Targa Resources Corp.
Form S-4
December 03, 2015
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As filed with the Securities and Exchange Commission on December 3, 2015

Registration No. 333-

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form S-4

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

TARGA RESOURCES CORP.

(Exact name of registrant as specified in its charter)

Delaware	**4922**	**20-3701075**
(State or other jurisdiction of incorporation or organization)	**(Primary Standard Industrial Classification Code Number**	**(I.R.S. employer identification number)**

1000 Louisiana, Suite 4300

Houston, Texas 77002

(713) 584-1000

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Joe Bob Perkins

Chief Executive Officer

1000 Louisiana, Suite 4300

Houston, Texas 77002

(713) 584-1000

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Christopher S. Collins

Vinson & Elkins LLP

1001 Fannin Street, Suite 2500

Houston, Texas 77002

(713) 758-2222

Srinivas M. Raju

Richards Layton & Finger, PA

One Rodney Square

920 North King Street

Wilmington, Delaware 19801

(302) 651-7701

Approximate date of commencement of proposed sale to the public: As soon as practicable after this registration statement becomes effective and upon consummation of the merger described in the enclosed joint proxy statement/prospectus.

If the securities being registered on this Form are to be offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box. ¨

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act of 1933, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act of 1933, check the following box and list the Securities Act registration statement number of the earlier effective registration statement

for the same offering. ¨

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

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

If applicable, place an X in the box to designate the appropriate rule provision relied upon in conducting this transaction:

Exchange Act Rule 13e-4(i) (Cross-Border Issuer Tender Offer) ¨

Exchange Act Rule 14d-1(d) (Cross-Border Third-Party Tender Offer) ¨

CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be registered[(1)]	Proposed Maximum Offering Price per Unit	Proposed maximum aggregate offering price[(2)]	Amount of registration fee[(3)]
Common stock, par value $0.001 per share	104,502,234	N/A	$3,810,117,757	$383,679

(1) This Registration Statement relates to shares of common stock, par value $0.001 per share, of Targa Resources Corp., a Delaware corporation, estimated to be issuable upon the completion of the merger described herein.

(2) The proposed maximum aggregate offering price was calculated based upon the market value of the common units representing limited partner interests in Targa Resources Partners LP (TRP common units), the securities to be converted into the right to receive the merger consideration in the merger, in accordance with Rules 457(c) and 457(f) under the Securities Act as follows: the product of (a) $22.605, the average of the high and low prices per unit of the TRP common units as reported on the New York Stock Exchange on December 1, 2015 and (b) 168,551,991, the estimated maximum number of TRP common units that may be exchanged for the merger consideration in the merger.

(3) Calculated by multiplying the proposed maximum aggregate offering price by 0.0001007.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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The information in this preliminary joint proxy statement/prospectus is not complete and may be changed. Targa Resources Corp. may not distribute or issue the securities being registered pursuant to this registration statement until the registration statement, as filed with the Securities and Exchange Commission (of which this preliminary joint proxy statement/prospectus is a part), is effective. This preliminary joint proxy statement/prospectus is not an offer to sell nor should it be considered a solicitation of an offer to buy the securities described herein in any state where the offer or sale is not permitted.

PRELIMINARY SUBJECT TO COMPLETION DATED DECEMBER 3, 2015

MERGER PROPOSED YOUR VOTE IS VERY IMPORTANT

On November 2, 2015, Targa Resources Corp. (TRC), Spartan Merger Sub LLC, a subsidiary of TRC (Merger Sub), Targa Resources Partners LP (TRP) and Targa Resources GP LLC, the general partner of TRP (TRP GP), entered into an Agreement and Plan of Merger (the Merger Agreement), pursuant to which TRC will acquire indirectly all of the outstanding common units representing limited partner interests in TRP (TRP common units) that TRC and its subsidiaries do not already own. Upon the terms and conditions set forth in the Merger Agreement, Merger Sub will be merged with and into TRP (the Merger), with TRP continuing as the surviving entity and as a subsidiary of TRC. The conflicts committee of the board of directors of TRP GP (the TRP GP Conflicts Committee) and the board of directors of TRP GP (the TRP GP Board) each have determined that the Merger is fair and reasonable to, and in the best interests of, TRP and the common unitholders of TRP (the TRP common unitholders) (other than TRC, TRP GP and their affiliates), and have unanimously approved the Merger Agreement and the Merger.

If the Merger is completed, each outstanding TRP common unit not owned by TRC or its subsidiaries will be converted into the right to receive 0.62 of a share of common stock of TRC, par value $0.001 per share (TRC shares and such consideration, the Merger Consideration). Based on the closing price of TRC shares on November 2, 2015, the last trading day before the public announcement of the Merger, the aggregate value of the Merger Consideration was approximately $6.08 billion. No fractional TRC shares will be issued in the Merger, and TRP common unitholders will, instead, receive cash in lieu of fractional TRC shares. Stockholders of TRC (the TRC stockholders) will continue to own their existing TRC shares. Based on the estimated number of TRC shares and TRP common units that will be outstanding immediately prior to the closing of the Merger, upon the closing of the Merger, former TRP common unitholders and current TRC stockholders will own approximately 65% and 35% of the combined company, respectively.

TRC and TRP will each hold special meetings of their stockholders and common unitholders, respectively, in connection with the proposed Merger. At the special meeting of TRC stockholders (the TRC special meeting), the TRC stockholders will be asked to vote on the proposal to approve the issuance of TRC shares to TRP common unitholders pursuant to the Merger Agreement (the TRC stock issuance proposal). Approval of the TRC stock issuance proposal requires the affirmative vote of a majority of the TRC shares present in person or represented by proxy at the TRC special meeting and entitled to vote thereon. At the special meeting of TRP common unitholders, the

TRP common unitholders will be asked to vote on the proposal to approve the Merger Agreement (the Merger proposal). Approval of the Merger proposal requires the affirmative vote of a majority of the outstanding TRP common units.

We cannot complete the Merger unless the TRC stockholders approve the TRC stock issuance proposal and the TRP common unitholders approve the Merger proposal. **Accordingly, your vote is very important regardless of the number of TRC shares or TRP common units you own. Voting instructions are set forth inside this joint proxy statement/prospectus.**

The board of directors of TRC (the TRC Board) recommends that the TRC stockholders vote FOR the TRC stock issuance proposal and FOR the adjournment of the TRC special meeting if necessary to solicit additional proxies if there are not sufficient votes to approve the TRC stock issuance proposal at the time of the TRC special meeting. In considering the recommendation of the TRC Board, TRC shareholders should be aware that some of TRC s directors and executive officers may have interests in the Merger that are different from, or in addition to, the interests they may have as TRC shareholders. See The Merger Interests of Certain Persons in the Merger.

The TRP GP Conflicts Committee and the TRP GP Board each recommend that the TRP common unitholders vote FOR the Merger proposal and FOR the approval, on an advisory, non-binding basis, of the compensation payments that may be paid or become payable to TRP s named executive officers in connection with the Merger. In considering the recommendation of the TRP GP Board, TRP common unitholders should be aware that some of TRP GP s directors and executive officers may have interests in the Merger that are different from, or in addition to, the interests they may have as TRP common unitholders. See The Merger Interests of Certain Persons in the Merger.

This joint proxy statement/prospectus provides you with detailed information about the proposed Merger and related matters. You are encouraged to read the entire document carefully. In particular, see Risk Factors beginning on page 30 of this joint proxy statement/prospectus for a discussion of risks relevant to the Merger and TRC s business following the Merger.

TRC shares are listed on the New York Stock Exchange (NYSE) under the symbol TRGP, and TRP common units are listed on the NYSE under the symbol NGLS. The last reported sale price of TRC shares on the NYSE on December 1, 2015 was $38.32. The last reported sale price of TRP common units on the NYSE on December 1, 2015 was $22.16.

James W. Whalen

Executive Chairman of the

Board of Directors of

Targa Resources Corp. and Targa Resources GP LLC

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the securities to be issued under this joint proxy statement/prospectus or has determined if this document is truthful or complete. Any representation to the contrary is a criminal offense.

This joint proxy statement/prospectus is dated , 2016 and is being first mailed to TRP common unitholders and TRC stockholders on or about , 2016.

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Houston, Texas

, 2016

TARGA RESOURCES CORP.

1000 Louisiana Street

Suite 4300

Houston, Texas 77002

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS

To the Stockholders of Targa Resources Corp.:

A special meeting (the TRC special meeting) of stockholders of Targa Resources Corp. (TRC) will be held on , 2016 at , local time, at , for the following purposes:

- to consider and vote upon a proposal to approve the issuance (the TRC stock issuance) of shares of common stock of TRC, par value $0.001 per share (TRC shares), in connection with the merger (the Merger) contemplated by the Agreement and Plan of Merger (the Merger Agreement), dated as of November 2, 2015, by and among TRC, Spartan Merger Sub LLC (Merger Sub), Targa Resources Partners LP (TRP) and Targa Resources GP LLC (TRP GP), which is referred to as the TRC stock issuance proposal ; and

- to consider and vote on a proposal to approve the adjournment of the TRC special meeting, if necessary to solicit additional proxies if there are not sufficient votes to approve the foregoing proposal at the time of the TRC special meeting, which is referred to as the adjournment proposal.

Approval of each of the TRC stock issuance proposal and the adjournment proposal requires the affirmative vote of a majority of the TRC shares present in person or represented by proxy at the TRC special meeting and entitled to vote thereon. Abstentions will have the same effect as votes against the TRC stock issuance proposal and the adjournment proposal. Assuming there is a quorum, failures to vote and broker non-votes (if any) will have no effect on the TRC stock issuance proposal and the adjournment proposal.

We cannot complete the Merger unless the stockholders of TRC (the TRC stockholders) approve the TRC stock issuance proposal. **Accordingly, your vote is very important regardless of the number of TRC shares you own.**

The board of directors of TRC (the TRC Board) unanimously determined that the Merger, the Merger Agreement, and the transactions contemplated thereby, including the TRC stock issuance, are in the best interests of TRC and the TRC stockholders. The TRC Board unanimously approved the Merger, the Merger Agreement and the transactions contemplated thereby, including the TRC stock issuance, and recommends that the TRC stockholders vote FOR the TRC stock issuance proposal and FOR the adjournment proposal.

In considering the recommendation of the TRC Board, TRC shareholders should be aware that some of TRC s directors and executive officers may have interests in the Merger that are different from, or in addition to, the interests they may have as TRC shareholders. See The Merger Interests of Certain Persons in the Merger.

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Only TRC stockholders of record at the close of business on , 2016 are entitled to notice of and to vote at the TRC special meeting. A list of stockholders entitled to vote at the TRC special meeting will be available for inspection at TRC s offices in Houston, Texas for any purpose relevant to the TRC special meeting during normal business hours for a period of ten days before the meeting and at the TRC special meeting. References to the TRC special meeting in this joint proxy statement/prospectus are to such special meeting as adjourned or postponed.

YOUR VOTE IS IMPORTANT. WHETHER OR NOT YOU EXPECT TO ATTEND THE TRC SPECIAL MEETING, PLEASE SUBMIT YOUR PROXY IN ONE OF THE FOLLOWING WAYS:

If you hold your TRC shares in the name of a bank, broker or other nominee, you should follow the instructions provided by your bank, broker or other nominee when voting your TRC shares.

If you hold your TRC shares in your own name, you may submit your proxy by:

using the toll-free telephone number shown on the proxy card;

using the Internet website shown on the proxy card; or

marking, signing, dating and promptly returning the enclosed proxy card in the postage-paid envelope. It requires no postage if mailed in the United States.

The enclosed joint proxy statement/prospectus provides a detailed description of the Merger and the Merger Agreement as well as a description of the TRC stock issuance. You are urged to read this joint proxy statement/prospectus, including any documents incorporated by reference, and the Annexes carefully and in their entirety. If you have any questions concerning the Merger or this joint proxy statement/prospectus, would like additional copies or need help voting your TRC shares, please contact TRC s proxy solicitor:

D.F. King & Co., Inc.

48 Wall Street

New York, NY 10005

Banks and Brokers Call: (212) 269-5550

All Others Call Toll Free: (877) 478-5044

Email: trc@dfking.com

By order of the Board of Directors of

Targa Resources Corp.,

Joe Bob Perkins

Chief Executive Officer

Targa Resources Corp.

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Houston, Texas

, 2016

TARGA RESOURCES PARTNERS LP

1000 Louisiana Street

Suite 4300

Houston, Texas 77002

NOTICE OF SPECIAL MEETING OF COMMON UNITHOLDERS

To the Common Unitholders of Targa Resources Partners LP:

A special meeting (the TRP special meeting) of common unitholders of Targa Resources Partners LP (TRP) will be held on , 2016 at , local time, at , for the following purposes:

- to consider and vote upon a proposal to approve the Merger Agreement, which is referred to as the Merger proposal ; and

- to consider and vote upon, on an advisory, non-binding basis, the compensation payments that may be paid or become payable to TRP s named executive officers in connection with the Merger, which is referred to as the TRP compensation proposal.

Approval of the Merger proposal requires the affirmative vote of a majority of the outstanding common units representing limited partner interests in TRP (TRP common units). Approval, on an advisory, non-binding basis, of the TRP compensation proposal requires the affirmative vote of a majority of the outstanding TRP common units entitled to vote and be present in person or by proxy at the TRP special meeting. Abstentions, failures to vote and broker non-votes (if any) will have the same effect as votes against the Merger proposal and the TRP compensation proposal. **The vote on the TRP compensation proposal is a vote separate and apart from the vote on the Merger proposal. Accordingly, you may vote to approve the Merger proposal and vote not to approve the TRP compensation proposal and vice versa. Because the vote on the TRP compensation proposal is advisory in nature only, it will not be binding on TRP or TRC.**

We cannot complete the Merger unless the TRP common unitholders approve the Merger proposal. **Accordingly, your vote is very important regardless of the number of TRP common units you own.**

The conflicts committee of the board of directors of TRP GP (the TRP GP Conflicts Committee) and the board of directors of TRP GP (the TRP GP Board) each have determined that the Merger is fair and reasonable to, and in the best interests of, TRP and the TRP common unitholders (the TRP common unitholders) (other than TRC, TRP GP and their affiliates) (the TRP unaffiliated common unitholders), and have unanimously approved the Merger Agreement and the Merger. The TRP GP Conflicts Committee and the TRP GP Board each recommend that the TRP common unitholders vote FOR the Merger proposal and FOR the TRP

compensation proposal. For more information regarding the recommendation of the TRP GP Conflicts Committee and the TRP GP Board, including the obligations of the TRP GP Conflicts Committee and the TRP GP Board in making such determination under the Second Amended and Restated Agreement of Limited Partnership of TRP, dated as of October 15, 2015 (the TRP partnership agreement), see The Merger Recommendation of the TRP GP Conflicts Committee and the TRP GP Board and their Reasons for the Merger.

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In considering the recommendation of the TRP GP Board, TRP common unitholders should be aware that some of TRP GP s directors and executive officers may have interests in the Merger that are different from, or in addition to, the interests they may have as TRP common unitholders. See The Merger Interests of Certain Persons in the Merger.

Only TRP common unitholders of record at the close of business on , 2016 are entitled to notice of and to vote at the TRP special meeting. A list of common unitholders entitled to vote at the TRP special meeting will be available for inspection at TRP s offices in Houston, Texas for any purpose relevant to the TRP special meeting during normal business hours for a period of ten days before the meeting and at the TRP special meeting. References to the TRP special meeting in this joint proxy statement/prospectus are to such special meeting as adjourned or postponed.

YOUR VOTE IS IMPORTANT. WHETHER OR NOT YOU EXPECT TO ATTEND THE TRP SPECIAL MEETING, PLEASE SUBMIT YOUR PROXY IN ONE OF THE FOLLOWING WAYS:

If you hold your TRP common units in the name of a bank, broker or other nominee, you should follow the instructions provided by your bank, broker or other nominee when voting your TRP common units.

If you hold your TRP common units in your own name, you may submit your proxy by:

using the toll-free telephone number shown on the proxy card;

using the Internet website shown on the proxy card; or

marking, signing, dating and promptly returning the enclosed proxy card in the postage-paid envelope. It requires no postage if mailed in the United States.

The enclosed joint proxy statement/prospectus provides a detailed description of the Merger and the Merger Agreement as well as a description of the TRC stock issuance of TRC shares. You are urged to read this joint proxy statement/prospectus, including any documents incorporated by reference, and the Annexes carefully and in their entirety. If you have any questions concerning the Merger or this joint proxy statement/prospectus, would like additional copies or need help voting your TRP common units, please contact TRP s proxy solicitor:

D.F. King & Co., Inc.

48 Wall Street

New York, NY 10005

Banks and Brokers Call: (212) 269-5550

All Others Call Toll Free: (877) 478-5044

Email: trp@dfking.com

By order of the Board of Directors of

Targa Resources GP LLC,

Joe Bob Perkins

Chief Executive Officer

Targa Resources GP LLC

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IMPORTANT NOTE ABOUT THIS JOINT PROXY STATEMENT/PROSPECTUS

This joint proxy statement/prospectus, which forms part of a registration statement on Form S-4 filed with the Securities and Exchange Commission (the SEC) constitutes a proxy statement of TRP under Section 14(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act), with respect to the solicitation of proxies for the TRP special meeting to approve the Merger proposal and the TRP compensation proposal. This joint proxy statement/prospectus also constitutes a proxy statement of TRC under Section 14(a) of the Exchange Act with respect to the solicitation of proxies for the TRC special meeting to, among other things, approve the TRC stock issuance proposal and a prospectus of TRC under Section 5 of the Securities Act of 1933, as amended (the Securities Act), for TRC shares that will be issued to TRP common unitholders in the Merger pursuant to the Merger Agreement.

As permitted under the rules of the SEC, this joint proxy statement/prospectus incorporates by reference important business and financial information about TRC and TRP from other documents filed with the SEC that are not included in or delivered with this joint proxy statement/prospectus. See Where You Can Find More Information beginning on page 142. You can obtain any of the documents incorporated by reference into this document from TRC or TRP, as the case may be, or from the SEC s website at *http://www.sec.gov*. This information is also available to you without charge upon your request in writing or by telephone from TRC or TRP at the following addresses and telephone numbers:

Targa Resources Corp.

Targa Resources Partners LP

1000 Louisiana Street, Suite 4300

Attention: Investor Relations

Houston, Texas 77002

Telephone: (713) 584-1133

Please note that copies of the documents provided to you will not include exhibits, unless the exhibits are specifically incorporated by reference into the documents or this joint proxy statement/prospectus.

You may obtain certain of these documents at TRC s website, *http://www.targaresources.com*, by selecting Investors and then selecting SEC Filings TRGP, and at TRP s website, *http://www.targaresources.com*, by selecting Investor Relations and then selecting SEC Filings NGLS. Information contained on TRC s and TRP s websites is expressly not incorporated by reference into this joint proxy statement/prospectus.

In order to receive timely delivery of requested documents in advance of the special meetings, your request should be received no later than , 2016. If you request any documents, TRC or TRP will mail them to you by first class mail, or another equally prompt means, after receipt of your request.

TRC and TRP have not authorized anyone to give any information or make any representation about the Merger, TRC or TRP that is different from, or in addition to, that contained in this joint proxy statement/prospectus or in any of the materials that have been incorporated by reference into this joint proxy statement/prospectus. Therefore, if anyone distributes this type of information, you should not rely on it. If you are in a jurisdiction where offers to exchange or

sell, or solicitations of offers to exchange or purchase, the securities offered by this joint proxy statement/prospectus or the solicitation of proxies are unlawful, or you are a person to whom it is unlawful to direct these types of activities, then the offer presented in this joint proxy statement/prospectus does not extend to you. The information contained in this joint proxy statement/prospectus speaks only as of the date of this joint proxy statement/prospectus, or in the case of information in a document incorporated by reference, as of the date of such document, unless the information specifically indicates that another date applies. All information in this document concerning TRC has been furnished by TRC. All information in this document concerning TRP has been furnished by TRP.

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JOINT PROXY STATEMENT/PROSPECTUS

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QUESTIONS AND ANSWERS ABOUT THE MERGER AND THE SPECIAL MEETINGS

Important Information and Risks. *The following are brief answers to some questions that you may have regarding the proposed Merger. You should read and consider carefully the remainder of this joint proxy statement/prospectus, including the Risk Factors beginning on page 30 and the attached Annexes, because the information in this section does not provide all of the information that might be important to you. Additional important information and descriptions of risk factors are also contained in the documents incorporated by reference in this joint proxy statement/prospectus. See Where You Can Find More Information beginning on page 142.*

Q: What is the proposed transaction and why am I receiving these materials?

A: TRC and TRP have agreed to combine by merging Merger Sub, a subsidiary of TRC, with and into TRP under the terms of the Merger Agreement that is described in this joint proxy statement/prospectus and attached as Annex A. You are receiving this document because the Merger cannot be completed without the approval of the TRC stockholders and the TRP common unitholders.

Q: Why are TRC and TRP proposing the Merger?

A: TRC and TRP believe that the Merger will benefit both TRC shareholders and TRP common unitholders. See The Merger Recommendation of the TRC Board and its Reasons for the Merger and The Merger Recommendation of the TRP GP Conflicts Committee and the TRP GP Board and their Reasons for the Merger.

Q: What will TRP common unitholders receive in the Merger?

A: If the Merger is completed, each outstanding TRP common unit not owned by TRC or its subsidiaries will be converted into the right to receive 0.62 of a TRC share (such consideration, the Merger Consideration and such ratio, the Exchange Ratio). Based on the closing price of TRC shares on November 2, 2015, the last trading day before the public announcement of the Merger, the aggregate value of the Merger Consideration was approximately $6.08 billion. The Exchange Ratio is fixed and will not be adjusted on account of any change in price of either TRC shares or TRP common units prior to completion of the Merger. If the Exchange Ratio would result in a TRP common unitholder being entitled to receive a fraction of a TRC share, such TRP common unitholder will receive cash from TRC in lieu of such fractional interest in an amount equal to such fractional interest multiplied by the average of the closing prices of TRC shares for the five consecutive New York Stock Exchange (NYSE) full trading days prior to the closing date of the Merger.

Q: What will TRC stockholders receive in the Merger?

A: TRC stockholders will simply retain the TRC shares they currently own. They will not receive any additional TRC shares in the Merger.

Q: Where will my shares or units trade after the Merger?

A: TRC shares will continue to trade on the NYSE under the symbol TRGP. TRP common units will no longer be publicly traded after the completion of the Merger.

Q: What happens to my future distributions or dividends?

A: Once the Merger is completed and TRP common units are exchanged for TRC shares, when dividends are approved and declared and paid by TRC, former TRP common unitholders will receive dividends on the TRC shares they receive in the Merger in accordance with TRC s then current dividend policy

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(if any) and at the discretion of the TRC Board. TRP common unitholders will receive distributions on their TRP common units for the quarter ended , 2016. TRP common unitholders will not receive both distributions from TRP and dividends from TRC for the same quarter. See Market Prices and Dividend and Distribution Information.

Current TRC stockholders will continue to receive dividends on their TRC shares in accordance with TRC s then current dividend policy (if any) and at the discretion of the TRC Board. See Comparison of the Rights of TRC Stockholders and TRP Common Unitholders.

Q: When and where will the special meetings be held?

A: *TRC stockholders:* The TRC special meeting will be held at on , 2016, at , local time.

TRP common unitholders: The TRP special meeting will be held at on , 2016, at , local time.

Q: Who is entitled to vote at the special meetings?

A: *TRC stockholders:* The record date for the TRC special meeting is , 2016. Only TRC stockholders of record as of the close of business on the record date are entitled to notice of, and to vote at, the TRC special meeting.

TRP common unitholders: The record date for the TRP special meeting is , 2016. Only TRP common unitholders of record as of the close of business on the record date are entitled to notice of, and to vote at, the TRP special meeting.

Q: What constitutes a quorum at the special meetings?

A: *TRC stockholders:* The holders of a majority of the outstanding TRC shares, represented in person or by proxy (by submitting a properly executed proxy card or properly submitting your proxy by telephone or Internet), on the record date will constitute a quorum and will permit TRC to conduct the proposed business at the TRC special meeting. Proxies received but marked as abstentions will be counted as TRC shares that are present and entitled to vote for purposes of determining the presence of a quorum. If an executed proxy is returned by a bank, broker or other nominee holding TRC shares in street name indicating that the broker does not have discretionary authority as to certain TRC shares to vote on a specific proposal (a broker non-vote with respect to such proposal), such TRC shares will not be considered present at the TRC special meeting for purposes of determining the presence of a quorum and will not be included in the vote.

TRP common unitholders: The holders of a majority of the outstanding TRP common units represented in person or by proxy (by submitting a properly executed proxy card or properly submitting a proxy by telephone or Internet) will constitute a quorum and will permit TRP to conduct the proposed business at the TRP special meeting. Proxies received but marked as abstentions will be counted as units that are present and entitled to vote for purposes of determining the presence of a quorum. Broker non-votes (if any) will not be considered present at the TRP special meeting for purposes of determining the presence of a quorum and will not be included in the vote.

Q: What is the vote required to approve each proposal?

A: *TRC stockholders:* Approval of each of the TRC stock issuance proposal and the adjournment proposal requires the affirmative vote of a majority of the TRC shares present in person or represented by proxy at the TRC special meeting and entitled to vote thereon. Abstentions will have the same effect as votes against the TRC stock issuance proposal and the adjournment proposal. Assuming there is a quorum, failures to vote and broker non-votes (if any) will have no effect on the TRC stock issuance proposal and the adjournment proposal.

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All of the directors and executive officers of TRC beneficially owned, in the aggregate, approximately % of the outstanding TRC shares as of the record date. TRC believes that the directors and executive officers of TRC will vote in favor of the TRC stock issuance proposal and the adjournment proposal.

TRP common unitholders: Approval of the Merger proposal requires the affirmative vote of a majority of the outstanding TRP common units. Approval, on an advisory, non-binding basis, of the TRP compensation proposal requires the affirmative vote of a majority of the outstanding TRP common units entitled to vote and be present in person or by proxy at the TRP special meeting. Abstentions, failures to vote and broker non-votes (if any) will have the same effect as votes against the Merger proposal and the TRP compensation proposal. **The vote on the TRP compensation proposal is a vote separate and apart from the vote on the Merger proposal. Accordingly, you may vote to approve the Merger proposal and vote not to approve the TRP compensation proposal and vice versa. Because the vote on the TRP compensation proposal is advisory in nature only, it will not be binding on TRP or TRC.**

Pursuant to the Merger Agreement, TRC has agreed to vote or cause to be voted all TRP common units beneficially owned by TRC in favor of the Merger proposal unless there is a TRP adverse recommendation change (as defined under The Merger Agreement TRP GP Recommendation and TRP Adverse Recommendation Change). TRC beneficially owned approximately % of the outstanding TRP common units as of the record date.

All of the directors and executive officers of TRP GP beneficially owned, in the aggregate, approximately % of the outstanding TRP common units as of the record date. TRC and TRP believe that the directors and executive officers of TRP GP will vote in favor of the Merger proposal. TRC and TRP also believe that the directors and executive officers of TRP GP will vote in favor of the TRP compensation proposal.

Q: How do I vote my TRC shares or TRP common units if I hold them in my own name?

A: *TRC stockholders:* After you have read this joint proxy statement/prospectus carefully, please respond by completing, signing and dating your proxy card and returning it in the enclosed postage-paid envelope, or by submitting your proxy by telephone or the Internet as soon as possible in accordance with the instructions provided under The TRC Special Meeting Voting Procedures Voting by TRC Stockholders.

TRP common unitholders: After you have read this joint proxy statement/prospectus carefully, please respond by completing, signing and dating your proxy card and returning it in the enclosed postage-paid envelope, or by submitting your proxy by telephone or the Internet as soon as possible in accordance with the instructions provided under The TRP Special Meeting Voting Procedures Voting by TRP Common Unitholders.

Q: If my TRC shares or TRP common units are held in street name by my bank, broker or other nominee, will my bank, broker or other nominee vote them for me?

A: *TRC stockholders:* As a general rule, absent specific instructions from you, your bank, broker or other nominee is not allowed to vote your TRC shares on any proposal on which your bank, broker or other nominee does not have discretionary authority. The only proposals for consideration at the TRC special meeting are the TRC stock issuance proposal and the adjournment proposal, which are non-discretionary

matters for which banks, brokers or other nominees do not have discretionary authority to vote. To instruct your bank, broker or other nominee how to vote, you should follow the directions that your bank, broker or other nominee provides to you.

Please note that you may not vote your TRC shares held in street name by returning a proxy card directly to TRC or by voting in person at the TRC special meeting unless you provide a legal proxy,

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which you must obtain from your bank, broker or other nominee. If you do not instruct your bank, broker or other nominee on how to vote your TRC shares, your bank, broker or other nominee cannot vote your TRC shares, which will result in the absence of a vote for or against the TRC stock issuance proposal and the adjournment proposal. You should therefore provide your bank, broker or other nominee with instructions as to how to vote your TRC shares.

TRP common unitholders: As a general rule, absent specific instructions from you, your bank, broker or other nominee is not allowed to vote your TRP common units on any proposal on which your bank, broker or other nominee does not have discretionary authority. The only proposals for consideration at the TRP special meeting are the Merger proposal and the TRP compensation proposal, which are non-discretionary matters for which banks, brokers or other nominees do not have discretionary authority to vote. To instruct your bank, broker or other nominee how to vote, you should follow the directions that your bank, broker or other nominee provides to you.

Please note that you may not vote your TRP common units held in street name by returning a proxy card directly to TRP or by voting in person at the TRP special meeting unless you provide a legal proxy, which you must obtain from your bank, broker or other nominee. If you do not instruct your bank, broker or other nominee on how to vote your TRP common units, your bank, broker or other nominee cannot vote your TRP common units, which will have the same effect as a vote against the Merger proposal and the TRP compensation proposal. You should therefore provide your bank, broker or other nominee with instructions as to how to vote your TRP common units.

Q: When do you expect the Merger to be completed?

A: We currently expect the Merger to close in the first quarter of 2016. A number of conditions must be satisfied before TRC and TRP can complete the Merger, including the approval of the TRC stock issuance by the TRC stockholders and the approval of the Merger Agreement by the TRP common unitholders. Although TRC and TRP cannot be sure when all of the conditions to the Merger will be satisfied, TRC and TRP expect to complete the Merger as soon as practicable following the TRC and TRP special meetings (assuming the TRC stock issuance and the Merger proposal are approved by the TRC stockholders and TRP common unitholders, respectively), which are currently expected to be held in March of 2016, subject to, among other things, the registration statement of which this joint proxy statement/prospectus forms a part having been declared effective under the Securities Act. See The Merger Agreement Conditions to Completion of the Merger and Risk Factors The Merger is subject to conditions, including some conditions that may not be satisfied on a timely basis, if at all. Failure to complete the Merger, or significant delays in completing the Merger, could negatively affect each party s future business and financial results and the trading prices of TRC shares and TRP common units.

Q: How does the TRC Board recommend that the TRC stockholders vote?

A: The TRC Board recommends that TRC stockholders vote FOR the TRC stock issuance proposal and FOR the adjournment proposal.

On November 2, 2015, the TRC Board unanimously determined that the Merger, the Merger Agreement, and the transactions contemplated thereby, including the TRC stock issuance, are in the best interests of TRC and the TRC stockholders. The TRC Board unanimously approved the Merger, the Merger Agreement and the transactions contemplated thereby, including the TRC stock issuance, and recommends that the TRC stockholders vote FOR the

TRC stock issuance proposal and FOR the adjournment proposal.

In considering the recommendation of the TRC Board, TRC shareholders should be aware that some of TRC s directors and executive officers may have interests in the Merger that are different from, or in addition to, the interests they may have as TRC shareholders. See The Merger Interests of Certain Persons in the Merger.

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Q: How does the TRP GP Board recommend that the TRP common unitholders vote?

A: The TRP GP Board recommends that TRP common unitholders vote FOR the Merger proposal and FOR the TRP compensation proposal.

On November 2, 2015, the TRP GP Conflicts Committee and the TRP GP Board each determined that the Merger is fair and reasonable to, and in the best interests of, TRP and the TRP unaffiliated common unitholders, and unanimously approved the Merger Agreement and the Merger. The TRP GP Conflicts Committee and the TRP GP Board each recommend that the TRP common unitholders vote FOR the Merger proposal and FOR the TRP compensation proposal. The TRP GP Conflicts Committee s approval constitutes Special Approval, as such term is defined by the TRP partnership agreement. **For more information regarding the recommendation of the TRP GP Conflicts Committee and the TRP GP Board, including the obligations of the TRP GP Conflicts Committee and the TRP GP Board in making such determination under the TRP partnership agreement, see The Merger Recommendation of the TRP GP Conflicts Committee and the TRP GP Board and their Reasons for the Merger.**

In considering the recommendation of the TRP GP Conflicts Committee and the TRP GP Board, TRP common unitholders should be aware that some of TRP GP s directors and executive officers may have interests in the Merger that are different from, or in addition to, the interests they may have as TRP common unitholders. See The Merger Interests of Certain Persons in the Merger.

Q: What are the expected U.S. federal income tax consequences to a TRP common unitholder as a result of the Merger?

A: The receipt of TRC shares and cash in lieu of fractional shares, if any, in exchange for TRP common units pursuant to the Merger Agreement will be a taxable transaction to U.S. holders (as defined in Material U.S. Federal Income Tax Consequences) for U.S. federal income tax purposes. A U.S. holder will generally recognize capital gain or loss on the receipt of TRC shares and/or any cash in lieu of fractional shares in exchange for TRP common units. However, a portion of this gain or loss, which will likely be substantial, will be separately computed and taxed as ordinary income or loss to the extent attributable to unrealized receivables, including depreciation recapture, or to inventory items owned by TRP and its subsidiaries. Passive losses that were not deductible by a U.S. holder in prior taxable periods because they exceeded a U.S. holder s share of TRP s income may become available to offset a portion of the gain recognized by such U.S. holder. See Material U.S. Federal Income Tax Consequences for a more complete discussion of the expected material U.S. federal income tax consequences of the Merger.

Q: What are the expected U.S. federal income tax consequences for a TRP common unitholder of the ownership of TRC shares after the Merger is completed?

A: TRC is classified as a corporation for U.S. federal income tax purposes and is subject to U.S. federal income tax on its taxable income. A distribution of cash by TRC to a stockholder who is a U.S. holder (as defined in Material U.S. Federal Income Tax Consequences) generally will be included in such U.S. holder s income as ordinary dividend income to the extent of TRC s current or accumulated earnings and profits as determined

under U.S. federal income tax principles. A portion of the cash distributed to TRC stockholders by TRC after the Merger may exceed TRC s current or accumulated earnings and profits. Distributions of cash in excess of TRC s current or accumulated earnings and profits will be treated as a non-taxable return of capital reducing a U.S. holder s adjusted tax basis in such U.S. holder s TRC shares and, to the extent the distribution exceeds such stockholder s adjusted tax basis, as capital gain from the sale or exchange of such TRC shares. See Material U.S. Federal Income Tax Consequences for a more complete discussion of the expected material U.S. federal income tax consequences of owning and disposing of TRC shares received in the Merger.

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Q: Are TRC stockholders or TRP common unitholders entitled to appraisal rights?

A: No. Neither TRC stockholders nor TRP common unitholders are entitled to appraisal rights in connection with the Merger under applicable law or contractual appraisal rights under TRC s organizational documents, the TRP partnership agreement or the Merger Agreement.

Q: What will happen to the 9.00% Series A Fixed-to-Floating Rate Cumulative Redeemable Perpetual Preferred Units of TRP (the TRP Series A Preferred Units) in the Merger?

A: The TRP Series A Preferred Units will remain outstanding as limited partner interests in TRP and continue to trade on the NYSE under the symbol NGLS.PRA following the Merger.

Q: What will happen to TRP s outstanding senior notes in the Merger?

A: TRP s senior notes will remain outstanding as indebtedness of TRP following the Merger.

Q: What if I do not vote?

A: *TRC stockholders:* If you vote abstain on your proxy card, it will have the same effect as a vote against the TRC stock issuance proposal and the adjournment proposal. If you do not vote in person or by proxy, or a broker non-vote is made, assuming there is a quorum, it will have no effect on the TRC stock issuance proposal and the adjournment proposal. If you sign and return your proxy card but do not indicate how you want to vote, your proxy will be counted as a vote FOR the TRC stock issuance proposal and FOR the adjournment proposal.

TRP common unitholders: If you vote abstain on your proxy card, it will have the same effect as a vote against the Merger proposal and the TRP compensation proposal. If you do not vote in person or by proxy, or a broker non-vote is made, it will have the same effect as a vote against the Merger proposal and the TRP compensation proposal. If you sign and return your proxy card but do not indicate how you want to vote, your proxy will be counted as a vote FOR the Merger proposal and FOR the TRP compensation proposal.

Q: If I am planning to attend a special meeting in person, should I still vote by proxy?

A: Yes. Whether or not you plan to attend the TRC special meeting or the TRP special meeting, as applicable, you should vote by proxy. Your TRC shares or TRP common units will not be voted if you do not vote by proxy or do not vote in person at the TRC special meeting or the TRP special meeting, as applicable.

Q: Who may attend the TRC special meeting and the TRP special meeting?

A: TRC stockholders (or their authorized representatives) and TRC s invited guests may attend the TRC special meeting. TRP common unitholders (or their authorized representatives) and TRP s invited guests may attend the TRP special meeting. All attendees should be prepared to present government-issued photo identification (such as a driver s license or passport) for admittance.

Q: Can I change my vote after I have submitted my proxy?

A: Yes. If you own your TRC shares or TRP common units in your own name, you may revoke your proxy at any time prior to its exercise by:

giving written notice of revocation to the Secretary of TRP GP or the Secretary of TRC, as applicable, at or before the TRC special meeting or the TRP special meeting, as applicable;

appearing and voting in person at the TRC special meeting or the TRP special meeting, as applicable; or

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properly completing and executing a later dated proxy and delivering it to the Secretary of TRP GP or the Secretary of TRC, as applicable, at or before the TRC special meeting or the TRP special meeting, as applicable.

Your presence without voting at the TRC special meeting or the TRP special meeting, as applicable, will not automatically revoke your proxy, and any revocation during the meeting will not affect votes previously taken.

Q: What should I do if I receive more than one set of voting materials for the TRC special meeting or the TRP special meeting?

A: You may receive more than one set of voting materials for the TRC special meeting or the TRP special meeting and the materials may include multiple proxy cards or voting instruction cards. For example, you will receive a separate voting instruction card for each brokerage account in which you hold TRC shares or TRP common units. Additionally, if you are a holder of record registered in more than one name, you will receive more than one proxy card. Finally, if you hold both TRC shares and TRP common units, you will receive two separate packages of proxy materials. Please complete, sign, date and return each proxy card and voting instruction card that you receive according to the instructions on it.

Q: Whom do I call if I have further questions about voting, the special meetings or the Merger?

A: TRC stockholders and TRP common unitholders who have questions about the Merger, including the procedures for voting their shares or units, or who desire additional copies of this joint proxy statement/prospectus or additional proxy cards should contact:

TRC Stockholders	**TRP Common Unitholders**
D.F. King & Co., Inc.	D.F. King & Co., Inc.
48 Wall Street	48 Wall Street
New York, NY 10005	New York, NY 10005
Banks and Brokers Call: (212) 269-5550	Banks and Brokers Call: (212) 269-5550
All Others Call Toll Free: (877) 478-5044	All Others Call Toll Free: (877) 478-5044
Email: trc@dfking.com	Email: trp@dfking.com
or	or
Targa Resources Corp.	**Targa Resources Partners LP**

1000 Louisiana Street, Suite 4300

Attention: Investor Relations

Houston, Texas 77002

Telephone: (713) 584-1133

1000 Louisiana Street, Suite 4300

Attention: Investor Relations

Houston, Texas 77002

Telephone: (713) 584-1133

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SUMMARY

This summary highlights some of the information in this joint proxy statement/prospectus. It may not contain all of the information that is important to you. To understand the Merger fully and for a more complete description of the terms of the Merger, you should read carefully this document, the documents incorporated by reference, and the Annexes to this document, including the full text of the Merger Agreement included as Annex A. See Where You Can Find More Information beginning on page 142.

The Parties

Targa Resources Corp.

Targa Resources Corp., or TRC, is a publicly traded Delaware corporation formed in October 2005. TRC does not directly own any operating assets; its main source of future revenue therefore is from general and limited partner interests, including incentive distribution rights (IDRs), in TRP. TRC shares are listed on the NY>2008 **2007(In thousands)**

Patents and technology
$16,281 $15,105
Accumulated amortization of patents and technology
(7,119) (6,714)

Intangibles, net
9,162 8,391
Other assets
398 167

Intangibles and other assets, net
$9,560 $8,558

The estimated annual amortization expense for intangible assets as of June 30, 2008 is $705,000 in 2008, $850,000 in 2009, $1.1 million in 2010, $1 million in 2011, $980,000 in 2012, and $4.9 million in total for all years thereafter.

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

	June 30, 2008	December 31, 2007
	(In thousands)	
Accrued legal	$ 783	$ 417
Income taxes payable	33	534
Other current liabilities	1,663	1,678
Total other current liabilities	$ 2,479	$ 2,629
Deferred revenue, current portion	$ 5,348	$ 4,352
Customer advances	91	126
Total current deferred revenue, and customer advances	$ 5,439	$ 4,478

7. LONG-TERM DEFERRED REVENUE

On June 30, 2008, long-term deferred revenue was $15.7 million and included approximately $13.6 million of deferred revenue from Sony Computer Entertainment. On December 31, 2007, long-term deferred revenue was $14.3 million and included approximately $11.7 million from Sony Computer Entertainment. See Note 9 for further discussion.

8. STOCK-BASED COMPENSATION

Stock Options and Awards

The Company s stock option program is a long-term retention program that is intended to attract, retain, and provide incentives for talented employees, officers, and directors, and to align stockholder and employee interests. Essentially all of the Company s employees participate in this stock option program. Since inception, under the Company s stock option plans, the Company may grant options to purchase up to 19,377,974 shares of its common stock to employees, directors, and consultants at prices not less than the fair market value on the date of grant for incentive stock options and not less than 85% of fair market value on the date of grant for nonstatutory stock options. These options generally vest over 4 years and expire 10 years from the date of grant. On June 30, 2008, options to purchase 2,168,010 shares of common stock were available for grant, and options to purchase 7,505,995 shares of common stock were outstanding.

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

On April 30, 2008, the Company s Board of Directors approved the issuance of equity awards under the Immersion Corporation 2008 Employment Inducement Award Plan (the 2008 Plan). Under the 2008 Plan, the Company may issue awards in the form of stock options, stock appreciation rights, restricted stock purchase rights, restricted stock bonuses, restricted stock units, performance shares, performance units, deferred compensation awards, and other cash

and stock awards. Such awards may be granted to new employees who had not previously been a director, and former employees or directors whose period of service was followed by a bona-fide period of non-employment.

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

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offering period or purchase stock having a value greater than $25,000 in any calendar year as measured at the beginning of the offering period. A total of 500,000 shares of common stock are reserved for the issuance under the ESPP plus an automatic annual increase on January 1, 2001 and on each January 1 thereafter through January 1, 2010 by an amount equal to the lesser of 500,000 shares per year or a number of shares determined by the Board of Directors. As of June 30, 2008, 370,825 shares had been purchased since the inception of the ESPP. Under SFAS No. 123R, Share-Based Payment, (SFAS No. 123R), the ESPP is considered a compensatory plan and the Company is required to recognize compensation cost related to the fair value of common stock purchased under the ESPP.

The Company did not modify its ESPP in the six months ended June 30, 2008.

General Stock Option Information

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

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value
Outstanding at December 31, 2007 (3,774,245 exercisable at a weighted average price of $9.11 per share)	6,014,370	$ 9.11		
Granted (weighted average fair value of $5.10 per share)	2,035,925	8.94		
Exercised	(189,504)	5.91		
Cancelled	(354,796)	9.60		
Outstanding at June 30, 2008	7,505,995	$ 9.12	5.96	$2.88 million
Exercisable at June 30, 2008	4,180,829	$ 9.06	3.88	$2.79 million

The expected to vest share balance as of June 30, 2008 is 6,250,503.

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of the Company s common stock for the options that were in-the-money at June 30, 2008. The aggregate intrinsic value of options exercised under the Company s stock option plans, determined as of the date of option exercise, was $647,000 for the six months ended June 30, 2008.

Additional information regarding options outstanding as of June 30, 2008 is as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$1.20 - $6.03	839,975	4.29	$ 3.61	806,397	$ 3.53
6.07 - 6.95	1,052,097	6.51	6.69	670,585	6.64
6.96 - 7.02	763,089	5.63	6.99	669,117	6.99
7.03 - 8.34	564,804	5.80	7.71	268,787	7.90

8.61 - 8.61	757,837	9.33	8.61		
8.67 - 9.01	795,106	3.44	8.98	576,318	8.97
9.04 - 9.04	754,102	6.89	9.04	262,205	9.04
9.11 - 9.81	938,500	7.79	9.67	207,144	9.24
10.00 -17.15	751,051	4.96	13.41	449,592	12.42
17.27 -43.25	289,434	2.32	31.34	270,684	32.32
$1.20-$43.25	7,505,995	5.96	$ 9.12	4,180,829	$ 9.06

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Stock-based Compensation

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

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

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

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

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

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
Options	**2008**	**2007**	**2008**	**2007**
Expected term (in years)	5.5	6.25	5.5	6.25
Volatility	63%	59%	62%	60%
Interest rate	3.4%	5.0%	2.9%	4.6%
Dividend yield				

	Three Months Ended June 30,		Six Months Ended June 30,	
Employee Stock PurchasePlan	**2008**	**2007**	**2008**	**2007**
Expected term (in years)	0.5	0.5	0.5	0.5
Volatility	73%	45%	73%	45%
Interest rate	2.2%	5.2%	2.2%	5.2%
Dividend yield				

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Income Statement Classifications	(In thousands)		(In thousands)	
Cost of product sales	$ 52	$ 26	$ 75	$ 46
Sales and marketing	326	217	580	377
Research and development	183	128	465	314
General and administrative	404	238	809	506
Total	$ 965	$ 609	$ 1,929	$ 1,243

SFAS No. 123R requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow. For the three months and six months ended June 30, 2008, the Company recorded $69,000 and $176,000, respectively, of excess tax benefits from stock-based compensation. For the three months and six months ended June 30, 2007, the Company recorded $760,000 and $9.2 million, respectively, of excess tax benefits from stock-based compensation.

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

As of June 30, 2008, there was $11.6 million of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock options granted to the Company s employees and directors. This cost will be recognized over an estimated weighted-average period of approximately 3.07 years. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

Warrants

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

Stock Repurchase Program

On November 1, 2007, the Company announced its Board of Directors authorized the repurchase of up to $50 million of the Company s common stock. The Company may repurchase its stock for cash in the open market in accordance with applicable securities laws. The timing of and amount of any stock repurchase will depend on share price, corporate and regulatory requirements, economic and market conditions, and other factors. The stock repurchase authorization has no expiration date, does not require the Company to repurchase a specific number of shares, and may be modified, suspended, or discontinued at any time. During the quarter ended June 30, 2008, the Company repurchased 718,683 shares for $6.2 million at an average cost of $8.56 through open market repurchases. This amount is classified as treasury stock on our condensed consolidated balance sheet.

9. LITIGATION CONCLUSIONS AND PATENT LICENSE

In March 2007, the Company s patent infringement litigation with Sony Computer Entertainment concluded. Sony Computer Entertainment satisfied the judgment against it from the United States District Court for the Northern District of California, which included damages, pre-judgment interest, costs and interest totaling $97.3 million, along with compulsory license fees already paid to the Company of $30.6 million and interest earned on these fees of $1.8 million. As of March 19, 2007, the Company and Sony Computer Entertainment entered into an agreement

whereby the Company granted Sony Computer Entertainment and certain of its affiliates a worldwide, non-transferable, non-exclusive license under the Company s patents that have issued, may issue, or claim a priority date before March 2017 for the going forward use, development, manufacture, sale, lease, importation, and distribution of Sony Computer Entertainment s current and past PlayStation and related products. The

license does not cover adult, foundry, medical, automotive, industrial, mobility, or gambling products. Subject to the terms of the agreement, the Company also granted Sony Computer Entertainment and certain of its affiliates certain other licenses (relating to PlayStation games, backward compatibility of future consoles, and the use of their licensed products with certain third party products), an option to obtain licenses in the future with respect to future gaming products and certain releases and covenants not to sue. Sony Computer Entertainment granted the Company certain covenants not to sue and agreed to pay the Company twelve quarterly installments of $1.875 million (for a total of $22.5 million) beginning on March 31, 2007 and ending on December 31, 2009, and may pay the Company certain other fees and royalty amounts. In total, the Company will receive a minimum of $152.2 million through the conclusion of the litigation and the business agreement. In accordance with the guidance from EITF No. 00-21, the Company has allocated the present value of the total payments, equal to $149.9 million, between each element based on their relative fair values. Under this allocation, the Company recorded $119.9 million as litigation conclusions and patent license income, and the remaining $30.0 million is allocated to deferred license revenue to the extent payment is received in advance of revenue recognition. Such deferred revenue was $16.6 million at June 30, 2008. The Company recorded $749,000 and $1.5 million as revenue for the three-month and six-month periods ended June 30, 2008, respectively. The Company recorded $749,000 and $856,000 as revenue for the three-month and six-month periods ended June 30, 2007, respectively. On June 30, 2008, the Company had recorded $3.9 million of the $30.0 million as revenue and will record the remaining $26.1 million as revenue, on a straight-line basis, over the remaining capture period of the patents licensed, ending March 19, 2017. The Company has accounted for future payments in accordance with Accounting Principles Board Opinion No. 21 (ABP No. 21). Under APB No. 21, the Company determined the present value of the $22.5 million future payments to equal $20.2 million. The Company is accounting for the difference of $2.3 million as interest income as each $1.875 million quarterly payment installment becomes due.

In 2003, the Company executed a series of agreements with Microsoft that provided for settlement of its lawsuit against Microsoft as well as various licensing, sublicensing, and equity and financing arrangements. Under the terms of these agreements, in the event that the Company elects to settle the action in the United States District Court for the Northern District of California entitled *Immersion Corporation v. Sony Computer Entertainment of America, Inc., Sony Computer Entertainment Inc. and Microsoft Corporation*, Case No. C02-00710 CW (WDB), as such action pertains to Sony Computer Entertainment, and grant certain rights, the Company would be obligated to pay Microsoft a minimum of $15.0 million for amounts up to $100.0 million received from Sony Computer Entertainment, plus 25% of amounts over $100.0 million up to $150.0 million, and 17.5% of amounts over $150.0 million. The Company determined that the conclusion of its litigation with Sony Computer Entertainment does not trigger any payment obligations under its Microsoft agreements. Accordingly, the liability of $15.0 million that was in the financial statements at December 31, 2006 was extinguished, and the Company accounted for this sum during 2007 as litigation conclusions and patent license income. However, in a letter sent to the Company dated May 1, 2007, Microsoft disputed the Company s position and stated that it believes the Company owes Microsoft at least $27.5 million, which it increased to $35.6 million at a court ordered mediation meeting on December 11, 2007. On June 18, 2007, Microsoft filed a complaint against the Company in the U.S. District Court for the Western District of Washington alleging one claim for breach of a contract. The Company disputes Microsoft s allegations and intends to vigorously defend itself. See Contingencies Note 14. The results of any litigation are inherently uncertain, and there can be no assurance that the Company s position will prevail.

10. INCOME TAXES

For the three months and six months ended June 30, 2008, the Company recorded income tax benefits of $1.6 million and $2.6 million on income (loss) before taxes of $(4.7) million and $(8.3) million yielding effective tax rates of 34.4% and 31.7%, respectively. For the three months and six months ended June 30, 2007, the Company recorded income tax benefits (provisions) for income taxes of $1.5 million and $(13.6) million, on income (loss) before taxes of $(1.3) million and $129.6 million, yielding effective tax rates of 113.3% and 10.5%. The effective tax rate for 2008 differs from the statutory rate primarily due to certain permanent items and foreign withholding taxes. The income tax benefit and provision for the three months and six months ended June 30, 2008 and 2007, respectively, are as a result of applying the estimated annual effective tax rate to income (loss) before taxes,

adjusted for certain discrete items which are fully recognized in the period they occur.

The Company adopted FIN 48, regarding accounting for uncertain tax benefits, on January 1, 2007. As of June 30, 2008, the Company has unrecognized tax benefits of approximately $640,000, including interest of $13,000 which, if recognized, would result in a reduction of the Company s effective tax rate. Future changes in the unrecognized tax benefit will have an impact on the effective tax rate. There were no material changes in the amount of unrecognized tax benefits during the quarter ended June 30, 2008. The Company does not expect any material changes to its liability for unrecognized tax benefits during the next twelve months. The Company s policy is to account for interest and penalties related to uncertain tax positions as a component of income tax provision.

The Company is subject to taxation in the United States and various states and foreign jurisdictions. The tax years 1993-2007 remain open to examination by the federal and most state tax authorities due to net operating loss and credit carryforwards.

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The Company s foreign operations in Canada are open to audit under statute of limitation for the years ending December 31, 1998 through 2007. During June 2008, the Internal Revenue Service concluded the examination of calendar year 2004 with no changes.

Net deferred tax assets were approximately $7.9 million as of June 30, 2008 and are primarily timing differences between amounts recorded for financial reporting purposes and amounts used for income tax purposes. During the quarter ended June 30, 2008, the Company evaluated ownership changes from 2004 to 2008 and determined that there were no limitations on the Company s net operating loss carryforwards.

The Company s income taxes payable for federal and state purposes have been reduced by the tax benefits from employee stock options. The net tax benefits from employee stock option transactions were approximately $75,000 and $182,000 during the three months and six months ended June 30, 2008, respectively and are reflected as an increase to additional paid-in capital. The net tax benefits from employee stock options for the three months and six months ended June 30, 2007 were approximately $1.3 million and $11.8 million, respectively. The Company includes only the direct tax effects of employee stock incentive plans in calculating this increase to additional paid-in capital.

11. NET INCOME (LOSS) PER SHARE

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007 (restated)
Numerator:				
Net income (loss) used in computing basic net income (loss) per share	$ (3,091)	$ 176	$ (5,676)	$ 116,014
Interest on 5% Convertible Debentures				304
Net income (loss) used in computing diluted net income (loss) per share	$ (3,091)	$ 176	$ (5,676)	$ 116,318
Denominator:				
Shares used in computation of basic net income (loss) per share (weighted average common shares outstanding)	30,356	26,297	30,417	25,822
Dilutive potential common shares:				
Stock options		1,933		1,553
Warrants		389		345
5% Convertible Debentures				2,846
Shares used in computation of diluted net income (loss) per share	30,356	28,619	30,417	30,566
Basic net income (loss) per share	$ (0.10)	$ 0.01	$ (0.19)	$ 4.49
Diluted net income (loss) per share	$ (0.10)	$ 0.01	$ (0.19)	$ 3.81

As of June 30, 2008, the Company had securities outstanding that could potentially dilute basic earnings per share in the future, but were excluded from the computation of diluted net loss per share in the periods presented since their effect would have been anti-dilutive. These outstanding securities consisted of the following:

	June 30, 2008
Outstanding stock options	7,505,995
Warrants	436,772

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

12. COMPREHENSIVE INCOME (LOSS)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(In thousands)		(In thousands)	
				(restated)
Net income (loss)	$ (3,091)	$ 176	$ (5,676)	$ 116,014
Change in unrealized losses on short-term investments	(21)	(25)	(29)	(25)
Foreign currency translation adjustment	(8)	32	(20)	32
Total comprehensive income (loss)	$ (3,120)	$ 183	$ (5,725)	$ 116,021

13. SEGMENT REPORTING, GEOGRAPHIC INFORMATION, AND SIGNIFICANT CUSTOMERS

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

The Company s chief operating decision maker (CODM) is the Chief Executive Officer. The CODM allocates resources to and assesses the performance of each operating segment using information about its revenue and operating profit before interest and taxes. A description of the types of products and services provided by each operating segment is as follows:

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(In thousands)		(In thousands)	
				(restated)
Revenues:				
Immersion Computing, Entertainment, and Industrial	$ 5,012	$ 4,474	$ 10,200	$ 8,232
Immersion Medical	4,301	4,147	7,309	6,804
Intersegment eliminations		(26)	(41)	(27)
Total	$ 9,313	$ 8,595	$ 17,468	$ 15,009
Net Income (Loss):				
Immersion Computing, Entertainment, and Industrial	$ (2,647)	$ 152	$ (4,056)	$ 116,847
Immersion Medical	(456)	23	(1,615)	(839)
Intersegment eliminations	12	1	(5)	6
Total	$ (3,091)	$ 176	$ (5,676)	$ 116,014

	June 30 2008	December 31 2007
	(In thousands)	
Total Assets:		
Immersion Computing, Entertainment, and Industrial	$ 177,222	$ 181,860
Immersion Medical	7,668	6,552
Intersegment eliminations	(21,625)	(20,044)
Total	$ 163,265	$ 168,368

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

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(In thousands)		(In thousands)	
Revenues:				
Consumer, Computing, and Entertainment	$ 2,913	$ 1,716	$ 5,964	$ 3,490
3D	1,092	1,097	2,318	2,088
Touch Interface Products	1,007	1,635	1,877	2,627
Subtotal Immersion Computing, Entertainment, and Industrial	5,012	4,448	10,159	8,205
Immersion Medical	4,301	4,147	7,309	6,804
Total	$ 9,313	$ 8,595	$ 17,468	$ 15,009

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
North America	59%	60%	59%	63%
Europe	18%	18%	20%	17%
Far East	18%	17%	16%	16%
Rest of the world	5%	5%	5%	4%
Total	100%	100%	100%	100%

The Company derived approximately 51% and 58% of its total revenues from the United States of America for the three months ended June 30, 2008 and 2007, respectively. The Company derived 11% of its total revenues from Japan for the three months ended June 30, 2007. The Company derived 10% of its total revenues from Germany for the three months ended June 30, 2007. The Company derived 54% and 62% of its total revenues from the United States of America for the six months ended June 30, 2008 and 2007, respectively. The Company derived 11% of its total revenues from Japan for the six months ended June 30, 2007. Revenues from other countries represented less than 10% individually for the periods presented.

The majority of the Company s long-lived assets are located in the United States of America. Long-lived assets include net property and equipment and long-term investments and other assets. Long-lived assets that were outside the United States of America constituted less than 10% of the total on June 30, 2008 and December 31, 2007.

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

	Three Months Ended	Six Months Ended

	June 30,		June 30,	
	2008	**2007**	**2008**	**2007**
Customer A	13%	12%	12%	12%
Customer B	*%	11%	*%	*%
Total	13%	23%	12%	12%

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

Customer A accounted for 20% of the Company s accounts receivable on June 30, 2008. Customer B accounted for 24% of the Company s accounts receivable on December 31, 2007. No other customer accounted for more than 10% of the Company s accounts receivable on June 30, 2008 or on December 31, 2007.

14. CONTINGENCIES

In re Immersion Corporation

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

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

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

The Company and most of the issuer defendants had settled with the plaintiffs. In this settlement, plaintiffs would have dismissed and released all claims against the Immersion Defendants in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of certain claims the Company may have against the underwriters. The Immersion Defendants would not have been required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeded the amount of the insurance coverage, a circumstance that the Company believed was remote. In September 2005, the District Court granted preliminary approval of the settlement. The District Court held a hearing to consider final approval of the settlement on April 24, 2006, and took the matter under submission. Subsequently, the U.S. Court of Appeals for the Second Circuit vacated the class certification of plaintiffs claims against the underwriters in six cases designated as focus or test cases. *Miles v. Merrill Lynch & Co. (In re Initial Public Offering Securities Litigation)*, 471 F.3d 24 (2d Cir. 2006). Thereafter, the District Court ordered a stay of all proceedings in all of the lawsuits pending the outcome of plaintiffs petition to the Second Circuit for rehearing en banc and resolution of the class certification issue. On April 6, 2007, the Second Circuit denied plaintiffs petition for rehearing, but clarified that the plaintiffs may seek to certify a more limited class in the District Court. Accordingly, the parties withdrew the prior settlement, and plaintiffs filed an amended complaint in attempt to comply with the Second Circuit s ruling. On March 26, 2008, the District Court denied in part and granted in part the motions to dismiss the focus cases on substantially the same grounds as set forth in its prior opinion. There is no guarantee that an amended or renegotiated settlement will be reached, and if reached, approved. The Company has not accrued for any loss on this matter, and believes the possibility of loss to be remote.

Internet Services LLC Litigation

On October 20, 2004, Internet Services LLC (ISLLC) filed claims against the Company in its lawsuit against Sony Computer Entertainment in the U.S. District Court for the Northern District of California, alleging that the Company breached a contract with ISLLC by suing Sony Computer Entertainment for patent infringement relating to

haptically-enabled software whose topics or images are allegedly age-restricted, for judicial apportionment of damages between ISLLC and the Company of the damages awarded by the jury, and for a judicial declaration with respect to ISLLC s rights and duties under agreements with the Company. On December 29, 2004, the District Court issued an order dismissing ISLLC s claims against Sony Computer Entertainment with prejudice and dismissing ISLLC s claims against the Company without prejudice to ISLLC filing a new complaint if it can do so in good faith without contradicting, or repeating the deficiency of, its complaint.

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

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

On February 8, 2006, ISLLC filed a lawsuit against the Company in the Superior Court of Santa Clara County. ISLLC s complaint sought a share of the damages awarded to the Company in the March 24, 2005 Judgment and of the Microsoft settlement proceeds, and generally restated the claims already adjudicated by the District Court. On March 16, 2006, the Company answered the complaint, cross claimed for declaratory relief, breach of contract by ISLLC, and for rescission of the contract, and removed the lawsuit to federal court. The case was assigned to Judge Wilken in the U.S. District Court for the Northern District of California as a case related to the previous proceedings involving Sony Computer Entertainment and ISLLC. ISLLC filed its answer to the Company s cross claims on April 27, 2006. ISLLC also moved to remand the case to Superior Court. On July 10, 2006, Judge Wilken issued an order denying ISLLC s motion to remand. On September 5, 2006, Judge Wilken granted the stipulated request by the parties to stay discovery and other proceedings in the case pending the disposition of ISLLC s appeal from the District Court s previous orders. The case was stayed from December 1, 2006 pending the Federal Circuit s disposition on the appeal. As noted above, the Federal Circuit issued its opinion on April 4, 2007 and entered a judgment affirming the District Court s previous orders.

On May 10, 2007, ISLLC filed a motion in the District Court to remand its latest action to the Superior Court or in the alternative for leave to file an amended complaint to remove the declaratory relief claim. The Company opposed ISLLC s motion, and cross-moved for judgment on the pleadings on the grounds that ISLLC s claims are barred by res judicata and collateral estoppel. On June 26, 2007, the District Court ruled on the motions, denying ISLLC s motion to remand or for leave to file an amended complaint, and granting in part the Company s motion for judgment on the pleadings. The District Court dismissed ISLLC s claim for declaratory relief. ISLLC s claims for breach of contract, promissory fraud, and constructive trust, to the extent not inconsistent with the District Court s previous rulings, remained. On February 20, 2008, ISLLC filed a motion to extend all dates in the matter by ninety (90) days due to circumstances relating to ISLLC s dealings with a third party, and the possibility that ISLLC s counsel (Keker & Van Nest) may withdraw in the case. On March 18, 2008, the District Court entered an order denying ISLLC s request to extend dates.

On March 24, 2008, ISLLC s counsel filed a motion to withdraw as counsel. On May 1, 2008, the District Court denied ISLLC s counsel s motion to withdraw without prejudice. On May 28, 2008, ISLLC s counsel renewed its motion to withdraw as ISLLC s counsel of record. On June 19, 2008, the District Court granted the renewed motion.

On April 10, 2008, Immersion filed a motion for summary judgment on ISLLC s remaining claims for breach of contract, promissory fraud, and constructive trust, as well as Immersion s counterclaim for declaratory relief that ISLLC was not entitled to a share of any of court-ordered compulsory license payments Immersion received from Sony Computer Entertainment. On May 16, 2008, the District Court entered an order granting Immersion s motion for summary judgment on all of ISLLC s claims, as well as Immersion s counterclaim for declaratory relief. As a result, the only claims remaining in the action are Immersion s counterclaims against ISLLC.

On July 15, 2008, the Company filed a Motion For Default Judgment Or, In The Alternative, For Order To Show Cause Re Default based on ISLLC s failure to retain new counsel, and also its failure to comply with certain pretrial

orders of the District Court and provide certain discovery. On July 16, 2008 the District Court granted the Company s motion in part and ordered ISLLC to show cause within ten days from the date of the District Court s order why default judgment should not be entered against ISLLC. After receiving briefing from both parties on July 28, 2008, the District Court discharged the order to show cause. On ISLLC s motion to continue the trial, the District Court ordered that the jury trial will begin on September 15, 2008.

The Company has participated in court-ordered mediation proceedings, which to date have not been successful. The Company intends to vigorously prosecute its counterclaims against ISLLC.

Microsoft Corporation v. Immersion Corporation

On June 18, 2007, Microsoft filed a complaint against the Company in the U.S. District Court for the Western District of Washington alleging one claim for breach of a contract. Microsoft alleges that the Company breached a Sublicense Agreement executed in connection with the parties settlement in 2003 of the Company s claims of patent infringement against Microsoft in *Immersion Corporation v. Microsoft Corporation, Sony Computer Entertainment Inc. and Sony Computer Entertainment America, Inc., United States District Court for the Northern District of California, Case No. 02-0710-CW* (see discussion above). The complaint alleges that Microsoft is entitled to payments that Microsoft contends are due under the Sublicense Agreement as a result of Sony Computer Entertainment s satisfaction of the judgment in the Company s lawsuit against Sony Computer

Entertainment and payment of other sums to the Company. In a letter sent to the Company dated May 1, 2007, Microsoft stated that it believes the Company owes Microsoft at least $27.5 million, which it increased to $35.6 million at a court ordered mediation meeting on December 11, 2007. The Company was served with the complaint on July 6, 2007. On September 4, 2007, the Company filed its Answer, Affirmative Defenses, and Counterclaims alleging that Microsoft breached its confidentiality obligations by publicly disclosing previously confidential the terms of the Company s business agreement with Sony Computer Entertainment. The parties participated in a court-ordered mediation on December 11, 2007, but were unsuccessful in resolving the matter. On January 10, 2008, Microsoft filed a motion to disqualify the Company s counsel, Irell & Manella LLP on the grounds that one or more attorneys might be witnesses in the proceeding. On March 7, 2008, the District Court issued an Order denying Microsoft s motion.

On April 17, 2008, Microsoft filed a motion for partial summary judgment on the Company s counterclaim for breach of the confidentiality agreement between the Company and Microsoft based on Microsoft s publication of the March 2007 Sony-Immersion Agreement. On May 6, 2008, the Company filed its opposition brief, and on May 9, 2008, Microsoft filed its reply brief. On June 10, 2008, the District Court deferred ruling on Microsoft s motion and requested the Company present additional information regarding its breach of contract counterclaim, which the Company did on June 27, 2008. On August 1, 2008, the District Court denied Microsoft s motion for summary judgment on this matter.

On June 26, 2008, Microsoft filed a motion for partial summary judgment on Microsoft s claim for breach of contract. On June 27, 2008 Microsoft filed another motion for partial summary judgment on the Company s affirmative defenses. The Company filed its opposition to the breach of contract motion on July 17, 2008, and the opposition to the affirmative defense related motion on July 21, 2008. Microsoft s filed its reply papers on July 25, 2008. In addition to opposing Microsoft s motions, on July 17, 2008, the Company filed a motion for partial summary judgment on Microsoft s allegation that the Company breached the implied covenant of good faith and fair dealing in the 2003 Microsoft-Immersion Sublicense Agreement in connection with the Company s 2007 agreement with Sony Computer Entertainment. Microsoft filed its opposition to this motion on August 4, 2008, and the Company s reply is due August 8, 2008. The District Court has requested oral arguments on all three motions for partial summary judgment. The District Court has not yet ruled on these motions.

The Company has not accrued any loss related to these allegations. The range of reasonable possible loss is from zero to $35.6 million. The Company disputes Microsoft s allegations and intends to vigorously defend itself.

Other Contingencies

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

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

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

15. RESTATEMENT OF PREVIOUSLY ISSUED QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

Subsequent to the filing of Form 10-Q for the six months ended June 30, 2007, the Company determined that there were errors in its accounting for income taxes for the release of deferred income tax valuation allowance related to

stock option deductions for prior years and the utilization of an incorrect effective state tax rate. The Company restated its previously reported provision for income taxes of $7.0 million to $13.6 million and previously reported net income of $122.6 million to $116.0

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million. The impact on the condensed consolidated statements of operations and condensed consolidated cash flows is presented below:

	Six Months Ended June 30, 2007		
	As Previously Reported	Adjustments	As Restated
	(In thousands except per share amounts)		
Total revenues	$ 15,009	$	$ 15,009
Income before provision for income taxes	$ 129,641	$	$ 129,641
Provision for income taxes	(7,032)	(6,595)	(13,627)
Net income	$ 122,609	$ (6,595)	$ 116,014
Basic net income per share	$ 4.75	$ (0.26)	$ 4.49
Shares used in calculating basic net income per share	25,822		25,822
Diluted net income per share	$ 4.03	$ (0.22)	$ 3.81
Shares used in calculating diluted net income per share	30,530	36	30,566
Changes to cash flows from operating activities:			
Net income	$ 122,609	$ (6,595)	$ 116,014
Excess tax benefits from stock-based compensation	(1,876)	(7,364)	(9,240)
Deferred income taxes	(5,409)	(259)	(5,668)
Income taxes payable	7,288	6,227	13,515
Other long-term liabilities	20	627	647
Net cash provided by operating activities	93,844	(7,364)	86,480
Changes to cash flows from financing activities:			
Excess tax benefits from stock-based compensation	$ 1,876	$ 7,364	$ 9,240
Net cash provided by financing activities	10,345	7,364	17,709

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

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The forward-looking statements involve risks and uncertainties. Forward-looking statements are identified by words such as anticipates, believes, expects, intends, may, will, and other similar expressions. However, these words are only way we identify forward-looking statements. In addition, any statements, which refer to expectations, projections, or other characterizations of future events, or circumstances, are forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, including those set forth below in Management s Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors, those described elsewhere in this report, and those described in our other reports filed with the SEC. We caution you not to place undue reliance on these forward-looking statements, which speak only as

of the date of this report, and we undertake no obligation to update these forward-looking statements after the filing of this report. You are urged to review carefully and consider our various disclosures in this report and in our other reports publicly disclosed or filed with the SEC that attempt to advise you of the risks and factors that may affect our business.

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OVERVIEW

We are a leading provider of haptic technologies that allow people to use their sense of touch more fully when operating a wide variety of digital devices. To achieve this heightened interactivity, we develop and manufacture or license a wide range of hardware and software technologies and products. While we believe that our technologies are broadly applicable, we are currently focusing our marketing and business development activities on the following target application areas: automotive, consumer electronics, entertainment, gaming, and commercial and industrial controls; medical simulation; mobile communications; and three-dimensional design and interaction. We manage these application areas under two operating and reportable segments: 1) Immersion Computing, Entertainment, and Industrial and 2) Immersion Medical.

In some markets, such as video console gaming, mobile phones, and automotive controls, we license our technologies to manufacturers who use them in products sold under their own brand names. In other markets, such as medical simulation and 3D design and interaction, we sell products manufactured under our own brand name through direct sales to end users, distributors, OEMs, or value-added resellers. From time to time, we also engage in development projects for third parties.

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

Revenue Recognition

We recognize revenues in accordance with applicable accounting standards, including SAB No. 104, Revenue Recognition, EITF No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables, AICPA SOP 81-1 Accounting for Performance for Construction-Type and Certain Production-Type contracts, and AICPA SOP 97-2, Software Revenue Recognition, as amended. Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, the fee is fixed and determinable, and collectibility is probable. We derive our revenues from three principal sources: royalty and license fees, product sales, and development contracts.

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

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

License revenue model	Revenue recognition
Perpetual license of intellectual property portfolio based on per unit royalties, no services contracted.	Based on royalty reports received from licensees. No further obligations to licensee exist.

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

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Individual contracts may have characteristics that do not fall within a specific license model or may have characteristics of a combination of license models. Under those circumstances, we recognize revenue in accordance with SAB No. 104, EITF No. 00-21, SOP 81-1, and SOP 97-2, as amended, to guide the accounting treatment for each individual contract. See also the discussions regarding Multiple element arrangements below. If the information received from our licensees regarding royalties is incorrect or inaccurate, our revenues in future periods may be adversely affected. To date, none of the information we have received from our licensees has caused any material reduction in future period revenues.

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

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

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

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

Stock-based Compensation

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

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

Expected term We estimate the expected term of options granted by calculating the average term from our historical stock option exercise experience. We used the simplified method as prescribed by SAB No. 107 for options granted prior to December 31, 2007.

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

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

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

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

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

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

See Note 8 to the condensed consolidated financial statements for further information regarding the SFAS No. 123R disclosures.

Accounting for Income Taxes

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Management must make assumptions, judgments, and estimates to determine our current provision for income taxes and also our deferred tax assets and liabilities and any valuation allowance to be recorded against a deferred tax asset.

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

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

Litigation Conclusions and Patent License

In March 2007, we announced the conclusion of our patent infringement litigation against Sony Computer Entertainment at the U.S. Court of Appeals for the Federal Circuit. Sony Computer Entertainment satisfied the U.S. District Court for the Northern District of California judgment against it. As of March 19, 2007, we entered into a new business agreement with Sony Computer Entertainment. We determined that the conclusion of our litigation with Sony Computer Entertainment did not trigger any payment obligations under our Microsoft agreements. However, on June 18, 2007, Microsoft filed a complaint against us in the United States District Court for the Western District of Washington alleging breach of our Sublicense Agreement dated July 25,

2003 and seeks damages, specific performance, declaratory judgment, and attorneys fees and costs. At a court ordered mediation meeting on December 11, 2007, Microsoft indicated they believe the amount owed to be $35.6 million. We believe that we are not obligated under the Sublicense Agreement with Microsoft to make any payment to Microsoft relating to the conclusion of our litigation with Sony Computer Entertainment. We intend to defend this lawsuit vigorously. The results of any litigation are inherently uncertain, and there can be no assurance that our position will prevail.

Our judgments and assessments related to the accounting of these liabilities could differ from actual results.

Short-term Investments

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

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

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

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

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

Level 2: Quoted prices in markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly;

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

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

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

Further information about the application of SFAS No. 157 may be found in Note 2 to the condensed consolidated financial statements.

Recovery of Accounts Receivable

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

resulting in an impairment of their ability to make payments, additional allowances might be required. To date such estimated losses have been within our expectations.

Inventory Reserves

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

Product Return and Warranty Reserves

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

Intangible Assets

We have acquired patents and other intangibles. In addition, we capitalize the external legal and filing fees associated with patents and trademarks. We assess the recoverability of our intangible assets, and we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets that affect our condensed consolidated financial statements. If these estimates or related assumptions change in the future, we may be required to record impairment charges for these assets. We amortize our intangible assets related to patents and trademarks, once they issue, over their estimated useful lives, generally 10 years. Future changes in the estimated useful life could affect the amount of future period amortization expense that we will incur. During the three months and six months ended June 30, 2008, we capitalized costs associated with patents and trademarks of $673,000 and $1.2 million, respectively. Our total amortization expense for the same periods for all intangible assets was $170,000, and $405,000, respectively.

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

RESULTS OF OPERATIONS FOR THE THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007

The following Management s Discussion and Analysis gives effect to the restatement discussed in Note 15 to the condensed consolidated financial statements.

Overview

We achieved an 8% increase in revenues during the three months ended June 30, 2008 as compared to the three months ended June 30, 2007. The second quarter revenue growth was primarily due to a 15% increase in royalty and license revenues mainly from increased mobility royalty and license fees, a 2% increase in product sales primarily from touch interface products, and a 35% increase in development contract revenues primarily from increased development contracts within our medical business. We achieved a 16% increase in revenues during the six months ended June 30, 2008 as compared to the six months ended June 30, 2007. The first six months revenue growth was primarily due to a 34% increase in royalty and license revenues mainly from increased mobility royalty and license fees, a 4% increase in product sales primarily from 3D and touch interface products, and a 36% increase in development contract revenues primarily from increased development contracts within our medical business. Our net loss was $3.1 million for the three months ended June 30, 2008 compared to net income of $176,000 for the three months ended June 30, 2007. Our net loss was $5.7 million for the six months ended June 30, 2008 compared to net income of $116.0 million for the six months ended June 30, 2007. In the second quarter of 2008 and throughout the first six months of 2008, we continued to invest in research, development, sales, and marketing across all our key business segments. In March 2007, we concluded our patent infringement litigation against Sony Computer Entertainment and recognized a gain of $119.9 million of litigation conclusions and patent license in the first six months of 2007.

For the remainder of 2008, we expect to continue to focus on the execution of sales and marketing plans in our established businesses to increase revenue and make selected investments in product and technology development and

sales and marketing for longer-term growth areas. Our success could be limited by several factors, including the timely release of our new products or our licensees products, continued market acceptance of our products and technology, the introduction of new products by existing or new competitors, and the cost of ongoing litigation. For a further discussion of these and other risk factors, see Part II, Item 1A Risk Factors.

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REVENUES	June 30, 2008	2007	Change
	($ In thousands)		
Three months ended:			
Royalty and license	$ 3,171	$ 2,747	15%
Product sales	5,386	5,289	2%
Development contracts and other	756	559	35%
Total Revenue	$ 9,313	$ 8,595	8%
Six months ended:			
Royalty and license	$ 6,632	$ 4,958	34%
Product sales	9,237	8,879	4%
Development contracts and other	1,599	1,172	36%
Total Revenue	$ 17,468	$ 15,009	16%

Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007

Total Revenue Our total revenue for the second quarter of 2008 increased by $718,000 or 8% from the second quarter of 2007.

Royalty and license revenue Royalty and license revenue is comprised of royalties earned on sales by our VibeTonz and TouchSense licensees and license fees charged for our intellectual property portfolio. Royalty and license revenue for the three months ended June 30, 2008 was $3.2 million, an increase of $424,000 or 15% from the three months ended June 30, 2007. The increase in royalty and license revenue was due to an increase in mobile device license and royalty revenue of $813,000 and an increase in gaming royalties of $247,000, partially offset by a decrease in touch interface product royalties of $636,000.

Mobile device license and royalty revenue increased due to the shipment of additional VibeTonz enabled phones by LG Electronics, which began in the second quarter of 2007, and the signing of a new license contract with mobile device manufacturer Nokia at the end of the second quarter of 2007. Touch interface product royalties decreased due to the recognition of certain automotive royalty payments in the second quarter of 2007 that did not recur, partially offset by increased licensee revenue from additional products licensed in the automotive market.

The increase in gaming royalties for the second quarter of 2008 compared to the similar period in 2007 was mainly due to the increase in sales of new products for the PS3 such as Logitech s steering wheel. Although the revenue from our third-party peripheral licensees has generally continued to decline primarily due to i) the reduced sales of past generation video console systems due to the launches of the next-generation console models from Microsoft (Xbox 360), Sony (PlayStation 3), and Nintendo (Wii), and ii) the decline in third-party market share of aftermarket game console controllers due to the launch of next-generation peripherals by manufacturers of console systems, we are seeing the decline begin to stabilize.

Sony announced on May 8, 2006 that the vibration feature that is currently available on PlayStation (PS1) and PlayStation 2 (PS2) console systems would be removed from the new PlayStation 3 (PS3) console system. The PS3 console system was launched in late 2006 in the United States and Japan without native vibration or any force feedback capability of any kind. In the first quarter of 2007, Sony released an update to the PS3 console system that offered limited vibration and force feedback support for some older PS1 and PS2 games and controllers. In September 2007, Sony announced that it would fully restore vibration feedback features for the PS3 console system. The new PS3 DualShock 3 controllers with vibration feedback were released in Japan in November 2007 as standalone products sold separately from the PS3 console system. Sony released the PS3 DualShock 3 controller in April 2008 in the U.S. and released a version in Europe in July of 2008. While a very limited number of third party

PS3 vibration and force feedback products have been announced recently, we do not know to what extent Sony will foster the market for other third-party PS3 gaming peripherals with vibration feedback. To the extent Sony discourages or impedes third-party controller makers from making more PS3 controllers with vibration feedback, our licensing revenue from third-party PS3 peripherals will continue to be severely limited.

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Based on our litigation conclusion and new business agreement entered into with Sony Computer Entertainment in March 2007 (see Note 9 to the condensed consolidated financial statements for more discussion), we will recognize a minimum of $30.0 million as royalty and license revenue from March 2007 through March 2017, approximately $750,000 per quarter. For the Microsoft Xbox 360 video console system launched in November 2005, Microsoft has, to date, not broadly licensed third parties to produce game controllers. Because our gaming royalties come mainly from third-party manufacturers, unless Microsoft broadens its licenses to third-party controller makers, particularly with respect to wireless controllers for Xbox 360, our gaming royalty revenue may decline. Additionally, Microsoft is now making touch-enabled wheels covered by its royalty-free, perpetual, irrevocable license to our worldwide portfolio of patents that could compete with our licensees current or future products for which we earn per unit royalties. For the Nintendo Wii video console system launched in December 2006, Nintendo has, to date, not yet broadly licensed third parties to produce game controllers for its Wii game console. Because our gaming royalties come mainly from third-party manufacturers, unless Nintendo broadens its licenses to third-party controller makers, our gaming royalty revenue may decline.

Product sales Product sales for the three months ended June 30, 2008 were $5.4 million, an increase of $97,000 or 2% as compared to the three months ended June 30, 2007. The increase in product sales was primarily due to an increase in product sales from touch interface products of $149,000 partially offset by a decrease in medical product sales of $37,000. Touch interface products include touchscreen and touch panel components, rotary modules, and commercial gaming products. Touch interface products increased primarily due to increased sales of touchscreen and touch panel components and increased sales of force feedback electronics for arcade gaming. Decreased medical product sales was mainly due to reduced sales of our endovascular and Virtual IV simulator platforms partially offset by increases in our endoscopy and laparoscopy simulators. This decrease in product sales was primarily a result of significant orders that was not expected to repeat of endovascular devices during the three months ending June 30, 2007. The sales increases of our endoscopy and laparoscopy simulators resulted mainly from an increased emphasis on the laparoscopy platform and modules along with continued expansion of international sales for both endoscopy and laparoscopy.

Development contract and other revenue Development contract and other revenue is comprised of revenue on commercial contracts and extended support and warranty contracts. Development contract and other revenue was $756,000 during the three months ended June 30, 2008, an increase of $197,000 or 35% as compared to the three months ended June 30, 2007. The increase was mainly attributable to an increase in medical contract revenue of $191,000 due to increased development contracts. In addition, there was increased revenue recognized on mobile device development contracts and support of $138,000, offset by decreased Touch Interface Product contract revenue of $142,000 mainly due to contracts being completed in 2007.

We categorize our geographic information into four major regions: North America, Europe, Far East, and Rest of the World. In the second quarter of 2008, revenue generated in North America, Europe, Far East, and Rest of the World represented 59%, 18%, 18%, and 5%, respectively, compared to 60%, 18%, 17%, and 5%, respectively, for the second quarter of 2007. The shift in revenues among regions was mainly due to an increase in mobile device license and contract revenue and medical product revenue from the Far East and a decrease in Touch Interface Product development contract revenue in North America.

Six Months Ended June 30, 2008 Compared to Six Months Ended June 30, 2007

Total Revenue Our total revenue for the first six months of 2008 increased by $2.5 million or 16% from the first six months of 2007.

Royalty and license revenue Royalty and license revenue for the six months ended June 30, 2008 was $6.6 million, an increase of $1.7 million or 34% from the six months ended June 30, 2007. The increase in royalty and license revenue was primarily due to an increase in mobile device license and royalty revenue of $1.6 million and an increase in gaming royalties of $577,000 offset by a decrease in touch interface product royalties of $517,000.

Mobile device license and royalty revenue increased due to the additional shipment of VibeTonz enabled phones by LG Electronics which began in the second quarter of 2007, and the signing of a new license contract with mobile device manufacturer Nokia at the end of the second quarter of 2007. The increase in gaming royalties was mainly due to an increase in royalty and license revenue from first-party gaming licensee Sony Computer Entertainment. In

addition, there was increased royalty and license revenue from third-party peripheral gaming licensees. Touch interface product royalties decreased due to the recognition of certain automotive royalty payments in the second quarter of 2007 that did not recur, partially offset by increased licensee revenue from additional products licensed in the automotive market.

Product sales Product sales for the six months ended June 30, 2008 were $9.2 million, an increase of $358,000 or 4% as compared to the six months ended June 30, 2007. The increase in product sales was primarily due to increased 3D product sales of $211,000, mainly due to increased sales of our CyberForce®, CyberGlove®, CyberGrasp®, and MicroScribe products. In addition, there was an increase in product sales from touch interface products of $195,000 primarily due to increased sales of touchscreen and touch panel components and increased sales of force feedback electronics for arcade gaming. Medical product

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sales decreased by $48,000 mainly due to reduced sales of our endovascular and Virtual IV simulator platforms partially offset by increases in our endoscopy and laparoscopy simulators. This decrease in product sales was primarily a result of significant orders that were not expected to repeat of endovascular devices during the three months ending June 30, 2007. The sales increases of our endoscopy and laparoscopy simulators resulted mainly from an increased emphasis on the laparoscopy platform and modules along with continued expansion of international sales for both endoscopy and laparoscopy.

Development contract and other revenue Development contract and other revenue was $1.6 million during the six months ended June 30, 2008, an increase of $427,000 or 36% as compared to the six months ended June 30, 2007. The increase was mainly attributable to an increase in medical contract revenue of $554,000 due to increased development contracts. In addition, there was increased revenue recognized on mobile device development contracts and support of $283,000, offset by decreased touch interface product contract revenue of $429,000 mainly due to contracts being completed in 2007.

In the first six months of 2008, revenue generated in North America, Europe, Far East, and Rest of the World represented 59%, 20%, 16%, and 5%, respectively, compared to 63%, 17%, 16%, and 4%, respectively, for the first six months of 2007. The shift in revenues among regions was mainly due to an increase in revenue from mobile device license and contract revenue and touch interface product royalty revenue from Europe without corresponding increases in North America. In the six months ended June 30, 2008, we added several sales and support personnel to help grow our international business.

COST OF PRODUCT SALES	**June 30, 2008**	**2007**	**Change**
	($ In thousands)		
Three months ended:			
Cost of product sales	$2,570	$2,427	6%
% of total product revenue	48%	46%	
Six months ended:			
Cost of product sales	$4,656	$3,970	17%
% of total product revenue	50%	45%	

Cost of Product Sales Our cost of product sales consists primarily of materials, labor, and overhead. There is no cost of product sales associated with royalty revenue or development contract revenue. Cost of product sales was $2.6 million, an increase of $143,000 or 6% for the three months ended June 30, 2008 as compared to the three months ended June 30, 2007. The increase in cost of product sales was primarily due to an increase of overhead costs of $224,000 offset by decreased direct material costs of $81,000. Overhead costs increased, in part, as a result of increased salary expense primarily due to the costs of programs to improve quality processes within our manufacturing operations which we anticipate will continue throughout 2008. The decrease in direct material costs was mainly a result of an increase of certain medical products with lower costs in the product sales mix. Cost of product sales increased as a percentage of product revenue to 48% in the first three months of 2008 from 46% in the first three months of 2007. This increase is mainly due the increased overhead costs mentioned above as well as increased sales of our lower margin Touch Interface Products changing the sales mix.

Cost of product sales was $4.7 million, an increase of $686,000 or 17% for the six months ended June 30, 2008 as compared to the six months ended June 30, 2007. The increase in cost of product sales was primarily due to an increase of overhead costs of $422,000, an increase in excess and obsolete inventory provisions of $157,000, and increased direct material costs of $54,000. Overhead costs increased, in part, as a result of increased salary expense primarily due to the costs of programs to improve quality processes within our manufacturing operations which we anticipate will continue throughout 2008. The increase in direct material costs was mainly a result of increased product sales. Cost of product sales increased as a percentage of product revenue to 50% in the first six months of

2008 from 45% in the first six months of 2007. This increase is mainly due the increased overhead costs mentioned above as well as increased sales of our lower margin Touch Interface Products changing the sales mix.

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OPERATING EXPENSES AND OTHER	June 30, 2008	2007	Change
	($ In thousands)		
Three months ended:			
Sales and marketing	$ 4,258	$ 3,030	41%
% of total revenue	46%	35%	
Research and development	$ 2,855	$ 2,513	14%
% of total revenue	31%	29%	
General and administrative	$ 5,084	$ 3,122	63%
% of total revenue	55%	36%	
Amortization of intangibles	$ 170	$ 242	(30)%
% of total revenue	2%	3%	
Six months ended:			
Sales and marketing	$ 7,700	$ 5,733	34%
% of total revenue	44%	38%	
Research and development	$ 6,084	$ 5,056	20%
% of total revenue	35%	34%	
General and administrative	$ 9,347	$ 6,381	46%
% of total revenue	54%	43%	
Amortization of intangibles	$ 405	$ 496	(18)%
% of total revenue	2%	3%	
Litigation conclusions and patent license	$	$ (134,900)	*%
% of total revenue	%	*%	

* - Not meaningful

Sales and Marketing Our sales and marketing expenses are comprised primarily of employee compensation and benefits costs, advertising, public relations, trade shows, brochures, market development funds, travel, and an allocation of facilities costs. Sales and marketing expenses were $4.3 million, an increase of $1.2 million or 41% in the second quarter of 2008 compared to the comparable period in 2007. The increase was primarily due to increased compensation, benefits, and overhead of $524,000, increased marketing, advertising, and public relations costs of $304,000, increased sales and marketing travel expense of $153,000, increased consulting costs of $119,000 to supplement our sales and marketing staff, and an increase in bad debt expense of $50,000. The increased compensation, benefits, and overhead expense were primarily due to an increase in sales and marketing headcount, increased compensation for sales and marketing personnel, and increased non-cash stock based compensation charges, partially offset by decreased variable compensation. We expect to continue to focus our sales and marketing efforts on medical, mobile device, and touchscreen market opportunities to build greater market acceptance for our touch technologies as well as continue to expand our sales and marketing presence internationally. We will continue to invest in sales and marketing in future periods to exploit market opportunities for our technology.

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Sales and marketing expenses were $7.7 million, an increase of $2.0 million or 34% in the first six months of 2008 compared to the same period in 2007. The increase was primarily due to increased compensation, benefits, and overhead of $966,000, increased marketing, advertising, and public relations costs of $414,000, increased sales and marketing travel expense of $197,000, increased employee recruiting costs of $137,000, increased consulting costs of $92,000 to supplement our sales and marketing staff, and an increase in bad debt expense of $84,000. The increased compensation, benefits, and overhead expense and increased recruiting costs were primarily due to an increase in sales and marketing headcount, increased compensation for sales and marketing personnel, and increased non-cash stock based compensation charges, partially offset by decreased variable compensation.

Research and Development Our research and development expenses are comprised primarily of employee compensation and benefits costs, consulting fees, tooling and supplies, and an allocation of facilities costs. Research and development expenses were $2.9 million, an increase of $342,000 or 14% in the second quarter of 2008 compared to the same period in 2007. The increase was primarily due to increased compensation, benefits, and overhead of $256,000 and an increase in professional consulting expense of $70,000 to supplement our engineering staff. The increased compensation, benefits, and overhead expense was primarily due to increased research and development headcount, increased compensation for research and development personnel, and increased non-cash stock based compensation charges. We believe that continued significant investment in research and development is critical to our future success, and we expect to make investments in areas of research and technology development to support future growth.

Research and development expenses were $6.1 million, an increase of $1.0 million or 20% in the first six months of 2008 compared to the same period in 2007. The increase was primarily due to increased compensation, benefits, and overhead of $703,000, an increase in professional consulting expense of $200,000 to supplement our engineering staff, and an increase in prototyping expenses of $63,000. The increased compensation, benefits, and overhead expense was primarily due to increased research and development headcount, increased compensation for research and development personnel, and increased non-cash stock based compensation charges.

General and Administrative Our general and administrative expenses are comprised primarily of employee compensation and benefits, legal and professional fees, office supplies, travel, and an allocation of facilities costs. General and administrative expenses were $5.1 million, an increase of $2.0 million or 63% in the second quarter of 2008 compared to the same period in 2007. The increase was primarily due to increased compensation, benefits, and overhead of $970,000 and increased legal, professional, and license fee expense of $895,000. The increased compensation, benefits, and overhead expense was primarily due to increased general and administrative headcount, increased compensation for general and administrative personnel, and increased non-cash stock based compensation charges. The increased legal, professional, and license fee expenses were primarily due to increased litigation costs offset in part by reduced audit, tax, and accounting fees mainly related to the accounting and valuation for Sony Computer Entertainment litigation conclusion and patent license that occurred in the second quarter of 2007. We expect that the dollar amount of general and administrative expenses to continue to be a significant component of our operating expenses. We will continue to incur costs related to litigation as we continue to protect and defend our intellectual property.

General and administrative expenses were $9.3 million, an increase of $3.0 million or 46% in the first six months of 2008 compared to the same period in 2007. The increase was primarily due to increased compensation, benefits, and overhead of $1.6 million and increased legal, professional, and license fee expense of $1.2 million. The increased compensation, benefits, and overhead expense was primarily due to increased general and administrative headcount, increased compensation for general and administrative personnel, and increased non-cash stock based compensation charges. The increased legal, professional, and license fee expenses were primarily due increased litigation costs offset in part by reduced audit, tax, and accounting fees mainly related to the accounting and valuation for Sony Computer Entertainment litigation conclusion and patent license that occurred in 2007.

Amortization of Intangibles Our amortization of intangibles is comprised primarily of patent amortization and other intangible amortization. Amortization of intangibles decreased by $72,000 or 30% in the second quarter of 2008 compared to the same period in 2007. Amortization of intangibles decreased by $91,000 or 18% in the first six months of 2008 compared to the same period in 2007.The decrease was primarily attributable to some intangible assets

reaching full amortization partially offset by an increase from the cost and number of new patents being amortized.

Litigation Conclusions and Patent License There were no litigation conclusions and patent license items for the second quarter of 2008 or 2007. There were no litigation conclusions and patent license items for the second six months of 2008. For the same period in 2007, the $134.9 million is comprised of $119.9 million related to Sony Computer Entertainment and $15.0 million related to the release of the Microsoft long-term customer advance.

In March 2007, we concluded our patent infringement litigation against Sony Computer Entertainment at the U.S. Court of Appeals for the Federal Circuit. In satisfaction of the Amended Judgment, we received funds totaling $97.3 million, inclusive of

the award for past damages, pre-judgment interest and costs, and post-judgment interest. Additionally, we retained $32.4 million of compulsory license fees and interest thereon previously paid to us by Sony Computer Entertainment pursuant to court orders. As of March 19, 2007, both parties entered into an agreement whereby we granted Sony Computer Entertainment and certain of its affiliates a worldwide, non-transferable, non-exclusive license under our patents that have issued, may issue, or claim a priority date before March 2017 for the going forward use, development, manufacture, sale, lease, importation, and distribution of its current and past PlayStation and related products. The license does not cover adult, foundry, medical, automotive, industrial, mobility, or gambling products. Subject to the terms of the agreement, we also granted Sony Computer Entertainment and certain of its affiliates certain other licenses (relating to PlayStation games, backward compatibility of future consoles, and the use of their licensed products with certain third party products), an option to obtain licenses in the future with respect to future gaming products and certain releases and covenants not to sue. Sony Computer Entertainment granted us certain covenants not to sue and agreed to pay us twelve quarterly installments of $1.875 million (for a total of $22.5 million) beginning on March 31, 2007 and ending on December 31, 2009, and may pay us certain other fees and royalty amounts. In total, we will receive a minimum of $152.2 million through the conclusion of the litigation and the separate patent license. In accordance with the guidance from EITF No. 00-21, we allocated the present value of the total payments, equal to $149.9 million, between each element based on their relative fair values. Under this allocation, we recorded $119.9 million as litigation conclusions and patent license income and the remaining $30.0 million was allocated to deferred license revenue. We recorded $749,000 as revenue for each of the three months ended June 30, 2008 and 2007. We recorded $1.5 million and $856,000 as revenue for the six months ended June 30, 2008 and 2007, respectively. At June 30, 2008, we had recorded $3.9 million of the $30.0 million as revenue and will record the remaining $26.1 million as revenue, on a straight-line basis, over the remaining capture period of the patents licensed, ending March 19, 2017. We have accounted for future payments in accordance with APB No. 21. Under APB No. 21, we determined the present value of the $22.5 million future payments to equal $20.2 million. We are accounting for the difference of $2.3 million as interest income as each $1.875 million quarterly payment installment becomes due.

Under the terms of a series of agreements that we entered into with Microsoft in 2003, in the event we had elected to settle the action in the United States District Court for the Northern District of California entitled *Immersion Corporation v. Sony Computer Entertainment of America, Inc., Sony Computer Entertainment Inc. and Microsoft Corporation*, Case No. C02-00710 CW (WDB), as such action pertains to Sony Computer Entertainment, and grant certain rights, we would be obligated to pay Microsoft a minimum of $15.0 million for amounts up to $100.0 million received from Sony Computer Entertainment, plus 25% of amounts over $100.0 million up to $150.0 million, and 17.5% of amounts over $150.0 million. The patent infringement litigation with Sony Computer Entertainment was concluded in March 2007 at the U.S. Court of Appeals for the Federal Circuit without settlement. We determined that the conclusion of our litigation with Sony Computer Entertainment did not trigger any payment obligations under our Microsoft agreements. Accordingly, the liability of $15.0 million that was in the financial statements at December 31, 2006 was extinguished, and we accounted for this sum during 2007 as litigation conclusions and patent license income. However, in a letter sent to us dated May 1, 2007, Microsoft disputed our position and stated that it believes we owe Microsoft at least $27.5 million, which it increased to $35.6 million at a court ordered mediation meeting on December 11, 2007. On June 18, 2007, Microsoft filed a complaint against us in the U.S. District Court for the Western District of Washington alleging one claim for breach of a contract. We dispute Microsoft s allegations and intend to vigorously defend ourselves. See Contingencies Note 14 to the condensed consolidated financial statements. The results of any litigation are inherently uncertain, and there can be no assurance that our position will prevail.

Interest and Other Income Interest and other income consist primarily of interest income and dividend income from cash and cash equivalents and short-term investments. Interest and other income decreased by $911,000 in the second quarter of 2008 compared to the same period in 2007. This was primarily the result of decreased interest income due to reduced interest rates on cash, cash equivalents, and short-term investments.

Interest and other income increased by $235,000 in the first six months of 2008 compared to the same period in 2007. This improvement was primarily the result of additional interest income earned on increased cash, cash equivalents, and short-term investments and gain on the sale of short-term investments, partially offset by reduced

interest rates on interest earned on cash, cash equivalents, and short-term investments.

Interest Expense Interest expense consisted primarily of interest and accretion expense on our 5% Convertible Debentures. Interest expense decreased by $407,000 in the second quarter of 2008 compared to the same period in 2007 due to the conversion and redemption of our 5% Convertible Debentures during the third quarter of 2007. Interest expense decreased by $813,000 in the first six months of 2008 compared to the same period in 2007 due to the conversion and redemption of our 5% Convertible Debentures during the third quarter of 2007.

Provision for Income Taxes Based on the second quarter of 2008 pre-tax loss of $4.7 million and future projections, we recorded a benefit for income taxes for the quarter ended March 31, 2008 of $1.6 million, yielding an effective tax rate of 34.4%. For the three months ended June 30, 2007, we recorded a benefit for income taxes of $1.5 million on a pre-tax loss of $1.3 million, yielding an effective tax rate of 113.3%.

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The income tax benefit for the three months ended June 30, 2008 and June 30, 2007 were arrived at as a result of applying the estimated annual effective tax rate to cumulative loss before taxes, adjusted for certain discrete items that are fully recognized in the period they occur.

Based on the first six months of 2008 pre-tax loss of $8.3 million and future projections, we recorded a benefit for income taxes for the quarter ended March 31, 2008 of $2.6 million, yielding an effective tax rate of 31.7%. For the first six months of 2007, we recorded a provision for income taxes of $13.6 million on a pre-tax profit of $129.6 million, yielding an effective tax rate of 10.5 %.

The income tax benefit for the six months ended June 30, 2008 is arrived at as a result of applying the estimated annual effective tax rate to cumulative loss before taxes, adjusted for certain discrete items that are fully recognized in the period they occur. The provision for income taxes for the six months ended June 30, 2007, which were previously fully reserved, is primarily reflective of federal and state tax expense as a result of our pre-tax income of $129.6 million mainly due to the litigation conclusions and patent license from Sony Computer Entertainment, see Note 9 to the condensed consolidated financial statements. For the six months ended June 30, 2007, the effective tax rate differs from the statutory rate primarily due to the significant reduction in our valuation allowance against deferred tax assets as we used the majority of our net operating loss carryforwards against taxable income.

SEGMENT RESULTS FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(In thousands)		(In thousands)	
Revenues:				
Immersion Computing, Entertainment, and Industrial	$ 5,012	$ 4,474	$ 10,200	$ 8,232
Immersion Medical	4,301	4,147	7,309	6,804
Intersegment eliminations		(26)	(41)	(27)
Total	$ 9,313	$ 8,595	$ 17,468	$ 15,009
Net Income (Loss):				
Immersion Computing, Entertainment, and Industrial	$ (2,647)	$ 152	$ (4,056)	$ 116,847
Immersion Medical	(456)	23	(1,615)	(839)
Intersegment eliminations	12	1	(5)	6
Total	$ (3,091)	$ 176	$ (5,676)	$ 116,014

* Segment assets and expenses relating to our corporate operations are not allocated but are included in Immersion Computing, Entertainment, and Industrial as

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

Immersion Computing, Entertainment, and Industrial segment Revenues from the Immersion Computing, Entertainment, and Industrial segment were $5.0 million, an increase of $538,000 or 12% in the second quarter of 2008 compared to the same period in 2007. Royalty and license revenues increased by $423,000 mainly due to the shipment of VibeTonz-enabled phones by LG Electronics that began in the second quarter of 2007; the signing of a new license contract with mobile device manufacturer Nokia that began after the end of the second quarter of 2007; additional royalty and license revenue from newer gaming licensees; and the increase in sales of new products from third-party gaming licensees. This increase in royalty and license revenue was partially offset by decreased touch interface product royalties from the recognition of certain automotive royalty payments in the second quarter of 2007 that did not recur. Product sales increased by $108,000 primarily due to additional touch interface products sales of touchscreen and touch panel components and force feedback electronics for arcade gaming. Net loss for the three months ended June 30, 2008 was $2.6 million, an increase of $2.8 million compared to the same period in 2007. The increase was primarily due to an increase in general and administrative expenses of $1.7 million, a decrease in interest and other income of $915,000 mainly due to reduced interest rates, an increase in sales and marketing expenses of $766,000, and an increase of research and development expenses of $294,000. The increases to the net loss were partially offset by a decrease in interest expense of $407,000 due to the conversion and redemption of our 5% Convertible Debentures, higher gross margin of

$283,000 mainly from increased royalty and license revenue and product sales, and decreased provision for income taxes of $119,000.

Revenues from the Immersion Computing, Entertainment, and Industrial segment were $10.2 million, an increase of $2.0 million or 24% in the first six months of 2008 compared to the same period in 2007. Royalty and license revenues increased by $1.7 million, mainly due to the shipment of VibeTonz-enabled phones by LG Electronics that began after the second quarter of 2007; the signing of a new license contract with mobile device manufacturer Nokia at the end of the second quarter of 2007; and new royalty and license revenue from Sony Computer Entertainment, partially offset by decreased touch interface product royalties from the recognition of certain automotive royalty payments in the second quarter of 2007 that did not recur. Product sales increased by $420,000 primarily due to increased 3D product sales mainly due to increased sales of our CyberForce, CyberGlove, CyberGrasp, and MicroScribe products and an increase in product sales from touch interface products primarily due to increased sales of touchscreen and touch panel components and increased sales of force feedback electronics for arcade gaming. Development contract revenue decreased by $126,000 primarily due to reduced touch interface product contract revenue, partially offset by increased revenue on mobile device development contracts and support. Net loss for the six months ended June 30, 2008 was $4.1 million, an increase of $120.9 million compared to the same period in 2007. The increase was primarily due to litigation conclusions and patent license income of $134.9 million ($119.9 million from Sony Computer Entertainment and $15.0 million related to the release of the Microsoft long-term customer advance) occurring in the first six months of 2007 not re-occurring in the first six months of 2008; an increase in general and administrative expenses of $2.6 million; an increase in sales and marketing expenses of $1.3 million; and an increase of research and development expenses of $701,000. The increase to the net loss were partially offset by decreased provision for income taxes of $16.2 million; increased gross margin of $1.3 million mainly from increased sales; and a decrease in interest expense of $814,000 due to the conversion and redemption of our 5% Convertible Debentures; and an increase in interest and other income of $150,000.

Immersion Medical segment Revenues from Immersion Medical were $4.3 million, an increase of $154,000 or 4%, for the second quarter of 2008 compared to the same period in 2007. The increase was primarily due to an increase of $191,000 in medical development contract revenue offset by a decrease in product sales of $37,000. Net loss for the three months ended June 30, 2008 was $456,000, an increase of $479,000 compared to the same period in 2007. The increase was mainly due to increased sales and marketing expenses of $463,000 as the segment expands international sales and marketing efforts, and increased general and administrative expenses of $256,000. The increased operating expenses were offset in part by increased gross margin of $280,000 primarily due to the increased revenue from higher margin development contracts and an increase in the product sales mix of certain products with lower costs.

Revenues from Immersion Medical were $7.3 million, an increase of $505,000 or 7%, for the first six months of 2008 compared to the same period in 2007. The increase was primarily due to an increase of $553,000 in medical development contract revenue offset by reduced product revenue of $49,000. Net loss for the six months ended June 30, 2008 was $1.6 million, an increase of $776,000 or 92% compared to the same period in 2007. The increase was mainly due to increased sales and marketing expenses of $632,000 as the segment expands international sales and marketing efforts, increased general and administrative expenses of $329,000 primarily due to increased litigation costs, and increased research and development expenses of $327,000. The increased operating expenses were offset in part by increased gross margin of $497,000 due to the increased revenue from higher margin development contracts.

LIQUIDITY AND CAPITAL RESOURCES

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

On June 30, 2008, our cash, cash equivalents, and short-term investments totaled $129.4 million, a decrease of $8.7 million from $138.1 million on December 31, 2007.

In March 2007, we concluded our patent infringement litigation against Sony Computer Entertainment at the U.S. Court of Appeals for the Federal Circuit. In satisfaction of the Amended Judgment, we received funds totaling $97.3 million, inclusive of the award for past damages, pre-judgment interest and costs, and post-judgment interest. Additionally, we retained $32.4 million of compulsory license fees and interest thereon previously paid to us by Sony Computer Entertainment pursuant to court orders. Furthermore, we entered into a new business agreement. Under the new business agreement, we are to receive twelve quarterly installments of $1.875 million for a total of $22.5 million beginning on March 31, 2007 and ending on December 31, 2009. As of June 30, 2008, we had received six of these installments.

We determined that the conclusion of our litigation with Sony Computer Entertainment did not trigger any payment obligations under our Microsoft agreements as noted in Note 9 to the condensed consolidated financial statements. Accordingly, the liability of $15.0 million that was in the financial statements at December 31, 2006 was extinguished, and we accounted for this sum during 2007 as litigation conclusions and patent license income. However, in a letter sent to us dated May 1, 2007, Microsoft disputed our position and stated that it believes we owe Microsoft at least $27.5 million, which it increased to $35.6 million at a court ordered mediation meeting on December 11, 2007. On June 18, 2007, Microsoft filed a complaint against us in the U.S. District Court for the Western District of Washington alleging one claim for breach of a contract. We dispute Microsoft s allegations and intend to vigorously defend ourselves. See Contingencies Note 14 to the condensed consolidated financial statements. The results of any litigation are inherently uncertain, and there can be no assurance that our position will prevail.

Net cash used in operating activities during the six months ended June 30, 2008 was $1.5 million, a change of $88.0 million from the $86.5 million provided during the six months ended June 30, 2007. Cash used in operations during the six months ended June 30, 2008 was primarily the result of a net loss of $5.7 million, a decrease of $1.2 million due to a change in prepaid expenses and other current assets, a decrease of $590,000 due to a change in inventories, a decrease of $475,000 due to a change in deferred income taxes, and a decrease of $319,000 due to a change in income taxes payable. These decreases were offset by a $2.4 million increase due to a change in deferred revenue and customer advances, an increase of $1.2 million due to a change in accrued compensation and other current liabilities, an increase of $290,000 due to a change in accounts payable, and an increase of $175,000 due to a change in accounts receivable. Cash provided by operations during the six months ended June 30, 2008 was also impacted by noncash charges and credits of $2.6 million, including $1.9 million of noncash stock-based compensation, $541,000 in depreciation and amortization, $405,000 in amortization of intangibles, partially offset by a credit of $176,000 from excess tax benefits from stock-based compensation, and an $80,000 realized gain on sales of short-term investments.

Net cash provided from investing activities during the six months ended June 30, 2008 was $17.2 million, compared to the $26.4 million used in investing activities during the six months ended June 30, 2007, an increase of $43.6 million. Net cash provided by investing activities during the period consisted of an increase in maturities or sales of short-term investments of $52.0 million, partially offset by purchases of short-term investments of $32.1 million; a $1.6 million increase in intangibles and other assets, primarily due to capitalization of external patent filing and application costs; and $1.1 million used to purchase property and equipment.

Net cash used in financing activities during the six months ended June 30, 2008 was $4.7 million compared to $17.7 million provided during the six months ended June 30, 2007, or a $22.4 million decrease from the prior year. Net cash used in financing activities for the period consisted primarily of purchases of treasury stock of $6.2 million, partially offset by issuances of common stock and exercises of stock options and warrants in the amount of $1.3 million, and an increase of $176,000 from excess tax benefits from tax deductible stock-based compensation.

We believe that our cash and cash equivalents will be sufficient to meet our working capital needs for at least the next twelve months. We have continuing litigation and we will continue to protect and defend our extensive intellectual property portfolio across all business segments which could require ongoing use of our working capital. We anticipate that capital expenditures for the year ended December 31, 2008 will total approximately $2.0 million in connection with anticipated maintenance and upgrades to operations and infrastructure. On November 1, 2007, we announced that our Board of Directors authorized the repurchase of up to $50 million of our common stock. During the quarter ended June 30, 2008, we repurchased 718,683 shares for $6.2 million at an average net cost of $8.56 through open market repurchases. Additionally, if we acquire one or more businesses, patents, or products, or invest in other companies, our cash or capital requirements could increase substantially. In the event of such an acquisition, or should any unanticipated circumstances arise that significantly increase our capital requirements, we may elect to raise additional capital through debt or equity financing. Any of these events could result in substantial dilution to our stockholders. Although we expect to be able to raise additional capital if necessary, there is no assurance that such additional capital will be available on terms acceptable to us, if at all.

SUMMARY DISCLOSURES ABOUT CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The following table reflects a summary of our contractual cash obligations and other commercial commitments as of December 31, 2007:

Contractual Obligations	Total	2008	2009 and 2010	2011 and 2012
		(In thousands)		
Operating leases	$2,300	$1,100	$1,191	$ 9

As discussed in Note 10 to the condensed consolidated financial statements, effective January 1, 2007, we adopted the provisions of FIN48. On June 30, 2008, we had a liability for unrecognized tax benefits totaling approximately $640,000,

including interest of $13,000. Due to the uncertainties related to these tax matters, we are unable to make a reasonably reliable estimate when cash settlement with a taxing authority will occur. Settlement of such amounts could require the utilization of working capital.

RECENT ACCOUNTING PRONOUNCEMENTS

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Cash Equivalents and Short-term Investments We have cash equivalents and short-term investments of $128.2 million as of June 30, 2008. These securities are subject to interest rate fluctuations. An increase in interest rates could adversely affect the market value of our cash equivalents and short-term investments. A hypothetical 100 basis point increase in interest rates would result in an approximate $172,000 decrease in the fair value of our cash equivalents and short-term investments as of June 30, 2008.

We limit our exposure to interest rate and credit risk by establishing and monitoring clear policies and guidelines for our cash equivalents and short-term investment portfolios. The primary objective of our policies is to preserve principal while at the same time maximizing yields, without significantly increasing risk. Our investment policy limits the maximum weighted average duration of all invested funds to 12 months. Our policy s guidelines also limit exposure to loss by limiting the sums we can invest in any individual security and restricting investment to securities that meet certain defined credit ratings. We do not use derivative financial instruments in our investment portfolio to manage interest rate risk.

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

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 30, 2008. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of June 30, 2008 due to a material weakness in our internal control over financial reporting with respect to accounting for income taxes that was initially determined and disclosed in our Annual Report on Form 10-K for our fiscal year ended December 31, 2007.

The material weakness we disclosed was in the area of accounting for income taxes. Our review and monitoring of the accuracy of the components of the deferred income tax valuation allowances and related stock option deductions, and the review and monitoring of the effective state income tax rate utilized in the determination of state income taxes were not effective in identifying errors in these calculations. This resulted in material adjustments to the previously reported quarterly unaudited financial results as of March 31, 2007 and the cumulative loss amounts for quarterly unaudited financial results as of June 30, 2007, and September 30, 2007. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

In connection with our plan to remediate this material weakness, we have engaged in, and are continuing to engage in, substantial efforts to improve our internal control over financial reporting and disclosure controls and procedures related to income tax matters including the following:

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1. We initiated a search to hire appropriate personnel to enable us to properly account for and disclose income taxes; to design and implement controls to ensure that the rationale for positions taken on certain tax matters will be adequately documented and appropriately communicated to all internal and external members of our tax team; and design and implement controls over the adjustment of the income tax accounts based on the preparation and filing of income tax returns.

2. We engaged outside consultants to advise us in complex tax accounting areas, to enhance our preparation and review of tax accounting and disclosure and to assist us in the design and implementation of controls over the accounting for income taxes and other tax related matters.

We believe that these corrective steps, once fully implemented, will sufficiently remediate the material weaknesses described above.

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

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes to our internal control over financial reporting during the quarter ended June 30, 2008 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In re Immersion Corporation

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

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

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

We and most of the issuer defendants had settled with the plaintiffs. In this settlement, plaintiffs would have dismissed and released all claims against the Immersion Defendants in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of certain claims we may have against the underwriters. The Immersion Defendants would not have been

required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeded the amount of the insurance coverage, a circumstance that we believed was remote. In September 2005, the District Court granted preliminary approval of the settlement.

The District Court held a hearing to consider final approval of the settlement on April 24, 2006 and took the matter under submission. Subsequently, the Second Circuit vacated the class certification of plaintiffs claims against the underwriters in six cases designated as focus or test cases. Miles v. Merrill Lynch & Co. (In re Initial Public Offering Securities Litigation, 471 F.3d 24 (2d Cir. 2006). Thereafter, the District Court ordered a stay of all proceedings in all of the lawsuits pending the outcome of plaintiffs petition to the U.S. Court of Appeals for the Second Circuit for rehearing en banc and resolution of the class certification issue. On April 6, 2007, the Second Circuit denied plaintiffs petition for rehearing, but clarified that the plaintiffs may seek to certify a more limited class in the District Court. Accordingly, the parties withdrew the prior settlement, and plaintiffs filed an amended complaint in attempt to comply with the Second Circuit s ruling. On March 26, 2008, the District Court denied in part and granted in part the motions to dismiss the focus cases on substantially the same grounds as set forth in its prior opinion. There is no guarantee that an amended or renegotiated settlement will be reached, and if reached approved.

Internet Services LLC Litigation

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

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

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

On February 8, 2006, ISLLC filed a lawsuit against us in the Superior Court of Santa Clara County. ISLLC s complaint sought a share of the damages awarded to us in the March 24, 2005 Judgment and of the Microsoft settlement proceeds, and generally restated the claims already adjudicated by the District Court. On March 16, 2006, we answered the complaint, cross claimed for declaratory relief, breach of contract by ISLLC, and for rescission of the contract, and removed the lawsuit to federal court. The case was assigned to Judge Wilken in the U.S. District Court for the Northern District of California as a case related to the previous proceedings involving Sony Computer Entertainment and ISLLC. ISLLC filed its answer to our cross claims on April 27, 2006. ISLLC also moved to remand the case to Superior Court. On July 10, 2006, Judge Wilken issued an order denying ISLLC s motion to remand. On September 5, 2006, Judge Wilken granted the stipulated request by the parties to stay discovery and other proceedings in the case pending the disposition of ISLLC s appeal from the District Court s previous orders. The case was stayed from December 1, 2006 pending the Federal Circuit s disposition on the appeal. As noted above, the Federal Circuit issued its opinion on April 4, 2007, and entered a judgment affirming the District Court s previous orders.

On May 10, 2007, ISLLC filed a motion in the District Court to remand its latest action to the Superior Court or in the alternative for leave to file an amended complaint to remove the declaratory relief claim. We opposed ISLLC s motion, and cross-moved for judgment on the pleadings on the grounds that ISLLC s claims are barred by res judicata and collateral estoppel. On June 26, 2007, the District Court ruled on the motions, denying ISLLC s motion to remand or for leave to file an amended complaint, and granting in part our motion for judgment on the pleadings. The District Court dismissed ISLLC s claim for declaratory relief. ISLLC s claims for breach of contract, promissory fraud, and

constructive trust, to the extent not inconsistent with the District Court s previous rulings, remained. On February 20, 2008, ISLLC filed a motion to extend all dates in the matter by ninety (90) days due to circumstances relating to ISLLC s dealings with a third party, and the possibility that ISLLC s counsel (Keker & Van Nest) may withdraw in the case. On March 18, 2008, the District Court entered an order denying ISLLC s request to extend dates.

On March 24, 2008, ISLLC s counsel filed a motion to withdraw as counsel. On May 1, 2008, the District Court denied ISLLC s counsel s motion to withdraw without prejudice. On May 28, 2008, ISLLC s counsel renewed its motion to withdraw as ISLLC s counsel of record. On June 19, 2008, the District Court granted the renewed motion.

On April 10, 2008, we filed a motion for summary judgment on ISLLC s remaining claims for breach of contract, promissory fraud, and constructive trust, as well as our counterclaim for declaratory relief that ISLLC was not entitled to a share of any of court-ordered compulsory license payments we received from Sony Computer Entertainment. On May 16, 2008, the District Court entered an order granting our motion for summary judgment on all of ISLLC s claims, as well as our counterclaim for declaratory relief. As a result, the only claims remaining in the action are our counterclaims against ISLLC.

On July 15, 2008, we filed a Motion For Default Judgment Or, In The Alternative, For Order To Show Cause Re Default based on ISLLC s failure to retain new counsel, and also its failure to comply with certain pretrial orders of the District Court and provide certain discovery. On July 16, 2008 the District Court granted our motion in part and ordered ISLLC to show cause within ten days from the date of the District Court s order why default judgment should not be entered against ISLLC. After receiving briefing from both parties on July 28, 2008, the District Court discharged the order to show cause. On ISLLC s motion to continue the trial, the District Court ordered that the jury trial will begin on September 15, 2008.

We have participated in court-ordered mediation proceedings, which to date have not been successful. We intend to vigorously prosecute our counterclaims against ISLLC.

Microsoft Corporation v. Immersion Corporation

On June 18, 2007, Microsoft filed a complaint against us in the U.S. District Court for the Western District of Washington alleging one claim for breach of a contract. Microsoft alleges that we breached a Sublicense Agreement executed in connection with the parties settlement in 2003 of our claims of patent infringement against Microsoft in *Immersion Corporation v. Microsoft Corporation, Sony Computer Entertainment Inc. and Sony Computer Entertainment America, Inc., United States District Court for the Northern District of California, Case No. 02-0710-CW)*. The complaint alleges that Microsoft is entitled to payments that Microsoft contends are due under the Sublicense Agreement as a result of Sony Computer Entertainment s satisfaction of the judgment in our lawsuit against Sony Computer Entertainment and payment of other sums to us. In a letter sent to us dated May 1, 2007, Microsoft stated that it believes we owe Microsoft at least $27.5 million, which it increased to $35.6 million at a court ordered mediation meeting on December 11, 2007. We were served with the complaint on July 6, 2007. On September 4, 2007, we filed our Answer, Affirmative Defenses and Counterclaims alleging that Microsoft breached its confidentiality obligations by publicly disclosing previously confidential the terms of our business agreement with Sony Computer Entertainment. The parties participated in a court-ordered mediation on December 11, 2007, but were unsuccessful in resolving the matter. On January 10, 2008, Microsoft filed a motion to disqualify our counsel, Irell & Manella LLP on the grounds that one or more attorneys might be witnesses in the proceeding. On March 7, 2008, the District Court issued an Order denying Microsoft s motion.

On April 17, 2008, Microsoft filed a motion for partial summary judgment on our counterclaim for breach of the confidentiality agreement between us and Microsoft based on Microsoft s publication of the March 2007 Sony-Immersion Agreement. On May 6, 2008, we filed our opposition brief, and on May 9, 2008, Microsoft filed its reply brief. On June 10, 2008, the District Court deferred ruling on Microsoft s motion and requested we present additional information regarding our breach of contract counterclaim, which we did on June 27, 2008. On August 1, 2008, the District Court denied Microsoft s motion for summary judgment on this matter.

On June 26, 2008, Microsoft filed a motion for partial summary judgment on Microsoft s claim for breach of contract. On June 27, 2008 Microsoft filed another motion for partial summary judgment on our affirmative defenses. We filed our opposition to the breach of contract motion on July 17, 2008, and the opposition to the affirmative defense related motion on July 21, 2008. Microsoft s filed its reply papers on July 25, 2008. In addition to opposing Microsoft s motions, on July 17, 2008, we filed a motion for partial summary judgment on Microsoft s allegation that we breached the implied covenant of good faith and fair dealing in the 2003 Microsoft-Immersion Sublicense Agreement in connection with our 2007 agreement with Sony. Microsoft filed its opposition to this motion on August 4, 2008, and our reply is due August 8, 2008. The District Court has requested oral arguments on all three motions for partial summary judgment. The District Court has not yet ruled on these motions.

We dispute Microsoft s allegations and intend to vigorously defend ourselves.

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

On April 16, 2008, we announced that our wholly owned subsidiary, Immersion Medical, Inc., filed lawsuits for patent infringement in the United States District Court for the Eastern District of Texas against Mentice AB, Mentice SA, Simbionix USA Corp., and Simbionix Ltd (collectively the Defendants). On July 11, 2008, Mentice AB and Mentice SA (collectively, Mentice) answered the complaint by denying the material allegations and alleging counterclaims seeking a judicial declaration

that the asserted patents were invalid, unenforceable, or not infringed. On July 11, 2008, Simbionix USA Corp. and Simbionix Ltd, (collectively, Simbionix) filed a motion to stay or dismiss the lawsuit, and in the alternative, a motion to transfer venue for convenience to Ohio. On August 7, 2008, we filed our opposition to both motions filed by Simbionix.

We intend to vigorously prosecute this lawsuit.

ITEM 1A. RISK FACTORS

Company Risks

WE HAD AN ACCUMULATED DEFICIT OF $26 MILLION AS OF JUNE 30, 2008, HAVE A HISTORY OF LOSSES, MAY EXPERIENCE LOSSES IN THE FUTURE, AND MAY NOT ACHIEVE OR MAINTAIN PROFITABILITY IN THE FUTURE.

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

continue to develop our technologies;

increase our sales and marketing efforts;

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

protect and enforce our intellectual property;

pursue strategic relationships;

acquire intellectual property or other assets from third-parties;

invest in systems and processes to manage our business; and

expand international facilities.

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

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

In 2003, we executed a series of agreements with Microsoft as described in Note 9 to the condensed consolidated financial statements that provided for settlement of our lawsuit against Microsoft as well as various licensing, sublicensing, and equity and financing arrangements under the Microsoft agreements. In accordance with the sublicense agreement, in the event that we elected to settle the action in the United States District Court for the Northern District of California, entitled Immersion Corporation v. Sony Computer Entertainment of America, Inc., Sony Computer Entertainment Inc. and Microsoft Corporation, Case No. C02-00710 CW (WDB), as such action pertains to Sony Computer Entertainment, and grant certain rights, we would be obligated to pay Microsoft a minimum of $15.0 million for amounts up to $100.0 million received from Sony Computer Entertainment, plus 25% of amounts over $100.0 million up to $150.0 million, and 17.5% of amounts over $150.0 million. In March 2007, we announced the conclusion of our patent infringement litigation against Sony Computer Entertainment at the U.S. Court of Appeals for the Federal Circuit. Sony Computer Entertainment satisfied the District Court judgment against it. As of March 19, 2007, we and Sony Computer Entertainment entered into a new business agreement. We determined that we are not obligated under our agreements with Microsoft to make any payment to it relating to the conclusion of our litigation with Sony Computer Entertainment. However, in a letter sent to us dated May 1, 2007,

Microsoft disputed our position and stated that it believes we owe Microsoft at least $27.5 million, which it increased to $35.6 million at a court ordered mediation meeting on December 11, 2007. Further, on June 18, 2007, Microsoft filed a complaint against us in the U.S. District Court for the Western District of Washington alleging we are in breach of our contract with Microsoft, and that it is entitled to a share of the judgment monies and other sums we received from Sony Computer Entertainment. We dispute Microsoft s allegations and intend to

vigorously defend ourselves in the lawsuit. The results of any litigation are inherently uncertain, and there can be no assurance that our position will prevail. The Company has not accrued any loss related to these allegations. The range of reasonable possible loss is from zero to $35.6 million.

OUR CURRENT LITIGATION UNDERTAKINGS ARE EXPENSIVE, DISRUPTIVE, AND TIME CONSUMING, AND WILL CONTINUE TO BE, UNTIL RESOLVED, AND REGARDLESS OF WHETHER WE ARE ULTIMATELY SUCCESSFUL, COULD ADVERSELY AFFECT OUR BUSINESS.

We are involved in litigation with Internet Services, LLC (ISLLC) involving claims for breach of contract and rescission against ISLLC in the U.S. District Court for the Northern District of California.

We are also involved in litigation against Microsoft, as noted above.

We are involved in legal proceedings relating to a class action lawsuit filed on November 9, 2001, related to In re Initial Public Offering Securities Litigation. The named defendants are Immersion and three of our current or former officers or directors and certain underwriters of our November 12, 1999 IPO. Subsequently, two of the individual defendants stipulated to a dismissal without prejudice. We and most of the issuer defendants had settled with the plaintiffs. However, the settlement offer has subsequently been withdrawn.

Our wholly owned subsidiary, Immersion Medical, Inc., filed lawsuits for patent infringement against Mentice AB, Mentice SA, Simbionix USA Corp., and Simbionix Ltd in the United States District Court for the Eastern District of Texas.

Due to the inherent uncertainties of litigation, we cannot accurately predict how these cases will ultimately be resolved. We anticipate that the litigation will continue to be costly, and there can be no assurance that we will be successful or able to recover the costs we incur in connection with the litigation. We expense litigation costs as incurred, and only accrue for costs that have been incurred but not paid to the vendor as of the financial statement date. Litigation has diverted, and is likely to continue to divert, the efforts and attention of some of our key management and personnel. As a result, until such time as it is resolved, litigation could adversely affect our business. Further, any unfavorable outcome could adversely affect our business. For additional background on litigation, please see Note 14 to the condensed consolidated financial statements and the section titled Item 1. Legal Proceedings.

LITIGATION REGARDING INTELLECTUAL PROPERTY RIGHTS COULD BE EXPENSIVE, DISRUPTIVE, AND TIME CONSUMING; COULD RESULT IN THE IMPAIRMENT OR LOSS OF PORTIONS OF OUR INTELLECTUAL PROPERTY; AND COULD ADVERSELY AFFECT OUR BUSINESS.

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

We attempt to avoid infringing known proprietary rights of third parties. However, third parties may hold, or may in the future be issued, patents that could be infringed by our products or technologies. Any of these third parties might make a claim of infringement against us with respect to the products that we manufacture and the technologies that we license. From time to time, we have received letters from companies, several of which have significantly greater financial resources than we do, asserting that some of our technologies, or those of our licensees, infringe their intellectual property rights. Certain of our licensees may receive similar letters from these or other companies from

time to time. Such letters or subsequent litigation may influence our licensees decisions whether to ship products incorporating our technologies. In addition, such letters may cause a dispute between our licensees and us over indemnification for the infringement claim. Any of these notices, or additional notices that we or our licensees could receive in the future from these or other companies, could lead to litigation against us, either regarding the infringement claim or the indemnification claim.

We have acquired patents from third parties and also license some technologies from third parties. We must rely upon the owners of the patents or the technologies for information on the origin and ownership of the acquired or licensed technologies. As a result, our exposure to infringement claims may increase. We generally obtain representations as to the origin and ownership of acquired or licensed technologies and indemnification to cover any breach of these representations. However, representations may not be accurate and indemnification may not provide adequate compensation for breach of the representations. Intellectual property claims against our licensees, or us, whether or not they have merit, could be time-consuming to defend, cause product

shipment delays, require us to pay damages, harm existing license arrangements, or require us or our licensees to cease utilizing the technologies unless we can enter into licensing agreements. Licensing agreements might not be available on terms acceptable to us or at all. Furthermore, claims by third parties against our licensees could also result in claims by our licensees against us for indemnification.

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

WE ARE SUBJECT TO THE RISK OF ADDITIONAL LITIGATION IN CONNECTION WITH THE RESTATEMENT OF OUR CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND THE POTENTIAL LIABILITY FROM ANY SUCH LITIGATION COULD MATERIALLY AND ADVERSELY AFFECT OUR BUSINESS.

We announced that we restated our condensed consolidated financial statements for the quarterly periods ended March 31, 2007, June 30, 2007, and September 30, 2007. We have restated the condensed consolidated financial statements for the six months ended June 30, 2007 in this report. See Note 15 to the condensed consolidated statements. We plan to restate the 2007 third quarter condensed consolidated financial statements prospectively when we file our 2008 third quarter condensed consolidated financial statements on Form 10-Q. As a result of the restatement of our condensed consolidated financial statements, we could become subject to purported class action, derivative, or other securities litigation. As of the date hereof, we are not aware of any such litigation having been commenced against us related to these matters, but we cannot predict whether any such litigation will be commenced or, if it is, the outcome of any such litigation. The initiation of any such securities litigation may harm our business and financial condition.

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

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

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

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

PRODUCT LIABILITY CLAIMS COULD BE TIME-CONSUMING AND COSTLY TO DEFEND AND COULD EXPOSE US TO LOSS.

Our products or our licensees products may have flaws or other defects that may lead to personal or other injury claims. If products that we or our licensees sell cause personal injury, property injury, financial loss, or other injury to our or our licensees customers, the customers or our licensees may seek damages or other recovery from us. Any claims against us would be time-consuming, expensive to defend, and distracting to management, and could result in

damages and injure our reputation, the reputation of our technology and services, and/or the reputation of our products, or the reputation of our licensees or their products. This damage could limit the market for our and our licensees products and harm our results of operations.

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

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

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

Industry and Technology Risks

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

A key part of our business strategy is to license our intellectual property to companies that manufacture and sell products incorporating our touch-enabling technologies. Sales of those products generate royalty and license revenue for us. For the three months ended June 30, 2008 and 2007, 34% and 32%, respectively, of our total revenues were royalty and license revenues. For the six months ended June 30, 2008 and 2007, 38% and 33%, respectively, of our total revenues were royalty and license revenues. However, we do not control or influence the design, manufacture, quality control, promotion, distribution, or pricing of products that are manufactured and sold by our licensees, nor can we control consolidation within an industry which could either reduce the number of licensing products available or reduce royalty rates for the combined licensees. In addition, we generally do not have commitments from our licensees that they will continue to use our technologies in current or future products. As a result, products incorporating our technologies may not be brought to market, meet quality control standards, achieve commercial acceptance, or generate meaningful royalty revenue for us. For us to generate royalty revenue, licensees that pay us per-unit royalties must manufacture and distribute products incorporating our touch-enabling technologies in a timely fashion and generate consumer demand through marketing and other promotional activities. Products incorporating our touch-enabling technologies are generally more difficult to design and manufacture, which may cause product introduction delays or quality control problems. If our licensees fail to stimulate and capitalize upon market demand for products that generate royalties for us, or if products are recalled because of quality control problems, our revenues will not grow and could decline. Alternatively, if a product that incorporates our touch-enabling technologies achieves widespread market acceptance, the product manufacturer may elect to stop paying us, attempt to design around our intellectual property, challenge our intellectual property, or stop making it rather than pay us royalties based on sales of the product.

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

A significant 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. These requirements and restrictions could be in the form of hardware technical specifications, software technical specifications, security specifications or other security mechanisms, component vendor specifications, licensing fees and/or terms and conditions, or other forms. If third-party peripheral makers cannot or are not allowed to obtain or satisfy these requirements or restrictions, our

gaming royalty revenues could be significantly reduced. Furthermore, should a significant video game console maker choose to omit touch-enabling capabilities from its console system or somehow restrict or impede the ability of third parties to make touch-enabling peripherals, it may very well lead our gaming licensees to stop making products with touch-enabling capabilities, thereby significantly reducing our gaming royalty revenues.

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

to decline as more consumers switch to the PS3 console system and other next-generation console systems like the Nintendo Wii and Microsoft Xbox 360.

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

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

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

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

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

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

Laerdal accounts for a significant portion of our revenue. For the three months ended June 30, 2008, and 2007, 13% and 12%, respectively, of our total revenues were derived from Laerdal. For the six months ended June 30, 2008, and 2007, 12% and 12%, respectively, of our total revenues were derived from Laerdal. If our product sales to Laerdal decline, then our total revenue may decline.

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

Medtronic accounts for a significant portion of our revenue. For the three months ended June 30, 2008 and 2007, 8% and 11%, respectively, of our total revenues were derived from Medtronic. For the six months ended June 30, 2008 and 2007 9% and 9%, respectively, of our total revenues were derived from Medtronic. If our product sales to Medtronic decline, and/or Medtronic reduces the development activities we perform, then our total revenue may decline.

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

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

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

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

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

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

On July 1, 2006, the European Union s RoHS Directive became effective. This Directive eliminates most uses of lead, cadmium, hexavalent-chromium, mercury, and certain fire retardants in electronics placed on the market after the effective date. Since the introduction of the European Union s RoHS Directive, other regions of the world have announced or implemented similar regulations. In order to sell products into regions that adopt these or similar regulations, we have to assess each product and determine whether they comply with the requirements of the regulations or whether they are exempt from meeting the requirements of the regulations. If we determine that a product is not exempt and does not comply with adopted regulations, we will have to make changes to the product or its documentation if we want to sell that product into the region once the regulations become effective. Making such changes may be costly to perform and may have a negative impact on our results of operations. In addition, there can be no assurance that the national enforcement bodies of the regions adopting such regulations will agree with our assessment that certain of our products and documentation comply with or are exempt from the regulations. If products are determined not to be compliant or exempt, we will not be able to ship them in the region that adopts such regulations until such time that they are compliant, and this may have a negative impact on our revenue and results of operations.

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

BECAUSE PERSONAL COMPUTER PERIPHERAL PRODUCTS THAT INCORPORATE OUR TOUCH-ENABLING TECHNOLOGIES CURRENTLY WORK WITH MICROSOFT S OPERATING SYSTEM SOFTWARE, OUR COSTS COULD INCREASE AND OUR REVENUES COULD DECLINE IF MICROSOFT MODIFIES ITS OPERATING SYSTEM SOFTWARE.

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

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

IF WE ARE UNABLE TO DEVELOP OPEN SOURCE COMPLIANT PRODUCTS, OUR ABILITY TO LICENSE OUR TECHNOLOGIES AND GENERATE REVENUES WOULD BE IMPAIRED.

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

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

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

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

Rapid technological change, short product life cycles, cyclical market patterns, declining average selling prices, and increasing foreign and domestic competition characterize the markets in which we and our licensees compete. We believe that competition in these markets will continue to be intense and that competitive pressures will drive the price of our products and our licensees products downward. These price reductions, if not offset by increases in unit sales or productivity, will cause our revenues to decline.

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

THE MARKET FOR CERTAIN TOUCH-ENABLING TECHNOLOGIES AND TOUCH-ENABLED PRODUCTS IS AT AN EARLY STAGE AND IF MARKET DEMAND DOES NOT DEVELOP, WE MAY NOT ACHIEVE OR SUSTAIN REVENUE GROWTH.

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

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

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

IF WE FAIL TO INCREASE SALES OF OUR MEDICAL SIMULATION DEVICES, OUR FINANCIAL CONDITION AND OPERATIONS MAY SUFFER.

Many medical institutions do not budget for simulation devices. To increase sales of our simulation devices, we must, in addition to convincing medical institution personnel of the usefulness of the devices, persuade them to

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

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

Our revenue growth is significantly dependent on our ability to enter into new licensing arrangements. Our failure to enter into new or renewal of licensing arrangements will cause our operating results to suffer. We face numerous risks in obtaining new

licenses on terms consistent with our business objectives and in maintaining, expanding, and supporting our relationships with our current licensees. These risks include:

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

IF WE FAIL TO PROTECT AND ENFORCE OUR INTELLECTUAL PROPERTY RIGHTS, OUR ABILITY TO LICENSE OUR TECHNOLOGIES AND GENERATE REVENUES WOULD BE IMPAIRED.

Our business depends on generating revenues by licensing our intellectual property rights and by selling products that incorporate our technologies. We rely on our significant patent portfolio to protect our proprietary rights. If we are not able to protect and enforce those rights, our ability to obtain future licenses or maintain current licenses and royalty revenue could be impaired. In addition, if a court or the patent

office were to limit the scope, declare unenforceable, or invalidate any of our patents, current licensees may refuse to make royalty payments, or they may choose to challenge one or more of our patents. It is also possible that:

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

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

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

CERTAIN TERMS OR RIGHTS GRANTED IN OUR LICENSE AGREEMENTS OR OUR DEVELOPMENT CONTRACTS MAY LIMIT OUR FUTURE REVENUE OPPORTUNITIES.

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

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

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

IF WE FAIL TO DEVELOP NEW OR ENHANCED TECHNOLOGIES FOR NEW APPLICATIONS AND PLATFORMS, WE MAY NOT BE ABLE TO CREATE A MARKET FOR OUR TECHNOLOGIES OR OUR TECHNOLOGIES MAY BECOME OBSOLETE, AND OUR ABILITY TO GROW AND OUR RESULTS OF OPERATIONS MIGHT BE HARMED.

Our initiatives to develop new and enhanced technologies and to commercialize these technologies for new applications and new platforms may not be successful or timely. Any new or enhanced technologies may not be favorably received by consumers and could damage our reputation or our brand. Expanding our technologies could also require significant additional expenses and strain our management, financial, and operational resources. Moreover, technology products generally have relatively short product life cycles and our current products may become obsolete in the future. Additionally, as haptic technology gains market momentum, more research by universities and/or corporations or other parties may be performed potentially leading to strong intellectual property positions by third parties in certain areas of haptics or the launch of haptics products before we commercialize our own technology. Our ability to generate revenues will be harmed if:

- we fail to develop new technologies or products;
- the technologies we develop infringe on third-party patents or other third-party rights;

our new technologies fail to gain market acceptance; or

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

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

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

THE HIGHER COST OF PRODUCTS INCORPORATING OUR TOUCH-ENABLING TECHNOLOGIES MAY INHIBIT OR PREVENT THEIR WIDESPREAD ADOPTION.

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

THIRD-PARTY VALIDATION STUDIES MAY NOT DEMONSTRATE ALL THE BENEFITS OF OUR MEDICAL TRAINING SIMULATORS, WHICH COULD AFFECT CUSTOMER MOTIVATION TO BUY.

In medical training, validation studies are generally used to confirm the usefulness of new techniques, devices, and training methods. For medical training simulators, several levels of validation are generally tested: content, concurrent, construct, and predictive. A validation study performed by a third party, such as a hospital, a teaching institution, or even an individual healthcare professional, could result in showing little or no benefit for one or more types of validation for our medical training simulators. Such validation study results published in medical journals could impact the willingness of customers to buy our training simulators, especially new simulators that have not previously been validated. Due to the time generally required to complete and publish additional validation studies (usually more than a year), the negative impact on sales revenue could be significant.

MEDICAL LICENSING AND CERTIFICATION AUTHORITIES MAY NOT RECOMMEND OR REQUIRE USE OF OUR TECHNOLOGIES FOR TRAINING AND/OR TESTING PURPOSES, SIGNIFICANTLY SLOWING OR INHIBITING THE MARKET PENETRATION OF OUR MEDICAL SIMULATION TECHNOLOGIES.

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

WE HAVE LIMITED DISTRIBUTION CHANNELS AND RESOURCES TO MARKET AND SELL OUR MEDICAL SIMULATORS, TOUCH INTERFACE PRODUCTS, AND THREE-DIMENSIONAL SIMULATION AND DIGITIZING PRODUCTS, AND IF WE ARE UNSUCCESSFUL IN MARKETING AND SELLING THESE PRODUCTS, WE MAY NOT ACHIEVE OR SUSTAIN PRODUCT REVENUE GROWTH.

We have limited resources for marketing and selling medical simulation, touch interface, or three-dimensional simulation and digitizing products, either directly or through distributors. To achieve our business objectives, we must build a balanced mixture of sales through a direct sales channel and through qualified distribution channels. The success of our efforts to sell medical simulation, touch interface, and three-dimensional simulation products will depend upon our ability to retain and develop a qualified sales force and effective distribution channels. We may not be successful in attracting and retaining the personnel necessary to sell and market our products. A number of our

distributors represent small, specialized companies and may not have

sufficient capital or human resources to support the complexities of selling and supporting our products. There can be no assurance that our direct selling efforts will be effective, distributors or OEMs will market our products successfully or, if our relationships with distributors or OEMs terminate, that we will be able to establish relationships with other distributors or OEMs on satisfactory terms, if at all. Any disruption in the distribution, sales, or marketing network for our products could have a material adverse effect on our product revenues.

COMPETITION IN THE MEDICAL MARKET MAY REDUCE OUR REVENUE.

If the medical simulation market develops as we anticipate, we believe that we will have increased competition. As in many developing markets, acquisitions, or consolidations may occur that could lead to larger competitors with more resources or broader market penetration. This increased competition may result in the decline of our revenue and may cause us to reduce our selling prices.

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

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

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

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

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

Any future periods of rapid economic and technological change may place significant strains on our managerial, financial, engineering, or other resources. Further economic weakness, in combination with our complex technologies, may demand an unusually high level of managerial effectiveness in anticipating, planning, coordinating, and meeting our operational needs as well as the needs of our licensees. Our failure to effectively manage these resources during periods of rapid economic or technological change may harm our business.

WE MIGHT BE UNABLE TO RETAIN OR RECRUIT NECESSARY PERSONNEL, WHICH COULD SLOW THE DEVELOPMENT AND DEPLOYMENT OF OUR TECHNOLOGIES.

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

We believe that our future success will also depend largely on our ability to attract, integrate, and retain sales, support, marketing, and research and development personnel. Competition for such personnel is intense, and we may not be successful in attracting, integrating, and retaining such personnel. Given the protracted nature of if, how, and when we collect royalties on new design contracts, it may be difficult to craft compensation plans that will attract and retain the level of salesmanship needed to secure these contracts. Our stock option program is a long-term retention program that is intended to attract, retain, and provide incentives for talented employees, officers and directors, and to

align stockholder and employee interests. Additionally some of our executive officers and key employees hold stock options with exercise prices above the current market price of our common stock. Each of these factors may impair our ability to retain the services of our executive officers and key employees. Our technologies are complex and we rely upon the continued service of our existing personnel to support licensees, enhance existing technologies, and develop new technologies.

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Investment Risks

OUR QUARTERLY REVENUES AND OPERATING RESULTS ARE VOLATILE, AND IF OUR FUTURE RESULTS ARE BELOW THE EXPECTATIONS OF PUBLIC MARKET ANALYSTS OR INVESTORS, THE PRICE OF OUR COMMON STOCK IS LIKELY TO DECLINE.

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

These factors include:

the establishment or loss of licensing relationships;

the timing and recognition of payments under fixed and/or up-front license agreements;

the timing of work performed under development agreements;

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

litigation or claims regarding our restatement, internal controls, or other matters;

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

our ability to develop and improve our technologies;

our ability to attract, integrate, and retain qualified personnel;

seasonality in the demand for our products or our licensees products; and

our ability to build or ship products on a timely basis.

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

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

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OUR STOCK PRICE MAY FLUCTUATE REGARDLESS OF OUR PERFORMANCE.

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

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

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

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

PROVISIONS IN OUR CHARTER DOCUMENTS AND DELAWARE LAW COULD PREVENT OR DELAY A CHANGE IN CONTROL, WHICH COULD REDUCE THE MARKET PRICE OF OUR COMMON STOCK.

Provisions in our certificate of incorporation and bylaws may have the effect of delaying or preventing a change of control or changes in our management. In addition, certain provisions of Delaware law may discourage, delay, or prevent someone from acquiring or merging with us. These provisions could limit the price that investors might be willing to pay in the future for shares.

WE MAY ENGAGE IN ACQUISITIONS THAT COULD DILUTE STOCKHOLDERS INTERESTS, DIVERT MANAGEMENT ATTENTION, OR CAUSE INTEGRATION PROBLEMS.

As part of our business strategy, we have in the past and may in the future, acquire businesses or intellectual property that we feel could complement our business, enhance our technical capabilities, or increase our intellectual property portfolio. If we consummate acquisitions through cash and/or an exchange of our securities, our stockholders could suffer significant dilution. Acquisitions could also create risks for us, including:

- unanticipated costs associated with the acquisitions;
- use of substantial portions of our available cash to consummate the acquisitions;
- diversion of management s attention from other business concerns;

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difficulties in assimilation of acquired personnel or operations;

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

charges for write-down of assets associated with unsuccessful acquisitions; and

potential intellectual property infringement claims related to newly acquired product lines.

Any acquisitions, even if successfully completed, might not generate significant additional revenue or provide any benefit to our business. In addition to acquisitions, we may also consider making strategic divestitures. With any divestiture, there are risks that future operating results could be unfavorably impacted.

FAILURE TO MAINTAIN EFFECTIVE INTERNAL CONTROLS IN ACCORDANCE WITH SECTION 404 OF THE SARBANES-OXLEY ACT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS AND STOCK PRICE.

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

WE HAVE DETERMINED THAT OUR INTERNAL CONTROLS RELATING TO INCOME TAXES ARE CURRENTLY INEFFECTIVE.

As discussed in Part I, Item 4, *Controls and Procedures*, our management team, under the supervision and with the participation of our Chief Financial Officer and former Chief Executive Officer, conducted an evaluation of the effectiveness of the design and operation of our internal controls as of December 31, 2007. They concluded that our internal controls over financial reporting as they relate to income taxes were ineffective as of that date. We have subsequently initiated actions that are intended to improve our accounting for income taxes and the related internal controls. Any material weakness in our internal controls over the accounting for income taxes could impair our ability to report our financial position and results of operations accurately and in a timely manner.

WE HAVE IDENTIFIED A MATERIAL WEAKNESS IN OUR INTERNAL CONTROLS RELATED TO THE ACCOUNTING FOR INCOME TAXES AS OF DECEMBER 31, 2007 THAT, IF NOT PROPERLY REMEDIATED, COULD RESULT IN MATERIAL MISSTATEMENTS IN OUR FINANCIAL STATEMENTS IN FUTURE PERIODS.

Based on an evaluation of our disclosure controls and procedures as of December 31, 2007, due to the existence of a deficiency in the operation of our internal controls related to the accounting for income taxes, which constituted a material weakness in our internal control over financial reporting, our management has concluded that such disclosure controls and procedures were not effective as of such date. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. The identified deficiency pertained to controls which were not adequately designed to ensure proper accounting and disclosure of income taxes. These inadequate controls resulted in adjustments to our previously reported quarterly unaudited financial results as of March 31, 2007 and the cumulative loss amounts for quarterly unaudited financial results as of June 30, 2007 and September 30, 2007.

Because of this material weakness, there is risk that a material misstatement of our annual or quarterly financial statements will not be prevented or detected. We are currently in the process of implementing control procedures to remediate the material weakness. We cannot guarantee, however, that such remediation efforts will correct the material weakness such that our internal control over financial reporting will be effective. In the event that we do not adequately remedy this material weakness, or if we fail to maintain effective internal controls in future periods, our operating results, financial position and stock price could be adversely affected.

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AS OUR BUSINESS GROWS, SUCH GROWTH MAY PLACE A SIGNIFICANT STRAIN ON OUR MANAGEMENT AND OPERATIONS AND, AS A RESULT, OUR BUSINESS MAY SUFFER.

We plan to continue expanding our business, and our expected growth could place a significant strain on our management systems, infrastructure and other resources. To manage the expected growth of our operations and increases in the number of our personnel, we will need to invest the necessary capital to upgrade and improve our operational, financial and management reporting systems. Accordingly, we are currently transitioning the preparation of all of our internal reporting to new or upgraded management information systems, which are expected to be implemented near the end of 2008. If we encounter problems with the implementation of these systems, we may have difficulties preparing or tracking internal information, which could adversely affect our financial results. If our management fails to respond effectively to changes in our business, our business may suffer.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Below is a summary of stock repurchases for the quarter ending June 30, 2008. See Note 8 of our condensed consolidated financial statements for information regarding our stock repurchase program.

Program/Period (1)	Shares Repurchased (2)	Average Price Per Share	Approximate Dollar Value that May Yet Be Purchased Under the Program
Beginning approximate dollar value available to be repurchased as of March 31, 2008			$ 50,000,000
May 1 - May 31, 2008	298,683	$ 9.46	
June 1 - June 30, 2008	420,000	$ 7.93	
Total shares repurchased	718,683	$ 8.56	6,154,903
Ending approximate dollar value that may be repurchased under the Program as of June 30, 2008			$ 43,845,097

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

We held our annual meeting of stockholders (the Annual Meeting) on June 4, 2008, to consider and vote on the following proposals to: (i) elect two members of the Board of Directors to serve for a three-year term as Class III Directors (Proposal 1); and (ii) ratify the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2008 (Proposal 2).

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

Nominees	Number of Votes For	Withheld Authority
John Hodgman	22,607,255	1,670,937
Emily Liggett	22,926,268	1,351,924

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Mr. Hodgman s and Ms. Liggett s terms will expire at the 2011 annual meeting. Other directors terms of office continue as follows: Anne DeGheest, Jack Saltich, and Victor Viegas (Class I term expires at the 2009 annual meeting) and Clent Richardson and Robert Van Naarden (Class II term expires at the 2010 annual meeting).

Proposal 2: The ratification of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2008:

Number of Votes For	Number of Votes Against	Number of Votes Abstained
23,949,357	183,798	145,037

ITEM 6. EXHIBITS

The following exhibits are filed herewith:

Exhibit Number	Description
10.36	Executive Incentive Plan dated April 21, 2008 by and between Immersion Corporation and Stephen Ambler.
10.37	Executive Incentive Plan dated April 21, 2008 by and between Immersion Corporation and Victor Viegas.
10.38	The Immersion Corporation 2008 Employment Inducement Award Plan dated April 30, 2008.
10.39	Form of Stock Option Agreement for Immersion Corporation 2008 Employment Inducement Award Plan dated April 30, 2008.
10.40	Resignation agreement and general release of claims dated April 28, 2008 by and between Immersion Corporation and Victor Viegas.
10.41	Retention and ownership change event agreement dated April 17, 2008 by and between Immersion Corporation and Clent Richardson.
10.42	Restated Offer of Employment with Immersion Corporation effective April 28, 2008 by and between Immersion Corporation and Clent Richardson.
10.43	Executive Incentive Plan dated May 23, 2008 by and between Immersion Corporation and Richard Vogel.
31.1	Certification of Clent Richardson, President, Chief Executive Officer, and Director, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Stephen Ambler, Chief Financial Officer and Vice President, Finance, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Clent Richardson, President, Chief Executive Officer, and Director, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Stephen Ambler, Chief Financial Officer and Vice President, Finance, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

Date: August 8, 2008

IMMERSION CORPORATION

By /s/ Stephen Ambler
Stephen Ambler
Chief Financial Officer and Vice President, Finance

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