IMMERSION CORP
Form 10-K/A
February 08, 2010

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

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

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2008

or

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

Commission File Number 000-27969

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

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

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

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

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

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

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

None

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

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

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

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

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

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

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

The aggregate market value of the registrant s common stock held by non-affiliates of the registrant on June 30, 2008, the last business day of the registrant s most recently completed second fiscal quarter, was $350,475,801 (based on the closing sales price of the registrant s common stock on that date). Shares of the registrant s common stock held by each officer and director and each person whom owns 5% or more of the outstanding common stock of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. Number of shares of common stock outstanding at February 23, 2009: 27,945,484.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2009 Annual Meeting are incorporated by reference into Part III hereof.

IMMERSION CORPORATION

2008 FORM 10-K/A ANNUAL REPORT

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Forward-looking Statements

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

EXPLANATORY NOTE

Immersion Corporation is filing this Amendment No. 1 on Form 10-K/A (the Amendment) to its Annual Report on Form 10-K for the year ended December 31, 2008, originally filed March 9, 2009 (the Original Filing) to amend and restate the following previously-filed consolidated financial statements and selected financial data (and related disclosures) (the Restatement): (1) our consolidated balance sheets as of December 31, 2008 and 2007 and the related consolidated statements of operations, stockholders equity, and cash flows for each of fiscal years ended December 31, 2008, 2007 and 2006 contained in Part II, Item 8 of this Amendment; (2) the selected financial data as of and for our fiscal years ended in December 31, 2008, 2007, and 2006 contained in Part II, Item 6 of this Amendment; (3) management s discussion and analysis of our financial condition and results of operations as of and for our fiscal years ended December 31, 2008, 2007, and 2006 contained in Part II, Item 7 of this Amendment; and (4) the unaudited quarterly financial information for each quarter in our fiscal years ended December 31, 2008 and 2007 in Note 19, Quarterly Results of Operations (Unaudited) (Restated) of the Notes to Consolidated Financial Statements in Part II, Item 8 of this Amendment. The Restatement results from our management s determination subsequent to the issuance of our financial statements for the year ended December 31, 2008 that there were errors in 1) the recording of revenue transactions from our Medical line of business in the years ended December 31, 2008, 2007, and 2006; 2) the recording of stock-based compensation expense for the years ended December 31, 2008 and 2007; 3) the recording of interest income arising from future installments due from Sony Computer Entertainment determined under the interest method for the years ended December 31, 2008 and 2007; and (4) the recording of amortization and impairment of patents in the years ended December 31, 2008, 2007, and 2006 and therefore our consolidated financial statements required restatement. In addition, as part of the Restatement, we have corrected other errors that were not significant individually or in the aggregate. Refer to Notes 2 and 19 to the consolidated financial statements included in Item 8 for further discussion of the Restatement.

Financial information related to the years ended December 31, 2008 and 2007, and the interim periods therein included in the reports on Form 10-K, Form 10-Q and Form 8-K previously filed by us and all related earnings press releases and similar communications issued by us during these periods, should not be relied upon and in the event there are discrepancies between this Amendment and previous reports, press releases and similar communications, the information in this Amendment shall control.

As announced on July 1, 2009, the Audit Committee of our Board of Directors, assisted by legal counsel and independent forensic accountants, commenced, and has now completed, an independent investigation into certain previous revenue transactions in our Medical line of business to determine whether revenue recognition was proper, and whether our internal controls relating to revenue recognition are sufficient. On August 10, 2009, we announced that the Audit Committee determined that we would restate our financial statements for the fiscal year ended December 31, 2008, and the interim periods therein, and for the first quarter of fiscal 2009, ended March 31, 2009, as a result of errors in those financial statements.

Subsequently, on November 17, 2009, we announced that we would restate our financial statements for the fiscal year ended December 31, 2007, as a result of an error in our accounting for stock-based compensation expense which was identified after we upgraded to a new version of the equity program administration software that we license from a third-party provider as well as an error in the way interest income was being recognized for installment payments receivable under a license with Sony Computer Entertainment that was granted at the conclusion of the patent infringement litigation with Sony.

During the course of the investigation and preparation of the restatement, we also identified additional transactions in the fiscal years ended December 31, 2007 and 2006 for which revenue should have been reversed and recognized in future periods as a result of premature recognition of revenue for products sold with FOB Destination or other similar shipping terms. In addition, we also identified certain errors in the amortization and impairment of patents for the years ended December 31, 2008, 2007, 2006 and prior years and have corrected these amounts in this Amendment as well as restated the opening balance of retained earnings as of January 1, 2006.

Background of the Restatement

Revenue Recognition in Medical Line of Business

In June 2009, management notified the Audit Committee that it had become aware of an apparent side agreement that contained modifications to our standard terms of contract. Specifically, a vice president of international sales for the Medical line of business may have committed us to provide a customer with certain exclusivity rights that neither the employee nor we had the power to grant as well as extended payment terms for certain transactions. In response, the Audit Committee, with the assistance of outside legal counsel and a forensic accounting firm, initiated an internal investigation to review all of the transactions with this customer to evaluate whether revenue was recognized appropriately. During the course of the investigation and after reviewing the electronic and hard copy files of the same vice president of international sales for the Medical line of business, certain transactions with other customers were identified for further investigation.

While the investigation was ongoing, management notified the Audit Committee that it had learned that certain sales personnel in our Medical line of business had made commitments to customers in connection with a sale for a product that was not available at the time revenue was originally recognized and promised products that lacked sufficient functionality to permit recognition of revenue at the time revenue was originally recognized. In response, the Audit Committee expanded the scope of the investigation to include these transactions as well as other transactions in which the same products were promised or otherwise ultimately delivered.

The investigation included review of revenue recorded in the Medical line of business in fiscal 2008 and the first quarter of fiscal 2009. During the course of the investigation, the investigation team under the supervision of the Audit Committee collected and reviewed more than 15,000 pages of hard copy documents from individual custodians, department files and central files, and also collected and searched more than 1.2 million electronically stored files. The investigation team under the supervision of the Audit Committee conducted interviews of 17 current and former employees and third-party providers. The information obtained through this investigation was analyzed in conjunction with accounting records. From this and other information, certain transactions were identified and tested for compliance with our revenue recognition policies. Testing procedures included review of customer contracts, customer correspondence and emails, sales quotes, customer purchase orders, shipping documentation, invoices, and cash receipts.

On August 10, 2009, we concluded that as a result of the errors indentified in the investigation, we would restate our financial statements for fiscal year 2008, and the interim periods therein and the first quarter of 2009, and that our previously filed financial statements for these periods should not be relied on. Also on August 10, 2009, we filed a

Current Report on Form 8-K with the SEC disclosing the restatement and the non-reliance on our previously published financial information for fiscal year 2008 and the interim periods therein, and the first quarter of 2009.

Restatement of Stock-Based Compensation Expense

In September 2009, we upgraded to a new version of the software that automates the administration of our employee equity programs and calculates our stock-based compensation expense. Following the upgrade, we identified differences in the stock-based compensation expense of prior periods and, after reviewing such differences, identified an error in our accounting for stock-based compensation expense. Specifically, the prior version of the software incorrectly calculated stock-based compensation expense by continuing to apply a weighted average forfeiture rate to the vested portion of stock option awards until the grant s final vest date, rather than reflecting actual forfeitures as awards vested, resulting in an understatement of stock-based compensation expense in certain periods prior to the grant s final vest date. The accounting error relates to the timing of the recognition of stock-based compensation, but does not change the aggregate amount of stock-based compensation expense to be recognized.

Accounting for Interest Income

In October 2009, we reviewed the accounting of the interest income recognition for a license agreement entered into in March 2007 between us and Sony Computer Entertainment as part of the conclusion of the patent infringement action that we had asserted against Sony. Under the license agreement, we granted Sony Computer Entertainment and certain of its affiliates a worldwide, non-transferable, non-exclusive license under our patents that have issued, may issue, or claim a priority date before March 2017 for the going forward use, development, manufacture, sale, lease, importation, and distribution of Sony s current and past PlayStation and related products in exchange for certain covenants not to sue and the payment of twelve quarterly installments of $1.875 million (for a total of $22.5 million) beginning on March 31, 2007 and ending on December 31, 2009, as well as certain other fees and royalty amounts. We accounted for future payments in accordance with Accounting Principles Board Opinion No. 21 Interest on Receivables and Payables (APB No. 21). Under APB No. 21, we determined the present value of the $22.5 million future payments was $20.2 million. We accounted for the difference of $2.3 million as interest income as each $1.875 million quarterly payment installment became due. Following the review, we identified an error in the way interest income was being recognized as future installments were being recorded. This accounting error relates to the timing of the recognition of interest income but does not change the overall interest income to be recognized for the Sony license.

On November 13, 2009, we concluded that as a result of the errors in accounting for stock compensation expense and the recognition of interest income, we would restate our financial statements for fiscal year 2007, and that previously filed financial statements for these periods should not be relied on. On November 17, 2009, we filed a Current Report on Form 8-K with the SEC disclosing the restatement and the non-reliance on our previously published financial information for these periods.

Other Corrections

As discussed above, we have also made other corrections that were not significant individually or in the aggregate.

On February 8, 2010, we filed this Form 10-K/A and the Amendment No. 1 to Quarterly Report on Form 10-Q for the quarter ended March 31, 2009. We also issued a press release and filed a Current Report on Form 8-K to announce the final restated financial information and conclusions of the Audit Committee s investigation.

Findings and Recommendations Related to Revenue Recognition in the Medical Line of Business

Side Agreement

As discussed above, the Audit Committee determined that a vice president of international sales for the Medical line of business may have made certain commitments to a customer in the form of an undisclosed apparent side agreement dated in the fourth quarter of fiscal 2008. The customer and we had previously executed a distribution agreement in May 2008, and the customer entered into various sales transactions with us, both before and after the date of the apparent side agreement, each of which was reviewed during the investigation. The Audit

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Committee concluded that revenue had not appropriately been recognized on such transactions for the following reasons:

Second Quarter Fiscal Year 2008

We originally recognized $511,000 in revenue in the second quarter of fiscal 2008 on a sale of medical products to the customer. Based upon facts discovered during the investigation, we have now concluded that revenue should not have been recognized during this quarter because (i) the product remained in a third-party warehouse and was not shipped to the customer until the fourth quarter of fiscal 2008; (ii) the commitments suggested in the apparent side agreement caused the terms of earlier transactions to be deemed not final until the distribution agreement between the parties was terminated in the third quarter of fiscal 2009; and (iii) we had conflicting exclusivity arrangements in effect from the second quarter of fiscal 2008 through the fourth quarter of fiscal 2008; and (iv) concessions related to payment terms caused the amount to not be fixed and determinable. Accordingly, the revenue for this transaction was deferred until the third quarter of fiscal 2009 at which time we had received the cash payment for the transaction and during which time we terminated the distribution agreement with the customer.

Third Quarter Fiscal Year 2008

In the third quarter of fiscal 2008, we entered into two separate transactions with the same customer and recognized revenue of $42,000 and $481,000 for such transactions. We determined that the $42,000 in revenue should not have been recognized during this quarter for the reasons described in the preceding paragraph. The revenue for this transaction has now been deferred until the third quarter of fiscal 2009 at which time we received the cash payment for the transaction and we terminated the distribution agreement with the customer.

The revenue for the second of these transactions of $481,000 also should not have been recognized in the third quarter of fiscal 2008 because (i) the product remained in a third-party warehouse and was not shipped to the customer until the fourth quarter of fiscal 2008; (ii) the commitments made in the side agreement caused the terms of earlier transactions to be deemed not final until the distribution agreement between the parties was terminated in the third quarter of fiscal 2009; and (iii) concessions related to payment terms caused the amount to not be fixed and determinable. We have received payment in the amount of $438,000 for this transaction, which we have deferred until the third quarter of fiscal 2009 when the distribution agreement with the customer was terminated. We have not received payment of the remaining $43,000 which has been reversed and will be recognized when and if payment is received.

Fourth Quarter Fiscal Year 2008

We recorded revenue for two transactions in the fourth quarter of fiscal 2008 with the same customer, one for $320,000 and the other for $265,000. The product for which we recorded $320,000 in revenue was stored in a third-party warehouse until the second quarter of fiscal 2009 at which time we agreed to accept the product as a return. Accordingly, the revenue previously recognized on this transaction will be reversed and no revenue will be recognized.

The revenue for the second transaction of $265,000 should not have been recognized in the fourth quarter of fiscal 2008 because the product was stored in a third-party warehouse and shipped to the customer in the second quarter of fiscal 2009. In connection with this transaction, the same vice president of international sales for the Medical line of business may have also committed us to provide a module to this customer for a simulator without sufficient functionality to permit recognition of revenue at the time revenue was originally recognized. Revenue for this transaction has been reversed and will be recognized when and if payment is received.

Total Impact on Revenue from Side Agreement for Fiscal 2008

We determined that a total of $1.6 million of revenue recorded from the customer in fiscal 2008 had not been appropriately recognized, $995,000 of which has been deferred and $623,000 of which has been reversed and not recognized.

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The Audit Committee concluded that there is no evidence that anyone at the company other than the vice president of international sales for the Medical line of business and his direct report knew of the apparent side agreement suggesting a commitment by us to provide exclusivity rights and extended payment terms until the apparent side agreement was transmitted to our chief executive officer in June 2009. In addition, the Audit Committee concluded that no corporate finance or legal personnel at our headquarters were aware that the products purchased by this customer were being stored at a third-party warehouse.

Commitment of Deliverables that are Unavailable or Lack Functionality

In reviewing the transactions where sales personnel in our Medical line of business had made commitments by us to provide products that were not available or products that included components that were not fully developed at the time of sale, we concluded that revenue was not appropriately recognized on certain transactions resulting in restatement adjustments to revenue in various reporting periods.

The following transactions occurred during the fourth quarter of 2008. Specifically, the following errors were identified:

In the fourth quarter of fiscal 2008, we recorded revenue for five transactions where the product sold lacked sufficient functionality to permit recognition of revenue. In three of these transactions totaling $468,000 in revenue, we delivered a fully functional upgrade to the product in the first quarter of fiscal 2009. In the fourth transaction for which we had recorded $130,000 in revenue, sales personnel also promised a deliverable that was not available in the fourth quarter of fiscal 2008. We have deferred this revenue until such time as the deliverable is provided, or the issue is otherwise resolved. In the fifth transaction, for which we had recorded $129,000 in revenue, the purchase order provided for certain acceptance criteria that were not met in the fourth quarter of fiscal 2008. Thus, the revenue associated with this transaction has been deferred until such time, if at all, as the acceptance criteria is met. In sum, for fiscal 2008, a total of $727,000 in revenue was deferred as a result of this issue.

Additional Transactions Analyzed

During the investigation and subsequent preparation of the Restatement, we also discovered additional transactions in our Medical line of business where revenue was not properly recognized due to one or more of the following reasons:

- Premature recognition of revenue for products sold with FOB Destination or other similar shipping terms, or for incomplete shipment of products or storage of products following shipment;
- Non-standard terms and conditions that prevented recognition of revenue upon shipment, including rights of return, extended payment terms, product replacement commitments, potential free upgrades and other non-standard commitments, that prevented recognition of revenue upon shipment; and
- Lack of probable collectability at the time revenue was recognized.

As a result, the following amounts have been deferred or reversed and will be recognized in subsequent periods:

- $125,000 of revenue improperly recognized in fiscal 2006 was recognized in fiscal 2007; and
- $1.3 million of revenue improperly recorded in fiscal 2008 has been deferred until future periods.

Other Impact of Revenue Adjustments

As a result of the adjustments to revenue discussed above, cost of product sales decreased by $1.4 million for the year ended December 31, 2008, increased by $23,000 for the year ended December 31, 2007, decreased by $21,000 for the year ended December 31, 2006 and commission expense decreased by $114,000 for the year ended December 31, 2008. Also, as a result of the adjustment in costs of product sales, we recorded deferred cost of goods sold in the amount of $1.1 million at December 31, 2008 which is reported as prepaid expenses and other current assets on the balance sheet.

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Other Errors in Consolidated Financial Statements

We also corrected the consolidated financial statements for the following items:

Stock-Based Compensation Expense. As described above, we identified a software-based error in our calculated stock-based compensation expense. The previous version of software used to calculate stock-based compensation expense incorrectly continued to apply a weighted average forfeiture rate to the vested portion of stock option awards until the grant s final vest date, rather than reflecting actual forfeitures as awards vested. This error resulted in an understatement of stock-based compensation expense in certain periods prior to the grant s final vest date. We recorded additional stock-based compensation expense of approximately $717,000 in fiscal 2007 and $1.3 million in fiscal 2008.

Interest Income. As described above, we identified an error in the accounting relating to the timing of the recognition of interest income with respect to our patent license with Sony Computer Entertainment. Accordingly, we recorded additional interest income of approximately $769,000 in fiscal 2007 and $128,000 in fiscal 2008. This accounting error related to the timing of the recognition of interest income but does not change the overall interest income to be recognized.

Amortization and Impairment of Intangibles. We identified instances where we had not commenced amortization of patents in the periods the patents were granted. In addition, we identified certain patent applications that were abandoned but had not been previously identified as such and have corrected this error by increasing amortization and impairment of intangibles by $105,000, $58,000 and $57,000 in the years ended December 31, 2008, 2007 and 2006 respectively, and reduced the opening balance of retained earnings as of January 1, 2006 by $235,000.

Impact of Corrections on Previously Issued Consolidated Financial Statements

Our accompanying consolidated financial statements have been restated resulting from the restatement adjustments described above, as follows:

	Detailed Components of Revenue Transaction Adjustments ($ in thousands)			
	Revenue	**Cost of Product Sales**	**Commission Expense**	**Total Impact of Revenue Adjustments**
Year ended December 31, 2006				
Increase (Decrease)	$ (125) (1)	$ 21	$	$ (104)
Year ended December 31, 2007				
Increase (Decrease)	$ 211 (2)	$ (23)	$	$ 188
Year ended December 31, 2008				
Increase (Decrease)	$ (3,659) (3)	$ 1,400	$ 114	$ (2,145)

(1) For year ended December 31, 2006, reflects decrease of $125,000 in revenue as discussed in Additional Transactions Analyzed .

(2) For year ended December 31, 2007, reflects increase of $125,000 in revenue as discussed in Additional Transactions Analyzed and an increase of $86,000 in revenue due to warranty adjustment.

(3) For year ended December 31, 2008, reflects decrease of $1.6 million in revenue as discussed in Side Agreement , a decrease of $727,000 in revenue as discussed in Commitment of Deliverables that are Unavailable or Lack Functionality , and a decrease of $1.3 million in revenue as discussed in Additional Transactions Analyzed .

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Summary of Impact of Restatement Adjustments

	Loss from Continuing Operations Before Provision for Income Taxes						Loss from Continuing Operations
	Revenue Transaction Adjustments (1)	Interest Income	Amortization and Impairment of Intangibles	Stock-based Compensation	Total	Income Tax Effect	Total Adjustments Net of Tax
	($ in thousands)						
Year ended December 31, 2006							
Increase (Decrease)	$ (104)	$	$ (57)	$	$ (161)	$ 3	$ (158)
Year ended December 31, 2007							
Increase (Decrease)	$ 188	$ 769	$ (58)	$ (717)	$ 182	$ (114)	$ 68
Year ended December 31, 2008							
Increase (Decrease)	$ (2,145)	$ 128	$ (105)	$ (1,269)	$ (3,391)	$ 86	$ (3,305)

(1) See table above

Internal Control Deficiencies

As further discussed in Part II, Item 9A of this Form 10-K/A under the caption Controls and Procedures, during the course of its investigation, the Audit Committee identified internal control deficiencies relating primarily to the failure to communicate complete information regarding certain sales transactions containing non-standard terms among sales, finance, accounting, legal and members of senior management.

As a result of its investigation, our Audit Committee has made recommendations to the Board of Directors and management and those recommendations have been approved. These recommendations include: (i) enhancing policies and procedures relating to revenue recognition, including updating and distributing existing revenue recognition policies, more formalized delineation of roles and responsibilities for employees involved in revenue recognition, quarterly reviews to include reviews of a larger percentage of sales transactions, more robust documentation of quarterly review findings and more formalized processes requiring sales organization to notify finance and obtain corporate approval of non-standard terms; (ii) enhanced policies and procedures relating to product development, including quarterly meetings between finance, R&D and sales to discuss product development roadmap and timing of new product releases; and (iii) enhanced training and oversight, including annual revenue recognition training for all executive, finance, sales and operational personnel, new hire and recurring training held annually, code of ethics training, review of existing commission and bonus plans to recommend changes consistent with findings of the investigation and the creation of an internal audit function. Management has provided the Audit Committee with a formal remediation plan based on the foregoing that the Audit Committee has approved and management is currently implementing. Further, management identified other material weaknesses as a result of their review of the internal controls over financial reporting which are more fully described in Item 9A.

The following items in this report have been amended as a result of the Restatement:

Part I:

Item 1: Business

Item 1A: Risk Factors

Part II:

Item 6: Selected Financial Data;

Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations;

Item 8: Financial Statements and Supplementary Data;

Item 9A: Controls and Procedures

Part IV:

Item 15: Exhibits and Financial Statement Schedules

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For convenience of the reader, this Form 10-K/A sets forth the Original Filing in its entirety, as amended by, and to reflect the Restatement. We have not modified or updated disclosures presented in our original annual report on Form 10-K, except as required to reflect the effects of this Restatement. Accordingly, this Form 10-K/A does not reflect events occurring after the Original Filing and does not modify or update those disclosures affected by subsequent events, except specifically referenced herein. Information not affected by the Restatement is unchanged and reflects the disclosures made at the time of the Original Filing on March 9, 2009. References to the annual report on Form 10-K herein shall refer to the annual report on Form 10-K originally filed on March 9, 2009.

PART I

Item 1. *Business*

Overview

Immersion Corporation was incorporated in 1993 in California and reincorporated in Delaware in 1999. We consummated our initial public offering on November 12, 1999. Our common stock trades on the NASDAQ Global Market under the symbol IMMR. Immersion Corporation is a leading provider of haptic technologies that allow people to use their sense of touch more fully when operating a wide variety of digital devices. To achieve this heightened interactivity, we develop and manufacture or license a wide range of hardware and software technologies and products. While we believe that our technologies are broadly applicable, we are currently focusing our marketing and business development activities on the following target application areas: automotive, consumer electronics, gaming, and commercial and industrial devices and controls; medical simulation; and mobile communications. We manage these application areas under two operating and reportable segments: 1) the Touch Line of Business and 2) the Medical Line of Business. See Management s Discussion and Analysis of Financial Condition and Results of Operations as well as the notes to the consolidated financial statements for revenue information for these segments for the past three years.

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

Our objective is to drive adoption of our touch technologies across markets and applications to improve the user experience with digital devices and systems. We and our wholly owned subsidiaries hold more than 700 issued or pending patents in the U.S. and other countries, covering various aspects of hardware and software technologies.

Haptics and Its Benefits

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

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

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Actuators can also be designed into devices used in automotive, industrial, medical, or retail kiosk and point-of-sale systems, such as digital switches, rotary controls, touchscreens, and touch surfaces.

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

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

Our Solutions

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

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

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

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

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

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

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Licensed Solutions

In some markets, such as video console gaming, consumer electronics, mobile phones, and automotive controls, we license our technologies to original equipment manufacturers (OEM) or their suppliers who include them in products sold under their own brand names.

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

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

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

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

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

Compatible with Industry Standards We have designed our hardware and software technologies for our licensees to be compatible with industry hardware and software standards. Our technologies operate across multiple platforms and comply with such standards as Microsoft s entertainment application programming interface, DirectX, and a standard communications interface, Universal Serial Bus (USB). More generally, our software driver and API technology has been designed to be easily ported to a variety of operating systems including Windows, Windows CE, Mac OS X, BREW/REX (from QUALCOMM), Java (J2SE), various Linux platforms including Android, and VxWorks.

Manufactured Product Solutions

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

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

components used in our haptic touchscreen and touch surface solutions;

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

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

We also manufacture and private-label some products for customers under their own brand names. In addition, we may resell another manufacturer s product into our customer base such as certain types of medical simulators.

On November 17, 2008, we announced our intent to divest our line of 3D products, the sale of which occurred in 2009. These products include our:

MicroScribe® digitizers;

a 3D interaction product line; and

SoftMouse® 3D positioning device.

The previously reported results of operations for our 3D products have been retrospectively reclassified and included in Discontinued Operations within the Consolidated Statement of Operations for the fiscal years ended December 31, 2008, 2007, and 2006, respectively.

Touch Line of Business

Products and Markets

We initially licensed our intellectual property for touch-enabling technologies for consumer gaming peripherals in 1996 and extended beyond gaming to other applications of our haptics-related products and services.

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

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

For the years ended December 31, 2008, 2007, and 2006, respectively 30%, 24%, and 21% of our total revenues were generated from PC and console gaming revenues.

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

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

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

TouchSense components include technologies for haptic touchscreens and programmable haptic rotary controls. In early 2009, Samsung announced its new P3 personal media player, currently scheduled to ship in

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

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

Our licensees currently include the top three makers of mobile phones by volume in the world: Nokia, Samsung, and LG Electronics plus others such as Pantech Co., Ltd. and KTF Technologies Inc. In 2008, approximately 33 million handsets with TouchSense technology were shipped by our licensees, a nearly six-fold increase over 2007. Since its launch in the first handset in 2005, our TouchSense technology has shipped in over 42 million handsets.

For the years ended December 31, 2008, 2007, and 2006, respectively 17%, 8%, and 2% of our total revenues were generated from mobile communication revenues.

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

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

We have licensed our TouchSense rotary technology for use in vehicle controls since 2002. Siemens VDO Automotive (now Continental) has licensed our technology for use in the high-end Volkswagen Phaeton sedan and Bentley cars. ALPS Electric, also a licensee, has produced a haptic rotary control that has been included in the Mercedes-Benz S-Class sedan starting in the fall of 2005. ALPS also produced a two-dimensional haptic control module called the Remote Touch controller in the Lexus RX 350 and 450h. These 2010 Lexus models were announced in November 2008 and launched in the U.S. in February 2009. Other licensees of TouchSense technology in the automotive industry include: Methode Electronics, Inc., a global designer and manufacturer of electronic component and subsystem devices; Visteon Corporation, a leading global automotive supplier that designs, engineers, and manufactures innovative climate, interior, electronic and lighting products for vehicle manufacturers; Volkswagen, Europe s largest automaker; and SMK Corporation of Tokyo, a global manufacturer of electromechanical components. Since its launch in the first vehicle in 2001 our TouchSense technology has shipped in over 2.4 million vehicles.

For the years ended December 31, 2008, 2007, and 2006, respectively 9%, 12%, and 11% of our total revenues were automotive revenues.

3D and Mechanical CAD Design During 2008 we sold three-dimensional and mechanical computer-aided design products that allow users to create three-dimensional computer models directly from physical objects and also to precisely measure manufactured parts. We also manufactured and sold the CyberGlove system, a fully instrumented glove that measures the movement of a user s hand and, used in conjunction with our software, maps the movement to a graphical hand on the computer screen. In addition, we manufactured and sold specialized products such as computer peripherals that incorporate advanced computer peripheral technologies. On November 17, 2008, we announced our intent to divest these lines of 3D digitizing products in 2009. On February 24, 2009, we sold the line of peripheral products for an immaterial amount. The previously reported results of operations for our 3D products have been retrospectively reclassified and included in Discontinued Operations within the Consolidated Statement of Operations for the fiscal years ended December 31, 2008, 2007, and 2006, respectively.

Sales and Distribution

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

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

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

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

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

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

Competition

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

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

Several companies also currently market touch feedback products that are competitive to ours in non-consumer markets. These companies could also shift their focus to the consumer market. In addition, our licensees or other companies may develop products that compete with products employing our touch-enabling technologies, but are based on alternative technologies, or develop technologies that are similar or superior to our technologies, duplicate our technologies, or design around our patents. Many of our licensees, including Microsoft, LG Electronics, Logitech, Nokia, Samsung, and others have greater financial and technical resources upon which to draw in attempting to develop computer peripheral or mobile phone technologies that do not make use of our touch-enabling technologies.

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

Medical Line of Business

Products and Markets

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

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

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

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

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

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

Sales and Distribution

Sales of these products may experience seasonal fluctuations related to teaching hospitals summer residency programs. In addition, there may be variations in timing of revenue recognition from the sale of systems with upgrade rights and from development contracts. The latter may depend on numerous factors including contract milestones and timing of work performed against the contract.

With respect to medical simulation products, we employ a direct sales force and a network of international distributors that sell simulation systems to hospitals, colleges and universities, nursing schools, medical schools, emergency medical technician training programs, the military, medical device companies, and other organizations involved in procedural medicine. During 2008, we expanded our direct sales force in international markets and signed agreements with additional distributors for sales of our products in Europe, Latin America, and Asia Pacific regions.

For the years ended December 31, 2008, 2007, and 2006, respectively 40%, 52%, and 61%, of our total revenues were generated from medical revenues. For the years ended December 31, 2007 and 2006, respectively 12% and 22% of our total revenues consisted of licensing, product revenue, or development revenues from Medtronic.

Competition

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

Research and Development

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

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

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

Licensee Interaction To support the successful design and adoption of our technology in a licensee s product, we make efforts to ensure clear communication with our customers. Typically, collaborative development efforts are structured using a four-phase approach including Product Definition, Concept Development, Detail Design, and Production Design phases. This four-phase design process is typically used for designing new systems when the solution is not known beforehand. Each phase includes formal design reviews and documentation. The continuation of our development effort is contingent upon successful completion and acceptance of prior phases. This method ensures that the customer s financial risk is minimized and that project deliverables remain consistent with the goals established in the Product Definition phase.

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

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

For the years ended December 31, 2008, 2007, and 2006, research and development expenses were $13.1 million, $10.4 million, and $7.6 million respectively.

Intellectual Property

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

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

We and our wholly owned subsidiaries hold more than 700 issued or pending patents in the U.S. and other countries that cover various aspects of our hardware and software technologies. Some of our U.S. patents have begun to expire starting in 2007.

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

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

Investor Information

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

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

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

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Employees

As of December 31, 2008, we had 184 full-time and 2 part-time employees, including 68 in research and development, 54 in sales and marketing, and 64 in legal, finance, administration, and operations. As of that date, we also had 23 independent contractors. None of our employees are represented by a labor union, and we consider our employee relations to be positive.

Executive Officers

The following table sets forth information regarding our executive officers as of March 9, 2009.

Name	Position with the Company	Age
Clent Richardson	President, Chief Executive Officer, and member of the Board of Directors	47
Stephen Ambler	Chief Financial Officer	49
Daniel Chavez	Senior Vice President and General Manager, Medical Line of Business	51
G. Craig Vachon	Senior Vice President and General Manager, Touch Line of Business	45

Clent Richardson joined Immersion in April 2008 as President, Chief Executive Officer and member of the Board of Directors. From July 2007 through March 2008 Mr. Richardson was Chief Marketing Officer of TiVo, Inc., a provider of technology and services for digital video recorders. In April 2004, Mr. Richardson joined Nortel Networks Inc., a telecommunications networks and solutions company, as Vice President of Global Marketing, Enterprise Networks and was promoted to Chief Marketing Officer in October 2004 and served in that capacity through February 2006. From August 2003 to November 2003, Mr. Richardson was a management consultant for America Online, Inc., an internet services and media company. From April 2001 to March 2003, Mr. Richardson was Chief Sales and Marketing Officer and a member of the Board of Directors of T-Mobile U.K., a wireless phone company, and concurrently chairman of T-Mobile Retail, Ltd. Mr. Richardson served as Vice President, Worldwide Developer Relations from December 1997 to March 2001 and also as Vice President, Worldwide Solutions Marketing (from February 2000 to March 2001) for Apple Computer, Inc., a consumer electronics and software manufacturer. Prior to December 1997, Mr. Richardson served as Vice President, Marketing and Sales for Design Intelligence, Inc.; senior manager, Evangelism for Apple Computer, Inc.; Vice President and Director of Sales for Foster Ousley Conley, Inc.; and held several sales and management positions within GTE Corporation (now part of Verizon) over a five year period including Group Manager, Major Accounts in California for GTE Mobilenet, a subsidiary of GTE Corporation. Mr. Richardson holds a B.A. in Counseling Psychology from Antioch University.

Stephen Ambler joined Immersion in February 2005 as Chief Financial Officer. From April 2001 to January 2005, Mr. Ambler served as Chief Financial Officer and Vice President, Finance of Bam! Entertainment, Inc., a producer of interactive video games. From April 1994 to March 2001, he served as Director of Finance and Administration for Europe and then Chief Financial Officer, Secretary, and Senior Vice President, Finance of Insignia Solutions PLC, a wireless solutions software company. From December 1992 to March 1994, he served as Financial Controller and Company Secretary for Ampex Great Britain Limited, a producer of recording equipment and magnetic tape for the television and defense industries. From May 1988 to December 1992, he served as Financial Controller and then Finance Director of Carlton Cabletime Limited, a supplier of cable television equipment. Mr. Ambler holds a diploma in Accounting Studies from Oxford Polytechnic in England and is qualified as a Chartered Accountant in England and Wales.

Daniel Chavez joined Immersion in December 2008 as Senior Vice President and General Manager of the Medical Line of Business. Mr. Chavez previously served as interim Senior Vice President and General Manager of Immersion s

Medical Line of Business since August 2008. From January 2007 to July 2008, Mr. Chavez was a health information technology consultant focused on business planning, strategic alliance development, product management, and marketing. From September 2001 to December 2006, Mr. Chavez held various positions at Availity, LLC, a healthcare transactions company, including Senior Vice President, Operations, Vice President, Operations, and Vice President, Business Development. Prior to September 2001, Mr. Chavez held positions with Emstat Corporation, Computer Sciences Corporation, Stellcom Technologies, Inc., Science Applications International Corporation, GTE Corporation and IBM Corporation. Mr. Chavez holds an M.B.A. from Stanford University and a B.A. in Economics from San Jose State University.

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

Item 1A. *Risk Factors*

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

Company Risks

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

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

We had an accumulated deficit of $72 million as of December 31, 2008, have a history of losses, expect to experience losses in the future, and may not achieve or maintain profitability in the future.

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

- continue to develop our technologies;
- increase our sales and marketing efforts;
- attempt to expand the market for touch-enabled technologies and products and change our business;
- protect and enforce our intellectual property;

- pursue strategic relationships;
- acquire intellectual property or other assets from third-parties; and
- invest in systems and processes to manage our business.

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

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We have little or no control or influence on our licensees design, manufacturing, promotion, distribution, or pricing of their products incorporating our touch-enabling technologies, upon which we generate royalty revenue.

A key part of our business strategy is to license our intellectual property to companies that manufacture and sell products incorporating our touch-enabling technologies. Sales of those products generate royalty and license revenue for us. For the years ended December 31, 2008, 2007 and 2006, 51%, 39% and 32%, respectively, of our total revenues were royalty and license revenues. We do not control or influence the design, manufacture, quality control, promotion, distribution, or pricing of products that are manufactured and sold by our licensees, nor can we control consolidation within an industry which could either reduce the number of licensing products available or reduce royalty rates for the combined licensees. In addition, we generally do not have commitments from our licensees that they will continue to use our technologies in current or future products. As a result, products incorporating our technologies may not be brought to market, achieve commercial acceptance, or otherwise generate meaningful royalty revenue for us. For us to generate royalty revenue, licensees that pay us per-unit royalties must manufacture and distribute products incorporating our touch-enabling technologies in a timely fashion and generate consumer demand through marketing and other promotional activities. If our licensees products fail to achieve commercial success or if products are recalled because of quality control problems, our revenues will not grow and could decline.

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

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

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

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

Both the Microsoft Xbox 360 and Nintendo Wii include touch-enabling capabilities. For the Microsoft Xbox 360 video console system launched in November 2005, Microsoft has, to date, not yet broadly licensed third parties to produce peripherals for its Xbox 360 game console. To the extent Microsoft does not fully license third parties, Microsoft s share of all aftermarket Xbox 360 game controller sales will likely remain high or increase, which we

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expect will limit our gaming royalty revenue. Additionally, Microsoft is now making touch-enabled steering wheel products covered by their royalty-free, perpetual, irrevocable license to our worldwide portfolio of patents that could compete with our licensees current products for which we earn per unit royalties.

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

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

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

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

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

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

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

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

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

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

- the lengthy and expensive process of building a relationship with potential licensees;
- the competition we may face with the internal design teams of existing and potential licensees;
- difficulties in persuading product manufacturers to work with us, to rely on us for critical technology, and to disclose to us proprietary product development and other strategies;
- difficulties with persuading potential licensees who may have developed their own intellectual property or licensed intellectual property from other parties in areas related to ours to license our technology versus continuing to develop their own or license from other parties;
- challenges in demonstrating the compelling value of our technologies in new applications like mobile phones, portable devices, and touchscreens;
- difficulties in persuading existing and potential licensees to bear the development costs and risks necessary to incorporate our technologies into their products;
- difficulties in obtaining new automotive licensees for yet-to-be commercialized technology because their suppliers may not be ready to meet stringent quality and parts availability requirements;
- inability to sign new gaming licenses if the video console makers choose not to license third parties to make peripherals for their new consoles; and
- reluctance of content developers, mobile phone manufacturers, and service providers to sign license agreements without a critical mass of other such inter-dependent supporters of the mobile phone industry also having a license, or without enough phones in the market that incorporate our technologies.

Our recently-announced consolidation of our Medical operations may not be successful, and may negatively impact our business

In March 2009, we announced that we are consolidating the operations of our Medical line of business with the rest of our business. As a result of this consolidation, we will be moving the operations of our Medical line of business from Maryland to our headquarters in San Jose, California. Consolidations and business restructurings involve numerous risks and uncertainties, including, but not limited to: the potential loss of key employees, customers and business partners; market uncertainty related to our future business plans; the incurrence of unexpected expenses or charges; diversion of management attention from other key areas of our business; negative impacts on employee morale; and other potential dislocations and disruptions to the business. For 2008, our Medical line of business represented 40% of our total revenues. Accordingly, if we are unable to manage this consolidation effectively, our overall business and operating results could be materially and adversely affected.

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

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

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

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

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

Our current litigation undertakings are 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 the litigation will continue to be costly, and there can be no assurance that we will be successful or able to recover the costs we incur in connection with the litigation. We expense litigation 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 has diverted, and is likely to continue to divert, the efforts and attention of some of our key management and personnel. As a result, until such time as it is resolved, litigation 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 17 to the consolidated financial statements in Part I and Item 1. Legal Proceedings of this Part II.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- laws and contractual restrictions may not be sufficient to prevent misappropriation of our technologies or deter others from developing similar technologies; and
- policing unauthorized use of our patented technologies, trademarks, and other proprietary rights would be difficult, expensive, and time-consuming, within and particularly outside of the United States of America.

Certain terms or rights granted in our license agreements or our development contracts may limit our future revenue opportunities.

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

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

Our initiatives to develop new and enhanced technologies and to commercialize these technologies for new applications and new platforms may not be successful or timely. Any new or enhanced technologies may not be favorably received by consumers and could damage our reputation or our brand. Expanding our technologies could also require significant additional expenses and strain our management, financial, and operational resources. Moreover, technology products generally have relatively short product life cycles and our current products may become obsolete in the future. Our ability to generate revenues will be harmed if:

- we fail to develop new technologies or products;

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

our new technologies fail to gain market acceptance; or

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

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

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

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

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

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

Third-party validation studies may not demonstrate all the benefits of our medical training simulators, which could affect customer motivation to buy.

In medical training, validation studies are generally used to confirm the usefulness of new techniques, devices, and training methods. For medical training simulators, several levels of validation are generally tested: content, concurrent, construct, and predictive. A validation study performed by a third party, such as a hospital, a teaching institution, or even an individual healthcare professional, could result in showing little or no benefit for one or more types of validation for our medical training simulators. Such validation study results published in medical journals could impact the willingness of customers to buy our training simulators, especially new simulators that have not previously been validated. In addition, customers may be reluctant to purchase these products if no studies have been published or until a favorable study has been published, which would negatively impact our revenues from sales of these products.

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

Several key medical certification bodies, including the American Board of Internal Medicine (ABIM), the American Board of Surgery (ABS), and the American College of Cardiology (ACC), have great influence in recommending particular medical methodologies, including medical training and testing methodologies, for use by medical professionals. In the event that the ABIM and the ACC, as well as other, similar bodies, do not endorse medical simulation products in general, or our products in particular, as a training and/or testing tool, and in addition in the event that the Enhancing Simulation Act of 2009 does not pass into law, market penetration for our products in the medical market could be significantly and adversely affected.

We have limited distribution channels and resources to market and sell our products, and if we are unsuccessful in marketing and selling these products, we may not achieve or sustain product revenue growth.

We have limited resources for marketing and selling our products, either directly or through distributors. To achieve our business objectives, we must build a balanced mixture of sales through a direct sales channel and through qualified distribution channels. The success of our efforts to sell products will depend upon our ability to retain and develop a qualified sales force and effective distribution channels. We may not be successful in attracting and retaining the personnel necessary to sell and market our products. A number of our distributors are small, specialized companies and may not have sufficient capital or human resources to support the complexities of selling and supporting our products. In addition, many of our distributors do not have exclusive relationships with us and may not devote sufficient time and attention to selling our products. There can be no assurance that our direct selling efforts will be effective, distributors or OEMs will market our products successfully or, if our relationships with distributors or OEMs terminate, that we will be able to establish relationships with other distributors or OEMs on satisfactory terms, if at all. Any disruption in the distribution, sales, or marketing network for our products could have a material adverse effect on our product revenues.

It is difficult for us to predict the sales volume of our distribution channels, which makes it difficult for us to forecast our business.

The sales volumes for our limited distribution channels are volatile and hard to predict. We consider forecasts in determining our component needs and our inventory requirements. If the business in these limited distribution channels fails to meet expectations, or if we fail to accurately forecast our customers product demands, we may have inadequate or excess inventory of our products or components or assets that are not realizable, which could adversely affect our operating results.

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

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

In the medical simulation market, we face competition from Simbionix USA Corporation, Mentice Corporation, Medical Education Technologies, Inc., and Medical Simulation Corporation. In the mobility and touchscreen markets, we face competition from internal design teams of existing and potential OEM customers. As a result of their licenses to our patent portfolios, we could face competition from Microsoft and Sony.

Our licensees or other third parties may also seek to develop products using our intellectual property or develop alternative designs that attempt to circumvent our intellectual property or that they believe do not require a license under our intellectual property. These potential competitors may have significantly greater financial, technical, and marketing resources than we do, and the costs associated with asserting our intellectual property rights against such products and such potential competitors could be significant. Moreover, if such alternative designs were determined by a court not to require a license under our intellectual property rights, competition from such unlicensed products could limit or reduce our revenues.

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

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

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

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

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

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

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

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

Our business has undergone significant changes in recent periods, including the proposed divestiture of our 3D business, new management, consolidation of our touch, gaming, and mobility businesses and personnel changes and focus on additional target markets. These changes have required significant investments of cash and other resources, as well as management s time and attention and have placed significant strains on our managerial, financial, engineering, or other resources. We cannot assure you that these efforts will result in growing our business successfully or in increased operating performance.

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

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

compliance with multiple, conflicting and changing governmental laws and regulations;

laws and business practices favoring local competitors;

foreign exchange and currency risks;

difficulty in collecting accounts receivable or longer payment cycles;

import and export restrictions and tariffs;

- difficulties staffing and managing foreign operations;
- difficulties and expense in enforcing intellectual property rights;
- business risks, including fluctuations in demand for our products and the cost and effort to conduct international operations and travel abroad to promote international distribution and overall global economic conditions;
- multiple conflicting tax laws and regulations; and
- political and economic instability.

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

Clent Richardson, our chief executive officer, and other members of our executive management team are relatively new and if there are difficulties with this leadership transition it could impede the execution of our business strategy.

Clent Richardson, our Chief Executive Officer, was hired in April 2008, and other members of our executive management team also joined us in 2008. Our success will depend to a significant extent on their ability to implement a successful strategy, to successfully lead and motivate our employees, and to work effectively with other members of our executive management team and board of directors. If this leadership transition is not successful, our ability to execute our business strategy would be impeded.

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

Our ability to develop and deploy our technologies and to sustain our revenue growth depends upon the continued service of our management and other key personnel, many of whom would be difficult to replace. 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. Our stock option and award program is a long-term retention program that is intended to attract, retain, and provide incentives for talented employees, officers and directors, and to align stockholder and employee interests. Additionally some of our executive officers and key employees hold stock options with exercise prices above the current market price of our common stock. Each of these factors may impair our ability to retain the services of our executive officers and key employees. Our technologies are complex and we rely upon the continued service of our existing personnel to support licensees, enhance existing technologies, and develop new technologies.

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

Our facilities could be subject to a catastrophic loss such as fire, flood, earthquake, power outage, or terrorist activity. A substantial portion of our research and development activities, manufacturing, our corporate headquarters, and other critical business operations are located near major earthquake faults in San Jose, California, an area with a history of seismic events. An earthquake at or near our facilities could disrupt our operations, delay production and shipments of our products or technologies, and result in large expenses to repair and replace the

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facility. While we believe that we maintain insurance sufficient to cover most long-term potential losses at our facilities, our existing insurance may not be adequate for all possible losses. In addition, California has experienced problems with its power supply in recent years. As a result, we have experienced utility cost increases and may experience unexpected interruptions in our power supply that could have a material adverse effect on our sales, results of operations, and financial condition.

Investment Risks

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

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

These factors include:

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

Our stock price may fluctuate regardless of our performance.

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

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

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

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

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

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

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

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

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

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

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

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

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

unanticipated costs associated with the acquisitions;

use of substantial portions of our available cash to consummate the acquisitions;

diversion of management s attention from other business concerns;

difficulties in assimilation of acquired personnel or operations;

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

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

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

potential costs associated with failed acquisition efforts.

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

Failure to maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act could have a material adverse effect on our business and stock price.

The Sarbanes-Oxley Act of 2002 requires, among other things, that we establish and maintain internal control over financial reporting and disclosure controls and procedures. We must perform system and process evaluation and testing of our internal control over financial reporting to allow management to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our independent registered public accounting firm is also required to report on our internal control over financial reporting. Our testing and our auditor s testing may reveal deficiencies in our internal control over financial reporting that are deemed to be material weaknesses and render our internal control over financial reporting ineffective. We have incurred, and we expect to continue to incur, substantial accounting and auditing expense and expend significant management time in complying with the requirements of Section 404. If we are not able to comply with the requirements of Section 404 in a timely manner, or if we or our independent registered public accounting firm identify deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline and we could be subject to investigations or sanctions by the SEC, The NASDAQ Stock Market, or NASDAQ, or other regulatory authorities, or become subject to litigation. To the extent any material weaknesses in our internal control over financial reporting are identified in the future, we could be required to expend significant management time and financial resources to correct such material weaknesses or to respond to any resulting regulatory investigations or proceedings.

If we fail to address material weaknesses in our internal control over financial reporting, we may not be able to report our financial results accurately or timely or prevent fraud, any of which could harm our business or reputation and cause the price of our common stock to decline.

As discussed in Part II, Item 9A, *Controls and Procedures*, our management team, under the supervision and with the participation of our Interim Chief Financial Officer and our Interim Chief Executive Officer, conducted a re-evaluation of our internal controls as of December 31, 2008. Management concluded that we had a continuing material weakness in internal controls over financial reporting related to income taxes and a material weakness in internal controls over (1) revenue recognition modification to our policies and procedures to ensure that modifications to, or side agreements associated with, our standard terms of contract are properly approved, documented, tracked and recorded, (2) revenue recognition compliance with specified shipping terms to ensure these controls to determine the point at which title and risk of loss passes to the customer are appropriate, (3) revenue recognition release of new products to ensure that new product releases are properly approved and documented, and (4) the calculation of stock-based compensation expense related to the application of the forfeiture rate. We have subsequently initiated actions that are intended to improve our accounting for income taxes, revenue recognition, accounting for stock-based compensation, and the related internal controls. Due to the continuing presence of these material weaknesses and the ongoing implementation of remedial actions for these material weaknesses as of December 31, 2008, management concluded that our internal control over financial reporting was not effective as of December 31, 2008 and it is likely that these material weaknesses will not be fully remediated as of December 31, 2009. Any continuation of these material weaknesses in our internal controls over the accounting for income taxes, revenue recognition and accounting for stock-based compensation could impair our ability to report our financial position and results of operations accurately and in a timely manner or prevent fraud, the occurrence of any of which could harm our business or reputation and cause the price of our common stock to decline.

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

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

Item 1B. *Unresolved Staff Comments*

None.

Item 2. *Properties*

We lease a facility in San Jose, California of approximately 48,000 square feet, which serves as our corporate headquarters and includes our sales, marketing, administration, research and development, manufacturing, and distribution functions for the Touch operating segment. Products produced in San Jose include several of our touch interface products, including rotary encoders, components to enable tactile feedback in touchscreens, and various arcade gaming products. The lease for this property expires in June 2014.

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We lease a facility in Montreal, Quebec, Canada of approximately 9,200 square feet, for our subsidiary, Immersion Canada, Inc. The facility is used for sales administration, research and development, and administration functions. The lease for this property expires in October 2010.

We lease a facility in Gaithersburg, Maryland of approximately 18,900 square feet, for the Medical operating segment. The facility is used for sales, marketing, administration, research and development, manufacturing, and distribution functions for the Endoscopy AccuTouch System, the CathLab VR System, Virtual IV System, the Lap VR System, and the insightArthroVR arthroscopy surgical simulator. The lease for this property expires in May 2009. As part of our announced consolidation of our medical operations to our San Jose, California facilities, we will not renew this lease. We also lease storage space in Gaithersburg, Maryland of approximately 1,460 square feet, and this lease expires in October 2010.

We lease office space in Seocho-gu, Seoul, Korea. The facility is used for sales and marketing support and research and development functions. This lease expires in November 2009.

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

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

Item 3. *Legal Proceedings*

In re Immersion Corporation

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

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

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

We and most of the issuer defendants had settled with the plaintiffs. In September 2005, the District Court granted preliminary approval of the settlement. The District Court held a hearing to consider final approval of the settlement on April 24, 2006 and took the matter under submission. Subsequently, the Second Circuit vacated the class certification of plaintiffs claims against the underwriters in six cases designated as focus or test cases. Thereafter, the District Court ordered a stay of all proceedings in all of the lawsuits pending the outcome of plaintiffs petition to the U.S. Court of Appeals for the Second Circuit for rehearing en banc and resolution of the class certification issue. On April 6, 2007, the Second Circuit denied plaintiffs petition for rehearing, but clarified that the plaintiffs may seek to certify a more limited class in the District Court. Accordingly, the parties withdrew the prior settlement, and plaintiffs filed an amended complaint in attempt to comply with the Second Circuit s ruling. On March 26, 2008, the District Court denied in part and granted in part the motions to dismiss the focus cases on substantially the same grounds as set forth in its prior opinion.

In September 2008, all of the parties to the lawsuits reached a settlement, subject to documentation and approval of the District Court. As before, the Immersion Defendants would not be required to contribute to the settlement. Subsequently, an underwriter defendant filed for bankruptcy and other underwriter defendants were acquired. We believe that the settlement remains in place, and that final documentation will be presented to the District Court by April 1, 2009. If the settlement is not consummated and then approved by the District Court, we intend to defend the lawsuit vigorously.

Internet Services LLC Litigation

On October 20, 2004, ISLLC filed claims against us in its lawsuit against Sony Computer Entertainment in the U.S. District Court for the Northern District of California, alleging that we breached a contract with ISLLC by suing Sony Computer Entertainment for patent infringement relating to haptically-enabled software whose topics or images are allegedly age-restricted, for judicial apportionment of damages between ISLLC and us of the damages awarded by the jury, and for a judicial declaration with respect to ISLLC s rights and duties under agreements with us. On December 29, 2004, the District Court issued an order dismissing ISLLC s claims against Sony Computer Entertainment with prejudice and dismissing ISLLC s claims against us without prejudice to ISLLC. On January 12, 2005, ISLLC filed Amended Cross-Claims and Counterclaims against us that contained similar claims. On March 24, 2005, the District Court again dismissed certain of these claims with prejudice and dismissed the other claims without prejudice.

On February 8, 2006, ISLLC filed a lawsuit against us in the Superior Court of Santa Clara County. ISLLC s complaint sought a share of the damages awarded to us in the Sony litigation and of the Microsoft settlement proceeds, and generally restated the claims already adjudicated by the District Court. On March 16, 2006, we answered the complaint, cross claimed for declaratory relief, breach of contract by ISLLC, and for rescission of the contract, and removed the lawsuit to federal court. The case was assigned to Judge Wilken in the U.S. District Court for the Northern District of California as a case related to the previous proceedings involving Sony Computer Entertainment and ISLLC. On May 10, 2007, ISLLC filed a motion in the District Court to remand its latest action to the Superior Court or in the alternative for leave to file an amended complaint. We opposed ISLLC s motion, and cross-moved for judgment on the pleadings. On June 26, 2007, the District Court ruled on the motions, denying ISLLC s motion to remand or for leave to file an amended complaint, and granting in part our motion for judgment on the pleadings. The District Court also dismissed one of ISLLC s claims. However, on May 16, 2008, the District Court entered an order granting our motion for summary judgment on all of ISLLC s claims, as well as our counterclaim for declaratory relief. As a result, the only claims remaining in the action were our counterclaims against ISLLC. On August 22, 2008, we settled our counterclaims against ISLLC and amended the terms of our existing business agreement with ISLLC. On August 25, 2008, the District Court entered an order dismissing Immersion s counterclaims and closed the case.

Microsoft Corporation v. Immersion Corporation

On June 18, 2007, Microsoft filed a complaint against us in the U.S. District Court for the Western District of Washington alleging one claim for breach of a contract. Microsoft alleged that we breached a Sublicense Agreement executed in connection with the parties settlement in 2003 of our claims of patent infringement against Microsoft in *Immersion Corporation v. Microsoft Corporation, Sony Computer Entertainment Inc. and Sony Computer Entertainment America, Inc., United States District Court for the Northern District of California, Case No. 02-0710-CW).* The complaint alleged that Microsoft was entitled to payments that Microsoft contends are due under the Sublicense Agreement as a result of Sony Computer Entertainment s satisfaction of the judgment in our lawsuit against Sony Computer Entertainment and payment of other sums to us. In a letter sent to us dated May 1, 2007, Microsoft stated that it believed we owed Microsoft at least $27.5 million, an amount that was subsequently increased to $35.6 million. Although we disputed Microsoft s allegations, on August 25, 2008 the parties agreed to settle all claims. The Company had made no offers to settle prior to August 25, 2008. Under the terms of the settlement, we paid Microsoft $20.8 million in October 2008.

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

On April 16, 2008, we announced that our wholly owned subsidiary, Immersion Medical, Inc., filed lawsuits for patent infringement in the United States District Court for the Eastern District of Texas against Mentice AB, Mentice SA, Simbionix USA Corp., and Simbionix Ltd (collectively the Defendants), seeking damages and injunctive relief. On July 11, 2008, Mentice AB and Mentice SA (collectively, Mentice) answered the complaint by denying the material allegations and alleging counterclaims seeking a judicial declaration that the asserted patents were invalid, unenforceable, or not infringed. On July 11, 2008, Simbionix USA Corp. and Simbionix Ltd, (collectively, Simbionix) filed a motion to stay or dismiss the lawsuit, and a motion to transfer venue for convenience to Ohio. On August 7, 2008, we filed our opposition to both motions filed by Simbionix. The court has not ruled on the pending motions. On December 2, 2008, the court held a status conference in which it set a trial date for December 5, 2011 and a claim construction hearing for June 5, 2011.

We intend to vigorously prosecute this lawsuit.

Item 4. ***Submission of Matters to a Vote of Security Holders***

No matters were submitted to a vote of security holders in the fourth quarter of fiscal 2008.

PART II

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

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

	High	Low
Fiscal year ended December 31, 2008		
Fourth Quarter	$ 6.35	$ 2.72
Third Quarter	$ 7.92	$ 5.22
Second Quarter	$ 11.82	$ 6.43
First Quarter	$ 13.38	$ 6.61
Fiscal year ended December 31, 2007		
Fourth Quarter	$ 18.60	$ 12.01
Third Quarter	$ 20.68	$ 12.00
Second Quarter	$ 15.28	$ 8.80
First Quarter	$ 9.90	$ 6.71

On February 23, 2009, the closing price was $3.86 and there were 142 holders of record of our common stock. Because many of such shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

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Issuer Repurchases of Equity Securities

Below is a summary of stock repurchases for the quarter ending December 31, 2008. See Note 11 of our consolidated financial statements for information regarding our stock repurchase program.

	Shares Repurchased(2)	Average Price per Share	Approximate Dollar Value that May Yet Be Purchased Under the Program
Program/Period(1)			
Beginning approximate dollar value available to be repurchased as of September 30, 2008			$ 36,648,689
October 1 October 31, 2008	920,000	$ 5.23	
November 1 November 30, 2008	40,000	$ 5.75	
December 1 December 31, 2008			
Total shares repurchased	960,000	$ 5.25	5,038,040
Ending approximate dollar value that may be repurchased under the Program as of December 31, 2008			$ 31,610,649

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

(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 pursuant to a trading plan designed to satisfy the conditions of Rule 10b5-1 under the Securities and Exchange Act of 1934, as amended.

Dividend Policy

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

Item 6. *Selected Financial Data*

The statement of operations data for the years ended December 31, 2008, 2007 and 2006, and the balance sheet data as of December 31, 2008, 2007 and 2006 have been restated as set forth in this Form 10-K/A. The information set forth below is qualified in its entirety by, and should be read in conjunction with Item 7, Management s Discussion and

Analysis of Financial Condition and Results of Operations, and the consolidated financial statements and related notes thereto included in Item 8 of this Form 10-K/A. The information presented in the following tables reflects our restatement of the consolidated financial statements, as is more fully described in the Explanatory Note Regarding Restatement immediately preceding Part I, Item 1 and in Note 2, Restatement of Consolidated Financial Statements, of the Notes to Consolidated Financial Statements in Item 8. We have not amended our previously-filed Quarterly Reports on Form 10-Q for the periods affected by the restatement. In addition, we intend to file restated condensed consolidated quarterly financial statements for each of the periods ended March 31, 2008, June 30, 2008 and September 30, 2008 in connection with the filing of our Form 10-Q/A for the period ended March 31, 2009 and with the filing of our Forms 10-Q for each of the periods ended June 30, 2009 and September 30, 2009. The financial information that has been previously filed or otherwise reported for these periods is superseded by the information in this Form 10-K/A, and the financial statements and related financial information contained in such previously-filed reports should no longer be relied upon.

	Years Ended December 31,				
	2008(1)(3) As Restated	2007(1)(2)(3) As Restated	2006(1)(3) As Restated	2005(3)	2004(3)
	(In thousands, except per share data)				
STATEMENTS OF OPERATIONS DATA:					
Revenues	$ 27,981	$ 30,140	$ 22,959	$ 19,683	$ 18,810
Cost and expenses(2)	77,075	(93,138)	32,937	32,686	41,306
Operating income (loss)	(49,094)	123,278	(9,978)	(13,003)	(22,496)
Income tax benefit (provision) from continuing operations	(5,088)	(12,850)	218	298	950
Income (loss) from continuing operations	(50,258)	116,027	(11,087)	(13,732)	(22,043)
Gain (loss) from discontinued operations (net of tax)	(732)	1,059	505	647	1,305
Net income (loss)	(50,990)	117,086	(10,582)	(13,085)	(20,738)
Basic net income (loss) per share					
Continuing operations	$ (1.70)	$ 4.19	$ (0.45)	$ (0.57)	$ (0.97)
Discontinued operations	$ (0.02)	$ 0.04	$ 0.02	$ 0.03	$ 0.06
Total	$ (1.72)	$ 4.23	$ (0.43)	$ (0.54)	$ (0.91)
Diluted net income (loss) per share					
Continuing operations	$ (1.70)	$ 3.68	$ (0.45)	$ (0.57)	$ (0.97)
Discontinued operations	$ (0.02)	$ 0.03	$ 0.02	$ 0.03	$ 0.06
Total	$ (1.72)	$ 3.71	$ (0.43)	$ (0.54)	$ (0.91)
Shares used in calculating net loss per share					
Basic	29,575	27,662	24,556	24,027	22,698
Diluted	29,575	31,667	24,556	24,027	22,698

	December 31,				
	2008(1) As Restated	2007(1) As Restated	2006(1) As Restated	2005	2004
	(In thousands)				
BALANCE SHEET DATA:					
Cash, cash equivalents, and short-term investments	$ 85,743	$ 138,112	$ 32,012	$ 28,171	$ 25,538
Working capital	82,972	143,160	33,557	28,885	23,088
Total assets	113,587	167,931	49,623	44,760	42,250
Long-term debt, less current portion			18,122	17,490	16,917
Long-term customer advance from Microsoft			15,000	15,000	15,000
Total stockholders equity (deficit)	79,778	142,177	(23,385)	(16,795)	(5,967)

(1) Amounts have been updated to reflect the effects of the restatement disclosed in Note 2 Restatement of Consolidated Financial Statements of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Form 10K/A.

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

(3) Information has been retrospectively restated to present the results of our 3D product line as a discontinued operation. See Note 13 Restructuring and Discontinued Operations in the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Form 10K/A.

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

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

This Management s Discussion and Analysis of Financial Condition and Results of Operations includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The forward-looking statements involve risks and uncertainties. Forward-looking statements are identified by words such as anticipates, believes, expects, intends, will, and other similar expressions. However, these words are not the only way we identify forward-looking statements. In addition, any statements, which refer to expectations, projections, or other characterizations of future events or circumstances, are forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, including those set forth in Item 1A, Risk Factors, those described elsewhere in this report, and those described in our other reports filed with the SEC. We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report, and we undertake no obligation to release the results of any revisions to these forward-looking statements that could occur after the filing of this report.

Restatement

With this amendment to our annual report on Form 10-K, we have restated the following previously filed consolidated financial statements, data and related disclosures:

(1) Our consolidated balance sheets as of December 31, 2008 and 2007 and the related consolidated statements of operations, stockholders equity, and cash flows for the fiscal years ended December 2008, 2007 and 2006 in Part II, Item 8;

(2) Our selected financial data as of and for our fiscal years ended December 31, 2008, 2007 and 2006 in Part II, Item 6;

(3) Our management s discussion and analysis of financial condition and results of operations as of and for our fiscal years ended December 31, 2008, 2007 and 2006 contained herein; and

(4) Our unaudited quarterly financial information for each quarter in our fiscal years ended December 31, 2008 and 2007 in Note 19, Quarterly Results of Operations (Unaudited) (Restated) of the Notes to Consolidated Financial Statements in Part II, Item 8.

The Restatement results from our management s determination subsequent to the issuance of our financial statements for the year ended December 31, 2008 that there were errors in 1) the recording of revenue transactions from our Medical line of business in the years ended December 31, 2008, 2007, and 2006; 2) the recording of stock-based compensation expense for the years ended December 31, 2008 and 2007; 3) the recording of interest income arising from future installments due from Sony Computer Entertainment determined under the interest method for the years ended December 31, 2008 and 2007; and (4) the recording of amortization and impairment of patents in the years ended December 31, 2008, 2007, and 2006, and therefore our consolidated financial statements required restatement. We have also corrected other errors that were not significant individually or in the aggregate. See Explanatory Note

Regarding Restatement immediately preceding Part I, Item 1 and Note 2, Restatement of Consolidated Financial Statements of the Notes to Consolidated Financial Statements in Part II, Item 8 for a detailed discussion of the review and effect of the restatement.

The following discussion and analysis of our financial condition and results of operations incorporates the restated amounts. For this reason the data set forth in this section may not be comparable to discussions and data in our previously filed Annual Reports.

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Critical Accounting Policies and Estimates

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

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

Revenue Recognition

We recognize revenues in accordance with applicable accounting standards, including SEC Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition (SAB No. 104), Emerging Issues Task Force (EITF) No. 00- 21 (EITF No. 00-21), Accounting for Revenue Arrangements with Multiple Deliverables, American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, Software Revenue Recognition (SOP 97-2), as amended. Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, the fee is fixed and determinable, and collectability is probable. We derive our revenues from three principal sources: royalty and license fees, product sales, and development contracts.

Royalty and license revenue We recognize royalty and license revenue based on royalty reports or related information received from the licensee as well as time-based licenses of our intellectual property portfolio. Up-front payments under license agreements are deferred and recognized as revenue either based on the royalty reports received or amortized over the license period depending on the nature of the agreement. Advance payments under license agreements that also require us to provide future services to the licensee are deferred and recognized over the service period once services commence when vendor-specific objective evidence (VSOE) related to the value of the services does not exist.

We generally recognize revenue from our licensees under one or a combination of the following license models:

License revenue model	**Revenue recognition**
Perpetual license of intellectual property portfolio based on per unit royalties, no services contracted.	Based on royalty reports received from licensees. No further obligations to licensee exist.
Time-based license of intellectual property portfolio with up-front payments and/or annual minimum royalty requirements, no services contracted. Licensees have certain rights to updates to the intellectual property portfolio during the contract period.	Based on straight-line amortization of annual minimum/up-front payment recognized over contract period or annual minimum period.

Perpetual license of intellectual property portfolio or technology license along with contract for development work.	Based on proportional performance method over the service period or completed performance method.
License of software or technology, no modification necessary, no services contracted.	Up-front revenue recognition based on SOP 97-2 criteria or EITF No. 00-21, as applicable.

Individual contracts may have characteristics that do not fall within a specific license model or may have characteristics of a combination of license models. Under those circumstances, we recognize revenue in accordance with SAB No. 104, EITF No. 00-21, and SOP 97-2, as amended, to guide the accounting treatment for each individual contract. See also the discussions regarding Multiple element arrangements below. If the information received from our licensees regarding royalties is incorrect or inaccurate, our revenues in future periods may be adversely affected. To date, none of the information we have received from our licensees has caused any material reduction in future period revenues.

Product sales We generally recognize revenues from product sales when the product is shipped, provided the other revenue recognition criteria are met, including that collection is determined to be probable and no significant obligation remains. We sell the majority of our products with warranties ranging from three to sixty months. We record the estimated warranty costs during the quarter the revenue is recognized. Historically, warranty-related costs and related accruals have not been significant. We offer a general right of return on the MicroScribe product line for 14 days after purchase. We recognize revenue at the time of shipment of a MicroScribe digitizer and provide an accrual for potential returns based on historical experience. We offer no other general right of return on our products.

Development contracts and other revenue Development contracts and other revenue is comprised of professional services (consulting services and/or development contracts), customer support, and extended warranty contracts. Development contract revenues are recognized under the cost-to-cost percentage-of-completion accounting method based on physical completion of the work to be performed or completed contract method. Losses on contracts are recognized when determined. Revisions in estimates are reflected in the period in which the conditions become known. Customer support and extended warranty contract revenue is recognized ratably over the contractual period.

Multiple element arrangements We enter into revenue arrangements in which the customer purchases a combination of patent, technology, and/or software licenses, products, professional services, support, and extended warranties (multiple element arrangements). We allocate revenue to each element based on the relative fair value of each of the elements. If vendor specific objective evidence of fair value does not exist, the revenue is generally recorded over the term of the contract or upon delivery of all elements for which vendor specific evidence of fair value does not exist.

Our revenue recognition policies are significant because our revenues are a key component of our results of operations. In addition, our revenue recognition determines the timing of certain expenses, such as commissions and royalties. Revenue results are difficult to predict, and any shortfall in revenue or delay in recognizing revenue could cause our operating results to vary significantly from quarter to quarter and could result in greater or future operating losses.

Stock-based Compensation

We account for stock-based compensation in accordance with SFAS No. 123R Share-Based Payment (SFAS No. 123R). We elected the modified-prospective method, under which prior periods are not revised for comparative purposes. Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period.

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

Expected term We estimate the expected term of options granted by calculating the average term from our historical stock option exercise experience. We used the simplified method as prescribed by SAB No. 107 for options granted prior to January 1, 2008.

Expected volatility We estimate the volatility of our common stock taking into consideration our historical stock price movement, the volatility of stock prices of companies of similar size with similar businesses, if any, and our expected future stock price trends based on known or anticipated events.

Risk-free interest rate We base the risk-free interest rate that we use in the option pricing model on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on the options.

Expected dividend We do not anticipate paying any cash dividends in the foreseeable future and therefore use an expected dividend yield of zero in the option pricing model.

Forfeitures We are required to estimate future forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of compensation expense to be recognized in future periods.

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

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

See Note 11 to the consolidated financial statements for further information regarding the SFAS No. 123R disclosures.

Accounting for Income Taxes

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

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

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

Litigation Settlements, Conclusions, and Patent License

In March 2007, we announced the conclusion of our patent infringement litigation against Sony Computer Entertainment at the U.S. Court of Appeals for the Federal Circuit. Sony Computer Entertainment satisfied the U.S. District Court for the Northern District of California judgment against it. As of March 19, 2007, we entered into a new business agreement with Sony Computer Entertainment. We determined that the conclusion of our litigation with Sony Computer Entertainment did not trigger any payment obligations under our Microsoft agreements. However, on June 18, 2007, Microsoft filed a complaint against us in the United States District Court for the Western District of Washington alleging breach of our Sublicense Agreement dated July 25, 2003 and seeked damages, specific performance, declaratory judgment, and attorneys fees and costs. At a court ordered mediation meeting on December 11, 2007, Microsoft indicated they believe the amount owed to be $35.6 million. On August 25, 2008, the parties agreed to settle Microsoft s breach of contract claim as well as our counterclaim. The settlement arrangement provided that we pay Microsoft $20.8 million, which we paid in October 2008, and the case was dismissed.

Short-term Investments

Our short-term investments consist primarily of highly liquid commercial paper and government agency securities purchased with an original or remaining maturity of greater than 90 days on the date of purchase. We classify all debt securities with readily determinable market values as available-for-sale in accordance with SFAS No. 115. 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 in accordance with Accounting Research Bulletin No. 43, Chapter 3A, Working Capital Current Assets and Current Liabilities, as they are reasonably expected to be realized in cash or sold during our normal operating cycle. These investments are carried at fair market value with unrealized gains and losses considered to be temporary in nature reported as a separate component of other comprehensive income (loss) within stockholders equity.

We follow the guidance provided by Financial Accounting Standards Board (FASB) Staff Position (FSP) 115-1/124-1 and EITF No. 03-01 The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments to assess whether our investments with unrealized loss positions are other than temporarily impaired. Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and are reported in the consolidated statement of operations. Factors considered in determining whether a loss is temporary include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

Effective January 1, 2008, we adopted the provisions of SFAS No. 157, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements required under other accounting pronouncements. SFAS No. 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. SFAS No. 157 also requires that a fair value measurement reflect the assumptions market participants would use in pricing an asset or liability based on the best information available. Assumptions include the risks inherent in a particular valuation technique (such as a pricing model) and/or the risks inherent in the inputs to the model.

SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under SFAS No. 157 are described below:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical unrestricted assets or liabilities;

Level 2: Quoted prices in markets that are less active or financial instruments for which all significant inputs are observable, either directly or indirectly;

Level 3: Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

A financial instrument s level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

In February 2008, the Financial FASB issued FSP No. 157-2 that delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) until fiscal years beginning after November 15, 2008. The delay is intended to allow the FASB and constituents additional time to consider the effect of various implementation issues that have arisen, or that may arise, from the application of SFAS No. 157. We continue to assess the impact that FSP 157-2 may have on our consolidated financial position and results of operations.

Further information about the application of SFAS No. 157 may be found in Note 3 to the consolidated financial statements.

Recovery of Accounts Receivable

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

Inventory Reserves

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

Product Return and Warranty Reserves

We provide for estimated costs of future anticipated product returns and warranty obligations based on historical experience when related revenues are recognized, and we defer extended warranty-related revenue over the related warranty term.

Intangible Assets

We have acquired patents and other intangible assets. In addition, we capitalize the external legal and filing fees associated with patents and trademarks. We assess the recoverability of our intangible assets, and we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets that affect our consolidated financial statements. If these estimates or related assumptions change in the future, we may be required to record impairment charges for these assets. We amortize our intangible assets related to patents and trademarks, once they issue, 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 2008, we capitalized costs associated with patents and trademarks of $2.4 million. Our total amortization expense for the same period for all intangible assets was $842,000.

Restructuring Costs

We calculate our Restructuring costs based upon our estimate of workforce reduction costs, asset impairment charges, and other appropriate charges resulting from a restructuring. The Company accounts for restructuring costs in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets and SFAS No. 146, Accounting for Costs Associated with Exit of Disposal Activities Based on our assumptions, judgments, and estimates, we determine whether we need to record an impairment charge to reduce the value of the asset carried on our balance sheet to its estimated fair value. Assumptions, judgments and estimates about future values are complex and often subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in our business strategy.

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

Results of Operations

Overview of 2008

During 2008, we achieved several milestones. We continued to invest in research, development, sales, and marketing across all our key business segments. Key events in the year were as follows:

- Royalty and license revenue growth of 20% in 2008 over 2007.
- We continued to have strong growth of Mobility revenues as shown by the 106% increase in 2008 over 2007.
- We announced the divestiture of our 3D product line, which was completed in 2009. Operations of our 3D product line have been retrospectively classified as discontinued operations in our consolidated statement of operations.
- In August 2008, we settled our litigation with Microsoft and we agreed to make a one-time payment to Microsoft in the amount of $20.8 million, which was recorded in the third quarter of 2008 and paid in October 2008.

With our planned divestiture of the 3D product line we hope to achieve cost reductions that can positively impact our future financial results. With our plan to move the medical operating segment to San Jose, we hope to achieve additional cost reductions in 2009. In 2009, we expect to continue to focus on the execution of plans in our established businesses to increase revenue and make selected investments for product-based solutions for longer-term growth areas. Our success could be limited by several factors, including the current macro-economic climate, the timely release of our new products and our licensees products, continued market acceptance of our products and technology, the introduction of new products by existing or new competitors, and the cost of ongoing litigation. For a further discussion of these and other risk factors, see Item 1A Risk Factors.

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

	Years Ended December 31,		
	2008	2007	2006
Revenues:			
Royalty and license	50.9%	39.4%	31.8%
Product sales	39.7	46.9	53.8
Development contracts and other	9.4	13.7	14.4
Total revenues	100.0	100.0	100.0
Costs and expenses:			
Cost of product sales (exclusive of amortization of intangibles shown separately below)	26.9	24.1	24.8
Sales and marketing	55.3	34.1	44.4
Research and development	46.7	34.5	33.1
General and administrative	68.8	42.1	43.5
Amortization and impairment of intangibles	3.2	3.8	4.9
Litigation settlements, conclusions, and patent license	74.1	(447.6)	(7.2)
Restructuring costs	0.5		
Total costs and expenses	275.5	(309.0)	143.5
Operating income (loss)	(175.5)	409.0	(43.5)
Interest and other income	15.0	22.0	1.2
Interest and other expense	(0.9)	(3.4)	(6.9)
Income (loss) from continuing operations before provision for income taxes	(161.4)	427.6	(49.2)
Provision for income taxes	(18.2)	(42.6)	0.9
Income (loss) from continuing operations	(179.6)	385.0	(48.3)
Discontinued operations, net of provision for income taxes	(2.6)	3.5	2.2
Net income (loss)	(182.2)%	388.5%	(46.1)%

Comparison of Years Ended December 31, 2008, 2007, and 2006

Revenues

	2008	% Change	2007	% Change	2006
			($ in thousands)		

Royalty and license	$ 14,254	20%	$ 11,881	63%	$ 7,304
Product sales	11,110	(21)%	14,138	15%	12,342
Development contracts and other	2,617	(36)%	4,121	24%	3,313
Total revenue	$ 27,981	(7)%	$ 30,140	31%	$ 22,959

Fiscal 2008 Compared to Fiscal 2007

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

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

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

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

Sony announced on May 8, 2006 that the vibration feature that is currently available on PlayStation (PS1) and PlayStation 2 (PS2) console systems would be removed from the new PlayStation 3 (PS3) console system. The PS3 console system was launched in late 2006 in the United States and Japan without native vibration or any force feedback capability of any kind. In the first quarter of 2007, Sony released an update to the PS3 console system that offered limited vibration and force feedback support for some older PS1 and PS2 games and controllers. In September 2007, Sony announced that it would fully restore vibration feedback features for the PS3 console system. The new PS3 DualShock 3 controllers with vibration feedback were released in Japan in November 2007 as standalone products sold separately from the PS3 console system. In April 2008, Sony released the PS3 DualShock 3 controller in the U.S. and released a version in Europe in July of 2008. While a very limited number of third party PS3 vibration and force feedback products have been announced recently, including various steering wheel models from Logitech, we do not know to what extent Sony will foster the market for other third-party PS3 gaming peripherals with vibration feedback. To the extent Sony discourages or impedes third-party controller makers from making more PS3 controllers with vibration feedback, our licensing revenue from third-party PS3 peripherals will continue to be severely limited.

Based on our litigation conclusion and new business agreement entered into with Sony Computer Entertainment in March 2007 (see Note 12 to the consolidated financial statements for more discussion), we will recognize a minimum of $30.0 million as royalty and license revenue from March 2007 through March 2017, approximately $750,000 per quarter. For the Microsoft Xbox 360 video console system launched in November 2005, Microsoft has, to date, not broadly licensed third parties to produce game controllers. Because our gaming royalties come mainly from third-party manufacturers, unless Microsoft broadens its licenses to third-party controller makers, particularly with respect to wireless controllers for Xbox 360, our gaming royalty revenue may decline. Additionally, Microsoft is now making touch-enabled wheels covered by its royalty-free, perpetual, irrevocable license to our worldwide portfolio of patents that could compete with our licensees current or future products for which we earn per unit royalties. For the Nintendo Wii video console system launched in December 2006, Nintendo has, to date, not yet broadly licensed third parties to produce game controllers for its Wii game console. Because our gaming royalties come mainly from third-party manufacturers, unless Nintendo broadens its licenses to third-party controller makers, our gaming royalty revenue may decline.

Touch interface product royalties decreased mainly due to the recognition of certain automotive royalty payments in the second quarter of 2007 that did not recur. In addition, BMW has begun to remove our technology from certain controller systems, that also caused automotive royalties to decline. We expect that this removal of our technology from certain controller systems will cause our automotive royalty revenue to decline in the future, which may be partially offset by new vehicles from other manufacturers brought to market.

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

Development contracts and other revenue Development contracts and other revenue decreased by $1.5 million or 36% from 2007 to 2008. Development contracts and other revenue is comprised of revenue on commercial and government contracts. The decrease was mainly attributable to a decrease in medical contract revenue of $1.3 million due to the completion of work performed under medical contracts that occurred in 2007 through the first six months of 2008, and decreased touch interface product contract revenue of $564,000 primarily due to contracts being completed during the year. Partially offsetting this, there was increased revenue recognized on mobile device development contracts and support of $370,000. We do not currently have any government projects in development. We continue to transition our engineering resources from certain commercial development contract efforts to product development efforts that focus on leveraging our existing sales and channel distribution capabilities.

Fiscal 2007 Compared to Fiscal 2006

Total Revenue Our total revenue for the year ended December 31, 2007 increased by $7.1 million or 31% to $30.1 million, from $23.0 million in 2006.

Royalty and license revenue Royalty and license revenue increased by $4.6 million or 63% from 2006 to 2007. The increase in royalty and license revenue was primarily a result of an increase in gaming royalties of $2.4 million, an increase in mobile device license and royalty revenue of $1.3 million, and an increase in touch interface product royalties of $1.0 million, offset in part by a decrease in medical license fees of $147,000.

The increase in gaming royalties compared to 2006 was mainly due to new royalty and license revenue from first-party gaming licensee Sony Computer Entertainment. During 2007, we recognized $2.4 million of revenue from Sony Computer Entertainment. Sony Computer Entertainment became a licensee in March 2007, and accordingly there was no license revenue from Sony Computer Entertainment in the prior year comparative period. In addition, revenues from our third-party peripheral licensees generally continued to decline primarily due to reduced sales of past generation video console systems and the significant decline in third-party market share of aftermarket game console controllers.

Mobile device license and royalty revenue increased due to the shipment of more TouchSense enabled phones by Samsung and LG Electronics, and the signing of a new license contract with mobile device manufacturer Nokia at the end of the second quarter of 2007. Touch interface product royalties increased due to increased licensee revenue from additional products licensed in the automotive market and the recognition of certain one-time royalty payments in the second quarter of 2007. The decrease in medical royalty and license revenue was primarily due to a decrease in license revenue from our license and development agreements with Medtronic.

Product sales Product sales increased by $1.8 million or 15% from 2006 to 2007. The increase in product sales was primarily due to increased medical product sales of $1.4 million, mainly due to increased sales of our endoscopy and Virtual IV simulator platforms. This increase in product sales was a result of pursuing a product growth strategy for our medical business, which includes leveraging our industry alliances, resulting in significant increases in the sales of our Virtual IV platform and expanding international sales, resulting in additional increases in revenue from our endoscopy platform. Sales of our touch interface products increased by $390,000 including increased sales of touchscreen and touch panel components, force feedback electronics for arcade gaming, and rotary modules. The increase in touch interface products is attributable to the successful introduction of a customers product in which our arcade gaming boards are used as well as increased shipments of our rotary modules as a result of design wins.

Development contracts and other revenue Development contracts and other revenue increased by $808,000 or 24% from 2006 to 2007. Commercial contract revenue increased by $1.8 million due to increased medical contract revenue primarily from Medtronic for four new development contracts completed in 2007, increased contract revenue from the completion of one mobile device development contract, and increased revenue from new and continuing mobile device development contracts, partially offset by a decrease in touch interface product contract revenue. Partially offsetting the increase in commercial contract revenue was a decrease in government contract work of $1.1 million primarily due to the completion of work performed under a medical government contract in 2006.

Cost of Product Sales

	2008	% Change	2007	% Change	2006
			($ in thousands)		
Cost of product sales	$ 7,516	3%	$ 7,272	28%	$ 5,690
% of product sales	68%		51%		46%

Our cost of product sales (exclusive of amortization of intangibles) consists primarily of materials, labor, and overhead. There is no cost of product sales associated with royalty and license revenue or development contract revenue. Cost of product sales increased by $244,000 or 3% from 2007 to 2008. The increase in cost of product sales was primarily due to an increase of overhead costs of $383,000, an increase in excess and obsolete inventory provisions of $235,000, increased provision for warranty and repair costs of $177,000, and increased royalties of $137,000 partially offset by decreased material and production costs of $666,000. Overhead costs increased, in part, as a result of increased salary expense from additional headcount and other costs of programs to improve quality processes within our manufacturing operations. The decrease in direct material costs was mainly a result of decreased product sales. Royalty costs increased due to increased sales of certain medical products with associated royalty costs. Cost of product sales increased as a percentage of product revenue to 68% in 2008 from 51% in 2007. This increase is mainly due to reduced sales and the increased overhead and other costs mentioned above.

Cost of product sales increased by $1.6 million or 28% from 2006 to 2007. The increase in cost of product sales was primarily due to an increase of overhead costs of $934,000, increased material and production costs of $479,000, and increased freight of $158,000. The increase in material and production costs was primarily a result of increased product sales. Overhead costs increased, in part, as a result of increased salary expense primarily due to increased headcount to support programs to improve quality processes as well as other improvements within our manufacturing operations that we anticipate will continue in 2008. Cost of product sales increased as a percentage of product revenue to 51% in 2007 from 46% in 2006. This increase is mainly due to the increased overhead costs mentioned above as well as increased sales of our lower margin Virtual IV medical simulator changing the sales mix.

Expenses

	2008	% Change	2007	% Change	2006
			($ in thousands)		
Sales and marketing	$ 15,472	51%	$ 10,272	1%	$ 10,186
Research and development	13,058	26%	10,389	37%	7,609
General and administrative	19,249	52%	12,683	27%	9,981
Amortization and impairment of intangibles	888	(23)%	1,146	2%	1,121
Litigation conclusions and patent license	20,750	*%	(134,900)	*%	(1,650)
Restructuring costs	142	*%		*%	

* Percentage not meaningful.

Sales and Marketing Our sales and marketing expenses are comprised primarily of employee compensation and benefits, sales commissions, advertising, trade shows, brochures, market development funds, travel, and an allocation of facilities costs. Sales and marketing expenses increased by $5.2 million or 51% in 2008 compared to 2007. The increase was primarily due to increased compensation, benefits, and overhead of $2.2 million, increased marketing, advertising, and public relations costs of $1.1 million, increased sales and marketing travel expense of $622,000, increased consulting costs of $551,000 to supplement our sales and marketing staff, increased office and facilities expenses of $307,000, an increase in bad debt expense of $236,000, and increased employee recruiting costs of $163,000. The increased sales and marketing expenses were primarily due to an increase in sales and marketing headcount and the expanding of our sales and marketing efforts internationally. In addition, the increased compensation, benefits, and overhead expense was mainly due to an increase in sales and marketing headcount, increased compensation for sales and marketing personnel, and increased non-cash stock based compensation charges. We expect to continue to focus our sales and marketing efforts on medical and touch market opportunities to build greater market acceptance for our technologies as well as continue to expand our sales and marketing presence internationally. We will continue to invest in sales and marketing in future periods to exploit market opportunities for our technology.

Sales and marketing expenses increased by $86,000 or 1% in 2007 compared to 2006. The increase was mainly the result of an increase in bad debt expense of $142,000 and an increase in professional and consulting expenses of $117,000 primarily due to increased employee recruitment fees offset in part by decreased advertising and marketing expenses including, collateral, product marketing, and public relations costs of $84,000 and decreased sales and marketing travel expense of $53,000.

Research and Development Our research and development expenses are comprised primarily of employee compensation and benefits, consulting fees, tooling and supplies, and an allocation of facilities costs. Research and development expenses increased by $2.7 million or 26% in 2008 compared to 2007. The increase was primarily due to increased compensation, benefits, and overhead expense of $1.7 million, increased professional and consulting expense of $585,000 to supplement our engineering staff, and an increase in lab and prototyping expenses of $277,000 in support of sales efforts. The increased compensation, benefits, and overhead expense was primarily due to increased research and development headcount and increased non-cash stock-based compensation charges. We expect to move away from custom-engineering projects and move to product-based solutions and believe that continued significant investment in research and development is critical to our future success, and we expect to make significant investments in areas of research and technology development to support future growth.

Research and development expenses increased by $2.8 million or 37% in 2007 compared to 2006. The increase was primarily due to increased compensation, benefits, and overhead expense of $2.5 million, increased professional and consulting expense of $214,000 to supplement our engineering staff, and an increase in travel of $143,000 in support of sales efforts, offset in part by a decrease in prototyping expenses of $114,000. The increased compensation, benefits, and overhead expense was primarily due to increased research and development headcount and increased non-cash stock-based compensation charges. Additionally, environmental regulation compliance caused overall research and development expenses to increase for the period.

General and Administrative Our general and administrative expenses are comprised primarily of employee compensation and benefits, legal and professional fees, office supplies, travel, and an allocation of facilities costs. General and administrative expenses increased by $6.6 million or 52% in 2008 compared to 2007. The increase was primarily due to increased legal, professional, and license fee expense of $3.4 million, increased compensation, benefits, and overhead of $2.5 million, increased travel costs of $274,000, and increased supplies and office and facilities expense of $183,000. The increased legal, professional, and license fee expenses were primarily due to increased litigation and other activities that we were engaged in, mainly the litigation with Microsoft; increased consulting costs; and increased recruiting costs due to management changes. The increased compensation, benefits, and overhead expense was primarily due to changes in executive personnel that resulted in additional costs, increased general and administrative headcount, increased compensation for general and administrative personnel, and increased non-cash stock-based compensation charges. We expect that the dollar amount of general and administrative expenses to continue to be a significant component of our operating expenses. We will continue to incur costs related to litigation as we continue to assert our intellectual property rights and defend lawsuits brought against us.

General and administrative expenses increased by $2.7 million or 27% in 2007 compared to 2006. The increase was mainly due to increased legal and professional fee expenses of $2.0 million, increased compensation, benefits, and overhead expense of $464,000, increased public company expense of $70,000, and increased bank and investment fees of $56,000. The increased legal and professional fee expenses were primarily due to increased audit, tax, and accounting fees due to the accounting and valuation for Sony Computer Entertainment litigation conclusion and patent license, resolution of a routine SEC review of our prior periodic filings, and income tax related issues; increased general legal and patent costs; and increased consulting costs related to long term strategic planning. The increased compensation, benefits, and overhead expense was primarily due to increased headcount and increased bonus and incentive compensation.

Amortization and impairment of Intangibles Our amortization impairment of intangibles is comprised primarily of patent amortization and other intangible amortization along with impairment or write off of abandoned and expired patents. Amortization and impair of intangibles decreased by $258,000 or 23% from 2007 to 2008. The decrease was primarily attributable to some intangible assets reaching full amortization partially offset by an increase from the cost and number of new patents being amortized. Amortization of intangibles increased by $25,000 or 2% from 2006 to 2007. The increase was primarily attributable to an increase from the cost and number of new patents being amortized.

Litigation Settlements, Conclusions, and Patent License Litigation settlements, conclusions, and patent license was $20.8 million of expense for fiscal 2008, all of which related to our settlement with Microsoft, compared to income of $134.9 million for the same period in 2007, a change of $155.7 million. Litigation settlements, conclusions, and patent license increased by $133.2 million in 2007 compared to 2006. For fiscal 2007, the $134.9 million is comprised of $119.9 million related to Sony Computer Entertainment and $15.0 million related to the release of the Microsoft long-term customer advance. The $1.7 million paid to the Company in fiscal 2006 related to a patent infringement case against PDP.

In March 2007, we concluded our patent infringement litigation against Sony Computer Entertainment at the U.S. Court of Appeals for the Federal Circuit. In satisfaction of the Amended Judgment, we received funds totaling $97.3 million, inclusive of the award for past damages, pre-judgment interest and costs, and post-judgment interest. Additionally, we retained $32.4 million of compulsory license fees and interest thereon previously paid to us by Sony Computer Entertainment pursuant to court orders. As of March 19, 2007, both parties entered into an agreement whereby we granted Sony Computer Entertainment and certain of its affiliates a worldwide, non-transferable, non-exclusive license under our patents that have issued, may issue, or claim a priority date before March 2017 for the going forward use, development, manufacture, sale, lease, importation, and distribution of its current and past PlayStation and related products. The license does not cover adult, foundry, medical, automotive, industrial, mobility, or gambling products. Subject to the terms of the agreement, we also granted Sony Computer Entertainment and certain of its affiliates certain other licenses (relating to PlayStation games, backward compatibility of future consoles, and the use of their licensed products with certain third party products), an option to obtain licenses in the future with respect to future gaming products and certain releases and covenants not to sue. Sony Computer Entertainment granted us certain covenants not to sue and agreed to pay us twelve quarterly installments of $1.875 million (for a total of $22.5 million) beginning on March 31, 2007 and ending on December 31, 2009, and may pay us certain other fees and royalty amounts. In total, we will receive a minimum of $152.2 million through the conclusion of the litigation and the separate patent license. In accordance with the guidance from EITF No. 00-21, we allocated the present value of the total payments, equal to $149.9 million, between each element based on their relative fair values. Under this allocation, we recorded $119.9 million as litigation conclusions and patent license income and the remaining $30.0 million was allocated to deferred license revenue. Such deferred revenue was $18.4 million as of December 31, 2008. We recorded $2.4 million and $3.0 million as revenue for the years ended December 31, 2007, and 2008, respectively. On December 31, 2008, we had recorded $5.4 million of the $30.0 million as revenue and will record the remaining $24.6 million as revenue, on a straight-line basis, over the remaining capture period of the patents licensed, ending March 19, 2017. We accounted for future payments in accordance with Accounting Principles Board Opinion No. 21 (ABP No. 21). Under APB No. 21, we determined the present value of the $22.5 million future payments to equal $20.2 million. This amount is accounted for at December 31, 2008 in deferred revenue.

We are accounting for the difference of $2.3 million as interest income as each $1.875 million quarterly payment installment becomes due.

Under the terms of a series of agreements that we entered into with Microsoft in 2003, in the event we had elected to settle the action in the United States District Court for the Northern District of California entitled *Immersion Corporation v. Sony Computer Entertainment of America, Inc., Sony Computer Entertainment Inc. and Microsoft Corporation*, Case No. C02-00710 CW (WDB), as such action pertains to Sony Computer Entertainment, and grant certain rights, we would be obligated to pay Microsoft a minimum of $15.0 million for amounts up to

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$100.0 million received from Sony Computer Entertainment, plus 25% of amounts over $100.0 million up to $150.0 million, and 17.5% of amounts over $150.0 million. The patent infringement litigation with Sony Computer Entertainment was concluded in March 2007 at the U.S. Court of Appeals for the Federal Circuit without settlement. We determined that the conclusion of our litigation with Sony Computer Entertainment did not trigger any payment obligations under our Microsoft agreements. Accordingly, the liability of $15.0 million that was in the financial statements at December 31, 2006 was extinguished, and we accounted for this sum during 2007 as litigation conclusions and patent license income. However, on June 18, 2007, Microsoft filed a complaint against us in the U.S. District Court for the Western District of Washington alleging one claim for breach of a contract. In a letter sent to us dated May 1, 2007, Microsoft stated that it believed we owed Microsoft at least $27.5 million, an amount that was subsequently increased to $35.6 million. Although we disputed Microsoft s allegations, on August 25, 2008 the parties agreed to settle all claims. We made no offers to settle prior to August 25, 2008. Under the terms of the settlement, we paid Microsoft $20.8 million in October 2008.

In February 2006, we announced that we had settled our legal differences in our complaint for patent infringement against PDP and that both parties had agreed to dismiss all claims and counterclaims relating to this matter. In addition to the Confidential Settlement Agreement, PDP entered into a worldwide license to our patents for vibro-tactile devices in the consumer gaming peripheral field of use. According to the terms of the agreement, PDP will make royalty payments to us based on sales by PDP of spinning mass vibro-tactile gamepads, steering wheels, and other game controllers for dedicated gaming consoles, such as the Sony PS1 and PS2, the Nintendo GameCube, and the Microsoft Xbox and Xbox 360. For the year ended December 31, 2006 PDP paid us $1.7 million, and we recorded that amount as litigation conclusions and patent license income.

Restructuring Restructuring costs consist primarily of severance benefits paid as the result of the reduction of workforce due to business changes in our Touch segment of $142,000. There were no restructuring charges incurred in the years ended 2006 or 2007.

Interest and Other Income/Expense

	2008	% Change	2007	% Change	2006
			($ in thousands)		
Interest and other income	$ 4,174	(37)%	$ 6,623	2308%	$ 275
Interest and other expense	(250)	(76)%	(1,024)	(36)%	(1,602)

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

Interest and other income increased by $6.3 million from 2006 to 2007 as a result of increased interest income earned on increased cash, cash equivalents, and short-term investments invested after the receipt of the judgment from Sony Computer Entertainment in March 2007. Interest income earned on the payments from Sony Computer Entertainment up until the judgment became final had been included in deferred revenue. Accreted interest income on payments received from Sony Computer Entertainment was $1.0 million and $904,000 in 2007 and 2008, respectively, and accreted interest income on payments to be received is expected to be $377,000 in 2009.

Interest and Other Expense Interest and other expense consists primarily of interest and accretion expense on our 5% Senior Subordinated Convertible Debentures (5% Convertible Debentures) and accretion and dividend expense on our long-term customer advance from Microsoft along with impairment losses on long term notes receivable. Interest and other expense decreased by $774,000 from 2007 to 2008 due to the elimination of interest expense from the conversion and redemption of our 5% Convertible Debentures during the third quarter of 2007 partially offset by impairment losses on long term notes receivable. Interest and other expense decreased by $578,000 from 2006 to 2007 due to the conversion and redemption of our 5% Convertible Debentures during the third quarter of 2007. See Note 8 to the consolidated financial statements.

Provision for Taxes

	2008	% Change	2007	% Change	2006
			($ in thousands)		
Provision for income taxes	$ 5,088	(60)%	$ 12,850	(5994)%	$ (218)

Provision for Income Taxes For the year ended 2008, we recorded a provision for income taxes of $5.1 million yielding an effective tax rate of 11.3%. The current year tax provision is reflective of the recording of a full valuation allowance against our entire deferred tax asset balance in the period due to losses in fiscal 2008, the variability of operating results, and near term projected losses. Accordingly, the effective tax rate differs from the statutory rate. For the year ended 2007, we recorded a provision for income taxes of $12.9 million yielding an effective tax rate of 10.0%. The 2007 tax provision is primarily reflective of federal and state tax expense as a result of our pre-tax income of $128.9 million mainly due to the litigation conclusions and patent license from Sony Computer Entertainment, see Note 12 to the consolidated financial statements. The effective tax rate differs from the statutory rate primarily due to the significant reduction in our valuation allowance against deferred tax assets as we used the majority of our net operating loss carryforwards against current year taxable income. For the year ended 2006, we recorded a benefit for income taxes of $218,000, yielding an effective tax rate of (1.9%). The provision for income tax was based on federal and state alternative minimum income tax payable on taxable income and foreign withholding tax expense. Although we incurred a pre-tax loss of $11.3 million, sums received from Sony Computer Entertainment and interest thereon included in long-term deferred revenue, approximating $11.1 million in 2006, are taxable, thus giving rise to an overall taxable profit. The effective tax rate differs from the statutory rate primarily due to the recording of a full valuation allowance against deferred tax assets.

Discontinued Operations

	2008	% Change	2007	% Change	2006
			($ in thousands)		
Discontinued Operations	$ (732)	(169)%	$ 1,059	110%	$ 505

Discontinued Operations Discontinued operations consists of operations of our 3D product line, the divesture of which was announced in November 2008 and sold in the first quarter and second quarter of 2009 that have been classified as discontinued operations in the consolidated statement of operations (see Note 13 to the consolidated financial statements for more discussion). Loss from discontinued operations, net of tax, increased by $1.8 million primarily due to inventory impairment charges and charges resulting from non-cancellable purchase orders of $2.1 million, severance costs of $105,000 and asset impairment charges of $275,000 partially offset by reduced income taxes of $752,000.

Segment Results for the Years Ended December 31, 2008, 2007, and 2006 are as follows:

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

	2008	% Change	2007	% Change	2006
			($ in thousands)		
Revenues:					
Touch	$ 16,912	16%	$ 14,590	61%	$ 9,040
Medical	11,180	(29)%	15,639	12%	14,009
Intersegment eliminations	(111)		(89)		(90)
Total	$ 27,981	(7)%	$ 30,140	31%	$ 22,959
Operating Income (Loss)*:					
Touch	$ (40,289)	(133)%	$ 122,771	1244%	$ (10,733)
Medical	(8,808)	(1765)%	529	(29)%	746
Intersegment eliminations	3		(22)		9
Total	$ (49,094)	(140)%	$ 123,278	1335%	$ (9,978)

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

Fiscal 2008 Compared to Fiscal 2007

Touch segment Revenues from the Touch segment increased by $2.3 million, or 16% in 2008 compared to 2007. Royalty and license revenues increased by $2.4 million, mainly due to an increase in mobile device license and royalty revenue primarily due to the shipment of additional TouchSense enabled phones, and an increase in gaming royalties mainly due to the recognition of previously deferred revenues from ISLLC and the increase in sales of new steering wheel products from Logitech offset by a decrease in touch interface product royalties mainly due to the recognition of certain automotive royalty payments in the second quarter of 2007 that did not recur. Product sales increased by $134,000 primarily due to an increase in product sales from touch interface products, mainly due to increased sales of touchscreen and touch panel components and increased sales of commercial gaming products. Development contract revenue decreased by $180,000 primarily due to reduced touch interface product contract revenue partially offset by increased revenue on mobile device development contracts and support. The segment s operating income changed by $163.1 million to an operating loss in 2008 as compared to an operating profit in 2007. The change was primarily due to increased litigation settlements, conclusions, and patent license income of $134.9 million ($119.9 million from Sony Computer Entertainment and $15.0 million related to the release of the

Microsoft long-term customer advance) occurring in 2007 and the Microsoft settlement expense in 2008 of $20.8 million; an increase in general and administrative expenses of $4.5 million; an increase in sales and marketing expenses of $2.9 million; an increase of research and development expenses of $1.9 million, and increased restructuring charges of $142,000. The change from income in 2007 to a loss in 2008 was partially offset by increased gross margin of $1.8 million mainly from increased royalty and license revenue and decreased amortization and impairment of intangibles of $255,000.

Medical segment Revenues from Medical decreased by $4.5 million or 29%, from 2007 to 2008. The decrease was primarily due to a decrease in medical product sales of $3.1 million mainly due to decreased sales of our endoscopy, endovascular, laparoscopy, and Virtual IV simulator platforms partially offset by increases in our arthroscopy simulators; and a decrease of $1.3 million in medical development contract revenue due to work completed under medical contracts in 2007. The decrease in medical contracts also represents continued efforts to move away from development work and concentrate on product sales and licensing. The decrease in product sales was primarily due to decreased international sales and delays in new product introductions. The segment s operating income changed by $9.3 million to a loss in 2008 as compared to a profit in 2007. The loss was mainly due to a decrease in gross margin of $4.2 million primarily due to decreased sales and a change in product sales mix, increased sales and marketing expenses of $2.3 million primarily due to international sales and marketing efforts, increased general and administrative expenses of $2.1 million, mainly litigation and legal costs, and increased research and development expenses of $756,000. With our plan to move the medical operating segment to San Jose, we hope to achieve certain cost reductions in 2009.

Fiscal 2007 Compared to Fiscal 2006

Touch segment Revenues from the Touch segment increased by $5.6 million, or 61% in 2007 compared to 2006. Royalty and license revenue increased by $4.7 million, mainly due to increased gaming royalties primarily from Sony Computer Entertainment, increased mobile device license and royalty revenue, and increased royalties and license fees from our touch interface product licensees. Product sales increased by $371,000, mainly due to increased sales of our touch interface products including touchscreen and touch panel components, force feedback electronics for arcade gaming, and rotary modules. Development contract revenue increased by $455,000, primarily due to continued revenue from mobile device development contracts, partially offset by a decrease in touch interface product contract revenue. The segment s operating income for 2007 increased by $133.5 million as compared to 2006. The increase was primarily due to the litigation conclusions and patent license income of $134.9 million ($119.9 million from Sony Computer Entertainment and $15.0 million from Microsoft) and increased gross margin of $4.4 million primarily due to increased sales. The increases were partially offset by an increase in general and administrative expenses of $3.1 million primarily due to increased legal and professional fees; the reduction of litigation settlements of $1.7 million from PDP in 2006; an increase of research and development expenses of $675,000 and an increase in sales and marketing expenses of $312,000.

Immersion Medical segment Revenues from Medical increased by $1.6 million, or 12% from 2006 to 2007. The increase was primarily due to an increase of $1.4 million in product sales and an increase of $370,000 in development contract revenue, partially offset by a decrease of $147,000 in royalty and license revenue. Product sales increased primarily due to increased sales of our endoscopy and our Virtual IV simulator platforms. This increase in product sales was a result of pursuing a product growth strategy for our medical business, which includes leveraging our industry alliances, resulting in significant increases in the sales of our Virtual IV platform; and expanding international sales, resulting in additional increases in the sales of our endoscopy platform. Increased contract revenue recognized from our contracts with Medtronic contributed to the increase in development contract revenue. Segment operating income for 2007 was $529,000, a decrease of $217,000 from the operating income of $746,000 for 2006. The reduction in net income was mainly due to increased operating expenses of $1.5 million offset by increased gross margin of $1.3 million. The increased operating expenses included increased research and development expenses of $2.1 million primarily due to increased headcount, offset in part by decreased general and administrative expenses of $398,000 and reduced sales and marketing expenses of $227,000. The increased gross margin was primarily due to increased product sales and increased development contracts primarily from Medtronic.

Liquidity and Capital Resources

Our cash, cash equivalents, and short-term investments consist primarily of money market funds and highly liquid commercial paper and government agency securities. All of our short-term investments are classified as available-for-sale under the provisions of SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. The securities are stated at market value, with unrealized gains and losses reported as a component of accumulated other comprehensive income, within stockholders equity.

On December 31, 2008, our cash, cash equivalents, and short-term investments totaled $85.7 million, a decrease of $52.4 million from $138.1 million on December 31, 2007.

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In March 2007, we concluded our patent infringement litigation against Sony Computer Entertainment and we received $97.3 million. Furthermore, we entered into a new business agreement under which, we are to receive twelve quarterly installments of $1.875 million for a total of $22.5 million beginning on March 31, 2007 and ending on December 31, 2009. As of December 31, 2008, we had received eight of these installments.

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

Net cash used in operating activities during 2008 was $30.4 million, a change of $115.0 million from the $84.6 million provided by operating activities during 2007. Cash used in operations during 2008 was primarily the result of a net loss of $51.0 million, a decrease of $1.5 million due to a change in other long-term liabilities, a decrease of $1.3 million due to a change in prepaid expenses and other current assets, a decrease of $1.0 million due to a change in accounts receivables, and a decrease of $415,000 due to a change in income taxes payable. These decreases were offset by an increase of $7.3 million due to a change in deferred income taxes, a $6.1 million increase due to a change in deferred revenue and customer advances and long-term customer advance from Microsoft, an increase of $2.4 million due to a change in accrued compensation and other current liabilities, and an increase of $1.5 million due to a change in accounts payable. Cash provided by operations during 2008 was also impacted by noncash charges and credits of $7.6 million, including $5.3 million of noncash stock-based compensation, $1.2 million in depreciation and amortization, $888,000 in amortization and impairment of intangibles, an increase to allowance for doubtful accounts of $351,000, partially offset by a credit of $220,000 from excess tax benefits from stock-based compensation. Net cash provided by operating activities during 2007 was $84.6 million, a change of $79.2 million from the $5.4 million provided by operating activities during 2006. Cash provided by operations during 2007 was primarily the result of our net income of $117.1 million, an increase of $15.2 million due to a change in income taxes payable, an increase of $960,000 due to a change in other long-term liabilities, and an increase of $620,000 due to a change in accrued compensation and other current liabilities. These increases were offset by a $30.6 million decrease due to a change in deferred revenue and customer advances mainly related to the conclusion of our patent litigation with Sony Computer Entertainment and the extinguishment of the customer advance from Microsoft, a decrease of $7.3 million due to a change in deferred income taxes, a decrease of $1.8 million due to a change in prepaid expenses and other current assets, a decrease of $943,000 due to a change in inventories, a decrease of $618,000 due to a change in accounts payable due to the timing of payments to vendors, and a decrease of $388,000 due to a change in accounts receivable. Cash provided by operations during 2007 was also impacted by noncash charges and credits resulting in a net credit of $7.6 million including a credit of $13.6 million from excess tax benefits from stock-based compensation, partially offset by $3.4 million of noncash stock-based compensation, $1.1 million in amortization and write off of intangibles, $911,000 in depreciation and amortization, and $535,000 in accretion expenses on our 5% Convertible Debentures.

Net cash provided by investing activities during 2008 was $25.3 million, compared to the $55.2 million used in investing activities during 2007, an increase of $80.5 million. Net cash provided by investing activities during the period consisted of an increase in maturities or sales of short-term investments of $90.0 million, partially offset by purchases of short-term investments of $59.2 million; $3.1 million used to purchase property and equipment, and a $2.4 million increase in intangibles and other assets, primarily due to capitalization of external patent filing and application costs. Net cash used in investing activities during 2007 was $55.2 million, compared to the $2.8 million used in investing activities during 2006, an increase of $52.4 million. Net cash used in investing activities during 2007 consisted of an increase in purchases of short-term investments of $96.7 million, a $2.2 million increase in intangibles and other assets, primarily due to capitalization of external patent filing and application costs, and $1.4 million used to purchase property and equipment, offset in part by $45.1 million of maturities or sales of short-term investments.

Net cash used in financing activities during 2008 was $16.6 million compared to $25.2 million provided during 2007, or a $41.8 million increase from the prior year. Net cash used in financing activities for the period consisted primarily of purchases of treasury stock of $18.4 million, partially offset by issuances of common stock and exercises of stock options and warrants in the amount of $1.6 million, and an increase of $220,000 from excess tax benefits from tax deductible stock-based compensation. Net cash provided by financing activities during 2007 was

$25.2 million compared to $1.3 million provided during 2006, or a $23.9 million increase from the prior year. Net cash provided by financing activities during 2007 consisted primarily of an increase of $13.6 million from excess tax benefits from tax deductible stock-based compensation, and issuances of common stock and exercises of stock options and warrants in the amount of $13.1 million, offset in part by the partial redemption of our 5% Convertible Debentures of $1.4 million with the remainder converted to common stock.

We believe that our cash and cash equivalents will be sufficient to meet our working capital needs for at least the next twelve months. We will continue to protect and defend our extensive intellectual property portfolio across all business segments. We anticipate that capital expenditures for the year ended December 31, 2009 will total approximately $3.0 million in connection with anticipated maintenance and upgrades to operations and infrastructure. Cash flows from our discontinued operations have been included in our consolidated statement of cash flows with continuing operations within each cash flow category. The absence of cash flows from discontinued operations is not expected to affect our future liquidity or capital resources. Additionally, if we acquire one or more businesses, patents, or products, our cash or capital requirements could increase substantially. In the event of such an acquisition, or should any unanticipated circumstances arise that significantly increase our capital requirements, we may elect to raise additional capital through debt or equity financing. Any of these events could result in substantial dilution to our stockholders. Although we expect to be able to raise additional capital if necessary, there is no assurance that such additional capital will be available on terms acceptable to us, if at all.

Summary Disclosures about Contractual Obligations and Commercial Commitments

The following table reflects a summary of our contractual cash obligations and other commercial commitments as of December 31, 2008 (in thousands):

Contractual Obligations	**Total**	**2009**	**2010 and 2011**	**2012 and 2013**	**2014**
Operating Leases	$ 3,555	$ 928	$ 1,250	$ 1,094	$ 283

As discussed in Note 14 to the consolidated financial statements, effective January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, (FIN 48). At December 31, 2008, we had a liability for unrecognized tax benefits totaling $642,000 including interest of $15,000, of which approximately $212,000 could be payable in cash. Due to the uncertainties related to these tax matters, we are unable to make a reasonably reliable estimate when cash settlement with a taxing authority will occur. Settlement of such amounts could require the utilization of working capital.

Recent Accounting Pronouncements

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

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

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

Cash Equivalents and Short-term Investments We have cash equivalents and short-term investments of $83.4 million as of December 31, 2008. These securities are subject to interest rate fluctuations. An increase in interest rates could adversely affect the market value of our fixed income securities. A hypothetical 100 basis point increase in interest rates would result in an approximate $110,000 decrease in the fair value of our cash equivalents and short-term investments as of December 31, 2008.

We limit our exposure to interest rate and credit risk by establishing and monitoring clear policies and guidelines for our cash equivalents and short-term investment portfolios. The primary objective of our policies is to preserve principal while at the same time maximizing yields, without significantly increasing risk. Our investment policy limits the maximum weighted average duration of all invested funds to 12 months. Our policy s guidelines

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also limit exposure to loss by limiting the sums we can invest in any individual security and restricting investment to securities that meet certain defined credit ratings. We do not use derivative financial instruments in our investment portfolio to manage interest rate risk.

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

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

IMMERSION CORPORATION

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Immersion Corporation:

We have audited the accompanying consolidated balance sheets of Immersion Corporation and subsidiaries (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of operations, stockholders equity (deficit), and cash flows for each of the three years in the period ended December 31, 2008. Our audits also included the financial statement schedule listed in the Index at Item 15 (a) 2. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Immersion Corporation and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, the Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of Statement of Financial Accounting Standards No. 109,* effective January 1, 2007.

As described in Note 2, the accompanying consolidated financial statements for the years ended December 31, 2008, 2007 and 2006 have been restated.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 9, 2009 (February 8, 2010 as to the effects of the additional material weaknesses related to stock-based compensation expense and revenue recognition described in Management s Report on Internal Controls Over Financial Reporting (as revised)) expressed an adverse opinion on the effectiveness of the Company s internal control over financial reporting because of material weaknesses.

/s/ DELOITTE & TOUCHE LLP

San Jose, California
March 9, 2009 (February 8, 2010 as to the effects of the Restatement discussed in Note 2 and of discontinued operations discussed in Note 13)

IMMERSION CORPORATION

CONSOLIDATED BALANCE SHEETS

	December 31, 2008 As Restated(1)	December 31, 2007 As Restated(1)
	(In thousands, except share and per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 64,769	$ 86,493
Short-term investments	20,974	51,619
Accounts receivable (net of allowances for doubtful accounts of: 2008 $436; 2007 $85)	6,114	5,494
Inventories, net	3,757	3,674
Deferred income taxes	311	3,378
Prepaid expenses and other current assets	4,344	3,036
Total current assets	100,269	153,694
Property and equipment, net	3,827	2,112
Deferred income tax assets, net		3,917
Intangibles and other assets, net	9,491	8,208
Total assets	$ 113,587	$ 167,931
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 2,842	$ 1,657
Accrued compensation	2,920	1,828
Other current liabilities	3,493	2,656
Deferred revenue and customer advances (Note 7)	8,042	4,393
Total current liabilities	17,297	10,534
Long-term deferred revenue	15,989	13,500
Deferred income tax liabilities	311	
Other long-term liabilities	212	1,720
Total liabilities	33,809	25,754
Commitments and contingencies (Notes 10 and 17)		
Stockholders equity:		
Common stock and additional paid-in capital $0.001 par value; 100,000,000 shares authorized; shares issued: December 31, 2008 30,674,045	167,870	160,862

and December 31, 2007 30,389,850; shares outstanding: December 31, 2008 27,887,482 and December 31, 2007 30,389,850		
Warrants	1,731	1,731
Accumulated other comprehensive income	109	137
Accumulated deficit	(71,543)	(20,553)
Treasury stock at cost: December 31, 2008 2,786,563 shares and December 31, 2007 0 shares	(18,389)	
Total stockholders equity	79,778	142,177
Total liabilities and stockholders equity	$ 113,587	$ 167,931

(1) See Note 2 Restatement of Consolidated Financial Statements of Notes to Consolidated Financial Statements.

See notes to consolidated financial statements.

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IMMERSION CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31,		
	2008 As Restated(1)	2007 As Restated(1)	2006 As Restated(1)
	(In thousands, except per share amounts)		
Revenues:			
Royalty and license	$ 14,254	$ 11,881	$ 7,304
Product sales	11,110	14,138	12,342
Development contracts and other	2,617	4,121	3,313
Total revenues	27,981	30,140	22,959
Costs and expenses:			
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	7,516	7,272	5,690
Sales and marketing	15,472	10,272	10,186
Research and development	13,058	10,389	7,609
General and administrative	19,249	12,683	9,981
Amortization and impairment of intangibles	888	1,146	1,121
Litigation settlements, conclusions, and patent license	20,750	(134,900)	(1,650)
Restructuring costs	142		
Total costs and expenses	77,075	(93,138)	32,937
Operating income (loss)	(49,094)	123,278	(9,978)
Interest and other income	4,174	6,623	275
Interest and other expense	(250)	(1,024)	(1,602)
Income (loss) from continuing operations before provision for income taxes	(45,170)	128,877	(11,305)
Benefit (provision) for income taxes	(5,088)	(12,850)	218
Income (loss) from continuing operations	(50,258)	116,027	(11,087)
Discontinued operations (Note 13) :			
Gain (loss) from discontinued operations, net of provision for income taxes of $0, $752, and $359	(732)	1,059	505
Net income (loss)	$ (50,990)	$ 117,086	$ (10,582)
Basic net income (loss) per share:			
Continuing operations	$ (1.70)	$ 4.19	$ (0.45)
Discontinued operations	(0.02)	0.04	0.02

Total	$ (1.72)	$ 4.23	$ (0.43)
Shares used in calculating basic net income (loss) per share	29,575	27,662	24,556
Diluted net income (loss) per share:			
Continuing operations	$ (1.70)	$ 3.68	$ (0.45)
Discontinued operations	(0.02)	0.03	0.02
Total	$ (1.72)	$ 3.71	$ (0.43)
Shares used in calculating diluted net income (loss) per share	29,575	31,667	24,556

(1) See Note 2 Restatement of Consolidated Financial Statements of Notes to Consolidated Financial Statements.

See notes to consolidated financial statements.

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IMMERSION CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)

	Common Stock and Additional Paid-In Capital			Accumulated Other Comprehensive	Accumulated	Treasury Stock		Total Stockholders Equity	T Comp In
	Shares	Amount	Warrants	Income	Deficit	Shares	Amount	(Deficit)	(I
	(In thousands, except share amounts)								
at January 1,	24,360,427	$ 106,277	$ 3,686	$ 64	$ (127,057)			$ (17,030)	
1)					(10,582)			(10,582)	$ (
currency on adjustment				3				3	
nensive loss(1)									$ (
of stock for ESPP	47,335	242						242	
of stock options	389,810	1,009						1,009	
sed compensation		2,937						2,937	
efits from sed ation		36						36	
at December 31,	24,797,572	$ 110,501	$ 3,686	$ 67	$ (137,639)		$	$ (23,385)	
me(1)					117,086			117,086	$ 1
currency on adjustment				88				88	
ed gain (loss) on -for-sale s, net of taxes				(18)				(18)	
nensive income(1)									$ 1
on of long-term on stock	2,656,677	17,257						17,257	
of stock for ESPP	56,516	317						317	
of stock options	2,609,573	12,707						12,707	
of warrants	269,512	832	(801)					31	
on of warrants		1,154	(1,154)						
		3,446						3,446	

sed ation(1)									
efits from sed ation(1)		14,648						14,648	
at December 31,	30,389,850	$ 160,862	$ 1,731	$ 137	$ (20,553)		$	$ 142,177	
1)					(50,990)			(50,990)	$ (
currency on adjustment				(39)				(39)	
ed gain (loss) on -for-sale s, net of taxes				11				11	
hensive loss(1)									$ (
of stock for ESPP	47,158	330						330	
of stock options	237,037	1,253						1,253	
sed ation(1)		5,327						5,327	
efits from sed ation(1)		98						98	
stock purchases						2,786,563	(18,389)	(18,389)	
at December 31,	30,674,045	$ 167,870	$ 1,731	$ 109	$ (71,543)	2,786,563	$ (18,389)	$ 79,778	

(1) See Note 2 Restatement of Consolidated Financial Statements of Notes to Consolidated Financial Statements.

See notes to consolidated financial statements.

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IMMERSION CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2008 As Restated(1)	2007 As Restated(1)	2006 As Restated(1)
		(In thousands)	
Cash flows from operating activities:			
Net income (loss)	$ (50,990)	$ 117,086	$ (10,582)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,210	911	772
Amortization and impairment of intangibles	888	1,146	1,121
Stock-based compensation	5,327	3,446	2,937
Excess tax benefits from stock-based compensation	(220)	(13,556)	(36)
Realized gain on short-term investments	(81)		
Allowance (recovery) for doubtful accounts	351	(54)	(244)
Interest expense accretion on 5% Convertible Debenture		535	632
Fair value adjustment of Put Option and Registration Rights		(15)	(34)
Loss on disposal of equipment	93	15	15
Changes in operating assets and liabilities:			
Accounts receivable	(1,012)	(388)	(134)
Inventories	(1)	(943)	57
Deferred income taxes	7,295	(7,297)	
Prepaid expenses and other current assets	(1,310)	(1,840)	(73)
Other assets	12	(62)	
Accounts payable	1,473	(618)	191
Accrued compensation and other current liabilities	2,384	620	516
Income taxes payable	(415)	15,211	
Deferred revenue and customer advances and long-term customer advance from Microsoft	6,140	(30,607)	9,465
Other long-term liabilities	(1,508)	960	760
Net cash provided by (used in) operating activities	(30,364)	84,550	5,363
Cash flows provided by (used in) investing activities:			
Purchases of short-term investments	(59,242)	(96,719)	
Maturities or sales of short-term investments	89,978	45,110	
Additions to intangibles	(2,394)	(2,199)	(1,640)
Purchases of property and equipment	(3,090)	(1,438)	(1,130)
Net cash provided by (used in) investing activities	25,252	(55,246)	(2,770)
Cash flows provided by (used in) financing activities:			

Issuance of common stock under employee stock purchase plan		330		317		242
Exercise of stock options and warrants		1,253		12,738		1,009
Excess tax benefits from stock-based compensation		220		13,556		36
Payment on long-term debt				(1,400)		(5)
Purchases of treasury stock		(18,389)				
Net cash provided by (used in) financing activities		(16,586)		25,211		1,282
Effect of exchange rates on cash and cash equivalents		(26)		(34)		(34)
Net increase (decrease) in cash and cash equivalents		(21,724)		54,481		3,841
Cash and cash equivalents:						
Beginning of year		86,493		32,012		28,171
End of year	$	64,769	$	86,493	$	32,012
Supplemental disclosure of cash flow information:						
Cash paid (received) for taxes	$	(1,586)	$	6,882	$	28
Cash paid for interest	$		$	572	$	1,004
Supplemental disclosure of noncash investing and financing activities:						
Issuance of common stock in connection with the conversion of the 5% Convertible Debentures	$		$	17,257	$	
Amounts accrued for property and equipment, and intangibles	$	605	$		$	

(1) See Note 2 Restatement of Consolidated Financial Statements of Notes to Consolidated Financial Statements.

See notes to consolidated financial statements.

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Significant Accounting Policies

Description of Business

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

Principles of Consolidation and Basis of Presentation

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

Cash Equivalents

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

Short-term Investments

The Company s short-term investments consist primarily of highly liquid commercial paper and government agency securities purchased with an original or remaining maturity of greater than 90 days on the date of purchase. The Company classifies all debt securities with readily determinable market values as available-for-sale in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS No. 115). Even though the stated maturity dates of these debt securities may be one year or more beyond the balance sheet date, the Company has classified all debt securities as short-term investments in accordance with Accounting Research Bulletin No. 43, Chapter 3A, Working Capital Current Assets and Current Liabilities, as they are reasonably expected to be realized in cash or sold during the normal operating cycle of the Company. These investments are carried at fair market value with unrealized gains and losses considered to be temporary in nature reported as a separate component of other comprehensive income (loss) within stockholders equity (deficit). The Company reviews all investments for reductions in fair value that are other-than-temporary. When such reductions occur, the cost of the investment is adjusted to fair value through loss on investments on the consolidated statement of operations. Gains and losses on investments are calculated on the basis of specific identification.

Allowance for Doubtful Accounts

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

Inventories

Inventories are stated at the lower of cost (principally on a standard cost basis which approximates FIFO) or market. The Company reduces its inventory value for estimated obsolete and slow moving inventory in an amount equal to the difference between the cost of inventory and the net realizable value based upon assumptions about future demand and market conditions.

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Property and Equipment

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

Computer equipment and purchased software	3 years
Machinery and equipment	3-5 years
Furniture and fixtures	5-7 years

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

Intangible Assets

The Company accounts for its intangible assets in accordance with SFAS No. 142, Goodwill and Other Intangible Assets (SFAS No. 142). SFAS No. 142 addresses the initial recognition and measurement of intangible assets acquired outside of a business combination and the accounting for goodwill and other intangible assets subsequent to their acquisition. SFAS No. 142 provides that intangible assets with finite useful lives will be amortized and that goodwill and intangible assets with indefinite lives will not be amortized but rather will be tested at least annually for impairment.

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

Long-lived Assets

The Company evaluates its long-lived assets for impairment in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, whenever events or changes in circumstances indicate that the carrying amount of that asset may not be recoverable. An impairment loss would be recognized when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Measurement of an impairment loss for long-lived assets and certain identifiable intangible assets that management expects to hold and use is based on the fair value of the asset.

Product Warranty

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

Revenue Recognition

The Company recognizes revenues in accordance with applicable accounting standards, including Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition (SAB No. 104), EI

No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables (EITF No. 00-21) and SOP 97-2, Software Revenue Recognition (SOP 97-2), as amended. Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, the fee is fixed and determinable, and collectability is probable. The Company derives its revenues from three principal sources: royalty and license fees, product sales, and development contracts.

Royalty and license revenue The Company recognizes royalty and license revenue based on royalty reports or related information received from the licensee as well as time-based licenses of its intellectual property portfolio. Up-front payments under license agreements are deferred and recognized as revenue either based on the royalty reports received or amortized over the license period depending on the nature of the agreement. Advance payments under license agreements that also require the Company to provide future services to the licensee are deferred and

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

recognized over the service period once services commence when vendor-specific objective evidence of fair value (VSOE) related to the value of the services does not exist.

The Company generally recognizes revenue from its licensees under one or a combination of the following models:

License Revenue Model	Revenue Recognition
Perpetual license of intellectual property portfolio based on per unit royalties, no services contracted.	Based on royalty reports received from licensees. No further obligations to licensee exist.
Time-based license of intellectual property portfolio with up-front payments and/or annual minimum royalty requirements, no services contracted. Licensees have certain rights to updates to the intellectual property portfolio during the contract period.	Based on straight-line amortization of annual minimum/up-front payment recognized over contract period or annual minimum period.
Perpetual license of intellectual property portfolio or technology license along with contract for development work.	Based on proportional performance method over the service period or completed performance method.
License of software or technology, no modification necessary, no services contracted.	Up-front revenue recognition based on SOP 97-2 criteria or SAB No. 104, as applicable.

Individual contracts may have characteristics that do not fall within a specific license model or may have characteristics of a combination of license models. Under those circumstances, the Company recognizes revenue in accordance with SAB No. 104, EITF No. 00-21 and SOP 97-2, as amended, to guide the accounting treatment for each individual contract. See also the discussion regarding Multiple element arrangements below.

Product sales The Company generally recognizes revenues from product sales when the product is shipped, provided the other revenue recognition criteria are met, including that collection is determined to be probable and no significant obligation remains. The Company sells the majority of its products with warranties ranging from three to sixty months. The Company records the estimated warranty costs during the quarter the revenue is recognized. Historically, warranty-related costs and related accruals have not been significant. The Company offers a general right of return on the MicroScribe® product line for 14 days after purchase. The Company recognizes revenue at the time of shipment of a MicroScribe digitizer and provides an accrual for potential returns based on historical experience. The Company offers no other general right of return on its products.

Development contracts and other revenue Development contracts and other revenue is comprised of professional services (consulting services and/or development contracts), customer support, and extended warranty contracts. Development contract revenues are recognized under the cost-to-cost percentage-of-completion accounting method based on physical completion of the work to be performed or completed contract method. Losses on contracts are recognized when determined. Revisions in estimates are reflected in the period in which the conditions become known. Customer support and extended warranty contract revenue is recognized ratably over the contractual period.

Multiple element arrangements The Company enters into revenue arrangements in which the customer purchases a combination of patent, technology, and/or software licenses, products, professional services, support, and extended warranties (multiple element arrangements). The Company allocates revenue to each element based on the relative fair value of each of the elements. If vendor specific objective evidence of fair value does not exist, the revenue is generally recorded over the term of the contract or upon delivery of all elements for which vendor specific objective evidence does not exist.

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Advertising

Advertising costs (including obligations under cooperative marketing programs) are expensed as incurred and included in sales and marketing expense. Advertising expense was $229,000, $102,000, and $279,000 in 2008, 2007, and 2006, respectively.

Research and Development

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

Income Taxes

The Company provides for income taxes using the asset and liability approach defined by SFAS No. 109 Accounting for Income Taxes (SFAS No. 109). Deferred tax assets and liabilities are recognized for the expected tax consequences between the tax bases of assets and liabilities and their reported amounts. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized and are reversed at such time that realization is believed to be more likely than not.

Software Development Costs

Certain of the Company s products include software. Costs for the development of new software products and substantial enhancements to existing software products are expensed as incurred until technological feasibility has been established, at which time any additional costs would be capitalized in accordance with SFAS No. 86, Computer Software to be Sold, Leased or Otherwise Marketed. The Company considers technological feasibility to be established upon completion of a working model of the software and the related hardware. Because the Company believes its current process for developing software is essentially completed concurrently with the establishment of technological feasibility, no costs have been capitalized to date.

Stock-based Compensation

On January 1, 2006, the Company adopted the provisions of, and accounted for stock-based compensation in accordance with, SFAS No. 123R, Share-Based Payment (SFAS No. 123R) which replaced SFAS No. 123 Accounting for Stock-Based Compensation, (SFAS No. 123), and supersedes APB No. 25. Under the fair value recognition provisions of SFAS No. 123R, 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. The valuation provisions of SFAS No. 123R apply to new grants and to grants that were outstanding as of the effective date and are subsequently modified. Estimated compensation for grants that were outstanding as of the effective date will be recognized over the remaining service period using the compensation cost estimated for the SFAS No. 123 pro forma disclosures.

With respect to its adoption of SFAS No. 123R, the Company elected the modified-prospective method, under which prior periods are not revised for comparative purposes. The adoption of SFAS No. 123R had a material impact on the Company s consolidated financial position, results of operations, and cash flows for the year ended December 31, 2006, 2007, and 2008. See Note 11 for further information regarding the Company s stock-based compensation assumptions and expenses.

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Comprehensive Income (Loss)

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

	December 31,		
	2008	2007	2006
	(In thousands)		
Net unrealized losses on short-term investments	$ 19	$ 7	$
Foreign currency translation adjustment	90	130	67
Accumulated other comprehensive income	$ 109	$ 137	$ 67

Use of Estimates

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

Concentration of Credit Risks

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

Certain Significant Risks and Uncertainties

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

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

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fair Value of Financial Instruments

Financial instruments consist primarily of cash equivalents, short-term investments, accounts receivable and accounts payable. Cash equivalents and short term investments are stated at fair value based on quoted market prices. The recorded cost of accounts receivable and accounts payable approximate the fair value of the respective assets and liabilities.

Foreign Currency Translation

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

Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159). The new Statement allows entities to choose, at specified election dates, to measure eligible financial assets and liabilities at fair value in situations in which they are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item s fair value in subsequent reporting periods must be recognized in current earnings. SFAS No. 159 also establishes presentation and disclosure requirements designed to draw comparison between entities that elect different measurement attributes for similar assets and liabilities. SFAS No. 159 was effective on January 1, 2008. The Company did not elect the fair value option for any of its financial instruments, therefore the adoption of SFAS No. 159 did not impact the consolidated financial statements.

In April 2008, the FASB issued FSP No. FAS 142-3, Determination of the Useful Life of Intangible Assets (FSP No. FAS 142-3). FSP No. FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under Statement of SFAS No. 142, Goodwill and Other Intangible Assets. FSP No. FAS 142-3 is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact that FSP No. FAS 142-3 will have on its results of operations, financial position, or cash flows.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) (SFAS No. 141(R)), Business Combinations , which replaces SFAS No 141. The statement retains the purchase method of accounting for acquisitions, but requires a number of changes, including changes in the way assets and liabilities are recognized in purchase accounting. It also changes the recognition of assets acquired and liabilities assumed arising from contingencies, requires the capitalization of in-process research and development at fair value, and requires the expensing of acquisition-related costs as incurred. SFAS No. 141(R) is effective for the Company beginning January 1, 2009 and will be applied prospectively to business combinations completed on or after that date. The impact of the adoption of SFAS No. 141(R) will depend on the nature and extent of any business combinations occurring on or after January 1, 2009.

2. Restatement of Consolidated Financial Statements.

Subsequent to the issuance of the Company s 2008 consolidated financial statements, the Company s management determined that errors existed in its previously issued consolidated financial statements. As a result, the accompanying consolidated financial statement for the years ended December 31, 2008, 2007 and 2006 have

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

been restated from amounts previously reported. The following summarized the nature of the errors and the effects on the consolidated financial statements.:

Revenue Transactions

Side Agreement

The Company determined that certain commitments may have been made to a customer of its Medical line of business in the form of an undisclosed apparent side agreement dated in the fourth quarter of fiscal 2008. The customer and the Company had previously executed a distribution agreement in May 2008, and the customer entered into various sales transactions with the Company, both before and after the date of the apparent side agreement. The Company concluded that revenue should not have been recognized on certain transactions resulting in restatement adjustments to revenue in various reporting periods for the following reasons: (i) in certain circumstances, the product remained in a third-party warehouse and was not shipped to the customer until after the quarter in which revenue was recognized; (ii) a previously undisclosed apparent side agreement caused the terms of earlier transactions to be deemed not final until the distribution agreement between the customer and the Company was terminated; (iii) in certain circumstances, the Company had conflicting exclusivity arrangements in effect during the quarters when the Company was recognizing revenue for transactions with such customer; and (iv) concessions related to extended payment terms caused the amount to not be fixed and determinable. As a result, the Company determined that a total of $1.6 million of revenue previously recorded in fiscal 2008 was inappropriately recognized, of which $995,000 has been deferred and $623,000 reversed and not recognized.

Commitment of Deliverables that were Unavailable or Lack Functionality

Certain sales in the Medical line of business included commitments by the Company to provide products that were not available or products that included components that were not fully developed at the time of the sale. As a result, the Company concluded that revenue was not appropriately recognized. Accordingly, a total of $727,000 of revenue previously recorded in fiscal 2008 has been deferred until fiscal 2009.

Additional Transactions Analyzed

The Company also discovered additional transactions in its Medical line of business where revenue was not properly recognized due to one or more of the following reasons:

- Premature recognition of revenue for products sold with FOB Destination or other similar shipping terms, or for incomplete shipment of products or storage of products following shipment;

- Non-standard terms and conditions that prevented recognition of revenue upon shipment, including rights of return, extended payment terms, product replacement commitments, potential free upgrades and other non-standard commitments, that prevented recognition of revenue upon shipment; and

- Lack of probable collectability at the time revenue was recognized.

As a result, of these additional transactions, the following correcting adjustments have been recorded:

$125,000 of revenue previously recorded in fiscal 2006 has been recognized in fiscal 2007; and

$1.3 million of revenue previously recorded in fiscal 2008 has been deferred and will be recorded in fiscal 2009.

Other Impact of Revenue Adjustments

As a result of the adjustments to revenues discussed above, cost of product sales decreased by $1.4 million for the year ended December 31, 2008, increased by $23,000 for the year ended December 31, 2007, decreased by $21,000 for the year ended December 31, 2006 and commission expense increased by $114,000 for the year ended

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008. Also, as a result of the adjustment in cost of product sales, the Company recorded deferred cost of goods sold in the amount of $1.1 million at December 31, 2008 which is reported as prepaid expenses and other current assets on the balance sheet.

Other Errors in Consolidated Financial Statements

The Company also corrected the consolidated financial statements for the following:

Stock-Based Compensation Expense. The Company identified a software based error in its calculated stock-based compensation expense. The previous version of software used to calculate stock-based compensation expense incorrectly continued to apply a weighted average forfeiture rate to the vested portion of stock option awards until the grant s final vest date, rather than reflecting actual forfeitures as awards vested. This error resulted in an understatement of stock-based compensation expense in certain periods prior to the grant s final vest date. The Company recorded additional stock-based compensation expense of approximately $717,000 in fiscal 2007 and $1.3 million in fiscal 2008.

Interest Income. The Company identified an error in the accounting relating to the timing of the recognition of interest income with respect to its patent license with Sony Computer Entertainment. Accordingly, the Company recorded additional interest income of approximately $769,000 in fiscal 2007 and $128,000 in fiscal 2008. This accounting error related to the timing of the recognition of interest income but does not change the overall interest income to be recognized.

Amortization and Impairment of Intangibles. The Company identified instances where it had not commenced amortization of patents in the periods the patents were granted. In addition, the Company identified certain patent applications that were abandoned but had not been previously identified as such and has corrected this error by increasing amortization and impairment of intangibles by $105,000, $58,000 and $57,000 in the years ended December 31, 2008, 2007 and 2006, respectively. The Company also reduced the opening balance of accumulated deficit as of January 1, 2006 by $235,000 from the $126.8 million which was previously reported to the restated amount of $127.1 million.

Impact of Corrections on Previously Issued Consolidated Financial Statements

The Company s accompanying consolidated financial statements have been restated resulting from the restatement adjustments described above, as follows:

Detailed Components of Revenue Transaction Adjustments
($ in thousands)

Revenue	Cost of Product Sales	Commission Expense	Total Impact of Revenue Adjustments
$ (125) (1)	$ 21	$	$ (104)

Year ended December 31, 2006 Increase (Decrease)										
Year ended December 31, 2007 Increase (Decrease)	$	211	(2)	$	(23)	$		$	188	
Year ended December 31, 2008 Increase (Decrease)	$	(3,659)	(3)	$	1,400	$	114	$	(2,145)	

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(1) For year ended December 31, 2006, reflects decrease of $125,000 in revenue as discussed in Additional Transactions Analyzed .

(2) For year ended December 31, 2007, reflects increase of $125,000 in revenue as discussed in Additional Transactions Analyzed and an increase of $86,000 in revenue due to warranty adjustment.

(3) For year ended December 31, 2008, reflects decrease of $1.6 million in revenue as discussed in Side Agreement a decrease of $727,000 in revenue as discussed in Commitment of Deliverables that are Unavailable or Lack Functionality , and a decrease of $1.3 million in revenue as discussed in Additional Transactions Analyzed .

Summary of Impact of Restatement Adjustments

	Loss from Continuing Operations Before Provision for Income Taxes						Loss from Continuing Operations
	Revenue Transaction Adjustments (1)	**Interest Income**	**Amortization and Impairment of Intangibles**	**Stock-based Compensation**	**Total**	**Income Tax Effect**	**Total Adjustments Net of Tax**
	($ in thousands)						
Year ended December 31, 2006 Increase (Decrease)	$ (104)	$ -	$ (57)	$ -	$ (161)	$ 3	$ (158)
Year ended December 31, 2007 Increase (Decrease)	$ 188	$ 769	$ (58)	$ (717)	$ 182	$ (114)	$ 68
Year ended December 31, 2008 Increase (Decrease)	$ (2,145)	$ 128	$ (105)	$ (1,269)	$ (3,391)	$ 86	$ (3,305)

(1) See table above

Additionally, as disclosed in footnote 13 the previously reported results of operations of the 3D product line for all periods presented have been reclassified and reported as a separate component of income in discontinued operations.

The following tables present the impact of the restatement on the Company s previously issued audited consolidated balance sheets as of December 31, 2008 and 2007, and its consolidated statements of operations and cash flows for the years ended December 31, 2008, 2007 and 2006:

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONSOLIDATED BALANCE SHEET
(In thousands)

	As of December 31, 2008		
	As Previously Reported	Restatement Adjustments	As Restated
ASSETS			
Current assets:			
Cash and cash equivalents	$ 64,769	$ -	$ 64,769
Short-term investments	20,974	-	20,974
Accounts receivable, net	6,829	(715)	6,114
Inventories, net	3,396	361	3,757
Deferred income taxes	226	85	311
Prepaid expenses and other current assets	3,225	1,119	4,344
Total current assets	99,419	850	100,269
Property and equipment, net	3,827		3,827
Intangibles, net and other assets	9,945	(454)	9,491
Total assets	$ 113,191	$ 396	$ 113,587
LIABILITIES AND STOCKHOLDERS EQUITY			
Current liabilities:			
Accounts payable	$ 2,842	$ -	$ 2,842
Accrued compensation	3,010	(90)	2,920
Other current liabilities	3,466	27	3,493
Deferred revenue and customer advances	5,125	2,917	8,042
Total current liabilities	14,443	2,854	17,297
Long-term deferred revenue	16,887	(898)	15,989
Deferred income tax liabilities	226	85	311
Other long-term liabilities	212	-	212
Total liabilities	31,768	2,041	33,809
Stockholders equity:			
Common stock and additional paid-in capital	165,885	1,985	167,870
Warrants	1,731	-	1,731
Accumulated other comprehensive income	109	-	109

Accumulated deficit	(67,913)	(3,630)	(71,543)
Treasury stock	(18,389)	-	(18,389)
Total stockholders equity	81,423	(1,645)	79,778
Total liabilities and stockholders equity	$ 113,191	$ 396	$ 113,587

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	Year Ended December 31, 2008			
	As Previously Reported	Discontinued Operations	Restatement Adjustments	As Restated
Revenues:				
Royalty and license	$ 14,254	$ -	$ -	$ 14,254
Product sales	19,504	(4,735)	(3,659)	11,110
Development contracts and other	2,777	(160)	-	2,617
Total revenues	36,535	(4,895)	(3,659)	27,981
Costs and expenses:				
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	12,441	(3,576)	(1,349)	7,516
Sales and marketing	16,851	(1,656)	277	15,472
Research and development	12,555	-	503	13,058
General and administrative	18,929	-	320	19,249
Amortization and impairment of intangibles	779	-	109	888
Litigation settlements, conclusions and patent license	20,750	-	-	20,750
Restructuring costs	537	(395)	-	142
Total costs and expenses	82,842	(5,627)	(140)	77,075
Operating loss	(46,307)	732	(3,519)	(49,094)
Interest and other income	4,046	-	128	4,174
Interest expense	(250)	-	-	(250)
Loss from continuing operations before provision for income taxes	(42,511)	732	(3,391)	(45,170)
Provision for income taxes	(5,174)	-	86	(5,088)
Loss from continuing operations	(47,685)	732	(3,305)	(50,258)
Discontinued operations:				
Loss from discontinued operations, net of provision for income taxes of $0	-	(732)	-	(732)
Net loss	$ (47,685)	$ -	$ (3,305)	$ (50,990)

Basic and diluted net loss per share								
Continuing operations	$	(1.61)	$	0.02	$	(0.11)	$	(1.70)
Discontinued operations		-		(0.02)		-		(0.02)
Total	$	(1.61)	$	-	$	(0.11)	$	(1.72)
Shares used in calculating basic and diluted net loss per share		29,575		-		-		29,575

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands)

	Year Ended December 31, 2008		
	As Previously Reported	Restatement Adjustments	As Restated
Cash flows from operating activities:			
Net loss	$ (47,685)	$ (3,305)	$ (50,990)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,210	-	1,210
Amortization and impairment of intangibles	779	109	888
Stock-based compensation	4,058	1,269	5,327
Excess tax benefits from stock-based compensation	(200)	(20)	(220)
Realized gain on short-term investments	(81)	-	(81)
Allowance for doubtful accounts	351	-	351
Loss on disposal of equipment	93	-	93
Changes in operating assets and liabilities:			
Accounts receivable	(1,726)	714	(1,012)
Inventories	360	(361)	(1)
Deferred income taxes	7,382	(87)	7,295
Prepaid expenses and other current assets	(191)	(1,119)	(1,310)
Other assets	12	-	12
Accounts payable	1,473	-	1,473
Accrued compensation and other current liabilities	2,474	(90)	2,384
Income taxes payable	(415)	-	(415)
Deferred revenue and customer advances	3,265	2,875	6,140
Other long-term liabilities	(1,508)	-	(1,508)
Net cash used in operating activities	(30,349)	(15)	(30,364)
Cash flows provided by (used in) investing activities:			
Purchases of short-term investments	(59,242)	-	(59,242)
Maturities of short-term investments	89,978	-	89,978
Additions to intangibles	(2,389)	(5)	(2,394)
Purchases of property and equipment	(3,090)	-	(3,090)
Net cash provided by investing activities	25,257	(5)	25,252
Cash flows provided by (used in) financing activities:			

Issuance of common stock under employee stock purchase plan		330		-		330
Exercise of stock options and warrants		1,253		-		1,253
Excess tax benefits from stock-based compensation		200		20		220
Purchases of treasury stock		(18,389)		-		(18,389)
Net cash used in financing activities		(16,606)		20		(16,586)
Effect (decrease) of exchange rates on cash and cash equivalents		(26)		-		(26)
Net decrease in cash and cash equivalents		(21,724)		-		(21,724)
Cash and cash equivalents:						
Beginning of the period		86,493		-		86,493
End of the period	$	64,769	$	-	$	64,769
Supplemental disclosure of cash flow information:						
Cash received for taxes	$	(1,586)	$	-	$	(1,586)
Non-cash investing and financing activities:						
Amounts accrued for purchase of treasury stock	$	605	$	-	$	605

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONSOLIDATED BALANCE SHEET
(In thousands)

	As of December 31, 2007		
	As Previously Reported	Restatement Adjustments	As Restated
ASSETS			
Current assets:			
Cash and cash equivalents	$ 86,493	$ -	$ 86,493
Short-term investments	51,619	-	51,619
Accounts receivable, net	5,494	-	5,494
Inventories, net	3,674	-	3,674
Deferred income taxes	3,351	27	3,378
Prepaid expenses and other current assets	3,036	-	3,036
Total current assets	153,667	27	153,694
Property and equipment, net	2,112	-	2,112
Deferred income tax assets, net	4,031	(114)	3,917
Intangibles, net and other assets	8,558	(350)	8,208
Total assets	$ 168,368	$ (437)	$ 167,931
LIABILITIES AND STOCKHOLDERS EQUITY			
Current liabilities:			
Accounts payable	$ 1,657	$ -	$ 1,657
Accrued compensation	1,828	-	1,828
Other current liabilities	2,629	27	2,656
Deferred revenue and customer advances	4,478	(85)	4,393
Total current liabilities	10,592	(58)	10,534
Long-term deferred revenue	14,269	(769)	13,500
Other long-term liabilities	1,720	-	1,720
Total liabilities	26,581	(827)	25,754
Stockholders equity:			
Common stock and additional paid-in capital	160,147	715	160,862
Warrants	1,731	-	1,731
Accumulated other comprehensive income	137	-	137
Accumulated deficit	(20,228)	(325)	(20,553)

Total stockholders equity		141,787		390		142,177
Total liabilities and stockholders equity	$	168,368	$	(437)	$	167,931

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	Year Ended December 31, 2007			
	As Previously Reported	Discontinued Operations	Restatement Adjustments	As Restated
Revenues:				
Royalty and license	$ 11,881	$ -	$ -	$ 11,881
Product sales	18,541	(4,614)	211	14,138
Development contracts and other	4,280	(159)	-	4,121
Total revenues	34,702	(4,773)	211	30,140
Costs and expenses:				
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	8,808	(1,565)	29	7,272
Sales and marketing	11,493	(1,397)	176	10,272
Research and development	10,056	-	333	10,389
General and administrative	12,567	-	116	12,683
Amortization and impairment of intangibles	1,002	-	144	1,146
Litigation settlements, conclusions and patent license	(134,900)	-	-	(134,900)
Total costs and expenses	(90,974)	(2,962)	798	(93,138)
Operating income	125,676	(1,811)	(587)	123,278
Interest and other income	5,854	-	769	6,623
Interest expense	(1,024)	-	-	(1,024)
Income from continuing operations before provision for income taxes	130,506	(1,811)	182	128,877
Provision for income taxes	(13,488)	752	(114)	(12,850)
Income from continuing operations	117,018	(1,059)	68	116,027
Discontinued operations:				
Gain from discontinued operations, net of provision for income taxes of $752	-	1,059	-	1,059
Net income	$ 117,018	$ -	$ 68	$ 117,086

Basic net income per share								
Continuing operations	$	4.23	$	(0.04)	$	-	$	4.19
Discontinued operations		-		0.04		-		0.04
Total	$	4.23	$	-	$	-	$	4.23
Shares used in calculating basic net income per share		27,662		-		-		27,662
Diluted net income per share								
Continuing operations	$	3.71	$	(0.03)	$	-	$	3.68
Discontinued operations		-		0.03		-		0.03
Total	$	3.71	$	-	$	-	$	3.71
Shares used in calculating diluted net income per share		31,667		-		-		31,667

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands)

	Year Ended December 31, 2007		
	As Previously Reported	Restatement Adjustments	As Restated
Cash flows from operating activities:			
Net income	$ 117,018	$ 68	$ 117,086
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	911	-	911
Amortization and impairment of intangibles	1,002	144	1,146
Stock-based compensation	2,729	717	3,446
Excess tax benefits from stock-based compensation	(13,505)	(51)	(13,556)
Recovery for doubtful accounts	(54)	-	(54)
Interest expense accretion on 5% Convertible Debenture	535	-	535
Fair value adjustment of Put Option and Registration Rights	(15)	-	(15)
Loss on disposal of equipment	15	-	15
Changes in operating assets and liabilities:			
Accounts receivable	(263)	(125)	(388)
Inventories	(965)	22	(943)
Deferred income taxes	(7,382)	85	(7,297)
Prepaid expenses and other current assets	(1,842)	2	(1,840)
Other assets	(62)	-	(62)
Accounts payable	(618)	-	(618)
Accrued compensation and other current liabilities	620	-	620
Income taxes payable	15,184	27	15,211
Deferred revenue and customer advances	(29,753)	(854)	(30,607)
Other long-term liabilities	960	-	960
Net cash provided by operating activities	84,515	35	84,550
Cash flows provided by (used in) investing activities:			
Purchases of short-term investments	(96,719)	-	(96,719)
Maturities of short-term investments	45,110	-	45,110
Additions to intangibles	(2,113)	(86)	(2,199)
Purchases of property and equipment	(1,438)	-	(1,438)
Net cash used in investing activities	(55,160)	(86)	(55,246)

Cash flows provided by (used in) financing activities:						
Issuance of common stock under employee stock purchase plan		317		-		317
Exercise of stock options and warrants		12,738		-		12,738
Excess tax benefits from stock-based compensation		13,505		51		13,556
Purchases of treasury stock		(1,400)		-		(1,400)
Net cash provided by financing activities		25,160		51		25,211
Effect (decrease) of exchange rates on cash and cash equivalents		(34)		-		(34)
Net increase in cash and cash equivalents		54,481		-		54,481
Cash and cash equivalents:						
Beginning of the period		32,012		-		32,012
End of the period	$	86,493	$	-	$	86,493
Supplemental disclosure of cash flow information:						
Cash paid for taxes	$	6,882	$	-	$	6,882
Cash paid for interest	$	572	$	-	$	572
Non-cash investing and financing activities:						
Issuance of common stock in connection with the conversion of the 5% convertible debentures	$	17,257	$	-	$	17,257

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	Year Ended December 31, 2006			
	As Previously Reported	Discontinued Operations	Restatement Adjustments	As Restated
Revenues:				
Royalty and license	$ 7,304	$ -	$ -	$ 7,304
Product sales	17,083	(4,616)	(125)	12,342
Development contracts and other	3,466	(153)	-	3,313
Total revenues	27,853	(4,769)	(125)	22,959
Costs and expenses:				
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	7,193	(1,482)	(21)	5,690
Sales and marketing	12,609	(2,423)	-	10,186
Research and development	7,609	-	-	7,609
General and administrative	10,076	-	(95)	9,981
Amortization and impairment of intangibles	969	-	152	1,121
Litigation settlements, conclusions and patent license	(1,650)	-	-	(1,650)
Total costs and expenses	36,806	(3,905)	36	32,937
Operating loss	(8,953)	(864)	(161)	(9,978)
Interest and other income	275	-		275
Interest expense	(1,602)	-	-	(1,602)
Loss from continuing operations before provision for income taxes	(10,280)	(864)	(161)	(11,305)
Provision for income taxes	(144)	359	3	218
Loss from continuing operations	(10,424)	(505)	(158)	(11,087)
Discontinued operations:				
Gain from discontinued operations, net of provision for income taxes of $359	-	505	-	505
Net loss	$ (10,424)	$ -	$ (158)	$ (10,582)
Basic and diluted net loss per share				

Continuing operations	$	(0.42)	$	(0.02)	$	(0.01)	$	(0.45)
Discontinued operations		-		0.02		-		0.02
Total	$	(0.42)	$	-	$	(0.01)	$	(0.43)
Shares used in calculating basic and diluted net loss per share		24,556		-		-		24,556

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands)

	Year Ended December 31, 2006		
	As Previously Reported	Restatement Adjustments	As Restated
Cash flows from operating activities:			
Net income	$ (10,424)	$ (158)	$ (10,582)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	772	-	772
Amortization and impairment of intangibles	1,038	83	1,121
Stock-based compensation	2,937	-	2,937
Excess tax benefits from stock-based compensation	(36)	-	(36)
Recovery of doubtful accounts	(244)	-	(244)
Interest expense accretion on 5% Convertible Debenture	632	-	632
Fair value adjustment of Put Option and Registration Rights	(34)	-	(34)
Loss on disposal of equipment	15	-	15
Changes in operating assets and liabilities:			
Accounts receivable	(259)	125	(134)
Inventories	79	(22)	57
Prepaid expenses and other current assets	(71)	(2)	(73)
Accounts payable	191	-	191
Accrued compensation and other current liabilities	516	-	516
Deferred revenue and customer advances and long-term customer advance from Microsoft	9,465	-	9,465
Other long-term liabilities	760	-	760
Net cash provided by operating activities	5,337	26	5,363
Cash flows provided by (used in) investing activities:			
Additions to intangibles	(1,614)	(26)	(1,640)
Purchases of property and equipment	(1,130)		(1,130)
Net cash used in investing activities	(2,744)	(26)	(2,770)
Cash flows provided by (used in) financing activities:			
Issuance of common stock under employee stock purchase plan	242	-	242
Exercise of stock options and warrants	1,009	-	1,009
Excess tax benefits from stock-based compensation	36	-	36

Payment on long-term debt		(5)		-		(5)
Net cash provided by financing activities		1,282		-		1,282
Effect (decrease) of exchange rates on cash and cash equivalents		(34)		-		(34)
Net increase in cash and cash equivalents		3,841		-		3,841
Cash and cash equivalents:						
Beginning of the period		28,171		-		28,171
End of the period	$	32,012	$	-	$	32,012
Supplemental disclosure of cash flow information:						
Cash paid for taxes	$	28	$	-	$	28
Cash paid for interest	$	1,004	$	-	$	1,004

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Disclosures

Short-term Investments

	December 31, 2008			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
	(In thousands)			
Commercial paper	$ 9,980	$ 1	$	$ 9,981
Government agency securities	10,975	18		10,993
Total	$ 20,955	$ 19	$	$ 20,974

	December 31, 2007			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
	(In thousands)			
Commercial paper	$ 41,740	$	$ (34)	$ 41,706
Government agency securities	9,871	42		9,913
Total	$ 51,611	$ 42	$ (34)	$ 51,619

The contractual maturities of the Company s available-for-sale securities on December 31, 2008 and December 31, 2007 were all due in one year or less.

Cash Equivalents and Short-term Investments

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

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

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

The following table sets forth the Company s cash equivalents and short-term investments that are measured at fair value on a recurring basis by level within the fair value hierarchy as of December 31, 2008. As required by SFAS No. 157, these are classified based on the lowest level of input that is significant to the fair value measurement.

	Fair value measurement using			Assets at
	Level 1	Level 2	Level 3	fair value
	(In thousands)			
Corporate commercial paper	$	$ 24,971	$	$ 24,971
U.S. Government agency securities	23,978			23,978
Money market accounts	34,429			34,429
Total	$ 58,407	$ 24,971	$	$ 83,378

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The above table excludes $2.4 million of cash held in banks.

4. Inventories

	December 31, 2008	December 31, 2007
	(In thousands)	
Raw materials and subassemblies	$ 3,119	$ 2,843
Work in process	209	179
Finished goods	429	652
Inventories, net	$ 3,757	$ 3,674

5. Property and Equipment

	December 31, 2008	December 31, 2007
	(In thousands)	
Computer equipment and purchased software	$ 4,735	$ 3,195
Machinery and equipment	3,269	2,532
Furniture and fixtures	1,336	1,212
Leasehold improvements	1,261	1,267
Total	10,601	8,206
Less accumulated depreciation	(6,774)	(6,094)
Property and equipment, net	$ 3,827	$ 2,112

6. Intangibles and Other Assets

	December 31, 2008	December 31, 2007
	(In thousands)	
Patents and technology	$ 17,008	$ 14,872
Other assets	156	167

Gross intangibles and other assets	17,164	15,039
Accumulated amortization of patents and technology	(7,673)	(6,831)
Intangibles and other assets, net	$ 9,491	$ 8,208

The Company amortizes its intangible assets related to patents and trademarks, over their estimated useful lives, generally 10 years. Amortization of intangibles excluding impairments during the years ended December 31, 2008, 2007, and 2006 was $842,000, $1.0 million and $990,000, respectively. The estimated annual amortization expense for intangible assets as of December 31, 2008 is $754,000 in 2009, $1.2 million in 2010, $1.1 million in 2011, $1.0 million in 2012, $992,000 in 2013, and $4.4 million in total for all years thereafter, assuming no future acquisitions, write-offs, or impairment charges.

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Components of Other Current Liabilities and Deferred Revenue and Customer Advances

	December 31, 2008	December 31, 2007
	(In thousands)	
Accrued legal	$ 491	$ 417
Income taxes payable	36	561
Other current liabilities	2,966	1,678
Total other current liabilities	$ 3,493	$ 2,656
Deferred revenue, current	$ 7,954	$ 4,267
Customer advances	88	126
Total deferred revenue, current and customer advances	$ 8,042	$ 4,393

8. Long-term Debt

5% Senior Subordinated Convertible Debentures (5% Convertible Debentures)

On December 23, 2004, the Company issued an aggregate principal amount of $20.0 million of 5% Convertible Debentures. The 5% Convertible Debentures original maturity date was December 22, 2009. On July 27, 2007, the Company announced that it had notified the holders of its 5% Convertible Debentures of its intent to redeem all of the 5% Convertible Debentures in full, pursuant to the mandatory redemption provision. Approximately $20.1 million of principal and accrued interest was then outstanding under the 5% Convertible Debentures. Under the terms of the 5% Convertible Debentures, once the closing bid price of the Company s common stock exceeded $14.053 per share for 20 consecutive trading days, the Company could redeem the 5% Convertible Debentures at the end of a 30-day notice period. Prior to the end of the 30-day period, the holders of the 5% Convertible Debenture could have elected to convert the principal and accrued interest outstanding into shares of the Company s common stock at a conversion price of $7.0265 per share. The 5% Convertible Debentures ceased to accrue further interest upon the Company s election to affect the mandatory redemption. During the notice period, $17.2 million of 5% Convertible Debentures and approximately $67,000 of accrued interest were converted into 2,656,677 shares of common stock. At the end of the notice period, $1.4 million of 5% Convertible Debentures were redeemed for cash. Interest expense of approximately $106,000 was incurred from unaccreted interest recognized upon the redemption of $1.4 million of 5% Convertible Debentures. Amounts outstanding at both December 31, 2008 and 2007 were $0.

9. Long-term Deferred Revenue

On December 31, 2008, long-term deferred revenue was $16.0 million and included approximately $14.5 million of deferred revenue from Sony Computer Entertainment. See Note 12 for further discussion. On December 31, 2007, long-term deferred revenue was $13.5 million and included approximately $10.9 million of deferred revenue from Sony Computer Entertainment.

10. Commitments

The Company leases several of its facilities, vehicles, and some office equipment under noncancelable operating lease arrangements that expire at various dates through 2014.

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Minimum future lease payments are as follows:

	Operating Leases (In thousands)
2009	$ 928
2010	695
2011	555
2012	539
2013	555
Thereafter	283
Total future minimum lease payments	$ 3,555

Rent expense was $1.2 million, $1.2 million, and $1.1 million in 2008, 2007, and 2006, respectively.

11. Stock-based Compensation

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. Essentially all of the Company s employees participate in the equity incentive program. The Company may grant options, stock appreciation rights, restricted stock, restricted stock units (RSUs), performance shares, performance units, and other stock-based or cash-based awards to employees, directors, and consultants. Since inception, the Company has approved programs that allow the recipient the right to purchase up to 19,434,593 shares of its common stock. Under these programs, stock options may be granted at prices not less than the fair market value on the date of grant for incentive stock options and not less than 85% of fair market value on the date of grant for nonstatutory stock options. These options generally vest over 4 years and expire 10 years from the date of grant. RSUs generally vest over 3 years. On December 31, 2008, 2,638,924 shares of common stock were available for grant, and there were 7,009,667 options to purchase shares of common stock outstanding, as well as 34,500 RSUs outstanding.

On June 6, 2007, the Company s stockholders approved the Immersion Corporation 2007 Equity Incentive Plan (the 2007 Plan). The 2007 Plan replaced the Company s 1997 Stock Option Plan (the 1997 Plan). Effective June 6, 2007, the 1997 Plan was terminated. Under the 2007 Plan, the Company may grant stock options, stock appreciation rights, restricted stock, RSUs, performance shares, performance units, and other stock-based or cash-based awards to employees and consultants. The 2007 Plan also authorizes the grant of awards of stock options, stock appreciation rights, restricted stock, and restricted stock units to non-employee members of the Company s Board of Directors and deferred compensation awards to officers, directors, and certain management or highly compensated employees. The 2007 Plan authorizes the issuance of 2,303,232 shares of the Company s common stock, and up to an additional 1,000,000 shares subject to awards that remain outstanding under the 1997 Plan as of June 6, 2007 and which subsequently terminate without having been exercised or which are forfeited to the Company.

On April 30, 2008, the Company s Board of Directors approved the issuance of equity awards under the Immersion Corporation 2008 Employment Inducement Award Plan (the 2008 Plan). Under the 2008 Plan, the Company may issue awards in the form of stock options, stock appreciation rights, restricted stock purchase rights, restricted stock bonuses, RSUs, performance shares, performance units, deferred compensation awards, and other cash and stock awards. Such awards may be granted to new employees who had not previously been a director or former employees or directors whose period of service was followed by a bona-fide period of non-employment.

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan. 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 500,000 shares of common stock are reserved for the issuance under the ESPP plus an automatic annual increase on each January 1 hereafter through January 1, 2010 by an amount equal to the lesser of 500,000 shares per year or a number of shares determined by the Board of Directors. As of December 31, 2008, 397,813 shares had been purchased since the inception of the ESPP. Under SFAS No. 123R, the ESPP is considered a compensatory plan and the Company is required to recognize compensation cost related to the fair value of common stock purchased under the ESPP.

The Company did not modify its ESPP during the year ended December 31, 2008.

General Stock Option Information

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

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value
Outstanding at January 1, 2006 (4,595,431 exercisable at a weighted average price of $8.03 per share)	7,340,796	7.24		
Granted (weighted average fair value of $4.31 per share)	1,224,453	6.90		
Exercised	(389,810)	2.59		
Cancelled	(590,016)	7.64		
Outstanding at December 31, 2006 (5,403,314 exercisable at a weighted average price of $7.65 per share)	7,585,423	7.40		
Granted (weighted average fair value of $6.43 per share)	1,442,458	10.58		
Exercised(1)	(2,610,856)	4.87		
Cancelled	(402,655)	9.58		

Outstanding at December 31, 2007 (3,774,245 exercisable at a weighted average price of $9.11 per share)	6,014,370		9.11			
Granted (weighted average fair value of $4.84 per share)	2,438,775		8.43			
Exercised	(237,037)		5.29			
Cancelled	(1,206,441)		8.35			
Outstanding at December 31, 2008	7,009,667	$	9.13	5.49	$	1.9 million
Exercisable at December 31, 2008	4,055,180	$	9.35	3.48	$	1.8 million

(1) There were 1,283 options that net settled in 2007.

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The number of shares subject to options expected to vest as of December 31, 2008 is approximately 6.3 million.

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 at December 31, 2008. The aggregate intrinsic value of options exercised under the Company s stock option plans, determined as of the date of option exercise was $786,800 for the year ended December 31, 2008.

Additional information regarding options outstanding as of December 31, 2008 is as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 1.20 $ 5.91	704,756	5.11	$ 3.23	576,713	$ 2.79
5.92 6.79	815,212	6.45	6.22	489,468	6.32
6.81 7.00	1,038,774	5.33	6.97	907,081	6.98
7.02 8.61	1,199,991	7.25	8.18	275,706	7.85
8.67 9.01	788,778	1.54	8.99	570,321	8.98
9.04 9.24	772,671	5.31	9.09	471,121	9.13
9.47 9.81	704,000	9.11	9.81	1,000	9.47
10.00 17.27	721,051	4.63	13.81	499,336	13.30
23.13 34.75	239,548	1.15	31.58	239,548	31.58
43.25 43.25	24,886	1.28	43.25	24,886	43.25
$ 1.20 $43.25	7,009,667	5.49	$ 9.13	4,055,180	$ 9.35

Restricted Stock Units

Restricted stock unit activity for the twelve months ended December 31, 2008 is as follows:

	Number of Shares	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Beginning balance at December 31, 2007			
Awarded	34,500		
Released			
Forfeited			
Ending Balance at December 31, 2008	34,500	1.33	$ 203,205
Expected to Vest	27,134	1.33	$ 159,819

The aggregate intrinsic value is calculated as the market value as of the end of the reporting period.

Stock-based Compensation

Valuation and amortization method The Company uses the Black-Scholes-Merton option pricing model (Black-Scholes model), single-option approach to determine the fair value of stock options and ESPP shares. All share-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. The determination of the fair value of stock-based payment

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

awards on the date of grant using an option-pricing model is affected by the Company s 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, the Company s expected stock price volatility over the term of the awards, risk-free interest rate, and expected dividends.

Expected term The Company estimates the expected term of options granted by calculating the average term from the Company s historical stock option exercise experience. The expected term of ESPP shares is the length of the offering period. The Company used the simplified method as prescribed by SAB No. 107 for options granted prior to December 31, 2007.

Expected volatility The Company estimates the volatility of its common stock taking into consideration its historical stock price movement, the volatility of stock prices of companies of similar size with similar businesses, if any, and its expected future stock price trends based on known or anticipated events.

Risk-free interest rate The Company bases the risk-free interest rate that it uses in the option pricing model on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on the options.

Expected dividend The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option-pricing model.

Forfeitures The Company is required to estimate future forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and records stock-based compensation expense only for those awards that are expected to vest.

The assumptions used to value option grants and shares under the ESPP are as follows:

	Options			Employee Stock Purchase Plan		
	2008	**2007**	**2006**	**2008**	**2007**	**2006**
Expected life (in years)	5.5	6.25	6.25	0.5	0.5	0.5
Interest rate	2.7%	4.5%	4.8%	2.0%	5.1%	4.9%
Volatility	63%	60%	62%	88%	50%	51%
Dividend yield						

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

	Year Ended December 31,		
	2008	**2007**	**2006**
	(In thousands)		

Income Statement Classifications			
Cost of product sales	$ 209	$ 109	$ 70
Sales and marketing	1,369	905	972
Research and development	1,396	969	492
General and administrative	2,259	1,343	1,145
Total continuing operations	5,233	3,326	2,679
Discontinued operations	94	120	258
Total	$ 5,327	$ 3,446	$ 2,937

SFAS No. 123R requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. For the years ended December 31, 2008,

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2007 and 2006, the Company recorded $220,000, $13.6 million, and $36,000, respectively, of excess tax benefits from stock-based compensation.

The Company has calculated an additional paid-in capital (APIC) pool pursuant to the provisions of SFAS No. 123R. The APIC pool represents the excess tax benefits related to stock-based compensation that are available to absorb future tax deficiencies. The Company includes only those excess tax benefits that have been realized in accordance with SFAS No. 109, Accounting for Income Taxes. If the amount of future tax deficiencies is greater than the available APIC pool, the Company will record the excess as income tax expense in its consolidated statements of operations.

As of December 31, 2008, there was $9.6 million of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock options and RSUs granted to the Company s employees and directors. This cost will be recognized over an estimated weighted-average period of approximately 2.9 years for options and 2.1 years for RSUs. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

Warrants

On December 23, 2004, the Company, in conjunction with the 5% Convertible Debentures (see Note 8), issued warrants to purchase an aggregate of 426,951 shares of its common stock at an exercise price of $7.0265 per share. The warrants may be exercised at any time prior to 5:00 p.m. Eastern time, on December 23, 2009. Any warrants not exercised prior to such time will expire.

Stock Repurchase Program

On November 1, 2007, the Company announced its Board of Directors authorized the repurchase of up to $50 million of the Company s common stock. The Company may repurchase its stock for cash in the open market in accordance with applicable securities laws. The timing of and amount of any stock repurchase will depend on share price, corporate and regulatory requirements, economic and market conditions, and other factors. The stock repurchase authorization has no expiration date, does not require the Company to repurchase a specific number of shares, and may be modified, suspended, or discontinued at any time.

During the twelve months ended December 31, 2008, the Company repurchased 2.8 million shares for $18.4 million at an average cost of $6.60 through open market repurchases. This amount is classified as treasury stock on the Company s consolidated balance sheet.

12. Litigation Settlement, Conclusions, and Patent License

In 2003, the Company executed a series of agreements with Microsoft that provided for settlement of its lawsuit against Microsoft as well as various licensing, sublicensing, and equity and financing arrangements. Under the terms of these agreements, in the event that the Company elected to settle the action in the United States District Court for the Northern District of California entitled *Immersion Corporation v. Sony Computer Entertainment of America, Inc., Sony Computer Entertainment Inc. and Microsoft Corporation*, Case No. C02-00710 CW (WDB), as such action pertains to Sony Computer Entertainment, and grant certain rights, the Company would be obligated to pay Microsoft a minimum of $15.0 million for amounts up to $100.0 million received from Sony Computer Entertainment, plus 25%

of amounts over $100.0 million up to $150.0 million, and 17.5% of amounts over $150.0 million. The Company determined that the conclusion of its litigation with Sony Computer Entertainment did not trigger any payment obligations under its Microsoft agreements. Accordingly, the liability of $15.0 million that was in the financial statements at December 31, 2006 was extinguished, and the Company accounted for this sum during 2007 as litigation conclusions and patent license income. However, on June 18, 2007, Microsoft filed a complaint against the Company in the U.S. District Court for the Western District of Washington alleging one claim for breach of a contract. Microsoft alleged that the Company breached a Sublicense Agreement executed in

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

connection with the parties settlement in 2003 of the Company s claims of patent infringement against Microsoft. The complaint alleged that Microsoft was entitled to payments that Microsoft contends are due under the Sublicense Agreement as a result of Sony Computer Entertainment s satisfaction of the judgment in the Company s lawsuit against Sony Computer Entertainment and payment of other sums to the Company. In a letter sent to the Company dated May 1, 2007, Microsoft stated that it believed the Company owed Microsoft at least $27.5 million, an amount that was subsequently increased to $35.6 million. Although the Company disputed Microsoft s allegations, on August 25, 2008 the parties agreed to settle all claims. The Company had made no offers to settle prior to August 25, 2008. Under the terms of the settlement, the Company paid Microsoft $20.8 million in October 2008.

In March 2007, the Company s patent infringement litigation with Sony Computer Entertainment concluded. Sony Computer Entertainment satisfied the judgment against it from the United States District Court for the Northern District of California, which included damages, pre-judgment interest, costs and interest totaling $97.3 million, along with compulsory license fees already paid to the Company of $30.6 million and interest earned on these fees of $1.8 million. As of March 19, 2007, the Company and Sony Computer Entertainment entered into an agreement whereby the Company granted Sony Computer Entertainment and certain of its affiliates a worldwide, non-transferable, non-exclusive license under the Company s patents that have issued, may issue, or claim a priority date before March 2017 for the going forward use, development, manufacture, sale, lease, importation, and distribution of Sony Computer Entertainment s current and past PlayStation and related products. The license does not cover adult, foundry, medical, automotive, industrial, mobility, or gambling products. Subject to the terms of the agreement, the Company also granted Sony Computer Entertainment and certain of its affiliates certain other licenses (relating to PlayStation games, backward compatibility of future consoles, and the use of their licensed products with certain third party products), an option to obtain licenses in the future with respect to future gaming products and certain releases and covenants not to sue. Sony Computer Entertainment granted the Company certain covenants not to sue and agreed to pay the Company twelve quarterly installments of $1.875 million (for a total of $22.5 million) beginning on March 31, 2007 and ending on December 31, 2009, and may pay the Company certain other fees and royalty amounts. In total, the Company will receive a minimum of $152.2 million through the conclusion of the litigation and the business agreement. In accordance with the guidance from EITF No. 00-21, the Company has allocated the present value of the total payments, equal to $149.9 million, between each element based on their relative fair values. Under this allocation, the Company recorded $119.9 million as litigation conclusions and patent license income, and the remaining $30.0 million is allocated to deferred license revenue to the extent payment is received in advance of revenue recognition. Such deferred revenue was $18.4 million at December 31, 2008. The Company recorded $2.4 million and $3.0 million as revenue for the years ended December 31, 2007, and 2008, respectively. On December 31, 2008, the Company had recorded $5.4 million of the $30.0 million as revenue and will record the remaining $24.6 million as revenue, on a straight-line basis, over the remaining capture period of the patents licensed, ending March 19, 2017. The Company has accounted for future payments in accordance with Accounting Principles Board Opinion No. 21 (ABP No. 21). Under APB No. 21, the Company determined the present value of the $22.5 million future payments to equal $20.2 million. The Company is accounting for the difference of $2.3 million as interest income as each $1.875 million quarterly payment installment becomes due. This amount is accounted for at December 31, 2008 in deferred revenue.

On October 20, 2004, Internet Services LLC (ISLLC) filed claims against the Company in its lawsuit against Sony Computer Entertainment in the U.S. District Court for the Northern District of California, alleging that the Company breached a contract with ISLLC by suing Sony Computer Entertainment for patent infringement relating to haptically-enabled software whose topics or images are allegedly age-restricted, for judicial apportionment of damages between ISLLC and the Company of the damages awarded by the jury, and for a judicial declaration with respect to ISLLC s rights and duties under agreements with the Company. On December 29, 2004, the District Court issued an order dismissing ISLLC s claims against Sony Computer Entertainment with prejudice and dismissing ISLLC s claims against the Company without prejudice to ISLLC. On January 12, 2005, ISLLC filed Amended Cross-Claims and Counterclaims against the Company that contained similar claims. On March 24, 2005, the

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

District Court again dismissed certain of these claims with prejudice and dismissed the other claims without prejudice.

On February 8, 2006, ISLLC filed a lawsuit against the Company in the Superior Court of Santa Clara County. ISLLC s complaint sought a share of the damages awarded to the Company in the Sony litigation and of the Microsoft settlement proceeds, and generally restated the claims already adjudicated by the District Court. On March 16, 2006, the Company answered the complaint, cross claimed for declaratory relief, breach of contract by ISLLC, and for rescission of the contract, and removed the lawsuit to federal court. The case was assigned to Judge Wilken in the U.S. District Court for the Northern District of California as a case related to the previous proceedings involving Sony Computer Entertainment and ISLLC. On May 10, 2007, ISLLC filed a motion in the District Court to remand its latest action to the Superior Court, or in the alternative, for leave to file an amended complaint. The Company opposed ISLLC s motion, and cross-moved for judgment on the pleadings. On June 26, 2007, the District Court ruled on the motions, denying ISLLC s motion to remand or for leave to file an amended complaint, and granting in part the Company s motion for judgment on the pleadings. The District Court also dismissed one of ISLLC s claims. However, on May 16, 2008, the District Court entered an order granting the Company s motion for summary judgment on all of ISLLC s claims, as well as the Company s counterclaim for declaratory relief. As a result, the only claims remaining in the action were the Company s counterclaims against ISLLC. On August 22, 2008, the Company settled its counterclaims against ISLLC and amended the terms of its existing business agreement with ISLLC. On August 25, 2008, the District Court entered an order dismissing the Company s counterclaims and closed the case. For the year ended December 31, 2008, the Company recognized $1.1 million in royalty and license revenue as of result of this settlement with ISLLC.

On September 24, 2004, the Company filed in the United States District Court for the Northern District of California a complaint for patent infringement against Performance Designed Products (PDP) (formerly Electro Source LLC). On February 28, 2006, the Company announced that it had settled its legal differences with PDP and the Company and PDP agreed to dismiss all claims and counterclaims relating to this matter. In addition to the Confidential Settlement Agreement, PDP entered into a worldwide license to the Company s patents for vibro-tactile devices in the consumer gaming peripheral field of use under which PDP makes royalty payments to the Company based on sales by PDP of spinning mass vibro-tactile gamepads, steering wheels, and other game controllers for dedicated gaming consoles. During 2006, PDP paid the Company $1.7 million which was recorded as litigation conclusions and patent license income.

13. Restructuring Costs and Discontinued Operations

The Company accounts for restructuring costs and Discontinued Operations in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets and SFAS No. 146, Accounting for Costs Associated with Exit of Disposal Activities .

Restructuring Costs:

There were no restructuring charges incurred in the years ended 2006 or 2007. The following table sets forth the one-time charges that are included in the restructuring line on the Company s Consolidated Statement of Operations for the year ended December 31, 2008:

	Year Ended December 31, 2008			December 31, 2008
		Deduct		
	Add Charges	Cash Payments	Non-Cash Expense	Restructuring Reserves
Workforce Reductions	$ 142			$ 142

The Company recorded restructuring charges of $142,000 consisting of severance benefits paid as the result of the reduction of workforce due to business changes in the Company s Touch segment. Workforce reduction costs are included in accrued compensation on the Company s balance sheet. All of the severance benefits are expected to be paid in the first quarter of 2009 with the exception of certain COBRA costs that will be paid by the end of 2010.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Results of discontinued operations:

On November 17, 2008, the Company announced that it will divest its 3D product line which is part of the Touch segment. The Company s 3D product line consists of a variety of products in the area of 3D digitizing, 3D measurement and inspection, and 3D interaction and includes products such as MicroScribe digitizers, CyberGlove family of products and a SoftMouse 3D positioning device. In the first quarter of 2009, the Company sold or abandoned operations of the 3D product line. The results of the 3D product line have been retrospectively restated as discontinued operations for all periods presented. The Company terminated the employment of 13 employees associated with the 3D product line such that they will no longer be on the Company s payroll by the end of the first quarter of 2009. In addition, at the end of the fourth quarter of 2008, there have been other reorganizations in the Company s Touch segment resulting in additional workforce reductions.

The following is a summary of the components of income from discontinued operations included in the consolidated statements of operations:

	Years Ended December 31,		
	2008	2007	2006
	(In thousands)		
Revenues	$ 4,895	$ 4,773	$ 4,769
Cost of Revenue	3,576	1,565	1,482
Sales and Marketing	1,656	1,397	2,423
Restructuring costs	395		
Income (loss) from discontinued operations before taxes	(732)	1,811	864
Benefit (provision) for taxes		(752)	(359)
Gain (loss) from discontinued operations (net of tax)	$ (732)	$ 1,059	$ 505

Included in restructuring costs within discontinuing operations are severance benefits of $105,000 as the result of the reduction of workforce due to the divesting of the 3D product line. These amounts remained unpaid in accrued compensation as of December 31, 2009. Workforce reduction costs are included in accrued compensation on the Company s balance sheet. All of the severance benefits are expected to be paid in the first quarter of 2009 with the exception of certain COBRA costs that will be paid by the end of 2010. Also included in restructuring costs within discontinued operations are asset impairment charges which include reserves taken against capitalized patent costs of $255,000 and fixed assets write-offs of $20,000 due to the divesting of the 3D product line. The Company also took an additional inventory impairment charge of $2.0 million of the 3D product inventory that is included in cost of product sales within discontinued operations.

14. Income Taxes

For the years ended December 31, 2008, 2007, and 2006, the Company recorded provision (benefit) for income taxes of $5.1 million, $12.9 million, and $(218,000), respectively, yielding effective tax rates of 11.3%, 10.0%, and (1.9%), respectively. The 2008 provision for income tax resulted from recording a valuation allowance on specific deferred tax assets and foreign withholding tax expense. The 2007 provision for income tax was based on federal and state regular income tax payable on taxable income and foreign withholding tax expense. The 2006 provision for income tax was based on federal and state alternative minimum income tax payable and foreign withholding tax expense.

For 2008, the Company reported pre-tax book income (loss) from continuing operations of ($45.2) million which includes the $20.8 million litigation conclusion and settlement of its lawsuit against Microsoft. For 2007 and 2006, the Company reported pre-tax book income (loss) of $128.9 million and ($11.3) million.

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The domestic and foreign components of income (loss) before provision for income taxes were as follows:

	Years Ended December 31, 2008	2007	2006
	(In thousands)		
Domestic	$ (45,456)	$ 128,745	$ (9,848)
Foreign	286	132	(1,457)
Total	$ (45,170)	$ 128,877	$ (11,305)

The provision for income taxes consisted of the following:

	Years Ended December 31, 2008	2007	2006
	(In thousands)		
Current:			
United States federal	$ (2,810)	$ 15,929	$ (251)
Foreign	452	125	74
State and local	152	4,173	(52)
Total current	(2,206)	20,227	(229)
Deferred:			
United States federal	6,505	(6,578)	9
Foreign			
State and local	789	(799)	2
Total deferred	7,294	(7,377)	11
	$ 5,088	$ 12,850	$ (218)

The Company s income tax receivable for federal purposes had been increased by the tax benefits from employee stock options. The net tax benefits from employee stock option transactions were $97,000 for 2008 and were reflected as an increase to additional paid-in capital in the Consolidated Statements of Stockholders Equity (Deficit). The net tax benefits from employee stock options for 2007 were $14.7 million and for 2006 were insignificant. The Company includes only the direct tax effects of employee stock incentive plans in calculating this increase to additional paid-in capital.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Deferred tax assets and liabilities are recognized for the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, tax losses, and credit carryforwards. Significant components of the net deferred tax assets and liabilities consisted of:

	December 31, 2008	December 31, 2007
	(In thousands)	
Deferred tax assets:		
Net operating loss carryforwards	$ 12,135	$ 1,747
State income taxes	1	781
Deferred revenue	6,407	4,880
Research and development credits	4,088	1,214
Reserves and accruals recognized in different periods	3,756	1,495
Basis difference in investment	1,255	1,276
Capitalized R&D expenses	1,355	1,502
Other	1	273
Total deferred tax assets	28,998	13,168
Deferred tax liabilities:		
Depreciation and amortization	(3,451)	(2,366)
Valuation allowance	(25,547)	(3,507)
Net deferred tax assets	$	$ 7,295

As of December 31, 2008, the net operating loss carryforwards for federal and state income tax purposes were approximately $28.2 million and $37.3 million, respectively. The federal net operating losses expire between 2019 and 2028 and the state net operating losses begin to expire in 2029. As of December 31, 2008, the Company had federal and state tax credit carryforwards of approximately $3.4 million and $33,000, respectively, available to offset future taxable income. The federal credit carryforwards will expire between 2009 and 2028 and the California tax credits will carryforward indefinitely. In addition, as of December 31, 2008, the Company has Canadian research and development credit carryforwards of $1.0 million, which will expire at various dates through 2018. Approximately $126,000 of the state net operating loss carryforwards represent the stock option deduction arising from activity under the company s stock option plan, the benefit of which will increase additional paid-in-capital when realized. These operating losses and credits carryforwards have not been reviewed by the relevant tax authorities and could be subject to adjustment upon examinations.

During 2008, the Company recorded a valuation allowance for the entire deferred tax asset as a result of uncertainties regarding the realization of the asset balance due to losses in fiscal 2008, the variability of operating results, and near term projected results. In the event that the Company determines the deferred tax asset 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.

Utilization of a portion of the Company s federal net operating loss carryforward is limited in accordance with IRC Section 382, due to an ownership change that occurred during 1999. Utilization of these losses is limited to approximately $1.1 million annually. The remaining unused loss of $2.8 million will expire between 2019 and 2020, if not utilized. During 2005, the Company evaluated ownership changes from 1999 to 2004 and determined that there were no further limitations on the Company s net operating loss carryforwards.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For purposes of the reconciliation between the provision for (benefit from) income taxes at the statutory rate and the effective tax rate, a national U.S. 35% rate is applied as follows:

	2008	2007	2006
Federal statutory tax rate	(35.0)%	35.0%	(35.0)%
State taxes, net of federal benefit	(3.5)	4.2	(6.3)
Non-deductible interest	0.0	0.3	8.0
Stock compensation expense	1.4	0.4	3.6
Other	(0.4)	1.4	(0.2)
Valuation allowance	48.8	(28.5)	28.0
Effective tax rate	11.3%	10.0%	(1.9)%

Undistributed earnings of the Company s foreign subsidiaries are considered to be indefinitely reinvested and accordingly, no provision for federal and state income taxes has been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, the Company would be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to various foreign countries.

Effective January 1, 2007, the Company adopted the provision of Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertain Income Taxes An interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a comprehensive model for how companies should recognize, measure, present and disclose in their financial statements uncertain tax positions taken or expected to be taken on a tax return. Under FIN 48, tax positions must initially be recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions must initially and subsequently be measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the tax authority assuming full knowledge of the position and relevant facts. The adoption of FIN 48 did not have an impact on stockholders equity as the Company had a full valuation allowance at the time of adoption. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	Unrecognized Tax Benefits (In thousands)
Balance at January 1, 2008	$ 628
Gross increases for tax positions of prior years	
Gross decreases for tax positions of prior years	
Settlements	
Lapse of statute of limitations	
Balance at December 31, 2008	$ 628

The unrecognized tax benefits relate primarily to federal and state research and development credits. The Company s policy is to account for interest and penalties related to uncertain tax positions as a component of income tax expense. As of December 31, 2008, the Company accrued interest or penalties related to uncertain tax positions in the amount of $15,000. The Company does not expect any material changes to its liability for unrecognized income tax benefits during the next 12 months. As of December 31, 2008, the total amount of unrecognized tax benefits that would affect the Company s effective tax rate, if recognized, is $212,000.

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. Net Income (Loss) Per Share

The following is a reconciliation of the numerators and denominators used in computing basic and diluted net loss per share:

	Years Ended December 31, 2008	2007	2006
	(In thousands, except per share amounts)		
Numerator:			
Income (loss) from continuing operations	$ (50,258)	$ 116,027	$ (11,087)
Gain (loss) from discontinued operations, net of tax	(732)	1,059	505
Net Income (loss) used in computing basic net income (loss) per share	$ (50,990)	$ 117,086	$ (10,582)
Income (loss) from continuing operations	$ (50,258)	$ 116,027	$ (11,087)
Interest on 5% Convertible Debentures		348	
Income (loss) from continuing operations used in computing diluted net income (loss) per share	(50,258)	116,375	(11,087)
Gain (loss) from discontinued operations, net of tax	(732)	1,059	505
Net income (loss) used in computing diluted net income (loss) per share	$ (50,990)	$ 117,434	$ (10,582)
Denominator:			
Shares used in computation of basic net income (loss) per share (weighted average common shares outstanding)	29,575	27,662	24,556
Dilutive potential common shares:			
Stock options		1,989	
Warrants		305	
5% Convertible Debentures		1,711	
Shares used in computation of diluted net income (loss) per share	29,575	31,667	24,556
Basic net income (loss) per share from:			
Continuing operations	$ (1.70)	$ 4.19	$ (0.45)
Discontinued operations	$ (0.02)	$ 0.04	$ 0.02
Net Income (loss)	$ (1.72)	$ 4.23	$ (0.43)
Diluted net income (loss) per share from			
Continuing operations	$ (1.70)	$ 3.68	$ (0.45)
Discontinued operations	$ (0.02)	$ 0.03	$ 0.02

Net Income (loss)	$	(1.72)	$	3.71	$	(0.43)

For the year ended December 31, 2007, options and warrants to purchase approximately 1.4 million shares of common stock with exercise prices greater than the average fair market value of the Company s stock of $12.39 were not included in the calculation because the effect would have been anti-dilutive.

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of December 31, 2008 and 2006, the Company had securities outstanding that could potentially dilute basic earnings per share in the future, but were excluded from the computation of diluted net loss per share in the periods presented since their effect would have been anti-dilutive. These outstanding securities consisted of the following:

	December 31,	
	2008	**2006**
Outstanding stock options	7,009,667	7,585,423
Unvested Restricted Stock Units	34,500	
Warrants	434,332	808,762
5% Senior Subordinated Convertible Debentures		2,846,363

16. Employee Benefit Plan

The Company has a 401(k) tax-deferred savings plan under which eligible employees may elect to have a portion of their salary deferred and contributed to the 401(k) plan. Contributions may be made by the Company at the discretion of the Board of Directors. Beginning in January 2008, the Company matched 25% of the employee s contribution up to $2,000 for the year. The Company contributed approximately $149,000 during the year ended December 31, 2008. The Company did not make any contributions during the years ended December 31, 2007 or 2006.

17. Contingencies

In re Immersion Corporation

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

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

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

The Company and most of the issuer defendants had settled with the plaintiffs. In September 2005, the District Court granted preliminary approval of the settlement. The District Court held a hearing to consider final approval of the settlement on April 24, 2006, and took the matter under submission. Subsequently, the U.S. Court of Appeals for the Second Circuit vacated the class certification of plaintiffs claims against the underwriters in six cases designated as focus or test cases. Thereafter, the District Court ordered a stay of all proceedings in all of the lawsuits

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

pending the outcome of plaintiffs petition to the Second Circuit for rehearing en banc and resolution of the class certification issue. On April 6, 2007, the Second Circuit denied plaintiffs petition for rehearing, but clarified that the plaintiffs may seek to certify a more limited class in the District Court. Accordingly, the parties withdrew the prior settlement, and plaintiffs filed an amended complaint in attempt to comply with the Second Circuit s ruling. On March 26, 2008, the District Court denied in part and granted in part the motions to dismiss the focus cases on substantially the same grounds as set forth in its prior opinion.

In September 2008, all of the parties to the lawsuits reached a settlement, subject to documentation and approval of the District Court. As before, the Immersion Defendants would not be required to contribute to the settlement. Subsequently, an underwriter defendant filed for bankruptcy and other underwriter defendants were acquired. We believe that the settlement remains in place, and that final documentation will be presented to the District Court by April 1, 2009. If the settlement is not consummated and then approved by the District Court, we intend to defend the lawsuit vigorously.

Other Contingencies

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

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

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

18. Segment Reporting, Geographic Information, and Significant Customers

The Company develops, manufactures, licenses, and supports a wide range of hardware and software technologies that more fully engage users sense of touch when operating digital devices. The Company focuses on the following target application areas: automotive, consumer electronics, entertainment, gaming, and commercial and industrial controls; medical simulation; mobile communications; and three-dimensional design and interaction. The Company manages these application areas under two operating and reportable segments: 1) Touch (previously called Immersion Computing, Entertainment, and Industrial), and 2) Medical. The Company determines its reportable segments in accordance with criteria outlined in SFAS No. 131, Disclosures about Segments of an Enterprise and Related

Information.

The Company s chief operating decision maker (CODM) is the Chief Executive Officer. The CODM allocates resources to and assesses the performance of each operating segment using information about its revenue

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and operating income (loss). A description of the types of products and services provided by each operating segment is as follows:

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

Summarized financial information concerning the Company s reportable segments for the respective years ended December 31 is shown in the following table:

	Touch	Medical	Intersegment Eliminations(4)	Total
		(In thousands)		
2008				
Revenues				
Royalty and license	$ 14,249	$ 5	$	$ 14,254
Product sales	1,236	9,985	(111)	11,110
Development contracts and other	1,427	1,190		2,617
Total revenues	$ 16,912	$ 11,180	$ (111)	$ 27,981
Operating income (loss)(1)(3)	$ (40,289)	$ (8,808)	$ 3	$ (49,094)
Interest and other income	4,169	5		4,174
Interest and other expense	(250)			(250)
Depreciation and amortization and impairment of intangibles	1,366	732		2,098
Net income (loss)(1)(3)	(42,201)	(8,792)	3	(50,990)
Long-lived assets: capital expenditures and capitalized patent fees	3,704	1,780		5,484
Total assets	129,305	11,471	(27,189)	113,587
2007				
Revenues				
Royalty and license	$ 11,880	$ 1	$	$ 11,881
Product sales	1,102	13,108	(72)	14,138
Development contracts and other	1,608	2,530	(17)	4,121
Total revenues	$ 14,590	$ 15,639	$ (89)	$ 30,140
Operating income (loss)(1)	$ 122,771	$ 529	$ (22)	$ 123,278
Interest and other income	6,619	4		6,623
Interest and other expense(2)	(1,024)			(1,024)
	1,437	620		2,057

Depreciation and amortization and impairment of intangibles				
Net income (loss)(1)	116,586	522	(22)	117,086
Long-lived assets: capital expenditures and capitalized patent fees	3,152	485		3,637
Deferred income tax assets, net	7,295			7,295
Total assets	181,423	6,552	(20,044)	167,931
2006				
Revenues				
Royalty and license	$ 7,156	$ 148	$	$ 7,304
Product sales	731	11,701	(90)	12,342
Development contracts and other	1,153	2,160		3,313
Total revenues	$ 9,040	$ 14,009	$ (90)	$ 22,959
Operating income (loss)	$ (10,733)	$ 746	$ 9	$ (9,978)
Interest and other income	275			275
Interest and other expense(2)	(1,598)	(4)		(1,602)
Depreciation and amortization and impairment of intangibles	1,370	523		1,893
Net income (loss)	(11,333)	742	9	(10,582)
Long-lived assets: capital expenditures and capitalized patent fees	1,824	946		2,770
Total assets	63,991	7,391	(21,759)	49,623

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(1) Included in operating income (loss) and net income (loss) in 2008 and 2007 are litigation settlement, conclusions, and patent license of $20.8 million and $(134.9) million, respectively, for the Touch segment, see Note 12.

(2) Includes interest on 5% Convertible Debentures and amortization of 5% Convertible Debentures issued December 2004 and notes payable, recorded as interest expense.

(3) Included in operating income (loss) and net income (loss) in 2008 are restructuring costs of $142,000 for the Touch segment.

(4) Intersegment eliminations represent eliminations for intercompany sales and cost of sales and intercompany receivables and payables between Touch and Medical segments.

The Company operates primarily in the United States of America and in Canada where it operates through its wholly owned subsidiary, Immersion Canada, Inc. Segment assets and expenses relating to the Company s corporate operations are not allocated but are included in Touch as that is how they are considered for management evaluation purposes. As a result, the segment information may not be indicative of the financial position or results of operations that would have been achieved had these segments operated as unaffiliated entities. Management measures the performance of each segment based on several metrics, including net income (loss). These results are used, in part, to evaluate the performance of, and allocate resources to each of the segments.

Revenue by Product Lines

Information regarding revenue from external customers by product lines is as follows:

	2008	2007 (In thousands)	2006
Revenues:			
Consumer, Computing, and Entertainment	$ 13,350	$ 9,641	$ 5,290
Touch Interface Products	3,451	4,860	3,660
Subtotal Touch	16,801	14,501	8,950
Medical	11,180	15,639	14,009
Total	$ 27,981	$ 30,140	$ 22,959

Revenue by Region

The following is a summary of revenues by geographic areas. Revenues are broken out geographically by the ship-to location of the customer. Geographic revenue as a percentage of total revenue was as follows:

	Years Ended December 31,		
	2008	2007	2006
North America	67%	70%	77%
Europe	15%	16%	13%
Far East	15%	11%	9%
Rest of the world	3%	3%	1%
Total	100%	100%	100%

For the years ended December 31, 2008, 2007, and 2006 the Company derived 64%, 69%, and 76%, respectively, of its total revenues from the United States of America. For the years ended December 31, 2008, the

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Company derived 10% of its total revenues from Korea. Revenues from other countries represented less than 10% individually for the periods presented.

Significant Customers

Customers comprising 10% or greater of the Company s net revenues are summarized as follows:

	Years Ended December 31,		
	2008	**2007**	**2006**
Customer A	12%	13%	*
Customer B	*	12%	22%
Customer C	*	*	*
Customer D	10%	*	*
Total	22%	25%	22%

Of the significant customers noted above, Customer C had a balance of 10% of the outstanding accounts receivable at December 31, 2008. Customer B had a balance of 24% and 50% of the outstanding accounts receivable at December 31, 2007 and 2006, respectively.

The majority of the Company s long-lived assets are located in the United States of America. Long-lived assets include net property and equipment and long-term investments and other assets. Long-lived assets that were outside the United States of America constituted less than 10% of the total on December 31, 2008 and December 31, 2007.

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

19. Quarterly Results of Operations (Unaudited) (Restated)

The following table presents certain consolidated statement of operations data for the Company s eight most recent quarters.

As discussed in Note 2, the Company has restated its annual consolidated financial statements for 2008, 2007 and 2006. In addition, the Company intends to file restated condensed consolidated quarterly financial statements for each of the periods ended March 31, 2008, June 30, 2008 and September 30, 2008 in connection with the filing of its Forms 10-Q/A for the period March 31, 2009 and with the filing of its Forms 10-Q for each of the periods ending June 30, 2009 and September 30, 2009, respectively.

	Dec 31, 2008	Sept 30, 2008	June 30, 2008	Mar 31, 2008	Dec 31, 2007	Sept 30, 2007	June 30, 2007	Mar 31, 2007
	(In thousands, except per share data)							
Revenues	$ 6,467	$ 7,055	$ 7,619	$ 6,840	$ 8,600	$ 8,647	$ 7,344	$ 5,549
Gross profit	4,506	5,235	5,568	5,156	6,837	6,419	5,381	4,231
Operating income (loss)	(8,468)	(27,732)	(6,531)	(6,363)	(2,105)	(1,658)	(3,293)	130,334
Income (loss) from continuing operations before taxes	(8,140)	(26,744)	(5,558)	(4,728)	(95)	243	(1,560)	130,289
Income tax benefit (provision) from continuing operations	(1,121)	(7,124)	1,903	1,254	345	15	1,318	(14,528)
Net income (loss) from continuing operations	(9,261)	(33,868)	(3,655)	(3,474)	250	258	(242)	115,761
Net income (loss) from discontinued operations (net of tax)	(1,433)	165	210	326	416	244	780	(381)
Net income (loss)	(10,694)	(33,703)	(3,445)	(3,148)	666	502	538	115,380
Basic net income (loss) per share								
Continuing operations(1)	$ (0.33)	$ (1.15)	$ (0.12)	$ (0.11)	$ 0.01	$ 0.01	$ (0.01)	$ 4.57
Discontinued operations(1)	$ (0.05)	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.03	$ (0.02)
Total(1)	$ (0.38)	$ (1.14)	$ (0.11)	$ (0.10)	$ 0.02	$ 0.02	$ 0.02	$ 4.55
Diluted net income (loss) per share								
Continuing operations(1)	$ (0.33)	$ (1.15)	$ (0.12)	$ (0.11)	$ 0.01	$ 0.01	$ (0.01)	$ 3.91
Discontinued operations(1)	$ (0.05)	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.03	$ (0.02)
Total(1)	$ (0.38)	$ (1.14)	$ (0.11)	$ (0.10)	$ 0.02	$ 0.02	$ 0.02	$ 3.89
Shares used in calculating net income (loss) per share								

Basic	28,046	29,448	30,356	30,478	30,253	28,630	26,297	25,343
Diluted	28,046	29,448	30,356	30,478	32,488	31,399	28,619	29,677

(1) The quarterly earnings per share information is calculated separately for each period. Therefore, the sum of such quarterly per share amounts may differ from the total for the year.

Additionally, as disclosed in footnote 13 the previously reported results of operations of the 3D product line for all periods presented have been reclassified and reported as a separate component of income in discontinued operations.

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables present the effects of adjustments made to the Company s previously reported quarterly financial information for each of the quarters in our fiscal years ended December 31, 2008 and 2007:

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	Three Months Ended December 31, 2008			
	As Previously Reported	Discontinued Operations	Restatement Adjustments	As Restated
Revenues:				
Royalty and license	$ 2,861	$	$	$ 2,861
Product sales	5,512	(1,336)	(1,146)	3,030
Development contracts and other	613	(37)		576
Total revenues	8,986	(1,373)	(1,146)	6,467
Costs and expenses:				
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	4,834	(2,478)	(395)	1,961
Sales and marketing	4,855	(510)	17	4,362
Research and development	3,316		69	3,385
General and administrative	4,808		62	4,870
Amortization and impairment of intangibles	195		20	215
Restructuring costs	537	(395)		142
Total costs and expenses	18,545	(3,383)	(227)	14,935
Operating loss	(9,559)	2,010	(919)	(8,468)
Interest and other income	642		(64)	578
Interest and other expense	(250)			(250)
Loss from continuing operations before provision for income taxes	(9,167)	2,010	(983)	(8,140)
Provision for income taxes	(544)	(540)	(37)	(1,121)
Loss from continuing operations	(9,711)	1,470	(1,020)	(9,261)
Discontinued operations:				
Loss from discontinued operations, net of provision for income taxes of $(576)		(1,470)	37	(1,433)

Net loss	$	(9,711)	$		$	(983)	$	(10,694)
Basic and diluted net loss per share								
Continuing operations	$	(0.35)	$	0.05	$	(0.03)	$	(0.33)
Discontinued operations				(0.05)				(0.05)
Total	$	(0.35)	$		$	(0.03)	$	(0.38)
Shares used in calculating basic and diluted net loss per share		28,046						28,046

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	Three Months Ended September, 2008			
	As Previously Reported	Discontinued Operations	Restatement Adjustments	As Restated
Revenues:				
Royalty and license	$ 4,761	$	$	$ 4,761
Product sales	4,755	(1,177)	(1,822)	1,756
Development contracts and other	565	(27)		538
Total revenues	10,081	(1,204)	(1,822)	7,055
Costs and expenses:				
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	2,951	(394)	(737)	1,820
Sales and marketing	4,296	(392)	15	3,919
Research and development	3,155		88	3,243
General and administrative	4,774		80	4,854
Amortization and impairment of intangibles	179		22	201
Litigation settlements, conclusions and patent license	20,750			20,750
Total costs and expenses	36,105	(786)	(532)	34,787
Operating loss	(26,024)	(418)	(1,290)	(27,732)
Interest and other income	988			988
Loss from continuing operations before provision for income taxes	(25,036)	(418)	(1,290)	(26,744)
Provision for income taxes	(7,262)	214	(76)	(7,124)
Loss from continuing operations	(32,298)	(204)	(1,366)	(33,868)
Discontinued operations:				
Gain from discontinued operations, net of provision for income taxes of $252		204	(39)	165
Net loss	$ (32,298)	$	$ (1,405)	$ (33,703)

Basic and diluted net loss per share								
Continuing operations	$	(1.10)	$	(0.01)	$	(0.04)	$	(1.15)
Discontinued operations				0.01				0.01
Total	$	(1.10)	$		$	(0.04)	$	(1.14)
Shares used in calculating basic and diluted net loss per share		29,448						29,448

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	Three Months Ended June 30, 2008			
	As Previously Reported	Discontinued Operations	Restatement Adjustments	As Restated
Revenues:				
Royalty and license	$ 3,171	$	$	$ 3,171
Product sales	5,386	(1,040)	(602)	3,744
Development contracts and other	756	(52)		704
Total revenues	9,313	(1,092)	(602)	7,619
Costs and expenses:				
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	2,570	(301)	(218)	2,051
Sales and marketing	4,258	(448)	36	3,846
Research and development	2,855		85	2,940
General and administrative	5,084		27	5,111
Amortization and impairment of intangibles	170		32	202
Total costs and expenses	14,937	(749)	(38)	14,150
Operating loss	(5,624)	(343)	(564)	(6,531)
Interest and other income	909		64	973
Loss from continuing operations before provision for income taxes	(4,715)	(343)	(500)	(5,558)
Benefit for income taxes	1,624	131	148	1,903
Loss from continuing operations	(3,091)	(212)	(352)	(3,655)
Discontinued operations:				
Gain from discontinued operations, net of provision for income taxes of $133		212	(2)	210
Net loss	$ (3,091)	$	$ (354)	$ (3,445)
Basic and diluted net loss per share				

Continuing operations	$	(0.10)	$	(0.01)	$	(0.01)	$	(0.12)
Discontinued operations				0.01				0.01
Total	$	(0.10)	$		$	(0.01)	$	(0.11)
Shares used in calculating basic and diluted net loss per share		30,356						30,356

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	Three Months Ended March 31, 2008			
	As Previously Reported	Discontinued Operations	Restatement Adjustments	As Restated
Revenues:				
Royalty and license	$ 3,461	$	$	$ 3,461
Product sales	3,851	(1,182)	(89)	2,580
Development contracts and other	843	(44)		799
Total revenues	8,155	(1,226)	(89)	6,840
Costs and expenses:				
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	2,086	(403)	1	1,684
Sales and marketing	3,442	(306)	209	3,345
Research and development	3,229		261	3,490
General and administrative	4,263		151	4,414
Amortization and impairment of intangibles	235		35	270
Total costs and expenses	13,255	(709)	657	13,203
Operating loss	(5,100)	(517)	(746)	(6,363)
Interest and other income	1,507		128	1,635
Loss from continuing operations before provision for income taxes	(3,593)	(517)	(618)	(4,728)
Benefit for income taxes	1,008	195	51	1,254
Loss from continuing operations	(2,585)	(322)	(567)	(3,474)
Discontinued operations:				
Gain from discontinued operations, net of provision for income taxes of $192		322	4	326
Net loss	$ (2,585)	$	$ (563)	$ (3,148)
Basic and diluted net loss per share				
Continuing operations	$ (0.08)	$ (0.01)	$ (0.02)	$ (0.11)

Discontinued operations		0.01		0.01
Total	$ (0.08)	$	$ (0.02)	$ (0.10)
Shares used in calculating basic and diluted net loss per share	30,478			30,478

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	Three Months Ended December 31, 2007			
	As Previously Reported	Discontinued Operations	Restatement Adjustments	As Restated
Revenues:				
Royalty and license	$ 4,019	$	$	$ 4,019
Product sales	4,242	(1,609)	361	2,994
Development contracts and other	1,629	(42)		1,587
Total revenues	9,890	(1,651)	361	8,600
Costs and expenses:				
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	2,275	(566)	54	1,763
Sales and marketing	2,935	(317)		2,618
Research and development	2,518		73	2,591
General and administrative	3,405		7	3,412
Amortization and impairment of intangibles	263		58	321
Total costs and expenses	11,396	(883)	192	10,705
Operating income	(1,506)	(768)	169	(2,105)
Interest and other income	1,817		193	2,010
Income from continuing operations before provision for income taxes	311	(768)	362	(95)
Benefit for income taxes	200	352	(207)	345
Income from continuing operations	511	(416)	155	250
Discontinued operations:				
Gain from discontinued operations, net of provision for income taxes of $352		416		416
Net income	$ 511	$	$ 155	$ 666
Basic net income per share				
Continuing operations	$ 0.02	$ (0.01)	$	$ 0.01

Discontinued operations				0.01				0.01
Total	$	0.02	$		$		$	0.02
Shares used in calculating basic net income per share		30,253						30,253
Diluted net income per share								
Continuing operations	$	0.02	$	(0.01)	$		$	0.01
Discontinued operations				0.01				0.01
Total	$	0.02	$		$		$	0.02
Shares used in calculating diluted net income per share		32,488						32,488

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	Three Months Ended September 30, 2007			
	As Previously Reported	Discontinued Operations	Restatement Adjustments	As Restated
Revenues:				
Royalty and license	$ 2,904	$	$	$ 2,904
Product sales	5,420	(994)	(121)	4,305
Development contracts and other	1,479	(41)		1,438
Total revenues	9,803	(1,035)	(121)	8,647
Costs and expenses:				
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	2,563	(371)	36	2,228
Sales and marketing	2,825	(336)	(8)	2,481
Research and development	2,482		33	2,515
General and administrative	2,781		42	2,823
Amortization and impairment of intangibles	243		15	258
Total costs and expenses	10,894	(707)	118	10,305
Operating income	(1,091)	(328)	(239)	(1,658)
Interest and other income	1,856		256	2,112
Interest expense	(211)			(211)
Income from continuing operations before provision for income taxes	554	(328)	17	243
Provision for income taxes	(61)	84	(8)	15
Income from continuing operations	493	(244)	9	258
Discontinued operations:				
Gain from discontinued operations, net of provision for income taxes of $84		244		244
Net income	$ 493	$	$ 9	$ 502
Basic net income per share				
Continuing operations	$ 0.02	$ (0.01)	$	$ 0.01

Discontinued operations				0.01				0.01
Total	$	0.02	$		$		$	0.02
Shares used in calculating basic net income per share		28,630						28,630
Diluted net income per share								
Continuing operations	$	0.02	$	(0.01)	$		$	0.01
Discontinued operations				0.01				0.01
Total	$	0.02	$		$		$	0.02
Shares used in calculating diluted net income per share		31,399						31,399

IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	Three Months Ended June 30, 2007			
	As Previously Reported	Discontinued Operations	Restatement Adjustments	As Restated
Revenues:				
Royalty and license	$ 2,747	$	$	$ 2,747
Product sales	5,289	(1,055)	(154)	4,080
Development contracts and other	559	(42)		517
Total revenues	8,595	(1,097)	(154)	7,344
Costs and expenses:				
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	2,427	(366)	(98)	1,963
Sales and marketing	3,030	(409)	77	2,698
Research and development	2,513		57	2,570
General and administrative	3,122		(12)	3,110
Amortization and impairment of intangibles	242		54	296
Total costs and expenses	11,334	(775)	78	10,637
Operating income	(2,739)	(322)	(232)	(3,293)
Interest and other income	1,820		320	2,140
Interest expense	(407)			(407)
Income from continuing operations before provision for income taxes	(1,326)	(322)	88	(1,560)
Benefit for income taxes	1,502	(458)	274	1,318
Income from continuing operations	176	(780)	362	(242)
Discontinued operations:				
Gain from discontinued operations, net of benefit for income taxes of $458		780		780
Net income	$ 176	$	$ 362	$ 538
Basic net income per share				

Continuing operations	$	0.01	$	(0.03)	$	0.01	$	(0.01)
Discontinued operations				0.03	$			0.03
Total	$	0.01	$		$	0.01	$	0.02
Shares used in calculating basic net income per share		26,297						26,297
Diluted net income per share								
Continuing operations	$	0.01	$	(0.03)	$	0.01	$	(0.01)
Discontinued operations				0.03	$			0.03
Total	$	0.01	$		$	0.01	$	0.02
Shares used in calculating diluted net income per share		28,619						28,619

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IMMERSION CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	Three Months Ended March 31, 2007			
	As Previously Reported	Discontinued Operations	Restatement Adjustments	As Restated
Revenues:				
Royalty and license	$ 2,211	$	$	$ 2,211
Product sales	3,590	(956)	125	2,759
Development contracts and other	613	(34)		579
Total revenues	6,414	(990)	125	5,549
Costs and expenses:				
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	1,543	(262)	37	1,318
Sales and marketing	2,703	(335)	107	2,475
Research and development	2,543		170	2,713
General and administrative	3,259		79	3,338
Amortization and impairment of intangibles	254		17	271
Litigation settlements, conclusions and patent license	(134,900)			(134,900)
Total costs and expenses	(124,598)	(597)	410	(124,785)
Operating income	131,012	(393)	(285)	130,334
Interest and other income	361			361
Interest expense	(406)			(406)
Income from continuing operations before provision for income taxes	130,967	(393)	(285)	130,289
Provision for income taxes	(15,129)	774	(173)	(14,528)
Income from continuing operations	115,838	381	(458)	115,761
Discontinued operations:				
Gain from discontinued operations, net of provision for income taxes of $774		(381)		(381)
Net income	$ 115,838	$	$ (458)	$ 115,380

Basic net income per share								
Continuing operations	$	4.57	$	0.02	$	(0.02)	$	4.57
Discontinued operations				(0.02)				(0.02)
Total	$	4.57	$		$	(0.02)	$	4.55
Shares used in calculating basic net income per share		25,343						25,343
Diluted net income per share								
Continuing operations	$	3.91	$	0.02	$	(0.02)	$	3.91
Discontinued operations				(0.02)				(0.02)
Total	$	3.91	$		$	(0.02)	$	3.89
Shares used in calculating diluted net income per share		29,677						29,677

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

None.

Item 9A. ***Control and Procedures***

Management s Evaluation of Disclosure Controls and Procedures (As Revised)

Our management, with the participation of our Interim Chief Executive Officer and Interim Chief Financial Officer, re-evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act as of December 31, 2008. The purpose of these controls and procedures is to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC s rules, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, to allow timely decisions regarding required disclosures.

In connection with the restatement described in Note 2 to our consolidated financial statements, our management, with the participation of our Interim Chief Executive Officer and Interim Chief Financial Officer re-evaluated our disclosure controls and procedures and determined that there were material weaknesses in our internal control over financial reporting as of December 31, 2008, as more fully described in Management s Report on Internal Control over Financial Reporting (As Revised), below. A material weakness is a deficiency, or combination of deficiencies, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. Based on this re-evaluation and because of the material weaknesses described below, our Interim Chief Executive Officer and Interim Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of December 31, 2008.

Management s Report on Internal Control over Financial Reporting (as revised)

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). Internal control over financial reporting is a process designed by, or under the supervision of, our Chief Executive Officer and our Chief Financial Officer and effected by our Board of Directors and management to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. In connection with the restatement discussed in Note 2 to the consolidated financial statements, our management, with the participation of our Interim CEO and our Interim CFO, re-assessed the effectiveness of our internal control over financial reporting as of December 31, 2008. Management s re-assessment of internal control over financial reporting was conducted using the criteria in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In performing the re-assessment, our management concluded that, as of December 31, 2008, our internal control over financial reporting was not effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with GAAP because of the following material weaknesses:

As set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, our management determined that a material weakness existed in controls over accounting for income taxes as of December 31, 2007. During fiscal 2008, we continued to lack sufficient resources with the appropriate level of technical accounting expertise in the accounting for income taxes within the accounting function and therefore were unable to accurately perform or remediate certain of the designed controls during fiscal 2008. Our management, including the interim CEO and the interim CFO, has concluded that there is a continuing presence of the material weakness with respect to income taxes or ongoing implementation of remedial actions as of December 31, 2008.

Revenue Recognition: Modifications to Sales Arrangements Our controls relating to the modification of our standard sales arrangements were not designed or operating effectively as of December 31, 2008. These controls are intended to ensure that changes, written or otherwise, to the terms and conditions governing each sale are documented, approved and recorded timely and accurately. This control deficiency led to a misstatement in our consolidated financial statements which resulted in a restatement thereof.

Revenue Recognition: Compliance with Specified Shipping Terms Our controls relating to the identification of and accounting for shipping terms in our sales arrangements were not operating effectively as of December 31, 2008. These controls are intended to determine the point at which title and risk of loss passes to the customer and to properly apply this information in the determination of our revenue recognition. This control deficiency led to a misstatement in our consolidated financial statements which resulted in a restatement thereof.

Revenue Recognition: Release of New Products for sale Our controls relating to the release and approval for sale of new products were not operating effectively as of December 31, 2008. These controls are intended to ensure that revenue is recognized only on fully functional products which have final approval by management prior to release for sale to customers. This control deficiency led to a misstatement in our consolidated financial statements which resulted in a restatement thereof.

Stock-based Compensation Our controls related to the application of forfeiture rates in the determination of stock-based compensation were not operating effectively as of December 31, 2008. This control deficiency led to a misstatement in our consolidated financial statements which resulted in a restatement thereof.

We reviewed the results of management s assessment with the Audit Committee of our Board of Directors. Our independent registered public accounting firm, Deloitte & Touche LLP, which audited the consolidated financial statements included in this amended Annual Report has issued an attestation report, included elsewhere herein, which expresses an adverse opinion on the effectiveness of our internal control over financial reporting.

Changes in internal control over financial reporting

Other than the remedial efforts to address our material weaknesses as described further below, that took place or that were ongoing during the three months ended December 31, 2008, there were no changes in our internal control over financial reporting during the three months ended December 31, 2008 that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

Plans for Remediation

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

Subsequent to December 31, 2007 through the filing date of this Amendment, we have undertaken the following remedial efforts to address the material weakness in our internal control over financial reporting with respect to income taxes discussed above:

During the first quarter of fiscal 2008, we engaged outside consultants to advise us in areas of complex tax accounting and to design and implement controls to ensure proper communication with our personnel to obtain the needed advice and review of tax related accounting and reporting documentation.

In November 2008, we hired a senior tax manager who had responsibility to consider and apply proper accounting for income taxes, design and implement controls to ensure that the rationale for positions taken on certain tax matters would be adequately documented and appropriately communicated to all internal and external members of our tax team, and design and implement controls over the adjustment of the income tax accounts based on the preparation and filing of income tax returns. In June 2009, the senior tax manager departed the Company and we outsourced the preparation of the Company s quarterly and annual tax calculations and the related financial disclosures including the rationale for recognizing the benefits of certain tax positions in the financial statements to an external provider with oversight responsibility remaining with the corporate controller. We continue to evaluate additional steps to remediate this material weakness.

Subsequent to December 31, 2008 through the filing date of this Amendment, we have undertaken the following remedial efforts to address the material weaknesses in our internal control over financial reporting with respect to revenue recognition discussed above:

We are in the process of improving our documentation of existing revenue recognition policies, including policies involving non-standard terms and conditions, multiple element arrangements, modifications to shipping terms and requests for pre-release products;

We have restructured our finance department such that the individuals responsible for the recognition of revenue are all located at our headquarters and report directly to the Interim CFO with clearly delineated responsibilities;

We have held training sessions on revenue recognition policies with the sales personnel and will continue to implement training and oversight of executive, finance, sales and operational personnel and new hires to ensure compliance with revenue recognition policies;

We have redesigned the quarterly sub-certification process to cover a wider variety of topics that could affect the financial statements and added more employees to this certification process;

We have implemented a process of obtaining quarterly certifications from all sales personnel certifying that they are not aware of any side agreements modifying our standard terms of contracts;

We have implemented a process of obtaining, on an annual basis, signed acknowledgments from each employee that he or she has read and is in compliance with our code of ethics and employee handbook;

We have improved our legal and financial review process of all sales order packages for all terms and conditions prior to shipment, and

We are in the process of automating the approval process for the release of all products in development to production, which approval process requires the approval of finance personnel.

In addition, we continue to take the steps set forth in the remedial plan approved by the Audit Committee as further discussed in the Explanatory Note.

Subsequent to December 31, 2008 through the filing date of this Amendment, we have undertaken the following remedial efforts to address the material weakness in our internal control over financial reporting with respect to the calculation of stock-based compensation discussed above:

We are in the process of adding a control procedure to test the calculation of the third-party stock-based compensation reports on a quarterly basis, including upon upgrades to new versions of the software, and to ensure timely review of the technical updates to the software.

Inherent Limitations on the Effectiveness of Internal Controls

A system of internal control over financial reporting is intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP; however no control system, no matter how well designed and operated, can provide absolute assurance that financial statement errors and misstatements will be prevented or detected. 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.

Item 9B. ***Other Information***

None.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Immersion Corporation:

We have audited Immersion Corporation and subsidiaries (the Company) internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control over Financial Reporting (as revised). Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on that risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company s annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses have been identified and included in management s assessment:

> The Company s controls over accounting for income taxes did not operate effectively. In particular, errors were detected in the tax calculations for the quarterly and annual financial statements.
>
> The Company lacks sufficient resources with the appropriate level of technical accounting expertise in the accounting for income taxes within the accounting function.

The Company s controls relating to the identification of modifications to standard sales arrangements were not designed or operating effectively.

The Company s controls over the identification of and accounting for shipping terms in its sales arrangements were not operating effectively.

The Company s controls over the proper review and accounting for revenue transactions containing deliverables that were not available or not fully functional were not designed or operating effectively.

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The Company s controls relating to the application of forfeiture rates in the determination of stock-based compensation were not operating effectively.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2008, of the Company and this report does not affect our report on such financial statements and financial statement schedule.

In our opinion, because of the effect of the material weaknesses identified above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial schedule as of and for the year ended December 31, 2008 of the Company and our report dated March 9, 2009 (February 8, 2010 as to the effects of the restatement discussed in Note 2 and discontinued operations discussed in Note 13 to the consolidated financial statements) expressed an unqualified opinion on those financial statements and financial statement schedule and includes an explanatory paragraph relating to the restatement.

/s/ DELOITTE & TOUCHE LLP

San Jose, California

March 9, 2009 (February 8, 2010 as to the effects of the additional material weaknesses related to stock-based compensation expense and revenue recognition described in Managements Report on Internal Controls Over Financial Reporting (as revised)).

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PART III

The SEC allows us to include information required in this report by referring to other documents or reports we have already or will soon be filing. This is called Incorporation by Reference. We intend to file our definitive proxy statement pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report, and certain information therein is incorporated in this report by reference.

Item 10. *Directors, Executive Officers and Corporate Governance*

The information required by Item 10 with respect to executive officers is set forth in Part I of this Annual Report on Form 10-K/A and the remaining information required by Item 10 is incorporated by reference from the sections entitled Election of Directors, Section 16(a) Beneficial Ownership Reporting Compliance, and Corporate Governance in Immersion s definitive Proxy Statement for its 2009 annual stockholders meeting.

Item 11. *Executive Compensation*

The information required by Item 11 is incorporated by reference from the section entitled Executive Compensation in Immersion s definitive Proxy Statement for its 2009 annual stockholders meeting.

Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*

The information required by Item 12 is incorporated by reference from the section entitled Principal Stockholders and Stock Ownership by Management in Immersion s definitive Proxy Statement for its 2009 annual stockholders meeting.

Item 13. *Certain Relationships and Related Transactions, and Director Independence*

The information required by Item 13 is incorporated by reference from the section entitled Related Person Transactions and Corporate Governance Independence of Directors in Immersion s definitive Proxy Statement for its 2009 annual stockholders meeting.

Item 14. *Principal Accounting Fees and Services*

The information required by Item 14 is incorporated by reference from the section entitled Ratification of Appointment of Independent Registered Public Accounting Firm in Immersion s definitive Proxy Statement for its 2009 annual stockholders meeting.

PART IV.

Item 15. *Exhibits, Financial Statement Schedules*

(a) The following documents are filed as part of this Form:

1. *Financial Statements*

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2. *Financial Statement Schedules*

The following financial statement schedule of Immersion Corporation for the years ended December 31, 2008, 2007, and 2006 is filed as part of this Annual Report and should be read in conjunction with the Consolidated Financial Statements of Immersion Corporation.

Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the consolidated financial statements or notes herein.

3. *Exhibits:*

The following exhibits are filed herewith:

		Incorporated by Reference				
Exhibit Number	**Exhibit Description**	**Form**	**File No.**	**Exhibit**	**Filing Date**	**Filed Herewith**
3.1	Amended and Restated Bylaws, dated October 31, 2007.	8-K	000-27969		November 1, 2007	
3.2	Amended and Restated Certificate of Incorporation.	10-Q	000-27969		August 14, 2000	
3.3	Certificate of Designation of the Powers, Preferences and Rights of Series A Redeemable Convertible Preferred Stock.	8-K	000-27969		July 29, 2003	
10.1	1994 Stock Option Plan and form of Incentive Stock Option Agreement and form of Nonqualified Stock Option Agreement.	S-1	333-86361		September 1, 1999	
10.2	1997 Stock Option Plan and form of Incentive Stock Option Agreement and form of Nonqualified Stock Option Agreement.	S-1/A	333-86361		November 5, 1999	
10.3#	Intellectual Property License Agreement with Logitech, Inc. dated October 4, 1996.	S-1/A	333-86361		November 12, 1999	
10.4#	Intellectual Property License Agreement with Logitech, Inc. dated April 13, 1998.	S-1/A	333-86361		November 12, 1999	
10.5#		S-1/A	333-86361			

	Technology Product Development Agreement with Logitech, Inc. dated April 13, 1998.			November 12, 1999
10.6	1999 Employee Stock Purchase Plan and form of subscription agreement thereunder.	S-1/A	333-86361	October 5, 1999
10.7	Industrial Lease between WW&LJ Gateways, Ltd. and Immersion Corporation dated January 11, 2000.	10-Q	000-27969	May 15, 2000
10.8	Amendment #1 to the April 13, 1998 Intellectual Property License Agreement and Technology Product Development Agreement with Logitech, Inc. dated March 21, 2000.	10-Q	000-27969	May 15, 2000
10.9	Immersion Corporation 2000 Non-Officer Nonstatutory Stock Option Plan.	S-4	333-45254	September 6, 2000
10.10	Immersion Corporation 2000 HT Non-Officer Nonstatutory Stock Option Plan.	8-K	000-27969	October 13, 2000
10.11	Logitech Letter Agreement dated September 26, 2000.	10-K	000-27969	April 2, 2001
10.12	Lease Agreement between Mor Bennington LLLP and HT Medical Systems, Inc. dated February 2, 1999.	10-K	000-27969	April 2, 2001
10.13	Haptic Technologies, Inc. 2000 Stock Option Plan.	S-4	333-45254	September 6, 2000
10.14#	Amendment to 1996 Intellectual Property License Agreement by and between Immersion Corporation and Logitech, Inc. dated October 11, 2001.	10-K	000-27969	March 28, 2002
10.15#	Settlement Agreement dated July 25, 2003 by and between Microsoft Corporation and Immersion Corporation.	S-3	333-108607	September 8, 2003
10.16#	License Agreement dated July 25, 2003 by and between Microsoft Corporation and Immersion Corporation.	S-3/A	333-108607	February 13, 2004

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Filed Herewith
10.17	First Amendment to Lease between WW&LJ Gateways, Ltd. and Immersion Corporation dated March 17, 2004.	S-3/A	333-108607		March 24, 2004	
10.18	Letter Agreement dated March 18, 2004 by and between Microsoft Corporation and Immersion Corporation.	S-3/A	333-108607		March 24, 2004	
10.19	Form of Indemnity Agreement.	S-3/A	333-108607		March 24, 2004	
10.20	Purchase Agreement dated December 22, 2004, by and between Immersion Corporation and the purchasers named therein.	8-K	000-27969		December 27, 2004	
10.21*	Employment Agreement dated January 27, 2005 by and between Immersion Corporation and Stephen Ambler.	10-K	000-27969		March 11, 2005	
10.22#	Agreement by and among Sony Computer Entertainment America Inc., Sony Computer Entertainment Inc., and Immersion Corporation dated March 1, 2007.	10-Q	000-27969		March 1, 2007	
10.23	2007 Equity Incentive Plan with Forms of Notice of Stock Option and Forms of Stock Option Agreement (for both U.S. and Non-U.S. Participants) dated June 6, 2007.	8-K	000-27969		June 12, 2007	
10.24*	Form of Retention and Ownership Change Event Agreement approved on June 14, 2007.	8-K	000-27969		June 15, 2007	
10.25*	Executive Incentive Plan dated April 21, 2008 by and between Immersion Corporation and Stephen Ambler.	10-Q	000-27969		August 8, 2008	
10.26	The Immersion Corporation 2008 Employment Inducement Award Plan dated April 30, 2008.	10-Q	000-27969		August 8, 2008	

10.27	Form of Stock Option Agreement for Immersion Corporation 2008 Employment Inducement Award Plan dated April 30, 2008.	10-Q	000-27969	August 8, 2008
10.28*	Resignation agreement and general release of claims dated April 28, 2008 by and between Immersion Corporation and Victor Viegas.	10-Q	000-27969	August 8, 2008
10.29*	Retention and ownership change event agreement dated April 17, 2008 by and between Immersion Corporation and Clent Richardson.	10-Q	000-27969	August 8, 2008
10.30*	Restated Offer of Employment with Immersion Corporation effective April 28, 2008 by and between Immersion Corporation and Clent Richardson.	10-Q	000-27969	August 8, 2008
10.31*	Executive Incentive Plan dated August 7, 2008 by and between Immersion Corporation and Clent Richardson.	10-Q	000-27969	November 7, 2008
10.32	Settlement Agreement dated August 25, 2008 by and between Microsoft Corporation and Immersion Corporation.	10-Q	000-27969	November 7, 2008
10.33*	Offer Letter dated November 25, 2008 by and between Immersion Corporation and Daniel J. Chavez.	8-K	000-27969	December 8, 2008
10.34*	Retention and Ownership Change Event Agreement dated December 4, 2008 by and between Immersion Corporation and Daniel J. Chavez.	8-K	000-27969	December 8, 2008
10.35	Second Amendment to Lease between Irvine Company, as successor-in-interest to WW&LJ Gateways, Ltd. and Immersion Corporation dated January 15, 2009.	8-K	000-27969	February 5, 2009
10.36	Form of RSU Agreement for Immersion Corporation 2008 Employment Inducement Award Plan dated April 30, 2008.	8-K	000-27969	March 4, 2009
21.1	Subsidiaries of Immersion Corporation.	8-K	000-27969	March 9, 2009

23.1	Consent of Independent Registered Public Accounting Firm.	X

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Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Filed Herewith
31.1	Certification of Victor Viegas, Interim Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
31.2	Certification of Henry Hirvela, Interim Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
32.1	Certification of Victor Viegas, Interim Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
32.2	Certification of Henry Hirvela, Interim Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X

Certain information has been omitted and filed separately with the Commission. Confidential treatment has been granted with respect to the omitted portions.

* Constitutes a management contract or compensatory plan required to be filed pursuant to Item 15(b) of Form 10-K.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

IMMERSION CORPORATION

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

Date: February 8, 2010

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Victor Viegas and Henry Hirvela, jointly and severally, his or her attorneys-in-fact, each with the power of substitution, for him or her in any and all capacities, to sign any amendments to this Amendment No. 1 to Annual Report on Form 10-K/A and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his or her substitute or substitutes, may do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Amendment No. 1 to Annual Report on Form 10-K/A has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ VICTOR VIEGAS Victor Viegas	Interim Chief Executive Officer and Director	February 8, 2010
/s/ HENRY HIRVELA Henry Hirvela	Interim Chief Financial Officer	February 8, 2010
/s/ JOHN HODGMAN John Hodgman	Director	February 8, 2010
/s/ JACK SALTICH Jack Saltich	Director	February 8, 2010
/s/ EMILY LIGGETT	Director	February 8, 2010

Emily Liggett		
/s/ ROBERT VAN NAARDEN	Director	February 8, 2010
Robert Van Naarden		
/s/ ANNE DEGHEEST	Director	February 8, 2010
Anne DeGheest		

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SCHEDULE II

VALUATION AND QUALIFYING ACCOUNTS

	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions/ Write-offs	Balance at End of Period
		(In thousands)		
Year ended December 31, 2008				
Allowance for doubtful accounts	$ 85	$ 354	$ 3	$ 436
Year ended December 31, 2007				
Allowance for doubtful accounts	$ 139	$ (33)	$ 21	$ 85
Year ended December 31, 2006				
Allowance for doubtful accounts	$ 383	$ (164)	$ 80	$ 139