

IMMERSION CORP  
Form 10-Q  
November 06, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

(MARK ONE)

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

**For the quarterly period ended September 30, 2013**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 000-27969**

**IMMERSION CORPORATION**  
**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction of**  
**incorporation or organization)**  
**30 Rio Robles, San Jose, California 95134**  
**(Address of principal executive offices) (Zip Code)**  
**(408) 467-1900**  
**(Registrant's telephone number, including area code)**

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

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

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller Reporting company <input type="checkbox"/>

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

Number of shares of common stock outstanding at October 29, 2013: 28,598,664.

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**IMMERSION CORPORATION**

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	<b>September 30 2013</b>	<b>December 31, 2012</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 16,664	\$ 4,558
Short-term investments	47,990	38,988
Accounts and other receivables (net of allowances for doubtful accounts of: \$139 and \$134, respectively)	294	1,878
Inventories	0	141
Deferred income taxes	165	165
Prepaid expenses and other current assets	870	706
Total current assets	65,983	46,436
Property and equipment, net	984	1,281
Intangibles and other assets, net	17,165	15,725
Total assets	\$ 84,132	\$ 63,442
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 618	\$ 338
Accrued compensation	3,353	2,502
Other current liabilities	1,379	1,022
Deferred revenue and customer advances	11,186	3,934
Total current liabilities	16,536	7,796
Long-term deferred revenue	8,045	10,221
Deferred income tax liabilities	165	165
Other long-term liabilities	551	619
Total liabilities	25,297	18,801
Contingencies (Note 13)		

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Stockholders' equity:		
Common stock and additional paid-in capital \$0.001 par value; 100,000,000 shares authorized; 33,581,408 and 32,278,330 shares issued, respectively; 28,598,664 and 27,295,586 shares outstanding, respectively		
	196,776	186,822
Accumulated other comprehensive income	115	109
Accumulated deficit	(107,487)	(111,721)
Treasury stock at cost: 4,982,744 shares	(30,569)	(30,569)
Total stockholders' equity	58,835	44,641
Total liabilities and stockholders' equity	\$ 84,132	\$ 63,442

See accompanying Notes to Condensed Consolidated Financial Statements.

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**IMMERSION CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**AND COMPREHENSIVE INCOME (LOSS)**

**(In thousands, except per share amounts)**

**(Unaudited)**

	<b>Three Months Ended September 30</b>		<b>Nine Months Ended September 30</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Revenues:				
Royalty and license	\$ 10,951	\$ 6,371	\$ 34,580	\$ 21,386
Product sales	12	529	44	1,145
Development contracts and other	379	242	779	778
Total revenues	11,342	7,142	35,403	23,309
Costs and expenses:				
Cost of revenues (exclusive of amortization, abandonment, and impairment of intangibles shown separately below)	111	273	386	802
Sales and marketing	2,151	1,632	6,692	5,072
Research and development	2,640	2,088	7,876	6,406
General and administrative	4,533	5,750	14,647	14,882
Amortization, abandonment, and impairment of intangibles	487	337	1,364	1,071
Total costs and expenses	9,922	10,080	30,965	28,233
Operating income (loss)	1,420	(2,938)	4,438	(4,924)
Interest and other income	42	66	80	144
Income (loss) from continuing operations before provision for income taxes	1,462	(2,872)	4,518	(4,780)
Provision for income taxes	(257)	(118)	(284)	(737)
Income (loss) from continuing operations	1,205	(2,990)	4,234	(5,517)
Discontinued operations (Note 10) :				
Gain on sales of discontinued operations net of provision for income taxes of \$0, \$0, \$0, and \$97	0	0	0	153
Net income (loss)	\$ 1,205	\$ (2,990)	\$ 4,234	\$ (5,364)
Basic net income (loss) per share				

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Continuing operations	0.04	(0.11)	0.15	(0.20)
Discontinued operations	0.00	0.00	0.00	0.01
Total	\$ 0.04	\$ (0.11)	\$ 0.15	\$ (0.19)
Shares used in calculating basic net income (loss) per share	28,558	27,658	28,047	27,885
Diluted net income (loss) per share				
Continuing operations	0.04	(0.11)	0.14	(0.20)
Discontinued operations	0.00	0.00	0.00	0.01
Total	\$ 0.04	\$ (0.11)	\$ 0.14	\$ (0.19)
Shares used in calculating diluted net income (loss) per share	29,653	27,658	29,205	27,885
Other Comprehensive Income (loss)				
Change in unrealized gains (losses) on short-term investments	10	6	6	(11)
Total Other Comprehensive Income (loss)	10	6	6	(11)
Total Comprehensive Income (loss)	\$ 1,215	\$ (2,984)	\$ 4,240	\$ (5,375)

See accompanying Notes to Condensed Consolidated Financial Statements.

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**IMMERSION CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(unaudited)

	<b>Nine Months Ended September 30,</b>	
	<b>2013</b>	<b>2012</b>
Cash flows from operating activities:		
Net income (loss)	\$ 4,234	\$ (5,364)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization of property and equipment	459	490
Amortization, abandonment, and impairment of intangibles	1,364	1,071
Stock-based compensation	3,438	2,346
Allowance (recovery) for doubtful accounts	7	113
Loss on disposal of equipment	12	27
Gain on sales of discontinued operations	0	(153)
Changes in operating assets and liabilities:		
Accounts and other receivables	1,577	(28)
Inventories	141	64
Prepaid expenses and other current assets	(164)	(294)
Other assets	(58)	(45)
Accounts payable	142	1,214
Accrued compensation and other current liabilities	1,079	622
Deferred revenue and customer advances	5,076	(1,699)
Other long-term liabilities	(68)	339
Net cash provided by (used in) operating activities	17,239	(1,297)
Cash flows provided by (used in) used in investing activities:		
Purchases of available-for-sale investments	(71,955)	(29,956)
Proceeds from maturities of available-for-sale investments	63,000	45,000
Additions to intangibles	(2,520)	(2,323)
Purchases of property and equipment	(174)	(931)
Proceeds from sales of discontinued operations	0	250
Net cash provided by (used in) investing activities	(11,649)	12,040
Cash flows provided by (used in) financing activities:		
Issuance of common stock under employee stock purchase plan	198	122
Exercise of stock options	6,318	974
Purchase of treasury stock	0	(5,248)



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Net cash provided by (used in) financing activities	6,516	(4,152)
Net increase in cash and cash equivalents	12,106	6,591
Cash and cash equivalents:		
Beginning of the period	4,558	7,298
End of the period	\$ 16,664	\$ 13,889
Supplemental disclosure of cash flow information:		
Cash paid for taxes, net of refunds	\$ 13	\$ 21
Supplemental disclosure of non-cash operating, investing, and financing activities:		
Amounts accrued for property and equipment, and intangibles	\$ 709	\$ 647
Release of Restricted Stock Units and Awards under company stock plan	\$ 3,183	\$ 1,298

See accompanying Notes to Condensed Consolidated Financial Statements.

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**IMMERSION CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2013**

**(Unaudited)**

**1. SIGNIFICANT ACCOUNTING POLICIES**

*Description of Business*

Immersion Corporation (the Company) was incorporated in 1993 in California and reincorporated in Delaware in 1999. It is an intellectual property (IP) and technology licensing company that creates, designs, develops, and licenses patented haptic innovations and technologies that allow people to use their sense of touch more fully when operating a wide variety of digital devices.

*Principles of Consolidation and Basis of Presentation*

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

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

The results of operations for the interim period ended September 30, 2013 are not necessarily indicative of the results to be expected for the full year.

*Revenue Recognition*

The Company recognizes revenues in accordance with applicable accounting standards, including Accounting Standards Codification (ASC) 605-10-S99, Revenue Recognition (ASC 605-10-S99); ASC 605-25, Multiple Element Arrangements (ASC 605-25); and ASC 985-605, Software-Revenue Recognition (ASC 985-605). The Company derives its revenues from three principal sources: royalty and license fees, product sales, and development contracts. As described below, management judgments and estimates must be made and used in connection with the revenue recognized in any accounting period. Material differences may result in the amount and timing of revenue for any period based on the judgments and estimates made by management. Specifically, in connection with each transaction, the Company must evaluate whether: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred,

(iii) the fee is fixed or determinable, and (iv) collectibility is probable. The Company applies these criteria as discussed below.

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

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

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

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

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

*Development contracts and other revenue* Development contracts and other revenue are comprised of engineering services (engineering services and/or development contracts), and in limited cases, post contract customer support (PCS). Engineering services revenues are recognized under the proportional performance accounting method based on physical completion of the work to be performed or completed performance method. A provision for losses on contracts is made, if necessary, in the period in which the loss becomes probable and can be reasonably estimated. Revisions in estimates are reflected in the period in which the conditions become known. To date, such losses have not been significant. Revenue from PCS is typically recognized over the period of the ongoing obligation, which is generally consistent with the contractual term.

*Multiple element arrangements* The Company enters into multiple element arrangements in which customers purchase time-based non-exclusive licenses that cannot be resold to others, which include a combination of software and/or IP licenses, engineering services, and in limited cases PCS. For arrangements that are software based and include software and engineering services, the services are generally not essential to the functionality of the software, and customers may purchase engineering services to facilitate the adoption of the Company's technology, but they may also decide to use their own resources or appoint other engineering service organizations to perform these services. For arrangements that are in substance subscription arrangements, the entire arrangement fee is recognized ratably over the contract term, subject to any limitations related to extended payment terms. For arrangements involving upfront fees for services and royalties earned by the Company based on unit or sales volumes of the respective licensees, and the services are performed ratably over the arrangement or front-end loaded; the upfront fees are recognized ratably over the contract term and royalties based on unit or sales volume are recognized when they become fixed and determinable. As the Company is unable to estimate the licensees' sales in any given quarter to determine the royalties due to it, the Company recognizes per unit or sales volume driven royalty revenues based on royalties reported by licensees and when all revenue recognition criteria are met.



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*Product sales* The Company recognizes revenue from the sale of products and the license of associated software, if any, and expenses all related costs of products sold, once delivery has occurred and customer acceptance, if required, has been achieved. The Company typically grants to customers a warranty that guarantees the products will substantially conform to the Company's current specifications for generally three to twelve months from the delivery date pursuant to the terms of the arrangement. Historically, warranty-related costs have not been significant.

*Comprehensive Loss*

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

	Nine Months Ended September 30, 2013		
	Unrealized Gains and Losses on Available-for Sale Securities		Foreign Currency Items Total
	(In thousands)		
Beginning balance	\$ 8	\$ 101	\$ 109
Other comprehensive income (loss) before reclassifications	6	0	6
Amounts reclassified from accumulated other comprehensive income (loss)	0	0	0
Net current period other comprehensive income (loss)	6	0	6
Ending Balance	\$ 14	\$ 101	\$ 115

*Recent Accounting Pronouncements*

In February 2013, the Financial Accounting Standards Board ( FASB ) ratified Accounting Standards Update ( ASU ) 2013-02 Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Comprehensive Income ( ASU 2013-02). ASU 2013-02 requires entities to disclose additional information about items reclassified out of accumulated other comprehensive income ( AOCI ) including AOCI balances by component and significant items reclassified out of AOCI. This ASU is effective for reporting periods beginning after December 15, 2012, and is being applied prospectively. These amendments will change the manner in which the Company presents comprehensive income by reporting these additional disclosure items in the condensed consolidated statements of operations and comprehensive loss or footnotes when they occur.

In July 2013, the FASB ratified ASU 2013-11 Presenting an Unrecognized Tax Benefit ( UTB ) When a Net Operating Loss Carryforward Exists ( ASU 2013-11 ). ASU 2013-02 provides that an UTB, or a portion thereof, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent that a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date to settle any additional income taxes that would result from disallowance of a tax position, or the tax law does not require the entity to use, and the entity does not

intend to use, the deferred tax asset for such purpose, then the unrecognized tax benefit should be presented as a liability. This ASU is effective for reporting periods beginning after December 15, 2013, and may be applied retrospectively. The Company is required to adopt ASU 2013-11 as of January 1, 2014, and is currently evaluating the potential impact, if any, of the adoption on its consolidated results of operations and financial condition.

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

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

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

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

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

Financial instruments measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012 are classified based on the valuation technique in the table below:

<b>September 30, 2013</b>				
<b>Fair value measurements using</b>				
<b>Quoted Prices in</b>				
<b>Active</b>				
<b>Markets</b>				
<b>for</b>				
<b>Identical</b>				
<b>Assets</b>				
<b>(Level</b>				
<b>1)</b>				
<b>Significant</b>				
<b>Other</b>				
<b>Observable</b>				
<b>Inputs</b>				
<b>(Level 2)</b>				
<b>Significant</b>				
<b>Unobservable</b>				
<b>Inputs</b>				
<b>(Level 3)</b>				
<b>Total</b>				
<b>(In thousands)</b>				
<b>Assets:</b>				
U.S. Treasury securities	\$ 0	\$ 56,990	\$ 0	\$ 56,990
Money market accounts	3,064	0	0	3,064
Total assets at fair value	\$ 3,064	\$ 56,990	\$ 0	\$ 60,054

The above table excludes \$4.6 million of cash held in banks.





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December 31, 2012				
Fair value measurements using				
Quoted Prices in				
Active				
Markets				
for				
Identical				
Assets				
(Level				
1)				
Significant				
Other				
Observable				
Inputs				
(Level 2)				
Significant				
Unobservable				
Inputs				
(Level 3)				
Total				
(In thousands)				
<b>Assets:</b>				
U.S. Treasury securities	\$ 0	\$ 38,988	\$ 0	\$ 38,988
Money market accounts	52	0	0	52
Total assets at fair value	\$ 52	\$ 38,988	\$ 0	\$ 39,040

The above table excludes \$4.5 million of cash held in banks.

*Short-term Investments*

September 30, 2013				
Gross				
Unrealized				
Holding				
Gains				
Unrealized				
Holding				
Losses				
Fair				
Value				
(In thousands)				
U.S. Treasury securities	\$ 47,976	\$ 14	\$ 0	\$ 47,990
Total	\$ 47,976	\$ 14	\$ 0	\$ 47,990

December 31, 2012				
Gross				
Unrealized				
Holding				
Gains				
Unrealized				
Holding				
Losses				
Fair				
Value				
(In thousands)				
U.S. Treasury securities	\$ 38,980	\$ 8	\$ 0	\$ 38,988
Total	\$ 38,980	\$ 8	\$ 0	\$ 38,988

The contractual maturities of the Company's available-for-sale securities on September 30, 2013 and December 31, 2012 were all due within one year.



**Table of Contents****3. ACCOUNTS AND OTHER RECEIVABLES**

	<b>September 30, 2013</b>	<b>December 31, 2012</b>
	<b>(In thousands)</b>	
Trade accounts receivable	\$ 38	\$ 1,528
Receivables from vendors and other	256	350
Accounts and other receivables	\$ 294	\$ 1,878

**4. INVENTORIES**

	<b>September 30, 2013</b>	<b>December 31, 2012</b>
	<b>(In thousands)</b>	
Raw materials and subassemblies	\$ 0	\$ 138
Finished goods	0	3
Inventories	\$ 0	\$ 141

**5. PROPERTY AND EQUIPMENT**

	<b>September 30, 2013</b>	<b>December 31, 2012</b>
	<b>(In thousands)</b>	
Computer equipment and purchased software	\$ 3,573	\$ 3,748
Machinery and equipment	704	654
Furniture and fixtures	578	546
Leasehold improvements	905	884
Total	5,760	5,832
Less accumulated depreciation	(4,776)	(4,551)
Property and equipment, net	\$ 984	\$ 1,281

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	<b>September 30, 2013</b>	<b>December 31, 2012</b>
	<b>(In thousands)</b>	
Patents and trademarks	\$ 28,357	\$ 26,206
Other assets	208	192
Gross intangibles and other assets	28,565	26,398
Accumulated amortization of patents and trademarks	(11,400)	(10,673)
Intangibles and other assets, net	\$ 17,165	\$ 15,725

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

	<b>Three Months Ended September 30, 2013      2012</b>		<b>Nine Months Ended September 30, 2013      2012</b>	
	<b>(In thousands)</b>		<b>(In thousands)</b>	
Amortization of Intangibles - excluding impairments or abandonments	\$ 318	\$ 264	\$ 935	\$ 777

The table below includes estimated remaining annual amortization expense for issued patents and trademarks as of September 30, 2013.

	<b>Estimated Amortization Expense (In thousands)</b>
Remainder of 2013	\$ 323
2014	1,198
2015	1,093
2016	999
2017	870
Thereafter	2,739
Total	\$ 7,222

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

	September 30, 2013	December 31, 2012
	(In thousands)	
Patents in process	\$ 9,735	\$ 9,270

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

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

	<b>September 30, 2013</b>	<b>December 31, 2012</b>
	<b>(In thousands)</b>	
Accrued legal	\$ 723	\$ 410
Income taxes payable	26	30
Other current liabilities	630	582
 Total other current liabilities	 \$ 1,379	 \$ 1,022
 Deferred revenue	 \$ 11,186	 \$ 3,920
Customer advances	0	14
 Total deferred revenue and customer advances	 \$ 11,186	 \$ 3,934

## 8. LONG-TERM DEFERRED REVENUE

Long-term deferred revenue consisted of the following:

	<b>September 30, 2013</b>	<b>December 31, 2012</b>
	<b>(In thousands)</b>	
Deferred revenue for Sony Computer Entertainment	\$ 7,388	\$ 9,636
Other deferred revenue	657	585
 Long-term deferred revenue	 \$ 8,045	 \$ 10,221

## 9. STOCK-BASED COMPENSATION

### *Stock Options and Awards*

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

date of grant. Restricted stock generally vests over one year. RSUs generally vest over 3 years. Awards granted other than an option or stock appreciation right shall reduce the common stock shares available for grant by 1.75 shares for every share issued.



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	<b>September 30, 2013</b>
Common stock shares available for grant	1,800,151
Common stock options outstanding	3,225,204
Restricted stock awards outstanding	44,000
Restricted stock units outstanding	710,723

*Employee Stock Purchase Plan*

The Company has an Employee Stock Purchase Plan ( ESPP ). Under the ESPP, eligible employees may purchase common stock through payroll deductions at a purchase price of 85% of the lower of the fair market value of the Company's stock at the beginning of the offering period or the purchase date. Participants may not purchase more than 2,000 shares in a six-month offering period or purchase stock having a value greater than \$25,000 in any calendar year as measured at the beginning of the offering period. A total of 1,000,000 shares of common stock have been reserved for issuance under the ESPP. As of September 30, 2013, 519,440 shares had been purchased since the inception of the ESPP in 1999. Under ASC 718-10, the ESPP is considered a compensatory plan and the Company is required to recognize compensation cost related to the fair value of the award purchased under the ESPP. Shares purchased under the ESPP for the nine months ended September 30, 2013 are listed below. Shares purchased under the ESPP for the nine months ended September 30, 2012 are 25,628. The intrinsic value listed below is calculated as the difference between the market value on the date of purchase and the purchase price of the shares.

	<b>Nine Months Ended September 30, 2013</b>
Shares purchased under ESPP	36,921
Average price of shares purchased under ESPP	\$ 5.36
Intrinsic value of shares purchased under ESPP	\$ 210,984

*Summary of Stock Options*

The following table sets forth the summary of option activity under the Company's stock option plans for the nine months ended September 30, 2013 and year ended December 31, 2012:

	<b>Nine Months Ended September 30, 2013</b>	<b>Year Ended December 31, 2012</b>
Beginning outstanding balance	3,155,631	3,267,838
Granted	1,036,900	425,150
Exercised	(943,609)	(231,403)
Forfeited and cancelled	(23,718)	(305,954)
Ending outstanding balance	3,225,204	3,155,631
Aggregate intrinsic value of options exercised	\$ 5,694,000	\$ 443,000

Weighted average fair value of options granted	5.61	3.35
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The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of the Company's common stock for the options that were in-the-money.

Information regarding stock options outstanding at September 30, 2013 and December 31, 2012 is summarized below:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (In millions)
<b>December 31, 2012</b>				
Options outstanding	3,155,631	\$ 6.65	5.24	\$ 3.5
Options vested and expected to vest using estimated forfeiture rates	3,019,979	6.67	5.17	3.4
Options exercisable	2,329,987	6.91	4.69	2.5
<b>September 30, 2013</b>				
Options outstanding	3,225,204	\$ 7.74	5.70	\$ 18.2
Options vested and expected to vest using estimated forfeiture rates	2,953,946	7.56	5.64	17.2
Options exercisable	1,692,770	6.70	5.13	11.4
<i>Summary of Restricted Stock Units</i>				

RSU activity for the nine months ended September 30, 2013 and year ended December 31, 2012 was as follows:

	Nine Months Ended September 30, 2013	Year Ended December 31, 2012
Beginning outstanding balance	708,651	407,765
Awarded	294,150	555,911
Released	(278,548)	(203,519)
Forfeited	(13,530)	(51,506)
Ending outstanding balance	710,723	708,651
Weighted average grant date fair value of RSUs		
granted	\$ 7.12	\$ 6.64
Total fair value of RSUs released	2,507,000	1,128,000
Total fair value of RSUs remaining unvested	9,382,000	4,868,000

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Information regarding RSUs outstanding at September 30, 2013 and December 31, 2012 is summarized below:

	<b>Number of Shares</b>	<b>Weighted Average Remaining Contractual Life (years)</b>	<b>Aggregate Intrinsic Value (In millions)</b>	<b>Fair Value (In millions)</b>
<b><u>December 31, 2012</u></b>				
RSUs outstanding	708,651	1.09	\$ 4.9	\$ 4.9
RSUs vested and expected to vest using estimated forfeiture rates	588,170	1.05	4.0	
<b><u>September 30, 2013</u></b>				
RSUs outstanding	710,723	1.12	\$ 9.4	\$ 9.4
RSUs vested and expected to vest using estimated forfeiture rates	599,840	1.10	7.9	

*Summary of Restricted Stock Awards*

Restricted stock award activity for the nine months ended September 30, 2013 and year ended December 31, 2012 was as follows:

	<b>Nine Months Ended September 30, 2013</b>	<b>Year Ended December 31, 2012</b>
Beginning outstanding balance	44,000	18,000
Awarded	44,000	57,750
Released	(44,000)	(31,750)
Forfeited	0	0
Ending outstanding balance	44,000	44,000
Weighted average grant date fair value of restricted stock awarded	\$ 14.09	\$ 5.70
Total fair value of restricted stock awards released	620,000	171,000

*Stock Plan Assumptions*

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

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	2012		2012	
<b><u>Options</u></b>				
Expected life (in years)	4.7	4.5	4.9	4.5
Volatility	64%	68%	68%	70%
Interest rate	1.3%	0.6%	0.8%	0.7%
Dividend yield	N/A	N/A	N/A	N/A

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
<b><u>Employee Stock Purchase Plan</u></b>				
Expected life (in years)	0.5	0.5	0.5	0.5
Volatility	69%	52%	67%	62%
Interest rate	0.8%	0.1%	0.1%	0.1%
Dividend yield	N/A	N/A	N/A	N/A

*Compensation Costs*

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

	Three Months Ended September 30, 2013      2012 (In thousands)		Nine Months Ended September 30, 2013      2012 (In thousands)					
<b><u>Statement of Operations Classifications</u></b>								
Sales and marketing	\$	223	\$	152	\$	496	\$	376
Research and development		231		173		807		586
General and administrative		795		483		2,135		1,384
Total	\$	1,249	\$	808	\$	3,438	\$	2,346

As of September 30, 2013, there was \$8.8 million related to stock options, restricted stock awards, and RSUs of unrecognized compensation cost, adjusted for estimated forfeitures, granted to the Company's employees and directors. This cost will be recognized over an estimated weighted-average period of approximately 3.46 years for options, 1.84 years for RSUs, and 0.68 years for restricted stock awards. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

*Stock Repurchase Program*

On November 1, 2007, the Company announced its Board of Directors authorized the repurchase of up to \$50 million of the Company's common stock. The Company may repurchase its stock for cash in the open market in accordance with applicable securities laws. The timing of and amount of any stock repurchase will depend on share price, corporate and regulatory requirements, economic and market conditions, and other factors. The stock repurchase authorization has no expiration date, does not require the Company to repurchase a specific number of shares, and may be modified, suspended, or discontinued at any time. During the three months and nine months ended September 30, 2013 there were no stock repurchases under this program, but the program currently remains available. During the three months ended September 30, 2012, the Company repurchased 581,200 shares for \$3.2 million at an average cost of \$5.51, net of transaction costs through open market repurchases. During the nine months ended September 30, 2012, the Company repurchased 968,488 shares for \$5.2 million at an average cost of \$5.42, net of transaction costs through open market repurchases.

#### 10. DISCONTINUED OPERATIONS

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

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

Income tax provisions from continuing operations consisted of the following:

	<b>Three Months Ended September 30, 2013      2012 (In thousands)</b>		<b>Nine Months Ended September 30, 2013      2012 (In thousands)</b>	
Income (loss) from continuing operations before provision for income taxes	\$ 1,462	\$ (2,872)	\$ 4,518	\$ (4,780)
Provision for income taxes	(257)	(118)	(284)	(737)
Effective tax rate	17.6%	(4.1)%	6.3%	(15.4)%

The effective tax rates differ from the statutory rate primarily due to the valuation allowance, foreign withholding taxes, and unrecognized tax benefits. The income tax provisions for the three months and nine months ended September 30, 2013 are primarily as a result of estimated state taxes and foreign withholding tax expense. The income tax provisions for the three months and nine months ended September 30, 2012 are primarily as a result of foreign withholding tax expense.

As of September 30, 2013, the Company had unrecognized tax benefits under ASC 740 Income Taxes of approximately \$689,000, including interest of \$62,000. The total amount of unrecognized tax benefits that would affect the Company's effective tax rate, if recognized, was \$261,000. There were no material changes in the amount of unrecognized tax benefits during the nine months ended September 30, 2013. The Company expects to release reserves and record a tax benefit due to the expiration of the statute of limitations during the next three months. The Company's policy is to account for interest and penalties related to uncertain tax positions as a component of income tax provision.

Because the Company had net operating loss and credit carryforwards, there are open statutes of limitations in which federal, state, and foreign taxing authorities may examine the Company's tax returns for all years from 1998 through the current period.

The Company maintains a valuation allowance for all its deferred tax assets at September 30, 2013 as a result of uncertainties regarding the realization of the asset balance due to historical losses, the variability of operating results, and uncertainty regarding near term projected results. As of the quarter ended September 30, 2013, the Company remained in a three-year cumulative pre-tax loss position. Based on current projections, and barring any one-time adjustments, the Company expects to be in a three-year cumulative pre-tax income position by December 31, 2013. The Company expects to complete a full evaluation of the realizability of its deferred tax assets by the end of the current fiscal year. In the event that the Company determines the deferred tax assets are realizable based on its assessment of relevant factors, an adjustment to the valuation allowance may increase income in the period such determination is made. The valuation allowance does not impact the Company's ability to utilize the underlying net operating loss carryforwards.



**Table of Contents****12. NET INCOME (LOSS) PER SHARE**

Basic net income (loss) per share is computed using the weighted average number of common shares outstanding for the period, excluding unvested restricted stock and RSUs. Diluted net income (loss) per share is based upon the weighted average common shares outstanding for the period plus dilutive potential shares including unvested restricted stock, RSUs, and stock options using the treasury stock method. The following is a reconciliation of the numerators and denominators used in computing basic and diluted net income (loss) per share:

	Three Months Ended September 30, 2013      2012		Nine Months Ended September 30, 2013      2012	
(in thousands except per share amounts)				
Numerator:				
Income (loss) from continuing operations	\$ 1,205	\$ (2,990)	\$ 4,234	\$ (5,517)
Gain from discontinued operations, net of tax	0	0	0	153
Net income (loss) used in computing basic and diluted net income (loss) per share	\$ 1,205	\$ (2,990)	\$ 4,234	\$ (5,364)
Denominator:				
Shares used in computation of basic net income (loss) per share (weighted average common shares outstanding)	28,558	27,658	28,047	27,885
Dilutive potential common shares:				
Restricted Stock and RSUs	302	0	333	0
Stock options	793	0	825	0
Shares used in computation of diluted net income (loss) per share	29,653	27,658	29,205	27,885
Basic net income (loss) per share from:				
Continuing operations	\$ 0.04	\$ (0.11)	\$ 0.15	\$ (0.20)
Discontinued operations	0.00	0.00	0.00	0.01
Total	\$ 0.04	\$ (0.11)	\$ 0.15	\$ (0.19)
Diluted net income (loss) per share:				
Continuing operations	\$ 0.04	\$ (0.11)	\$ 0.14	\$ (0.20)
Discontinued operations	0.00	0.00	0.00	0.01
Total	\$ 0.04	\$ (0.11)	\$ 0.14	\$ (0.19)

For the three months and nine months ended September 30, 2013, options to purchase approximately 1.2 million and 902,000 shares of common stock, respectively, with exercise prices greater than the average fair market value of the Company's stock of \$13.72 and \$11.53 per share, respectively, were not included in the calculation because the effect would have been anti-dilutive.



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As of September 30, 2012, the Company had securities outstanding that could potentially dilute basic earnings per share in the future, but these were excluded from the computation of diluted net loss per share for the three and nine months ended September 30, 2012, since their effect would have been anti-dilutive. These outstanding securities consisted of the following:

	<b>September 30, 2012</b>
Outstanding stock options	3,099,155
Unvested restricted stock awards	44,000
Unvested RSUs	676,755

**13. CONTINGENCIES***In re Immersion Corporation Securities Litigation*

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

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

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

*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' IP rights. Management believes that these claims are without merit. Additionally, periodically, the Company is involved in routine legal matters and contractual disputes incidental to its normal operations. In management's opinion, the resolution of such matters will not have a material adverse effect on the Company's condensed consolidated financial condition, results of operations, or liquidity.

In the normal course of business, the Company provides indemnifications of varying scope to customers against claims of IP infringement made by third parties arising from the use of the Company's IP, 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.

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

**OVERVIEW**

We are a premier IP and technology licensing company focused on the creation, design, development, and licensing of patented haptic innovations and technologies that allow people to use their sense of touch more fully when operating a wide variety of digital devices. Our mission is to transform user experiences through groundbreaking innovations and technologies designed to provide unique and customizable touch feedback effects, excite the senses in games, videos and music, restore mechanical feel by providing intuitive and unmistakable confirmation, improve safety by overcoming distractions, and expand usability when audio and visual feedback are ineffective or inefficient. While we believe that our innovations are broadly applicable, we are currently focusing our marketing and business development activities on the following target markets: mobile communications and consumer electronics, automotive, gaming, commercial and industrial, and medical. We manage these market areas under one operating and reportable segment.

In our target markets, we license our software and IP to manufacturers for use in products sold under their own brand names. We and our wholly-owned subsidiaries hold more than 1,400 issued or pending patents in the U.S. and other countries, covering a wide range of digital technologies, including many of the ways in which touch-related technology can be incorporated into and between hardware products, systems software, application software and digital content.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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

estimates and assumptions.

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

*Revenue Recognition*

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

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

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

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

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

*Royalty and license revenue* We license our patents and software to customers in a variety of industries such as mobility, gaming, automotive, and medical devices. A majority of these are variable fee arrangements where the royalties earned by us are based on unit or sales volumes of the respective licensees. We also enter into fixed license fee arrangements. The terms of the royalty agreements generally require licensees to give notification of royalties due to us within 30-45 days of the end of the quarter during which their related sales occur. As we are unable to reliably estimate the licensees' sales in any given quarter to determine the royalties due to us, we recognize royalty revenues based on royalties reported by licensees and when all revenue recognition criteria are met. We recognize fixed license fee revenue for licenses to our IP and software when earned under the terms of the agreements, which is generally

recognized on a straight-line basis over the expected term of the license. Certain royalties are based upon customer shipments or revenues and could be subject to change and may result in out of period adjustments.

*Development contracts and other revenue* Development contracts and other revenue are comprised of engineering services (engineering services and/or development contracts), and in limited cases, post contract customer support ( PCS ). Engineering services revenues are recognized under the proportional performance accounting method based on physical completion of the work to be performed or completed performance method. A provision for losses on contracts is made, if necessary, in the period in which the loss becomes probable and can be reasonably estimated. Revisions in estimates are reflected in the period in which the conditions become known. To date, such losses have not been significant. Revenue from PCS is typically recognized over the period of the ongoing obligation, which is generally consistent with the contractual term.



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*Multiple element arrangements* We enter into multiple element arrangements in which customers purchase time-based non-exclusive licenses that cannot be resold to others, which include a combination of software and/or IP licenses, engineering services, and in limited cases PCS. For arrangements that are software based and include software and engineering services, the services are generally not essential to the functionality of the software, and customers may purchase engineering services to facilitate the adoption of our technology, but they may also decide to use their own resources or appoint other engineering service organizations to perform these services. For arrangements that are in substance subscription arrangements, the entire arrangement fee is recognized ratably over the contract term, subject to any limitations related to extended payment terms. For arrangements involving upfront fees for services and royalties earned by us based on unit or sales volumes of the respective licensees, and the services are performed ratably over the arrangement or front-end loaded; the upfront fees are recognized ratably over the contract term and royalties based on unit or sales volume are recognized when they become fixed and determinable. As we are unable to estimate the licensees' sales in any given quarter to determine the royalties due to us, we recognize per unit or sales volume driven royalty revenues based on royalties reported by licensees and when all revenue recognition criteria are met.

*Product sales* We recognize revenue from the sale of products and the license of associated software, if any, and expense all related costs of products sold, once delivery has occurred and customer acceptance, if required, has been achieved. We typically grant our customers a warranty which guarantees that our products will substantially conform to our current specifications for generally three to twelve months from the delivery date pursuant to the terms of the arrangement. Historically, warranty-related costs have not been significant.

*Stock-based Compensation* Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period.

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

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

The Black-Scholes model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable, characteristics not present in our option grants and ESPP shares. Existing valuation models, including the Black-Scholes model, may not provide reliable measures of the fair values of our stock-based compensation. Consequently, there is a risk that our estimates of the fair values of our stock-based compensation awards on the grant dates may bear little resemblance to the actual values realized upon the exercise, expiration, early termination, or forfeiture of those stock-based payments in the future. Certain stock-based payments, such as employee stock options, may expire and be worthless or otherwise result in zero intrinsic value as compared to the fair values originally estimated on the grant date and reported in our financial statements. Alternatively, value may

be realized from these instruments that are significantly higher than the fair values originally estimated on the grant date and reported in our financial statements. There currently is no market-based mechanism or other practical application to verify the reliability and accuracy of the estimates stemming from these valuation models, nor is there a means to compare and adjust the estimates to actual values.

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See Note 9 to the condensed consolidated financial statements for further information regarding stock-based compensation.

*Accounting for Income Taxes*

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

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

Our assumptions, judgments, and estimates relative to the value of a deferred tax asset take into account predictions of the amount and category of future taxable income, such as income from operations or capital gains income. Actual operating results and the underlying amount and category of income in future years could render inaccurate our current assumptions, judgments, and estimates of recoverable net deferred tax assets. Any of the assumptions, judgments, and estimates mentioned above could cause our actual income tax obligations to differ from our estimates, thus materially impacting our financial position and results of operations. See Note 11 to the condensed consolidated financial statements for further information concerning income taxes.

*Short-term Investments*

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

For debt securities in an unrealized loss position, we are required to assess whether (i) we have the intent to sell the debt security or (ii) it is more likely than not that we will be required to sell the debt security before its anticipated recovery. If either of these conditions is met, an other-than-temporary impairment on the security must be recognized in earnings equal to the entire difference between its fair value and amortized cost basis.

For debt securities in an unrealized loss position which are deemed to be other-than-temporary where neither of the criteria in the paragraph above are present, the difference between the security's then-current amortized cost basis and fair value is separated into (i) the amount of the impairment related to the credit loss (i.e., the credit loss component) and (ii) the amount of the impairment related to all other factors (i.e., the non-credit loss component). The credit loss component is recognized in earnings. The non-credit loss component is recognized in accumulated other

comprehensive loss. The credit loss component is the excess of the amortized cost of the security over the best estimate of the present value of the cash flows expected to be collected from the debt security. The non-credit component is the residual amount of the other-than-temporary impairment.

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

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

*Patents and Intangible Assets*

We have acquired patents and other intangible assets. In addition, we capitalize the external legal, filing, and continuation or annuity fees associated with patents and trademarks. We assess the recoverability of our intangible assets, and we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets that affect our condensed consolidated financial statements. If these estimates or related assumptions change in the future, we may be required to record impairment charges for these assets. We amortize our intangible assets related to patents and trademarks, once they are issued, over their estimated useful lives, generally 10 years. Future changes in the estimated useful life could affect the amount of future period amortization expense that we will incur. During the nine months ended September 30, 2013, we capitalized costs associated with patents and trademarks of \$2.8 million. Our total amortization expense (exclusive of abandonments of \$429,000) for the same period was \$935,000.

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

**RESULTS OF OPERATIONS FOR THE THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012**

The following discussion and analysis includes our results of operations for the three months and nine months ended September 30, 2013 and 2012.

***Overview***

Royalty and license revenue increased by 72%, and our total revenue increased by 59% for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. Royalty and license revenue increased by 62%, and our total revenue increased by 52% for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The increase in royalty and license revenue for both the three and nine month periods was primarily due to increased mobility revenue.

Our net income was \$1.2 million for the three months ended September 30, 2013 as compared to a net loss of \$3.0 million for the three months ended September 30, 2012. The increase in net income was primarily due to increased gross profit of \$4.4 million resulting primarily from additional royalty and license revenue. Our net income was \$4.2 million for the nine months ended September 30, 2013 as compared to a net loss of \$5.4 million for the nine months ended September 30, 2012. The increase in net income was primarily due to increased gross profit of \$12.5 million

resulting primarily from additional royalty and license revenue partially offset by higher operating expenses mainly due to increased sales and marketing expenses and research and development expenses partially offset by decreased general and administrative expenses primarily due to reduced litigation expenses.

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In 2013, we expect royalty and license revenue to be the major component of our total revenues as we continue to sign contracts with new licensees, as our technology continues to be included in more of our licensees' products, and as we continue to implement our patent licensing program relating to Basic Haptics. IP litigation may cause us to expend significant financial resources in the future and may have an adverse effect on the results of our operations.

Additionally, our success could be limited by various factors, including global economic conditions, the timely release of our new products and our licensees' products, continued market acceptance of our products and technology, and the introduction of new products by existing or new competitors. For a further discussion of these and other risk factors, see Part II, Item 1A – Risk Factors.

REVENUES	September 30, 2013	September 30, 2012	Change	% Change
(In thousands)				
<u>Three months ended:</u>				
Royalty and license	\$ 10,951	\$ 6,371	\$ 4,580	72%
Product sales	12	529	(517)	(98)%
Development contracts and other	379	242	137	57%
Total Revenues	\$ 11,342	\$ 7,142	\$ 4,200	59%
<u>Nine months ended:</u>				
Royalty and license	\$ 34,580	\$ 21,386	\$ 13,194	62%
Product sales	44	1,145	(1,101)	(96)%
Development contracts and other	779	778	1	0%
Total Revenues	\$ 35,403	\$ 23,309	\$ 12,094	52%

**Three Months Ended September 30, 2013 Compared to Three Months Ended September 30, 2012**

*Royalty and license revenue* Royalty and license revenue is comprised of royalties earned on sales by our licensees and license fees charged for our software and IP portfolio. The increase in royalty and license revenue for the three months ended September 30, 2013 compared to the three months ended September 30, 2012 was primarily due to increases in royalty and license revenue from our mobility licensees.

Royalty and license revenue from mobility customers increased by 137% primarily due to increased mobility revenue from a new multi-year license agreement entered into with Samsung in March 2013; other new customer contracts in the U.S., China, and Japan; as well as increased mobile device business by existing licensees; partially offset by decreased license revenues from our European market. We also typically experience seasonally higher revenue from our mobility customers due to the reporting of holiday sales in the first calendar quarter compared to other calendar quarters. We anticipate that the mobility line of business will continue to be an important line of business as mobile device manufacturers continue to recognize the value of our IP and technology and as we expand our presence in China, Korea, and Japan.

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Royalty and license revenue from medical customers increased by 22% primarily due to an increased level of sales by these customers.

Royalty and license revenue from gaming customers was flat compared to the same quarter in 2012. Revenue from gaming customers can also fluctuate based upon consumer gaming preferences, the timing of introductions of new gaming console systems, and the timing of new products from third party peripheral makers that are our licensees. Although some licensees have experienced decreased sales due to softness in the market and lack of new gaming console systems, other licensees have begun to have increased sales based on the introduction of new products that have incorporated our technology. Our gaming royalty revenue is also seasonal, with holiday sales primarily reported during our first calendar quarter.

We expect royalty and license revenue to be the major component of our future revenue as our technology continues to be included in more products and as we continue our efforts to monetize our IP.

*Product sales* Product sales are currently comprised primarily of actuators, design kits, and integrated circuits. The decrease in product sales primarily reflects a reduction in medical product sales specifically related to our Virtual IV simulator product. In December of 2012 we entered into a royalty generating licensing agreement with our Virtual IV customer in accordance with which we no longer produce the Virtual IV system. As a result of this agreement, and as a result of a continuing focus on licensing our software and patents, we expect product sales will not be a significant portion of our revenue in the future.

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

We categorize our geographic information into four major regions: North America, Europe, Far East, and Rest of the World. In the three months ended September 30, 2013, revenue generated in North America, Europe, Far East, and Rest of the World represented 28%, 1%, 71%, and 0% of total revenue, respectively, compared to 38%, 11%, 51%, and 0% of total revenue, respectively, for the three months ended September 30, 2012. The shift in revenues among regions was mainly due to a relative increase in royalty and license revenue in the Far East partially offset by a relative decrease in royalty and license revenue in Europe. In addition, although royalty and license revenue increased in North America, it decreased as a percent of total revenue. The increase in royalty and license revenue from the Far East was mainly due to increased license and royalty revenue from our mobility licensees in Korea, China, and Japan, including increased revenue recognized under the new agreement entered into with Samsung. The decrease in royalty and license revenue in North America as a percentage of the total was primarily due to a decrease in product revenue from our medical customers partially offset by an increase in royalty and license revenue from our mobility and medical licensees. The decrease in royalty and license revenue in Europe was mainly due to a decrease in royalty and license revenue from our mobility licensees.

## **Nine Months Ended September 30, 2013 Compared to Nine Months Ended September 30, 2012**

*Royalty and license revenue* The increase in royalty and license revenue for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012 was primarily due to increases in royalty and license revenue from our mobility and medical licensees partially offset by decreases from our gaming licensees.



Royalty and license revenue from mobility customers increased by 134% primarily due to increased mobility revenue from a new multi-year license agreement entered into with Samsung in March 2013; increased mobile device business by existing licensees; as well as other new customer contracts in the U.S, China, and Japan; partially offset by decreased license revenues from our European market.

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Royalty and license revenue from medical customers increased by 29% primarily due an increased level of sales by these customers.

Royalty and license revenue from gaming customers decreased by 7% mainly due to a decrease in units shipped by certain licensees partially offset by amounts secured through our royalty compliance program. This decrease in units shipped was primarily due to softness in the console gaming market.

*Product sales* The decrease in product sales primarily reflects a reduction in medical product sales specifically related to our Virtual IV simulator product. As previously discussed, in December of 2012 we entered into a royalty generating licensing agreement with our Virtual IV customer in accordance with which we no longer produce the Virtual IV system.

*Development contracts and other revenue* Development contracts and other revenue is comprised of revenue from commercial contracts, primarily engineering services for customers. Development contracts and other revenue remained flat when compared to the prior period. Although there was a decrease in one time contract engineering services revenue from certain customers, it was offset by an increase in revenue from ongoing engineering services from certain mobility customers.

In the nine months ended September 30, 2013, revenue generated in North America, Europe, Far East, and Rest of the World represented 27%, 3%, 70%, and 0% of total revenue, respectively, compared to 42%, 12%, 46%, and 0% of total revenue, respectively, for the nine months ended September 30, 2012. The shift in revenues among regions was mainly due to a relative increase in royalty and license revenue in the Far East offset by a relative decrease in royalty and license revenue in North America and Europe. The increase in royalty and license revenue from the Far East was mainly due to increased license and royalty revenue from our mobility licensees in Korea, China, and Japan, including increased revenue recognized under the new agreement entered into with Samsung. The decrease in royalty and license revenue in North America was primarily due to a decrease in royalty and license revenue from our gaming licensees and our medical product customers partially offset by an increase in royalty and license revenue from our mobility and medical licensees. The decrease in royalty and license revenue in Europe was mainly due to a decrease in royalty and license revenue from our mobility licensees partially offset by an increase in royalty and license revenue from our gaming licensees.

	September 30, 2013      2012		Change	% Change
<b>COST OF REVENUES</b>				
	<b>(Dollars in thousands)</b>			
<u>Three months ended:</u>				
Cost of revenues	\$ 111	\$ 273	\$ (162)	(59)%
% of total revenues	1%	4%	(3)%	
<u>Nine months ended:</u>				
Cost of revenues	\$ 386	\$ 802	\$ (416)	(52)%
% of total revenues	1%	3%	(2)%	

*Cost of Revenues* Our cost of revenues consists primarily of labor related costs for development contracts and other; as well as direct materials, contract manufacturing, and other overhead costs for product sales. It excludes amortization and abandonment or impairment of intangibles. Lower product sales were the major contributor to the overall reduction in cost of revenues for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012. Specifically, the decrease in cost of revenues for 2013 as compared to 2012 was primarily due to decreased direct material costs, contract manufacturing costs, and related costs of \$184,000; and decreased

salary, benefits, and overhead for labor related to development contracts of \$16,000; partially offset by increased obsolescence expense of \$31,000. As previously discussed, we no longer produce the Virtual IV system. As a result, we expect cost of revenue will continue to be significantly reduced in 2013 compared to 2012.

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Lower product sales were the major contributor to the overall reduction in cost of revenues for the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012. Specifically, the decrease in cost of revenues for 2013 as compared to 2012 was primarily due to decreased direct material costs, contract manufacturing costs, and related costs of \$451,000; partially offset by increased obsolescence expense of \$29,000 and increased salary, benefits, and overhead for labor related to development contracts of \$13,000. As discussed above, we no longer produce the Virtual IV system. This has been and will continue to be the main contributor to the decrease in cost of revenues in 2013.

OPERATING EXPENSES	September 30, 2013	2012	Change	% Change
	(Dollars in thousands)			
<u>Three months ended:</u>				
Sales and marketing	\$ 2,151	\$ 1,632	\$ 519	32%
% of total revenue	19%	23%	(4)%	
Research and development	\$ 2,640	\$ 2,088	\$ 552	26%
% of total revenue	23%	29%	(6)%	
General and administrative	\$ 4,533	\$ 5,750	\$ (1,217)	(21)%
% of total revenue	40%	81%	(41)%	
Amortization and abandonment or impairment of intangibles	\$ 487	\$ 337	\$ 150	45%
% of total revenue	4%	5%	(1)%	
<u>Nine months ended:</u>				
Sales and marketing	\$ 6,692	\$ 5,072	\$ 1,620	32%
% of total revenue	19%	22%	(3)%	
Research and development	\$ 7,876	\$ 6,406	\$ 1,470	23%
% of total revenue	22%	27%	(5)%	
General and administrative	\$ 14,647	\$ 14,882	\$ (235)	(2)%
% of total revenue	41%	64%	(23)%	
Amortization and abandonment or impairment of intangibles	\$ 1,364	\$ 1,071	\$ 293	27%
% of total revenue	4%	5%	(1)%	

**Sales and Marketing** Our sales and marketing expenses are comprised primarily of employee compensation and benefits, sales commissions, advertising, trade shows, collateral marketing materials, market development funds, travel, and an allocation of facilities costs. The increase in sales and marketing expense for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012 was primarily due to increased compensation, benefits, and other related costs of \$531,000, mainly due to increased sales and marketing headcount, benefits, and stock compensation expense; increased travel of \$76,000 mainly due to increased headcount; and increased marketing, advertising, and public relations costs of \$28,000 due to current marketing initiatives. This was partially offset by a decrease in bad debt expense of \$118,000 that did not recur. We expect that sales and marketing expenses will continue to be significant as we continue to invest in sales and marketing to further our focus on building greater market acceptance for our touch technologies.



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The increase in sales and marketing expense for the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012 was primarily due to increased compensation, benefits, and other related costs of \$1.2 million, mainly due to increased sales and marketing headcount, benefits, and stock compensation expense; increased marketing, advertising, and public relations costs of \$227,000 and increased consulting expenses of \$134,000, both due to current marketing initiatives; and increased travel of \$215,000 mainly due to increased headcount. This was partially offset by a decrease in bad debt expense of \$106,000 that did not recur.

*Research and Development* Our research and development expenses are comprised primarily of employee compensation and benefits, consulting fees, tooling and supplies, and an allocation of facilities costs. The increase in research and development expenses for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012 was primarily due to increased compensation, benefits, and other related costs of \$424,000 mainly due to increased headcount, benefits, and stock compensation expense, and increased consulting and outside services expense of \$174,000; partially offset by decreased lab and prototyping costs of \$46,000. We believe that continued significant investment in research and development is critical to our future success, and we expect to make significant increased investments in areas of research and technology development to support future growth.

The increase in research and development expenses for the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012 was primarily due to increased compensation, benefits, and other related costs of \$1.1 million mainly due to increased headcount, benefits, and stock compensation expense, and increased consulting and outside services expense of \$325,000.

*General and Administrative* Our general and administrative expenses are comprised primarily of employee compensation and benefits, legal and professional fees, office supplies, travel, and an allocation of facilities costs. The decrease in general and administrative expenses for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012 was primarily due to decreased legal and professional expenses of \$2.1 million partially offset by increased compensation, benefits, and other related costs of \$736,000. The increased compensation, benefits, and other related costs were mainly due to increased headcount, benefits, and increased stock compensation expense. We will continue to incur costs related to litigation, which will cause our general and administrative expenses to be significant as we continue to assert our IP and contractual rights and defend any lawsuits brought against us, but we expect legal expenses will continue to be reduced in 2013 compared to 2012 due to litigation settlements in 2012 and the anticipated impact of a change in legal strategy related to our current litigation.

The decrease in general and administrative expenses for the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012 was primarily due to decreased legal and professional expenses of \$2.2 million, partially offset by increased compensation, benefits, and other related costs of \$1.7 million. The decreased legal and professional expenses were primarily due to decreased litigation expenses of \$1.8 million relating to ongoing and completed litigation, in addition to decreased patent related legal costs of \$237,000, and decreased other professional fees and consulting expense of \$167,000. The increased compensation, benefits, and other related costs were mainly due to increased headcount, benefits, and stock compensation expense.

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*Amortization, Abandonment, and Impairment of Intangibles* Our amortization, abandonment, and impairment of intangibles is comprised primarily of patent amortization and other intangible amortization along with write off of abandoned and expired patents. Amortization, abandonment, and impairment of intangibles increased for the three and nine months ended September 30, 2013 as compared to the three and nine months ended September 30, 2012 mainly due to increased amortization due to the increased number of patents as well as increased write off of abandoned and expired patents.

<b>PROVISION FOR TAXES</b>	<b>September 30, 2013</b>	<b>September 30, 2012</b>	<b>Change</b>	<b>% Change</b>
	<b>(Dollars in thousands)</b>			
<u>Three months ended:</u>				
Provision for income taxes	\$ (257)	\$ (118)	\$ (139)	(118)%
Income (loss) from continuing operations before provision for income taxes	\$ 1,462	\$ (2,872)		
Effective tax rate	17.6%	(4.1)%		
<u>Nine months ended:</u>				
Provision for income taxes	\$ (284)	\$ (737)	\$ 453	61%
Income (loss) from continuing operations before provision for income taxes	\$ 4,518	\$ (4,780)		
Effective tax rate	6.3%	(15.4)%		

*Provision for Income Taxes* The income tax provision increased for the three months ended September 30, 2013 compared to the three months ended September 30, 2012 primarily due to increased foreign withholding tax expense. The income tax provision decreased for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012 primarily due to decreased foreign withholding tax expense.

We maintained a valuation allowance for our entire deferred tax assets at September 30, 2013 and September 30, 2012 as a result of uncertainties regarding the realization of the asset balance due to historical losses, the variability of operating results, and limited visibility into our near term projected results. The process of evaluating the need to continue with a valuation allowance for deferred tax assets is highly subjective and requires significant judgment at many points during the analysis. In the first three months of fiscal 2013, we entered into a multi-year revenue arrangement with one of our key customers that contributed to our profitability in the first nine months of 2013 and has provided us better visibility to our projected results for fiscal 2013. As of the quarter ended September 30, 2013, we remained in a three-year cumulative pre-tax loss position. Based on current projections, and barring any one-time adjustments we expect to be in a three-year cumulative pre-tax income position by December 31, 2013. We expect to complete a full evaluation of the realizability of our deferred tax assets by the end of the current fiscal year. In the event that we determine the deferred tax assets are realizable based on our assessment of relevant factors, an adjustment to the valuation allowance may increase income in the period such determination is made. The valuation allowance does not impact our ability to utilize the underlying net operating loss carryforwards.

We also maintain liabilities for uncertain tax positions. We expect to release reserves and record a tax benefit due to the expiration of the applicable statute of limitations during the next three months. As of September 30, 2013, the total amount of unrecognized tax benefits that would affect our effective tax rate, if recognized, is \$261,000.

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DISCONTINUED OPERATIONS	September 30,		Change	% Change
	2013	2012		
(Dollars in thousands)				
<u>Three months ended:</u>				
Gain on sales from discontinued operations (net of provision for income taxes)	\$ 0	\$ 0	\$ 0	0%
% of total revenue	0%	0%		
<u>Nine months ended:</u>				
Gain on sales from discontinued operations (net of provision for income taxes)	\$ 0	\$ 153	\$ (153)	(100)%
% of total revenue	0%	1%		

*Discontinued Operations* Gain on sales of discontinued operations net of taxes is primarily comprised of additional payments received from the sale in 2009 of our 3D family of products. The decrease in the gain on sales of discontinued operations net of taxes for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012 is due to decreased payments received from the sale of our 3D family of products.

**LIQUIDITY AND CAPITAL RESOURCES**

Our cash, cash equivalents, and short-term investments consist primarily of money market funds and treasury bills and government agency securities. All of our short-term investments are classified as available-for-sale. The securities are stated at market value, with unrealized gains and losses reported as a component of accumulated other comprehensive income (loss), within stockholders' equity.

On September 30, 2013, our cash, cash equivalents, and short-term investments totaled \$64.7 million, an increase of \$21.2 million from \$43.5 million on December 31, 2012.

*Cash provided by (used in) operating activities*

Net cash provided by operating activities during the nine months ended September 30, 2013 was \$17.2 million, an increase of \$18.5 million from the \$1.3 million used in operating activities during the nine months ended September 30, 2012. Cash provided by operating activities during 2013 was primarily the result of our net income of \$4.2 million, an increase of \$5.1 million due to a change in deferred revenue and customer advances primarily due to additional deferred revenue mainly due to new agreements and projects with customers, an increase of \$1.6 million due to a change in accounts and other receivables mainly due to the collection of accounts receivable, and an increase of \$1.1 million due to a change in accrued compensation and other liabilities primarily from an increase in accruals for compensation and benefit related items and legal expenses. The amount of cash provided by operating activities during 2013 was also affected by noncash charges and credits of \$5.3 million, including \$3.4 million of noncash stock-based compensation, \$1.4 million in amortization, abandonment, and impairment of intangibles, and \$459,000 in depreciation and amortization.

*Cash provided by (used in) investing activities*

Net cash used in investing activities during the nine months ended September 30, 2013 was \$11.6 million, an increase in use of cash of \$23.6 million compared to the \$12.0 million provided by investing activities during the nine months ended September 30, 2012. Net cash used in investing activities during the current period consisted of purchases of short-term investments of \$72.0 million, additions to intangibles of \$2.5 million primarily due to capitalization of external patent filing and application costs, and additions to fixed assets of \$174,000. This was partially offset by maturities of short-term investments of \$63.0 million.





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

Net cash provided by financing activities during the nine months ended September 30, 2013 was \$6.5 million compared to the \$4.2 million used during the nine months ended September 30, 2012, an increased source of cash of \$10.7 million. Cash provided by financing activities during the nine months ended September 30, 2013 was due to the exercise of stock options and the issuance of common stock under the ESPP.

We believe that our cash, cash equivalents, and short-term investments will be sufficient to meet our working capital needs for at least the next twelve months. We will continue to protect and defend our extensive IP portfolio, which is expected to result in the continued use of cash. Our board of directors has approved repurchases of our shares of common stock under the previously authorized Stock Repurchase Program which has \$19.4 million remaining. We anticipate that capital expenditures for property and equipment for the year ended December 31, 2013 will be less than \$500,000. We anticipate that capitalization of external patent filings and application costs for the year ended December 31, 2013 will be approximately \$3.5 million. Cash from operations could also be affected by various risks and uncertainties, including, but not limited to the risks detailed in Part II, Item 1A titled "Risk Factors". Additionally, if we acquire businesses, patents, or products, our cash or capital requirements could increase substantially. In the event of such an acquisition, or should any unanticipated circumstances arise that significantly increase our capital requirements, we may elect to raise additional capital through debt or equity financing. Any of these events could result in substantial dilution to our stockholders. There is no assurance that such additional capital will be available on terms acceptable to us, if at all.

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

We presented our contractual obligations in our Annual Report on Form 10-K for the year ended December 31, 2012. Our principal commitments as of September 30, 2013 consist of obligations under operating leases and non-cancellable unconditional purchase obligations. There have been no material changes in those obligations during the nine months ended September 30, 2013.

As of September 30, 2013, we had a liability for unrecognized tax benefits totaling \$689,000 including interest of \$62,000, of which approximately \$261,000 could be payable in cash. We expect to release reserves and record a tax benefit due to the expiration of the statute of limitations during the next three months.

## **RECENT ACCOUNTING PRONOUNCEMENTS**

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

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

*Cash Equivalents and Short-term Investments* We had cash equivalents and short-term investments of \$60.1 million as of September 30, 2013, which are subject to interest rate fluctuations. An increase in interest rates could adversely affect the market value of our cash equivalents and short-term investments. A hypothetical 100 basis point increase in interest rates would result in a decrease of approximately \$245,000 in the fair value of our cash equivalents and

short-term investments as of September 30, 2013.

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

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

## **ITEM 4. CONTROLS AND PROCEDURES**

### **EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

Based on their evaluation as of September 30, 2013, our management with the participation of our Chief Executive Officer and Chief Financial Officer, have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective to ensure that the information required to be disclosed by us in this quarterly report on Form 10-Q was (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

There were no changes to internal controls over financial reporting that occurred during the quarter ended September 30, 2013 that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

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

## **PART II**

### **OTHER INFORMATION**

## **ITEM 1. LEGAL PROCEEDINGS**

### *In re Immersion Corporation Securities Litigation*

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

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

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

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

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

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

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

Complaint seeks damages and injunctive relief. The parties stipulated to stay the case pending the completion of the ITC investigation.

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

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

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

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

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

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

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

Motorola and HTC asserted that the patents are not infringed, invalid, and unenforceable.

On November 21, 2012, we entered into a confidential settlement agreement with Motorola. On January 15, 2013, the Administrative Law Judge issued an Initial Determination terminating the ITC investigation as to Motorola. On March 15, 2013, we dismissed the Motorola Delaware Complaint.

On March 12, 2013, we filed motions to suspend the procedural schedule and to terminate the ITC investigation against HTC. The Administrative Law Judge issued an order granting the motion to suspend the procedural schedule on March 19, 2013 and issued an Initial Determination terminating the ITC investigation as to HTC on March 27, 2013. The decision became final on April 26, 2013.

We requested that the U.S. District Court for the District of Delaware re-open the case against HTC filed in that Court, and the case was reopened on May 1, 2013. We filed an amended complaint on May 3, 2013. HTC answered the amended complaint on June 28, 2013, stating affirmative defenses of (1) non-infringement, (2) invalidity, (3) prosecution history estoppel, (4) equitable estoppel, exhaustion, license, and/or waiver, (5) intervening rights, (6) unclean hands, (7) patent misuse, (8) inequitable conduct based on 720 patent reexamination, (9) inequitable conduct ( 846 patent family), (10) inequitable conduct ( 288 patent), (11) double patenting, (12) failure to comply with 35 U.S.C. § 120, and (13) failure to mark / failure to mitigate.

In the United States Patent Office, HTC has filed requests for ex-parte reexamination of three of Immersion's patents: U.S. Patent No. 7,969,288 (the 288 patent), U.S. Patent No. 7,592,999 (the 999 patent), and U.S. Patent No. 7,982,720 (the 720 patent). Reexamination of the 288 patent was requested on July 30, 2012. The Patent Office granted the request on October 24, 2012. Reexamination of the 999 patent was requested on September 6, 2012. The Patent Office granted the request on November 26, 2012. Reexamination of the 720 patent was requested on September 10, 2012. The Patent Office granted the request on November 28, 2012. On March 19, 2013 the Patent Office issued a non-final office action regarding the reexamination of the 999 patent, rejecting claims 1-3, 6, 8-11, and 13-16. On April 2, 2013 the Patent Office issued a non-final office action regarding the reexamination of the 720 patent, rejecting claims 1-4, 10-13, 15-17, 19, 22, 23, 29, 30, and 33. On May 21, 2013 the Patent Office issued a non-final office action regarding the reexamination of the 288 patent, rejecting claims 18-26. On July 12, 2013, the Patent Office issued a notice of intent to issue reexamination certificate informing us that the reexamination proceeding for the 999 patent has been terminated resulting in the amendment of claims 2,3,6,9-11 and 14-16, the cancellation of claims 1,8 and 13 and the patentability of newly presented claims 18-20. On July 24, 2013, the Patent Office issued the 999 patent

reexamination certificate.

On May 20, 2013, HTC moved to stay the district court case pending completion of the reexaminations of the 288 patent, 999 patent, and 720 patent. On July 11, 2013 the Court denied HTC's motion. On September 30, 2013 the Court entered a Scheduling Order in the case. A hearing on claim construction and dispositive motions is scheduled for November 25, 2014, and trial is scheduled to begin on March 23, 2015.

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



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**ITEM 1A. RISK FACTORS**

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

**Company Risks**

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

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

the competition we may face from third parties and/or the internal design teams of existing and potential licensees;

difficulties in persuading third parties to work with us, to rely on us for critical technology, and to disclose to us proprietary product development and other strategies;

difficulties in persuading existing licensees of our software technologies to additionally license our patents that may cover products that do not include our software technologies;

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

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

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

inability to sign new gaming licenses if video console makers choose not to license third parties to make peripherals for their new consoles, if video console makers no longer require peripherals to play video games, if video console makers no longer utilize technology in the peripherals that are covered by our patents or if the overall market for video consoles deteriorates substantially;

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

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

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

Two customers accounted for 58% of our total revenues for the nine months ended September 30, 2013, of which one was Samsung Electronics Co., Ltd. Four customers accounted for approximately 53% of our total revenues for the nine months ended September 30, 2012, of which one was Samsung Electronics Co. We cannot be certain that customers that have accounted for significant revenue in past periods, individually or as a group, will continue to generate revenue in any future period. If we fail to renew or lose a major customer or group of customers, our revenue could decline if we are unable to replace the lost revenue with revenue from other sources.

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

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

While some of our license agreements provide for fixed royalty payments, many of our license agreements provide for per-unit royalties, and may also be subject to adjustments based on volume. The sales volume and prices of our licensees' products in any given period can be difficult to predict.

In addition, a portion of our revenue comes from development and support services provided to our licensees, or may be part of a contractual arrangement involving multiple elements. Depending upon the nature of the services or elements, all or a portion of the revenue may be recognized ratably over time or may be deferred in part or in whole.

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

***We are currently involved in litigation and administrative proceedings involving some of our key patents; any invalidation or limitation of the scope of our key patents could significantly harm our business.***

As more fully described under Legal Proceedings, we are currently involved in litigation involving some of our patents. The defendant in this litigation has challenged the validity, scope, enforceability and ownership of our patents. In addition, reexamination requests have been filed in the U.S. Patent and Trademark Office (PTO) with respect to patent claims at issue in our litigation. Under a reexamination proceeding and upon completion of the proceeding, the PTO may leave a patent in its present form, narrow the scope of the patent or cancel some or all of the claims of the patent. If some or all of the claims of the patents that are subject to reexamination are canceled, our business may be significantly harmed.

We cannot predict the outcome of the litigation or reexaminations. If there is an adverse ruling in any legal or administrative proceeding relating to the infringement, validity, enforceability or ownership of any of our patents, or if a court or an administrative body such as the PTO limits the scope of the claims of any of our patents, we could be prevented from enforcing, or earning future revenues from those patents, and the likelihood that customers will take new licenses and that current licensees will continue to agree to pay under their existing licenses could be significantly reduced. The resulting reduction in license fees and royalties could significantly harm our business, consolidated financial position, results of operations or cash flows, or the trading price of our common stock.

Furthermore, regardless of the merits of any claim, the continued maintenance of these legal and administrative proceedings may result in substantial legal expenses and diverts our management's time and attention away from our other business operations, which could significantly harm our business. The time to resolution and complexity of our litigation, its significance to our business, the propensity for delay in patent litigation, and the potential that we may lose particular motions as well as the overall litigation all could cause significant volatility in our stock price and materially adversely affect our business and consolidated financial position, results of operations and cash flows.

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

We have been in the past and are currently a party to various legal proceedings. Due to the inherent uncertainties of litigation, we cannot accurately predict how these cases will ultimately be resolved. We anticipate that currently pending litigation will continue to be costly and that future litigation or investigations will result in additional legal expenses, and there can be no assurance that we will be successful or be able to recover the costs we incur in connection with litigation or investigations. We expense litigation and investigatory costs as incurred, and only accrue for costs that have been incurred but not paid to the vendor as of the financial statement date. Litigation and investigations have diverted, and could continue to divert, the efforts and attention of some of our key management and personnel. As a result, until such time as it is resolved or concluded, litigation and investigations could adversely affect our business. Further, any unfavorable outcome could adversely affect our business. For additional background on this and our other litigation, please see Note 13 to the condensed consolidated financial statements in Part I, Item 1- Financial Information and Part II, 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 to our technology and under our IP. These rights may be granted in certain fields of use, or with respect to certain market sectors or product categories, and may include exclusive rights or sublicensing rights. We refer to the license terms and restrictions in our agreements, including, but not limited to, field of use definitions, market sector, and product category definitions, collectively as License Provisions.

Due to the continuing evolution of market sectors, product categories, and licensee business models, and to the compromises inherent in the drafting and negotiation of License Provisions, our licensees may, at some time during the term of their agreements with us, interpret License Provisions in their agreements in a way that is different from our interpretation of such License Provisions, or in a way that is in conflict with the rights that we have granted to other licensees. Such interpretations by our licensees may lead to claims that we have granted rights to one licensee that are inconsistent with the rights that we have granted to another licensee. Many of our customers report royalties to us based on their shipments or their revenues and their interpretation and allocation of contracted royalty rates. It is possible that the originally reported royalties could differ materially from those determined by either a customer self-reported correction or from an audit we have performed. These interpretations may also cause disagreements arising during customer audits, may lead to claims or litigation, and may have an adverse effect on the results of our operations. Further, although our agreements generally give us the right to audit books and records of our licensees, audits can be expensive, time consuming, and may not be cost justified based on our understanding of our licensees businesses. Pursuant to our license compliance program, we audit certain licensees to review the accuracy of the information contained in their royalty reports in an effort to decrease the likelihood that we will not receive the royalty revenues to which we are entitled under the terms of our license agreements, but we cannot give assurances that such audits will be effective.

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 an unexpected manner. As a result, in any agreement, we may have granted rights that will preclude or restrict our exploitation of new opportunities that arise after the execution of the agreement.



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***Competing technologies may harm our business.***

One of our biggest sources of competition is derived from decisions made by internal design groups at our original equipment manufacturer ( OEM ) customers and potential OEM customers. We expect that these internal design groups will continue to make choices regarding whether to implement haptics or not, whether to use our solutions or other standard haptic capability (e.g., haptic capability offered by the Android operating system), or even whether to develop their own haptic solutions. In instances where the design team elects not to use our solutions but implements unlicensed haptic capability, we intend to seek to enforce our IP. If the OEM is unwilling to enter into a license agreement, we may elect to pursue litigation which would harm our relationship with the OEM and could harm our relationships with other licensees or our ability to gain new customers, who may postpone licensing decisions pending the outcome of the litigation or dispute, or who may, as a result of such litigation, choose not to adopt our technologies. In addition, these legal proceedings could be very expensive and could have a negative impact on our financial results.

In our OEM agreements, we typically grant licenses to our patent portfolio for one or more specified fields of use. Depending on the specific terms of our agreement with an OEM, the OEM 's internal design group may be able to develop technology that is less expensive to implement or that enables products with higher performance or additional features than our own technology and products. Many of these internal design groups have substantially greater resources, greater financial strength and lower cost structures than we do. They also have the inherent advantage of access to internal corporate strategies, technology roadmaps and technical information. As a result, they may be able to bring alternative solutions to market more easily and quickly.

In addition to licensing OEMs directly, our business also includes licensing to semiconductor manufacturers who incorporate certain of our less advanced technologies into their integrated circuits for use in certain electronic devices. While our relationships with these semiconductor manufacturers increases our distribution channels by leveraging their sales channels, it is possible that OEMs may elect to implement haptics using less advanced integrated circuit solutions rather than the higher-end solutions we offer directly, which may negatively impact our financial results.

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

In many cases, we must win competitive selection processes, known as design wins, before our haptic technologies are included in our customers' products. These selection processes can be lengthy and can require us to incur significant design and development expenditures. We may not win the competitive selection process and may never generate any revenue despite incurring significant design and development expenditures. Because we typically focus on only a few customers in a given product area, the loss of a design win may result in our failure to have haptics added to new generation products in that area. This can result in lost sales and could hurt our position in future competitive selection processes to the extent we are not perceived as being a technology leader.

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

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

A significant portion of our gaming royalty revenues come from third-party peripheral makers who make licensed gaming products designed for use with popular video game console systems from Microsoft, Sony, and Nintendo. Video game console systems are closed, proprietary systems, and video game console system makers typically impose certain requirements or restrictions on third-party peripheral makers who wish to make peripherals that will be compatible with a particular video game console system. If third-party peripheral makers cannot or are not allowed to satisfy these requirements or restrictions, our gaming royalty revenues could be significantly reduced. Furthermore, should a significant video game console maker choose to omit touch-enabling capabilities from its console systems or somehow restrict or impede the ability of third parties to make touch-enabling peripherals, it could lead our gaming licensees to stop making products with touch-enabling capabilities, thereby significantly reducing our gaming royalty revenues. Also, if the gaming industry changes such that mobile or other platforms increase in popularity at the expense of traditional video game consoles, our gaming royalty revenues could be substantially reduced if we are unable to enter into replacement arrangements enabling us to license our IP in connection with gaming on such mobile or other platforms.



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

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

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

A key part of our business strategy is to license our IP to companies that manufacture and sell products incorporating our touch-enabling technologies. For the nine months ended September 30, 2013 and 2012, 98% and 92%, respectively, of our total revenues were royalty and license revenues. We do not control or influence the design, manufacture, quality control, promotion, distribution, or pricing of products that are manufactured and sold by our licensees, nor can we control consolidation within an industry which could either reduce the number of licensable products available or reduce royalty rates for the combined licensees. In addition, we generally do not have commitments from our licensees that they will continue to use our technologies in current or future products. As a result, products incorporating our technologies may not be brought to market, achieve commercial acceptance, or otherwise generate meaningful royalty revenue for us. For us to generate royalty and license revenue, licensees that pay us per-unit royalties must manufacture and distribute products incorporating our touch-enabling technologies in a timely fashion and generate consumer demand through marketing and other promotional activities. If our licensees' products fail to achieve commercial success or if products are recalled because of quality control problems or if our licensees do not ship products incorporating our touch-enabling technologies in a timely fashion or fail to achieve strong sales, our revenues will not grow and could decline.

***We had an accumulated deficit of \$107 million as of September 30, 2013, have only recently achieved profitability, and may not maintain profitability in the future.***

As of September 30, 2013, we had an accumulated deficit of \$107 million. We need to generate significant ongoing revenue to maintain consistent profitability. We anticipate that we will continue to incur expenses as we:

continue to engage in research and develop our technologies;

increase our sales and marketing efforts;

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

protect and enforce our IP;

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pursue strategic relationships;

incur costs related to pending and anticipated litigation; and

acquire IP or other assets from third-parties.

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

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

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

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

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

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

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

***Because we have a fixed payment license with Microsoft, our royalty revenue from licensing in the gaming market and other consumer markets has previously declined and may further do so if Microsoft increases its volume of sales of touch-enabled 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 (including sublicense rights) 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 devices and tablets. Microsoft has significantly greater financial, sales, and marketing resources, as well as greater name recognition and a larger customer base than some of our other licensees. In the event that Microsoft increases its share of these markets, our royalty revenue from other licensees in these market segments may decline.

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

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

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

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

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

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

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

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

In addition, our patents will continue to expire according to their terms. Our failure to continuously develop or acquire successful innovations and obtain patents on those innovations could significantly harm our business, financial condition, results of operations, or cash flows.

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

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

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

Any legal or administrative proceeding initiated by us to protect or enforce our IP rights may result in substantial legal expenses and may divert our management's time and attention away from our other business operations, which could significantly harm our business.

***Our business may suffer if third parties assert that we violate their IP rights.***

Third parties have previously claimed and may in the future claim that we or our customers are infringing upon their IP rights. Even if we believe that such claims are without merit, they can be time-consuming and costly to defend against and may divert management's attention and resources away from our business. Furthermore, third parties making such claims may be able to obtain injunctive or other equitable relief that could block our ability to further develop or commercialize some or all of our software technologies or services in the U.S. and abroad. Claims of IP infringement also might require us to enter into costly settlement or license agreements or pay costly damage awards. Even if we have an agreement that provides for a third party to indemnify us against such costs, the indemnifying party may be unable or unwilling to perform its contractual obligations under the agreement.

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We license some technologies from third parties. We must rely upon the owners of the technologies for information on the origin and ownership of the 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. If we cannot or do not license the infringed IP at all or on reasonable terms, or substitute similar technology from another source, our business, financial position, results of operations or cash flows could suffer.

***Recent changes to U.S. patent laws and proposed changes to the rules of the U.S. PTO may adversely impact our business.***

Our business relies in part on the uniform and historically consistent application of U.S. patent laws and regulations. There are numerous recent changes to the patent laws and proposed changes to the rules of the PTO, which may have a significant impact on our ability to protect our technology and enforce our IP rights. For example, on September 16, 2011, President Obama signed the Leahy-Smith America Invents Act, which codifies significant changes to the U.S. patent laws, including, among other things, changing from a first to invent to a first inventor to file system, limiting where a patentee may file a patent suit, requiring the apportionment of patent damages, replacing interference proceedings with derivation actions and creating a post-grant opposition process to challenge patents after they have been issued. The effects of these changes on our patent portfolio and business have yet to be determined, as the PTO must still implement regulations relating to these changes and the courts have yet to address the new provisions. The U.S. Congress is also considering additional amendments to the American Invents Act, which if enacted into law, may further restrict the scope and enforceability of our patents. In addition, in recent years, the courts have interpreted U.S. patent laws and regulations differently, and in particular the U.S. Supreme Court has decided a number of patent cases and continues to actively review more patent cases than it has in the past. Some of these changes or potential changes may not be advantageous for us, and may make it more difficult to obtain adequate patent protection or to enforce our patents against parties using them without a license or payment of royalties. These changes or potential changes could increase the costs and uncertainties surrounding the prosecution of our patent applications and the enforcement or defense of our patent rights, and could have a deleterious effect on our licensing program and, therefore, the royalties we can collect.

***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.***

We derive a significant portion of our revenues from licenses and royalties from a relatively small number of key technologies. We devote significant engineering resources to develop new technologies to address the evolving needs of our customers. To remain competitive, we must introduce new technologies in a timely manner and the market must adopt them. Our initiatives to develop new and enhanced technologies and to commercialize these technologies for new applications and new platforms may not be successful or timely. Any new or enhanced technologies may not be favorably received by our licensees or consumers and could damage our reputation or our brand. Expanding our technologies could also require significant additional expenses and strain our management, financial, and operational resources.

Moreover, technology products generally have relatively short product life cycles and our current technologies may become obsolete in the future. Our ability to achieve revenue growth also depends on our continuing ability to improve and reduce the cost of our technologies, to improve their ease of integration in both hardware and software, and to introduce these technologies to the marketplace in a timely manner. If our development efforts are not successful or are significantly delayed, companies may not incorporate our technologies into their products and our

revenues may not grow and could decline.



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

Mobile devices, tablets, touchscreens, personal computer and console gaming peripherals, and automotive and industrial controls incorporating our touch-enabling technologies can be more expensive than similar competitive products that are not touch-enabled. Although many OEMs have licensed our technologies, there is generally no commitment on their part to use our technologies in their devices. The greater expense of development and production of products containing our touch-enabling technologies, together with the higher price to the end customer, may be a significant barrier to their widespread adoption and sale.

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

We have seen, and believe that we will continue to see, an increase in customers requesting that we develop products that will operate in an open source environment. Developing open source compliant products, without imperiling the IP rights upon which our licensing business depends, may prove difficult under certain circumstances, thereby placing us at a competitive disadvantage for new product designs. Some of our proprietary technologies incorporate open source software that may be subject to open source licenses. These open source licenses may require that source code subject to the license be released or made available to the public. Such open source licenses may mandate that software developed based on source code that is subject to the open source license, or combined in specific ways with such open source software, become subject to the open source license. We take steps to ensure that proprietary software we do not wish to disclose is not combined with, or does not incorporate, open source software in ways that would require such proprietary software to be subject to an open source license. However, few courts have interpreted open source licenses, and the manner in which these licenses may be interpreted and enforced is therefore subject to some uncertainty. We often take steps to disclose source code for which disclosure is required under an open source license, but it is possible that we have or will make mistakes in doing so, which could negatively impact our brand or our adoption in the community, or could expose us to additional liability. In addition, we rely on multiple software programmers to design our proprietary products and technologies. Although we take steps to ensure that our programmers (both internal and outsourced) do not include open source software in products and technologies we intend to keep proprietary, we cannot be certain that open source software is not incorporated into products and technologies we intend to keep proprietary. In the event that portions of our proprietary technology are determined to be subject to an open source license, or are intentionally released under an open source license, we could be required to publicly release the relevant portions of our source code, which could reduce or eliminate our ability to commercialize our products and technologies. As a result, our revenues may not grow and could decline.

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

The current global economic conditions and political climate could materially hurt our business in a number of ways, including longer sales and renewal cycles, delays in adoption of our products or technologies or those of our customers, increased risk of competition, higher overhead costs as a percentage of revenue, delays in signing or failing to sign customer agreements or signing customer agreements with reduced royalty rates. In addition, our customers, potential customers, and business partners are facing similar challenges, which could materially and adversely affect the level of business they conduct with us or the sales volume of products that include our technology.

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

We currently have sales personnel in Japan, Korea, Taiwan, China, and Switzerland and we intend to expand our international activities. International operations are subject to a number of difficulties and special costs, including:

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

laws and business practices favoring local competitors;

foreign exchange and currency risks;

import and export restrictions, duties, tariffs, quotas and other barriers;

difficulties staffing and managing foreign operations;

difficulties and expense in enforcing IP rights;

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

multiple conflicting tax laws and regulations;

political and economic instability; and

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

Our international operations could also increase our exposure to international laws and regulations. If we cannot comply with foreign laws and regulations, which are often complex and subject to variation and unexpected changes, we could incur unexpected costs and potential litigation. For example, the governments of foreign countries might attempt to regulate our products or levy sales or other taxes relating to our activities. In addition, foreign countries may impose tariffs, duties, price controls, or other restrictions on foreign currencies or trade barriers, any of which could make it more difficult for us to conduct our business. Our international operations could also increase our exposure to complex international tax rules and regulations. Changes in, or interpretations of, tax rules and regulations may adversely affect our income tax provision. In addition, our operations outside the U.S. may be affected by changes in trade protection laws, policies and measures, and other regulatory requirements affecting trade and investment, including the Foreign Corrupt Practices Act and local laws prohibiting corrupt payments by our employees, vendors, or agents.

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

Our technologies are complex, and we rely upon the continued service of our existing personnel to support licensees, enhance existing technologies, and develop new technologies. Accordingly, our ability to develop and deploy our technologies and to sustain our revenue growth depends upon the continued service of our management and other key personnel, many of whom would be difficult to replace. Furthermore, we believe that there are a limited number of engineering and technical personnel that are experienced in haptics. Management and other key employees may voluntarily terminate their employment with us at any time without notice. The loss of management or key personnel could delay product development cycles or otherwise harm our business.

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

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

We plan to continue expanding our business, and any significant growth could place a significant strain on our management systems, infrastructure and other resources. We will need to continue to invest the necessary capital to upgrade and improve our operational, financial and management reporting systems. If our management fails to manage our growth effectively, we could experience increased costs, declines in product quality, and/or customer satisfaction, which could harm our business.

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

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

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

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

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

***Our customers may have difficulties obtaining the components necessary to manufacture haptic-based products, which could harm our business and results of operations.***

In order to manufacture haptic-based products, our customers require components such as actuators and amplifiers. The inability of suppliers to deliver adequate supplies of these components could disrupt our customers' production processes which would harm our business and results of operations. In addition, certain of our newer products require new types of components that we expect will be developed and sold by our ecosystem partners. Failure of our

ecosystem partners to bring these products to market in a timely and quality fashion at attractive prices may negatively affect our ability to secure customers for these newer products which could harm our business and results of operations. Component suppliers to customers could also be affected by natural disasters and other similar events.

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

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

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

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

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

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

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

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

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



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### **Investment Risks**

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

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

These factors include:

the establishment or loss of licensing relationships;

the timing and recognition of payments under fixed and/or up-front license agreements, as well as other multi-element arrangements;

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

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

developments in and costs of pursuing any pending litigation;

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

the timing of work performed under development agreements; and

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

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

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

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



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

Additionally, the SEC has promulgated final rules in connection with the Dodd-Frank Wall Street Reform and Consumer Protection Act, regarding disclosure of the use of certain minerals, known as conflict minerals, which are mined from the Democratic Republic of the Congo and adjoining countries. The metals covered by the rules include tin, tantalum, tungsten, and gold. The rules require us to conduct a reasonable country of origin inquiry to determine if we know or have reason to believe any of the minerals used in the production process may have originated from the Democratic Republic of the Congo or an adjoining country. If we are not able to determine the minerals did not originate from a covered country, we would be required to perform supply chain due diligence on members of our supply chain. These new requirements may also reduce the number of suppliers who provide conflict free metals, and may affect our, our customers or our manufactures ability to obtain products in sufficient quantities or at competitive prices. Compliance costs and the unavailability of raw materials could have a material adverse effect on our results of operations.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

unanticipated costs associated with the acquisitions;

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

diversion of management's attention from other business concerns;

difficulties in assimilation of acquired personnel or operations;

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

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

potential IP infringement claims related to newly-acquired product lines or technologies; and

potential costs associated with failed acquisition efforts.

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

## **ITEM 6. EXHIBITS**

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

## **SIGNATURES**

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

Date: November 6, 2013

IMMERSION CORPORATION

By

/s/ Paul Norris

Paul Norris

*Chief Financial Officer and Principal Accounting Officer*

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<b>Exhibit</b>	
<b>Number</b>	<b>Description</b>
10.1	Amendment No. 1, Effective as of August 1, 2013, to Amended and Restated License Agreement by and between Immersion Software Ireland Limited, Immersion Corporation, and Samsung Electronics Co., Ltd. Entered into as of January 1, 2013.
31.1	Certification of Victor Viegas, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Paul Norris, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Victor Viegas, Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of Paul Norris, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Report Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

\* This certification is deemed not filed for purposes of section 18 of the Exchange Act or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act or the Exchange Act.