intangibles - excluding impairments or abandonments	\$ 264	\$ 333	\$ 777	\$ 747

**Table of Contents**

The table below includes estimated remaining annual amortization expense for issued patents and trademarks as of September 30, 2012.

	Estimated Amortization Expense (In thousands)
Remainder of 2012	\$ 254
2013	1,024
2014	913
2015	839
2016	770
Thereafter	2,212
<b>Total</b>	<b>\$ 6,012</b>

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

	September 30, 2012	December 31, 2011
	(In thousands)	
Patents in process	\$ 9,239	\$ 8,448

Upon issuance, in process patents will be amortized over their estimated useful lives, generally 10 years.

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

	September 30, 2012	December 31, 2011
	(In thousands)	
Accrued legal	\$ 1,838	\$ 727
Income taxes payable	149	23
Other current liabilities	491	1,304
<b>Total other current liabilities</b>	<b>\$ 2,478</b>	<b>\$ 2,054</b>
Deferred revenue	\$ 4,635	\$ 4,046
Customer advances	16	74
<b>Total deferred revenue and customer advances</b>	<b>\$ 4,651</b>	<b>\$ 4,120</b>

**Table of Contents****8. LONG-TERM DEFERRED REVENUE**

Long-term deferred revenue consisted of the following:

	September 30, 2012	December 31, 2011
(In thousands)		
Deferred revenue for Sony Computer Entertainment	\$ 10,386	\$ 12,634
Other deferred revenue	613	595
Long-term deferred revenue	\$ 10,999	\$ 13,229

**9. STOCK-BASED COMPENSATION***Stock Options and Awards*

The Company's equity incentive program is a long-term retention program that is intended to attract, retain, and provide incentives for talented employees, consultants, officers, and directors and to align stockholder and employee interests. The Company may grant options, stock appreciation rights, restricted stock, restricted stock units (RSUs), performance shares, performance units, and other stock-based or cash-based awards to employees, officers, directors, and consultants. Under these programs, stock options may be granted at prices not less than the fair market value on the date of grant for stock options. These options generally vest over 4 years and expire from 5 to 10 years from the date of grant. Restricted stock generally vests over one year. RSUs generally vest over 3 years. Awards granted other than an option or stock appreciation right shall reduce the common stock shares available for grant by 1.75 shares for every share issued.

	September 30, 2012
Common stock shares available for grant	3,600,194
Common stock options outstanding	3,099,155
Restricted stock awards outstanding	44,000
Restricted stock units outstanding	676,755

*Employee Stock Purchase Plan*

The Company has an Employee Stock Purchase Plan (ESPP). Under the ESPP, eligible employees may purchase common stock through payroll deductions at a purchase price of 85% of the lower of the fair market value of the Company's stock at the beginning of the offering period or the purchase date. Participants may not purchase more than 2,000 shares in a six-month offering period or purchase stock having a value greater than \$25,000 in any calendar year as measured at the beginning of the offering period. A total of 1,000,000 shares of common stock have been reserved for issuance under the ESPP. As of September 30, 2012, 482,519 shares had been purchased since the inception of the ESPP in 1999. Under ASC 718-10, the ESPP is considered a compensatory plan and the Company is required to recognize compensation cost related to the fair value of the award purchased under the ESPP. Shares purchased under the ESPP for the nine months ended September 30, 2012 are listed below. Shares purchased under the ESPP for the nine months ended September 30, 2011 are 28,702. The intrinsic value listed below is calculated as the difference between the market value on the date of purchase and the purchase price of the shares.

**Table of Contents**

	Nine Months Ended September 30, 2012
Shares purchased under ESPP	25,628
Average price of shares purchased under ESPP	\$ 4.77
Intrinsic value of shares purchased under ESPP	\$ 21,553

*Summary of Stock Options*

The following table sets forth the summary of option activity under the Company's stock option plans for the nine months ended September 30, 2012 and year ended December 31, 2011:

	Nine Months Ended September 30, 2012	Year Ended December 31, 2011
Beginning outstanding balance	3,267,838	4,000,526
Granted	313,200	429,963
Exercised	(209,208)	(560,132)
Forfeited and cancelled	(272,675)	(602,519)
Ending outstanding balance	3,099,155	3,267,838
Aggregate intrinsic value of options exercised	\$ 395,000	\$ 2,485,000
Weighted average fair value of options granted	3.32	4.07

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of the Company's common stock for the options that were in-the-money.

Information regarding stock options outstanding at December 31, 2011 and September 30, 2012 is summarized below:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (In millions)
<b><u>December 31, 2011</u></b>				
Options outstanding	3,267,838	\$ 6.61	5.53	\$ 1.3
Options vested and expected to vest using estimated forfeiture rates	3,151,950	6.62	5.44	1.3
Options exercisable	2,377,683	6.99	4.61	0.8
<b><u>September 30, 2012</u></b>				
Options outstanding	3,099,155	\$ 6.65	5.56	\$ 1.3
Options vested and expected to vest using estimated forfeiture rates	2,993,600	6.66	5.52	1.3
Options exercisable	2,265,176	6.97	5.02	1.0

## Table of Contents

### Summary of Restricted Stock Units

RSU activity for the nine months ended September 30, 2012 and year ended December 31, 2011 was as follows:

	Nine Months Ended September 30, 2012	Year Ended December 31, 2011
Beginning outstanding balance	407,765	417,923
Awarded	479,911	243,908
Released	(203,519)	(159,384)
Forfeited	(7,402)	(94,682)
Ending outstanding balance	676,755	407,765
Weighted average grant date fair value of RSUs granted	\$ 6.78	\$ 6.61
Total fair value of RSUs released	1,128,000	1,163,000
Total fair value of RSUs remaining unvested	3,654,000	2,112,000

Information regarding RSUs outstanding at December 31, 2011 and September 30, 2012 is summarized below:

	Number of Shares	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (In millions)	Fair Value (In millions)
<b>December 31, 2011</b>				
RSUs outstanding	407,765	0.95	\$ 2.1	\$ 2.1
RSUs vested and expected to vest using estimated forfeiture rates	336,454	0.92	1.7	
<b>September 30, 2012</b>				
RSUs outstanding	676,755	1.24	\$ 3.7	\$ 3.7
RSUs vested and expected to vest using estimated forfeiture rates	551,319	1.21	3.0	

**Table of Contents***Summary of Restricted Stock Awards*

Restricted stock award activity for the nine months ended September 30, 2012 and year ended December 31, 2011 was as follows:

	<b>Nine Months Ended September 30, 2012</b>	<b>Year Ended December 31, 2011</b>
Beginning outstanding balance	18,000	18,000
Awarded	57,750	30,000
Released	(31,750)	(21,000)
Forfeited	0	(9,000)
Ending outstanding balance	44,000	18,000
Weighted average grant date fair value of restricted stock awarded	\$ 5.70	\$ 6.61
Total fair value of restricted stock awards released	329,000	159,000

*Stock Plan Assumptions*

The assumptions used to value option grants and ESPP share purchases under the Company's Stock Plans were as follows:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
<b>Options</b>	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Expected life (in years)	4.5	4.5	4.5	5.0
Volatility	68%	70%	70%	69%
Interest rate	0.6%	0.9%	0.7%	1.7%
Dividend yield	N/A	N/A	N/A	N/A

  

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
<b>Employee Stock Purchase Plan</b>	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Expected life (in years)	0.5	0.5	0.5	0.5
Volatility	52%	40%	62%	45%
Interest rate	0.1%	0.2%	0.1%	0.2%
Dividend yield	N/A	N/A	N/A	N/A

*Compensation Costs*

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>		<b>(In thousands)</b>	
<b>Statement of Operations Classifications</b>				
Sales and marketing	\$ 152	\$ 132	\$ 376	\$ 376
Research and development	173	201	586	639
General and administrative	483	607	1,384	1,690

Edgar Filing: IMMERSION CORP - Form 10-Q

Total	\$ 808	\$ 940	\$ 2,346	\$ 2,705
-------	--------	--------	----------	----------



## **Table of Contents**

As of September 30, 2012, there was \$4.9 million of unrecognized compensation cost related to stock options, restricted stock awards, and RSUs, 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 2.49 years for options, 2.01 years for RSUs, and 0.67 years for restricted stock awards. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

### *Stock Repurchase Program*

On November 1, 2007, the Company announced its Board of Directors authorized the repurchase of up to \$50 million of the Company's common stock. The Company may repurchase its stock for cash in the open market in accordance with applicable securities laws. The timing and amount of any stock repurchase will depend on share price, corporate and regulatory requirements, economic and market conditions, and other factors. The stock repurchase authorization has no expiration date, does not require the Company to repurchase a specific number of shares, and may be modified, suspended, or discontinued at any time. During the three months ended September 30, 2012, the Company repurchased 581,200 shares for \$3.2 million at an average cost of \$5.51 per share, net of transaction costs through open market repurchases. During the nine months ended September 30, 2012, the Company repurchased 968,488 shares for \$5.2 million at an average cost of \$5.42 per share, net of transaction costs through open market repurchases. During the three months and the nine months ended September 30, 2011, the Company repurchased 31,214 shares for \$188,000 at an average cost of \$6.02 per share, net of transaction costs through open market repurchases. These amounts repurchased are classified as treasury stock on the Company's condensed consolidated balance sheet.

## **10. DISCONTINUED OPERATIONS**

During 2009, the Company sold all of its 3D product line including inventory, fixed assets, and intangibles and recorded gains on the sale of discontinued operations of \$187,000 at the time of the sales. The consideration for the sales was \$2.7 million in the form of cash of \$320,000 and notes receivable of \$2.4 million payable through 2013, for which the proceeds are being recognized when they are received. The Company has abandoned all other 3D operations. Accordingly, the operations of the 3D product line have been classified as discontinued operations, net of income tax, in the condensed consolidated statement of operations for all periods presented. The assets sold consisted primarily of intangible assets that had no carrying value on the Company's books at the time of sale. In the three and nine months ended September 30, 2012, the Company recorded gains on sales of discontinued operations net of tax of \$0 and \$153,000, respectively from payments on notes from the sale of the 3D product line. In the three months and nine months ended September 30, 2011, the Company recorded gains on sales of discontinued operations net of tax of \$0 and \$61,000 respectively, from payments on notes from the sale of the 3D product line.

**Table of Contents****11. INCOME TAXES**

Income tax provisions from continuing operations consisted of the following:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>		<b>(In thousands)</b>	
Loss from continuing operations before provision for income taxes	\$ (2,872)	\$ (984)	\$ (4,780)	\$ (106)
Provision for income taxes	(118)	(428)	(737)	(1,289)
Effective tax rate	(4.1)%	(43.5)%	(15.4)%	(1216.0)%

The effective tax rates differ from the statutory rate primarily due to the valuation allowance, foreign withholding taxes, and unrecognized tax benefits. The income tax provision for the three and nine months ended September 30, 2012 and 2011 are primarily as a result of foreign withholding tax expense.

As of September 30, 2012, the Company had unrecognized tax benefits under ASC 740 Income Taxes of approximately \$681,000 including interest of \$53,000. The total amount of unrecognized tax benefits that would affect the Company's effective tax rate, if recognized, was \$253,000. There were no material changes in the amount of unrecognized tax benefits during the nine months ended September 30, 2012. The Company expects to release reserves and record a tax benefit due to the expiration of statute of limitations during the next twelve months. The Company's policy is to account for interest and penalties related to uncertain tax positions as a component of income tax provision.

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

The Company maintains a valuation allowance for its entire deferred tax assets at September 30, 2012 and December 31, 2011 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.

**Table of Contents****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:

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2011	
	2012	2011	2012	2011
	(in thousands except per share amounts)			
Numerator:				
Loss from continuing operations	\$ (2,990)	\$ (1,412)	\$ (5,517)	\$ (1,395)
Gain from discontinued operations, net of tax	0	0	153	61
Net loss used in computing basic and diluted net loss per share	\$ (2,990)	\$ (1,412)	\$ (5,364)	\$ (1,334)
Denominator:				
Shares used in computation of basic and diluted net loss per share (weighted average common shares outstanding)	27,658	28,918	27,885	28,595
Basic and diluted net loss per share from:				
Continuing operations	\$ (0.11)	\$ (0.05)	\$ (0.20)	\$ (0.05)
Discontinued operations	0.00	0.00	0.01	0.00
Total	\$ (0.11)	\$ (0.05)	\$ (0.19)	\$ (0.05)

As of September 30, 2012 and September 30, 2011, 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, 2012 and 2011, since their effect would have been anti-dilutive. These outstanding securities consisted of the following:

	<b>September 30, 2012</b>	<b>September 30, 2011</b>
	<b>(in thousands)</b>	
Outstanding stock options	3,099	3,585
Unvested restricted stock awards	44	18
Unvested RSUs	677	449

**13. CONTINGENCIES***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

## **Table of Contents**

Company and certain current and former Immersion directors and officers as defendants and allege violations of federal securities laws based on the Company's issuance of allegedly misleading financial statements. The various complaints assert claims covering the period from May 2007 through July 2009 and seek compensatory damages allegedly sustained by the purported class members.

On December 21, 2009, these class actions were consolidated by the court as *In Re Immersion Corporation Securities Litigation*. On the same day, the court appointed a lead plaintiff and lead plaintiff's counsel. Following the Company's restatement of its financial statements, lead plaintiff filed a consolidated complaint on April 9, 2010. Defendants moved to dismiss the action on June 15, 2010 and that motion was granted with leave to amend on March 11, 2011. Lead plaintiff filed an amended complaint on April 29, 2011. Defendants moved to dismiss the amended complaint on July 1, 2011. On December 16, 2011, the motion to dismiss was granted with prejudice and on December 19, 2011, judgment was entered in favor of defendants. On January 13, 2012, the plaintiffs filed a notice of appeal to the Ninth Circuit Court of Appeals. In May 2012, plaintiff filed his opening appeals brief. On July 13, 2012, the Company filed its response brief. On September 4, 2012, plaintiff filed his reply.

### *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. On May 3, 2010, the court issued an order staying the action, and that stay was lifted following dismissal of the securities class action in December 2011. On October 31, 2012, plaintiffs filed a statement with the Court indicating that in light of the settlement of the *Kasmer v. Richardson* action (referenced below), they intend to voluntarily dismiss their action with prejudice once the time to appeal the *Kasmer* settlement approval order has expired.

### *Kasmer v. Immersion Corporation*

On May 5, 2010, an action was filed in Delaware Chancery Court by a shareholder seeking to enforce a demand to inspect certain of the Company's records pursuant to Section 220 of the Delaware General Corporation Law, as a possible prelude to the shareholder bringing a derivative action. The Company filed an answer on June 14, 2010, questioning whether a proper purpose for the records inspection had been stated and raising other defenses concerning the scope of the demand, among other deficiencies. Following a one-day trial on December 2, 2010, the Court significantly narrowed the scope of the demand and the Company responded accordingly. On October 24, 2011, the shareholder filed a motion seeking to compel further responses to the demand. The Company believes that its responses complied with the Court's ruling and have opposed the shareholder's motion. On May 30, 2012, the same shareholder filed a putative shareholder derivative action in San Francisco Superior Court, entitled *Kasmer v. Richardson et. al.* purportedly on behalf of the Company and naming certain of its former directors and officers as individual defendants. The Complaint in that action has yet to be served on either the Company or any of the individual defendants. On June 5, 2012, the parties participated in a mediation session, and on the same day reached an agreement in principle to settle both the Delaware Chancery and *Kasmer v. Richardson* actions. The Delaware Chancery action was dismissed with prejudice by stipulation of the parties on October 22, 2012. The settlement of the *Kasmer v. Richardson* action was approved by the San Francisco Superior Court on October 26, 2012. The settlement will become final when the deadline to appeal the settlement approval order has expired, and once the *In re Immersion Corporation Derivative Litigation* action in the Northern District of California (referenced above) is dismissed with prejudice.

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.

**Table of Contents**

*Other Contingencies*

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

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

## **Table of Contents**

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

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

#### **OVERVIEW**

We are a leading provider of haptic technologies that allow people to use their sense of touch more fully when operating a wide variety of digital and other devices. To achieve this heightened interactivity, we develop and license or manufacture a wide range of patented technologies, software solutions, and products. While we believe that our technologies, solutions, and products are broadly applicable, we are currently focusing our marketing and business development activities on the following target lines of business: mobile communications and consumer electronics, automotive, gaming, commercial and industrial, and medical. We manage these business areas under one operating and reportable segment.

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

Our objective is to drive adoption of our touch technologies and solutions across markets and applications to improve the user experience with digital devices and systems. We and our wholly owned subsidiaries hold more than 1,200 issued or pending patents in the U.S. and other countries, covering various aspects of hardware and software technologies.

## Table of Contents

### 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 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, short-term investments, patents and intangible assets, income taxes, contingencies, and litigation. We base our estimates and assumptions on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates and assumptions.

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

#### *Revenue Recognition*

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, 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 license our portfolio of patents to customers in a variety of industries such as mobility, gaming, automotive, and medical devices. A majority of these are variable fee arrangements where the royalties earned by us are based on unit or sales volumes of the respective licensees. We also enter into fixed license fee arrangements. However, the terms of the royalty agreements generally require licensees to give notification of royalties due to us within 30–45 days of the end of the quarter during which their related sales occur. As we are unable to estimate the licensees' sales in any given quarter to determine the royalties due to us, we recognize royalty revenues based on royalties





## **Table of Contents**

reported by licensees during the quarter and when all revenue recognition criteria are met. We recognize fixed license fee revenue for licenses to our intellectual property when earned under the terms of the agreements, which is generally recognized when all deliverables including services are completed or recognized on a straight-line basis over the expected term of the license. Certain royalties are based upon customer shipments or revenues and could be subject to change and may result in out of period adjustments.

*Development contracts and other revenue* Development contracts and other revenue are 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 time-based licenses, which include a combination of software and/or intellectual property licenses, professional services and in limited cases, post contract customer support. For arrangements that are software based and include software and professional services, the services are generally not essential to the functionality of the software, and customers may purchase consulting services to facilitate the adoption of our technology, but they may also decide to use their own resources or appoint other professional service organizations to perform these services. For these arrangements, including those with post contract customer support, revenue is recognized either over the period of the ongoing obligation which is generally consistent with the contractual term, or when all deliverables including services have been completed.

Also affecting revenue recognition for contracts that have multiple element arrangements are two Accounting Standards Updates ( ASU ). In September 2009, the Financial Accounting Standards Board ( FASB ) ratified 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) was effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. We adopted ASU 2009-13 (update to ASC 605) as of January 1, 2011, and its application has had no impact on our condensed consolidated financial statements to date. 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 functionality. ASU 2009-14 (update to ASC 605) had an effective date that is consistent with ASU 2009-13 (update to ASC 605) above. We adopted ASU 2009-14 (update to ASC 605) as of January 1, 2011, and its application has had no impact on our condensed consolidated financial statements to date.

*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 three to twelve months from the delivery date pursuant to the terms of the arrangement. Historically, warranty-related costs have not been significant.

*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.

## **Table of Contents**

*Valuation and amortization method* We use the Black-Scholes model, single-option approach to determine the fair value of stock options, stock awards, and ESPP shares. All share-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. Stock-based compensation expense recognized at fair value includes the impact of estimated forfeitures. We estimate future forfeitures at the date of grant and revise the estimates if necessary, in subsequent periods if actual forfeitures differ from these estimates. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include actual and projected employee stock option exercise behaviors that impact the expected term, our expected stock price volatility over the term of the awards, the risk-free interest rate, and expected dividends, if any.

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, stock awards, and ESPP shares. Existing valuation models, including the Black-Scholes model, 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 9 to the condensed consolidated financial statements for further information regarding stock-based compensation.

### *Accounting for Income Taxes*

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, 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.

## **Table of Contents**

### *Short-term Investments*

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

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.

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.

### *Patents and Intangible Assets*

We have acquired patents and other intangible assets. In addition, we capitalize the external legal, filing, and continuation or annuity 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 nine months ended September 30, 2012, we capitalized costs associated with patents and trademarks of \$2.5 million. Our total amortization expense (exclusive of impairments or abandonments of \$294,000) for the same period was \$777,000.

---

## **Table of Contents**

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, 2012 AND 2011**

The following discussion and analysis includes our results of operations from continuing operations for the three months and nine months ended September 30, 2012 and 2011. Accordingly, any gain or loss on sale or income tax provision from discontinued operations have been aggregated and reported as a gain or loss from discontinued operations and are not a component of the aforementioned continuing operations discussion.

#### ***Overview***

We increased our royalty and license revenue by 8% and our overall revenue increased by 10% for the third quarter ended September 30, 2012 compared to the third quarter ended September 30, 2011. The increase in royalty and license revenue during such period was due to increased revenue primarily from our mobility, chip manufacturers and other, medical, and automotive licensees, partially offset by decreased revenue from our gaming licensees. In addition, contributing to the overall revenue increase was a 53% increase in product sales mainly due to additional sales of our Virtual IV simulation product. We increased our royalty and license revenue by 6% and our overall revenue increased by 2% for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011. The increase in royalty and license revenue during such period was mainly due to additional revenue from our medical, automotive, mobility, and gaming licensees. This increase was offset by a 39% decrease in product sales, mainly due to reduced sales of our Virtual IV simulation product.

Our loss from continuing operations was \$3.0 million for the third quarter ended September 30, 2012 as compared to a loss of \$1.4 million for the third quarter ended September 30, 2011. The loss was primarily due to higher operating expenses which included an increase in general and administrative expenses, mainly resulting from increased litigation expenses of approximately \$3.0 million. Our loss from continuing operations was \$5.5 million during the nine months ended September 30, 2012 as compared to a loss of \$1.4 million for the nine months ended September 30, 2011. The loss was primarily due to higher operating expenses which include an increase in general and administrative expenses, mainly resulting from increased litigation expenses of approximately \$6.0 million.

During the remainder of 2012, we expect royalty and licensing revenues to be the major component of our revenues as our technology continues to be included in more products. Intellectual property litigation will likely cause us to expend significant financial resources in the future and have an adverse effect on the results of our operations. Additionally, our success could be limited by several factors, including the current macro-economic climate, the timely release of our new technology and our licensees' products, continued market acceptance of our technology and our licensees' products, the introduction of new products by existing or new competitors, and the cost of ongoing litigation. For a further discussion of these and other risk factors, see Part II, Item 1A – Risk Factors.

**Table of Contents**

REVENUES	September 30, 2012      2011 (In thousands)		Change	% Change
Three months ended:				
Royalty and license	\$ 6,371	\$ 5,875	\$ 496	8%
Product sales	529	345	184	53%
Development contracts and other	242	275	(33)	(12)%
Total Revenues	\$ 7,142	\$ 6,495	\$ 647	10%
Nine months ended:				
Royalty and license	\$ 21,386	\$ 20,110	\$ 1,276	6%
Product sales	1,145	1,892	(747)	(39)%
Development contracts and other	778	943	(165)	(17)%
Total Revenues	\$ 23,309	\$ 22,945	\$ 364	2%

**Three Months Ended September 30, 2012 Compared to Three Months Ended September 30, 2011**

*Royalty and license revenue* Royalty and license revenue is comprised of royalties earned on sales by our licensees and license fees charged for our intellectual property portfolio. The increase in royalty and license revenue for the third quarter ended September 30, 2012 compared to the third quarter ended September 30, 2011 was primarily due to increases in royalty and license revenue from our mobility, chip and other, medical, and automotive licensees, partially offset by decreases from our gaming licensees.

Royalty and license revenue increased by 88% for chip manufacturer and other customers primarily due to increased volume of units sold by our chip manufacturer licensees. This increase is mainly due to additional integrated circuits being sold to new customers of our licensees. Royalty and license revenue increased by 21% for mobility customers primarily due to the adoption of our technology in new products sold by certain licensees along with additional volume of units sold by certain licensees. Royalty and license revenue increased by 13% for medical customers mainly due to increased license fees along with additional royalties from increased sales of royalty generating devices by our licensees. Royalty and license revenue increased by 10% for automotive customers primarily due to increased volume of units sold by our licensees. Royalty and license revenue decreased by 15% for gaming customers mainly due to a decrease in units shipped by certain licensees. This decrease was primarily due to the current softness in the console gaming market, which can fluctuate based upon consumer gaming preferences and the timing of introductions of new gaming console systems. We typically experience seasonally higher revenue from our gaming and mobility customers due to the reporting of holiday sales in the first calendar quarter.

We expect royalty and license revenue to be the major component of our future revenue as our technology continues to be included in more products and as we continue our efforts to monetize our intellectual property, particularly in the mobility market.

*Product sales* Product sales are comprised primarily of medical products, actuators, design kits, and integrated circuits. The increase in product sales was due mainly to a \$285,000 increase in medical product sales due to an increase in sales of our Virtual IV medical simulator product partially offset by reduced sales of integrated circuits and other touch products. Although product sales have increased in this recent quarter, we expect product sales will remain at reduced levels in 2012 primarily as a result of softer demand in this market and our continued focus on our licensing business model.

## **Table of Contents**

*Development contracts and other revenue* Development contracts and other revenue is comprised primarily of consulting services and development contracts. Development contracts and other revenue decreased mainly due to a decrease in contracted engineering service revenue from mobility customers. We continue to focus our engineering resources on development efforts that leverage our existing sales and channel distribution capabilities. Accordingly, we do not expect development contract revenue to be a significant part of total revenues in the future.

We categorize our geographic revenue information into four major regions: North America, Europe, Far East, and Rest of the World. In the third quarter ended September 30, 2012, revenue generated in North America, Europe, Far East, and Rest of the World represented 38%, 11%, 51%, and 0% of total revenue, respectively, compared to 40%, 13%, 47%, and 0% of total revenue, respectively, for the third quarter ended September 30, 2011. The shift in revenues among regions was mainly due to a decrease in royalty and license revenue in North America, partially offset by an increase in product revenue in North America and a decrease in contract revenue in Europe. These decreases were offset primarily by an increase in royalty and license revenue in the Far East. The decrease in North American royalty and license revenue was primarily from decreased royalties from gaming licensees partially offset by an increase in medical royalty revenue. The increase in North American product sales was primarily due to an increase in sales of our Virtual IV medical simulator products. The decrease in European contract revenue was primarily due to reduced contracted services and the timing of revenue recognition. The increase in royalty and license revenue from the Far East was mainly due to increased royalties from mobility licensees.

### **Nine Months Ended September 30, 2012 Compared to Nine Months Ended September 30, 2011**

*Royalty and license revenue* The increase in royalty and license revenue for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011 was primarily due to increases in royalty and license revenue from our medical, automotive, mobility, and gaming licensees.

Royalty and license revenue increased by 48% for medical customers and by 14% for automotive customers primarily due to additional volume of units sold by our licensees. Royalty and license revenue increased by 2% for gaming customers primarily due to increases in royalties due to an increase in units shipped by certain licensees. The increase in shipped units primarily reflects the adoption of our technology in new applications sold by certain licensees. Royalty and license revenue also increased by 2% for mobility customers partially due to increased royalties from new customers and in part by out of period adjustments of approximately \$420,000 which resulted from our compliance program efforts, partially offset by a decrease due to a difference in the timing of revenue recognition.

*Product sales* The decrease in product sales was due mainly to a \$683,000 decrease in medical product sales due to a reduction in sales of our Virtual IV medical simulator product because of reduced demand in this market.

*Development contracts and other revenue* Development contracts and other revenue decreased mainly due to a decrease in contracted engineering service revenue from medical customers.

In the nine months ended September 30, 2012, revenue generated in North America, Europe, Far East, and Rest of the World represented 42%, 12%, 46%, and 0% of total revenue, respectively, compared to 42%, 15%, 43%, and 0% of total revenue, respectively, for the nine months ended September 30, 2011. The shift in revenues among regions was mainly due to a decrease in product sales in North America and a decrease in royalty and license revenue in Europe offset by an increase in royalty and license revenue in North America and the Far East. The decrease in product sales in North America was primarily due to a reduction in sales of our Virtual IV medical simulator products. The decrease in European royalty and license revenue was primarily due to decreased mobile device revenue arising from the timing of revenue recognition as well as a decrease in gaming royalty revenue. The increase in North American royalty and license revenue was primarily from increased royalties from gaming and medical licensees. The increase in royalty and license revenue from the Far East was mainly due to increased royalties from mobility and automotive licensees.

**Table of Contents**

COST OF REVENUES	September 30,		Change	% Change
	2012	2011		
(Dollars in thousands)				
Three months ended:				
Cost of revenues	\$ 273	\$ 192	\$ 81	42%
% of total revenues	4%	3%	1%	
Nine months ended:				
Cost of revenues	\$ 802	\$ 913	\$ (111)	(12)%
% of total revenues	3%	4%	(1)%	

*Cost of Revenues* Our cost of revenues consists primarily of direct materials, contract manufacturing, and other overhead costs for product sales, and labor related costs for development contracts and other. It excludes amortization and impairment or abandonment of intangibles. Increased product sales were the major contributor to the overall increase of cost of revenues for the third quarter ended September 30, 2012 as compared to the third quarter ended September 30, 2011. Specifically, the increase in cost of revenues for 2012 as compared to 2011 was primarily due to increased direct material costs, contract manufacturing costs, and related costs of \$60,000; increased salary, benefits, and overhead of \$39,000; partially offset by a decrease in obsolescence expense of \$19,000.

Lower product sales were the major contributor to the overall reduction of cost of revenues for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011. Specifically, the decrease in cost of revenues for 2012 as compared to 2011 was primarily due to decreased direct material costs, contract manufacturing costs, and related costs of \$223,000; partially offset by an increase in obsolescence expense of \$48,000; and an increase in salary, benefits, and overhead of \$45,000. The decrease in direct material, contract manufacturing, related costs, and freight expense of approximately 31% was mainly due to a decrease in related product sales.

**Table of Contents**

OPERATING EXPENSES	September 30, 2012	September 30, 2011	Change	% Change
	(Dollars in thousands)			
Three months ended:				
Sales and marketing	\$ 1,632	\$ 1,643	\$ (11)	(1)%
% of total revenue	23%	25%	(2)%	
Research and development	\$ 2,088	\$ 2,183	\$ (95)	(4)%
% of total revenue	29%	34%	(5)%	
General and administrative	\$ 5,750	\$ 3,195	\$ 2,555	80%
% of total revenue	81%	49%	32%	
Amortization and impairment or abandonment of intangibles	\$ 337	\$ 324	\$ 13	4%
% of total revenue	5%	5%	0%	
Nine months ended:				
Sales and marketing	\$ 5,072	\$ 5,402	\$ (330)	(6)%
% of total revenue	22%	24%	(2)%	
Research and development	\$ 6,406	\$ 6,525	\$ (119)	(2)%
% of total revenue	27%	28%	(1)%	
General and administrative	\$ 14,882	\$ 9,367	\$ 5,515	59%
% of total revenue	64%	41%	23%	
Amortization and impairment or abandonment of intangibles	\$ 1,071	\$ 1,016	\$ 55	5%
% of total revenue	5%	4%	1%	

*Sales and Marketing* Our sales and marketing expenses are comprised primarily of employee compensation and benefits, sales commissions, advertising, trade shows, market development funds, travel, and an allocation of facilities costs. The decrease in sales and marketing expense for the third quarter ended September 30, 2012 as compared to the third quarter ended September 30, 2011 was primarily due to decreased compensation, benefits, and other related costs of \$173,000, mainly due to decreased sales and marketing headcount related expenses, partially offset by increased bad debt expense of \$105,000; increased marketing, advertising, and public relations costs of \$32,000 for current marketing initiatives; and increased office expenses of \$30,000.

The decrease in sales and marketing expense for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011 was primarily due to decreased compensation, benefits, and other related costs of \$545,000 mainly due to decreased sales and marketing headcount and benefits, partially offset by increased bad debt expense of \$137,000, increased marketing, advertising, and public relations costs of \$46,000 due to current marketing initiatives, and increased travel costs of \$34,000. We expect that sales and marketing expenses will continue to be significant as we continue to invest in sales and marketing to further our focus on building greater market acceptance for our touch technologies.



**Table of Contents**

**Research and Development** Our research and development expenses are comprised primarily of employee compensation and benefits, consulting fees, tooling and supplies, and an allocation of facilities costs. The decrease in research and development expenses for the third quarter ended September 30, 2012 as compared to the third quarter ended September 30, 2011 was primarily due to decreased compensation, benefits, and other related costs of \$96,000 and decreased consulting expense of \$22,000, which were partially offset by increased lab and prototyping costs of \$29,000. The decreased compensation, benefits, and other related costs were mainly due decreased research and development headcount related expenses.

The decrease in research and development expenses for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011 was primarily due to decreased consulting expense of \$105,000; decreased lab and prototyping costs of \$48,000; decreased compensation, benefits, and other related costs of \$44,000 mainly due to decreased headcount related expense; partially offset by increased recruitment expense of \$43,000 and increased travel expense of \$15,000. We believe that continued significant investment in research and development is critical to our future success, and we expect to make increased investments in areas of research and technology development to support future growth.

**General and Administrative** Our general and administrative expenses are comprised primarily of employee compensation and benefits, legal and professional fees, office supplies, travel, and an allocation of facilities costs. The increase in general and administrative expenses for the third quarter ended September 30, 2012 as compared to the third quarter ended September 30, 2011 was primarily due to increased legal, professional, and license fee expenses of \$2.8 million, partially offset by decreased compensation, benefits, and other related costs of \$272,000. The increased legal and professional expenses were primarily due to increased litigation expenses of \$3.0 million relating to ongoing litigation, partially offset by other professional services expenses that have decreased by \$200,000. The decreased compensation, benefits, and other related costs were mainly due to reduced stock compensation costs and reduced severance costs for terminated employees.

The increase in general and administrative expenses for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011 was primarily due to increased legal, professional, and license fee expenses of \$6.5 million, partially offset by decreased compensation, benefits, and other related costs of \$949,000. The increased legal and professional expenses were primarily due to increased litigation expenses of \$6.0 million relating to ongoing litigation, increased patent related legal costs of \$354,000 and increased other professional services expenses of \$168,000. The decreased compensation, benefits, and other related costs were mainly due to reduced stock compensation costs, decreased headcount, and reduced severance costs for terminated employees. We will continue to incur costs related to litigation, which will cause our general and administrative expenses to increase as we continue to assert our intellectual property and contractual rights and defend any lawsuits brought against us.

**Amortization, impairment, and abandonment of Intangibles** Our amortization, impairment and abandonment of intangibles are comprised primarily of patent amortization and other intangible amortization along with impairment and write off of abandoned and expired patents. Amortization, impairment and abandonment of intangibles increased for the third quarter ended September 30, 2012 as compared to the third quarter ended September 30, 2011, mainly due to increased write off of abandoned and expired patents partially offset by decreased amortization relating to issued patents. Amortization, impairment and abandonment of intangibles increased for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011 mainly due to increased amortization as a result of the increased number of issued patents, and increased write off of abandoned and expired patents.

INTEREST AND OTHER INCOME	September 30,		Change	% Change
	2012	2011		
(Dollars in thousands)				
Three months ended:				
Interest and other income	\$ 66	\$ 58	\$ 8	14%
% of total revenue	1%	1%	0%	
Nine months ended:				
Interest and other income	\$ 144	\$ 172	\$ (28)	(16)%
% of total revenue	1%	1%	0%	

**Table of Contents**

**Interest and Other Income** Interest and other income consists primarily of interest income from cash and cash equivalents and short-term investments, interest on notes receivable, exchange rate gains and losses, and other income. Interest and other income increased for the third quarter ended September 30, 2012 as compared to the third quarter ended September 30, 2011, primarily as a result of exchange rate gains partially offset by decreased interest income as a result of reduced cash, cash equivalents, and short-term investments. Interest and other income decreased for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011, primarily as a result of decreased interest income due to reduced cash, cash equivalents, and short-term investments and exchange rate losses; partially offset by increased interest on notes receivable.

PROVISION FOR TAXES	September 30,		Change	% Change
	2012	2011		
(Dollars in thousands)				
Three months ended:				
Provision for income taxes	\$ (118)	\$ (428)	\$ 310	72%
Income from continuing operations before income taxes	\$ (2,872)	\$ (984)		
Effective tax rate	(4.1)%	(43.5)%		
Nine months ended:				
Provision for income taxes	\$ (737)	\$ (1,289)	\$ 552	43%
Income from continuing operations before income taxes	\$ (4,780)	\$ (106)		
Effective tax rate	(15.4)%	(1216.0)%		

**Provision for Income Taxes** The income tax provision decreased for the third quarter and the nine months ended September 30, 2012 compared to the third quarter and nine months ended September 30, 2011 primarily due to decreased foreign withholding tax expense.

DISCONTINUED OPERATIONS	September 30, 2012	2011	Change	% Change
	(Dollars in thousands)			
Three months ended:				
Gain on sales from discontinued operations (net of provision for income taxes)	\$ 0	\$ 0	\$ 0	N/A
% of total revenue	0%	0%		
Nine months ended:				
Gain on sales from discontinued operations (net of provision for income taxes)	\$ 153	\$ 61	\$ 92	151%
% of total revenue	1%	0%		

## **Table of Contents**

*Discontinued Operations* Gain on sales of discontinued operations net of taxes is primarily comprised of additional payments received from the sale in 2009 of our 3D family of products. There were no gains on sales of discontinued operations net of taxes for the third quarter ended September 30, 2012 or the third quarter ended September 30, 2011. The increase in the gain on sales of discontinued operations net of taxes for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011 is primarily due to increased payments received from the sale of our 3D family of products.

## **LIQUIDITY AND CAPITAL RESOURCES**

Our cash, cash equivalents, and short-term investments consist primarily of money market funds and treasury bills 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 loss, within stockholders' equity.

On September 30, 2012, our cash, cash equivalents, and short-term investments totaled \$47.9 million, a decrease of \$8.4 million from \$56.3 million on December 31, 2011.

### *Cash used in (provided by) operating activities*

Net cash used in operating activities during the nine months ended September 30, 2012 was \$1.3 million, a decrease of \$3.5 million from the \$2.2 million provided by operating activities during the nine months ended September 30, 2011. Cash used in operating activities during 2012 was primarily the result of our net loss of \$5.4 million, a decrease of \$1.7 million due to a change in deferred revenue and customer advances primarily due to recognition of deferred revenue, and a decrease of \$294,000 due to a change in prepaid expenses and other current assets. These decreases were partially offset by an increase of \$1.2 million due to a change in accounts payable mainly from increased litigation activity, an increase of \$622,000 due to a change in accrued compensation and other current liabilities mainly from increased litigation activity, and an increase of \$339,000 primarily due to a change in other long-term liabilities due to an increase in deferred rent. Cash used in operating activities during 2012 was also affected by noncash charges of \$3.9 million, including \$2.3 million of noncash stock-based compensation, \$1.1 million in amortization, impairment, and abandonment of intangibles, \$490,000 in depreciation and amortization, \$113,000 for an increase in the allowance for doubtful accounts, partially offset by a credit of \$153,000 from a gain on sale of discontinued operations.

### *Cash provided by (used in) investing activities*

Net cash provided by investing activities during the nine months ended September 30, 2012 was \$12.0 million, compared to the \$2.3 million used in investing activities during the nine months ended September 30, 2011, an increased source of cash of \$14.3 million. Net cash provided by investing activities during 2012 consisted of maturities of short-term investments of \$45.0 million and proceeds from sales of discontinued operations of \$250,000. This was partially offset by purchases of short-term investments of \$30.0 million; additions to intangibles of \$2.3 million primarily due to capitalization of external patent filings and application costs; and purchases of property, plant, and equipment of \$931,000.

### *Cash used in (provided by) financing activities*

Net cash used in financing activities during the nine months ended September 30, 2012 was \$4.2 million compared to the \$2.4 million provided during the nine months ended September 30, 2011, an increased use of cash of \$6.6 million. Net cash used in financing activities during 2012 consisted primarily of repurchases of common stock of \$5.2 million, partially offset by exercises of stock options and the issuance of common stock under the employee stock purchase plan of \$1.1 million.

We believe that our cash, cash equivalents, and short-term investments will be sufficient to meet our working capital needs for at least the next twelve months. We will continue to protect and defend our extensive intellectual property portfolio, which is expected to result in the increased use of cash. Our Board has approved repurchases of our shares of common stock under the previously authorized Stock Repurchase Program which has approximately \$19.9 million remaining. We anticipate that capital expenditures for property and equipment for the year ending December 31, 2012 will be less than \$1.5 million. We anticipate that capitalization of external patent filing and application costs for the year ending December 31, 2012 will be less than \$3.5 million. Cash flows

## **Table of Contents**

from our discontinued operations have been included in our consolidated statement of cash flows with continuing operations within each cash flow category. The absence of cash flows from discontinued operations is not expected to affect our future liquidity or capital resources. Additionally, if we acquire businesses, patents, or products, our cash or capital requirements could increase substantially. In the event of such an acquisition, or should any unanticipated circumstances arise that significantly increase our capital requirements, we may elect to raise additional capital through debt or equity financing. Any of these events could result in substantial dilution to our stockholders. There is no assurance that such additional capital will be available on terms acceptable to us, if at all.

### **SUMMARY DISCLOSURES ABOUT CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS**

We presented our contractual obligations in our Annual Report on Form 10-K for the year ended December 31, 2011. Our principal commitments as of September 30, 2012 consist of obligations under operating leases and non-cancellable unconditional purchase obligations. There have been no significant changes in those obligations during the nine months ended September 30, 2012.

As of September 30, 2012, we had a liability for unrecognized tax benefits totaling \$681,000, including interest of \$53,000, of which approximately \$253,000 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.

### **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 \$43.6 million as of September 30, 2012, which are subject to interest rate fluctuations. An increase in interest rates could adversely affect the market value of our cash equivalents and short-term investments. A hypothetical 100 basis point increase in interest rates would result in a decrease of approximately \$133,000 in the fair value of our cash equivalents and short-term investments as of September 30, 2012.

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

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

**Table of Contents**

**ITEM 4. CONTROLS AND PROCEDURES**

**EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

Based on their evaluation as of September 30, 2012, our management with the participation of our Chief Executive Officer and Chief Financial Officer, have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective to ensure that the information required to be disclosed by us in this quarterly report on Form 10-Q was (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

There were no changes to internal controls over financial reporting that occurred during the quarter ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

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

**Table of Contents**

**PART II**

**OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

*In re Immersion Corporation Securities Litigation*

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

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

On December 21, 2009, these class actions were consolidated by the court as *In Re Immersion Corporation Securities Litigation*. On the same day, the court appointed a lead plaintiff and lead plaintiff's counsel. Following our restatement of financial statements, lead plaintiff filed a consolidated complaint on April 9, 2010. Defendants moved to dismiss the action on June 15, 2010 and that motion was granted with leave to amend on March 11, 2011. Lead plaintiff filed an amended complaint on April 29, 2011. Defendants moved to dismiss the amended complaint on July 1, 2011. On December 16, 2011, the motion to dismiss was granted with prejudice and on December 19, 2011, judgment was entered in favor of defendants. On January 13, 2012, the plaintiffs filed a notice of appeal to the Ninth Circuit Court of Appeals. In May 2012, plaintiff filed his opening appeals brief. On July 13, 2012, we filed our response brief. On September 4, 2012, plaintiff filed his reply.

*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. On May 3, 2010, the court issued an order staying the action, and that stay was lifted following dismissal of the securities class action in December 2011. On October 31, 2012, plaintiffs filed a statement with the Court indicating that in light of the settlement of the *Kasmer v. Richardson* action (referenced below), they intend to voluntarily dismiss their action with prejudice once the time to appeal the *Kasmer* settlement approval order has expired.

*Kasmer v. Immersion Corporation*

On May 5, 2010, an action was filed in Delaware Chancery Court by a shareholder seeking to enforce a demand to inspect certain of our records pursuant to Section 220 of the Delaware General Corporation Law, as a possible prelude to the shareholder bringing a derivative action. We filed our answer on June 14, 2010, questioning whether a proper purpose for the records inspection had been stated and raising other defenses concerning the scope of the demand, among other deficiencies. Following a one-day trial on December 2, 2010, the Court significantly narrowed the scope of the demand and we responded accordingly. On October 24, 2011, the shareholder filed a motion seeking to compel further responses to the demand. We believe that our responses complied with the Court's ruling and have opposed the shareholder's motion. On May 30, 2012, the same shareholder filed a putative shareholder derivative action in San Francisco Superior Court, entitled *Kasmer v. Richardson et. al.* purportedly on behalf of us and naming certain of our former directors and officers as individual defendants. The Complaint in that action has yet to be served on either us or any of the individual defendants. On June 5, 2012, the parties participated in a mediation session, and on the same day reached an agreement in principle to settle both the Delaware Chancery and *Kasmer v. Richardson* actions. The Delaware Chancery action was dismissed with prejudice by stipulation of the parties on October 22, 2012. The settlement of the *Kasmer v. Richardson* action was approved by the San Francisco Superior Court on October 26, 2012. The settlement will become final when the deadline to appeal the settlement

## Edgar Filing: IMMERSION CORP - Form 10-Q

approval order has expired, and once the *In re Immersion Corporation Derivative Litigation* action in the Northern District of California (referenced above) is dismissed with prejudice.

*Immersion Corporation vs. Motorola Mobility, Inc., Motorola Mobility Holdings, Inc., HTC Corporation, HTC America Holding, Inc., HTC America, Inc., HTC (B.V.I.) Corporation, Exedeia, Inc., Brightstar Corporation, and Brightpoint, Inc.*

On February 7, 2012, we filed a complaint against Motorola with the U.S. International Trade Commission (the ITC ) alleging that certain Motorola mobile electronic devices, including smartphones and cellular phones, infringe six of our patents that cover various uses of haptic effects in connection with touchscreens (the ITC Complaint ). The ITC Complaint requests that the ITC institute an immediate investigation into Motorola's unlicensed importation, sale for importation and/or sale after importation of mobile electronic devices, including smartphones and cellular phones, using haptic effects covered by our patents. The ITC Complaint further requests an exclusion order barring the importation, sale for importation and sale after importation of products that infringe our patents and cease and desist orders directing Motorola to cease importing, marketing, advertising, demonstrating, warehousing, distributing, selling, offering to sell and/or using mobile electronic devices incorporating haptic effects that infringe one or more of our patents. We amended the ITC Complaint on March 2, 2012 to add the following parties: HTC Corporation, HTC America Holding, Inc., HTC America, Inc., HTC (B.V.I.) Corporation, Exedeia,

---

## **Table of Contents**

Inc., Brightstar Corporation and Brightpoint, Inc. We subsequently withdrew HTC America Holding, Inc., HTC (B.V.I.) Corporation, Exede, Brightstar, and Brightpoint from the ITC Complaint. The ITC instituted an investigation against Motorola Mobility, Inc., Motorola Mobility Holdings, Inc., HTC Corporation, and HTC America, Inc. on April 2, 2012.

On February 7, 2012, we filed a complaint against Motorola in the U.S. District Court for the District of Delaware (the Motorola Delaware Complaint ) alleging that certain of Motorola's mobile electronic devices, including smartphones and cellular phones, infringe six of our patents that cover various uses of haptic effects. The Motorola Delaware Complaint covers the same patents as the ITC Complaint. The Motorola Delaware Complaint seeks damages and injunctive relief. The parties have stipulated to stay the case pending the completion of the ITC investigation.

On March 2, 2012, we filed a complaint against HTC Corporation, HTC America Holding, Inc., HTC America, Inc., HTC (B.V.I.) Corporation, Exede, Inc., Brightstar Corporation and Brightpoint, Inc. (collectively, HTC ) in the U.S. District Court for the District of Delaware (the HTC Delaware Complaint ) alleging that certain of HTC's mobile electronic devices, including smartphones and cellular phones, infringe six of our patents that cover various uses of haptic effects. The HTC Delaware Complaint covers the same patents as the ITC Complaint. The HTC Delaware Complaint seeks damages and injunctive relief. The parties have stipulated to stay the case pending the completion of the ITC investigation.

The ITC Complaint, Motorola Delaware Complaint and HTC Delaware Complaint assert infringement of the following patents:

U.S. Patent No 6,429,846: Haptic Feedback for Touchpads and Other Touch Controls

U.S. Patent No 7,592,999: Haptic Feedback for Touchpads and Other Touch Controls

U.S. Patent No 7,969,288: Force Feedback System Including Multi-Tasking Graphical Host Environment and Interface Device

U.S. Patent No 7,982,720: Haptic Feedback for Touchpads and Other Touch Controls

U.S. Patent No 8,031,181: Haptic Feedback for Touchpads and Other Touch Controls

U.S. Patent No 8,059,105: Haptic Feedback for Touchpads and Other Touch Controls

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**

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

### **Company Risks**

***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 and could decline.***

Our revenue growth is largely 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



## **Table of Contents**

face numerous risks in obtaining new or renewed 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 from 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 in 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 as we obtain new patents and develop new products versus continuing to develop their own intellectual property or license intellectual property from other parties;

challenges in demonstrating the compelling value of our technologies and challenges associated with customers' ability to easily implement our technologies;

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

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

inability to sign new gaming licenses if the video console makers choose not to license third parties to make peripherals for their new consoles or if video console makers no longer require peripherals to play video games;

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

inability of current or prospective licensees to ship certain mobile devices if they are involved in intellectual property infringement claims by third parties that ultimately prevent them from shipping products or that impose substantial royalties on their products.

***Our licensing cycle can be lengthy and costly and our marketing and licensing efforts may be unsuccessful.***

The process of persuading customers to adopt and license our technologies can be lengthy and, even if successful, there can be no assurance that our technologies will be used in a product that is ultimately brought to market, achieves commercial acceptance, or results in significant royalties or other payments to us. We generally incur significant marketing and sales expenses prior to entering into our license agreements. The length of time it takes to establish a new licensing relationship can take many months or even years. In addition, any intellectual property litigation that we engage in will likely have an impact on our ability to enter into new licenses and renewals of licenses. As such, we may incur costs in any particular period before any associated revenue stream begins, if at all. If our marketing and sales efforts are very lengthy or unsuccessful, then we may face a material adverse effect on our business and results of operations as a result of delay or failure to obtain royalties or other payments.



## **Table of Contents**

***Future revenue is difficult to predict for several reasons, and our failure to predict revenue accurately may cause our results to be below our expectations or those of analysts and result in our stock price declining.***

Our lengthy and costly license negotiation cycle and any intellectual property litigation that we may engage in make our future revenue difficult to predict because we may not be successful in entering into licenses with our customers on our estimated timelines and we may be reliant on litigation timelines which are difficult to control for any results or settlements.

While some of our license agreements provide for fixed royalty payments, many of our license agreements provide for per-unit royalties, and may also be subject to adjustments based on volume. The sales volume and prices of our licensees' products in any given period can be difficult to predict. As a result, our actual results may differ substantially from analyst estimates or our forecasts in any given period.

In addition, a portion of our revenue comes from development and support services provided to our licensees, or may be part of a contractual arrangement involving multiple elements. Depending upon the nature of the services or elements, all or a portion of the revenue may be recognized ratably over the support period or length of the contract, or may be recognized according to the proportional performance accounting method under GAAP. Contract revenue accounting may result in deferral of the service fees to the completion of the contract, or may cause it to be recognized over the period in which services are performed on a proportional performance basis and product development schedules for these projects may be changed or delayed.

All of these factors make it difficult to predict future licensing revenue and may result in our results being below our previously announced guidance or analysts' estimates, which would likely cause our stock price to decline.

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

Four customers accounted for approximately 53% of our total revenues for the nine months ended September 30, 2012. Three customers accounted for approximately 44% of our total revenues for nine months ended September 30, 2011. 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 fail to renew or lose a major customer or group of customers, our revenue could decline if we are unable to replace the lost revenue with revenue from other sources.

***Litigation regarding intellectual property rights is expensive; could be disruptive, time consuming and 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. On February 7, 2012, we filed a complaint against Motorola Mobility, Inc. and Motorola Mobility Holdings, Inc. (together, "Motorola") with the U.S. International Trade Commission ("ITC") and in a patent infringement complaint in the U.S. District Court for the District of Delaware which alleges that certain Motorola Android-based smartphones infringe six Immersion patents. On March 2, 2012, we added HTC Corporation, HTC America Holding, Inc., HTC America, Inc., HTC (B.V.I.) Corporation, Exedeia, Inc., Brightstar Corporation and Brightpoint, Inc. to the complaint in the ITC and filed a separate patent infringement complaint against HTC in the U.S. District Court for the District of Delaware. We subsequently withdrew HTC America Holding, Inc., HTC (B.V.I.) Corporation, Exedeia, Brightstar, and Brightpoint from the complaint in the ITC. The ITC instituted an investigation against Motorola, HTC Corporation, and HTC America, Inc. on April 2, 2012. We intend to enforce our intellectual property rights vigorously and may initiate further litigation against parties that we

## **Table of Contents**

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 is costly and could be time-consuming, 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. The time to resolution and complexity of our litigation, its relative importance to our business compared to other companies, and the potential that we may lose particular motions as well as the overall litigation all could cause our stock price to decline and materially adversely affect our business.

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 were not 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 make 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 or settlement amounts, 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. For example, the recently enacted Leahy-Smith America Invents Act makes significant changes to the U.S. patent laws, including, among other things, changing from a first inventor to file system, limiting where a patentee may file a patent suit, requiring the apportionment of patent damages, replacing interference proceedings with derivation actions and creating a post-grant opposition process to challenge patents after they have been issued. The effects of these changes on our patent portfolio and business have yet to be determined, as the Patent and Trademark Office must still implement regulations relating to these changes and the courts have yet to address the new provisions. 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.

## **Table of Contents**

***We had an accumulated deficit of \$112 million as of September 30, 2012, have a history of losses, and may not achieve or maintain profitability in the future.***

Since 1997, we have incurred losses in all but six quarters. As of September 30, 2012, we had an accumulated deficit of \$112 million. We need to generate significant ongoing revenue to achieve and maintain consistent profitability. We anticipate that we will continue to incur expenses as we:

continue to develop our technologies;

increase our sales and marketing efforts;

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

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, quality control, 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 nine months ended September 30, 2012 and 2011, 92% and 90%, respectively, of our total revenues were royalty and license revenues. We do not control or influence the design, manufacture, quality control, promotion, distribution, or pricing of products that are manufactured and sold by our licensees, nor can we control consolidation within an industry which could either reduce the number of licensing products available or reduce royalty rates for the combined licensees. In addition, we generally do not have commitments from our licensees that they will continue to use our technologies in current or future products. As a result, products incorporating our technologies may not be brought to market, achieve commercial acceptance, or otherwise generate meaningful royalty revenue for us. For us to generate royalty revenue, licensees that pay us per-unit royalties must manufacture and distribute products incorporating our touch-enabling technologies in a timely fashion and generate consumer demand through marketing and other promotional activities. If our licensees' products fail to achieve commercial success or if products are recalled because of quality control problems or if our licensees do not ship products incorporating our touch-enabling technologies in a timely fashion or fail to achieve strong sales, our revenues will not grow and could decline.

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



---

## **Table of Contents**

We deploy our limited engineering, customer service, technical support, quality assurance, and operations resources on a variety of different projects and programs intended to provide sufficient levels of quality necessary for channels and customers. Our success in various markets may depend on timely deliveries and overall levels of sustained quality and customer service. Our failure to provide favorable product and program deliverables and quality and customer service levels, or provide them at all, may disrupt channels and customers, harm our brand, and reduce our revenues.

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

The current economic conditions could materially hurt our business in a number of ways including longer sales and renewal cycles, delays in adoption of our products or technologies, increased risk of competition, higher overhead costs as a percentage of revenue, delays in signing or failing to sign customer agreements, or signing customer agreements with reduced royalty rates. In addition, our customers, 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.

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

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

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

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

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

Under the terms of our present agreement with Microsoft, Microsoft receives a royalty-free, perpetual, irrevocable license to our worldwide portfolio of patents. This license permits Microsoft to make, use, and sell hardware, software, and services, excluding specified products, covered by our patents. We will not receive any further revenues or royalties from Microsoft under our current agreement with Microsoft. Microsoft has a significant share of the market for touch-enabled console gaming computer peripherals and is pursuing other consumer markets such as mobile phones, tablets, 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 may decline.

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

The market for certain of our touch-enabling technologies and certain of our licensees' touch-enabled products is at an early stage. If we and our licensees are unable to develop demand for our touch-enabling

---

## **Table of Contents**

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 and content producers to create products that utilize our technologies. Negative product reviews or publicity about our company, our technologies, 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.

### ***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 systems 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.

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

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

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

effective patent protection may not be available in every country, particularly in Asia, in which we or our licensees do business. We also rely on licenses, confidentiality agreements, other contractual agreements, and copyright, trademark, and trade secret laws to establish and protect our proprietary rights. It is possible that:

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

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





---

**Table of Contents**

***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 to our technology and under our 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. Many of our customers report royalties to us based on their shipments or their revenues and their interpretation and allocation of contracted royalty rates. It is possible that the originally reported royalties could differ materially from those determined by either a customer self-reported correction or from an audit we have performed. These interpretations may also cause disagreements arising during customer audits, may lead to claims or litigation of those claims, and may have an adverse affect on the results of our operations. Further, although our agreements generally give us the right to audit books and records of our licensees, audits can be expensive, time consuming, and may not be cost justified based on our understanding of our licensees' businesses. Pursuant to our license compliance program, we audit certain licensees to review the accuracy of the information contained in their royalty reports in an effort to decrease the likelihood that we will not receive the royalty revenues to which we are entitled under the terms of our license agreements, but we cannot give assurances that such audits will be effective to that end.

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, such as our Integrator product, 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 technologies may become obsolete in the future. Our ability to generate revenues will be harmed if:

we fail to develop new technologies or products;

## **Table of Contents**

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 technologies become obsolete or fail to meet new regulatory requirements.

Our ability to achieve revenue growth also depends on our continuing ability to improve and reduce the cost of our technologies, to improve their ease of integration in both hardware and software, and to introduce these technologies to the marketplace in a timely manner. If our development efforts are not successful or are significantly delayed, companies may not incorporate our technologies into their products and our revenues may not grow and could decline.

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

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

### ***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 in the past and may do so 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 or other limitation 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 technologies and products and our licensees products downward. These price reductions, if not offset by increases in

## **Table of Contents**

unit sales, technology and product enhancements, or productivity, will cause our revenues to decline. If we fail to compete effectively, our business will be harmed. 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 technologies and products 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. We could also face competition from smaller start-up companies or new market entrants.

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 are able to develop our own intellectual property rights or 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 products. 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 have 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 change, 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 products it could materially adversely affect our business, financial condition, and results of operations.

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

## **Table of Contents**

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

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

We currently have sales personnel in Finland, Japan, Korea, Switzerland, and Taiwan and we intend to expand our international activities into China and Europe. 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, duties, tariffs, quotas and other barriers;

difficulties staffing and managing foreign operations;

difficulties and expense in enforcing intellectual property rights;

business risks, including fluctuations in demand for our technologies and products and the cost and effort to conduct international operations and travel abroad to promote international distribution and overall global economic conditions;

multiple conflicting tax laws and regulations;

political and economic instability; and

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

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

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

## **Table of Contents**

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

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

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

We are currently a party to various legal proceedings. Due to the inherent uncertainties of litigation, we cannot accurately predict how these cases will ultimately be resolved. We anticipate that currently pending litigation will continue to be costly and that future litigation or investigations will result in additional legal expenses, and there can be no assurance that we will be successful or be able to recover the costs we incur in connection with litigation or investigations. We expense litigation and investigatory costs as incurred, and only accrue for costs that have been incurred but not paid to the vendor as of the financial statement date. Litigation and investigations have diverted, and could continue to divert, the efforts and attention of some of our key management and personnel. As a result, until such time as it is resolved or concluded, litigation and investigations could adversely affect our business. Further, any unfavorable outcome could adversely affect our business. For additional background on this and our other litigation, please see Note 13 to the condensed consolidated financial statements and Part II, Item 1 Legal Proceedings .

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

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

---

**Table of Contents**

***Our technologies are complex and may contain undetected errors, which could harm our reputation and future sales.***

Any failure to provide high quality and reliable technologies, whether caused by our own failure or failures of our suppliers or OEM customers, could damage our reputation and reduce demand for our technologies. Our technologies have in the past contained, and may in the future contain, undetected errors or defects. Some errors in our technologies may only be discovered after a customer's product incorporating our technologies has been shipped to customers. Any errors or defects discovered in our technologies 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.

***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, with appropriate levels of quality, 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. Component suppliers to customers could also be affected by natural disasters and other similar events.

***Catastrophic events, such as natural disasters, war, and acts of terrorism could disrupt the business of our customers, which could harm our business and results of operations.***

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

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

Our facilities could be subject to a catastrophic loss such as fire, flood, earthquake, power outage, or terrorist activity. A substantial portion of our research and development activities, operations, our corporate headquarters, and other critical business operations are located near major earthquake faults in San Jose, California, an area with a history of seismic events. An earthquake at or near our facilities could disrupt our operations and result in large expenses to repair and replace the facility. While we believe that we maintain insurance sufficient to cover most long-term potential losses at our facilities, our existing insurance may not be adequate for all possible losses.

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

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

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



---

## **Table of Contents**

We have in the past had material weaknesses in our internal control over financial reporting. Ensuring that we have adequate internal financial and accounting controls and procedures in place to produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. Any failure on our part to remedy identified material weaknesses, or any additional delays or errors in our financial reporting, could cause our financial reporting to be unreliable and could have a material adverse effect on our business, results of operations, or financial condition and could have a substantial adverse impact on the trading price of our common stock.

We do not expect that our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within our company will have been detected.

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

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

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

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

## **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.

## **Table of Contents**

These factors include:

the establishment or loss of licensing relationships;

the timing and recognition of payments under fixed and/or up-front license agreements;

seasonality in the demand for our technologies or products or our licensees' products;

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

development in any pending litigation;

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

the timing of work performed under development agreements; and

corrections and true-ups to royalty payments and royalty rates from prior periods.

***Changes in financial accounting standards or practices may cause adverse, unexpected financial reporting fluctuations and affect our reported results of operations.***

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

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

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

***Our stock price may fluctuate regardless of our performance.***

The stock market has experienced extreme volatility that often has been unrelated or disproportionate to the performance of particular companies. These market fluctuations may cause our stock price to decline regardless of our performance. The market price of our common stock has been, and in the future could be, significantly affected by factors such as: actual or anticipated fluctuations in operating results; announcements of technical innovations; announcements regarding litigation in which we are involved; changes by game console manufacturers to not include touch-enabling capabilities in their products; new products or new contracts; sales or the perception in the market of possible sales of large number of shares of our common stock by insiders or others; stock repurchase activity; changes in securities analysts' recommendations; personnel changes; 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.

## **Table of Contents**

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

Any repurchases pursuant to our stock repurchase program could affect our stock price and add volatility. There can be no assurance that any repurchases will actually be made under the program, nor is there any assurance that a sufficient number of shares of our common stock will be repurchased to satisfy the market's expectations. Furthermore, there can be no assurance that any repurchases conducted under the plan will be made at the best possible price. The existence of a stock repurchase program could also cause our stock price to be higher than it would be in the absence of such a program and could potentially reduce the market liquidity for our stock. Additionally, we are permitted to and could discontinue our stock repurchase program at any time and any such discontinuation could cause the market price of our stock to decline.

### ***Provisions in our charter documents and Delaware law could prevent or delay a change in control, which could reduce the market price of our common stock.***

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

our board of directors is classified into three classes of directors with staggered three-year terms;

only our chairperson of the board of directors, a majority of our board of directors or 10% or greater stockholders are authorized to call a special meeting of stockholders;

our stockholders can only take action at a meeting of stockholders and not by written consent;

vacancies on our board of directors can be filled only by our board of directors and not by our stockholders;

our restated certificate of incorporation authorizes undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval; and

advance notice procedures apply for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders.

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

### ***We may engage in acquisitions that could dilute stockholders' interests, divert management attention, or cause integration problems.***

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

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

unanticipated costs associated with the acquisitions;



## Table of Contents

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 or technologies; 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 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, and/or customer satisfaction, which could harm our business.

## **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Below is a summary of stock repurchases for the quarter ended September 30, 2012. See Note 9 of our condensed consolidated financial statements for information regarding our stock repurchase program.

Program/Period (1)	Shares Repurchased (2)	Average Price Per Share	Approximate Dollar Value that May Yet Be Purchased Under the Program
Beginning approximate dollar value available to be repurchased as of June 30, 2012			\$ 23,113,000
July 1 – July 31, 2012	164,026	\$ 5.51	
August 1 – August 31, 2012	204,520	5.50	
September 1 – September 30, 2012	212,654	5.51	
Total shares repurchased	581,200		3,200,000
Ending approximate dollar value that may be repurchased under the Program as of September 30, 2012			\$ 19,913,000

## Edgar Filing: IMMERSION CORP - Form 10-Q

- (1) On November 1, 2007, our Board of Directors authorized a share repurchase program of up to \$50,000,000. This share repurchase authorization has no expiration date and does not require us to repurchase a specific number of shares. The timing and amount of any share repurchase will depend on the share price, corporate and regulatory requirements, economic and market conditions, and other factors. The repurchase authorization may be modified, suspended, or discontinued at any time.

**Table of Contents**

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

**ITEM 6. EXHIBITS**

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



**Table of Contents**

**SIGNATURES**

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

Date: November 7, 2012

IMMERSION CORPORATION

By    /s/ Paul Norris  
      Paul Norris  
      *Chief Financial Officer, and Principal Accounting  
      Officer*

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
31.1	Certification of Victor Viegas, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Paul Norris, 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 Paul Norris, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.1**	Interactive data files formatted in XBRL pursuant to Rule 405 of Regulation S-T.

\*\* XBRL (Extensible Business Reporting Language) information is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under those sections.