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

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

FORM 10-Q/A
Amendment No. 1

(MARK ONE)

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

For the quarterly period ended March 31, 2009

OR

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

For the transition period from__________to__________

Commission file number 000-27969

IMMERSION CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**94-3180138**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. 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)

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

Indicate by check mark 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 Exchange Act). Yes o No þ

Number of shares of common stock outstanding at April 30, 2009: 27,957,359

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EXPLANATORY NOTE REGARDING RESTATEMENT

Immersion Corporation is filing this Amendment No. 1 on Form 10-Q/A (the Amendment) to its Quarterly Report on Form 10-Q for the quarter ended March 31, 2009, originally filed May 6, 2009 (the Original Filing) to amend and restate the following previously-filed condensed consolidated financial statements (and related disclosures) (the Restatement): (1) our condensed consolidated balance sheet as of March 31, 2009 and the related condensed consolidated statements of operations and cash flows for each of the fiscal quarters ended March 31, 2009 and 2008 contained in Part I Item 1 of this Amendment; and (2) management s discussion and analysis of our financial condition and results of operations as of and for our fiscal quarters ended March 31, 2009 and 2008 contained in Part I, Item 2 of this Amendment. The Restatement results from our management s determination subsequent to the issuance of our financial statements for the quarter ended March 31, 2009 that there were errors in 1) the recording of revenue transactions from our Medical line of business; 2) the recording of stock-based compensation expense; 3) the recording of interest income arising from future installments due from Sony Computer Entertainment determined under the interest method; (4) the recording of amortization and impairment of patents; all of which affected the quarters ended March 31, 2009 and 2008; and (5) The Company s accounting of certain warrants to purchase company common stock subsequent to the adoption of a new accounting standard in the quarter ended March 31, 2009; and therefore our unaudited condensed 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 Note 2 to the condensed consolidated financial statements included in Item 1 for further discussion of the Restatement.

Financial information related to the interim periods ended March 31, 2009 and 2008 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 related to 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. Finally, we identified errors in the accounting of warrants to purchase company common stock related to the adoption of a new accounting standard in the first quarter of 2009.

Background of the Restatements

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 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 the stock-based compensation, but does not change the aggregate amount of stock-based compensation expense to be recognized.

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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 Amendment No. 1 to our Annual Report on Form 10-K for the year ended December 31, 2008 and this Form 10-Q/A. 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. As more fully described in Amendment No. 1 to the Annual Report on Form 10-K filed on February 8, 2010, the Company concluded that revenue had not been appropriately recognized on certain transactions resulting in restatement adjustments to revenue in various reporting periods. Revenue in the quarters ended March 31, 2008 and 2009 were not impacted by these findings. Bad debt expense and allowance for doubtful accounts of $623,000 previously recorded in the quarter ended March 31, 2009 relating to revenues that had been inappropriately recorded in earlier periods were reversed.

Commitment of Deliverables that are Unavailable or Lacked 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. Accordingly, a total of $468,000 recorded in fiscal 2008 has been deferred and recognized in the first quarter of 2009.

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, a net increase in revenue in the amount of $67,000 was recorded in the first quarter of 2009. This represents an increase of revenue of approximately $536,000 originally recorded in earlier periods that has been recorded in the first quarter of 2009 and a decrease of $469,000 of revenue originally recorded in the first quarter of 2009 that has been reversed and is expected to be recognized in future periods. Bad debt and allowance for doubtful accounts originally recorded in the first quarter of 2009 in the amount of $52,000 were also reversed. Approximately $80,000 of revenue recorded in the first quarter of 2008 was reversed and is to be recorded in subsequent periods.

Other Impact of Revenue Adjustments

As a result of the adjustments to revenues discussed above, cost of product sales increased by $118,000 for the quarter ended March 31, 2009 and commission expense increased by $86,000 for the quarter ended March 31, 2009. Also, as a result of the deferral of certain revenues, we recorded deferred cost of goods sold in the amount of $1.1 million at March 31, 2009 which is reported as prepaid expenses and other current assets on the balance sheet. As a result of the adjustment to revenues discussed above, cost of product sales decreased by $21,000 for the quarter ended March 31, 2008. There was no other impact on these accounts for the quarter ended March 31, 2008.

Other Errors in Condensed Consolidated Financial Statements

We also corrected the condensed 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 $163,000 and $643,000 for the first quarter of 2009 and 2008, respectively.

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 $128,000 in the first quarter of 2008 and a reduction in interest income of approximately $128,000 in the first quarter of 2009. 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 $19,000 and $35,000 in the quarters March 31, 2009 and 2008, respectively. Finally we identified that a change in the way we were amortizing our patents implemented in the first quarter of 2009 should not have been recorded; as a result we have decreased amortization of intangibles by $180,000 for the first quarter of 2009.

Warrants. As further described under the heading Warrants in Note 2 of the Notes to the Condensed Consolidated Financial Statements for the period ended March 31, 2009 we should have adopted Emerging Issues Task Force (EITF) Issue No. 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock* (*EITF 07-5*), as codified in FASB ASC topic 815, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock* effective January 1, 2009. EITF 07-5 provides that an entity should use a two step approach to evaluate whether an equity-linked financial instrument (or embedded feature) is indexed to its own stock, including evaluating the instrument s contingent exercise and settlement provisions. Therefore, warrants to purchase 426,951 shares of our common stock issued in 2004 that were previously classified as Warrants have been corrected for the adoption of EITF 07-5 and classified to Other Current Liabilities and Retained Earnings effective January 1, 2009 due to the presence of a warrant adjustment feature that allows for a change in the number of shares subject to issuance and a change in the exercise price of the warrant under certain circumstances, including the issuance of stock for cash in a secondary offering. The warrants expire on December 23, 2009 and the fair value balance of the remaining liability will be marked to market and recognized at each balance sheet date in non-operating income. As compared to amounts previously reported, we corrected the condensed consolidated financial statements to reflect the adoption of EITF 07-5 and recorded a decrease of $1.7 million to Warrants, an addition of $517,000 to Other Current Liabilities and $1.2 million to Retained Earnings as a cumulative effect of a change in accounting principle to our balance sheet as of January 1, 2009. We estimated the fair value of these warrant derivative liabilities using a Black-Scholes model as of March 31, 2009 to be $37,000 and recorded a credit of $480,000 in our condensed consolidated statement of operations in non-operating income for the quarter ended March 31, 2009.

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Impact of Corrections on Previously Issued Condensed Consolidated Financial Statements

Our accompanying condensed 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	Bad Debt Expense	Commission Expense	Total Impact of Revenue Adjustments
Three months ended March 31, 2009						
Increase (Decrease)	$ 528	(1)	$ (118)	$ 675	$ (86)	$ 999
Three months ended March 31, 2008						
Increase (Decrease)	$ (89)	(2)	$ 21	$ -	$ -	$ (68)

(1) For three months ended March 31, 2009, reflects increase of $468,000 in revenue as discussed in Commitment of Deliverables that are Unavailable or Lacked Functionality, a net increase in revenue of $67,000 as discussed in Additional Transactions Analyzed and decrease of $7,000 in revenue due to insignificant warranty adjustment.

(2) For three months ended March 31, 2008, reflects decrease of $80,000 in revenue as discussed in Additional Transactions Analyzed and a net decrease of $9,000 in revenue due to warranty adjustment.

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	Stock-based Compensation	Warrant Liability	Amortization and Impairment of Intangibles	Total	Income Tax Effect	Total Adjustments Net of Tax
	($ in thousands)							
Three months ended March 31, 2009								
Increase (Decrease)	$ 999	$ (128)	$ (163)	$ 480	$ 161	$ 1,349	$ -	$ 1,349
Three months ended								

March 31, 2008								
Increase (Decrease)	$ (68)	$ 128	$ (643)	$ -	$ (35)	$ (618)	$ 51	$ (567)

(1) See table above

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Internal Control Deficiencies

As further discussed in Part II, Item 9 of our Form 10-K/A for the year ended December 31, 2008 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 4. The following items in this report have been amended as a result of the Restatement:

Part I:

Item 1: Financial Statements

Item 2: Management s Discussion and Analysis of Financial Condition and Results of Operations

Item 4: Controls and Procedures

Part II:

Item 1A: Risk Factors

For convenience of the reader, this Form 10-Q/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 quarterly report on Form 10-Q, except as required to reflect the effects of this Restatement. Accordingly, this Form 10-Q/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 May 6, 2009. References to the quarterly report on Form 10-Q herein shall refer to the quarterly report on Form 10-Q originally filed on May 6, 2009.

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PART I
FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
IMMERSION CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)
(Unaudited)

	March 31, 2009 As Restated (1)	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 36,997	$ 64,769
Short-term investments	43,933	20,974
Accounts receivable (net of allowances for doubtful accounts of: March 31, 2009 $279 and December 31, 2008 $436	4,025	6,114
Inventories, net	4,431	3,757
Deferred income taxes	311	311
Prepaid expenses and other current assets	4,301	4,344
Total current assets	93,998	100,269
Property and equipment, net	4,379	3,827
Intangibles and other assets, net	10,064	9,491
Total assets	$ 108,441	$ 113,587
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 2,460	$ 2,842
Accrued compensation	2,242	2,920
Other current liabilities	3,310	3,493
Deferred revenue and customer advances	8,303	8,042
Total current liabilities	16,315	17,297
Long-term deferred revenue	16,916	15,989
Deferred income tax liabilities	311	311
Other long-term liabilities	217	212
Total liabilities	33,759	33,809
Contingencies (Note 16)		
Stockholders equity:		
Common stock and additional paid-in capital $0.001 par value; 100,000,000 shares authorized; shares issued: March 31, 2009 30,733,728 and	169,485	167,870

December 31, 2008 30,674,045; shares outstanding: March 31, 2009 27,945,859 and December 31, 2008 27,887,482		
Warrants	11	1,731
Accumulated other comprehensive income	40	109
Accumulated deficit	(76,457)	(71,543)
Treasury stock at cost: March 31, 2009 2,787,869 shares and December 31, 2008 2,786,563 shares	(18,397)	(18,389)
Total stockholders equity	74,682	79,778
Total liabilities and stockholders equity	$ 108,441	$ 113,587

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

See accompanying Notes to Condensed Consolidated Financial Statements.

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IMMERSION CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended March 31,	
	2009	**2008**
	As Restated (1)	As Restated (1)
Revenues:		
Royalty and license	$ 3,781	$ 3,461
Product sales	3,279	2,580
Development contracts and other	446	799
Total revenues	7,506	6,840
Costs and expenses:		
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	1,251	1,684
Sales and marketing	4,284	3,345
Research and development	3,929	3,490
General and administrative	4,384	4,414
Amortization and impairment of intangibles	215	270
Restructuring costs	646	
Total costs and expenses	14,709	13,203
Operating loss	(7,204)	(6,363)
Change in fair value of warrant liability	480	
Interest and other income	302	1,635
Loss from continuing operations before provision for income taxes	(6,421)	(4,728)
Benefit (provision) for income taxes	(91)	1,254
Loss from continuing operations	(6,512)	(3,474)
Discontinued operations (Note 10):		
Gain on sales of discontinued operations net of provision for income taxes of $0	167	
Gain from discontinued operations, net of provision for income taxes of $150 and $192 as of March 31, 2009 and 2008, respectively	235	326
Net loss	$ (6,110)	$ (3,148)
Basic and diluted net loss per share		
Continuing operations	$ (0.23)	$ (0.11)
Discontinued operations	0.01	0.01

Total	$ (0.22)	$ (0.10)
Shares used in calculating basic and diluted net loss per share	27,924	30,478

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

See accompanying Notes to Condensed Consolidated Financial Statements.

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IMMERSION CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(unaudited)

	Three Months Ended March 31,	
	2009	**2008**
	As Restated (1)	As Restated (1)
Cash flows from operating activities:		
Net loss	$ (6,110)	$ (3,148)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	390	260
Amortization and impairment of intangibles	215	270
Stock-based compensation	1,404	1,607
Excess tax benefits from stock-based compensation		(107)
Realized gain on short-term investments		(81)
Change in fair value of warrant liability	(480)	
Allowance for doubtful accounts	(156)	(12)
Loss on disposal of equipment	2	
Gain on sales of discontinued operations	(167)	
Changes in operating assets and liabilities:		
Accounts receivable	2,241	2,300
Inventories	(818)	(390)
Deferred income taxes		(306)
Prepaid expenses and other current assets	44	(1,233)
Other assets		(3)
Accounts payable	(469)	541
Accrued compensation and other current liabilities	(1,297)	521
Income taxes payable	2	(412)
Deferred revenue and customer advances	1,187	1,871
Other long-term liabilities	5	12
Net cash provided by (used in) operating activities	(4,007)	1,690
Cash flows provided by (used in) investing activities:		
Purchases of short-term investments	(33,962)	
Maturities of short-term investments	11,000	49,657
Additions to intangibles	(542)	(508)
Purchases of property and equipment	(580)	(280)
Proceeds from sales of discontinued operations	167	
Net cash provided by (used in) investing activities	(23,917)	48,869
Cash flows provided by financing activities:		
Issuance of common stock under employee stock purchase plan	134	168

Exercise of stock options and warrants		70		659
Excess tax benefits from stock-based compensation				107
Net cash provided by financing activities		204		934
Effect (decreases) of exchange rates on cash and cash equivalents		(52)		(5)
Net increase in cash and cash equivalents		(27,772)		51,488
Cash and cash equivalents:				
Beginning of the period		64,769		86,493
End of the period	$	36,997	$	137,981
Supplemental disclosure of cash flow information:				
Cash paid for taxes	$		$	761
Supplemental disclosure of non-cash investing and financing activities:				
Amounts accrued for property and equipment, and intangibles	$	1,090	$	
Shares issued upon vesting of restricted stock units	$	22	$	

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

See accompanying Notes to Condensed Consolidated Financial Statements.

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IMMERSION CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2009
(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES

Description of Business

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

Principles of Consolidation and Basis of Presentation

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

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all information and footnotes necessary for a complete presentation of the financial position, results of operations, and cash flows, in conformity with accounting principles generally accepted in the United States of America. These condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements included in the Company s Amendment No. 1 to Annual Report on Form 10-K/A for the fiscal year ended December 31, 2008. In the opinion of management, all adjustments consisting of only normal and recurring items necessary for the fair presentation of the financial position and results of operations for the interim period have been included.

The results of operations for the interim periods ended March 31, 2009 are not necessarily indicative of the results to be expected for the full year.

Revenue Recognition

The Company recognizes revenues in accordance with applicable accounting standards, including Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition (SAB No. 104); Emerging Issues Task Force (EITF) No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables (EITF No. 00-21); and American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) No. 97-2, Software Revenue Recognition (SOP No. 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 recognized over the service period once services commence when vendor-specific objective evidence (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 No. 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 No. 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 proportional performance accounting method based on physical completion of the work to be performed or completed performance 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 evidence of fair value does not exist.

Warrants In June 2008, EITF No. 07-5, Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity s Own Stock was issued. EITF 07-5 specifies a procedure to determine if an instrument is indexed to a company s own common stock. EITF 07-5 is effective for fiscal years beginning after December 15, 2008. Under EITF 07-5, the Company recalculates the fair value of certain warrants using the Black-Scholes option pricing model, and establishes a related derivative liability with an offset to common stock on the balance sheet with the cumulative effect of the change in accounting principle recognized as an adjustment to the opening balance of retained earnings. See Note 2 for disclosure of the cumulative effect of adoption. Subsequent adjustments to the fair value of the derivative liability are accounted for as other income.

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (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.

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 adoption of this guidance did not have a material impact on the Company s consolidated results of operations, financial position or cash flows.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS No. 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP No. FAS 115-2 and FAS No. 124-2). This FSP amends the other-than temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments in the financial statements. The most significant change the FSP brings is a revision to the amount of other-than-temporary loss of a debt security recorded in earnings. FSP No. FAS 115-2 and FAS No. 124-2 is effective for interim and annual reporting periods ending after June 15, 2009. The Company does not believe that the implementation of this standard will have a material impact on its condensed consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP No. FAS 157-4). This FSP provides additional guidance for estimating fair value in accordance with SFAS No. 157, Fair Value Measurements (SFAS No. 157), when the volume and level of activity for the asset or liability have significantly decreased. This FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. This FSP emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that

is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. FSP No. FAS 157-4 is effective for interim and annual reporting periods ending after June 15, 2009, and is applied prospectively. The Company does not believe that the implementation of this standard will have a material impact on its condensed consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 107-1 and Accounting Principles Board (APB) 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP No. FAS 107-1 and APB 28-1). This FSP amends SFAS No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods. FSP FAS 107-1 and APB 28-1 is effective for interim and annual reporting periods ending after June 15, 2009. The Company does not believe that the implementation of this standard will have a material impact on its consolidated financial statements.

2. RESTATEMENT OF THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Subsequent to the issuance of the Company s unaudited condensed consolidated financial statements for the quarter ended March 31, 2009, the Company s management determined that errors existed in its previously issued financial statements. As a result, the accompanying condensed consolidated financial statements for the quarters ended March 31, 2009 and 2008 have been restated from amounts previously reported. The following summarizes the nature of the errors and the effects on the condensed 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. Although revenue in the quarters ended March 31, 2008 and 2009 were not impacted by these findings, the Company recorded a restatement adjustment to reverse the bad debt expense and allowance for doubtful accounts of $623,000 previously recorded in the quarter ended March 31, 2009 relating to revenues that had been inappropriately recorded in earlier periods.

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 sale. As a result, the Company concluded that revenue was not appropriately recognized. Accordingly, certain revenues of $468,000 recorded in fiscal 2008 should have been deferred and has been recognized in the first quarter of 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, a net increase in revenue in the amount of $67,000 was recorded in the first quarter of 2009. This included an increase in revenue of approximately $536,000 originally recorded in earlier periods that has been recorded in the first quarter of 2009 and a decrease of $469,000 of revenue originally recorded in the first quarter of 2009 that has been reversed and is expected to be recognized in future periods. Bad debt and allowance for doubtful accounts originally recorded in the first quarter of 2009 in the amount of $52,000 were also reversed. Approximately $80,000 of revenue recorded in the first quarter of 2008 was reversed and will be recorded in subsequent periods.

Other Impact of Revenue Adjustments

As a result of the adjustments to revenues discussed above, cost of product sales increased by $118,000 for the quarter ended March 31, 2009 and commission expense increased by $86,000 for the quarter ended March 31, 2009. Also, as a result of the deferral of certain revenues, the Company recorded deferred cost of goods sold in the amount of $1.1 million at March 31, 2009 which is reported as prepaid expenses and other current assets on the balance sheet. As a result of the adjustment to revenues discussed above, cost of product sales decreased by $21,000 for the quarter ended March 31, 2008. There was no other impact on these accounts for the quarter ended March 31, 2008.

Other Errors in Condensed Consolidated Financial Statements

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

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 $163,000 and $643,000 for the first quarter of 2009 and 2008, respectively.

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 $128,000 in the first quarter of 2008 and a reduction in interest income of approximately $128,000 in the first quarter of 2009. 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 $19,000 and $35,000 in the quarters ended March 31, 2009 and 2008, respectively. Finally, we identified that a change in the way the Company was amortizing its patents implemented in the first quarter of 2009 should have not been recorded; as a result, the Company has decreased amortization of intangibles by $180,000 for the first quarter of 2009.

Warrants. The Company should have adopted Emerging Issues Task Force (EITF) Issue No. 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock* (*EITF 07-5*), as codified in FASB ASC topic 815, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock* effective January 1, 2009. EITF 07-5 provides that an entity should use a two step approach to evaluate whether an equity-linked financial instrument is indexed to its own stock, including evaluating the instrument s contingent exercise and settlement provisions. Therefore, warrants to purchase 426,951 shares of the Company s common stock issued in 2004 that were previously classified as Warrants have been corrected for the adoption of EITF 07-5 and classified to Other Current Liabilities and Retained Earnings effective January 1, 2009 due to the presence of a warrant adjustment feature that allows for a change in the number of shares subject to issuance and a change in the exercise price of the warrant under certain circumstances, including the issuance of stock for cash in a secondary offering. The warrants expire on December 23, 2009 and the fair value balance of the remaining liability will be marked to market and recognized at each balance sheet date in non-operating income through the end of 2009. As compared to amounts previously reported, the Company corrected the condensed consolidated financial statements to reflect the adoption of EITF 07-5 and recorded a decrease of $1.7 million to Warrants, an addition of $517,000 to Other Current Liabilities and $1.2 million to Retained Earnings as a cumulative effect of a change in accounting principle to its balance sheet as of January 1, 2009. The Company estimated the fair value of these warrant derivative liabilities using a Black-Scholes model as of March 31, 2009 to be $37,000 and recorded a credit of $480,000 in its condensed consolidated statement of operations in non-operating income for the quarter ended March 31, 2009.

Impact of Corrections on Previously Issued Condensed Consolidated Financial Statements

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

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Detailed Components of Revenue
Transaction Adjustments
($ in thousands)

	Revenue		Cost of Product Sales	Bad Debt Expense	Commission Expense	Total Imapact of Revenue Adjustments
Three months ended March 31, 2009 Increase (Decrease)	$ 528	(1)	$ (118)	$ 675	$ (86)	$ 999
Three months ended March 31, 2008 Increase (Decrease)	$ (89)	(2)	$ 21	$ -	$ -	$ (68)

(1) For three months ended March 31, 2009, reflects increase of $468,000 in revenue as discussed in Commitment of Deliverables that are Unavailable or Lacked Functionality, a net increase in revenue of $67,000 as discussed in Additional Transactions Analyzed and decrease of $7,000 in revenue due to warranty adjustment.

(2) For three months ended March 31, 2008, reflects decrease of $80,000 in revenue as discussed in Additional Transactions Analyzed and a net decrease of $9,000 in revenue due to warranty adjustment.

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	Stock-based Compensation	Warrant Liability	Amortization and Impairment of Intangibles	Total	Income Tax Effect	Total Adjustments Net of Tax
	($ in thousands)							
Three months ended March 31, 2009 Increase (Decrease)	$ 999	$ (128)	$ (163)	$ 480	$ 161	$ 1,349	$ -	$ 1,349

<u>Three months ended March 31, 2008</u>								
Increase (Decrease)	$ (68)	$ 128	$ (643)	$ -	$ (35)	$ (618)	$ 51	$ (567)

(1) See table above

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The following tables present the impact of the restatement on the Company s previously issued condensed consolidated balance sheet as of March 31, 2009 and its condensed consolidated statements of operations and cash flows for the quarters ended March 31, 2009 and 2008.

CONDENSED CONSOLIDATED BALANCE SHEET
(In thousands)

	As of March 31, 2009		
	As Previously Reported	Restatement Adjustments	As Restated
ASSETS			
Current assets:			
Cash and cash equivalents	$ 36,997	$ -	$ 36,997
Short-term investments	43,933	-	43,933
Accounts receivable, net	4,064	(39)	4,025
Inventories, net	4,136	295	4,431
Deferred income taxes	226	85	311
Prepaid expenses and other current assets	3,205	1,096	4,301
Total current assets	92,561	1,437	93,998
Property and equipment, net	4,379	-	4,379
Intangibles, net and other assets	10,358	(294)	10,064
Total assets	$ 107,298	$ 1,143	$ 108,441
LIABILITIES AND STOCKHOLDERS EQUITY			
Current liabilities:			
Accounts payable	$ 2,460	$ -	$ 2,460
Accrued compensation	2,248	(6)	2,242
Other current liabilities	3,247	63	3,310
Deferred revenue and customer advances	5,883	2,420	8,303
Total current liabilities	13,838	2,477	16,315
Long-term deferred revenue	17,685	(769)	16,916
Deferred income tax liabilities	226	85	311
Other long-term liabilities	217	-	217
Total liabilities	31,966	1,793	33,759
Stockholders equity:			
Common stock and additional paid-in capital	167,337	2,148	169,485
Warrants	1,724	(1,713)	11

Accumulated other comprehensive income	40	-	40
Accumulated deficit	(75,372)	(1,085)	(76,457)
Treasury stock at cost	(18,397)	-	(18,397)
Total stockholders equity	75,332	(650)	74,682
Total liabilities and stockholders equity	$ 107,298	$ 1,143	$ 108,441

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

	Three Months Ended March 31, 2009		
	As Previously Reported	Restatement Adjustments	As Restated
Revenues:			
Royalty and license	$ 3,781	$ -	$ 3,781
Product sales	2,751	528	3,279
Development contracts and other	446	-	446
Total revenues	6,978	528	7,506
Costs and expenses:			
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	1,126	125	1,251
Sales and marketing	4,760	(476)	4,284
Research and development	3,904	25	3,929
General and administrative	4,366	18	4,384
Amortization and impairment of intangibles	376	(161)	215
Restructuring costs	646	-	646
Total costs and expenses	15,178	(469)	14,709
Operating loss	(8,200)	997	(7,203)
Change in fair value of warrant liability	-	480	480
Interest and other income	430	(128)	302
Loss from continuing operations before provision for income taxes	(7,770)	1,349	(6,421)
Provision for income taxes	(91)	-	(91)
Loss from continuing operations	(7,861)	1,349	(6,512)
Discontinued operations:			
Gain on sales of discontinued operations net of provision for income taxes of $0	167	-	167
Gain from discontinued operations, net of provision for income taxes of $150	235	-	235

Net loss	$	(7,459)	$	1,349	$	(6,110)
Basic and diluted net loss per share						
Continuing operations	$	(0.28)	$	0.05	$	(0.23)
Discontinued operations		0.01		-		0.01
Total	$	(0.27)	$	0.05	$	(0.22)
Shares used in calculating basic and diluted net loss per share		27,924		-		27,924

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CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands)

	Three Months ended March 31, 2009		
	As Previously Reported	Restatement Adjustments	As Restated
Cash flows from operating activities:			
Net loss	$ (7,459)	$ 1,349	$ (6,110)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	390	-	390
Amortization and impairment of intangibles	376	(161)	215
Stock-based compensation	1,241	163	1,404
Change in fair value of warrant liability	-	(480)	(480)
Allowance for doubtful accounts	519	(675)	(156)
Loss on disposal of equipment	2	-	2
Gain on sales of discontinued operations	-	(167)	(167)
Changes in operating assets and liabilities:			
Accounts receivable	2,242	(1)	2,241
Inventories	(884)	66	(818)
Prepaid expenses and other current assets	20	24	44
Accounts payable	(469)	-	(469)
Accrued compensation and other current liabilities	(1,382)	85	(1,297)
Income taxes payable	2	-	2
Deferred revenue and customer advances	1,557	(370)	1,187
Other long-term liabilities	5	-	5
Net cash used in operating activities	(3,840)	(167)	(4,007)
Cash flows used in investing activities:			
Purchases of short-term investments	(33,962)	-	(33,962)
Maturities of short-term investments	11,000	-	11,000
Additions to Intangibles	(542)	-	(542)
Purchases of property and equipment	(580)	-	(580)
Proceeds from sales of discontinued operations	-	167	167
Net cash used in investing activities	(24,084)	167	(23,917)
Cash flows provided by financing activities:			
Issuance of common stock under employee stock purchase plan	134	-	134
Exercise of stock options and warrants	70	-	70
Net cash provided by financing activities	204	-	204

Effect (decrease) of exchange rates on cash and cash equivalents	(52)	-	(52)
Net decrease in cash and cash equivalents	(27,772)	-	(27,772)
Cash and cash equivalents:			
Beginning of the period	64,769	-	64,769
End of the period	$ 36,997	$ -	$ 36,997
Supplemental disclosure of non-cash investing and financing activities:			
Amounts accrued for property and equipment, and intangibles	$ 1,090	$ -	$ 1,090
Shares issued upon vesting of restricted stock units	$ 22	$ -	$ 22

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

	Three Months Ended March 31, 2008		
	As Previously Reported	**Restatement Adjustments**	**As Restated**
Revenues:			
Royalty and license	$ 3,461	$ -	$ 3,461
Product sales	2,669	(89)	2,580
Development contracts and other	799	-	799
Total revenues	6,929	(89)	6,840
Costs and expenses:			
Cost of product sales (exclusive of amortization and impairment of intangibles shown separately below)	1,683	1	1,684
Sales and marketing	3,136	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	12,546	657	13,203
Operating loss	(5,617)	(746)	(6,363)
Interest and other income	1,507	128	1,635
Loss from continuing operations before provision for income taxes	(4,110)	(618)	(4,728)
Benefit for income taxes	1,203	51	1,254
Loss from continuing operations	(2,907)	(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	$	(0.09)	$	(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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CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands)

	Three Months ended March 31, 2008		
	As Previously Reported	Adjustments	As Restated
Cash flows from operating activities:			
Net loss	$ (2,585)	$ (563)	$ (3,148)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	260	-	260
Amortization and impairment of intangibles	235	35	270
Stock-based compensation	964	643	1,607
Excess tax benefits from stock-based compensation	(107)	-	(107)
Realized gain on short-term investments	(81)	-	(81)
Allowance for doubtful accounts	(12)	-	(12)
Changes in operating assets and liabilities:			
Accounts receivable	2,220	80	2,300
Inventories	(369)	(21)	(390)
Deferred income taxes	(251)	(55)	(306)
Prepaid expenses and other current assets	(1,234)	1	(1,233)
Other assets	(3)	-	(3)
Accounts payable	541	-	541
Accrued compensation and other current liabilities	521	-	521
Income taxes payable	(412)	-	(412)
Deferred revenue and customer advances	1,991	(120)	1,871
Other long-term liabilities	12	-	12
Net cash provided by operating activities	1,690	-	1,690
Cash flows provided by investing activities:			
Maturities of short-term investments	49,657	-	49,657
Additions to intangibles	(508)	-	(508)
Purchases of property and equipment	(280)	-	(280)
Net cash provided by investing activities	48,869	-	48,869
Cash flows provided by financing activities:			
Issuance of common stock under employee stock purchase plan	168	-	168
Exercise of stock options and warrants	659	-	659
Excess tax benefits from stock-based compensation	107	-	107
Net cash provided by financing activities	934	-	934
Effect (decrease) of exchange rates on cash and cash equivalents	(5)	-	(5)

Net decrease in cash and cash equivalents		51,488		-		51,488
Cash and cash equivalents:						
Beginning of the period		86,493		-		86,493
End of the period	$	137,981	$	-	$	137,981
Supplemental disclosure of cash flow information:						
Cash paid for taxes	$	761	$	-	$	761

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3. FAIR VALUE MEASUREMENTS

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

The financial instruments of the Company measured at fair value on a recurring basis are cash equivalents, short-term investments, and warrant derivative liabilities. The Company s cash equivalents and short-term investments are generally classified within Level 1 or Level 2 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The Company s warrant derivative liabilities are generally classified within Level 3 of the fair value hierarchy because they are valued using unobservable inputs which reflect the reporting entity s own assumptions that market participants would use in pricing the liability. Unobservable inputs are developed based on the best information available in the circumstances and also include the Company s own data.

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

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

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

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

	March 31, 2009			
	Fair value measurements using			
	Level 1	**Level 2**	**Level 3**	**Total**
		(In thousands)		
Assets:				
Corporate commercial paper	$	$ 14,987	$	$ 14,987
U.S. government agency securities	34,017			34,017
Money market accounts	29,481			29,481
Total assets at fair value	$ 63,498	$ 14,987	$	$ 78,485
Liabilities:				
Warrant derivative liabilities	$	$	$ 37	$ 37
Total liabilities at fair value	$	$	$ 37	$ 37

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

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	December 31, 2008 Fair value measurement using			
	Level 1	Level 2	Level 3	Total
	(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

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

The following table provides a summary of changes in fair value in the Level 3 financial instrument for the three months ending March 31, 2009.

Warrant Derivative Liability	March 31, 2009 Fair Value Measurement Using Significant Unobservable Inputs (Level 3) (In thousands)
Balances, beginning of the period	$ 517
Change in fair value included in net loss	(480)
Balances, end of period	$ 37

Short Term Investments

	March 31, 2009			
Assets:	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
	(In thousands)			
Corporate commercial paper	$ 9,986	$ 1	$	$ 9,987
U.S. government agency securities	33,930	16		33,946
Total	$ 43,916	$ 17	$	$ 43,933

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

The contractual maturities of the Company s available-for-sale securities on March 31, 2009 and December 31, 2008 were all due in one year or less.

4. INVENTORIES

	March 31, 2009	December 31, 2008
	(In thousands)	
Raw materials and subassemblies	$ 3,276	$ 3,119
Work in process	565	209
Finished goods	590	429
Inventories, net	$ 4,431	$ 3,757

5. PROPERTY AND EQUIPMENT

	March 31, 2009	December 31, 2008
	(In thousands)	
Computer equipment and purchased software	$ 4,832	$ 4,735
Machinery and equipment	3,518	3,269
Furniture and fixtures	1,443	1,336
Leasehold improvements	1,631	1,261
Total	11,424	10,601
Less accumulated depreciation	(7,045)	(6,774)
Property and equipment, net	$ 4,379	$ 3,827

6. INTANGIBLES AND OTHER ASSETS

	March 31, 2009	December 31, 2008
	(In thousands)	
Patents and technology	$ 17,560	$ 17,008
Other assets	156	156
Gross intangibles and other assets	17,716	17,164
Accumulated amortization of patents and technology	(7,652)	(7,673)
Intangibles and other assets, net	$ 10,064	$ 9,491

The Company amortizes its intangible assets related to patents and trademarks, over their estimated useful lives, generally 10 years. The estimated annual amortization expense for intangible assets as of March 31, 2009 is $797,000 in 2009, $1.2 million in 2010, $1.2 million in 2011, $1.1 million in 2012, $1.1 million in 2013, and $4.8 million in total for all years thereafter.

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

	March 31, 2009	December 31, 2008
	(In thousands)	
Accrued legal	$ 447	$ 491
Income taxes payable	38	36
Other current liabilities	2,825	2,966
Total other current liabilities	$ 3,310	$ 3,493
Deferred revenue, current	$ 8,207	$ 7,954
Customer advances	96	88
Total deferred revenue, current and customer advances	$ 8,303	$ 8,042

8. LONG-TERM DEFERRED REVENUE

On March 31, 2009, long-term deferred revenue was $16.9 million and included approximately $15.5 million of deferred revenue from Sony Computer Entertainment. On December 31, 2008, long-term deferred revenue was $16.0 million and included approximately $14.5 million from Sony Computer Entertainment.

9. STOCK-BASED COMPENSATION

Stock Options and Awards

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The Company s equity incentive program is a long-term retention program that is intended to attract, retain, and provide incentives for talented employees, consultants, officers, and directors and to align stockholder and employee interests. The Company may grant options, stock appreciation rights, restricted stock, restricted stock units (RSUs), performance shares, performance units, and other stock-based or cash-based awards to employees, directors, and consultants. Under these programs, stock options may be granted at prices not less than the fair market value on the date of grant for stock options. These options generally vest over 4 years and expire 10 years from the date of grant. RSUs generally vest over 3 years. Restricted stock generally vests over one year. On March 31, 2009, 3,305,612 shares of common stock were available for grant, and there were 7,325,914 options to purchase shares of common stock outstanding, as well as 287,787 RSUs and shares of restricted stock outstanding.

General Stock Option Information

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

	Number of Shares
Outstanding at December 31, 2008 (4,055,180 exercisable at a weighted average price of $9.35 per share)	7,009,667
Granted (weighted average fair value of $2.09 per share)	1,195,433
Exercised	(25,307)
Forfeited and cancelled	(853,879)
Outstanding at March 31, 2009	7,325,914
Exercisable at March 31, 2009	3,980,188

Restricted Stock Units

Restricted stock unit activity for the three months ended March 31, 2009 is as follows:

	Number
Beginning balance at December 31, 2008	34,500
Awarded	246,287
Released	(4,000)
Forfeited	(16,000)
Ending Balance at March 31, 2009	260,787
Expected to Vest (1)	171,362

(1) RSUs expected to vest reflect estimated forfeiture rates.

Restricted Stock

Restricted stock activity for the three months ended March 31, 2009 is as follows:

	Number of Shares
Beginning balance at December 31, 2008	
Awarded	27,000
Released	
Forfeited	
Ending Balance at March 31, 2009	27,000

The assumptions used to value option grants and shares under the Company s Employee Stock Purchase Plan are as follows:

	Options		Employee Stock Purchase Plan	
	Three Months Ended March 31,		Three Months Ended March 31,	
	2009	2008	2009	2008
Expected term (in years)	5.5	5.5	0.5	0.5
Interest rate	1.8%	2.5%	0.4%	2.2%
Volatility	68.6%	62.0%	109.0%	73.0%
Dividend yield				

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

	Three Months Ended March 31,	
	2009	2008
Income Statement Classifications	(In thousands)	
Cost of product sales	$ 69	$ 43
Sales and marketing	230	423
Research and development	473	546
General and administrative	632	556
Total continuing operations	1,404	1,568
Discontinued operations		39
Total	$ 1,404	$ 1,607

As of March 31, 2009, there was $12.0 million of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock options, restricted stock and RSUs granted to the Company s employees and directors. This cost will be recognized over an estimated weighted-average period of approximately 3.3 years for options, 0.93 years for restricted stock and 2.88 years for RSUs. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

Stock Repurchase Program

On November 1, 2007, the Company announced that its board of directors authorized the repurchase of up to $50 million of the Company s common stock. The Company may repurchase its stock for cash in the open market in accordance with applicable securities laws. The timing of and amount of any stock repurchase will depend on share price, corporate and regulatory requirements, economic and market conditions, and other factors. The stock repurchase authorization has no expiration date, does not require the Company to repurchase a specific number of shares, and may be modified, suspended, or discontinued at any time. During the three months ended March 31, 2009 and March 31, 2008, there were no stock repurchases under this program.

Warrants

The Company adopted EITF Issue No. 07-5, Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock (EITF 07-5), Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock effective January 1, 2009. EITF 07-5 provides that an entity should use a two step approach to evaluate whether an equity-linked financial instrument is indexed to its own stock, including evaluating the instrument s contingent exercise and settlement provisions. Therefore, warrants to purchase 426,951 shares of the Company s common stock issued in 2004 that were previously classified as warrants have been corrected for the adoption of EITF 07-5 and classified to other current liabilities and retained earnings effective January 1, 2009 due to the presence of a warrant adjustment feature that allows for a change in the number of shares subject to issuance and a change in the exercise price of the warrant under certain circumstances, including the issuance of stock for cash in a secondary offering. The warrants expire on December 23, 2009 and the fair value balance of the remaining liability will be marked to market and recognized quarterly in non-operating income. The Company calculated the fair value of warrants using the Black-Scholes option pricing model, assuming a risk-free rate of 1.6%, a volatility factor of 66.9% as of December 31, 2009 and a contractual life of one year, and a derivative liability was established in the amount of $517,000 with an offset to warrants of $1.7 million and the cumulative effect of the change in accounting principle in the amount of $1.2 million recognized as an adjustment to the opening balance of retained earnings. At March 31, 2009, the Company recalculated the fair value of the warrants using the Black-Scholes option pricing model assuming a risk-free rate of 1.8%, a volatility factor of 68.6% and a contractual life of nine months. This resulted in the fair value of the warrants derivative liability declining in value to $37,000 with the decrease of $480,000 included in other income. The fair value of the warrants derivative liability will be recalculated at each balance sheet date until they expire in December 2009.

10. 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, respectively. The following table sets forth the charges and expenses that are included in the restructuring line on the Company s condensed consolidated Statement of Operations for the three months ended March 31, 2009:

	December 31, 2008	Quarter Ended March 31, 2009			March 31, 2009
	Restructuring Reserve	Add Charges	Deduct Cash Payments	Non-Cash Expenses	Restructuring Reserve
			(In thousands)		
Medical workforce reductions	$	$ 166	$	$	$ 166
Touch workforce reductions	142	480	(212)		410
Total	$ 142	$ 646	$ (212)	$	$ 576

Restructuring Costs

On March 2, 2009, the Company announced that it was relocating its Medical business operations from Gaithersburg, Maryland to San Jose, California. The Company had workforce reductions that were recorded as Medical segment restructuring charges for the three months ended March 31, 2009. Workforce reduction costs consisting of severance benefits of $166,000 are included in accrued compensation on the Company s condensed consolidated balance sheet. In addition, the Company expects to record approximately $200,000 of workforce reduction costs relating to the remaining service period of these Medical line of business employees for the three months ended June 30, 2009, bringing the cumulative total to $366,000. All of the severance benefits are expected to be paid in the second or third quarter of 2009 with the exception of certain COBRA costs that will be paid by the end of 2010. The Company will also incur costs in the remainder of 2009 for temporary housing, the closing down of the Gaithersburg, Maryland facility, and the movement of operations to the San Jose facility.

In addition, for the first three months ended March 31, 2009, there were reorganizations in the Company s Touch segment due to business changes causing workforce reductions that have been recorded as accrued compensation in the Company s condensed consolidated balance sheet and restructuring charges in the statement of operations for the three months ended March 31, 2009.

Results of Discontinued Operations

On November 17, 2008, the Company announced that it would divest its 3D product line which was part of its Touch segment. The Company s 3D product line consisted of a variety of products in the area of 3D digitizing, 3D measurement and inspection, and 3D interaction and included products such as MicroScribe digitizers, the CyberGlove family of products, and a SoftMouse 3D positioning device. In the three months ended March 31, 2009, the Company sold its CyberGlove and SoftMouse 3D positioning device product families including inventory, fixed assets, and intangibles and has recorded a gain on sale of discontinued operations of $167,000. Negotiated consideration for the sales was $900,000 in the form of cash and notes receivable and the proceeds will be recognized when they are received. The Company has abandoned all other 3D operations. Accordingly, the operations of the 3D product line have been classified as discontinued operations, net of income tax, in the condensed consolidated statement of operations. Included in restructuring costs within discontinued operations for the year ended December 31, 2008 were asset impairment charges which included reserves taken against capitalized patent costs of $255,000 and fixed asset write offs of $20,000 due to the divesting of the 3D product line. The Company had also accrued $105,000 of severance charges at December 31, 2008 which had been paid in cash as of March 31, 2009. Revenues included in discontinued operations of the 3D product line were $531,000 and $1.2 million for the three months ended March 31, 2009 and March 31, 2008, respectively. The assets sold consisted primarily of intangibles that had no carrying value on the Company s books at the time of sale.

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11. INTEREST AND OTHER INCOME

The Company has accounted for payments from Sony Computer Inc. due under a license entered in with them in 2007 in accordance with Accounting Principles Board (APB) Opinion No. 21. Under APB No. 21, the Company determined the present value of $22.5 million of payments from them due over the three years ended December 31, 2009 to equal $20.2 million. The Company is accounting for the difference of $2.3 million as interest income which is being recognized in the income statement as each quarterly payment installment becomes due.

In January 2009, the Company implemented EITF Issue No. 07-5, Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity s Own Stock . Quarterly the Company recalculates the fair value of its warrants using the Black-Scholes option pricing model. For the three months ending March 31, 2009, the change in the fair value of the warrant liability was $480,000.

12. INCOME TAXES

For the three months ended March 31, 2009, the Company recorded income tax provision of $91,000 on a pre-tax loss from continuing operations of $6.4 million, yielding an effective tax rate of 1.4%. For the three months ended March 31, 2008, the Company recorded an income tax benefit of $1.3 million on a pre-tax loss from continuing operations of $4.7 million, yielding an effective tax rate of (26.5)%. The effective tax rate differs from the statutory rate primarily due to the valuation allowance, foreign withholding taxes and interest on unrecognized tax benefits. The income tax provision or benefit for the three months ended March 31, 2009 and 2008, are as a result of applying the estimated annual effective tax rate to cumulative income (loss) before taxes, adjusted for certain discrete items which are fully recognized in the period they occur. The tax effect of the discontinued operations is removed to arrive at the income tax provision or benefit from continuing operations.

The Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, (FIN 48), regarding accounting for uncertain tax benefits, on January 1, 2007. As of March 31, 2009, the Company has unrecognized tax benefits of approximately $647,000, including interest of $20,000. The total amount of unrecognized tax benefits that would affect the Company s effective tax rate, if recognized, is $219,000. There were no material changes in the amount of unrecognized tax benefits during the quarter ended March 31, 2009. The Company does not expect any material changes to its liability for unrecognized tax benefits during the next twelve months. The Company s policy is to account for interest and penalties related to uncertain tax positions as a component of income tax provision.

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

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 assets are realizable, an adjustment to the valuation allowance may increase income in the period such determination is made. The valuation allowance does not impact the Company s ability to utilize the underlying net operating loss carryforwards.

The net tax benefits from employee stock option transactions were approximately $0 and $108,000 during the three months ended March 31, 2009 and March 31, 2008, respectively, and are reflected as an increase to additional paid-in capital. 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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13. NET LOSS PER SHARE

The following is a reconciliation of the numerators and denominators used in computing basic and diluted net loss per share (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2009	2008
Numerator:		
Loss from continuing operations	$ (6,512)	$ (3,474)
Gains from discontinued operations	402	326
Net loss	$ (6,110)	$ (3,148)
Denominator:		
Shares used in computation, basic and diluted (weighted average common shares outstanding)	27,924	30,478
Basic and diluted net loss per share:		
Continuing operations	$ (0.23)	$ (0.11)
Discontinued operations	0.01	0.01
Total	$ (0.22)	$ (0.10)

As of March 31, 2009 and 2008, the Company had securities outstanding that could potentially dilute basic earnings per share in the future, but these were excluded from the computation of diluted net loss per share in the periods presented since their effect would have been anti-dilutive. These outstanding securities consisted of the following:

	March 31, 2009	March 31, 2008
Outstanding stock options	7,325,914	6,840,918
Restricted stock and RSUs	287,787	
Warrants	431,243	436,772

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14. COMPREHENSIVE LOSS

The following table sets forth the components of comprehensive income (loss):

	Three Months Ended March 31,	
	2009	**2008**
	(In thousands)	
Net loss	$ (6,110)	$ (3,148)
Change in unrealized losses on short-term investments, net of tax	(2)	(7)
Foreign currency translation adjustment	(67)	(12)
Total comprehensive loss	$ (6,179)	$ (3,167)

15. SEGMENT REPORTING

The Company develops, manufactures, licenses, and supports a wide range of hardware and software technologies that more fully engage users sense of touch when operating digital devices. The Company focuses on the following target application areas: 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 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 mobility, computing, entertainment, and industrial applications. Medical develops, manufactures, and markets medical training simulators that recreate realistic healthcare environments.

The following tables display information about the Company s reportable segments:

	Three Months Ended March 31,	
	2009	2008
	(In thousands)	
Revenues:		
Touch	$ 4,475	$ 3,962
Medical	3,066	2,919
Intersegment eliminations	(35)	(41)
Total	$ 7,506	$ 6,840
Operating Loss:		
Touch	$ (5,016)	$ (4,888)
Medical	(2,187)	(1,458)
Intersegment eliminations	(1)	(17)
Total	$ (7,204)	$ (6,363)

	March 31, 2009	December 31, 2008
	(In thousands)	
Total Assets:		
Touch	$ 128,870	$ 129,305
Medical	10,575	11,471
Intersegment eliminations	(31,004)	(27,189)
Total	$ 108,441	$ 113,587

16. 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.

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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.

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

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

This Amendment No. 1 to Quarterly Report on Form 10-Q/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 forward-looking statements involve risks and uncertainties. Forward-looking statements are identified by words such as anticipates, believes, expects, intends, may, will, and other similar expressions. H these words are not the only way we identify forward-looking statements. In addition, any statements, which refer to expectations, projections, or other characterizations of future events, or circumstances, are forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, including those set forth below in Management s Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors, those described elsewhere in this report, and those described in our other reports filed with the SEC. We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report, and we undertake no obligation to update these forward-looking statements after the filing of this report. You are urged to review carefully and consider our various disclosures in this report and in our other reports publicly disclosed or filed with the SEC that attempt to advise you of the risks and factors that may affect our business.

RESTATEMENT OF CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

We have restated our condensed consolidated balance sheet as of December 31, 2008, and March 31, 2009 and the condensed consolidated statements of operations and cash flows for the three months ended March 31, 2009 and 2008, including applicable notes and related disclosures as reflected in this Amendment No. 1 to Form 10-Q.

The Restatement results from our management s determination subsequent to the issuance of our financial statements for the quarter ended March 31, 2009 that there were errors in 1) the recording of revenue transactions from our Medical line of business; 2) the recording of stock-based compensation expense; 3) the recording of interest income arising from future installments due from Sony Computer Entertainment determined under the interest method for the quarters ; (4) the recording of amortization and impairment of patents; all of which affected the quarters ended March 31, 2009 and 2008; (5) in addition, the Company determined that it had not adopted EITF 07-5 in the quarter ended March 31, 2009, as required and as such has corrected the classification of certain warrants to purchase company common stock in the quarter ended March 31, 2009; and therefore our condensed consolidated financial statements required restatement. We have also corrected other errors that were insignificant individually and in the aggregate. See Explanatory Note Regarding Restatement immediately preceding Part I, Item 1 and Note 2, Restatement of the unaudited condensed Consolidated Financial Statements of the Notes to Consolidated Financial Statements in Part I, Item 1 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 reflects the Restatement. For this reason the data set forth in this section may not be comparable to discussions and data in our previously filed Quarterly Reports.

OVERVIEW

We are a leading provider of haptic technologies that allow people to use their sense of touch more fully when operating a wide variety of digital devices. To achieve this heightened interactivity, we develop and manufacture or license a wide range of hardware and software technologies 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, entertainment, gaming, and commercial and industrial controls; medical simulation; and mobile communications. We manage these application areas under two operating and reportable segments: 1) Touch and 2) Medical.

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In some markets, such as video console gaming, 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. In the three months ended March 31, 2009, we divested our 3D product line which was part of our Touch segment. We ceased operations of the 3D product line and sold our CyberGlove and SoftMouse 3D positioning device product families. We have abandoned all other 3D operations.

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

Revenue Recognition

We recognize revenues in accordance with applicable accounting standards, including SAB No. 104, EITF No. 00-21 and SOP No. 97-2. 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 generally deferred and recognized over the service period once services commence when VSOE related to the value of the services does not exist.

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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 No. 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, we recognize revenue in accordance with SAB No. 104, EITF No. 00-21, and SOP No. 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 proportional performance accounting method based on physical completion of the work to be performed or completed performance 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. We accounted for stock-based compensation using 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 that impact the expected term and forfeiture rates, our expected stock price volatility over the term of the awards, risk-free interest rate, and expected dividends.

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. 110 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 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 record stock-based compensation expense only for those awards that are expected to vest. We estimate our forfeiture rate based on anticipated future trends in pre-vesting options and awards forfeitures and recent historical data.

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 9 to the condensed 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 condensed consolidated financial statements.

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

Short-term Investments

Our short-term investments consist primarily of highly liquid commercial paper and government agency securities purchased with an original or remaining maturity of greater than 90 days on the date of purchase. We classify all debt securities with readily determinable market values as available-for-sale in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. 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 within one year. These investments are carried at fair market value with unrealized gains and losses considered to be temporary in nature reported as a separate component of other comprehensive income (loss) within stockholders equity.

We follow the guidance provided by FSP No. 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 condensed 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 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. Effective January 1, 2009 we adopted SFAS No. 157 for nonfinancial assets and nonfinancial liabilities measured at fair value on a non-recurring basis. The adoption of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities did not have a material impact on our condensed consolidated financial positions, results of operations or cash flows.

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

Recovery of Accounts Receivable

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

Inventory 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 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 the first three months of 2009, we capitalized costs associated with patents and trademarks of $767,000. Our total amortization expense for the same period for all intangible assets was $214,000.

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 FOR THE THREE MONTHS ENDED MARCH 31, 2009 AND 2008

The following discussion and analysis includes our results of operations from continuing operations for the three months ended March 2009 and 2008. A separate discussion of the 3D product line under discontinued operations has been presented following our analysis of continuing operations. Accordingly, the sales, gross profit, sales and marketing expense, and income tax provision from our discontinued operations have been aggregated and reported as loss from discontinued operations and are not a component of the aforementioned continuing operations discussion.

Overview

We achieved a 10% increase in revenues from continuing operations during the three months ended March 31, 2009 as compared to the three months ended March 31, 2008. The first three months revenue growth was primarily due to a 9% increase in royalty and license revenues from increased Touch royalty and license fees mainly from customers that sell mobile devices. The revenue increase also included a 27% increase in product sales partially offset by a 44% decrease in development contract revenues. In conjunction with our plan to move our medical operating segment to San Jose and other workforce reductions in our Touch segment, we had restructuring costs relating to workforce reductions of $646,000. We divested our 3D product line and recorded a gain of $235,000 from discontinued operations for the three months ended March 31, 2009 as compared to a gain of $326,000 for the three months ended March 31, 2008. We also had a gain on the sale of discontinued operations of $167,000 for the three months ended March 31, 2009. Our net loss was $6.1 million for the three months ended March 31, 2009 compared to a net loss of $3.1 million for the three months ended March 31, 2008.

With our divestiture of the 3D product line, our move of the medical operating segment to San Jose, and other restructuring efforts, we hope to achieve certain cost reductions in 2009. In 2009, we expect to continue to focus on the execution of plans in our established businesses to seek 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 Part II Item 1A Risk Factors.

REVENUES	March 31, 2009	March 31, 2008	Change
	($ In thousands)		
Three months ended:			
Royalty and license	$ 3,781	$ 3,461	9%
Product sales	3,279	2,580	27%
Development contracts and other	446	799	(44)%
Total Revenue	$ 7,506	$ 6,840	10%

Three Months Ended March 31, 2009 Compared to Three Months Ended March 31, 2008

Total Revenue Our total revenue from continuing operations for the first three months of 2009 increased by $666,000 or 10% from the first three months of 2008.

Royalty and license revenue Royalty and license revenue is comprised of royalties earned on sales by our TouchSense licensees and license fees charged for our intellectual property portfolio. Royalty and license revenue for the three months ended March 31, 2009 was $3.8 million, an increase of $320,000 or 9% from the three months ended March 31, 2008. The increase in royalty and license revenue was primarily due to an increase in royalty and license revenue from our Touch segment from increased shipments by licensees of mobile devices partially offset by decreased shipments by gaming and automotive licensees. We expect royalty revenue to be a significant component of our revenue as our technology continues to be included in mobile phone handsets.

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

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

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

for its Wii game console. Because our gaming royalties come mainly from third-party manufacturers, unless Nintendo broadens its licenses to third-party controller makers, our gaming royalty revenue may decline.

In addition, BMW has begun to remove our technology from certain controller systems, which 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 for the three months ended March 31, 2009 were $3.3 million, an increase of $699,000 or 27% as compared to the three months ended March 31, 2008. The increase in product sales was primarily due to an increase in medical product sales. Increased medical product sales was mainly due to increased sales of our endoscopy, endovascular, and laparoscopy simulators partially offset by decreased Virtual IV simulators. This increase in product sales was a result of pursuing a product growth strategy for our medical business, which includes leveraging our strategic industry alliances, and expanding international sales. We expect that the current economic downturn may have a negative effect on capital purchases of our products in the near term.

Development contract and other revenue Development contract and other revenue is comprised of revenue on commercial contracts and extended support contracts. Development contract and other revenue was $446,000 during the three months ended March 31, 2009, a decrease of $353,000 or 44% as compared to the three months ended March 31, 2008. The decrease was mainly attributable to a decrease in medical contract revenue of $535,000 due to the completion of work performed under medical contracts that occurred through the first six months of 2008. Partially offsetting that decrease was increased revenue recognized on Touch development contracts and support of $182,000. 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.

We categorize our geographic information into four major regions: North America, Europe, Far East, and Rest of the World. In the first three months of 2009, revenue generated in North America, Europe, Far East, and Rest of the World represented 48%, 25%, 25%, and 2%, respectively, compared to 61%, 23%, 11%, and 5%, respectively, for the first three months of 2008. The shift in revenues among regions was mainly due to an increase in royalty revenue and medical product revenue from Europe and the Far East and a decrease in royalty and medical contract revenue in North America and Medical product revenue from the Rest of the World. We partially attribute increased European and Far East revenue to the addition of increased international sales and support personnel in 2008.

COST OF PRODUCT SALES	**March 31, 2009**	**2008**	**Change**
	($ In thousands)		
Three months ended:			
Cost of product sales	$1,251	$1,684	(26)%
% of total product revenue	38%	65%	

Cost of Product Sales 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 from continuing operations was $1.3 million, a decrease of $433,000 or 26% for the three months ended March 31, 2009 as compared to the three months ended March 31, 2008. The decrease in cost of product sales was primarily due to reduced obsolescence expense of $209,000 and reduced overhead costs of $136,000. The decrease in obsolescence

expense was mainly due to lower excess and obsolescence write-off from medical, touch, and other parts in 2009. Overhead costs decreased mainly as a result of reduced salary expense from decreased headcount. Cost of product sales decreased as a percentage of product revenue to 38% in the first three months of 2009 from 65% in the first three months of 2008. This decrease is mainly due to increased sales, the reduced costs mentioned above, and a change in the product sales mix where we sold a greater percentage of products with higher margins in 2009.

OPERATING EXPENSES AND OTHER	March 31, 2009	2008	Change
	($ In thousands)		
Three months ended:			
Sales and marketing	$4,284	$3,345	28%
% of total revenue	57%	49%	
Research and development	$3,929	$3,490	13%
% of total revenue	52%	51%	
General and administrative	$4,385	$4,414	(1)%
% of total revenue	58%	65%	
Amortization of intangibles	$ 215	$ 270	(20)%
% of total revenue	3%	4%	
Restructuring costs	$ 646	$	*%
% of total revenue	9%	*%	

* Not meaningful

Sales and Marketing Our sales and marketing expenses are comprised primarily of employee compensation and benefits costs, advertising, public relations, trade shows, brochures, market development funds, travel, and an allocation of facilities costs. Sales and marketing expenses from continuing operations were $4.3 million, an increase of $939,000 or 28% in the first three months of 2009 compared to the comparable period in 2008. The increase was primarily due to increased compensation, benefits, and overhead of $347,000, increased marketing, advertising, and public relations costs of $291,000, increased consulting costs of $220,000 to supplement our sales and marketing staff, and increased sales and marketing travel expense of $171,000. The increased sales and marketing expenses were primarily due to the expansion of our sales and marketing efforts internationally. We are taking steps to reduce our sales and marketing expenses, although we expect to continue to focus our sales and marketing efforts on medical, mobile device, and touchscreen market opportunities to build greater market acceptance for our touch technologies as well as continue to expand our sales and marketing presence internationally.

Research and Development Our research and development expenses are comprised primarily of employee compensation and benefits costs, consulting fees, tooling and supplies, and an allocation of facilities costs. Research and development expenses from continuing operations were $3.9 million, an increase of $439,000 or 13% in the first three months of 2009 compared to the same period in 2008. The increase was primarily due to increased compensation, benefits, and overhead of $391,000. The increased

compensation, benefits, and overhead expense was primarily due to increased research and development headcount. We are taking steps to reduce our research and development expenses, yet we 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.

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 from continuing operations were $4.4 million, a decrease of $29,000 or 1% in the first three months of 2009 compared to the same period in 2008. The decrease was primarily due to reduced legal and professional fees of $588,000 partially offset by increased compensation, benefits, and overhead of $354,000, increased travel of $87,000, increased public company expense of $61,000, and increased supplies and office expenses of $31,000. The decreased legal, professional, and license fee expenses were primarily due to decreased litigation costs, mainly Microsoft litigation which was settled in 2008; decreased audit, tax, and accounting fees due to completion of 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 reduction of income tax related issues, partially offset by increased consulting costs. The increased compensation, benefits, and overhead expense was primarily due to increased general and administrative headcount 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, but we are currently taking steps to reduce our general and administrative expenses. We will continue to incur costs related to litigation as we continue to assert our intellectual property and contractual rights and defend lawsuits brought against us.

Amortization and impairment of Intangibles Our amortization and impairment of intangibles is comprised primarily of patent amortization and other intangible amortization along with impairment or write off of intangibles. Amortization and impairment of intangibles decreased by $55,000 in the first three months of 2009 compared to the same period in 2008. The decrease was primarily attributable to some intangible assets reaching full amortization.

Restructuring Restructuring costs consist primarily of severance benefits paid in connection with the reduction of workforce due to severance benefits to be paid as the result of a planned reduction of workforce due to the relocation of the Maryland medical business operations to San Jose of $166,000 and severance benefits to be paid as the result of the reduction of workforce due to business changes in our Touch segment of $480,000. There were no restructuring charges incurred in the three months ended March 31, 2008. We expect to record approximately $200,000 of workforce reduction costs relating to the remaining service period of the Maryland business operations employees plus additional costs relating to the move and close down of facilities in the second quarter of 2009.

Change in fair value of warrant liability In January 2009, we adopted EITF Issue No. 07-5, Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity s Own Stock . Quarterly we recalculate the fair value of our warrants using the Black-Scholes option pricing model. For the three months ended March 31, 2009, the change in fair value of warrant liability was a gain of $480,000.

Interest and Other Income Interest and other income consist primarily of interest income and dividend income from cash and cash equivalents and short-term investments and gain on sale of short-term investments. Interest and other income decreased by $1.3 million in the first three months of 2009 compared to the same period in 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. We expect that the accretion of interest income relating to amounts receivable from Sony Computer Entertainment that was approximately $144,000 in the three months ended March 31, 2009 and will total approximately $377,000 in 2009 will be completed at the end of 2009.

Provision for Income Taxes We recorded a provision for income taxes for the three months ended March 31, 2009 of $91,000 on pre-tax loss from continuing operations of $6.4 million, yielding an effective tax rate of 1.4%. For the three months ended March 31, 2008, we recorded a benefit for income taxes of $1.3 million on pre-tax loss from continuing operations of $4.7 million, yielding an effective tax rate of (26.5)%. The income tax provision or benefit for the three months ended March 31, 2009 and March 31, 2008 are arrived at as a result of applying the estimated annual effective tax rate to cumulative income (loss) before taxes, adjusted for certain discrete items which are fully recognized in the period they occur. The tax effect of the discontinued operations is removed to arrive at the income tax provision or benefit from continuing operations.

Discontinued Operations In the three months ended March 31, 2009, we ceased operations of the 3D product line and sold both our CyberGlove family of products and SoftMouse 3D positioning device family of products and have recorded a gain on sale of discontinued operations of $167,000. Accordingly, the operations of the 3D product line have been classified as discontinued operations in the condensed consolidated statement of operations. Gain from discontinued operations, net of tax, decreased by $91,000 in the three months ended March 31, 2009 compared to the same period in 2008, primarily due to the decrease in activity due to the ceasing of 3D operations in the quarter ended March 31, 2009 resulting in reduced sales volumes and costs and expenses associated with 3D operations during that period.

SEGMENT RESULTS FOR THE THREE MONTHS ENDED MARCH 31, 2009 AND 2008

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.

	Three Months Ended March 31,	
	2009	**2008**
	(In thousands)	
Revenues:		
Touch	$ 4,475	$ 3,962
Medical	3,066	2,919
Intersegment eliminations	(35)	(41)
Total	$ 7,506	$ 6,840
Operating Loss:		
Touch	$ (5,016)	$ (4,888)
Medical	(2,187)	(1,458)
Intersegment eliminations	(1)	(17)
Total	$ (7,204)	$ (6,363)

* Note: 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.

Touch segment Revenues from the Touch segment were $4.5 million, an increase of $513,000 or 13% in the first three months of 2009 compared to the same period in 2008. Royalty and license revenues increased by $320,000 mainly due to increased shipments by licensees of mobile devices partially offset by decreased shipments by gaming and automotive licensees. Development contract revenue increased by

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$182,000 primarily due to increased development contracts and support. Operating loss for the three months ended March 31, 2009 was $5.0 million, an increase of $128,000 compared to the same period in 2008. The increase was primarily due to an increase in restructuring costs of $480,000, an increase of research and development expenses of $467,000, and an increase in sales and marketing expenses of $370,000. The increases to the net loss were partially offset by increased gross margin of $856,000 due to increased royalty and license revenue, a decrease in general and administrative expenses of $279,000, and a decrease to amortization and impairment of intangibles of $55,000.

Medical segment Revenues from the Medical segment were $3.1 million, an increase of $147,000 or 5%, for the first three months of 2009 compared to the same period in 2008. The increase was primarily due to increased sales of our endoscopy, endovascular, and laparoscopy simulators partially offset by decreased Virtual IV simulators partially offset by a reduction of medical development contract revenue due to the completion of work performed under medical contracts that occurred through the first six months of 2008. Operating loss for the three months ended March 31, 2009 was $2.2 million, an increase of $729,000 compared to the same period in 2008. The increase was mainly due to increased sales and marketing expenses of $569,000 as the segment expands international sales and marketing efforts, increased general and administrative expenses of $250,000, and an increase in restructuring costs of $166,000 partially offset by increased gross margin of $227,000 due to increased sales and product mix changes.

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. 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 March 31, 2009, our cash, cash equivalents, and short-term investments totaled $80.9 million, a decrease of $4.8 million from $85.7 million on December 31, 2008.

In March 2007, we concluded our patent infringement litigation against Sony Computer Entertainment and we received $97.3 million. As a result, 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 March 31, 2009, we had received nine of these installments.

Net cash used in operating activities during the three months ended March 31, 2009 was $4.0 million, a change of $5.7 million from the $1.7 million provided during the three months ended March 31, 2008. Cash used in operations during the three months ended March 31, 2009 was primarily the result of a net loss of $6.1 million, a decrease of $1.3 million due to a change in accrued compensation and other current liabilities, a decrease of $818,000 due to a change in inventories, and a decrease of $469,000 due to a change in accounts payable. These decreases were offset by a $2.2 million increase due to a change in accounts receivable and a $1.2 million increase due to a change in deferred revenue and customer advances. Cash used in operations during the three months ended March 31, 2009 was also impacted by noncash charges and credits of $1.3 million, including $1.4 million of noncash stock-based compensation, $390,000 in depreciation and amortization, and $215,000 in amortization of intangibles offset by a decrease to fair market value of warrants granted of $480,000 and to allowance for doubtful accounts of $156,000.

Net cash used in investing activities during the three months ended March 31, 2009 was $23.9 million, compared to the $48.9 million provided by investing activities during the three months ended March 31, 2008, a decrease of $72.8 million. Net cash used in investing activities during the period consisted of purchases of short-term investments of $34.0 million; $580,000 used to purchase property and equipment; and a $542,000 increase in intangibles and other assets, primarily due to capitalization of external patent filing and application costs partially offset by maturities or sales of short-term investments of $11.0 million and proceeds from sales of discontinued operations of $167,000.

Net cash provided by financing activities during the three months ended March 31, 2009 was $204,000 compared to $934,000 provided during the three months ended March 31, 2008, or a $730,000 decrease from the prior year. Net cash provided by financing activities for the period consisted primarily of issuances of common stock and exercises of stock options and warrants in the amount of $204,000.

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. 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:

Contractual Obligations	**Total**	**2009**	**2010 and 2011**	**2012 and 2013**	**2014**
			(In thousands)		
Operating leases	$ 3,555	$ 928	$ 1,250	$ 1,094	$ 283

As discussed in Note 12 to the condensed consolidated financial statements, effective January 1, 2007, we adopted the provisions of FIN 48. On March 31, 2009, we had a liability for unrecognized tax benefits totaling approximately $647,000, including interest of $20,000. 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 condensed consolidated financial statements for information regarding the effect of new accounting pronouncements on our financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Cash Equivalents and Short-term Investments We have cash equivalents and short-term investments of $78.5 million as of March 31, 2009. These securities are subject to interest rate fluctuations. An increase in interest rates could adversely affect the market value of our cash equivalents and short-term investments. A hypothetical 100 basis point increase in interest rates would result in an approximate $289,000 decrease in the fair value of our cash equivalents and short-term investments as of March 31, 2009.

We limit our exposure to interest rate and credit risk by establishing and monitoring clear policies and guidelines for our cash equivalents and short-term investment portfolios. The primary objective of our policies is to preserve principal while at the same time maximizing yields, without significantly increasing

risk. Our investment policy limits the maximum weighted average duration of all invested funds to 12 months. Our policy s guidelines also limit exposure to loss by limiting the sums we can invest in any individual security and restricting 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 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES (AS REVISED)

In connection with the restatement described in Note 2 to our condensed consolidated financial statements, 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 March 31, 2009. 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 Interim Chief Executive Officer and our Interim Chief Financial Officer, to allow timely decisions regarding required disclosures.

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 March 31, 2009, as more fully described in Management s Report on Internal Control over Financial Reporting (As Revised), in Amendment No. 1 to our Annual Report on 10-K on Form 10-K/A filed on February 8, 2010. As of March 31, 2009, we did not maintain effective controls to ensure completeness and accuracy with regard to the proper recognition, presentation and disclosure of conversion features of certain convertible debt instruments and warrants. Specifically, we determined that Emerging Issue Task Force 07-5, Determining Whether an Instrument (or an Embedded Feature) Is Indexed to an Entity s Own Stock (EITF 07-5) had not been properly adopted on January 1, 2009 with regard to the conversion feature in our MHR convertible note and certain warrants issued in 2005 and as more fully described in Note 16 to the condensed financial statements. As a result, our financial statements included in the Form 10-Q for the three months ended March 31, 2009 did not reflect the warrant as a derivative liability, nor the bifurcation of the embedded conversion feature in the MHR Convertible Note as a derivative liability. For the three months ended March 31, 2009, we understated the change in the fair value of the warrant liability and understated net income. As a result, we have concluded that there is a material weakness regarding the identification, evaluation, and adoption of applicable accounting guidance in a timely manner. 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 in our Form 10-K/A which has not been remediated as of March 31, 2009, our Interim Chief Executive Officer and Interim Chief Financial Officer have concluded that certain disclosure controls and procedures were not effective as of March 31, 2009.

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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 March 31, 2009, there were no changes in our internal control over financial reporting during the three months ended March 31, 2009 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 as initially reported in our Annual Report on Form 10-K for the year ended December 31, 2007:

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 March 31, 2009 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 described in Amendment No. 1 to our Annual Report on 10-K filed on February 8, 2010:

We are in the process of improving our documentation of our 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;

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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 and Item 9 in the Form 10-K/A for the year ended December 31, 2008.

Subsequent to March 31, 2009 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 the calculation of stock-based compensation and warrants 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.

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

PART II
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In re Immersion Corporation

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

The operative amended complaint is brought on purported behalf of all persons who purchased our common stock from the date of our IPO through December 6, 2000. It alleges liability under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, on the grounds that the registration statement for the IPO did not disclose that: (1) the underwriters agreed to allow certain customers to purchase shares in the IPO in exchange for excess commissions to be paid to the underwriters; and (2) the underwriters arranged for certain customers to purchase additional shares in

the aftermarket at predetermined prices. The complaint also appears to allege that false or misleading analyst reports were issued. The complaint does not claim any specific amount of damages.

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

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

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

On April 16, 2008, we announced that our wholly owned subsidiary, Immersion Medical, Inc., filed lawsuits for patent infringement in the United States District Court for the Eastern District of Texas against Mentice AB, Mentice SA, Simbionix USA Corp., and Simbionix Ltd (collectively the Defendants), seeking damages and injunctive relief. On July 11, 2008, Mentice AB and Mentice SA (collectively, Mentice) answered the complaint by denying the material allegations and alleging counterclaims seeking a judicial declaration that the asserted patents were invalid, unenforceable, or not infringed. On July 11, 2008, Simbionix USA Corp. and Simbionix Ltd, (collectively, Simbionix) filed a motion to stay or dismiss the lawsuit, and a motion to transfer venue for convenience to 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 1, 2011. We intend to vigorously prosecute this lawsuit.

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, risk of nonpayment or delayed payment by our customers, 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 $76 MILLION AS OF MARCH 31, 2009, HAVE A HISTORY OF LOSSES, EXPECT TO EXPERIENCE LOSSES IN THE FUTURE, AND MAY NOT ACHIEVE OR MAINTAIN PROFITABILITY IN THE FUTURE.

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

- continue to develop our technologies;
- increase our sales and marketing efforts;
- attempt to expand the market for touch-enabled technologies and products and change our business;
- protect and enforce our intellectual property;
- pursue strategic relationships;
- acquire intellectual property or other assets from third-parties; and
- invest in systems and processes to manage our business.

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

WE HAVE LITTLE OR NO CONTROL OR INFLUENCE ON OUR LICENSEES DESIGN, MANUFACTURING, PROMOTION, DISTRIBUTION, OR PRICING OF THEIR PRODUCTS INCORPORATING OUR TOUCH-ENABLING TECHNOLOGIES, UPON WHICH WE GENERATE ROYALTY REVENUE.

A key part of our business strategy is to license our intellectual property to companies that manufacture and sell products incorporating our touch-enabling technologies. Sales of those products generate royalty and license revenue for us. For the three months ended March 31, 2009 and 2008, 50% and 51%, 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. Sony has, to date, not yet broadly licensed third parties to produce peripherals of the PS3 system. To the extent Sony selectively limits its licensing to leading third-party controller makers to make PS3 controllers with vibration feedback, our licensing revenue from third-party PS3 peripherals will be severely limited. Sony continues to sell the PS2, and our third party licensees continue to sell licensed PS2 peripherals. However, sales of PS2 peripherals continue to decline as more consumers switch to the PS3 console system and other next-generation console systems like the Nintendo Wii and Microsoft Xbox 360.

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

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

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

WE GENERATE REVENUES FROM TOUCH-ENABLING COMPONENTS THAT ARE SOLD AND INCORPORATED INTO THIRD-PARTY PRODUCTS. WE HAVE LITTLE OR NO CONTROL OR INFLUENCE OVER THE DESIGN, MANUFACTURE, PROMOTION, DISTRIBUTION, OR PRICING OF THOSE THIRD-PARTY PRODUCTS.

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

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

We have entered into, and we expect to continue to enter into, agreements pursuant to which our licensees are granted rights under our technology and intellectual property. These rights may be granted in certain fields of use, or with respect to certain market sectors or product categories, and may include exclusive rights or sublicensing rights. We refer to the license terms and restrictions in our agreements,

including, but not limited to, field of use definitions, market sector, and product category definitions, collectively as License Provisions.

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

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

IF WE ARE UNABLE TO ENTER INTO NEW LICENSING ARRANGEMENTS WITH OUR EXISTING LICENSEES AND WITH ADDITIONAL THIRD-PARTY MANUFACTURERS FOR OUR TOUCH-ENABLING TECHNOLOGIES, OUR ROYALTY REVENUE MAY NOT GROW.

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

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

OUR 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 are moving the operations of our Medical

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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 the three months ended March 31, 2009 and 2008, our Medical line of business represented 41% and 43%, respectively, 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 ourselves 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.

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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 16 to the condensed consolidated financial statements 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.

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.

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 H.R. 855 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 divestiture of our 3D business, new management, consolidation of our touch, gaming, and mobility businesses, 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.

CERTAIN 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.

Various members of our executive management team joined us in 2008 and early 2009. 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 equity 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 facility. 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, dispositions and restructurings;
- 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 I, Item 4, 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 March 31, 2009. Management concluded that we had a continuing material weakness in internal controls over financial reporting related to income taxes and material weaknesses 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 (4) the calculation of stock-based compensation expense related to the application of the forfeiture rate and (5) the adoption of new accounting standards. We have subsequently initiated actions that are intended to improve our accounting for income taxes, revenue recognition, accounting for stock based compensation, the adoption of new accounting standards 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 March 31, 2009, management concluded that our internal control over financial reporting was not effective as of March 31, 2009 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, accounting for stock-based compensation and adopting new accounting standards 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.

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ITEM 6. EXHIBITS

The following exhibits are filed herewith:

Exhibit Number	Description
10.37*	Form of 2009 Executive Incentive Plan
10.38*	Amended and Restated Retention and Ownership Agreement dated April 20, 2009 between Immersion Corporation and Clent Richardson
10.39*	Amended and Restated Retention and Ownership Agreement dated April 23, 2009 between Immersion Corporation and Stephen Ambler
31.1	Certification of Victor Viegas, Interim Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Henry Hirvela, Interim Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Victor Viegas, Interim Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Henry Hirvela, Interim Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.01*	Form of Restricted Stock Agreement
99.02*	Form of Notice of Grant of Restricted Stock

* Filed previously with the Form 10-Q for the quarter ended March 31, 2009.

SIGNATURES

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

Date: February 8, 2010

IMMERSION CORPORATION

By /s/ Henry Hirvela

Henry Hirvela

Interim Chief Financial Officer

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