

IMMERSION CORP  
Form 10-Q  
August 01, 2014  
Table of Contents

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

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended June 30, 2014

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	94-3180138
(State or other jurisdiction of	(I.R.S. Employer
incorporation or organization)	Identification No.)
30 Rio Robles, San Jose, California 95134	

(Address of principal executive offices)(Zip Code)

(408) 467-1900

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller Reporting Company

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

Number of shares of common stock outstanding at July 24, 2014: 28,559,337.

**Table of Contents**

**IMMERSION CORPORATION**

**INDEX**

	<b>Page</b>
<b><u>PART I</u></b>	
<b><u>FINANCIAL INFORMATION</u></b>	
Item 1. <u>Financial Statements</u>	
<u>Unaudited Condensed Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013</u>	3
<u>Unaudited Condensed Consolidated Statements of Income and Comprehensive Income for the Three Months and Six Months Ended June 30, 2014 and 2013</u>	4
<u>Unaudited Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2014 and 2013</u>	5
<u>Unaudited Notes to Condensed Consolidated Financial Statements</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	35
Item 4. <u>Controls and Procedures</u>	35
<b><u>PART II</u></b>	
<b><u>OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	36
Item 1A. <u>Risk Factors</u>	38
Item 2. <u>Unregistered Sales of Equity Securities and use of Proceeds</u>	53
Item 6. <u>Exhibits</u>	53
<u>SIGNATURES</u>	54

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

	<b>June 30, 2014</b>	<b>December 31, 2013</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 17,217	\$ 14,136
Short-term investments	56,980	56,976
Accounts and other receivables (net of allowances for doubtful accounts of \$26 and \$9)	1,348	598
Deferred income taxes	7,784	7,784
Prepaid expenses and other current assets	1,094	690
Total current assets	84,423	80,184
Property and equipment, net	1,364	944
Deferred income tax assets	28,031	29,066
Intangibles and other assets, net	345	381
Total assets	\$ 114,163	\$ 110,575
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 1,366	\$ 682
Accrued compensation	2,060	4,680
Other current liabilities	2,119	1,653
Deferred revenue	18,020	8,920
Total current liabilities	23,565	15,935
Long-term deferred revenue	10,462	13,441
Other long-term liabilities	476	528
Total liabilities	34,503	29,904
Contingencies (Note 12)		
Stockholders equity:		

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Common stock and additional paid-in capital \$0.001 par value; 100,000,000 shares authorized; 34,092,042 and 33,619,766 shares issued, respectively; 28,493,004 and 28,637,022 shares outstanding, respectively	202,002	198,057
Accumulated other comprehensive income	114	112
Accumulated deficit	(84,896)	(86,929)
Treasury stock at cost: 5,599,038 and 4,982,744 shares, respectively	(37,560)	(30,569)
<b>Total stockholders equity</b>	<b>79,660</b>	<b>80,671</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 114,163</b>	<b>\$ 110,575</b>

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

**IMMERSION CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
**AND COMPREHENSIVE INCOME**

(In thousands, except per share amounts)

(Unaudited)

	<b>Three Months</b>		<b>Six Months Ended</b>	
	<b>Ended</b>		<b>June 30</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b>Revenues:</b>				
Royalty and license	\$ 11,602	\$ 9,980	\$ 26,759	\$ 23,629
Product sales	0	13	0	32
Development, services, and other	229	208	508	400
<b>Total revenues</b>	<b>11,831</b>	<b>10,201</b>	<b>27,267</b>	<b>24,061</b>
<b>Costs and expenses:</b>				
Cost of revenues (exclusive of amortization of intangibles shown separately below)	101	127	221	275
Sales and marketing	2,637	2,294	5,400	4,541
Research and development	3,006	2,663	6,064	5,236
General and administrative	5,950	4,649	12,471	11,827
Amortization of intangibles	20	20	40	40
<b>Total costs and expenses</b>	<b>11,714</b>	<b>9,753</b>	<b>24,196</b>	<b>21,919</b>
<b>Operating income</b>	<b>117</b>	<b>448</b>	<b>3,071</b>	<b>2,142</b>
Interest and other income	144	28	137	38
<b>Income before provision for income taxes</b>	<b>261</b>	<b>476</b>	<b>3,208</b>	<b>2,180</b>
Provision for income taxes	(92)	(10)	(1,175)	(27)
<b>Net income</b>	<b>\$ 169</b>	<b>\$ 466</b>	<b>\$ 2,033</b>	<b>\$ 2,153</b>
Basic net income per share	\$ 0.01	\$ 0.02	\$ 0.07	\$ 0.08
Shares used in calculating basic net income per share	28,383	28,146	28,376	27,787
Diluted net income per share	\$ 0.01	\$ 0.02	\$ 0.07	\$ 0.07
Shares used in calculating diluted net income per share	29,210	29,293	29,330	28,912

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Other Comprehensive Income				
Change in unrealized gains on short-term investments	1	1	2	4
Total Other Comprehensive Income	1	1	2	4
Total Comprehensive Income	\$ 170	\$ 467	\$ 2,035	\$ 2,157

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

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

(In thousands)

(Unaudited)

	<b>Six Months Ended June 30</b>	
	<b>2014</b>	<b>2013</b>
Cash flows provided by operating activities:		
Net income	\$ 2,033	\$ 2,153
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	234	313
Amortization of intangibles	40	40
Stock-based compensation	2,927	2,189
Allowance (recovery) for doubtful accounts	14	24
Loss on disposal of equipment	19	12
Changes in operating assets and liabilities:		
Accounts and other receivables	(764)	981
Inventories	0	100
Deferred income taxes	1,035	0
Prepaid expenses and other current assets	(404)	(239)
Other assets	(37)	(41)
Accounts payable	676	261
Accrued compensation and other current liabilities	(2,153)	(34)
Deferred revenue	6,121	8,652
Other long-term liabilities	(52)	(46)
Net cash provided by operating activities	9,689	14,365
Cash flows used in investing activities:		
Purchases of available-for-sale investments	(28,969)	(52,971)
Proceeds from maturities of available-for-sale investments	29,000	35,000
Purchases of property and equipment	(666)	(159)
Net cash used in investing activities	(635)	(18,130)
Cash flows provided by (used in) financing activities:		
Issuance of common stock under employee stock purchase plan	176	72
Exercise of stock options	842	6,039
Purchases of treasury stock	(6,991)	0
Net cash provided by (used in) financing activities	(5,973)	6,111
Net increase in cash and cash equivalents	3,081	2,346
Cash and cash equivalents:		



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Beginning of period	14,136	4,558
End of period	\$ 17,217	\$ 6,904
Supplemental disclosure of cash flow information		
Cash paid for taxes	\$ 25	\$ 5
Supplemental disclosure of noncash operating, investing, and financing activities		
Amounts accrued for property and equipment	\$ 30	\$ 3
Release of Restricted Stock Units and Awards under company stock plan	\$ 3,588	\$ 2,942

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents**

**IMMERSION CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**June 30, 2014**

**(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 focused on the creation, design, development, and licensing of 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.; Haptify, Inc.; and Immersion (Shanghai) Science & Technology Company, Ltd. 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, 2013. 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 three months and six months ended June 30, 2014 are not necessarily indicative of the results to be expected for the full year.

*Segment Information*

The Company develops, licenses, and supports a wide range of software and IP that more fully engage users' sense of touch when operating digital devices. The Company focuses on the following target application areas: mobility and consumer electronics, automotive, gaming, commercial and industrial, and medical. The Company's chief operating decision maker ( CODM ) is the Chief Executive Officer. The CODM allocates resources to and assesses the performance of the Company using information about its revenue and operating loss as one operating and reporting segment.

*Intangible Assets*

During the fourth quarter 2013, the Company elected to change its method of accounting for external patent-related costs associated with its internally developed patents and trademarks. Prior to the change the Company capitalized the external legal, filing, continuation or annuity fees associated with patent and trademark applications. These costs were amortized on a straight-line basis over their estimated economic useful lives which were generally ten years from the date of issuance. Under the current method of accounting, external patent-related costs are expensed as incurred and classified as general and administrative expenses in the Company's condensed consolidated statement of income consistent with the classification of internal legal costs associated with internally developed patents and trademarks. Costs

## Table of Contents

associated with acquired patents and other intangible assets continue to be capitalized as incurred. These costs are amortized utilizing the straight-line method, which approximates the pattern of consumption over the estimated useful lives of the respective assets, generally ten years.

In accordance with Accounting Standards Codification ( ASC ) 250, Accounting Changes and Error Corrections, the change in accounting method has been retrospectively applied to all prior periods presented herein. Comparative financial statements of prior years have been adjusted to apply the new method retrospectively.

### *Revenue Recognition*

The Company recognizes revenues in accordance with applicable accounting standards, including 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, development contract and service fees, and, previously, product sales. As described below, management judgments, assumptions, 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.

*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 fees, which is done on a customer-by-customer basis pursuant to the Company's 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. Certain 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. Certain royalties are based upon customer shipments or revenues and could be subject to change and may result in out of period adjustments. The Company recognizes fixed license fee revenue for licenses when earned under the terms of the agreements, which is generally recognized on a straight-line basis over the expected term of the license.

**Table of Contents**

*Development, services, and other revenue* Development, services, and other revenue are composed 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 reliably 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.

*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.

*Recent Accounting Pronouncements*

In May 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2014-09 Revenue from Contracts with Customers: Topic 606 ( ASU 2014-09 ) which will supersede the current revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Further, the guidance requires improved disclosures to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenue that is recognized. ASU 2014-09 is effective for reporting periods beginning after December 15, 2016, and permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through a cumulative adjustment. The Company is required to adopt ASU 2014-09 as of January 1, 2017, and is in the process of determining the method of adoption and evaluating the impact on its consolidated financial statements.

**2. FAIR VALUE MEASUREMENTS***Cash Equivalents and Short-term Investments*

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

**Table of Contents**

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 June 30, 2014 and December 31, 2013 are classified based on the valuation technique in the table below:

	<b>June 30, 2014</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	\$ 56,980	\$ 0	\$ 56,980
Money market accounts	12,532	0	0	12,532
Total assets at fair value	\$ 12,532	\$ 56,980	\$ 0	\$ 69,512

The above table excludes \$4.7 million of cash held in banks.

	<b>December 31, 2013</b>			
	<b>Fair value measurements using</b>			
	<b>Quoted Prices in</b>			
	<b>Active</b>			
	<b>Markets</b>			
	<b>for</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>Identical Assets (Level 1)</b>	<b>(Level 2)</b>			
	<b>(In thousands)</b>				
<b>Assets:</b>					
U.S. Treasury securities	\$ 0	\$ 56,976	\$ 0	\$ 56,976	
Money market accounts	10,075	0	0	10,075	
Total assets at fair value	\$ 10,075	\$ 56,976	\$ 0	\$ 67,051	

The above table excludes \$4.1 million of cash held in banks.

**Table of Contents***Short-term Investments*

	<b>June 30, 2014</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Holding Gains</b>	<b>Gross Unrealized Holding Losses</b>	<b>Fair Value</b>
	<b>(In thousands)</b>			
U.S. Treasury securities	\$ 56,967	\$ 13	\$ 0	\$ 56,980
Total	\$ 56,967	\$ 13	\$ 0	\$ 56,980

	<b>December 31, 2013</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Holding Gains</b>	<b>Gross Unrealized Holding Losses</b>	<b>Fair Value</b>
	<b>(In thousands)</b>			
U.S. Treasury securities	\$ 56,966	\$ 10	\$ 0	\$ 56,976
Total	\$ 56,966	\$ 10	\$ 0	\$ 56,976

The contractual maturities of the Company's available-for-sale securities on June 30, 2014 and December 31, 2013 were all due within one year.

## 3. ACCOUNTS AND OTHER RECEIVABLES

	<b>June 30, 2014</b>	<b>December 31, 2013</b>
	<b>(In thousands)</b>	
Trade accounts receivable	\$ 842	\$ 320
Receivables from vendors and other	506	278
Accounts and other receivables	\$ 1,348	\$ 598

**Table of Contents**

## 4. PROPERTY AND EQUIPMENT

	<b>June 30, 2014</b>	<b>December 31, 2013</b>
	<b>(In thousands)</b>	
Computer equipment and purchased software	\$ 3,411	\$ 3,595
Machinery and equipment	690	704
Furniture and fixtures	819	607
Leasehold improvements	1,293	938
<b>Total</b>	<b>6,213</b>	<b>5,844</b>
Less accumulated depreciation	(4,849)	(4,900)
<b>Property and equipment, net</b>	<b>\$ 1,364</b>	<b>\$ 944</b>

## 5. INTANGIBLES AND OTHER ASSETS

Intangible amounts have been impacted by the Company's change in accounting method for the treatment of external patent and trademark costs. The Company no longer capitalizes external legal, filing, and continuation or annuity fees associated with patent and trademark applications. Under the current method of accounting, these types of external patent-related costs are expensed as incurred and classified as general and administrative expenses in the Company's condensed consolidated statement of income consistent with the treatment of internal legal expenses. Costs associated with purchased patents and other intangible assets continue to be capitalized as incurred. See Note 1 to the condensed consolidated financial statements for additional information regarding this change in accounting method.

	<b>June 30, 2014</b>	<b>December 31, 2013</b>
	<b>(In thousands)</b>	
Purchased patents	\$ 5,731	\$ 5,731
Other assets	292	289
<b>Gross intangibles and other assets</b>	<b>6,023</b>	<b>6,020</b>
Accumulated amortization of purchased patents	(5,678)	(5,639)
<b>Intangibles and other assets, net</b>	<b>\$ 345</b>	<b>\$ 381</b>

**Table of Contents**

The Company amortizes its intangible assets related to purchased patents, over their estimated useful lives, generally 10 years from the purchase date. Amortization of intangibles was as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
	(In thousands)		(In thousands)	
Amortization of intangibles	\$ 20	\$ 20	\$ 40	\$ 40

The table below includes estimated remaining annual amortization expense for purchased patents as of June 30, 2014.

	Estimated Amortization Expense (In thousands)
Remainder of 2014	\$ 27
2015	20
2016	6
Total	\$ 53

## 6. COMPONENTS OF OTHER CURRENT LIABILITIES

	June 30,	December 31,
	2014	2013
	(In thousands)	
Accrued legal	\$ 1,216	\$ 780
Income taxes payable	53	41
Other current liabilities	850	832
Total other current liabilities	\$ 2,119	\$ 1,653

**Table of Contents****7. LONG-TERM DEFERRED REVENUE**

Long-term deferred revenue consisted of the following:

	<b>June 30, 2014</b>	<b>December 31, 2013</b>
	<b>(In thousands)</b>	
Deferred revenue for Sony Computer Entertainment	\$ 9,946	\$ 12,840
Other deferred revenue	516	601
<b>Long-term deferred revenue</b>	<b>\$ 10,462</b>	<b>\$ 13,441</b>

Deferred revenue for Sony Computer Entertainment represents deferred license revenue where payments have been received in advance of revenue recognition.

**8. 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 this program, 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 four years and expire from five to ten years from the date of grant. Restricted stock generally vests over one year. RSUs generally vest over three years. Awards granted other than an option or stock appreciation right reduce the common stock shares available for grant under the program by 1.75 shares for each share issued.

	<b>June 30, 2014</b>
Common stock shares available for grant	2,561,231
Common stock options outstanding	3,366,881
Restricted stock awards outstanding	35,364
Restricted stock units outstanding	565,872

*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 June 30, 2014, 537,110 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 six months ended June 30, 2014 are listed below. Shares purchased under the ESPP for the six months ended June 30, 2013 are 16,003. The intrinsic value listed below is calculated as the difference between the market value on the date of purchase and the purchase price of the shares.

**Table of Contents**

	<b>Six Months Ended June 30, 2014</b>
Shares purchased under ESPP	17,670
Average price of shares purchased under ESPP	\$ 9.95
Intrinsic value of shares purchased under ESPP	\$ 31,011

*Summary of Standard Stock Options*

The following table sets forth the summary of standard option activity under the Company's stock option plans for the six months ended June 30, 2014 and year ended December 31, 2013:

	<b>Six Months Ended June 30, 2014</b>	<b>Year Ended December 31, 2013</b>
Beginning outstanding balance	3,227,167	3,155,631
Granted	309,815	1,058,700
Exercised	(129,969)	(956,633)
Forfeited and cancelled	(90,132)	(30,531)
<b>Ending outstanding balance</b>	<b>3,316,881</b>	<b>3,227,167</b>
Aggregate intrinsic value of options exercised	\$ 617,000	\$ 5,774,000
Weighted average fair value of options granted	5.52	5.63

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 these standard stock options outstanding at June 30, 2014 and December 31, 2013 is summarized below:

	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Life (years)</b>	<b>Aggregate Intrinsic Value (In millions)</b>
<b>December 31, 2013</b>				
Options outstanding	3,227,167	\$ 7.78	5.46	\$ 9.9
Options vested and expected to vest using estimated forfeiture rates	2,994,044	7.61	5.41	9.6
Options exercisable	1,774,546	6.67	4.95	7.5
<b>June 30, 2014</b>				
Options outstanding	3,316,881	\$ 8.21	5.10	\$ 15.7

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Options vested and expected to vest using estimated forfeiture rates	3,166,036	8.11	5.05	15.3
Options exercisable	1,997,020	7.08	4.60	11.8



**Table of Contents***Summary of Market Condition Based Stock Options*

In 2014 the Company began granting options that are subject to both time-based vesting and a market condition. For these options, the closing price of the Company stock must exceed a certain level for a number of trading days within a specified timeframe or the options will be cancelled before the seven year life of the options. The following table sets forth the summary of the market-based option activity under the Company's stock option plans for the six months ended June 30, 2014:

	<b>Six Months Ended June 30, 2014</b>
<b><u>Market Condition Based Stock Options</u></b>	
Beginning outstanding balance	0
Granted	50,000
Exercised	0
Forfeited and cancelled	0
Ending outstanding balance	50,000
Aggregate intrinsic value of options exercised	\$ 0
Weighted average fair value of options granted	5.71

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 these market condition based stock options outstanding at June 30, 2014 is summarized below:

	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Life (years)</b>	<b>Aggregate Intrinsic Value (In millions)</b>
<b><u>Market Condition Based Stock Options</u></b>				
<b><u>June 30, 2014</u></b>				
Options outstanding	50,000	\$ 11.94	6.65	\$ 0.0
Options vested and expected to vest using estimated forfeiture rates	42,795	11.94	6.65	0.0
Options exercisable	0	0.00	0.00	0.0

**Table of Contents***Summary of Restricted Stock Units*

RSU activity for the six months ended June 30, 2014 and year ended December 31, 2013 was as follows:

	<b>Six Months Ended June 30, 2014</b>	<b>Year Ended December 31, 2013</b>
Beginning outstanding balance	668,056	708,651
Awarded	214,380	294,150
Released	(280,637)	(303,882)
Forfeited	(35,927)	(30,863)
<b>Ending outstanding balance</b>	<b>565,872</b>	<b>668,056</b>
Weighted average grant date fair value of RSUs granted	\$ 11.85	\$ 7.12
Total fair value of RSUs released	3,105,000	2,806,000
Total fair value of RSUs remaining unvested	7,198,000	6,934,000

Information regarding RSUs outstanding at June 30, 2014 and December 31, 2013 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, 2013</u></b>				
RSUs outstanding	668,056	0.91	\$ 6.9	\$ 6.9
RSUs vested and expected to vest using estimated forfeiture rates	583,711	0.89	6.1	
<b><u>June 30, 2014</u></b>				
RSUs outstanding	565,872	1.19	\$ 7.2	\$ 7.2
RSUs vested and expected to vest using estimated forfeiture rates	517,550	1.17	6.6	

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

Restricted stock award activity for the six months ended June 30, 2014 and year ended December 31, 2013 was as follows:

	<b>Six Months Ended June 30, 2014</b>	<b>Year Ended December 31, 2013</b>
Beginning outstanding balance	44,000	44,000
Awarded	35,364	44,000
Released	(44,000)	(44,000)
Forfeited	0	0
 Ending outstanding balance	 35,364	 44,000
 Weighted average grant date fair value of restricted stock awarded	 \$ 10.97	 \$ 14.09
Total fair value of restricted stock awards released	483,000	676,000

*Stock Plan Assumptions*

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

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b><u>Standard Stock Options</u></b>				
Expected life (in years)	4.7	4.7	4.7	4.9
Volatility	56%	67%	57%	68%
Interest rate	1.4%	0.8%	1.4%	0.8%
Dividend yield	N/A	N/A	N/A	N/A

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2014</b>		<b>2014</b>	
<b><u>Market Condition Based Stock Options</u></b>				
Expected life (in years)	N/A		7.0	
Volatility	N/A		66%	
Interest rate	N/A		2.2%	
Dividend yield	N/A		N/A	

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b><u>Employee Stock Purchase Plan</u></b>				
Expected life (in years)	N/A	N/A	0.5	0.5
Volatility	N/A	N/A	39%	66%
Interest rate	N/A	N/A	0.1%	0.1%
Dividend yield	N/A	N/A	N/A	N/A

**Table of Contents***Compensation Costs*

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(In thousands)</b>		<b>(In thousands)</b>	
<b><u>Statement of Income Classifications</u></b>				
Sales and marketing	\$ 324	\$ 109	\$ 554	\$ 273
Research and development	268	262	743	576
General and administrative	752	780	1,630	1,340
<b>Total</b>	<b>\$ 1,344</b>	<b>\$ 1,151</b>	<b>\$ 2,927</b>	<b>\$ 2,189</b>

As of June 30, 2014, there was \$8.3 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 3.12 years for standard options, 3.67 years for market condition based options, 1.75 years for RSUs, and 0.93 years for restricted stock awards. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

**9. STOCKHOLDERS' EQUITY***Comprehensive Income*

In February 2013, the FASB ratified 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. ASU 2013-02 was effective for reporting periods beginning after December 15, 2012, and was applied prospectively.

**Table of Contents**

The changes in accumulated other comprehensive income are included in the table below.

	<b>Six Months Ended June 30, 2014</b>		
	<b>Unrealized Gains and Losses on Available-for-Sale Securities</b>	<b>Foreign Currency Items</b>	<b>Total</b>
	<b>(In thousands)</b>		
Beginning balance	\$ 11	\$ 101	\$ 112
Other comprehensive income before reclassifications	2	0	2
Amounts reclassified from accumulated other comprehensive income	0	0	0
Net current period other comprehensive income	2	0	2
Ending Balance	\$ 13	\$ 101	\$ 114

*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 ( "Stock Repurchase Program" ). 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 and six months ended June 30, 2014, the Company repurchased 10,875 and 616,294 shares for \$109,000 and \$7.0 million at an average cost of \$10.03 and \$11.34, respectively, net of transaction costs, through open market repurchases. These amounts are classified as treasury stock on the Company's condensed consolidated balance sheet. The program currently remains available with approximately \$12.4 million that may yet be purchased under it. During the three and six months ended June 30, 2013 there were no stock repurchases under this program.

**10. INCOME TAXES**

Income tax provisions consisted of the following:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(In thousands)</b>		<b>(In thousands)</b>	
Income before provision for income taxes	\$ 261	\$ 476	\$ 3,208	\$ 2,180

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Provision for income taxes	(92)	(10)	(1,175)	(27)
Effective tax rate	35.2%	2.1%	36.6%	1.2%

**Table of Contents**

The provision for income tax for the three and six months ended June 30, 2014 resulted primarily from the Company's federal and foreign tax recognized at statutory rates, adjusted for the tax impact of nondeductible permanent items including stock-based compensation and foreign withholding taxes. The income tax provision for the three and six months ended June 30, 2013 is primarily as a result of foreign taxes and foreign withholding tax expense.

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. ASU 2013-11 was effective for reporting periods beginning after December 15, 2013, and may be applied retrospectively. The impact was not significant on the Company's condensed consolidated results of operations and financial condition.

As of June 30, 2014, the Company had unrecognized tax benefits under ASC 740 "Income Taxes", of approximately \$1.7 million including interest of \$69,000. The total amount of unrecognized tax benefits that would affect the Company's effective tax rate, if recognized, was \$268,000. There were no material changes in the amount of unrecognized tax benefits during the six months ended June 30, 2014. The Company expects to release reserves and record a tax benefit due to the expiration of applicable statutes of limitations during the next twelve months. The Company's policy is to account for interest and penalties related to uncertain tax positions as a component of income tax provision.

Net deferred income taxes were \$35.8 million as of June 30, 2014, consisting primarily of federal net operating loss carryforwards and timing differences between book and tax. 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 of \$7.1 million against deferred tax assets, including state and certain foreign deferred tax assets. The Company has determined there is not sufficient evidence to support the release of the valuation allowance against these state and foreign deferred tax assets.

**11. NET INCOME PER SHARE**

Basic net income 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 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 per share:

<b>Three Months Ended</b>		<b>Six Months Ended</b>	
<b>June 30,</b>		<b>June 30,</b>	
<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b>(in thousands except per share amounts)</b>			



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<b>Numerator:</b>								
Net income	\$	169	\$	466	\$	2,033	\$	2,153
<b>Denominator:</b>								
Shares used in computation of basic net income per share (weighted average common shares outstanding)		28,383		28,146		28,376		27,787
<b>Dilutive potential common shares:</b>								
Restricted Stock and RSUs		159		272		273		323
Stock options		668		875		681		802
Shares used in computation of diluted net income per share		29,210		29,293		29,330		28,912
Basic net income per share	\$	0.01	\$	0.02	\$	0.07	\$	0.08
Diluted net income per share	\$	0.01	\$	0.02	\$	0.07	\$	0.07

**Table of Contents**

For the three months and six months ended June 30, 2014, options to purchase approximately 1.6 million and 1.5 million shares of common stock, respectively, with exercise prices greater than the average fair market value of the Company's stock of \$10.85 and \$11.03 per share, respectively, were not included in the calculation because the effect would have been anti-dilutive.

For the three months and six months ended June 30, 2013, options to purchase approximately 1.1 million and 865,000 shares of common stock, respectively, with exercise prices greater than the average fair market value of the Company's stock of \$12.79 and \$10.39 per share, respectively, were not included in the calculation because the effect would have been anti-dilutive.

12. 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 Company directors and officers.

On September 2, 2009, a securities class action complaint was filed in the U.S. 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 Company 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.

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## **Table of Contents**

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, the 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. The 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. The Court heard oral argument on February 12, 2014 and took the matter under submission.

### *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.

## **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

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**Table of Contents**

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 1,700 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.

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, development contract and service fees, and, previously, product sales. 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.

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**Table of Contents**

*Collectibility is probable.* To recognize revenue, we must judge collectibility of 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. Certain 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. Certain royalties are based upon customer shipments or revenues and could be subject to change and may result in out of period adjustments. We recognize fixed license fee revenue for licenses when earned under the terms of the agreements, which is generally recognized on a straight-line basis over the expected term of the license.

*Development, services, and other revenue* Development, services, and other revenue are composed of engineering services (engineering services and/or development contracts), and in limited cases, 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* 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 reliably 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 methods* We use the Black-Scholes-Merton option pricing model ( Black-Scholes model ), single-option approach to determine the fair value of standard stock options and ESPP shares. All share-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. Stock-based compensation expense



## **Table of Contents**

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.

We use the Monte-Carlo Simulation model to value our stock options with a market condition. Valuation techniques such as a Monte-Carlo Simulation model have been developed to value path-dependent awards. The Monte-Carlo Simulation model is a generally accepted statistical technique used, in this instance, to simulate a range of future stock prices for the Company.

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 and the Monte-Carlo Simulation 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.

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.

See Note 8 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

## **Table of Contents**

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 10 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 within stockholders' equity.

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

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

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

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

### *Patents and Intangible Assets*

Intangible assets with finite useful lives are amortized and intangible assets with indefinite lives are not amortized but rather are tested at least annually for impairment.

We have acquired patents and other intangible assets. In addition, we internally develop and license IP and software, and when possible, we protect our IP and software with patents and trademarks. During the fourth quarter 2013, we

changed our method of accounting for external patent-related costs associated with our internally developed patents and trademarks. Prior to the change we capitalized the external legal, filing, and continuation or annuity fees associated with patent and trademark applications. These costs were amortized on a straight-line basis over their estimated economic useful lives which were generally 10 years from the date of issuance. Under the current method of accounting, external patent-related costs are expensed as incurred and classified as general and administrative expenses in our condensed consolidated

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**Table of Contents**

statement of income, consistent with the classification of internal legal costs associated with internally developed patents and trademarks. Costs associated with the purchase of patents continue to be capitalized as before. These costs are amortized utilizing the straight-line method, which approximates the pattern of consumption over the estimated useful lives of the respective assets, generally ten years. See Note 1 to the condensed consolidated financial statements for additional information regarding this change in accounting method.

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 SIX MONTHS ENDED JUNE 30, 2014 AND 2013**

The following discussion and analysis includes our results of operations for the three months and six months ended June 30, 2014 and 2013.

***Overview***

Total revenue increased by 16% for the three months ended June 30, 2014 compared to the three months ended June 30, 2013, driven by a 16% increase in royalty and license revenue. The increase in royalty and license revenue for the three month period was primarily due to increased revenue from our gaming and mobility licensees along with increases from our medical and automotive licensees as well. Total revenue increased by 13% for the six months ended June 30, 2014 compared to the six months ended June 30, 2013 driven by a 13% increase in royalty and license revenue. The increase in royalty and license revenue for the six month period was primarily due to increased revenue from our gaming licensees along with increases from our medical and automotive licensees; partially offset by a decrease in revenue from our mobility licensees, mainly due to decreased revenue of approximately \$2 million resulting from an overlapping receipt of both tail revenue and new revenue under an agreement that expired and was subsequently renewed in the three months ended March 2013 that did not recur in 2014.

Our net income was \$169,000 for the three months ended June 30, 2014 as compared to net income of \$466,000 for the three months ended June 30, 2013. The decrease in net income was primarily due to increased operating expenses of \$2.0 million mainly due to higher general and administrative expenses driven by increased litigation and other legal expenses, partially offset by increased gross profit of \$1.7 million resulting primarily from additional royalty and license revenue. Sales and marketing and research and development expenses also contributed to the operating expense increase compared to the prior year three month period. Our net income was \$2.0 million for the six months ended June 30, 2014 as compared to a net income of \$2.2 million for the six months ended June 30, 2013. The decrease in net income was primarily due to a higher provision for income taxes of \$1.1 million and increased operating expenses of \$2.3 million mainly due to increased sales and marketing expenses, research and development expenses, and general and administrative expenses primarily due to increased compensation, benefits, and other related costs; partially offset by increased gross profit of \$3.3 million resulting primarily from additional royalty and license revenue.

In 2014, we expect royalty and license revenue, mainly from our mobility and gaming lines of business, to be the major component of our revenue as our technology continues to be included in more of our licensees' products, and as we continue to execute 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.

**Table of Contents**

REVENUES	June 30,		Change	% Change
	2014	2013		
(In thousands)				
<u>Three months ended:</u>				
Royalty and license	\$ 11,602	\$ 9,980	\$ 1,622	16%
Product sales	0	13	(13)	(100)%
Development, services, and other	229	208	21	10%
<b>Total Revenues</b>	<b>\$ 11,831</b>	<b>\$ 10,201</b>	<b>\$ 1,630</b>	<b>16%</b>
<u>Six months ended:</u>				
Royalty and license	\$ 26,759	\$ 23,629	\$ 3,130	13%
Product sales	0	32	(32)	(100)%
Development, services, and other	508	400	108	27%
<b>Total Revenues</b>	<b>\$ 27,267</b>	<b>\$ 24,061</b>	<b>\$ 3,206</b>	<b>13%</b>

**Three Months Ended June 30, 2014 Compared to Three Months Ended June 30, 2013**

*Royalty and license revenue* Royalty and license revenue is composed of royalties earned on sales by our licensees and license fees charged for our IP. The increase in royalty and license revenue for the three months ended June 30, 2014 compared to the three months ended June 30, 2013 was primarily due to increases in royalty and license revenue from our mobility and gaming licensees and to a lesser extent increases from our automotive and medical licensees.

Variable royalty revenue based on shipping volumes and per unit prices increased to \$3.9 million for the three months ended June 30, 2014 from \$3.8 million for the three months ended June 30, 2013, due to an increased level of sales by our mobility and automotive customers, partially offset by a decreased level of sales by our gaming and medical customers. Fixed payment license revenue increased to \$7.7 million for the three months ended June 30, 2014 from \$6.2 million for the three months ended June 30, 2013, due to the increased license fees from gaming, mobility and medical licensees.

Royalty and license revenue from gaming customers increased by 23%, primarily due to the sale of gaming console products that have incorporated our technology and which were released to the market in the fourth quarter of 2013, including the Sony PlayStation 4. Revenue from gaming customers can 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.

Royalty and license revenue from mobility customers increased by 15%, primarily due to increased revenue from the new licensees in China and the U.S. from whom we did not receive any revenue in the year-ago period. Partially offsetting this increase was a decrease in revenue from our mobility customers in Japan due to a consolidation in the market. We anticipate that the mobility line of business will continue to be of primary importance as mobile device manufacturers continue to recognize the value of our IP and technology and as we expand our presence in Asia.

Royalty and license revenue from medical customers increased by 14%, primarily due to increased license fees from licensees.





## **Table of Contents**

Royalty and license revenue from automotive customers increased by 9%, due to our technology being incorporated in an increased volume of vehicles sold by our licensees.

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. We typically experience seasonally higher revenue from our gaming and mobility customers due to the reporting of holiday sales in the first calendar quarter compared to other calendar quarters. As we have entered into license agreements that include recurring fixed payments to us, we expect that the effect of seasonality may be less in 2014 and in future years.

*Product sales* Product sales decreased as we discontinued selling all products as of December 31, 2013. We will have no future product sales and will focus on licensing our software and patents going forward.

*Development, services, and other revenue* Development, services, and other revenue is composed of primarily of development work, implementation support, and other contract engineering services provided to customers. Development, services, and other revenue increased mainly due to an increase in ongoing engineering services for new and legacy 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, services, and other revenue to be a significant part of total revenues in the future.

We categorize our geographic information into three major regions: North America, Europe and Asia. In the three months ended June 30, 2014, revenue generated in North America, Europe and Asia represented 31%, 2% and 67% of total revenue, respectively, compared to 21%, 8% and 71% of total revenues, respectively, for the three months ended June 30, 2013. The shift in revenues among regions was mainly due to an increase in royalty and license revenue in North America primarily due to an increase from our gaming and mobility licensees. This was offset by a decrease in royalty and license revenue in Europe which was primarily due to decreased revenue from our gaming licensees. The increase in royalty and license revenue in Asia from our gaming and mobility licensees was relatively less than the increase in North America, resulting in a decrease in the percentage of revenue attributed to Asia as a part of total revenue.

## **Six Months Ended June 30, 2014 Compared to Six Months Ended June 30, 2013**

*Royalty and license revenue* The increase in royalty and license revenue for the six months ended June 30, 2014 compared to the six months ended June 30, 2013 was primarily due to increased revenue from our gaming licensees and to a lesser extent from our medical and automotive licensees partially offset by a decrease in revenue from our mobility licensees.

Variable royalty revenue based on shipping volumes and per unit prices increased to \$11.4 million for the six months ended June 30, 2014 from \$11.3 million for the six months ended June 30, 2013, due to an increased level of sales by our gaming licensees, partially offset by decreased revenue of approximately \$2 million resulting from an overlapping receipt of both tail revenue and new revenue under an agreement that expired and was subsequently renewed in the first six months of 2013 that did not recur in 2014. Fixed payment license increased to \$15.3 million for the six months ended June 30, 2014 from \$12.3 million for the six months ended June 30, 2013, due to increased fees from gaming, mobility and medical licensees.

Royalty and license revenue from gaming customers increased by 63%, primarily due to the sale of new gaming console products that have incorporated our technology which were released to the market in the fourth quarter of 2013, including the Sony PlayStation 4. Revenue from gaming customers can 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.

Royalty and license revenue from medical customers increased by 26%, primarily due to an increased volume of units sold by these customers and increased fees from licensees.

**Table of Contents**

Royalty and license revenue from automotive customers increased by 16%, due to our technology being incorporated in an increased volume of vehicles sold by our licensees.

Royalty and license revenue from mobility customers decreased by 4%, primarily due to decreased revenue of approximately \$2 million resulting from an overlapping receipt of both tail revenue and new revenue under an agreement that expired and was subsequently renewed in the six months ended June 2013 that did not recur in 2014. Partially offsetting this decrease was additional revenue from new customer contracts in China and the U.S.

*Product sales* Product sales decreased as we discontinued selling all products as of December 31, 2013. We will have no future product sales and will focus on licensing our software and patents going forward.

*Development, services, and other revenue* Development, services, and other revenue increased mainly due to an increase in ongoing engineering services for new and legacy 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, services, and other revenue to be a significant part of total revenues in the future.

We categorize our geographic information into three major regions: North America, Europe and Asia. In the six months ended June 30, 2014, revenue generated in North America, Europe and Asia represented 33%, 4% and 63% of total revenues, respectively, compared to 26%, 4% and 70% of total revenues, respectively, for the six months ended June 30, 2013. The shift in revenues among regions was mainly due to an increase in royalty and license revenue in North America offset by a slight decrease in royalty and license revenue in Europe. The increase in royalty and license revenue in North America was primarily due to an increase from our gaming and mobility licensees. The decrease in royalty and license revenue from Europe was primarily due to decreased revenue from our gaming licensees; partially offset by increased revenue from our automobile licensees. The increase in royalty and license revenue in Asia from our gaming and mobility licensees was relatively less than the increase in North America, resulting in a decrease in the percentage of revenue attributed to Asia as a part of total revenue.

COST OF REVENUES	June 30,		Change	% Change
	2014	2013		
	(Dollars in thousands)			
Three months ended:				
Cost of revenues	\$ 101	\$ 127	\$ (26)	(20)%
% of total revenues	1%	1%	0%	
Six months ended:				
Cost of revenues	\$ 221	\$ 275	\$ (54)	(20)%
% of total revenues	1%	1%	0%	

*Cost of Revenues* Our cost of revenues consists primarily of labor related costs for development, services, and other revenue; as well as direct materials, contract manufacturing, and other overhead costs for product sales. The discontinuation of all product sales as of December 31, 2013 was the major contributor to the reduction of cost of revenues for the three and six months ended June 30, 2014 as compared to the three and six months ended 2013. Future costs of revenues will be limited to costs for development, services, and other revenue.

**Table of Contents**

OPERATING EXPENSES	June 30,		Change	% Change
	2014	2013		
	(Dollars in thousands)			
Three months ended:				
Sales and marketing	\$ 2,637	\$ 2,294	\$ 343	15%
% of total revenue	22%	22%	0%	
Research and development	\$ 3,006	\$ 2,663	\$ 343	13%
% of total revenue	25%	26%	(1)%	
General and administrative	\$ 5,950	\$ 4,649	\$ 1,301	28%
% of total revenue	50%	46%	4%	
Amortization of intangibles	\$ 20	\$ 20	\$ 0	0%
% of total revenue	0%	0%	0%	
Six months ended:				
Sales and marketing	\$ 5,400	\$ 4,541	\$ 859	19%
% of total revenue	20%	19%	1%	
Research and development	\$ 6,064	\$ 5,236	\$ 828	16%
% of total revenue	22%	22%	0%	
General and administrative	\$ 12,471	\$ 11,827	\$ 644	5%
% of total revenue	46%	49%	(3)%	
Amortization of intangibles	\$ 40	\$ 40	\$ 0	0%
% of total revenue	0%	0%	0%	

*Sales and Marketing* Our sales and marketing expenses are composed 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 June 30, 2014 as compared to the three months ended June 30, 2013 was primarily due to increased compensation, benefits, and other related costs of \$446,000, mainly due to increased headcount and stock compensation expense; and increased travel costs of \$50,000 due to increased headcount; partially offset by decreased marketing and advertising costs of \$144,000. We expect that sales and marketing expenses will increase in 2014 as we continue to invest in sales and marketing to further our focus on increasing market acceptance for our touch technologies and expanding our focus on the content and media business.

The increase in sales and marketing expense for the six months ended June 30, 2014 as compared to the six months ended June 30, 2013 was primarily due to increased compensation, benefits, and other related costs of \$737,000, mainly due to increased headcount and stock compensation expense; increased travel costs of \$170,000 mainly due to increased headcount; partially offset by decreased marketing, advertising, and public relations costs of \$61,000.

*Research and Development* Our research and development expenses are composed primarily of employee compensation and benefits, consulting fees, tooling and supplies, and an allocation of facilities

**Table of Contents**

costs. The increase in research and development expenses for the three months ended June 30, 2014 as compared to the three months ended June 30, 2013 was primarily due to increased compensation, benefits, and other related costs of \$146,000 mainly due to increased headcount expense, increased travel costs of \$67,000 due to increased headcount, and increased consulting and outside services expense of \$77,000, in part related to our investment in our content and media initiative. 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 including investment in our content and media business.

The increase in research and development expenses for the six months ended June 30, 2014 as compared to the six months ended June 30, 2013 was primarily due to increased compensation, benefits, and other related costs of \$535,000 mainly due to increased headcount, benefits, and stock compensation expense; increased travel costs of \$109,000 due to increased headcount; and increased consulting and outside services expense of \$154,000, in part related to our investment in our content and media initiative.

*General and Administrative* Our general and administrative expenses are composed primarily of employee compensation and benefits, legal and professional fees, external legal costs for patents, office supplies, travel, and an allocation of facilities costs. The increase in general and administrative expenses for the three months ended June 30, 2014 as compared to the three months ended June 30, 2013 was primarily due to increased legal, professional and license fee expenses of \$1.6 million; partially offset by decreased compensation, benefits, and other related costs of \$306,000. The increased legal, professional and license fee expenses were primarily due to increased patent related legal costs of \$693,000, increased litigation expenses of \$455,000 relating to ongoing litigation, and increased other professional services and license fee expenses of \$406,000. We will continue to incur costs related to litigation, as we continue to assert our IP and contractual rights and defend any lawsuits brought against us.

The increase in general and administrative expenses for the six months ended June 30, 2014 as compared to the six months ended June 30, 2013 was primarily due to increased legal, professional and license fee expenses of \$362,000, increased compensation, benefits, and other related costs of \$102,000, increased public company expense, fees, and taxes of \$102,000, and increased foreign exchange expense of \$78,000. The increased legal, professional and license fee expenses were primarily due to increased patent related legal costs of \$777,000, increased other professional services and license fee expense of \$721,000, partially offset by decreased litigation expenses of \$1.1 million relating to ongoing and completed litigation.

INTEREST AND OTHER INCOME	June 30,		Change	% Change
	2014	2013		
	(Dollars in thousands)			
Three months ended:				
Interest and other income	\$ 144	\$ 28	\$ 116	414%
% of total revenue	1%	0%	1%	
Six months ended:				
Interest and other income	\$ 137	\$ 38	\$ 99	261%
% of total revenue	1%	0%	1%	

*Interest and Other Income* Interest and other income consists primarily of interest income from cash and cash equivalents and short-term investments, interest on notes receivable, exchange rate gains and losses, and other income. Interest and other income increased for the three and six months ended June 30, 2014 as compared to the three and six months ended June 30, 2013, primarily as a result of exchange rate gains and increased interest on notes receivable.



**Table of Contents**

PROVISION FOR TAXES	June 30,		Change	% Change
	2014	2013		
	(Dollars in thousands)			
Three months ended:				
Provision for income taxes	\$ (92)	\$ (10)	\$ (82)	820%
Income before provision for income taxes	\$ 261	\$ 476		
Effective tax rate	35.2%	2.1%		
Six months ended:				
Provision for income taxes	\$ (1,175)	\$ (27)	\$ (1,148)	4252%
Income before provision for income taxes	\$ 3,208	\$ 2,180		
Effective tax rate	36.6%	1.2%		

*Provision for Income Taxes* For the three months ended June 30, 2014 we recorded a provision for income taxes of \$92,000 yielding an effective tax rate of 35.2%. The effective tax rate was estimated based upon a forecast of our full year results. For the three months ended June 30, 2013 we recorded a provision for income taxes of \$10,000 yielding an effective tax rate of 2.1%. We carried a full valuation allowance in the prior year period and, as a result, the provision primarily reflects foreign tax withholding expense incurred in the period.

In 2014, we began and continue to expect to use a 35% tax rate to record the federal portion of our income tax provision expense, yet we continue to expect there to be a minimal cash impact as we will use our net operating losses and other deferred tax assets that have been carried forward to reduce taxes paid in cash.

For the six months ended June 30, 2014 we recorded a provision for income taxes of \$1.2 million yielding an effective tax rate of 36.6%. The effective tax rate was estimated based upon a forecast of our full year results. The effective rate was greater than the U.S. Federal tax rate of 35% primarily due to permanent differences between book and tax pre-tax income. For the six months ended June 30, 2013 we recorded a provision for income taxes of \$27,000 yielding an effective tax rate of 1.2%. The provision primarily reflects foreign tax withholding expense incurred in the period.

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 six months. As of June 30, 2014, the total amount of unrecognized tax benefits that would affect our effective tax rate, if recognized, is \$268,000.

**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, within stockholders' equity.

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**Table of Contents**

On June 30, 2014, our cash, cash equivalents, and short-term investments totaled \$74.2 million, an increase of \$3.1 million from \$71.1 million on December 31, 2013.

*Cash provided by (used in) operating activities*

Net cash provided by operating activities during the six months ended June 30, 2014 was \$9.7 million, a decrease of \$4.7 million from the \$14.4 million provided by operating activities during the six months ended June 30, 2013. Cash provided by operating activities during the current period was primarily the result of our net income of \$2.0 million, an increase of \$6.1 million due to a change in deferred revenue mainly due to additional payments from customers that were deferred, an increase of \$1.0 million due to a change in deferred income taxes due to their use to reduce tax payments in the quarter, and an increase of \$676,000 due to a change in accounts payable primarily arising from the timing of payments to vendors. These increases were partially offset by a decrease of \$2.2 million due to a change in accrued compensation and other liabilities mainly from a decrease in accruals for compensation and benefit related items, a decrease of \$764,000 due to a change in accounts receivable arising from the timing of cash collections, and a decrease of \$404,000 due to a change in prepaid expenses and other current assets. Cash provided by operating activities during the current period was also affected by noncash charges of \$3.2 million, including \$2.9 million of noncash stock-based compensation and \$234,000 in depreciation and amortization of property and equipment.

*Cash provided by (used in) investing activities*

Net cash used in investing activities during the six months ended June 30, 2014 was \$635,000, a decrease in cash used of \$17.5 million compared to the \$18.1 million used in investing activities during the six months ended June 30, 2013. Net cash used in investing activities during the current period consisted of purchases of available-for-sale investments of \$29.0 million and additions to fixed assets of \$666,000. This was partially offset by maturities of available-for-sale investments of \$29.0 million.

*Cash provided by (used in) financing activities*

Net cash used in financing activities during the six months ended June 30, 2014 was \$6.0 million compared to \$6.1 million provided during the six months ended June 30, 2013, a decrease in cash provided of \$12.1 million. Net cash used in financing activities during the current period consisted primarily of repurchases of common stock of \$7.0 million, partially offset by exercises of stock options and the issuance of common stock under our ESPP of \$1.0 million.

We believe that our cash, cash equivalents, and short-term investments will be sufficient to meet our working capital needs for at least the next twelve months. We will continue to invest in, 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 \$12.4 million remaining. We anticipate that capital expenditures for property and equipment for the year ended December 31, 2014 will be less than \$2.0 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 technology, 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, 2013. Our principal commitments as of June 30, 2014 consisted of obligations under operating leases. There have been no material changes in those obligations during the six months ended June 30, 2014.

## **Table of Contents**

As of June 30, 2014, we had a liability for unrecognized tax benefits totaling \$1.7 million including interest of \$69,000, of which approximately \$268,000 could be payable in cash. The Company expects to release reserves and record a tax benefit due to the expiration of statute of limitations during the next six 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 \$69.5 million as of June 30, 2014, 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 \$368,000 in the fair value of our cash equivalents and short-term investments as of June 30, 2014.

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

*Foreign Currency Exchange Rates* A substantial majority of our revenue, expense, and capital purchasing activities are transacted in U.S. dollars. However, we do incur certain operating costs for our foreign operations in other currencies but these operations are limited in scope and thus we are not materially exposed to foreign currency fluctuations. Additionally we have some reliance on international 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 June 30, 2014, 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.

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**Table of Contents**

There were no changes to internal controls over financial reporting that occurred during the quarter ended June 30, 2014 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.

On September 2, 2009, a securities class action complaint was filed in the U.S. 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, the 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. The 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. The Court heard oral argument on February 12, 2014 and took the matter under submission.

*Immersion Corporation vs. Motorola Mobility, Inc., Motorola Mobility Holdings, Inc., HTC Corporation, HTC America Holding, Inc., HTC America, Inc., HTC (B.V.I.) Corporation, Exede, 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 ). 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.)

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**Table of Contents**

Corporation, Exedeia, Inc., Brightstar Corporation and Brightpoint, Inc. We subsequently withdrew HTC America Holding, Inc., HTC (B.V.I.) Corporation, Exedeia, 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 March 2, 2012, we filed a complaint against HTC Corporation, HTC America Holding, Inc., HTC America, Inc., HTC (B.V.I.) Corporation, Exedeia, 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.

The HTC Delaware Complaint currently asserts infringement of the following patents:

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

U.S. Patent No 7,969,288: 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

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. 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.

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

In the U.S. Patent Office, HTC filed requests for ex-parte reexamination of three of our 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 U.S. Patent Office granted the request on October 24, 2012. Reexamination of the 999 patent was requested on September 6, 2012. The U.S. Patent Office granted the request on November 26, 2012. Reexamination of the 720 patent was requested on September 10, 2012. The U.S. Patent Office granted the request on November 28, 2012. On July 24, 2013, the U.S. Patent Office issued a Reexamination Certificate for the 999 patent, after certain claims were cancelled and other claims were amended. On February 18, 2014, the U.S. Patent Office

**Table of Contents**

issued a Reexamination Certificate for the 720 patent after certain claims were cancelled and other claims were amended. On February 10, 2014 the U.S. Patent Office issued a Reexamination Certificate for the 288 patent after certain claims were cancelled and claim 18 was amended.

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

**ITEM 1A. RISK FACTORS**

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 who compensate us for including our software in certain of their touch-enabled products to also license and compensate us for our patents that cover other touch-enabled products of theirs that do not include our software;

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

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;

difficulties in entering into or renewing 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 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.

**Table of Contents**

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

Samsung Electronics accounted for approximately 37% and another customer accounted for 11% of our total revenues for the six months ended June 30, 2014. Samsung Electronics accounted for approximately 51% of our total revenues for the six months ended June 30, 2013. We cannot be certain that customers that have accounted for significant revenue in past periods, individually or as a group, will continue to generate similar 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.

Some of our license agreements provide for per-unit royalty payments 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, in certain geographic and product markets, we have increasingly entered into licensing agreements pursuant to which customers make fixed recurring payments to us in exchange for use of our IP and technology. As a result, a portion of the revenue we report each quarter results from the recognition of deferred revenue from fixed payments we have received from these customers during previous quarters. If we were to experience significant decline in our ability to renew these agreements or enter into new agreements that include fixed recurring payments, our reported financial results might not reflect such downturns until future periods. Moreover, to the extent our business model depends on fixed payments that we recognize over time, it may also be difficult for us to rapidly increase our revenues through additional sales in any period, as revenue from new customers will be recognized over multiple quarters. Additionally, if we have agreed that a customer may pay us a fixed amount for use of our IP and technology during a given time period, we may receive lower revenues than we would have received under a per unit royalty arrangement if the customer's business grows or it otherwise performs better than we anticipated at the time we entered into our licensing agreement with the customer.

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.

***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 continue to expand our international activities, including continued investment in Asia. International operations are subject to a number of difficulties and special costs, including:

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

**Table of Contents**

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

the possibility of 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 United States 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 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 Part II, Item 1- 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.

We cannot predict the outcome of pending litigation. 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 U.S. Patent and Trademark Office 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 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 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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**Table of Contents**

***Our current or any future 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 or any future litigation will continue to be costly and that future litigation 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. We expense litigation costs as incurred, and only accrue for costs that have been incurred but not paid to the vendor as of the financial statement date. Litigation has diverted, and 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 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 12 to the condensed consolidated financial statements in Part I, Item 1- Financial Statements and Supplementary Data 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 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 risk of our not receiving royalty revenues to which we are entitled, 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.

**Table of Contents**

***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. These internal design groups typically make choices regarding whether to implement haptics or not, whether to use our software 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 software 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



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**Table of Contents**

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 software or IP in connection with gaming on such mobile or other platforms.

***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.

***If we fail to successfully manage our new content and media initiative, our results of operations could be negatively impacted.***

We seek to find new applications and markets for our technologies. We have invested and continue to invest significant resources in the development of technologies and software related to enhancing mobile content with haptics. Market acceptance of these new technologies and software offerings will be dependent in part on our ability to show that mobile content enhanced with haptics generates greater levels of consumer engagement, improves long-term content recall and generates more positive levels of enjoyment and brand sentiment. While we do not anticipate any meaningful revenue associated with this initiative in 2014, if we are unable to successfully establish these new offerings, our results of operations could be negatively impacted.

***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 software and IP to companies that manufacture and sell products incorporating our touch-enabling technologies. For the six months ended June 30, 2014 and 2013, 98% 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 their products are recalled because of quality control problems or if they 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.

**Table of Contents**

***If we fail to protect and enforce our IP rights or if we fail to continuously develop or acquire successful innovations and obtain patents on these innovations, 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 and technological security measures 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.

***We had an accumulated deficit of \$85 million as of June 30, 2014, have only recently achieved profitability, and may not maintain profitability in the future.***

As of June 30, 2014, we had an accumulated deficit of \$85 million. We need to generate significant ongoing revenue to maintain consistent profitability. We will continue to incur expenses as we:

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;

international expansion;

pursue strategic relationships;

incur costs related to pending and anticipated litigation; and

acquire IP or other assets from third-parties.

## **Table of Contents**

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 meet delivery schedules and to provide support for our various technologies and, as a result, we could fail to deliver software and services 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 high quality customer deliverables in a timely fashion or at all, or our failure to maintain sufficient customer service levels, could disrupt our customer relationships, harm our brand, and reduce our revenues.

***Our business depends in part on access to third-party platforms and technologies, and if the access is withdrawn, denied, or is not available on terms acceptable to us, or if the platforms or technologies change, 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 and technologies. Our business relies on our access to these platforms and technologies of third parties, which can be withdrawn, denied or not be available on terms acceptable to us.

Our access to third-party platforms and technologies may require paying royalties or other amounts, which lowers our 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 in ways that negatively impact the operation of our software.

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, 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, including with respect to Microsoft's Xbox One gaming product. 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.

***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.

## **Table of Contents**

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.

### ***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 United States 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.

We license some technologies from third parties. We must rely upon the owners of these 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.

### ***Changes to U.S. patent laws and to the rules of the 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 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 codified 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 PTO has developed new and untested regulations and procedures to govern the full implementation of the Leahy-Smith America Invents Act, and many of the substantive changes to patent law associated with the Leahy-Smith America Invents Act, and in particular, the first inventor to file provisions. It is not clear what impact the Leahy-Smith Act will have on the operation of our business and the protection and enforcement of our intellectual property. 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 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.





## **Table of Contents**

***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 and potential 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, potential licensees, or consumers and could damage our reputation or our brand. Expanding and enhancing 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.

***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, medical, 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 made 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.

**Table of Contents**

***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 would likely face 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.

***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.

***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, 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.

**Table of Contents**

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, including losses due to earthquakes.

***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 including losses due to earthquakes.



## **Table of Contents**

***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 controls or procedures, 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 or our licensees 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.

## **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

errors in our licensees' royalty reports, and corrections and true-ups to royalty payments and royalty rates from prior periods.



**Table of Contents**

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

A change in accounting standards, policies, or practices, such as the new revenue accounting standard that will become effective for Immersion in 2017, ASU No. 2014-09 Revenue from Contracts with Customers: Topic 606, 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 and other 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. These new requirements may reduce the number of suppliers who provide conflict free metals, and may affect our customers' ability to obtain products in sufficient quantities or at competitive prices, which could have an effect on our results of operations.

***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; the acquisition or loss of customers; 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



**Table of Contents**

the market's expectations. Furthermore, there can be no assurance that any repurchases conducted under the plan will be made at the best possible price. The existence of a stock repurchase program could also cause our stock price to be higher than it would be in the absence of such a program and could potentially reduce the market liquidity for our stock. Additionally, we are permitted to and could discontinue our stock repurchase program at any time and any such discontinuation could cause the market price of our stock to decline.

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

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

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

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

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

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

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

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

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

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

As part of our business strategy, we have in the past and may in the future, acquire businesses or 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;

**Table of Contents**

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 or other claims related to acquired businesses, assets, 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 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Below is a summary of stock repurchases for the quarter ended June 30, 2014. See Note 9 of our condensed consolidated financial statements for information regarding our stock repurchase program.

		Shares Repurchased (2)	Average Price Per Share	Approximate Dollar Value that May Yet Be Purchased Under the Program (in thousands)
Program/Period (1)				
Beginning approximate dollar value available to be repurchased as of March 31, 2014				\$ 12,558
April 1	April 30, 2014	10,324	\$ 10.03	
May 1	May 31, 2014	551	10.03	
June 1	June 30, 2014	0	0.00	
April 1	June 30, 2014	10,875		109
Ending approximate dollar value that may be repurchased under the Program as of June 30, 2014				\$ 12,449

(1) On November 1, 2007, our Board of Directors authorized a share repurchase program of up to \$50,000,000. This share repurchase authorization has no expiration date and does not require us to repurchase a specific number of

shares. The timing and amount of any share repurchase will depend on the share price, corporate and regulatory requirements, economic and market conditions, and other factors. The repurchase authorization may be modified, suspended, or discontinued at any time.

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

**ITEM 6. EXHIBITS**

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

**Table of Contents**

**SIGNATURES**

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

Date: August 1, 2014

IMMERSION CORPORATION

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

54

**Table of Contents****EXHIBIT INDEX**

<b>Number</b>	<b>Description</b>
10.1#	2011 Equity Incentive Plan (incorporated by reference to Annex A of Schedule 14A, File No. 000-27969, filed on April 22, 2014).
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.

# Constitutes a management contract or compensatory plan.