IMMERSION CORP
Form 10-Q
August 08, 2007

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

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended June 30, 2007

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 þ No o

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filero

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 August 2, 2007: 28,000,041

IMMERSION CORPORATION
INDEX

Table of Contents

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

	June 30, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 110,630	$ 32,012
Short-term investments	24,890	
Accounts receivable (net of allowances for doubtful accounts of: June 30, 2007 $111 and December 31, 2006 $139)	6,691	5,153
Inventories, net	3,090	2,639
Deferred income taxes	4,267	
Prepaid expenses and other current assets	912	1,179
Total current assets	150,480	40,983
Property and equipment, net	1,859	1,647
Intangibles and other assets, net	8,864	7,385
Total assets	$ 161,203	$ 50,015
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	$ 1,971	$ 2,334
Accrued compensation	1,697	1,526
Income taxes payable	3,083	
Other current liabilities	2,056	1,750
Deferred revenue and customer advances	6,763	1,716
Total current liabilities	15,570	7,326
Long-term debt	18,438	18,122
Long-term deferred revenue, less current portion	12,861	31,784
Long-term customer advance from Microsoft		15,000
Other long-term liabilities	792	775
Total liabilities	47,661	73,007
Contingencies (Note 15)		
Stockholders equity (deficit):		

Common stock and additional paid-in capital $0.001 par value; 100,000,000 shares authorized; shares issued and outstanding: June 30, 2007 26,873,158 and December 31, 2006 24,797,572	125,206	110,501
Warrants	2,899	3,686
Accumulated other comprehensive income	74	67
Accumulated deficit	(14,637)	(137,246)
Total stockholders equity (deficit)	113,542	(22,992)
Total liabilities and stockholders equity (deficit)	$ 161,203	$ 50,015

See accompanying Notes to Condensed Consolidated Financial Statements.

3

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Revenues:				
Royalty and license	$ 2,747	$ 1,702	$ 4,958	$ 3,612
Product sales	5,289	3,917	8,879	7,283
Development contracts and other	559	1,034	1,172	1,790
Total revenues	8,595	6,653	15,009	12,685
Costs and expenses:				
Cost of product sales (exclusive of amortization of intangibles shown separately below)	2,427	1,802	3,970	3,157
Sales and marketing	3,030	3,009	5,733	6,086
Research and development	2,513	1,802	5,056	3,531
General and administrative	3,122	2,296	6,381	5,107
Amortization of intangibles	242	219	496	429
Litigation conclusions and patent license		(400)	(134,900)	(1,050)
Total costs and expenses	11,334	8,728	(113,264)	17,260
Operating income (loss)	(2,739)	(2,075)	128,273	(4,575)
Interest and other income	1,820	84	2,181	187
Interest expense	(407)	(403)	(813)	(810)
Income (loss) before benefit (provision) for income taxes	(1,326)	(2,394)	129,641	(5,198)
Benefit (provision) for income taxes	1,502	15	(7,032)	(87)
Net income (loss)	$ 176	$ (2,379)	$ 122,609	$ (5,285)
Basic net income (loss) per share	$ 0.01	$ (0.10)	$ 4.75	$ (0.22)
Shares used in calculating basic net income (loss) per share	26,297	24,546	25,822	24,483
Diluted net income (loss) per share	$ 0.01	$ (0.10)	$ 4.03	$ (0.22)
Shares used in calculating diluted net income (loss) per share	28,619	24,546	30,530	24,483

See accompanying Notes to Condensed Consolidated Financial Statements.

4

Table of Contents

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

	Six Months Ended June 30, 2007	2006
Cash flows from operating activities:		
Net income (loss)	$ 122,609	$ (5,285)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	430	339
Amortization of intangibles	496	429
Stock-based compensation	1,243	1,417
Excess tax benefits from stock-based compensation	(1,876)	(18)
Interest expense accretion on 5% Convertible Debenture	316	316
Fair value adjustment of Put Option and Registration Rights	(2)	(10)
Loss on disposal of equipment	6	3
Changes in operating assets and liabilities:		
Accounts receivable	(1,520)	332
Inventories	(425)	237
Deferred income taxes	(5,409)	
Prepaid expenses and other current assets	269	102
Accounts payable	(1,188)	(1,221)
Accrued compensation and other current liabilities	464	607
Income taxes payable	7,288	
Deferred revenue and customer advances	(28,877)	6,157
Other long-term liabilities	20	
Net cash provided by operating activities	93,844	3,405
Cash flows used in investing activities:		
Purchases of short-term investments	(24,913)	
Intangibles and other assets	(833)	(643)
Purchases of property and equipment	(656)	(701)
Net cash used in investing activities	(26,402)	(1,344)
Cash flows from financing activities:		
Issuance of common stock under employee stock purchase plan	147	125
Exercise of stock options and warrants	8,322	433
Excess tax benefits from stock-based compensation	1,876	18
Payments on notes payable and capital leases		(5)
Net cash provided by financing activities	10,345	571
Effect of exchange rates on cash and cash equivalents	831	57

Net increase in cash and cash equivalents	78,618	2,689
Cash and cash equivalents:		
Beginning of the period	32,012	28,171
End of the period	$ 110,630	$ 30,860
Supplemental disclosure of cash flow information:		
Cash paid for taxes	$ 5,032	$ 27
Cash paid for interest	$ 500	$ 504

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

IMMERSION CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2007
(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 Annual Report on Form 10-K for the fiscal year ended December 31, 2006. In the opinion of management, all adjustments consisting of only normal recurring items necessary for the fair presentation of the financial position and results of operations for the interim periods have been included.

The results of operations for the interim periods ended June 30, 2007 are not necessarily indicative of the results to be expected for the full year.

Short-term Investments The Company s short-term investments consist primarily of highly liquid debt instruments purchased with an original or remaining maturity at the date of purchase of greater than 90 days. The Company classifies all debt securities with readily determinable market values as available-for-sale in accordance with Statement of Financial Accounting Standard (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities. These investments are carried at fair market value with unrealized gains and losses considered to be temporary in nature reported as a separate component of other comprehensive income (loss) within stockholders equity (deficit). The Company reviews all investments for reductions in fair value that are other-than-temporary. When such reductions occur, the cost of the investment is adjusted to fair value through loss on investments on the condensed consolidated statement of operations. Gains and losses on investments are calculated on the basis of specific identification.

Revenue Recognition The Company recognizes revenues in accordance with applicable accounting standards, including 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 the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, Software Revenue Recognition, 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 collectibility 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 based on either 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 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:

Table of Contents

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 cost-to-cost percentage-of-completion accounting method over the service period. Obligation to licensee exists until development work is complete.
License of software or technology, no modification necessary, no services contracted.	Up-front revenue recognition based on SOP 97-2 criteria or EITF No. 00-21, as applicable.

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

Product sales The Company recognizes revenues from product sales when the product is shipped, provided that collection is determined to be probable and no significant obligation remains. The Company sells the majority of its products with warranties ranging from 3 to 24 months. The Company records the estimated warranty costs during the quarter the revenue is recognized. Historically, warranty-related costs and related accruals have not been significant. The Company offers a general right of return on the MicroScribe® product line for 14 days after purchase. The Company recognizes revenue at the time of shipment of a MicroScribe digitizer and provides an accrual for potential returns based on historical experience. The Company offers no other general right of return on its products.

Development contracts and other revenue Development contracts and other revenue is comprised of professional services (consulting services and/or development contracts), customer support, and extended warranty contracts. Development contract revenues are recognized under the cost-to-cost percentage-of-completion accounting method based on physical completion of the work to be performed. 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). When VSOE of fair value exists for all elements, the Company allocates revenue to each element based on the relative fair value of each of the elements. The price charged when the element is sold separately generally determines the fair value or VSOE.

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

Recent Accounting Pronouncements In June 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with Statement No. 109 Accounting for Income Taxes, (SFAS No. 109). FIN 48 prescribes a two-step process to determine the amount of benefit to be recognized. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon examination. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. The Company adopted the provisions of FIN 48

Table of Contents

resulted in no adjustment to beginning retained earnings as the Company had a full valuation allowance on the deferred tax assets as of the adoption date. See Note 11.

In September 2006, the FASB issued Statement No. 157, Fair Value Measurements, (SFAS No. 157). SFAS No. 157 establishes a framework for measuring fair value by providing a standard definition for fair value as it applies to assets and liabilities. SFAS No. 157, which does not require any new fair value measurements, clarifies the application of other accounting pronouncements that require or permit fair value measurements. The effective date for the Company is January 1, 2008. The Company is currently evaluating the effect that the adoption of SFAS No. 157 will have on its financial position and results of operations.

In February 2007, the FASB issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159). The new Statement allows entities to choose, at specified election dates, to measure eligible financial assets and liabilities at fair value in situations in which they are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item s fair value in subsequent reporting periods must be recognized in current earnings. SFAS No. 159 also establishes presentation and disclosure requirements designed to draw comparison between entities that elect different measurement attributes for similar assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Early adoption is permitted subject to specific requirements outlined in the new Statement. The Company is currently evaluating the effect that the adoption of SFAS No. 159 will have on its financial position and results of operations.

2. INVENTORIES

	June 30, 2007	December 31, 2006
	(In thousands)	
Raw materials and subassemblies	$ 2,319	$ 2,267
Work in process	80	110
Finished goods	691	262
Inventories, net	$ 3,090	$ 2,639

3. PROPERTY AND EQUIPMENT

	June 30, 2007	December 31, 2006
	(In thousands)	
Computer equipment and purchased software	$ 3,168	$ 2,980
Machinery and equipment	3,020	2,817
Furniture and fixtures	1,318	1,280
Leasehold improvements	974	824
Total	8,480	7,901
Less accumulated depreciation	(6,621)	(6,254)
Property and equipment, net	$ 1,859	$ 1,647

4. INTANGIBLES AND OTHER ASSETS

Table of Contents

	June 30, 2007	December 31, 2006
	(In thousands)	
Patents and technology	$ 13,833	$ 13,011
Deferred income taxes	1,142	
Other assets	105	105
Gross intangibles and other assets	15,080	13,116
Accumulated amortization of patents and technology	(6,216)	(5,731)
Intangibles and other assets, net	$ 8,864	$ 7,385

The estimated annual amortization expense for intangible assets as of June 30, 2007 is $963,000 in 2007, $736,000 in 2008, $872,000 in 2009, $801,000 in 2010, $759,000 in 2011, and $4.0 million in total for all years thereafter.

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

	June 30, 2007	December 31, 2006
	(In thousands)	
Accrued legal	$ 368	$ 256
Other current liabilities	1,688	1,494
Total other current liabilities	$ 2,056	$ 1,750
Deferred revenue	$ 6,716	$ 1,646
Customer advances	47	70
Total current deferred revenue and customer advances	$ 6,763	$ 1,716

Deferred revenue at June 30, 2007 includes $3.0 million representing the current portion of deferred revenue from Sony Computer Entertainment. See Note 10 for further discussion.

6. LONG-TERM DEBT

5% Senior Subordinated Convertible Debenture (5% Convertible Debenture) On December 23, 2004, the Company issued an aggregate principal amount of $20.0 million of 5% Convertible Debentures. The 5% Convertible Debentures will mature on December 22, 2009 (see Note 16 for subsequent event discussion regarding Mandatory Redemption). The amount payable at maturity of each 5% Convertible Debenture is the initial principal plus all accrued but unpaid interest thereon, to the extent such principal amount and interest have not been converted into common stock or previously paid in cash. The Company cannot prepay the 5% Convertible Debenture except as described below in Mandatory Conversion and Mandatory Redemption of 5% Convertible Debentures at the Company s Option. Interest accrues daily on the principal amount of the 5% Convertible Debenture at a rate of 5% per year and is payable on the last day of each calendar quarter. Interest will cease to accrue on that portion of the 5% Convertible Debenture that is converted or paid, including pursuant to conversion rights or rights of redemption. The holder of a 5% Convertible

Debenture has the right to convert the outstanding principal amount and accrued and unpaid interest, in whole or in part, into the Company s common stock at a price of $7.0265 per common share, the Conversion Price. In the event of a change of control, a holder may require the Company to redeem all or a portion of its 5% Convertible Debenture. This is referred to as the Put Option. The redeemed portion shall be redeemed at a price equal to the redeemed amount multiplied by 100% of the principal amount of the 5% Convertible Debenture. The Conversion Price will be reduced in certain instances when the Company sells, or is deemed to have sold shares of common stock at a price less than the applicable Conversion Price, including the issuance of certain options, the issuance of convertible securities, or the change in exercise price or rate of conversion for options or convertible securities. The Conversion Price will be proportionately adjusted if the Company subdivides (by stock split, stock dividend, recapitalization, or otherwise) or combines (by combination, reverse stock split, or otherwise) one or more classes of its common stock. So long as any 5% Convertible Debentures are outstanding, the Company will not, nor will the Company permit any of its subsidiaries to directly or indirectly incur or guarantee, assume or suffer to exist, any indebtedness other than permitted indebtedness under the 5% Convertible Debenture agreement. If an event of default occurs, and is continuing with respect to any of the Company s 5% Convertible Debentures, the holder may, at its option, require the Company to redeem all or a portion of the 5% Convertible Debenture.

Mandatory Conversion and Mandatory Redemption of 5% Convertible Debentures at the Company s Option If the closing bid price of the Company s common stock is at or above $14.053 for at least 20 consecutive trading days and certain other conditions are met, the Company has the right to (i) require the holder of a 5% Convertible Debenture to convert the 5% Convertible Debenture in whole, including interest, into shares of the Company s common stock at a price of $7.0265 per common share, as may be adjusted under the debenture, as set forth and subject to the conditions in the 5% Convertible Debenture, or (ii) redeem the 5% Convertible Debenture. If the Company makes either of the foregoing elections with respect to any 5% Convertible Debenture, the Company must make the same election with respect to all 5% Convertible Debentures. As of July 26, 2007 the closing bid price of the Company s common stock exceeded $14.053 for 20 consecutive trading days and on July 27, 2007, the holders of the 5% Convertible Debentures were notified that the Company intended to effect the Mandatory Redemption (see Note 16).

Warrants On December 23, 2004, in connection with the issuance of the 5% Convertible Debentures, the Company issued warrants to purchase an aggregate of 426,951 shares of its common stock at an exercise price of $7.0265. The warrants may be exercised at any time prior to 5:00 p.m. Eastern time, on December 23, 2009. Any warrants not exercised prior to such time will expire. The exercise price will be reduced in certain instances where shares of common stock are sold or deemed to be sold at a price less than the applicable exercise price, including the issuance of certain options, the issuance of convertible securities, or the change in exercise price or rate of conversion for option or convertible securities. The exercise price will be proportionately adjusted if the Company subdivides (by stock split, stock dividend, recapitalization, or otherwise) or combines (by combination, reverse stock split, or otherwise) one or more classes of its common stock.

Registration Rights On April 18, 2005, the Company s registration statement relating to the 5% Convertible Debentures and the shares of common stock issuable upon conversion of the debentures and exercise of the warrants was declared effective by the Securities and Exchange Commission (SEC). The Company expects to keep this registration statement effective until the earlier of (i) such time as all of the shares covered by the prospectus have been disposed of pursuant to and in accordance with the registration statement, or (ii) the date on which the shares may be sold pursuant to Rule 144(k) of the Securities Act.

The Company incurred approximately $1.3 million in issuance costs and other expenses in connection with the offering. This amount has been deferred and is being amortized to interest expense over the term of the 5% Convertible Debenture. Additionally, the Company evaluated the various instruments included in the agreements entered into on December 22, 2004 and allocated the relative fair values to be as follows: warrants $1.7 million, Put Option $0.1 million, Registration Rights $0.1 million, issuance costs $1.3 million, 5% Convertible Debenture $16.8 million. The 5% Convertible Debentures will be accreted to $20.0 million over their five-year life, resulting in additional interest expense. The value of the warrants has been included in Stockholders Equity (Deficit); the value of the Put Option and Registration Rights have been recorded as a liability and are subject to future value adjustments; and the value of the 5% Convertible Debentures has been recorded as long-term debt.

Annual maturities of long-term debt as of June 30, 2007 are $20.0 million due on December 23, 2009 (see Note 16).

7. LONG-TERM DEFERRED REVENUE

On June 30, 2007, long-term deferred revenue was $12.9 million and included approximately $9.6 million of deferred revenue from Sony Computer Entertainment. On December 31, 2006, long-term deferred revenue was $31.8 million and included approximately $27.9 million of compulsory license fees and interest from Sony Computer Entertainment pursuant to Court orders dated January 10 and February 9, 2005. See Note 10 for further discussion.

8. LONG-TERM CUSTOMER ADVANCE FROM MICROSOFT

On July 25, 2003, the Company contemporaneously executed a series of agreements with Microsoft Corporation (Microsoft) that (1) settled the Company s lawsuit against Microsoft, (2) granted Microsoft a worldwide royalty-free, irrevocable license to the Company s portfolio of patents (the License Agreement) in exchange for a payment of

$19.9 million, (3) provided Microsoft with sublicense rights to pursue certain license arrangements directly with third parties including Sony Computer Entertainment which, if consummated, would result in payments to the Company (the Sublicense Rights), and conveyed to Microsoft the right to a payment of cash in the event of a settlement within certain parameters of the Company s patent litigation against Sony Computer Entertainment of America Inc. and Sony Computer Entertainment Inc. (the Participation

10

Table of Contents

Rights) in exchange for a payment of $0.1 million, (4) issued Microsoft shares of the Company s Series A Redeemable Convertible Preferred Stock (Series A Preferred Stock) for a payment of $6.0 million, and (5) granted the Company the right to sell up to $9.0 million of debentures to Microsoft under the terms and conditions established in newly authorized 7% Debentures with annual draw down rights over a 48-month period. The sublicense rights provided to Microsoft to contract directly with Sony Computer Entertainment expired in July 2005.

Under these agreements, in the event that the Company elects to settle the action in the United States District Court for the Northern District of California entitled *Immersion Corporation v. Sony Computer Entertainment of America, Inc., Sony Computer Entertainment Inc. and Microsoft Corporation*, Case No. C02-00710 CW (WDB), as such action pertains to Sony Computer Entertainment, the Company would be obligated to pay Microsoft a minimum of $15.0 million for amounts up to $100.0 million received from Sony Computer Entertainment on account of the Company s granting certain rights, plus 25% of amounts over $100.0 million up to $150.0 million, and 17.5% of amounts over $150.0 million. As of December 31, 2006, the Company reflected a liability of $15.0 million in its financial statements, being the minimum amount the Company would be obliged to pay to Microsoft upon a settlement with Sony Computer Entertainment.

In March 2007, the Company concluded its patent infringement litigation against Sony Computer Entertainment at the U.S. Court of Appeals for the Federal Circuit. Additionally, the Company and Sony Computer Entertainment entered into a new business agreement. The Company has determined that the conclusion of its litigation with Sony Computer Entertainment does not trigger any payment obligations under its Microsoft agreements. Accordingly, the liability of $15.0 million that was in the Company s financial statements at December 31, 2006 has been extinguished and the Company has accounted for this sum as litigation conclusions and patent license income in the three months ended March 31, 2007 and for the six months ended June 30, 2007. See Note 15, Contingencies. As the patent infringement litigation with Sony Computer Entertainment has concluded, the Company s right to sell 7% Debentures has expired.

9. STOCK-BASED COMPENSATION

On January 1, 2006, the Company adopted the provisions of, and accounted for stock-based compensation in accordance with, SFAS No. 123 revised 2004, Share-Based Payment (SFAS No. 123R) which replaced SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123) and supersedes Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25). Under the fair value recognition provisions of SFAS No. 123R, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period. The valuation provisions of SFAS No. 123R apply to new grants and to grants that were outstanding as of the effective date and are subsequently modified. Estimated compensation for grants that were outstanding as of the effective date will be recognized over the remaining service period using the compensation cost estimated for the SFAS No. 123 pro forma disclosures. Prior to the adoption of SFAS No. 123R, the Company used the Black-Scholes-Merton option-pricing model (Black-Scholes model), multi-option approach to determine the fair value of stock options and employee stock purchase plan shares for pro forma disclosures.

Stock Options The Company s stock option 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. The Company considers its option programs critical to its operation and productivity; essentially all of its employees participate. Since inception, under the Company s stock option plans, the Company may grant options to purchase up to 17,577,974 shares of its common stock to employees, directors, and consultants at prices not less than the fair market value on the date of grant for incentive stock options and not less than 85% of fair market value on the date of grant for nonstatutory stock options. These options generally vest over 4 years and expire 10 years from the date of grant. At June 30, 2007, options to purchase 2,777,392 shares of common stock were available for grant, and options to purchase 6,618,465 shares of common stock were outstanding.

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

Employee Stock Purchase Plan The Company has an employee stock purchase plan (ESPP). Under the ESPP, eligible employees may purchase common stock through payroll deductions at a purchase price of 85% of the lower of the fair market

Table of Contents

value of the Company s stock at the beginning of the offering period or the purchase date. Participants may not purchase more than 2,000 shares in a six-month offering period or purchase stock having a value greater than $25,000 in any calendar year as measured at the beginning of the offering period. A total of 500,000 shares of common stock are reserved for the issuance under the ESPP plus an automatic annual increase on January 1, 2001 and on each January 1 thereafter through January 1, 2010 by an amount equal to the lesser of 500,000 shares per year or a number of shares determined by the Board of Directors. As of June 30, 2007, 322,367 shares had been purchased under the ESPP. Under SFAS No. 123R, the ESPP is considered a compensatory plan and the Company is required to recognize compensation cost for sales made under the ESPP.

The Company did not modify its ESPP in the quarter ended June 30, 2007.

General Stock Option Information The following table sets forth the summary of option activity under the Company s stock option program for the six months ended June 30, 2007:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2006 (5,403,314 exercisable at a weighted average price of $7.65 per share)	7,585,423	$ 7.40		
Granted (weighted average fair value of $5.48 per share)	1,051,708	8.97		
Exercised	(1,796,008)	4.63		
Canceled	(222,658)	7.13		
Outstanding at June 30, 2007	6,618,465	$ 8.41	6.23	$48.7 million
Exercisable at June 30, 2007	4,231,067	$ 8.78	4.81	$31.4 million

The expected to vest balance as of June 30, 2007 is equal to the outstanding balance at that date without consideration of forfeitures.

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of the Company s common stock for the options that were in-the-money at June 30, 2007. The aggregate intrinsic value of options exercised under the Company s stock option plans, determined as of the date of option exercise was $8.2 million for the quarter ended June 30, 2007.

Additional information regarding options outstanding as of June 30, 2007 is as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 1.20 - $ 2.35	731,342	5.22	$ 1.68	731,342	$ 1.68

3.20 - 6.11	684,269	6.39	5.50	467,738	5.48
6.20 - 6.95	1,145,957	7.97	6.77	472,796	6.69
6.96 - 7.00	859,015	7.03	6.99	595,235	6.99
7.02 - 8.98	1,187,507	4.33	8.37	936,529	8.60
9.04 - 9.04	881,198	9.62	9.04		
9.11 - 15.50	724,043	4.47	10.68	622,293	10.85
17.13 - 33.50	374,747	2.43	26.60	374,747	26.60
34.75 - 34.75	5,501	1.29	34.75	5,501	34.75
43.25 - 43.25	24,886	2.78	43.25	24,886	43.25
$ 1.20 - $43.25	6,618,465	6.23	$ 8.41	4,231,067	$ 8.78

Stock-based Compensation

Table of Contents

Valuation and amortization method The Company uses 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. Prior to the adoption of SFAS No. 123R, the Company used the Black-Scholes model, multiple-option approach to determine the fair value of stock options and ESPP shares and amortization of resulting stock-based compensation amounts included in its pro forma disclosures of SFAS No. 123. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by the Company s stock price as well as assumptions regarding a number of complex and subjective variables. These variables include actual and projected employee stock option exercise behaviors, the Company s expected stock price volatility over the term of the awards, risk-free interest rate, and expected dividends.

Expected term The Company estimates the expected term of options granted by using the simplified method as prescribed by SAB No. 107. The expected term of ESPP shares is the length of the offering period.

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

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

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

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
Options	2007	2006	2007	2006
Expected term (in years)	6.25	6.25	6.25	6.25
Volatility	59%	62%	60%	62%
Interest rate	5.0%	5.1%	4.6%	4.9%
Dividend yield				

	Three Months Ended June 30,		Six Months Ended June 30,	
Employee Stock Purchase Plan	2007	2006	2007	2006
Expected term (in years)	0.5	0.5	0.5	0.5
Volatility	45%	34%	45%	34%
Interest rate	5.2%	4.6%	5.2%	4.6%
Dividend yield				

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

Income Statement Classifications	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
	(In thousands)		(In thousands)	
Cost of product sales	$ 26	$ 18	$ 46	$ 37
Sales and marketing	217	296	377	582
Research and development	128	121	314	250
General and administrative	238	259	506	548
Total	$ 609	$ 694	$ 1,243	$ 1,417

SFAS No. 123R requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. For the three months and six months ended June 30, 2007, the Company recorded $791,000 and $1.9 million, respectively, of excess tax benefits from stock-based compensation.

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

As of June 30, 2007, there was $5.1 million of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock options granted to the Company s employees and directors. This cost will be recognized over an estimated weighted-average period of approximately 2.6 years. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

10. LITIGATION CONCLUSIONS AND PATENT LICENSE

In March 2007, the Company s patent infringement litigation with Sony Computer Entertainment concluded. Sony Computer Entertainment satisfied the District Court judgment against it, which included damages, pre-judgment interest, costs and interest totaling $97.3 million, along with compulsory license fees already paid to the Company of $30.6 million and interest earned on these fees of $1.8 million. See Note 15 for further discussion of this litigation. As of March 19, 2007, the Company and Sony Computer Entertainment entered into an agreement whereby the Company granted Sony Computer Entertainment and its affiliates a worldwide, non-transferable, non-exclusive license of the Company s patents for the on-going use, development, manufacture, sale, lease, importation, and distribution of its current and past PlayStation and related products. The license does not cover adult, foundry, medical, automotive, industrial, mobility, or gambling products. The Company also granted to Sony Computer Entertainment a license of the Company s patents for the use, development, manufacture, sale, lease, importation, and distribution, by Sony Computer Entertainment and through third parties, of haptic game devices for use on those Sony PlayStation consoles. The Company also granted Sony Computer Entertainment certain other licenses, an option to obtain licenses in the future with respect to future gaming consoles, products, certain releases and covenants not to sue. Sony Computer Entertainment granted the Company certain covenants not to sue and agreed to pay the Company twelve quarterly installments of $1.875 million (for a total of $22.5 million) beginning on March 31, 2007 and ending on December 31, 2009, and may pay the Company certain other fees and royalty amounts. In total, the Company will receive a minimum of $152.2 million through the conclusion of the litigation and the business agreement. The Company engaged an independent firm of financial advisors to assist with the determination of the fair value of all the elements of both the litigation conclusion and the patent license. In accordance with the guidance from EITF No. 00-21, the Company has allocated the present value of the total payments, equal to $149.9 million, between each element based on their relative fair values. Under this allocation, the Company recorded $119.9 million as litigation conclusions and patent license income and the remaining $30.0 million is allocated to deferred license revenue. The Company recorded $749,000 and $856,000, as revenue, respectively, in the three-month and six-month periods ended June 30, 2007. The Company will record the remaining $29.1 million as revenue, on a straight-line basis, over the remaining capture period of the patents licensed, ending March 19, 2017. The Company has accounted for future payments in accordance with APB No. 21 Interest on Receivables and Payables. Under APB No. 21, the Company determined the present value of the $22.5 million future payments to equal $20.2 million. The Company is accounting for the difference of $2.3 million as interest income as each $1.875 million payment installment becomes due.

In 2003, the Company executed a series of agreements with Microsoft as described in Note 8 that provided for settlement of its lawsuit against Microsoft as well as various licensing, sublicensing, and equity and financing arrangements. Under the terms of

14

these agreements, in the event that the Company elects to settle the action in the United States District Court for the Northern District of California entitled *Immersion Corporation v. Sony Computer Entertainment of America, Inc., Sony Computer Entertainment Inc. and Microsoft Corporation*, Case No. C02-00710 CW (WDB), as such action pertains to Sony Computer Entertainment, the Company would be obligated to pay Microsoft a minimum of $15.0 million for amounts up to $100.0 million received from Sony Computer Entertainment on account of the Company s granting certain rights, plus 25% of amounts over $100.0 million up to $150.0 million, and 17.5% of amounts over $150.0 million. The Company has determined that the conclusion of its litigation with Sony Computer Entertainment does not trigger any payment obligations under its Microsoft agreements. Accordingly, the liability of $15.0 million that was in the financial statements at December 31, 2006 has been extinguished, and the Company has accounted for this sum as litigation conclusions and patent license income in the three-month period ended March 31, 2007. However, in a letter sent to the Company dated May 1, 2007, Microsoft disputed the Company s position and stated that it believes the Company owes Microsoft at least $27.5 million. On June 18, 2007, Microsoft filed a complaint against the Company in the U.S. District Court for the Western District of Washington alleging one claim for breach of a contract. The Company disputes Microsoft s allegations and intends to vigorously defend itself. See Contingencies Note 15. The results of any litigation are inherently uncertain, and there can be no assurance that the Company s position will prevail.

On September 24, 2004, the Company filed in the United States District Court for the Northern District of California a complaint for patent infringement against Electro Source LLC (Electro Source). On February 28, 2006, the Company announced that it had settled its legal differences with Electro Source and the Company and Electro Source agreed to dismiss all claims and counterclaims relating to this matter. In addition to the Confidential Settlement Agreement, Electro Source entered into a worldwide license to the Company s patents for vibro-tactile devices in the consumer gaming peripheral field of use under which Electro Source makes royalty payments to the Company based on sales by Electro Source of spinning mass vibro-tactile gamepads, steering wheels, and other game controllers for dedicated gaming consoles. In March 2006 and June 2006, Electro Source paid the Company $650,000 and $400,000, respectively, and the Company recorded $400,000 and $1.1 million as litigation conclusions and patent license income during the three-month and six-month periods ended June 30, 2006, respectively.

11. INCOME TAXES

For the three months and six months ended June 30, 2007, the Company recorded (benefits) provisions for income taxes of $(1.5) million and $7.0 million, yielding effective tax rates of 113.3% and 5.4%, respectively. For the three months and six months ended June 30, 2006, the Company recorded (benefits) provisions for income taxes of $(15,000) and $87,000, yielding effective tax rates or 0.6% and (1.7)%, respectively. During the second quarter of 2007, the Company generated a $1.3 million taxable loss. During the first six months of 2007, the Company generated $129.6 of taxable income and based upon these earnings and projected future taxable earnings the Company released $47.6 million of the valuation allowance previously recorded against the deferred tax assets. Although the Company incurred pre-tax losses for the six months ended June 30, 2006, sums received from Sony Computer Entertainment and interest thereon included in long-term deferred revenue, approximating $6.9 million during the period, created federal and state alternative minimum taxable income.

On January 1, 2007, the Company adopted FIN 48, Accounting for Uncertainty in Income Taxes. FIN 48 prescribes a recognition threshold that a tax position is required to meet before being recognized in the financial statements and provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition issues.

The application of FIN 48 would have resulted in a decrease in retained earnings of $628,000, except that the decrease was fully offset by the application of a valuation allowance. Future changes in the unrecognized tax benefit will have an impact on the effective tax rate due. Accrued interest on tax positions will be recorded as a component of income tax provision but is not significant at June 30, 2007. No interest or penalties were recorded upon the adoption of FIN 48 as of January 1, 2007 or in the six months ended June 30, 2007. The Company does not reasonably estimate that the unrecognized tax benefit will change significantly within the next twelve months.

The Company files its tax returns as prescribed by the tax laws of the jurisdictions in which it operates. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ending December 31, 1993 through 2006. The Company and its subsidiaries state income tax returns are open to audit under the statute of limitations for the years ending December 31, 1993 through 2006. The Company s foreign operations in Canada are open to audit under statute of limitation for the years ending December 31, 1998 through 2006. The Company s fiscal 2004 income tax return is currently under a routine examination by the Internal Revenue Service.

Net deferred income taxes were $5.4 million as of June 30, 2007 and are primarily timing differences between book and tax and federal net operating loss carryforwards of $2.8 million (net of $1.0 million) that are limited in utilization to approximately $1.1 million annually, which expire in 2020. During 2005, the Company evaluated ownership changes from 1999 to 2004 and determined that there were no further limitations on the Company s net operating loss carryforwards.

Table of Contents

12. NET INCOME (LOSS) PER SHARE

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Numerator:				
Net income (loss) used in computing basic net income (loss) per share	$ 176	$ (2,379)	$ 122,609	$ (5,285)
Interest on 5% Convertible Debentures			295	
Net income (loss) used in computing diluted net income (loss) per share	$ 176	$ (2,379)	$ 122,904	$ (5,285)
Denominator:				
Shares used in computation of basic net income (loss) per share (weighted average common shares outstanding)	26,297	24,546	25,822	24,483
Dilutive potential common shares:				
Stock options	1,933		1,517	
Warrants	389		345	
5% Convertible Debentures			2,846	
Shares used in computation of diluted net income (loss) per share	28,619	24,546	30,530	24,483
Basic net income (loss) per share	$ 0.01	$ (0.10)	$ 4.75	$ (0.22)
Diluted net income (loss) per share	$ 0.01	$ (0.10)	$ 4.03	$ (0.22)

For the three and six months ended June 30, 2007, options and warrants to purchase approximately 534,578 and 918,988 shares of common stock, respectively, with exercise prices greater than the average fair market value of the Company s stock of $11.27 and $9.50, respectively, were not included in the calculation because the effect would have been anti-dilutive. Additionally for the three months ended June 30, 2007, securities representing the conversion of the 5% Convertible Debentures of 2,846,363 were excluded from the calculation because the effect would have been anti-dilutive.

As of June 30, 2006, the Company had securities outstanding that could potentially dilute basic earnings per share, but were excluded from the computation of diluted net loss per share since their effect would have been anti-dilutive. These outstanding securities consisted of the following:

	June 30, 2006
Outstanding stock options	7,757,382
Warrants	808,762
5% Senior Subordinated Convertible Debentures	2,846,363

13. COMPREHENSIVE INCOME (LOSS)

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

16

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
Net income (loss)	$ 176	$ (2,379)	$ 122,609	$ (5,285)
Change in unrealized gains (losses) on short-term investments	(25)		(25)	
Foreign currency translation adjustment	32	21	32	21
Total comprehensive income (loss)	$ 183	$ (2,358)	$ 122,616	$ (5,264)

14. SEGMENT REPORTING, GEOGRAPHIC INFORMATION, AND SIGNIFICANT CUSTOMERS

The Company develops, manufactures, licenses, and supports a wide range of hardware and software technologies that more fully engage users sense of touch when operating digital devices. The Company focuses on five application areas gaming, mobility, 3D, touch interface, and medical. The Company manages these application areas under two operating and reportable segments: 1) Immersion Computing, Entertainment, and Industrial, and 2) Immersion Medical. The Company determines its reporting segments in accordance with criteria outlined in SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. The gaming, mobile devices, 3D, and touch interface areas do not individually meet the criteria for segment reporting as set out in SFAS No. 131.

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 profit before interest and taxes. A description of the types of products and services provided by each operating segment is as follows:

Immersion Computing, Entertainment, and Industrial develops and markets touch feedback technologies that enable software and hardware developers to enhance realism and usability in their computing, entertainment, and industrial applications. Immersion 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 June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
Revenues:				
Immersion Computing, Entertainment, and Industrial	$ 4,474	$ 3,229	$ 8,232	$ 6,677
Immersion Medical	4,147	3,475	6,804	6,076
Intersegment eliminations	(26)	(51)	(27)	(68)
Total	$ 8,595	$ 6,653	$ 15,009	$ 12,685
Net Income (Loss):				
Immersion Computing, Entertainment, and Industrial	$ 152	$ (2,464)	$ 123,442	$ (5,103)
Immersion Medical	23	95	(839)	(183)
Intersegment eliminations	1	(10)	6	1
Total	$ 176	$ (2,379)	$ 122,609	$ (5,285)

17

Table of Contents

	June 30, 2007	December 31, 2006
	(In thousands)	
Total Assets:		
Immersion Computing, Entertainment, and Industrial	$ 175,453	$ 64,280
Immersion Medical	6,414	7,494
Intersegment eliminations	(20,664)	(21,759)
Total	$ 161,203	$ 50,015

Intersegment eliminations represent eliminations for intercompany sales and cost of sales and intercompany receivables and payables between Immersion Computing, Entertainment, and Industrial and Immersion Medical segments.

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
Revenues:				
Consumer, Computing, and Entertainment	$ 1,716	$ 1,019	$ 3,490	$ 2,427
3D	1,097	1,182	2,088	2,359
Touch Interface Products	1,635	977	2,627	1,823
Subtotal Immersion Computing, Entertainment, and Industrial	4,448	3,178	8,205	6,609
Immersion Medical	4,147	3,475	6,804	6,076
Total	$ 8,595	$ 6,653	$ 15,009	$ 12,685

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
North America	60%	73%	63%	72%
Europe	18%	17%	17%	17%
Far East	17%	8%	16%	9%

Rest of the world	5%	2%	4%	2%
Total	100%	100%	100%	100%

The Company derived 58% and 70% of its total revenues from the United States of America for the three months ended June 30, 2007 and 2006, respectively. The Company derived 11% of its total revenues from Japan for the three months ended June 30, 2007. The Company derived 10% and 11% of its total revenues from Germany for the three months ended June 30, 2007 and 2006, respectively. The Company derived 62% and 70% of its total revenues from the United States of America for the six months ended June 30, 2007 and 2006, respectively. The Company derived 11% of its total revenues from Japan for the six months ended June 30, 2007. The Company derived 11% of its total revenues from Germany for the six months ended June 30, 2006. Revenues from other countries represented less than 10% individually for the periods presented.

The majority of the Company s long-lived assets are located in the United States of America. Long-lived assets include net property and equipment and long-term investments and other assets. Long-lived assets that were outside the United States of America constituted less than 10% of the total on June 30, 2007 and December 31, 2006.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Customer A	12%	*	12%	*
Customer B	11%	*	*	*
Total	23%	*	12%	*

* Revenue derived from customer represented less than 10% for the period.

Customer B and two other customers accounted for 11%, 22%, and 10%, respectively, of the Company s accounts receivable at June 30, 2007. Customer B accounted for 49% of the Company s accounts receivable at December 31, 2006. No other customer accounted for more than 10% of the Company s accounts receivable at December 31, 2006.

15. CONTINGENCIES

In re Immersion Corporation

The Company is involved in legal proceedings relating to a class action lawsuit filed on November 9, 2001, 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 the Company s November 12, 1999 initial public offering (IPO). Subsequently, two of the individual defendants stipulated to a dismissal without prejudice.

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

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

The Company and most of the issuer defendants have settled with the plaintiffs. In this settlement, plaintiffs have dismissed and released all claims against the Immersion Defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of certain claims the Company may have against the underwriters. The Immersion Defendants will not be required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeds the amount of the insurance coverage, a circumstance which the Company believes is remote. The settlement will require approval of the Court, which cannot be assured, after class members are given the opportunity to object to the settlement or opt out of the settlement.

In September 2005, the Court granted preliminary approval of the settlement. The Court held a hearing to consider final approval of the settlement on April 24, 2006, and took the matter under submission. Before the Court issued a final decision on the settlement, on December 5, 2006 the United States Court of Appeals for the Second Circuit vacated the class certification of plaintiffs claims against the underwriters in six cases designated as focus or test cases. *Miles v. Merrill Lynch & Co. (In re Initial Public Offering Securities Litigation).* Thereafter, on December 14, 2006, the Court ordered a stay of all proceedings in all of the lawsuits pending the outcome of plaintiffs petition to the Second Circuit Court of Appeals for a rehearing en banc and resolution of the class certification issue. On April 6, 2007, the Second Circuit Court of Appeals denied plaintiffs petition for a rehearing, but clarified that the plaintiffs may seek to certify a more limited class. Accordingly, the plaintiffs and issuers have stated that they are prepared to discuss how the settlement might be amended or renegotiated to comply with the decision of the Second Circuit Court of Appeals. On April 30, 2007, Plaintiffs stated that they intend to present a proposed redefined class to the Court. If the settlement is not amended or renegotiated and then approved by the Court, the Company cannot assure that it will prevail in the lawsuit.

Immersion Corporation vs. Microsoft Corporation, Sony Computer Entertainment Inc. and Sony Computer Entertainment of America, Inc.

On February 11, 2002, the Company filed a complaint against Microsoft Corporation, Sony Computer Entertainment, Inc., and Sony Computer Entertainment of America, Inc. in the U.S. District Court for the Northern District Court of California alleging infringement of U.S. Patent Nos. 5,889,672 and 6,275,213. On July 28, 2003, the Company announced that it had settled its legal differences with Microsoft, and both parties agreed to dismiss all claims and counterclaims relating to this matter as well as assume financial responsibility for their respective legal costs with respect to the lawsuit between the Company and Microsoft.

On September 21, 2004, after a trial, the jury returned its verdict in favor of the Company. The jury found all the asserted claims of the patents valid and infringed. The jury awarded the Company damages in the amount of $82.0 million. On March 24, 2005, Judge Wilken entered judgment in the Company s favor and awarded the Company $82.0 million in past damages, and pre-judgment interest in the amount of $8.9 million, for a total of $90.9 million. The Company was also awarded certain court costs. Court costs do not include attorneys fees. Additionally, the Court issued a permanent injunction against the manufacture, use, sale, or import into the United States of the infringing Sony PlayStation system consisting of the PlayStation consoles, Dual Shock controllers, and the 47 games found by the jury to infringe the Company s patents. The Court stayed the permanent injunction pending appeal to the United States Court of Appeals for the Federal Circuit. The Court further ordered Sony Computer Entertainment to pay a compulsory license fee at the rate of 1.37% for the duration of the stay of the permanent injunction at the same rate and conditions as previously awarded in its interim January 10, 2005 and February 9, 2005 Orders. On April 7, 2005, pursuant to a stipulation of the parties, the Court entered an Amended Judgment to clarify that the Judgment in favor of the Company and against Sony Computer Entertainment also encompassed Sony Computer Entertainment s counterclaims for declaratory relief on invalidity and unenforceability, as well as non-infringement.

On March 1, 2007, Sony Computer Entertainment withdrew and moved to dismiss its appeals from the District Court s April 7, 2005 Amended Judgment (and all interlocutory orders merged in the Amended Judgment). On March 2, 2007, Sony Computer Entertainment withdrew and moved to dismiss its appeal from the District Court s March 8, 2006 order denying Sony Computer Entertainment s motion for relief from final judgment under Rule 60(b) of the Federal Rules of Civil Procedure. On March 8, 2007, the Federal Circuit dismissed the Sony Computer Entertainment Rule 60(b) appeal. On March 14, 2007 the Federal Circuit dismissed the Sony Computer Entertainment appeal of Amended Judgment (and all interlocutory orders merged in the Amended Judgment). In accordance with the Amended Judgment, the Company received funds totaling $97.3 million in satisfaction of the judgment for past damages for sales and other activities with respect to the infringing Sony PlayStation system consisting of the PlayStation consoles, Dual Shock controllers, and the 47 games found by the jury to infringe the Company s patents, pre-judgment interest and costs, and post-judgment interest. Additionally, the Company retained $32.4 million of compulsory license fees and interest thereon previously paid to the Company by Sony Computer Entertainment ($27.9 million in long-term deferred revenue on December 31, 2006 and $4.5 million received subsequent to year end.) On March 19, 2007, the Company lodged with the court a Notice of Satisfaction of Judgment, indicating that Sony Computer Entertainment had satisfied and discharged the judgment that the court had entered. On March 19, 2007, pursuant to a Stipulation lodged with the court, Judge Wilken entered an order dissolving the permanent injunction.

On May 17, 2005, Sony Computer Entertainment filed a Request for Inter Partes Reexamination of the 333 Patent with the United States Patent and Trademark Office (PTO). On May 19, 2005, Sony Computer Entertainment filed a similar Request for reexamination of the 213 Patent. On March 27, 2007, the Company filed a petition to terminate the inter partes reexamination on the grounds that the District Court judgment was final and non-appealable. On June 5, 2007, the USPTO granted the Company s petition to terminate the inter partes proceedings.

Internet Services LLC Litigation

On October 20, 2004, Internet Services LLC (ISLLC) filed claims against the Company in its lawsuit against Sony Computer Entertainment, alleging that the Company breached a contract with ISLLC by suing Sony Computer Entertainment for patent infringement relating to haptically-enabled software whose topics or images are allegedly age-restricted, for judicial apportionment of damages between ISLLC and the Company of the damages awarded by the jury, and for a judicial declaration with respect to ISLLC s rights and duties under agreements with the Company. On December 29, 2004, the Court issued an order dismissing ISLLC s claims against Sony Computer Entertainment with prejudice and dismissing ISLLC s claims against the Company without prejudice to ISLLC filing a new complaint if it can do so in good faith without contradicting, or repeating the deficiency of, its complaint.

On January 12, 2005, ISLLC filed Amended Cross-Claims and Counterclaims against the Company that contained similar claims. ISLLC also realleged counterclaims against Sony Computer Entertainment. On January 28, 2005, the Company filed a motion to dismiss ISLLC s Amended Cross-Claims and a motion to strike ISLLC s Counterclaims against Sony Computer Entertainment. On March 24, 2005 the Court issued an order dismissing ISLLC s claims with prejudice as to ISLLC s claim seeking a declaratory judgment that it is an exclusive licensee under the 213 and 333 patents and as to ISLLC s claim seeking judicial apportionment of the damages verdict in the Sony Computer Entertainment case. The Court s order further dismissed ISLLC s claims without prejudice as to ISLLC s breach of contract and unjust enrichment claims.

ISLLC filed a notice of appeal of the District Court orders with the United States Court of Appeals for the Federal Circuit on April 18, 2005. On April 4, 2007, the Federal Circuit issued its opinion, affirming the District Court orders.

On February 8, 2006, ISLLC filed a lawsuit against the Company in the Superior Court of Santa Clara County. ISLLC s complaint seeks a share of the damages awarded to the Company in the March 24, 2005 Judgment and of the Microsoft settlement proceeds, and generally restates the claims already adjudicated by the District Court. On March 16, 2006, the Company answered the complaint, cross claimed for breach of contract by ISLLC and rescission of the contract, and removed the lawsuit to federal court. The case was assigned to Judge Wilken as a case related to the previous proceedings involving Sony Computer Entertainment and ISLLC. ISLLC filed its answer to the Company s cross claims on April 27, 2006. ISLLC also moved to remand the case to Superior Court. On July 10, 2006, Judge Wilken issued an order denying ISLLC s motion to remand. On September 5, 2006, Judge Wilken granted the stipulated request by the parties to stay discovery and other proceedings in the case pending the disposition of ISLLC s appeal from the Court s previous orders. The case was stayed from December 1, 2006 pending the Federal Circuit s disposition on the appeal. As noted above, the Federal Circuit issued its opinion on April 4, 2007, and entered a judgment affirming the District Court s previous orders. On April 23, 2007, ISLLC filed in the Federal Circuit a Petition for Panel Rehearing and a Motion to Extend Time. ISLLC argued that the Court should rehear the matter or correct and/or clarify the April 4, 2007 opinion. On May 7, 2007, the Federal Circuit denied ISLLC s petition.

On May 10, 2007, ISLLC filed a motion in the District Court to remand its latest action to the Superior Court or in the alternative for leave to file an amended complaint to remove the declaratory relief claim. The Company opposed ISLLC s motion, and cross-moved for judgment on the pleadings on the grounds that ISLLC s claims are barred by res judicata and collateral estoppel. On June 26, 2007, the Court ruled on the motions, denying ISLLC s motion to remand or for leave to file an amended complaint, and granting in part the Company s motion for judgment on the pleadings. The Court dismissed ISLLC s claim for declaratory relief. ISLLC s claims for breach of contract, promissory fraud, and constructive trust, to the extent not inconsistent with the Court s previous rulings, remain.

The Company intends to defend itself vigorously against ISLLC s allegations. The parties participated in a court ordered mediation on March 12, 2007, but were unsuccessful in resolving the matter.

Immersion Corporation vs. Thorner

On March 24, 2006, the Company filed a lawsuit against Mr. Craig Thorner in Santa Clara County Superior Court. The complaint alleges claims for breach of contract with respect to Thorner s license to a third party of U.S. Patent No. 5,684,722, which the Company has alleged is in violation of contractual obligations to it. The case was removed to federal court by Mr. Thorner, and has been assigned to Judge Jeremy Fogel. On May 1, 2006, Mr. Thorner filed an answer to the Company s claims and asserted counterclaims against the Company seeking, among other things, a portion of the proceeds from the Company s license with Microsoft, under theories of alleged breach of contract, breach of the implied covenant of good faith and fair dealing, fraud, promissory fraud, breach of fiduciary duty, and negligent misrepresentation. On July 28, 2006, the Company filed a motion for judgment on the pleadings seeking the dismissal of Mr. Thorner s breach of contract and fraud claims which allege a right to a

Table of Contents

portion of the proceeds from the Company s license with Microsoft. On September 1, 2006, the Court held a hearing on the Company s motion. On September 12, 2006, the Court issued an order granting the Company s motion for judgment on the pleadings as to Mr. Thorner s alleged claims for breach of contract and fraud. The Court dismissed Mr. Thorner s breach of contract and fraud claims, and allowed Mr. Thorner leave to amend his claim for alleged breach of contract with respect to alleged violations of the Company s reporting requirements that do not flow from the failure to report the Microsoft Settlement Agreement.

The parties participated in a court-ordered mediation on November 7, 2006, but were not successful in resolving the matter. The parties are in the process of conducting discovery.

On November 22, 2006, Thorner brought a motion for summary judgment arguing that the Company s breach of contract claim was barred by the doctrine of judicial estoppel as a result of a statement made in connection with the Sony Computer Entertainment Rule 60 (b) motion. On January 26, 2007, the Court held a hearing on Thorner s motion. On January 29, 2007, the Court issued an order denying Thorner s summary judgment motion, ruling that the Company s breach of contract claim was not barred by judicial estoppel. On February 5, 2007, with leave of Court, the Company filed a First Amended Complaint in the action to add Thorner s company, Virtual Reality Feedback Corporation (VRF), as a party-defendant. On February 9, 2007, Thorner filed an Amended Answer and Counterclaims. The Amended Counterclaims against the Company dropped the previously-dismissed counterclaims based on Thorner s claims for a share of the Company s settlement with Microsoft, but alleged other counterclaims for alleged Breach of Contract, Breach of the Implied Covenant of Good Faith and Fair Dealing, Promissory Fraud, Breach of Fiduciary Duty, Negligent Misrepresentation and Rescission. Thorner alleged in part that the Company breached its agreement with Thorner by failing to pay royalties for Vibetonz Studio Software Development Kit (SDK) and Immersion Studio for Gaming; that the Company breached alleged duties to Thorner to license the 722 patent; and that Thorner s agreement with the Company should be rescinded. Thorner s Amended Counterclaim does not specify an amount of damages sought but alleges that Thorner has been damaged in an amount to be proven at trial. The Company disputes Thorner s allegations and intends to vigorously oppose them.

On June 27, 2007, the parties informed the Court that they had reached an agreement in principle to resolve the case and requested that the Court vacate dates in the case. The parties requested a status conference in the event that the matter was not finally resolved. On July 3, 2007, the Court entered an Order approving the stipulation, vacating pending dates in the action, and setting September 7, 2007 as a date for a further status conference.

Faro Technologies Inc. v. Immersion Corporation

On May 3, 2007, Faro Technologies, Inc. (Faro) sued the Company in the Eastern District of Pennsylvania. The complaint alleges patent infringement of Faro s 5,402,582 patent by the Company s MicroScribe X product. The Company was not served with the complaint. On August 2, 2007, Faro filed a voluntary dismissal without prejudice of the complaint.

Microsoft Corporation v. Immersion Corporation

On June 18, 2007, Microsoft filed a complaint against the Company in the U.S. District Court for the Western District of Washington alleging one claim for breach of a contract. Microsoft alleges that the Company breached a Sublicense Agreement executed in connection with the parties settlement of litigation in 2003 (see discussion above regarding the settlement with Microsoft). The complaint alleges that Microsoft is entitled to a share of the judgment monies and other sums received from Sony Computer Entertainment. In a letter sent to the Company dated May 1, 2007, Microsoft stated that it believes the Company owes Microsoft at least $27.5 million. The Company was served with the complaint on July 6, 2007; its response is due on September 4, 2007. The Company disputes Microsoft s allegations and intends to vigorously defend itself.

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.

Table of Contents

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 minimal.

See also Note 6 regarding contingencies relating to the 5% Convertible Debenture.

16. SUBSEQUENT EVENT

On July 27, 2007 the Company announced that it had notified the holders of its 5% Convertible Debentures, due in 2009, of its intent to redeem all of the 5 % Convertible Debentures in full pursuant to the Mandatory Redemption provision in its 5% Convertible Debentures discussed in Note 6. Approximately $20.1 million of principal and accrued interest is outstanding under the 5% Convertible Debentures. Under the terms of the 5% Convertible Debentures, once the closing bid price of the Company s common stock exceeds $14.053 per share for 20 consecutive trading days, the Company may redeem the 5% Convertible Debentures at the end of a 30-day notice period. Prior to the end of the 30-day period, the holders of the 5% Convertible Debenture may elect to convert the principal and accrued interest outstanding into shares of the Company s common stock at a conversion price of $7.0265 per share. The 5% Convertible Debentures ceased to accrue further interest upon the Company s election to effect the Mandatory Redemption.

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

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

OVERVIEW

We develop, manufacture, license, and support a wide range of hardware and software technologies that enhance touch interaction with digital devices. We focus on five application areas gaming, mobility, 3D, touch interface, and medical. We manage these application areas under two operating and reportable segments: 1) Immersion Computing, Entertainment, and Industrial, and 2) Immersion Medical.

In markets where our touch technology is a small piece of a larger system (such as mobile phones, consumer gaming peripherals, and automotive interfaces), we license our technologies to third-party manufacturers who integrate our technology into their products and resell it under their own brand names. In other markets, where our touch technology is a complete system (like medical simulation systems and three-dimensional and professional products) or electronic components (like electronic arcade gaming boards, rotary encoders, and lateral actuators for tactile touchscreens), we manufacture and sell products under our own Immersion brand name, through direct sales, distributors, and value added resellers. In all market areas, we also engage in development projects for third parties and government agencies from time to time.

Our objective is to proliferate our technologies across markets, platforms, and applications so that touch and feel become as necessary as color, graphics, and sound in modern user interfaces. We and our wholly owned subsidiaries hold more than 600 issued or pending patents in the United States of America and other countries, covering various aspects of hardware and software technologies.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Table of Contents

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, 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, Revenue Recognition, EITF No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables, and AICPA SOP 97-2, Software Revenue Recognition, 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 collectibility 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 based on either the royalty reports received or amortized over the license period depending on the nature of the agreement. Advance payments under license agreements that also require us to provide future services to the licensee are deferred and recognized over the service period when VSOE related to the value of the services does not exist.

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

License revenue model	Revenue recognition
Perpetual license of intellectual property portfolio based on per unit royalties, no services contracted.	Based on royalty reports received from licensees. No further obligations to licensee exist.
Time-based license of intellectual property portfolio with up-front payments and/or annual minimum royalty requirements, no services contracted. Licensees have certain rights to updates to the intellectual property portfolio during the contract period.	Based on straight-line amortization of annual minimum/up-front payment recognized over contract period or annual minimum period.
Perpetual license of intellectual property portfolio or technology license along with contract for development work.	Based on cost-to-cost percentage-of-completion accounting method over the service period. Obligation to licensee exists until development work is complete.
License of software or technology, no modification necessary, no services contracted.	Up-front revenue recognition based on SOP 97-2 criteria or EITF No. 00-21, as applicable.

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

Product sales We recognize revenues from product sales when the product is shipped, provided collection is determined to be probable and no significant obligation remains. We sell the majority of our products with warranties ranging from three to twenty-four months. We record the estimated warranty costs during the quarter the revenue is recognized. Historically, warranty-related costs and related accruals have not been significant. We offer a general right of return on the MicroScribe product line for

14 days after purchase. We recognize revenue at the time of shipment of a MicroScribe digitizer and provide an accrual for potential returns based on historical experience. We offer no other general right of return on our products.

Development contracts and other revenue Development contracts and other revenue is comprised of professional services (consulting services and/or development contracts), customer support, and extended warranty contracts. Development contract revenues are recognized under the cost-to-cost percentage-of-completion accounting method based on physical completion of the work to be performed. 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). When VSOE of fair value exists for all elements, we allocate revenue to each element based on the relative fair value of each of the elements.

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 elected the modified-prospective method, under which prior periods are not revised for comparative purposes. Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period.

Valuation and amortization method We use the Black-Scholes model, single-option approach to determine the fair value of stock options and ESPP shares. All share-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include actual and projected employee stock option exercise behaviors, 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 using the simplified method as prescribed by SAB No. 107.

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

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

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

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

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

The Black-Scholes model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable, characteristics not present in our option grants and ESPP shares. Existing valuation models, including the Black-Scholes and lattice binomial models, may not provide reliable measures of the fair values of our stock-based

compensation. Consequently, there is a risk that our estimates of the fair values of our stock-based compensation awards on the grant dates may bear little resemblance to the actual values realized upon the exercise, expiration, early termination, or forfeiture of those stock-based payments in the future. Certain stock-based payments, such as employee stock options, may expire and be worthless or otherwise result in zero intrinsic value as compared to the fair values originally estimated on the grant date and reported in our financial statements. Alternatively, value may be realized from these instruments that are significantly higher than the fair values originally estimated on the grant date and reported in our financial statements. There currently is no market-based mechanism or other practical application to verify the reliability and accuracy of the estimates stemming from these valuation models, nor is there a means to compare and adjust the estimates to actual values.

See Note 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. 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.

Long-term Liabilities In 2003, we executed a series of agreements with Microsoft as described in Note 8 to the condensed consolidated financial statements that provided for settlement of our lawsuit against Microsoft as well as various licensing, sublicensing, and equity and financing arrangements. We accounted for the proceeds received under the agreements as a long-term customer advance based on certain provisions that would result in payment of funds to Microsoft. Upon Microsoft s election to convert its shares of our Series A Preferred Stock into common stock, we reduced the long-term customer advance from Microsoft to the minimum amount we would be obligated to pay Microsoft upon a settlement of the Sony Computer Entertainment Lawsuit as set forth in our agreements with Microsoft. The remainder of the consideration was transferred to common stock in 2004. Per the conditions as set forth in our agreements with Microsoft, in the event that we elected to settle the action in the United States District Court for the Northern District of California entitled *Immersion Corporation v. Sony Computer Entertainment of America, Inc., Sony Computer Entertainment Inc. and Microsoft Corporation*, Case No. C02-00710 CW (WDB), as such action pertains to Sony Computer Entertainment, we would be obligated to pay Microsoft a minimum of $15.0 million for amounts up to $100.0 million received from Sony Computer Entertainment on account of our granting certain rights, plus 25% of amounts over $100.0 million up to $150.0 million, and 17.5% of amounts over $150.0 million.

In March 2007, we announced the conclusion of our patent infringement litigation against Sony Computer Entertainment at the U.S. Court of Appeals for the Federal Circuit. Sony Computer Entertainment satisfied the District Court judgment against it. As of March 19, 2007, we entered into a new business agreement with Sony Computer Entertainment. We have determined that the conclusion of our litigation with Sony Computer Entertainment does not trigger any payment obligations under our Microsoft agreements. However, on June 18, 2007, Microsoft filed a complaint against us in the United States District Court for the Western District of Washington alleging breach of our Sublicense Agreement dated July 25, 2003 and seeks damages, specific performance, declaratory judgment and attorneys fees and costs. We believe that we are not obligated under the Sublicense Agreement with Microsoft to make any payment to Microsoft relating to the conclusion of our litigation with Sony Computer Entertainment. We intend to defend this lawsuit vigorously. The results of any litigation are inherently uncertain, and there can be no assurance that our position will prevail.

In December 2004, we executed a series of agreements as described in Note 6 to the condensed consolidated financial statements that provided for the issuance of 5% Convertible Debentures and warrants, and that granted certain registration rights to the holders of the 5% Convertible Debentures. We accounted for the issuance of our 5% Convertible Debentures and related warrants in accordance with EITF No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios and other related accounting guidance. We estimated the relative fair value of the various instruments included in the agreements entered into in December 2004 and allocated the relative fair values to be as follows: warrants $1.7 million, Put Option $0.1 million, Registration Rights $0.1 million, issuance costs $1.3 million, 5% Convertible Debentures $16.8 million. The 5% Convertible Debentures are being accreted to $20.0 million over their five-year life, resulting in additional interest expense. The value of the warrants is included in Stockholders Equity (Deficit), the value of the Put Option and Registration Rights are recorded as liabilities and are subject to future value adjustments, and the value of the 5% Convertible Debentures is recorded as long-term debt. As of July 26, 2007 the closing bid price of our common stock exceeded $14.053 for 20 consecutive trading days and on July 27, 2007, the holders of the 5% Convertible Debentures were notified that we intend to effect the Mandatory Redemption of the 5% Convertible Debentures (see Note 16 to the condensed consolidated financial statements regarding subsequent event).

Long-term Deferred Revenue In addition to normal items of deferred revenue due after one year, we had included Sony Computer Entertainment compulsory license fees and interest earned thereon in long-term deferred revenue due to the contingent nature of the court-ordered payments (see Note 7 to the condensed consolidated financial statements). Upon the conclusion of our patent litigation at the U.S. Court of Appeals for the Federal Circuit the contingency on these funds lapsed.

Short-term Investments Our short-term investments consist primarily of highly liquid debt instruments purchased with an original or remaining maturity at the date of purchase of greater than 90 days. 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. These investments are carried at fair market value with unrealized gains and losses considered to be temporary in nature reported as a separate component of other comprehensive income (loss) within stockholders equity (deficit). We review all investments for reductions in fair value that are other-than-temporary. When such reductions occur, the cost of the investment is adjusted to fair value through loss on investments on the condensed consolidated statement of operations. Gains and losses on investments are calculated on the basis of specific identification.

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

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

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

Intangible Assets We have acquired patents and other intangibles. 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 three months and six months ended June 30, 2007, we capitalized costs associated with patents and trademarks of $447,000 and $833,000, respectively. Our total amortization expense for the same periods for all intangible assets was $242,000 and $496,000, respectively.

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 AND SIX MONTHS ENDED JUNE 30, 2007 AND 2006

Overview

Table of Contents

We achieved a 29% increase in revenues during the three months ended June 30, 2007 as compared to the three months ended June 30, 2006 and an 18% increase in revenues during the six months ended June 30, 2007 as compared to the six months ended June 30, 2006. The second quarter revenue growth was primarily due to a 61% increase in royalty and license revenues, primarily gaming and touch interface product royalties and a 35% increase in product sales, primarily medical product sales. Our net income was $176,000 for the three months ended June 30, 2007 compared to a net loss of $2.4 million for the three months ended June 30, 2006, mainly due to an increase in revenues, income tax benefits, and increased interest income, partially offset by increased operating expenses. Our net income was $122.6 million for the six months ended June 30, 2007 compared to a net loss of $5.3 million for the six months ended June 30, 2006. The increase in net income was primarily due to the litigation conclusion and patent license from Sony Computer Entertainment of $119.9 million and the extinguishment of the liability to Microsoft of $15.0 million.

In March 2007, we announced the conclusion of our patent infringement litigation against Sony Computer Entertainment at the U.S. Court of Appeals for the Federal Circuit. In satisfaction of the Amended Judgment, we received funds totaling $97.3 million, inclusive of the award for past damages for sales and other activities with respect to the infringing Sony PlayStation system consisting of the PlayStation consoles, Dual Shock controllers, and the 47 games found by the jury to infringe our patents, pre-judgment interest and costs, and post-judgment interest. Additionally we retained the $32.4 million of compulsory license fees and interest thereon previously paid to us by Sony Computer Entertainment pursuant to Court Orders. We also entered into a new business agreement with Sony Computer Entertainment. In addition, in both March and June 2007, Sony Computer Entertainment made payments of $1.875 million pursuant to rights under the new business agreement.

During the remainder of 2007, we expect to focus on the execution of sales and marketing plans in our established businesses to increase revenue and make selected investments in product and technology development for longer-term new growth areas. In addition, we have budgeted to continue to protect and defend our extensive intellectual property portfolio across all business segments. Our continued success could be limited by several factors, including the timely release of our new products or 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 the section titled Risk Factors.

REVENUES	June 30, 2007	June 30, 2006	Change
	($ In thousands)		
Three months ended:			
Royalty and license	$ 2,747	$ 1,702	61%
Product sales	5,289	3,917	35%
Development contracts and other	559	1,034	(46)%
Total Revenue	$ 8,595	$ 6,653	29%
Six months ended:			
Royalty and license	$ 4,958	$ 3,612	37%
Product sales	8,879	7,283	22%
Development contracts and other	1,172	1,790	(35)%
Total Revenue	$ 15,009	$ 12,685	18%

Three Months Ended June 30, 2007 Compared to Three Months Ended June 30, 2006

Total Revenue Our total revenue for the second quarter of 2007 increased by $1.9 million or 29% from the second quarter of 2006.

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 June 30, 2007 was $2.7 million, an increase of $1.0 million or 61% from the three months ended June 30, 2006. The increase in royalty and license revenue was primarily due to an increase in touch interface product royalties of $681,000 and an increase in gaming royalties of $444,000.

Touch interface product royalties increased due to increased licensee revenue from the expansion of the number of products licensed to the automotive market and the recognition of certain royalty payments in the second quarter of 2007.

The increase in gaming royalties was mainly due to new royalty and license revenue from Sony Computer Entertainment, a first-party peripheral licensee, during the three months ended June 30, 2007, which offset a decrease in sales by our third-party peripheral licensees of royalty bearing gaming peripherals compared to last year. Sony Computer Entertainment became a licensee in March 2007, and accordingly there was no license revenue from them in the prior year comparative period. During the three months ended June 30, 2007, we recognized $749,000 of revenue from Sony Computer Entertainment. The decrease in revenues of $305,000 from our third-party peripheral licensees was primarily due to i) the reduced sales of past generation video console systems with the launches of the next-generation console models from Microsoft (Xbox 360), Sony (PlayStation 3), and Nintendo (Wii), and ii) the significant decline in third-party market share of aftermarket game console controllers as market share shifted to first-party peripheral makers due to the launch of the next-generation console models.

The market share shift to first-party peripheral makers in combination with other actions by Microsoft, Sony, and Nintendo has caused our gaming revenue from existing third-party peripheral licensees to decline. Sony announced on May 8, 2006 that the vibration feature that is currently available on controllers for PlayStation and PlayStation 2 would be removed from the new PlayStation 3 controller. The PlayStation 3 console system was launched in late 2006 in the United States and Japan without native vibration or any force feedback capability of any kind. This course of action by Sony has had material adverse consequences on our current and future gaming royalty revenues from third-party peripheral licensees since our gaming royalties have primarily been from licensed third-party controller products with vibration or force feedback capabilities that require some degree of vibration and/or force feedback support or compatibility in the video console system to be viable products. In the first quarter of 2007, Sony released an update to the PlayStation 3 that offers limited vibration and force feedback support for some older PS1 and PS2 games and rumble and force feedback controllers compatible with the PS1 and PS2 console systems. We do not know if this situation might change at some point in the life of the PlayStation 3 console system, or whether or to what extent the PlayStation 3 console will be compatible with or support rumble or force feedback in PS3 games or controllers compatible with the PS3 console system.

Based on our litigation conclusion and new business agreement entered into with Sony Computer Entertainment in March 2007 (see Note 10 to the condensed consolidated financial statements for more discussion) we will recognize a minimum of $30.0 million as royalty and license revenue from March 2007 through March 2017, approximately $750,000 per quarter. For the Microsoft Xbox 360 video console system launched in November 2005, Microsoft has, to date, not broadly licensed third parties to produce game controllers. Because our gaming royalties come mainly from third-party manufacturers, unless Microsoft licenses additional third-parties, our gaming royalty revenue may continue to decline. 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 licenses additional third-party licensees, our gaming royalty revenue may continue to decline.

Product sales Product sales for the three months ended June 30, 2007 were $5.3 million, an increase of $1.4 million or 35% as compared to the three months ended June 30, 2006. The increase in product sales was primarily due to increased medical product sales of $1.4 million, mainly due to increased sales of our endovascular, endoscopy, and Virtual IV simulator platforms. This increase in product sales was a result of pursuing a product growth strategy for our medical business, which includes developing new products, leveraging our industry alliances, and expanding international sales. In addition, there was an increase in product sales from touch interface products of $18,000 including increased sales of rotary modules. Touch interface products include touchscreen and touch panel components, rotary modules, and commercial gaming products. Partially offsetting this increase was a decrease in product sales of our 3D products of $93,000 primarily due to decreased sales of our MicroScribe, CyberGrasp®, and CyberGlove® products as a result of some sales force transitions.

Development contract and other revenue Development contract and other revenue is comprised of revenue on commercial and government contracts and extended support and warranty contracts. Development contract and other revenue was $559,000 during the three months ended June 30, 2007, a decrease of $475,000 or 46% as compared to the three months ended June 30, 2006. Government contract revenue decreased by $645,000 primarily due to the completion of work performed under a medical government contract. Partially offsetting this decrease was an increase in commercial contract revenue of $105,000 mainly due to increased revenue recognized on mobile device development contracts led by the completion of one mobile device development contract, partially offset by decreased medical and touch interface product development contract revenue.

We categorize our geographic information into four major regions: North America, Europe, Far East, and Rest of the World. In the second quarter of 2007, revenue generated in North America, Europe, Far East, and Rest of the World represented 60%, 18%, 17%, and 5%, respectively, compared to 73%, 17%, 8%, and 2%, respectively, for the second quarter of 2006. The shift in revenues among regions was mainly due to an increase in medical product revenue, touch interface product royalty revenue, and mobile devices royalty and development contract revenue in the Far East, and an increase in medical product sales in the Rest of the World, offset by a reduction in revenue from North American gaming licensees and a decrease in government contract revenue from customers in North America due to the completion of those projects in 2006.

Six Months Ended June 30, 2007 Compared to the Six Months Ended June 30, 2006

Total Revenue Our total revenue for the first six months of 2007 increased by $2.3 million or 18% from the first six months of 2006.

Royalty and license revenue Royalty and license revenue for the six months ended June 30, 2007 increased by $1.3 million or 37% from the six months ended June 30, 2006. The increase in royalty and license revenue was primarily due to an increase in gaming royalties of $699,000 and an increase in touch interface product royalties of $691,000, offset in part by a decrease in medical license fees of $83,000. The increase in gaming royalties was mainly due to new royalty and license revenue from Sony Computer Entertainment, a first-party peripheral licensee, during the six months ended June 30, 2007, which offset a decrease in sales by our third-party peripheral licensees of royalty bearing gaming peripherals compared to last year. Touch interface product royalties increased due to the expansion of the number of products licensed to the automotive market and the recognition of certain royalty payments in the second quarter of 2007. The decrease in medical royalty and license revenue was primarily due to a decrease in license revenue from our license and development agreements with Medtronic.

Product sales Product sales for the six months ended June 30, 2007 increased by $1.6 million or 22% as compared to the six months ended June 30, 2006. The increase in product sales was primarily due to increased medical product sales of $1.8 million, mainly due to increased sales of our endovascular, endoscopy, and Virtual IV simulator platforms. In addition, there was an increase in product sales from touch interface products of $58,000 including increased sales of rotary modules and commercial gaming products. Partially offsetting this increase was a decrease in product sales of our 3D products of $270,000 primarily due to decreased sales of our MicroScribe, CyberGlove, and CyberGrasp, products due to sales force transitions and quality initiatives.

Development contract and other revenue Development contract and other revenue for the six months ended June 30, 2007 decreased by $618,000 or 35% as compared to the six months ended June 30, 2006. Government contract work decreased by $1.1 million primarily due to the completion of work performed under a medical government contract in 2006. Partially offsetting this decrease was an increase in commercial contract revenue of $355,000 mainly due to increased development contract revenue from the completion of one mobile device development contract and continued revenue from another mobile device development contract. In addition, revenue from product repairs increased by $106,000.

In the first six month of 2007, revenue generated in North America, Europe, Far East, and Rest of the World represented 63%, 17%, 16%, and 4%, respectively, compared to 72%, 17%, 9%, and 2%, respectively, for the first six months of 2006. The shift in revenues among regions was mainly due to an increase in medical product revenue, touch interface product royalty revenue, and mobile devices royalty and development contract revenue in the Far East, and an increase in medical product sales in the Rest of the World, offset by a decrease in government contract revenue from customers in North America due to the completion of those projects in 2006.

	June 30,		Change
COST OF PRODUCT SALES	2007	2006	
	($ In thousands)		
Three months ended:			
Cost of product sales	$2,427	$1,802	35%
% of total product revenue	46%	46%	
Six months ended:			
Cost of product sales	$3,970	$3,157	26%
% of total product revenue	45%	43%	

Table of Contents

Cost of Product Sales Our cost of product sales consists primarily of materials, labor, and overhead. There is no cost of product sales associated with royalty revenue or development contract revenue. Cost of product sales was $2.4 million, an increase of $625,000 or 35% for the three months ended June 30, 2007 as compared to the three months ended June 30, 2006. The increase in cost of product sales was primarily due to increased direct material costs of $368,000 and an increase of overhead costs of $266,000, offset in part by decreased royalties of $32,000. The increase in direct material costs was a result of increased product sales. Overhead costs increased, in part, as a result of increased salary expense primarily due to the costs of programs to improve quality processes within our manufacturing operations which we anticipate will continue throughout 2007.

Cost of product sales increased by $813,000 or 26% for the six months ended June 30, 2007 as compared to the six months ended June 30, 2006. The increase in cost of product sales was primarily due to increased direct material costs of $519,000, and an increase of overhead costs of $328,000, offset in part by decreased royalties of $53,000. The increase in direct material costs was a result of increased product sales and a shift in product mix that included sales of our lower margin Virtual IV medical simulator. Overhead costs increased, in part, as a result of increased salary expense primarily due to the costs of programs to improve quality processes within our manufacturing operations.

Table of Contents

OPERATING EXPENSES AND OTHER	June 30, 2007	June 30, 2006	Change
	($ In thousands)		
Three months ended:			
Sales and marketing	$ 3,030	$ 3,009	1%
% of total revenue	35%	45%	
Research and development	$ 2,513	$ 1,802	39%
% of total revenue	29%	27%	
General and administrative	$ 3,122	$ 2,296	36%
% of total revenue	36%	35%	
Amortization of intangibles	$ 242	$ 219	11%
% of total revenue	3%	3%	
Litigation conclusions and patent license	$	$ (400)	*%
% of total revenue	%	(6)%	
Six months ended:			
Sales and marketing	$ 5,733	$ 6,086	(6)%
% of total revenue	38%	48%	
Research and development	$ 5,056	$ 3,531	43%
% of total revenue	34%	28%	
General and administrative	$ 6,381	$ 5,107	25%
% of total revenue	43%	40%	
Amortization of intangibles	$ 496	$ 429	16%
% of total revenue	3%	3%	
Litigation conclusions and patent license.	$(134,900)	$(1,050)	*%
% of total revenue	(899)%	(8)%	

* Percentage 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 were $3.0 million, an increase of $21,000 or 1% in the second quarter of 2007 compared to the comparable period in 2006. The increase was primarily due to increased salaries, benefits, and overhead expense of $59,000, an increase in bad debt expense of $39,000, an increase in professional consulting and license fees of $19,000, and an increase in inventory items used for demonstration purposes of $11,000, offset in part by decreased advertising and public relations costs of $59,000, and a decrease in travel expense to support sales and marketing efforts of $49,000 due to timing of programs and sales meetings. The increased compensation, benefits, and overhead expense was primarily due to increased variable compensation earned on increased sales and contracts signed during the period. 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. We expect to continue to invest in sales and marketing in future periods to exploit market opportunities for our technology.

Sales and marketing expenses decreased by $353,000 or 6% in the first six months of 2007 compared to the comparable period in 2006. The decrease was mainly the result of decreased compensation, benefits, and overhead expense of $122,000, decreased advertising and marketing expenses including, market research, product marketing and public relations costs of $117,000, and decreased travel expense to support sales and marketing efforts of $104,000. The decreased compensation, benefits, and overhead expense was primarily due to a reduction in headcount and decreased stock-based compensation expense offset in part by an increase in variable compensation earned on increased sales and contracts signed during the period.

Research and Development Our research and development expenses are comprised primarily of employee compensation and benefits, consulting fees, tooling and supplies, and an allocation of facilities costs. Research and development expenses were $2.5 million, an increase of $711,000 or 39% in the second quarter of 2007 compared to the same period in 2006. The increase was primarily due to increased compensation, benefits, and overhead of $514,000, an increase in professional consulting expense of $116,000 for non-recurring engineering projects, an increase in prototyping expenses of $64,000, and an increase in travel of $13,000. The increased compensation, benefits, and overhead expense was primarily due to increased research and development headcount. We believe that continued investment in research and development is critical to our future success, and we expect to make targeted investments in areas of product and technology development to support future growth.

Research and development expenses increased by $1.5 million or 43% in the first six months of 2007 compared to the same period in 2006. The increase was primarily due to increased compensation, benefits, and overhead of $1.1 million, an increase in professional consulting expense of $230,000 for non-recurring engineering projects, an increase in travel of $77,000 in support of sales efforts, and an increase in prototyping expenses of $51,000. The increased compensation, benefits, and overhead expense was primarily due to increased research and development headcount. Additionally, environmental regulation compliance has caused overall research and development expenses to increase for the period and we anticipate we will need to expend further costs and resources to meet new compliance regulations in the future.

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 were $3.1 million, an increase of $826,000 or 36% in the second quarter of 2007 compared to the same period in 2006. The increase was primarily due to increased legal, professional, and license fee expense of $823,000. The increased legal, professional, and license fee expenses were primarily due to increased audit, tax, and accounting fees mainly related to the accounting and valuation for Sony Computer Entertainment litigation conclusion and patent license and income tax related issues, increased general legal and patent costs, and increased consulting costs. We expect that the dollar amount of general and administrative expenses to continue to be a significant component of our operating expenses. We will continue to incur costs related to litigation as we continue to defend our intellectual property and defend lawsuits brought against us.

General and administrative increased by $1.3 million or 25% in the first six months of 2007 compared to the same period in 2006. The increase was primarily due to increased legal, professional, and license fee expense of $1.2 million and increased public company expense of $75,000. The increased legal, professional, and license fee expenses were primarily due to increased audit, tax, and accounting fees, increased general legal and patent costs, and increased consulting costs.

Amortization of Intangibles Our amortization of intangibles is comprised primarily of patent amortization and other intangible amortization. Amortization of intangibles increased by $23,000 or 11% in the second quarter of 2007 compared to the same period in 2006. Amortization of intangibles increased by $67,000 or 16% in the first six months of 2007 compared to the same period in 2006. The increases were primarily attributable to the increased cost and number of patents being amortized offset in part by some intangible assets reaching full amortization.

Litigation Conclusions and Patent License In March 2007, we concluded our patent infringement litigation against Sony Computer Entertainment at the U.S. Court of Appeals for the Federal Circuit. In satisfaction of the Amended Judgment, we received funds totaling $97.3 million, inclusive of the award for past damages, pre-judgment interest and costs, and post-judgment interest. Additionally, we retained $32.4 million of compulsory license fees and interest thereon previously paid to us by Sony Computer Entertainment pursuant to Court Orders. See Note 15 to the condensed consolidated financial statements for further discussion of this litigation. As of March 19, 2007 both parties entered into an agreement whereby we granted Sony Computer Entertainment and its affiliates a worldwide, non-transferable, non-exclusive license of our patents for the going-forward use, development, manufacture, sale, lease, importation, and distribution of its current and past PlayStation and related products. The license does not cover adult, foundry, medical, automotive, industrial, mobility, or gambling products. We also granted to Sony Computer Entertainment a license of our patents for the use, development, manufacture, sale, lease, importation, and distribution, by Sony Computer Entertainment and through third parties, of haptic game devices for use on those Sony PlayStation consoles. We also granted Sony Computer Entertainment certain other licenses, an option to obtain licenses in the future with respect to future gaming consoles, products, certain releases and covenants not to sue. Sony Computer Entertainment granted us certain covenants not to sue and agreed to pay us twelve quarterly installments of $1.875 million (for a total of $22.5 million) beginning on March 31, 2007 and ending on December 31, 2009, and may pay us certain other fees and royalty amounts. In total, we will receive a minimum of $152.2 million through the conclusion of the litigation and the separate patent license. We engaged an independent firm of financial advisors to assist with the determination of the fair value of all the elements of both the litigation conclusion and patent license. In accordance with the guidance from EITF No. 00-21, we allocated the present value of the total payments, equal to $149.9 million, between each element based on their relative fair values. Under this allocation, we recorded $119.9 million as litigation conclusions and patent license income and the remaining $30.0 million was allocated to deferred license revenue. We recorded $749,000 and $856,000, as revenue, respectively, in the three-month and six-month periods ended June 30, 2007. We will record the remaining $29.1 million as revenue, on a straight-line basis, over the remaining capture period of the patents licensed, ending March 19, 2017. We have accounted for future payments in accordance with APB No. 21 Interest on Receivables and Payables. Under APB No. 21, we determined the present value of the $22.5 million future payments to equal $20.2 million. We will account for the difference of $2.3 million as interest income as each $1.875 million payment installment becomes due.

Under the terms of a series of agreements that we entered into with Microsoft in 2003, in the event we had elected to settle the action in the United States District Court for the Northern District of California entitled *Immersion Corporation v. Sony Computer Entertainment of America, Inc., Sony Computer Entertainment Inc. and Microsoft Corporation*, Case No. C02-00710 CW (WDB), as such action pertains to Sony Computer Entertainment, we would be obligated to pay Microsoft a minimum of $15.0 million for amounts up to $100.0 million received from Sony Computer Entertainment on account of our granting certain rights, plus 25% of amounts over $100.0 million up to $150.0 million, and 17.5% of amounts over $150.0 million. The patent infringement litigation with Sony Computer Entertainment was concluded in March 2007 at the U.S. Court of Appeals for the Federal Circuit without settlement. We have determined that the conclusion of our litigation with Sony Computer Entertainment does not trigger any payment obligations under our Microsoft agreements. Accordingly, the liability of $15.0 million that was in the financial statements at December 31, 2006 was extinguished, and we have accounted for this sum as litigation conclusions and patent license income in the six-month period ended June 30, 2007. However, in a letter sent to us dated May 1, 2007, Microsoft disputed our position and stated that it believes we owe Microsoft at least $27.5 million. On June 18, 2007, Microsoft filed a complaint against us in the U.S. District Court for the Western District of Washington alleging one claim for breach of a contract. We dispute Microsoft s allegations and intend to vigorously defend ourselves. See Contingencies Note 15 to the condensed consolidated financial statements. The results of any litigation are inherently uncertain, and there can be no assurance that our position will prevail.

In February 2006, we announced that we had settled our legal differences in our complaint for patent infringement against Electro Source and that both parties had agreed to dismiss all claims and counterclaims relating to this matter. In addition to the Confidential Settlement Agreement, Electro Source entered into a worldwide license to our patents for vibro-tactile devices in the consumer gaming peripheral field of use. According to the terms of the agreement, Electro Source will make royalty payments to us based on sales by Electro Source of spinning mass vibro-tactile gamepads, steering wheels, and other game controllers for dedicated gaming consoles, such as the Sony PlayStation and PlayStation 2, the Nintendo GameCube, and the Microsoft Xbox and Xbox 360. In March 2006 and June 2006, Electro Source paid us $650,000 and $400,000, respectively, and we recorded $400,000 and $1.1 million as litigation conclusions and patent license income during the three-month and six-month periods ended June 30, 2006, respectively.

Interest and Other Income Interest and other income consists primarily of interest income and dividend income from cash and cash equivalents and short-term investments. Interest and other income increased by $1.7 million in the second quarter of 2007 compared to the same period in 2006. This improvement was primarily the result of increased interest income earned on increased cash, cash equivalents, and short-term investments invested after the receipt of the judgment from Sony Computer Entertainment in March 2007. Interest income earned on the payments from Sony Computer Entertainment up until the judgment became final had been included in deferred revenue. We expect interest income to increase throughout the remainder of the year due to interest income earned on our increased cash, cash equivalent, and short-term investment balances.

Interest and other income increased by $2.0 million in the first six months of 2007 compared to the same period in 2007. This improvement was the result of increased cash, cash equivalents, and short-term investments invested for the first six months of 2007 compared to the same period in 2006.

Interest Expense Interest expense consists primarily of interest and accretion expense on our 5% Convertible Debentures. Interest expense increased by $4,000 in the second quarter of 2007 compared to the same period in 2006. Interest expense increased by $3,000 in the first six months of 2007 compared to the same period in 2006. See subsequent Note 16 to the condensed consolidated financial statements with regard to future interest expense on our 5% Convertible Debentures.

Benefit (Provision) for Income Taxes For the second quarter of 2007, we recorded a benefit for income taxes of $(1.5) million on a pre-tax loss of $1.3 million, yielding an effective tax rate of 113.3%. For the second quarter of 2006, we recorded a benefit for income taxes of $(15,000) on a pre-tax loss of $2.4 million, yielding an effective tax rate of 0.6%. During the second quarter of 2007, we generated a $1.3 million taxable loss. Based on this loss and future projections, we recorded a benefit for

Table of Contents

income taxes for the quarter ended June 30, 2007. Reductions in estimated taxable income caused us to record a tax benefit for the quarter ended June 30, 2006.

For the six months ended June 30, 2007, we recorded a provision for income taxes of $7.0 on pre-tax income of $129.6 million, yielding an effective tax rate of 5.4%. For the six months ended June 30, 2006, we recorded a provision for income taxes of $87,000 on a pre-tax loss of $5.2 million, yielding an effective tax rate of (1.7)%. The provision for income taxes for the six months ended June 30, 2007 utilized a significant portion of our net operating loss carryforwards to offset taxable income that were previously fully reserved thereby reducing the overall effective tax rate. We released $47.0 million of the deferred tax valuation allowance in the six months ended June 30, 2006 as the income utilized a substantial portion of the deferred tax assets. The provision for income tax for the six months ended June 30, 2006 was based on federal and state alternative minimum income tax payable on taxable income. Although we incurred pre-tax losses in six months ended June 30, 2006, the sums received from Sony Computer Entertainment and interest thereon included in long term deferred revenue, approximating $6.9 million for the first six months of 2006 were taxable, giving rise to an overall taxable profit.

SEGMENT RESULTS FOR THE THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2007 AND 2006

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
Revenues:				
Immersion Computing, Entertainment, and Industrial	$ 4,474	$ 3,229	$ 8,232	$ 6,677
Immersion Medical	4,147	3,475	6,804	6,076
Intersegment eliminations	(26)	(51)	(27)	(68)
Total	$ 8,595	$ 6,653	$ 15,009	$ 12,685
Net Income (Loss):				
Immersion Computing, Entertainment, and Industrial	$ 152	$ (2,464)	$ 123,442	$ (5,103)
Immersion Medical	23	95	(839)	(183)
Intersegment eliminations	1	(10)	6	1
Total	$ 176	$ (2,379)	$ 122,609	$ (5,285)

* Segment assets and expenses relating to our corporate operations are not allocated but are included in Immersion Computing, Entertainment, and Industrial as that is how they are considered for management

evaluation purposes. As a result the segment information may not be indicative of the financial position or results of operations that would have been achieved had these segments operated as unaffiliated entities.

Immersion Computing, Entertainment, and Industrial segment Revenues from the Immersion Computing, Entertainment, and Industrial segment were $4.5 million, an increase of $1.3 million or 39% in the second quarter of 2007 compared to the same period in 2006. Royalty and license revenues increased by $1.1 million, mainly due to new royalty and license revenue from Sony Computer Entertainment, a first-party peripheral licensee, which was offset in part by a decrease in royalty and license revenue from our third-party peripheral licensees of royalty bearing gaming peripherals, and an increase in touch interface product royalties from the expansion of products licensed by us in the automotive market and the recognition of certain royalty payments during the second quarter. Development contract revenues increased by $217,000, primarily due to increased revenue from mobile device contracts, partially offset by a decrease in touch interface product development contracts. Product sales decreased by $100,000, mainly due to decreased sales of our 3D products including our MicroScribe, CyberGrasp, and CyberGlove products, partially offset by an increase in product sales from touch interface products, including sales of rotary modules. Net income for the three months ended June 30, 2007 was $152,000, an improvement of $2.6 million compared to the same period in 2006. The increase was primarily due to an increase in interest and other income of $1.7 million, an increase in benefit for income taxes $1.5 million, and increased gross margin of $1.0 million. The increases were partially offset by an increase of general and administrative expenses of $955,000, the reduction of litigation settlements of $400,000 from Electro Source in 2006, and an increase in research and development expenses of $138,000.

Revenues for the first six months of fiscal 2007 increased by $1.6 million, or 23% as compared to the same period last year for the Immersion Computing, Entertainment, and Industrial segment. Royalty and license revenue increased by $1.4 million, mainly due to increased gaming royalties and increased royalties and license fees from our touch interface product licensees as noted above; development contract revenue increased by $379,000, primarily due to increased revenue from mobile device contracts, offset in part by a reduction in revenue on touch interface products contracts; and product sales decreased by $253,000, mainly due to decreased sales of our 3D products partially offset by an increase in touch interface product sales. Net income for the six months ended June 30, 2007 was $123.4 million, an improvement of $128.5 million compared to the same period in 2006. The increase was primarily due to the litigation conclusions and patent license income of $134.9 million (Sony Computer Entertainment of $119.9 million and from Microsoft of $15.0 million), increased interest and other income of $2.0 million, increased gross margin of $1.3 million and a decrease in sales and marketing expenses of $189,000. The increases were partially offset by increased provision for income taxes of $6.9 million, an increase in general and administrative expenses of $1.4 million, the reduction of litigation settlements of $1.1 million from Electro Source in 2006, and an increase of research and development expenses of $367,000.

Immersion Medical segment Revenues from Immersion Medical were $4.1 million, an increase of $672,000 or 19%, for the second quarter of 2007 compared to the same period in 2006. The increase was primarily due to an increase of $1.4 million in product sales partially offset by a decrease of $692,000 in development contract revenue and a decrease in medical license fees of $83,000. Product sales increased primarily due to increased sales of our endovascular, endoscopy, and Virtual IV simulators. The product sales increase was a result of pursuing a product growth strategy for our medical business, which includes developing new products, leveraging our industry alliances, and expanding international sales. Development contract revenue decreased due to the completion of work performed under a government contract and a decrease in commercial contract revenue. Net income for the three months ended June 30, 2007 was $23,000, a decrease of $72,000 or 76% compared to the same period in 2006. The decline was mainly due to increased operating expenses of $374,000 partially offset by increased gross margin of $305,000. The increased operating expenses included increased research and development expenses of $573,000 partially offset by decreased general and administrative expenses of $129,000 and decreased sales and marketing expenses of $71,000.

Revenues from Immersion Medical were $6.8 million, an increase of $728,000 or 12%, for the first six months of 2007 compared to the same period in 2006. The increase was primarily due to an increase of $1.8 million in product sales partially offset by a decrease of $1.0 million in development contract revenue, and a decrease in medical license fees of $83,000. Product sales increased primarily due to increased sales of our endovascular, endoscopy, and Virtual IV simulators. The product sales increase was a result of our continued pursuit of a product growth strategy for our medical business as noted above. Development contract revenue decreased due to the completion of work performed under a government contract. Net loss for the six months ended June 30, 2007 was $839,000, an increase of $656,000 compared to the same period in 2006. The increased loss was mainly due to increased operating expenses of $839,000 partially offset by increased gross margin of $189,000. The increased operating expenses included increased research and development expenses of $1.2 million partially offset by decreased sales and marketing expenses of $164,000 and decreased general and administrative expenses of $155,000.

LIQUIDITY AND CAPITAL RESOURCES

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

On June 30, 2007 our cash, cash equivalents, and short-term investments totaled $135.5 million, an increase of $103.5 million from $32.0 million on December 31, 2006.

In March 2007, we concluded our patent infringement litigation against Sony Computer Entertainment at the U.S. Court of Appeals for the Federal Circuit. In satisfaction of the Amended Judgment, we received funds totaling $97.3 million, inclusive of the award for past damages, pre-judgment interest and costs, and post-judgment interest. Additionally, we retained $32.4 million of compulsory license fees and interest thereon previously paid to us by Sony Computer Entertainment pursuant to Court Orders. Furthermore, we entered into a new business agreement. Under the new business agreement 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 June 30, 2007 we have received two of these installments.

We have determined that the conclusion of our litigation with Sony Computer Entertainment does not trigger any payment obligations under our Microsoft agreements as noted in Note 8 to the condensed consolidated financial statements. Accordingly, the liability of $15.0 million that was in the financial statements at December 31, 2006 had been extinguished, and we have accounted for this sum as litigation conclusions and patent license income in the three-month period ended March 31, 2007. However, in a letter sent to us dated May 1, 2007, Microsoft disputed our position and stated that it believes we owe Microsoft at least $27.5 million. On June 18, 2007, Microsoft filed a complaint against us in the U.S. District Court for the Western District of

Washington alleging one claim for breach of a contract. We dispute Microsoft s allegations and intend to vigorously defend ourselves. See Contingencies Note 15 to the condensed consolidated financial statements. The results of any litigation are inherently uncertain, and there can be no assurance that our position will prevail.

In December 2004, we issued an aggregate principal amount of $20.0 million of 5% Convertible Debentures. The 5% Convertible Debentures were due to mature on December 22, 2009. The amount payable at maturity of each 5% Convertible Debenture was the initial principal plus all accrued but unpaid interest thereon, to the extent such principal amount and interest has not been converted into common stock or previously paid in cash. Our 5% Convertible Debentures accrued interest at 5% per annum. Accordingly, we were required to make interest payments in the amount of $1.0 million per annum until such time as the 5% Convertible Debentures were either converted to common stock or matured. If the closing bid price of our common stock was at or above $14.053 for at least 20 consecutive trading days, and certain other conditions are met, we had the right to (i) require the holder of a 5% Convertible Debenture to convert the 5% Convertible Debenture in whole, including interest, into shares of our common stock at a price of $7.0265 per common share, as may be adjusted under the debenture, as set forth and subject to the conditions in the 5% Convertible Debenture, or (ii) redeem the 5% Convertible Debenture. If we made either of the foregoing elections with respect to any 5% Convertible Debenture, we must make the same election with respect to all 5% Convertible Debentures. As of July 26, 2007, the closing bid price of our common stock exceeded $14.053 for 20 consecutive trading days and the holders of the 5% Convertible Debentures were notified that we intended to effect the Mandatory Redemption. The 5% Convertible Debentures ceased to accrue further interest upon our election to effect the Mandatory Redemption. See Note 16 to the condensed consolidated statements regarding subsequent event.

Net cash provided by operating activities during the six months ended June 30, 2007 was $93.8 million, a change of $90.4 million from the $3.4 million provided during the six months ended June 30, 2006. Cash provided by operations during the six months ended June 30, 2007 was primarily the result of our net income of $122.6 million, an increase of $7.3 million due to a change in income taxes payable, an increase of $464,000 due to a change in accrued compensation and other current liabilities, and an increase of $269,000 due to a change in prepaid expenses and other current assets. These increases were offset by a $28.9 million decrease due to a change in deferred revenue and customer advances mainly related to the conclusion of our patent litigation with Sony Computer Entertainment and the extinguishment of the customer advance from Microsoft, a decrease of $5.4 million due to a change in deferred income taxes, an decrease of $1.5 million due to a change in accounts receivable, a decrease of $1.2 million due to a change in accounts payable due to the timing of payments to vendors and a decrease of $425,000 due to a change in inventories. Cash provided by operations during the six months ended June 30, 2007 was also impacted by noncash charges and credits of $613,000, including a credit of $1.9 million from excess tax benefits from stock-based compensation, partially offset by $1.2 million of noncash stock-based compensation, $496,000 in amortization of intangibles, $430,000 in depreciation, and $316,000 in accretion expenses on our 5% Convertible Debentures.

Net cash used in investing activities during the six months ended June 30, 2007 was $26.4 million, compared to the $1.3 million used in investing activities during three months ended June 30, 2006, an increase of $25.1 million. Net cash used in investing activities during the period consisted of an increase in purchases of short-term investments of $24.9 million, an $833,000 increase in other assets, primarily due to capitalization of external patent filing and application costs, and $656,000 used to purchase capital equipment.

Net cash provided by financing activities during the six months ended June 30, 2007 was $10.3 million compared to $571,000 provided during the six months ended June 30, 2006, or a $9.8 million increase 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 in the amount of $8.5 million, and an increase of $1.9 million from excess tax benefits from tax deductible stock-based compensation.

We believe that our cash and cash equivalents will be sufficient to meet our working capital needs for at least the next twelve months. We will continue to protect and defend our extensive intellectual property portfolio across all business segments. We anticipate that capital expenditures for the year ended December 31, 2007 will total approximately $1.5 million in connection with anticipated maintenance and upgrades to operations and infrastructure. Additionally, if we acquire one or more businesses, patents, or products, our cash or capital requirements could increase substantially. In the event of such an acquisition, or should any unanticipated circumstances arise that significantly increase our capital requirements, we may elect to raise additional capital through debt or equity financing. Any of these events could result in substantial dilution to our stockholders. Although we expect to be able to raise additional capital if necessary, there is no assurance that such additional capital will be available on terms acceptable to us, if at all.

SUMMARY DISCLOSURES ABOUT CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The following table reflects a summary of our contractual cash obligations and other commercial commitments as of December 31, 2006, excluding our 5% Convertible Debenture:

Table of Contents

Contractual Obligations	Total	2007	2008 and 2009	2010 and 2011
		(In thousands)		
Operating leases	$ 2,951	$ 994	$ 1,638	$ 319

As of December 31, 2006 we had contractual obligations for outstanding principal and interest of $23.0 million due on our 5% Convertible Debentures. On July 27, 2007 we announced that we had notified the holders of the 5% Convertible Debentures, due in 2009, of our intent to redeem all of the 5 % Convertible Debentures in full as per the Mandatory Redemption of 5% Convertible Debentures discussed in Note 6 to the condensed consolidated financial statements. Approximately $20.1 million of principal and accrued interest is outstanding under the 5% Convertible Debentures. Under the terms of the 5% Convertible Debentures, once the closing bid price of our common stock exceeds $14.053 per share for 20 consecutive trading days, we may redeem the 5% Convertible Debentures at the end of a 30-day notice period. Prior to the end of the 30-day period, the holders of the 5% Convertible Debenture may elect to convert the principal and accrued interest outstanding into shares of our common stock at a conversion price of $7.0265 per share.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2006, the FASB issued FIN 48, Accounting for Uncertainty in Income Taxes. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 prescribes a two-step process to determine the amount of benefit to be recognized. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon examination. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. We adopted the provisions of FIN 48 on January 1, 2007. The adoption of FIN 48 resulted in no adjustment to beginning retained earnings as we had a full valuation allowance on the deferred tax asset as of the adoption date.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 establishes a framework for measuring fair value by providing a standard definition of fair value as it applies to assets and liabilities. SFAS No. 157, which does not require any new fair value measurements, clarifies the application of other accounting pronouncements that require or permit fair value measurements. The effective date for us is January 1, 2008. We are currently evaluating the effect that the adoption of SFAS No. 157 will have on our financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. The new Statement allows entities to choose, at specified election dates, to measure eligible financial assets and liabilities at fair value in situations in which they are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item s fair value in subsequent reporting periods must be recognized in current earnings. SFAS No. 159 also establishes presentation and disclosure requirements designed to draw comparison between entities that elect different measurement attributes for similar assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Early adoption is permitted subject to specific requirements outlined in the new Statement. We are currently evaluating the effect that the adoption of SFAS No. 159 will have on our financial position and results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have limited exposure to financial market risks, including changes in interest rates. The fair value of our investment portfolio or related income would not be significantly impacted by a 100 basis point increase or decrease in interest rates due mainly to the short-term nature of the major portion of our investment portfolio. An increase or decrease in interest rates would not significantly increase or decrease interest expense on debt obligations due to the fixed nature of our debt obligations. Our foreign operations are limited in scope and thus we are not materially exposed to foreign currency fluctuations.

As of June 30, 2007, we had outstanding $20.0 million of fixed rate long-term convertible debentures. The holder of a 5% Convertible Debenture had the right to convert the outstanding principal amount, and accrued and unpaid interest, in whole or in part into our common stock at a price of $7.0265 per common share, the Conversion Price. In the event of a change of control, a holder could require us to redeem all or a portion of their 5% Convertible Debenture. This is referred to as the Put Option. The redeemed portion shall be redeemed at a price equal to the redeemed amount multiplied by 100% of the principal amount of the 5% Convertible Debenture. If the closing bid price of our common stock was at or above $14.053 for at least 20 consecutive trading days and certain other conditions are met, we had the right to (i) require the holder of a 5% Convertible Debenture to convert the debenture in whole, including interest, into shares of our common stock at a price of $7.0265 per common share, as may be adjusted under the debenture, as set forth and subject to the conditions in the 5% Convertible Debenture, or (ii) redeem the 5% Convertible Debenture. If we made either of the foregoing elections with respect to any 5% Convertible Debenture, we must make the same election with respect to all 5% Convertible Debentures. As of July 26, 2007 the closing bid price of our common stock exceeded $14.053 for 20 consecutive trading days and on July 27, 2007, the holders of the 5% Convertible Debentures were notified that we intended to effect the Mandatory Redemption (see Note 16 to the condensed consolidated statements regarding subsequent event).

ITEM 4. CONTROLS AND PROCEDURES

Based on their evaluation as of June 30, 2007, our management with the participation of our Chief Executive Officer and Chief Financial Officer, have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were sufficiently effective to ensure that the information required to be disclosed by us in this quarterly report on Form 10-Q was recorded, processed, summarized and reported within the time periods specified in the SEC s rules for Form 10-Q.

There were no changes to internal controls over financial reporting during the quarter ended June 30, 2007 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

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

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 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 Court ruled on all defendants motions to dismiss. The motion was denied as to claims under the Securities Act of 1933 in the case involving us as well as in all other cases (except for 10 cases). The motion was denied as to the claim under Section 10(b) as to us, on the basis that the complaint alleged that we had made acquisition(s) following the IPO. The motion was granted as to the claim under Section 10(b), but denied as to the claim under Section 20(a), as to the remaining individual defendant.

We and most of the issuer defendants have settled with the plaintiffs. In this settlement, plaintiffs have dismissed and released all claims against the Immersion Defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of certain claims we may have against the underwriters. The Immersion Defendants will not be required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeds the amount of the insurance coverage, a circumstance which we believe is remote. The settlement will require approval of the Court, which cannot be assured, after class members are given the opportunity to object to the settlement or opt out of the settlement.

In September 2005, the Court granted preliminary approval of the settlement. The Court held a hearing to consider final approval of the settlement on April 24, 2006, and took the matter under submission. Before the Court issued a final decision on the settlement, on December 5, 2006 the United States Court of Appeals for the Second Circuit vacated the class certification of plaintiffs claims against the underwriters in six cases designated as focus or test cases. *Miles v. Merrill Lynch & Co. (In re Initial Public Offering Securities Litigation).* Thereafter, on December 14, 2006, the Court ordered a stay of all proceedings in all of the lawsuits pending the outcome of plaintiffs petition to the Second Circuit Court of Appeals for a rehearing en banc and resolution of the class certification issue. On April 6, 2007, the Second Circuit Court of Appeals denied plaintiffs petition for a rehearing, but clarified that the plaintiffs may seek to certify a more limited class. Accordingly, the plaintiffs and issuers have stated that they are prepared to discuss how the settlement might be amended or renegotiated to comply with the decision of the Second Circuit Court of Appeals. On April 30, 2007, Plaintiffs stated that they intend to present a proposed redefined class to the Court. If the settlement is not amended or renegotiated and then approved by the Court, we cannot be assured that we will prevail in the lawsuit.

Immersion Corporation vs. Microsoft Corporation, Sony Computer Entertainment Inc. and Sony Computer Entertainment of America, Inc.

On February 11, 2002, we filed a complaint against Microsoft Corporation, Sony Computer Entertainment, Inc., and Sony Computer Entertainment of America, Inc. in the U.S. District Court for the Northern District Court of California alleging infringement of U.S. Patent Nos. 5,889,672 and 6,275,213. On July 28, 2003, we announced that we had settled our legal differences with Microsoft, and both parties agreed to dismiss all claims and counterclaims relating to this matter as well as assume financial responsibility for their respective legal costs with respect to the lawsuit between us and Microsoft.

On September 21, 2004, after a trial, the jury returned its verdict in favor of us. The jury found all the asserted claims of the patents valid and infringed. The jury awarded us damages in the amount of $82.0 million. On March 24, 2005, Judge Wilken entered judgment in our favor and awarded us $82.0 million in past damages, and pre-judgment interest in the amount of $8.9 million, for a total of $90.9 million. We were also awarded certain court costs. Court costs do not include attorneys fees. Additionally, the Court issued a permanent injunction against the manufacture, use, sale, or import into the United States of the infringing Sony PlayStation system consisting of the PlayStation consoles, Dual Shock controllers, and the 47 games found by the jury to infringe our patents. The Court stayed the permanent injunction pending appeal to the United States Court of Appeals for the Federal Circuit. The Court further ordered Sony Computer Entertainment to pay a compulsory license fee at the rate of 1.37% for the duration of the stay of the permanent injunction at the same rate and conditions as previously awarded in its interim January 10, 2005 and February 9, 2005 Orders. On April 7, 2005, pursuant to a stipulation of the parties, the Court entered an Amended Judgment to clarify that the Judgment in favor of us and against Sony Computer Entertainment also encompassed Sony Computer Entertainment s counterclaims for declaratory relief on invalidity and unenforceability, as well as non-infringement.

On March 1, 2007, Sony Computer Entertainment withdrew and moved to dismiss its appeals from the District Court s April 7, 2005 Amended Judgment (and all interlocutory orders merged in the Amended Judgment). On March 2, 2007, Sony Computer Entertainment withdrew and moved to dismiss its appeal from the District Court s March 8, 2006 order denying Sony Computer Entertainment s motion for relief from final judgment under Rule 60(b) of the Federal Rules of Civil Procedure. On March 8, 2007, the Federal Circuit dismissed the Sony Computer Entertainment Rule 60(b) appeal. On March 14, 2007 the Federal Circuit dismissed the Sony Computer Entertainment appeal of Amended Judgment (and all interlocutory orders merged in the Amended Judgment). In accordance with the Amended Judgment, we received funds totaling $97.3 million in satisfaction of the judgment for past damages for sales and other activities with respect to the infringing Sony PlayStation system consisting of the PlayStation consoles, Dual Shock controllers, and the 47 games found by the jury to infringe our patents, pre-judgment interest and costs, and post-judgment interest. Additionally, we retained $32.4 million of compulsory license fees and interest thereon previously paid to us by Sony Computer Entertainment ($27.9 million in long-term deferred revenue on December 31, 2006 and $4.5 million received subsequent to year end.) On March 19, 2007, we lodged with the court a Notice of Satisfaction of Judgment, indicating that Sony Computer Entertainment had satisfied and discharged the judgment that the court had entered. On March 19, 2007, pursuant to a Stipulation lodged with the court, Judge Wilken entered an order dissolving the permanent injunction.

On May 17, 2005, Sony Computer Entertainment filed a Request for Inter Partes Reexamination of the 333 Patent with the United States Patent and Trademark Office (PTO). On May 19, 2005, Sony Computer Entertainment filed a similar Request for reexamination of the 213 Patent. On March 27, 2007, we filed a petition to terminate the inter partes reexamination on the grounds that the District Court judgment was final and non-appealable. On June 5, 2007, the USPTO granted our petition to terminate the inter partes proceedings.

Internet Services LLC Litigation

On October 20, 2004, Internet Services LLC (ISLLC) filed claims against us in our lawsuit against Sony Computer Entertainment, alleging that we breached a contract with ISLLC by suing Sony Computer Entertainment for patent infringement relating to haptically-enabled software whose topics or images are allegedly age-restricted, for judicial apportionment of damages between ISLLC and us of the damages awarded by the jury, and for a judicial declaration with respect to ISLLC s rights and duties under agreements with us. On December 29, 2004, the Court issued an order dismissing ISLLC s claims against Sony Computer Entertainment with prejudice and dismissing ISLLC s claims against us without prejudice to ISLLC filing a new complaint if it can do so in good faith without contradicting, or repeating the deficiency of, its complaint.

On January 12, 2005, ISLLC filed Amended Cross-Claims and Counterclaims against us that contained similar claims. ISLLC also realleged counterclaims against Sony Computer Entertainment. On January 28, 2005, we filed a motion to dismiss ISLLC s Amended Cross-Claims and a motion to strike ISLLC s Counterclaims against Sony Computer Entertainment. On March 24, 2005 the Court issued an order dismissing ISLLC s claims with prejudice as to ISLLC s claim seeking a declaratory judgment that it is an exclusive licensee under the 213 and 333 patents and as to ISLLC s claim seeking judicial apportionment of the damages verdict in the Sony Computer Entertainment case. The Court s order further dismissed ISLLC s claims without prejudice as to ISLLC s breach of contract and unjust enrichment claims.

ISLLC filed a notice of appeal of the District Court orders with the United States Court of Appeals for the Federal Circuit on April 18, 2005. On April 4, 2007, the Federal Circuit issued its opinion, affirming the District Court orders.

On February 8, 2006, ISLLC filed a lawsuit against us in the Superior Court of Santa Clara County. ISLLC s complaint seeks a share of the damages awarded to us in the March 24, 2005 Judgment and of the Microsoft settlement proceeds, and generally restates the claims already adjudicated by the District Court. On March 16, 2006, we answered the complaint, cross claimed for breach of contract by ISLLC and rescission of the contract, and removed the lawsuit to federal court. The case was assigned to Judge Wilken as a case related to the previous proceedings involving Sony Computer Entertainment and ISLLC. ISLLC filed its answer to our cross claims on April 27, 2006. ISLLC also moved to remand the case to Superior Court. On July 10, 2006, Judge Wilken issued an order denying ISLLC s motion to remand. On September 5, 2006, Judge Wilken granted the stipulated request by the parties to stay discovery and other proceedings in the case pending the disposition of ISLLC s appeal from the Court s previous orders. The case was stayed from December 1, 2006 pending the Federal Circuit s disposition on the appeal. As noted above, the Federal Circuit issued its opinion on April 4, 2007, and entered a judgment affirming the District Court s previous orders. On April 23, 2007, ISLLC filed in the Federal Circuit a Petition for Panel Rehearing and a Motion to Extend Time. ISLLC argued that the Court should rehear the matter or correct and/or clarify the April 4, 2007 opinion. On May 7, 2007, the Federal Circuit denied ISLLC s petition.

On May 10, 2007, ISLLC filed a motion in the District Court to remand its latest action to the Superior Court or in the alternative for leave to file an amended complaint to remove the declaratory relief claim. Immersion opposed ISLLC s motion, and cross-moved for judgment on the pleadings on the grounds that ISLLC s claims are barred by res judicata and collateral estoppel. On June 26, 2007, the Court ruled on the motions, denying ISLLC s motion to remand or for leave to file an amended complaint, and granting in part Immersion s motion for judgment on the pleadings. The Court dismissed ISLLC s claim for declaratory relief. ISLLC s claims for breach of contract, promissory fraud, and constructive trust, to the extent not inconsistent with the Court s previous rulings, remain.

We intend to defend ourselves vigorously against ISLLC s allegations. The parties participated in a court ordered mediation on March 12, 2007, but were unsuccessful in resolving the matter.

Immersion Corporation vs. Thorner

On March 24, 2006, we filed a lawsuit against Mr. Craig Thorner in Santa Clara County Superior Court. The complaint alleges claims for breach of contract with respect to Thorner s license to a third party of U.S. Patent No. 5,684,722, which we have alleged is in violation of contractual obligations to it. The case was removed to federal court by Mr. Thorner, and has been assigned to Judge Jeremy Fogel. On May 1, 2006, Mr. Thorner filed an answer to our claims and asserted counterclaims against us seeking, among other things, a portion of the proceeds from our license with Microsoft, under theories of alleged breach of contract, breach of the implied covenant of good faith and fair dealing, fraud, promissory fraud, breach of fiduciary duty, and negligent misrepresentation. On July 28, 2006, we filed a motion for judgment on the pleadings seeking the dismissal of Mr. Thorner s breach of contract and fraud claims which allege a right to a portion of the proceeds from our license with Microsoft. On September 1, 2006, the Court held a hearing on our motion. On September 12, 2006, the Court issued an order granting our motion for judgment on the pleadings as to Mr. Thorner s alleged claims for breach of contract and fraud. The Court dismissed Mr. Thorner s breach of contract and fraud claims, and allowed Mr. Thorner leave to amend his claim for alleged breach of contract with respect to alleged violations of our reporting requirements that do not flow from the failure to report the Microsoft Settlement Agreement.

The parties participated in a court-ordered mediation on November 7, 2006, but were not successful in resolving the matter. The parties are in the process of conducting discovery.

On November 22, 2006, Thorner brought a motion for summary judgment arguing that our breach of contract claim was barred by the doctrine of judicial estoppel as a result of a statement made in connection with the Sony Computer Entertainment Rule 60 (b) motion. On January 26, 2007, the Court held a hearing on Thorner s motion. On January 29, 2007, the Court issued an order denying Thorner s summary judgment motion, ruling that our breach of contract claim was not barred by judicial estoppel. On February 5, 2007, with leave of Court, we filed a First Amended Complaint in the action to add Thorner s company, Virtual Reality Feedback Corporation (VRF), as a party-defendant. On February 9, 2007, Thorner filed an Amended Answer and Counterclaims. The Amended Counterclaims against us dropped the previously-dismissed counterclaims based on Thorner s claims for a share of our settlement with Microsoft, but alleged other counterclaims for alleged Breach of Contract, Breach of the Implied Covenant of Good Faith and Fair Dealing, Promissory Fraud, Breach of Fiduciary Duty, Negligent Misrepresentation and Rescission. Thorner alleged in part that we breached our agreement with Thorner by failing to pay royalties for Vibetonz Studio SDK and Immersion Studio for Gaming; that we breached alleged duties to Thorner to license the 722 patent; and that Thorner s agreement with us should be rescinded. Thorner s Amended Counterclaim does not specify an amount of damages sought but alleges that Thorner has been damaged in an amount to be proven at trial. We dispute Thorner s allegations and intend to vigorously oppose them.

On June 27, 2007, the parties informed the Court that they had reached an agreement in principle to resolve the case and requested that the Court vacate dates in the case. The parties requested a status conference in the event that the matter was not finally resolved. On July 3, 2007, the Court entered an Order approving the stipulation, vacating pending dates in the action, and setting September 7, 2007 as a date for a further status conference.

Faro Technologies Inc. v. Immersion Corporation

On May 3, 2007, Faro sued us in the Eastern District of Pennsylvania. The complaint alleges patent infringement of Faro s 5,402,582 patent by our MicroScribe X product. We were not served with the complaint. On August 2, 2007, Faro filed a voluntary dismissal without prejudice of the complaint.

Microsoft Corporation v. Immersion Corporation.

On June 18, 2007, Microsoft filed a complaint against us in the U.S. District Court for the Western District of Washington alleging one claim for breach of a contract. Microsoft alleges that we breached a Sublicense Agreement executed in connection with the parties settlement of litigation in 2003 (see discussion above regarding settlement with Microsoft). The complaint alleges that Microsoft is entitled to a share of the judgment monies and other sums received from Sony Computer Entertainment. In a letter sent to us dated May 1, 2007, Microsoft stated that it believes we owe Microsoft at least $27.5 million. We were served with the complaint on July 6, 2007; its response is due on September 4, 2007. We dispute Microsoft s allegations and intend to vigorously defend ourselves.

ITEM 1A. RISK FACTORS

Company Risks

WE HAD AN ACCUMULATED DEFICIT OF $15 MILLION AS OF JUNE 30, 2007, HAVE A HISTORY OF LOSSES, MAY EXPERIENCE LOSSES IN THE FUTURE, AND MAY NOT ACHIEVE OR MAINTAIN PROFITABILITY IN THE FUTURE.

Since 1997, we have incurred losses in all but the two most recent quarters. We need to generate significant ongoing revenue to maintain profitability. We anticipate that our expenses will increase in the foreseeable future as we:

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

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

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 distracting to management 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 and our licensees 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 could not develop non-infringing technologies or license the infringed or similar technologies on a timely and cost-effective basis, our expenses would increase and our revenues could decrease.

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

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

The legal principles applicable to patents and patent licenses continue to change and evolve. 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.

MICROSOFT DISPUTES OUR ASSESSMENT THAT WE ARE NOT OBLIGATED UNDER OUR AGREEMENT WITH THEM TO MAKE ANY PAYMENT TO THEM RELATING TO THE CONCLUSION OF OUR LITIGATION WITH SONY COMPUTER ENTERTAINMENT. DEFENDING OUR POSITION MAY BE EXPENSIVE, DISRUPTIVE, AND TIME CONSUMING, AND REGARDLESS OF WHETHER WE ARE SUCCESSFUL, COULD ADVERSELY AFFECT OUR BUSINESS.

In 2003, we executed a series of agreements with Microsoft as described in Note 8 to the condensed consolidated financial statements that provided for settlement of our lawsuit against Microsoft as well as various licensing, sublicensing, and equity and financing arrangements under the Microsoft sublicensing agreement. In the event that we elected to settle the action in the United States District Court for the Northern District of California entitled Immersion Corporation v. Sony Computer Entertainment of America, Inc., Sony Computer Entertainment Inc. and Microsoft Corporation, Case No. C02-00710 CW (WDB), as such action pertains to Sony Computer Entertainment, we would be obligated to pay Microsoft a minimum of $15.0 million for amounts up to $100 million received from Sony Computer Entertainment on account of our granting certain rights, plus 25% of amounts over $100.0 million up to $150.0 million, and 17.5% of amounts over $150.0 million. In March 2007, we announced the conclusion of our patent infringement litigation against Sony Computer Entertainment at the U.S. Court of Appeals for the Federal Circuit. Sony Computer Entertainment satisfied the District Court judgment against it. As of March 19, 2007, we and Sony Computer Entertainment entered into a new business agreement. We have determined that we are not obligated under our agreements with Microsoft to make any payment to Microsoft relating to the conclusion of our litigation with Sony Computer Entertainment. However, in a letter sent to us dated May 1, 2007, Microsoft disputed our position and stated that it believes we owe Microsoft at least $27.5 million. Further, on June 18, 2007, Microsoft filed a complaint against us in the U.S. District Court for the Western District of Washington alleging we are in breach of our contract with Microsoft and that Microsoft is entitled to a share of the judgment monies and other sums we received from Sony. We dispute Microsoft s allegations and intend to vigorously defend ourselves in the lawsuit. The results of any litigation are inherently uncertain, and there can be no assurance that our position will prevail.

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 involved in litigation with ISLLC involving claims for breach of contract and rescission against ISLLC in the U.S. District Court for the Northern District of California.

We are involved in litigation with Mr. Craig Thorner in the U.S. District Court for the Northern District of California relating to our allegations of breach of contract with respect to Thorner s license to a third party of U.S. Patent No. 5,684,722 and his allegations of breach of contract, breach of the implied covenant of good faith and fair dealing, promissory fraud, breach of fiduciary duty, negligent misrepresentation, and rescission.

We are also involved in litigation against Microsoft. Microsoft s complaint against us alleges that we are in breach of the Sublicense Agreement executed in support of the parties settlement of litigation in 2003. The complaint alleges that Microsoft is entitled to a share of the judgment monies and other sums received from Sony Computer Entertainment at the conclusion of our patent litigation against Sony Computer Entertainment.

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 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 litigation, please see Note 15 to the condensed consolidated financial statements and the section titled Item 1. Legal Proceedings.

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 (a) claims that we have granted rights to one licensee which are inconsistent with the rights that we have granted to another licensee, and/or (b) claims by one licensee against another licensee that may result in our incurring indemnification or other obligations or liabilities.

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.

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. Any claims against us 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 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. We have not experienced any product liability claims to date. 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.

IF THE SETTLEMENT ON OUR CURRENT CLASS ACTION LAWSUIT FALLS THROUGH, THE CONTINUING LAWSUIT COULD BE EXPENSIVE, DISRUPTIVE, AND TIME CONSUMING TO DEFEND AGAINST, AND IF WE ARE NOT SUCCESSFUL, COULD ADVERSELY AFFECT OUR BUSINESS.

We are involved in legal proceedings relating to a class action lawsuit filed on November 9, 2001, related to In re Initial Public Offering Securities Litigation. The named defendants are Immersion and three of our current or former officers or directors and certain underwriters of our November 12, 1999 IPO. Subsequently, two of the individual defendants stipulated to a dismissal without prejudice. We and most of the issuer defendants have settled with the plaintiffs. However, the settlement requires approval by the Court, which cannot be assured, after class members are given the opportunity to object to the settlement or opt out of the settlement.

IF OUR FACILITIES WERE TO EXPERIENCE CATASTROPHIC LOSS, OUR OPERATIONS WOULD BE SERIOUSLY HARMED.

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

Industry and Technology Risks

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 June 30, 2007 and 2006, 32% and 26%, respectively, of our total revenues were royalty and license revenues. For the six months ended June 30, 2007 and 2006, 33% and 28%, respectively, of our total revenues were royalty and license revenues. However, 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. 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, meet quality control standards, achieve commercial acceptance, or 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. Products incorporating our touch-enabling technologies are generally more difficult to design and manufacture, which may cause product introduction delays or quality control problems. If our licensees fail to stimulate and capitalize upon market demand for products that generate royalties for us, or if products are recalled because of quality control problems, our revenues will not grow and could decline. Alternatively, if a product that incorporates our touch-enabling technologies achieves widespread market acceptance, the product manufacturer may elect to stop making it rather than pay us royalties based on sales of the product.

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.

A significant proportion 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. These requirements and restrictions could be in the form of hardware technical specifications, software technical specifications, security specifications or other security mechanisms, component vendor specifications, licensing terms and conditions, or other forms. 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. Sony announced on May 8, 2006 that the vibration feature that is currently available on controllers for PlayStation and PlayStation 2 would be removed from the new PlayStation 3 controller. The PlayStation 3 console system was launched in late 2006 in the United States and Japan without native vibration or any force feedback capability of any kind. This course of action by Sony has had material adverse consequences on our current and future gaming royalty revenues since our gaming royalties have primarily been from licensed third-party controller products with vibration or force feedback capabilities that require some degree of vibration and/or force feedback support or compatibility in the video console system to be viable products. Sony has since released an update to the PlayStation 3 that offers limited vibration and force feedback support for some older PS1 and PS2 games and PS1 and PS2 rumble and force feedback controllers only. We do not know if this situation might change at some point in the life of the PlayStation 3 console system, or whether or to what extent the PlayStation 3 console will be compatible with or support rumble or force feedback in PS3 games or PS3 controllers.

Both the recently launched 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 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 wheels covered by their royalty-free, perpetual, irrevocable license to our worldwide portfolio of patents that are in competition with our licensees 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 AND MAY FURTHER DECLINE 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.

LAERDAL MEDICAL CORPORATION (LAERDAL) ACCOUNTS FOR A SIGNIFICANT PORTION OF OUR REVENUES AND A REDUCTION IN SALES TO LAERDAL MAY REDUCE OUR TOTAL REVENUE.

Laerdal accounts for a significant portion of our revenue. For the three months ended June 30, 2007 and 2006, 12% and 8%, respectively, of our total revenues were derived from Laerdal. For the six months ended June 30, 2007 and 2006, 12% and 4%, respectively, of our total revenues were derived from Laerdal. If our product sales to Laerdal decline, then our total revenue may decline.

MEDTRONIC ACCOUNTS FOR A SIGNIFICANT PORTION OF OUR REVENUES AND A REDUCTION IN SALES TO MEDTRONIC, OR A REDUCTION IN DEVELOPMENT WORK FOR MEDTRONIC, MAY REDUCE OUR TOTAL REVENUE.

Medtronic accounts for a significant portion of our revenue. For the three months ended June 30, 2007 and 2006, 11% and 9%, respectively, of our total revenues were derived from Medtronic. For the six months ended June 30, 2007 and 2006, 9% and 8%, respectively, of our total revenues were derived from Medtronic. If our product sales to Medtronic decline, and/or Medtronic reduces the development activities we perform, then our total revenue may decline.

TOUCH INTERFACE PRODUCT ROYALTIES WILL BE REDUCED IF BMW WERE TO ABANDON ITS IDRIVE SYSTEM OR REMOVE OUR TECHNOLOGY FROM THE IDRIVE.

Our largest royalty stream from touch interface products is currently from BMW for its iDrive controller. Press reviews of this system have been largely negative and critical of the system s complex user interface, which we did not design. Nevertheless, this negative press may cause BMW to abandon the iDrive controller or to redesign it and/or remove our technology from it at any time. If our technology is not incorporated in the BMW vehicles our business may suffer.

WE DEPEND ON THIRD-PARTY SUPPLIERS, AND OUR REVENUE AND/OR RESULTS OF OPERATIONS COULD SUFFER IF WE FAIL TO MANAGE SUPPLIER ISSUES PROPERLY.

Our operations depend on our ability to anticipate our needs for components and products for a wide variety of systems, products, and services, and on our suppliers ability to deliver sufficient quantities of quality components, products, and services at reasonable prices in time for us to meet critical schedules. We may experience a shortage of, or a delay in receiving, certain supplies as a result of strong demand, capacity constraints, supplier financial weaknesses, disputes with suppliers, other problems experienced by suppliers, or problems faced during the transition to new suppliers. If shortages or delays persist, the price of these supplies may increase, we may be exposed to quality issues, or the supplies may not be available at all. We may not be able to secure enough supplies at reasonable prices or of acceptable quality to build products or provide services in a timely manner in the quantities or according to the specifications needed. We could lose time-sensitive sales, incur additional freight costs, or be unable to pass on price increases to our customers. If we cannot adequately address supply issues, we might have to reengineer some products or service offerings, resulting in further costs and delays. We intend to purchase certain products from a limited source in China. If the supply of these products were to be delayed or constrained, or of insufficient quality, we may be unable to find a new supplier on acceptable terms, or at all, or our ability to ship these new products could be delayed, any of which could harm our business, financial condition, and operating results.

Additionally, our use of single source suppliers for certain components could exacerbate our supplier issues. We obtain a significant number of components from single sources due to technology, availability, price, quality, or other considerations. In addition, new products that we introduce may use custom components obtained from only one source initially, until we have evaluated whether there is a need for additional suppliers. The performance of such single source suppliers may affect the quality, quantity, and price of supplies to us. Accordingly, our revenue and/or results of operations could be adversely impacted by such events.

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

On July 1, 2006, the European Union s RoHS Directive became effective. This Directive eliminates most uses of lead, cadmium, hexavalent-chromium, mercury, and certain fire retardants in electronics placed on the market after the effective date. Since the introduction of the European Union s RoHS Directive, other regions of the world have announced or implemented similar regulations. In order to sell products into regions that adopt these or similar regulations, we have to assess each product and determine whether they comply with the requirements of the 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.

In addition, our products or packaging may not meet all safety, electrical, labeling, marking or other requirements of all countries into which we ship products directly or our resellers sell our products. We attempt to comply with all known laws and regulations governing product sales into the countries we ship products. However, if products are determined not to be compliant or exempt, we will not be able to ship them in the region that has such regulations until such time that they are compliant, and this may have a negative impact on our revenue and results of operations. There is also the possibility of fines and legal costs as well as costs associated with a product recall if products or packaging is found not to meet the requirements.

BECAUSE PERSONAL COMPUTER PERIPHERAL PRODUCTS THAT INCORPORATE OUR TOUCH-ENABLING TECHNOLOGIES CURRENTLY MUST 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, and Windows XP operating systems, including DirectX, Microsoft s entertainment API. Modifications and new versions of Microsoft s operating system and APIs (including DirectX and the Windows Vista launched in early 2007) 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.

REDUCED SPENDING BY CORPORATE OR UNIVERSITY RESEARCH AND DEVELOPMENT DEPARTMENTS MAY ADVERSELY AFFECT SALES OF OUR THREE-DIMENSIONAL PRODUCTS.

Any economic downturn could lead to a reduction in corporate or university budgets for research and development in sectors, including the automotive and aerospace sectors, which use our three-dimensional and professional products. Sales of our three-dimensional and professional products, including our CyberGlove line of whole-hand sensing gloves and our MicroScribe line of digitizers, could be adversely affected by cuts in corporate research and development budgets.

COMPETITION BETWEEN OUR PRODUCTS AND OUR LICENSEES PRODUCTS MAY REDUCE OUR REVENUE.

Rapid technological change, short product life cycles, cyclical market patterns, declining average selling prices, and increasing foreign and domestic competition characterize the markets in which we and our licensees compete. 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.

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

WE HAVE EXPERIENCED SIGNIFICANT CHANGE IN OUR BUSINESS, AND OUR FAILURE TO MANAGE THE COMPLEXITIES ASSOCIATED WITH THE CHANGING ECONOMIC ENVIRONMENT AND TECHNOLOGY LANDSCAPE COULD HARM OUR BUSINESS.

Any future periods of rapid economic and technological change may place significant strains on our managerial, financial, engineering, and other resources. Our failure to effectively manage these resources during periods of rapid economic or technological change may harm our business.

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 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 INCREASE SALES OF OUR MEDICAL SIMULATION DEVICES, OUR FINANCIAL CONDITION AND OPERATIONS MAY SUFFER.

Many medical institutions do not budget for simulation devices. To increase sales of our simulation devices, we must, in addition to convincing medical institution personnel of the usefulness of the devices, persuade them to include a significant expenditure for the devices in their budgets. If these medical institutions are unwilling to budget for simulation devices or reduce their budgets as a result of cost-containment pressures or other factors, we may not be able to increase or maintain sales of medical simulators at a satisfactory rate. A decrease in sales or any failure to increase sales of our medical simulation products will harm our business.

Table of Contents

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 fact that we may compete with the internal design teams of existing and potential licensees;
- difficulties in persuading product manufacturers to work with us, to rely on us for critical technology, and to disclose to us proprietary product development and other strategies;
- difficulties with persuading potential licensees who may have developed their own intellectual property or licensed intellectual property from other parties in areas related to ours to license our technology versus continuing to develop their own or license from other parties;
- challenges in demonstrating the compelling value of our technologies in new applications like mobile phones, portable devices, and touchscreens;
- difficulties in persuading existing and potential licensees to bear the development costs and risks necessary to incorporate our technologies into their products;
- difficulties in obtaining new automotive licensees for yet-to-be commercialized technology because their suppliers may not be ready to meet stringent quality and parts availability requirements;
- inability to sign new gaming licensees if the video console makers choose not to license third parties to make peripherals for their new consoles;
- difficulty in signing new gaming licensees given the fact that Sony has included only limited support for vibration features in the PlayStation 3 or related products; 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.

A majority of our current royalty revenue has been derived from the licensing of our portfolio of touch-enabling technologies for video game console and personal computer gaming peripherals, such as gamepads, joysticks, and steering wheels. Though substantially smaller than the market for dedicated gaming console peripherals, the market for gamepads, joysticks, and steering wheels for use with personal computers is declining and is characterized by declining average selling prices. If the console peripheral market also experiences declines in sales and selling prices, we may not achieve royalty revenue growth.

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

Table of Contents

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, 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 ARE UNABLE TO CONTINUALLY IMPROVE AND REDUCE THE COST OF OUR TECHNOLOGIES, COMPANIES MAY NOT INCORPORATE OUR TECHNOLOGIES INTO THEIR PRODUCTS, WHICH COULD IMPAIR OUR REVENUE GROWTH.

Our ability to achieve revenue growth 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.

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. 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.

WE HAVE LIMITED ENGINEERING, QUALITY ASSURANCE AND MANUFACTURING RESOURCES TO DESIGN AND FULFILL TIMELY PRODUCT DELIVERABLES AND DELIVER SUFFICIENT LEVELS OF QUALITY IN SUPPORT OF OUR DIFFERENT PRODUCT AREAS. PRODUCTS AND SERVICES MAY NOT BE DELIVERED IN A TIMELY WAY, WITH SUFFICIENT LEVELS OF QUALITY, OR AT ALL, WHICH MAY REDUCE OUR REVENUE.

Table of Contents

Engineering, 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. Failure to provide product and program deliverables and quality levels in a timely way, or at all, may disrupt channels and customers 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, Samsung, Sony, and Nokia have licensed our technologies, the greater expense of development and production of products containing our touch-enabling technologies 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. Due to the time generally required to complete and publish additional validation studies (usually more than a year), the negative impact on sales revenue could be significant.

MEDICAL LICENSING AND CERTIFICATION AUTHORITIES MAY NOT RECOMMEND OR REQUIRE USE OF OUR TECHNOLOGIES FOR TRAINING AND/OR TESTING PURPOSES, 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) 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, market penetration for our products could be significantly and adversely affected.

WE HAVE LIMITED DISTRIBUTION CHANNELS AND RESOURCES TO MARKET AND SELL OUR MEDICAL SIMULATORS, TOUCH INTERFACE PRODUCTS, AND THREE-DIMENSIONAL SIMULATION AND DIGITIZING 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 medical simulation, touch interface, or three-dimensional simulation and digitizing 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 medical simulation, touch interface, and three-dimensional simulation 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 represent small, specialized companies and may not have sufficient capital or human resources to support the complexities of selling and supporting 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.

COMPETITION IN THE MEDICAL MARKET MAY REDUCE OUR REVENUE.

If the medical simulation market develops as we anticipate, we believe that we will have increased competition. As in many developing markets, acquisitions, or consolidations may occur that could lead to larger competitors with more resources or

52

broader market penetration. This increased competition may result in the decline of our revenue and may cause us to reduce our selling prices.

COMPETITION IN THE MOBILITY OR TOUCHSCREEN MARKETS MAY INCREASE OUR COSTS AND REDUCE OUR REVENUE.

If the mobility or touchscreen markets develop as we anticipate, we believe that we will face a greater number of competitors, possibly including the internal design teams of existing and potential OEM customers. These potential competitors may have significantly greater financial and technical resources than we do, and the costs associated with competing with such potential competitors could be significant. Additionally, increased competition may result in the reduction of our market share and/or cause us to reduce our prices, which may result in a decline in our revenue.

AUTOMOBILES INCORPORATING OUR TOUCH-ENABLING TECHNOLOGIES ARE SUBJECT TO LENGTHY PRODUCT DEVELOPMENT PERIODS, MAKING IT DIFFICULT TO PREDICT WHEN AND WHETHER WE WILL RECEIVE PER UNIT AUTOMOTIVE ROYALTIES.

The product development process for automobiles is very lengthy, sometimes longer than four years. We do not earn per unit 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 per unit 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 MIGHT BE UNABLE TO RETAIN OR RECRUIT NECESSARY PERSONNEL, WHICH COULD SLOW THE DEVELOPMENT AND DEPLOYMENT OF OUR TECHNOLOGIES.

Our ability to develop and deploy our technologies and to sustain our revenue growth depends upon the continued service of our management and other key personnel, many of whom would be difficult to replace. Management and other key employees may voluntarily terminate their employment with us at any time upon short notice. The loss of management or key personnel could delay product development cycles or otherwise harm our business.

We believe that our future success will also depend largely on our ability to attract, integrate, and retain sales, support, marketing, and research and development personnel. Competition for such personnel is intense, and we may not be successful in attracting, integrating, and retaining such personnel. Given the protracted nature of if, how, and when we collect royalties on new design contracts, it may be difficult to craft compensation plans that will attract and retain the level of salesmanship needed to secure these contracts. Our stock option 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 engineering personnel to support licensees, enhance existing technologies, and develop new technologies.

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;

53

Table of Contents

- the timing of work performed under development agreements;
- the timing of our expenses, including costs related to litigation, stock-based awards, acquisitions of technologies, or businesses;
- the timing of introductions and market acceptance of new products and product enhancements by us, our licensees, our competitors, or their competitors;
- our ability to develop and improve our technologies;
- our ability to attract, integrate, and retain qualified personnel; and
- seasonality in the demand for our products or our licensees products.

ISSUANCE OF THE SHARES OF COMMON STOCK UPON CONVERSION OF DEBENTURES, EXERCISE OF STOCK OPTIONS, AND EXERCISE OF WARRANTS WILL DILUTE THE OWNERSHIP INTEREST OF EXISTING STOCKHOLDERS AND COULD ADVERSELY AFFECT THE MARKET PRICE OF OUR COMMON STOCK.

The issuance of shares of common stock in the following circumstances will dilute the ownership interest of existing stockholders: (i) upon conversion of some or all of the convertible debentures (ii) upon exercise of some or all of the stock options, and (iii) upon exercise of some or all of the warrants. Any sales in the public market of the common stock issuable upon such conversion or upon such exercises, respectively, could adversely affect prevailing market prices of our common stock. In addition, the existence of these convertible debentures, stock options, and warrants may encourage short selling by market participants.

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; 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, such as the suit currently pending against us.

OUR MAJOR STOCKHOLDERS RETAIN SIGNIFICANT CONTROL OVER US, WHICH MAY LEAD TO CONFLICTS WITH OTHER STOCKHOLDERS OVER CORPORATE GOVERNANCE MATTERS AND COULD ALSO AFFECT THE VOLATILITY OF OUR STOCK PRICE.

We currently have, have had in the past, and may have in the future, stockholders who retain greater than 10%, or in some cases greater than 20%, of our outstanding stock. Acting together, these stockholders would be able to exercise significant influence over matters that our stockholders vote upon, including the election of directors and mergers or other business combinations, which could have the effect of delaying or preventing a third party from acquiring control over or merging with us. Further, if any individuals in this group elect to sell a significant portion or all of their holdings of our common stock, the trading price of our common stock could experience volatility.

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 management. 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.

54

Table of Contents

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. If we consummate acquisitions through cash and/or an exchange 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; and
- potential intellectual property infringement claims related to newly acquired product lines.

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.

If we fail to maintain the adequacy of our internal controls, as standards are modified, supplemented, or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act. Failure to maintain an effective internal control environment could have a material adverse effect on our business and stock price.

LEGISLATIVE ACTIONS, HIGHER INSURANCE COST, AND POTENTIAL NEW ACCOUNTING PRONOUNCEMENTS ARE LIKELY TO IMPACT OUR FUTURE FINANCIAL POSITION AND RESULTS OF OPERATIONS.

There have been regulatory changes and new accounting pronouncements including the Sarbanes-Oxley Act of 2002, and the recently enacted SFAS No. 123R, Share-Based Payment, which have had an effect on our financial position and results of operations. Under SFAS No. 123R, we have been required since January 1, 2006, to adopt a different method of determining the compensation expense of our employee stock options. SFAS No. 123R has had a significant adverse effect on our reported financial conditions and may impact the way we conduct our business.

There may potentially be new accounting pronouncements or additional regulatory rulings that also have an impact on our future financial position and results of operations. These and other potential changes could materially increase the expenses we report under generally accepted accounting principles, and adversely affect our operating results.

AUDITS FROM TAXING AUTHORITIES SUCH AS THE INTERNEL REVENUE SERVICE COULD IMPACT OUR FUTURE FINANCIAL POSITION AND RESULTS OF OPERATIONS.

Our fiscal 2004 income tax return is currently under a routine examination by the Internal Revenue Service. The results of this audit or other audits could adversely affect our financial position or operating results.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

We held our annual meeting of stockholders (the Annual Meeting) on June 6, 2007, to consider and vote on the following proposals to: (i) elect two members of the Board of Directors to serve for a three-year term as Class II Directors (Proposal 1); (ii) to ratify the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2007 (Proposal 2); and (iii) to consider and vote upon the approval of the Immersion Corporation 2007 Equity Incentive Plan (Proposal 3).

Table of Contents

Proposal 1: The stockholders elected the two nominees for Class II directors to our Board of Directors. The votes were as follows:

Nominees	Number of Votes For	Withheld Authority
Jonathan Rubinstein	22,131,348	436,626
Robert Van Naarden	22,362,320	205,654

Mr. Rubinstein s and Mr. Van Naarden s terms will expire at the 2010 annual meeting. The following directors terms of office continue until the annual meeting indicated: John Hodgman and Emily Liggett (Class III term expires at the 2008 annual meeting) and Anne DeGheest, Jack Saltich and Victor Viegas (Class I term expires at the 2009 annual meeting).

Proposal 2: The ratification of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2007:

Number of Votes For	Number of Votes Against	Number of Votes Abstained
21,451,415	1,102,150	14,409

Proposal 3: To consider and vote upon the approval of the Immersion Corporation 2007 Equity Incentive Plan:

Number of Votes For	Number of Votes Against	Number of Votes Abstained	Number of Broker Non-votes
5,768,625	3,550,881	124,132	13,124,336

ITEM 6. EXHIBITS

The following exhibits are filed herewith:

Exhibit Number	Description
31.1	Certification of Victor Viegas, President, Chief Executive Officer, and Director, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Stephen Ambler, Chief Financial Officer and Vice President, Finance, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Victor Viegas, President, Chief Executive Officer, and Director, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Stephen Ambler, Chief Financial Officer and Vice President, Finance, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

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

Date: August 8, 2007

IMMERSION CORPORATION

By /s/ Stephen Ambler

Stephen Ambler

Chief Financial Officer and Vice President, Finance

57

EXHIBIT INDEX

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