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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended March 31, 2003

OR

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

For the transition period from to

Commission file number 000-27969

IMMERSION CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**94-3180138**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

801 Fox Lane, San Jose, California 95131

(Address of principal executive offices)(Zip Code)

(408) 467-1900

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).
Yes [ ] No [X]

Number of shares of Common Stock outstanding at May 1, 2003: 20,180,120

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PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

IMMERSION CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)

	March 31, 2003	December 31, 2002 (1)
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,767	$ 8,717
Accounts receivable, (net of allowances for doubtful accounts of: 2003, $197; and 2002, $334)	3,121	3,645
Inventories	2,382	2,128
Prepaid expenses and other current assets	975	1,151
Total current assets	12,245	15,641
Property and equipment, net	1,840	2,044
Intangibles and other assets, net	6,601	6,616
Other investments	1,000	1,000
Total assets	$ 21,686	$ 25,301
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,015	$ 1,160
Accrued compensation	1,007	671
Other current liabilities	1,098	1,311
Deferred revenue and customer advances	2,436	3,515
Current portion of long-term debt and warrant liability	33	64
Current portion of capital lease obligation	21	22
Total current liabilities	5,610	6,743
Long-term debt, less current portion	26	26
Capital lease obligation, less current portion	21	25
Long-term deferred revenue, less current portion	5,479	4,559
Total liabilities	11,136	11,353
Contingencies (Note 9)		
Stockholders' equity:		
Common stock - $0.001 par value; 100,000,000 shares authorized; shares issued and outstanding: 2003, 20,147,196 and 2002, 20,137,040	89,072	89,061
Warrants	1,974	1,974
Deferred stock compensation	(815)	(1,046)
Accumulated other comprehensive income (loss)	1	(16)
Accumulated deficit	(79,682)	(76,025)
Total stockholders' equity	10,550	13,948
Total liabilities and stockholders' equity	$ 21,686	$ 25,301

See accompanying Notes to Condensed Consolidated Financial Statements.

(1) The balance sheet at December 31, 2002 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

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

	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002
Revenues:		
Royalty and license	$ 833	$ 1,234
Product sales	2,148	2,398
Development contracts and other	755	1,173
Total revenues	3,736	4,805
Costs and expenses:		
Cost of product sales	1,106	1,285
Sales and marketing	1,791	2,109
Research and development	1,689	1,703
General and administrative	2,156	1,978
Amortization of intangibles and deferred stock compensation *	649	914
Other charges	—	397
Total costs and expenses	7,391	8,386
Operating loss	(3,655)	(3,581)
Interest and other income	11	135
Interest and other expense	(13)	(208)
Net loss	$ (3,657)	$ (3,654)
Basic and diluted net loss per share	$ (0.18)	$ (0.19)
Shares used in calculating basic and diluted net loss per share	20,144	19,351
* Amortization of intangibles and deferred stock compensation		
Amortization of intangibles	$ 419	$ 576
Deferred stock compensation - sales and marketing	3	3
Deferred stock compensation - research and development	225	321
Deferred stock compensation - general and administrative	2	14
Total	$ 649	$ 914

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002
Cash flows from operating activities:		
Net loss	$(3,657)	$ (3,654)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	290	322
Amortization of intangibles	419	576
Amortization of deferred stock compensation	230	338
Amortization of discounts on notes payable	(1)	113
Fair value adjustment for warrant liability	—	(83)
Noncash interest expense	—	82
Noncash compensation expense	—	14
Loss on disposal of equipment	1	1
Changes in operating assets and liabilities:		
Accounts receivable	533	(4,743)
Inventories	(254)	62
Prepaid expenses and other current assets	176	645
Accounts payable	(406)	448
Accrued compensation and other current liabilities	116	50
Deferred revenue and customer advances	(158)	4,793
Net cash used in operating activities	(2,711)	(1,036)
Cash flows from investing activities:		
Purchases of short-term investments	—	(5)
Sales and maturities of short-term investments	—	2,550
Other assets	(404)	(72)
Purchases of property and equipment	(80)	(126)
Net cash provided by (used in) investing activities	(484)	2,347
Cash flows from financing activities:		
Issuance of common stock	11	68
Exercise of stock options	—	138
Exercise of warrants	—	50
Payments on notes payable and capital leases	(35)	(31)
Net cash provided by (used in) financing activities	(24)	225
Effect of exchange rates on cash and cash equivalents	269	(1)
Net increase (decrease) in cash and cash equivalents	(2,950)	1,535
Cash and cash equivalents:		
Beginning of the period	8,717	10,381
End of the period	$ 5,767	$11,916
Supplemental disclosure of cash flow information :		
Cash paid for interest	$ 6	$ 22

See accompanying Notes to Condensed Consolidated Financial Statements.

IMMERSION CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2003
(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES

Description of Business - Immersion Corporation (the "Company") was incorporated in May 1993 in California and reincorporated in Delaware in 1999 and provides technologies that enable users to interact with computers using their sense of touch.

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

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and, therefore, do not include all information and footnotes necessary for a complete presentation of the financial position, results of operations, and cash flows, in conformity with accounting principles generally accepted in the United States of America. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002.

The results of operations for the interim period ended March 31, 2003 are not necessarily indicative of the results to be expected for the full year.

Stoc*k-Based Compensation* - The Company accounts for its stock-based awards to employees using the intrinsic value method in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees", and its related interpretations. The Company accounts for stock-based awards to non-employees in accordance with Emerging Issues Task Force "EITF" Issue No. 96-18. Pro forma disclosures required under SFAS No. 123, "Accounting for Stock-Based Compensation,'' as amended, as if the Company had adopted the fair value based method of accounting for stock options are as follows (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2003	**2002**
Net loss - as reported	$(3,657)	$(3,654)
Add: Stock-based employee compensation included in reported net loss	230	338
Less: Stock-based compensation expense determined using fair value method	(1,021)	(1,712)
Net loss - pro forma	$(4,448)	$(5,028)
Basic and diluted loss per common share - as reported	$ (0.18)	$ (0.19)
Basic and diluted loss per common share - pro forma	$ (0.22)	$ (0.26)

Recent Accounting Pronouncements - In June 2002, the FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities," which addresses accounting for restructuring and similar costs. SFAS 146 supersedes previous accounting guidance, principally EITF Issue No. 94-3. The Company has adopted the provisions of SFAS 146 for restructuring activities initiated after December 31, 2002. SFAS 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under issue 94-3, a liability for an exit cost would be recognized at the date of the Company's commitment to an exit plan. SFAS 146 also establishes that the liability should be measured and recorded at fair value. Accordingly, SFAS 146 may affect the timing of recognizing future restructuring costs as well as the amounts recognized. The adoption of SFAS 146 did not impact our financial position, results of operations or cash flows.

In November 2002, the EITF reached a consensus on Issue No. 00-21 “Accounting for Revenue Arrangements with Multiple Deliverables”. The EITF concluded that revenue arrangements with multiple elements should be divided into separate units of accounting if the deliverables in the arrangement have value to the customer on a standalone basis, if there is objective and reliable evidence of fair value of the undelivered elements, and as long as there are no rights of return or additional performance guarantees by the Company. The provisions of EITF Issue No. 00-21 are applicable to agreements entered into in fiscal periods beginning after June 15, 2003. We are currently determining what effect, if any, the provisions of EITF Issue No. 00-21 will have on our operating results or financial condition.

In December 2002, the FASB issued SFAS No. 148, “Accounting for Stock-Based Compensation – Transition and Disclosure.” The statement amends SFAS No. 123, “Accounting for Stock-Based Compensation”, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. We adopted the disclosure provisions of SFAS No. 148 at December 31, 2002. We have not yet determined the effect that the transition provisions of SFAS No. 148 would have on our operating results or financial position, if any.

2. INVENTORIES

	March 31, 2003	December 31, 2002
	(In thousands)	
Raw materials and subassemblies	$1,691	$1,587
Work in process	162	183
Finished goods	529	358
Total	$2,382	$2,128

3. PROPERTY AND EQUIPMENT

	March 31, 2003	December 31, 2002
	(In thousands)	
Computer equipment and purchased software	$ 2,042	$ 2,002
Machinery and equipment	1,847	1,810
Furniture and fixtures	1,334	1,325
Leasehold improvements	692	692
Total	5,915	5,829
Less accumulated depreciation	(4,075)	(3,785)
Property and equipment, net	$ 1,840	$ 2,044

4. INTANGIBLES AND OTHER ASSETS

	March 31, 2003	December 31, 2002
	(In thousands)	
Purchased patents and technology	$ 7,366	$ 6,962
Other intangibles	5,748	5,748
Other assets	83	83
Gross purchased intangibles and other assets	$13,197	$12,793
Accumulated amortization of purchased patents and technology	(2,712)	(2,545)
Accumulated amortization of other intangibles	(3,884)	(3,632)
Net purchased intangibles and other assets	$ 6,601	$ 6,616

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

	March 31, 2003	December 31, 2002
	(In thousands)	
Accrued legal	$ 426	$ 523
Other current liabilities	672	788
Total other current liabilities	$1,098	$1,311
Deferred revenue	$2,397	$ 976
Customer advances	39	2,539
Total current deferred revenue and customer advances	$2,436	$3,515

At December 31, 2002, customer advances included a $2.5 million prepayment from one licensee. Subsequent to December 2002, $500,000 of this prepayment was returned to the licensee as a result of the final agreement reached between the Company and the licensee regarding the terms of the prepayment and the Company reclassed $2.0 million to deferred revenue.

6. NET LOSS PER SHARE

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

	Three Months Ended March 31,	
	2003	2002
Numerator:		
Net loss	$ (3,657)	$ (3,654)
Denominator:		
Shares used in computation, basic and diluted (weighted average common shares outstanding)	20,144	19,351
Net loss per share, basic and diluted	$ (0.18)	$ (0.19)

For the above-mentioned periods, 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:

	March 31,	
	2003	2002
Convertible note payable	—	226,450
Outstanding stock options	8,007,273	7,259,835
Warrants	511,999	511,999

7. COMPREHENSIVE LOSS

The following table sets forth the components of comprehensive loss:

	Three Months Ended March 31,	
	2003	2002
	(In thousands)	
Net loss	$(3,657)	$(3,654)
Foreign currency translation adjustment	17	(2)
Total comprehensive loss	$(3,640)	$(3,656)

8. SEGMENT INFORMATION, OPERATIONS BY GEOGRAPHIC AREA AND SIGNIFICANT CUSTOMERS

The Company designs, develops, produces, markets and licenses products based on touch-enabling technology. These devices are used in computer entertainment, personal computing, medical and other professional computing applications. The Company has two operating and reportable segments. Immersion Computing, Entertainment and Industrial develops and markets TouchSense and force-feedback technology that enables software and hardware developers to bring realism into their computing and entertainment experience and industrial applications. Immersion Medical develops, manufactures, and markets medical simulators that recreate realistic healthcare environments.

The following tables display information about our reportable segments:

	Three Months Ended March 31,	
	2003	2002
	(In thousands)	
Revenues:		
Immersion Computing, Entertainment and Industrial	$ 2,223	$ 3,368
Immersion Medical	1,648	1,443
Intersegment eliminations	(135)	(6)
Total	$ 3,736	$ 4,805
Net Loss:		
Immersion Computing, Entertainment and Industrial	$(3,377)	$(2,270)
Immersion Medical	(406)	(1,384)
Intersegment eliminations	126	—
Total	$(3,657)	$(3,654)

	March 31, 2003	December 31, 2002
	(In thousands)	
Total Assets:		
Immersion Computing, Entertainment and Industrial	$ 32,208	$ 36,389
Immersion Medical	3,349	2,919
Intersegment eliminations	(13,871)	(14,007)
Total	$ 21,686	$ 25,301

The Company operates primarily in the United States and in Canada where it operates through its wholly owned subsidiary, Immersion Canada. 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 loss. These results are used, in part, to evaluate the performance of, and allocate resources, to each of the segments.

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 March 31,	
	2003	2002
North America	72%	66%
Europe	18%	20%
Far East	9%	13%
Rest of the world	1%	1%
Total	100%	100%

The Company derived 67% and 65% of its total revenues from the United States for the three months ended March 31, 2003 and 2002 respectively. Revenues from other countries represented less than 10% individually for the periods presented.

The majority of the Company's long-lived assets were located in the United States. Long-lived assets included net property and equipment and long-term investments and other assets. Long-lived assets that were outside the United States constituted less than 10% of the total at March 31, 2003 and December 31, 2002.

SIGNIFICANT CUSTOMERS

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

	Three Months Ended March 31,	
	2003	2002
Customer A	*	11%
Customer B	10%	*
Customer C	12%	*
Total	22%	11%

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

No customer accounted for more than 10% of the Company's accounts receivable for the periods presented.

9. CONTINGENCIES

In re Immersion Corporation

We are involved in legal proceedings relating to a class action lawsuit filed on November 9, 2001. The case is now designated as In re Immersion Corporation Initial Public Offering Securities Litigation, No. Civ. 01-9975 (S.D.N.Y.), related as to In re Initial Public Offering Securities Litigation, No. 21 MC 92 (S.D.N.Y.). The action was filed in the United States District Court, Southern District of New York, against defendants Immersion Corporation, Louis Rosenberg (former Chief Executive Officer, President and Chairman of the Company), Victor Viegas (current President, Chief Executive Officer and Chief Financial Officer), Bruce Schena (former Chief Technology Officer and Director); and certain underwriters of Immersion's November 12, 1999 initial public offering. Subsequently, two of the individual defendants stipulated to a dismissal without prejudice. The case is purportedly brought on behalf of all persons who purchased the Company's common stock from November 12, 1999 through December 6, 2000.

The lawsuit has been consolidated for pretrial purposes with similar lawsuits relating to more than 300 other initial public offerings conducted in 1999 and 2000 before the Honorable Judge Shira A. Scheindlin. On May 29, 2002, plaintiffs electronically served an amended complaint. The amended complaint alleges violations of 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 prospectus incorporated in the registration statement for the Company's initial public offering failed to disclose, among other things, that (i) the underwriter had solicited and received excessive and undisclosed commissions from certain investors in exchange for which the underwriter allocated to those investors material portions of the shares of the Company's stock sold in the offering; and (ii) the underwriter had entered into agreements with customers whereby the underwriter agreed to allocate shares of the Company's stock sold in the offering to those customers in exchange for which the customers agreed to purchase additional shares of the Company's stock in the aftermarket at pre-determined prices. The amended complaint appears to allege that false or misleading analyst reports were issued. The amended complaint does not claim any specific amount of damages.

On July 15, 2002, the Company (as well as the other issuers and their affiliated individual defendants) filed a motion to dismiss. On February 19, 2003, the motion was granted in part and denied in part. The motion was denied as to claims under the Securities Act of 1933 in the case involving the Company, as well as all other cases (except for 10 cases). The motion was denied as to the claim under Section 10(b) of the Securities Exchange Act of 1934 as to the Company, on the basis that the complaint alleged that the Company had made acquisition (s) following the initial public offering. The motion was granted as to the claim under Section 10(b) of the Securities Exchange Act, but denied as to the claim under Section 20(a) of that Act, as to the remaining individual defendant. Management believes that the claims against the Company and individual defendants are without merit and intends to vigorously defend against them.

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

On February 11, 2002, we filed a complaint against Microsoft Corporation, Sony Computer Entertainment, Inc., and Sony Computer Entertainment of America, Inc. in the U.S. District Court for the Northern District Court of California alleging infringement of U.S. Patent Nos. 5,889,672 and 6,275,213. The case was assigned to United States District Judge Claudia Wilken. On April 4, 2002, Sony Computer Entertainment and Microsoft 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. The process of discovery and exchanging information and documents on infringement, invalidity, and claim construction, is ongoing. On October 8, 2002, we filed an amended complaint, withdrawing the claim under the '672 patent and adding claims under a new patent, U.S. Patent No. 6,424,333. On October 10, 2002, the Court entered an Amended Case Management Order that set, among other dates in the case, April 25, 2003 for a hearing to construe the claims of the asserted patents and April 5, 2004 for the start of trial. On October 28, 2002, Sony Computer Entertainment and Microsoft answered the amended complaint and alleged similar counterclaims for declaratory relief that the asserted patents are invalid, unenforceable, or not infringed. On March 21, 2003, Sony Computer Entertainment filed a motion for summary judgment of non-infringement. At Immersion's request, the Court ordered this motion stricken, without prejudice to its being refiled at a later date after the Court held the scheduled claim construction. On April 25, 2003, the Court held the scheduled claim construction hearing. It is anticipated that the Court will issue a written claim construction decision, though the timing of when the Court issues its ruling is within the Court's discretion. Due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation. We anticipate that the litigation will continue to be costly, and there can be no assurance that we will be able to recover the costs we incur in connection with the litigation. The 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, the litigation could adversely affect our business. Further, any unfavorable outcome could adversely affect our business.

Other Contingencies

In addition, the Company has received 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. The Company from time to time 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.

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 not the only way we identify forward-looking statements. In addition, any statements, which refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, including those set forth below in Management’s Discussion and Analysis of Financial Condition and Results of Operation and Factors That May Affect Future Results, 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 filed with the SEC that attempt to advise you of the risks and factors that may affect our business.

OVERVIEW

We develop, manufacture, license and support a wide range of hardware and software technologies that enable users to interact with a multitude of computing and other devices using their sense of touch. We manage our business under two operating and reportable segments: Immersion Computing, Entertainment and Industrial, and Immersion Medical. We focus on four application areas — consumer, computing and entertainment, medical simulation, industrial and automotive, and three-dimensional and professional. In high volume market areas such as consumer computer peripherals and automotive interfaces, we primarily license our touch-enabling technologies to third party manufacturers. We have licensed our intellectual property to numerous manufacturers of mice, joysticks, knobs, wheels and gamepads targeted at consumers. For lower-volume markets like medical simulation systems and three-dimensional and professional products, our primary strategy is to manufacture and sell products through direct sales, distributors and value added resellers. We sell medical simulation devices used to train and allow health care providers to practice and enhance their skills in a variety of procedures. These devices simulate such procedures as intravenous catheterization, endovascular interventions, and laparoscopic and endoscopic surgical procedures. We also sell three-dimensional and professional products. Our three-dimensional products include the MicroScribe G2 desktop digitizer product line and associated software and accessories, specialized whole-hand sensing gloves, armatures and software, including the CyberGlove, CyberGrasp, CyberForce, CyberTouch and VirtualHand software products that permit simulated interaction with three-dimensional environments. In all market areas, we also engage in development projects for third parties and government agencies from time to time.

We have entered into numerous contracts with government agencies and corporations since 1993. Government contracts help fund advanced research and development, are typically less than two years in duration, are usually for a fixed price or for our costs plus a fixed fee, and allow the government agency to license the resulting technology for government applications, specifically excluding any commercial activity. Corporate contracts are typically for product development consulting, are for a fixed fee and are also less than two years in duration.

Since inception, we have completed a number of acquisitions of patents and technology. We capitalize the cost of patents and technology and license agreements, except for amounts relating to acquired in-process research and development for which there is no alternative future use. As of March 31, 2003, we had capitalized patents and technology of $4.7 million, net of accumulated amortization of $2.7 million. We are amortizing these patents and technology over the estimated useful life of the technology of nine years.

We currently derive royalty revenue from sales of our licensees’ consumer computer peripheral devices, such as touch-enabled mice and joysticks. We also derive royalty revenue from the inclusion of touch-enabled controls incorporating our technology in automobiles and medical simulators. Our basic licensing model typically includes an up-front license fee and/or a royalty paid by the peripheral or automobile manufacturer that is a percentage of the wholesale selling price of the touch-enabled product. We derive product revenue from a number of sources including sales of our medical simulation hardware devices and from sales of the software modules that are used in conjunction with such devices. Other sources of product revenue include sales of our three-dimensional digitizing products, such as the MicroScribe G2 products and sales of hardware and software for our whole-hand sensing gloves, such as the CyberGlove. With respect to development projects, most such projects involve assisting our licensees in the development of their touch-enabled products for which we receive fixed payments for product-related deliverables.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2003 AND 2002

REVENUES	March 31, 2003	March 31, 2002	Change
	($ In thousands)		
Three months ended:			
Royalty and license	$ 833	$1,234	(32)%
Product sales	2,148	2,398	(10)%
Development contracts and other	755	1,173	(36)%
Total Revenue	$3,736	$4,805	(22)%

Total Revenue. Our total revenue for the first quarter of fiscal 2003 decreased by $1.1 million or 22% from the first quarter of fiscal 2002. Royalty revenue for the three months ended March 31, 2003 decreased to $833,000 from $1.2 million for the three months ended March 31, 2002, a decrease of 32%. Royalty revenue is comprised of royalties earned on sales by our TouchSense licensees and license fees charged for our intellectual property portfolio. This decrease is mainly due to weakness in the gaming market and the decline in sales of general computing and PC gaming peripheral devices. In addition, one of our licensees filed for bankruptcy protection under Chapter 11 and we derived less than $1,000 in royalty revenue from this licensee during the quarter ended March 31, 2003. We derived $217,000 of royalty revenue from this licensee during the three months ended March 31, 2002 and $447,000 for the full year 2002. In the short-term it may be difficult to replace this revenue source. Product sales for the three months ended March 31, 2003 decreased by $250,000 or 10% as compared to the three months ended March 31, 2002. The decrease in product sales was mainly due to a reduction in medical product sales of $158,000, and a reduction of $87,000 in our professional and industrial product line. Some of our products areas have not achieved commercial success beyond research centric customers and during this environment of economic decline and fixed budgets for research we have experienced reduced demand for such products. Development contract and other revenue is comprised of revenue on commercial and government contracts, which decreased by $418,000 during the first quarter of fiscal 2003, as compared to the first quarter of fiscal 2002. The decrease is attributable to a reduction in commercial automotive contracts entered into during the first quarter of fiscal 2003 compared to the first quarter of fiscal 2002 as well as a decrease in related development activity on some medical contracts. Both the automotive and medical slowdowns were attributable to the widespread downturn and the global instability that plagued many businesses in Q1 2003.

We categorize our geographic information into four major regions: North America, Europe, Far East and Rest of the World. In the first quarter of fiscal 2003, revenue generated in North America, Europe, Far East and Rest of the World represented 72%, 18%, 9% and 1% respectively compared to 66%, 20%, 13% and 1% respectively, for the first quarter of fiscal 2002. The shift in revenues among regions is mainly due to an increase in medical products sales to customers in North America and a decrease in automotive development contracts and royalties on computer peripherals from customers in the Far East.

COST OF PRODUCT SALES	March 31, 2003	March 31, 2002	Change
	($ In thousands)		
Three months ended:			
Cost of product sales	$1,106	$1,285	(14)%
% of total product revenue	51%	54%	

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 decreased by $179,000 or 14% for the three months ended March 31, 2003 as compared to the three months ended March 31, 2002.

The decrease is attributable to decreased direct material cost of $96,000 associated with reduced product sales for the quarter ended March 31, 2003. In addition, royalty obligations owed from product sales decreased by $76,000 for the quarter ended March 31, 2003 as compared to March 31, 2002. The decrease is due in part to the settlement agreement reached with MicroScribe LLC, which eliminated royalty payments on our MicroScribe G2 product line. Overhead expenses increased by $84,000 during the three months ended March 31, 2003 versus the comparable period last year but this increase was mainly offset by reduced inventory write-downs and scrap of $78,000.

	March 31,		
OPERATING EXPENSES AND OTHER	**2003**	**2002**	**Change**
	($ In thousands)		
Three months ended:			
Sales and marketing	$1,791	$2,109	(15)%
% of total revenue	48%	44%	
Research and development	$1,689	$1,703	(1)%
% of total revenue	45%	35%	
General and administrative	$2,156	$1,978	9%
% of total revenue	58%	41%	
Amortization of intangibles and deferred stock compensation	$ 649	$ 914	(29)%
% of total revenue	17%	19%	
Other charges	$ —	$ 397	(100)%
% of total revenue	0%	8%	

Sales and Marketing. Our sales and marketing expenses are comprised primarily of employee headcount and related compensation and benefits, advertising, trade shows, brochures, market development funds, travel and an allocation of facilities costs. Sales and marketing expenses decreased by $318,000 or 15% in the first quarter of fiscal 2003 compared to the comparable period in 2002. The decrease was mainly due to reduced headcount and related compensation, benefits and overhead costs of $56,000, reduced advertising and marketing expenses of $107,000 mainly for collateral reproduction and advertising, reduced professional and consulting fees of $63,000 and a decrease in bad debt expenses of $154,000 offset by increased travel expenses of $53,000. The reduction in marketing expenses reflects our ability to leverage programs and marketing materials initiated in prior periods and continued implementation of cost reductions initiated during 2002 and continued in 2003.

Research and Development. Our research and development expenses are comprised primarily of headcount and related compensation and benefits, consulting fees, tooling and supplies and an allocation of facilities costs. Research and development expenses decreased by $14,000 or 1% in the first quarter of fiscal 2003 compared to the same period in 2002. The decrease was mainly due to a decrease in outside professional consulting and licensing fees of $69,000 offset by increased personnel related and overhead costs of $47,000.

General and Administrative. Our general and administrative expenses are comprised primarily of employee headcount and related compensation and benefits, legal and professional fees, office supplies, travel and an allocation of facilities costs. General and administrative expenses increased by $178,000 or 9% in the first quarter of fiscal 2003 compared to the same period in 2002. The increase is mainly due to an increase in legal and professional fees of $387,000, mostly due to the litigation against both Sony and Microsoft, offset by decreased personnel related costs of $128,000 attributable to a decreased compensation, benefits and overhead, reduced public company expenses of $34,000 and reduced supplies costs of $26,000. We expect that the dollar amount of general and administrative expenses will increase in the future as we incur additional costs related to the litigation against us and an increase in legal fees due to the litigation against both Sony and Microsoft, as well as additional public company compliance costs.

Amortization of Intangibles and Deferred Stock Compensation. Our amortization of intangibles and deferred stock compensation is comprised primarily of patent amortization, other intangible amortization and deferred stock compensation. Amortization of intangibles and deferred stock compensation decreased by $265,000 or 29% in the first quarter of fiscal 2003 compared to the same period in 2002. The reduction is mainly attributable to a decrease of $170,000 related to amortization of other intangibles as those intangibles reach full amortization and $108,000 for the amortization of deferred stock compensation over the comparable first quarter in 2002 due to the expiration of vesting periods.

Other Charges. Other charges decreased by $397,000 or 100% in the first quarter of fiscal 2003 as compared to the first quarter of fiscal 2002. During the quarter ended March 31, 2002 we incurred $397,000 related to severance costs.

Interest and Other Income. Interest and other income consist primarily of interest income, dividend income and capital gains from cash and cash equivalents and short-term investments. Interest and other income declined by $124,000 in the first quarter of fiscal 2003 compared to the same period in 2002 as a result of reduced cash, cash equivalents and short-term investments invested for the period due to cash used in operating activities, as well as reduced yields on investments due to lower interest rates.

Interest and Other Expense. Interest and other expense consist primarily of interest expense on our notes payable and capital leases. Interest and other expense decreased by $195,000 for the three months ended March 31, 2003 compared to the three months ended March 31, 2002. The reduction of interest and other expense was mainly attributable to reduced interest expense associated with outstanding debt obligations that were paid during fiscal year 2002.

SEGMENT RESULTS FOR THE THREE MONTHS ENDED MARCH 31, 2003 AND 2002

	Three Months Ended March 31,	
	2003	**2002**
	(In thousands)	
Revenues:		
Immersion Computing, Entertainment and Industrial	$ 2,223	$ 3,368
Immersion Medical	1,648	1,443
Intersegment eliminations	(135)	(6)
Total	$ 3,736	$ 4,805
Net Loss:		
Immersion Computing, Entertainment and Industrial	$(3,377)	$(2,270)
Immersion Medical	(406)	(1,384)
Intersegment eliminations	126	—
Total	$(3,657)	$(3,654)

Immersion Computing, Entertainment and Industrial segment. Revenues from the Immersion Computing, Entertainment and Industrial segment decreased by $1.1 million or 34% in the first quarter of fiscal 2003 compared to the same period in 2002. All revenue categories experienced decline during the three months ended March 31, 2003 versus the three months ended March 31, 2002. The decrease is mainly due to a reduction in royalty revenue associated with a decline in the gaming market for the first quarter 2003 and a decline in product sales due to longer sales cycles. Net loss for the quarter ended March 31, 2003 increased by $1.1 million or 49% compared to the same period in 2002. Reduced revenues of $1.1 million as well as increased litigation costs of $597,000 associated with our litigation against both Sony and Microsoft offset by decreased sales and marketing expenses of $242,000 and decreased amortization of intangibles and deferred stock compensation of $261,000 account for the increase in net loss for the quarter ended March 31, 2003 compared to the same period in 2002.

Immersion Medical segment. Revenues from Immersion Medical increased by $205,000 or 14% for the first quarter of fiscal 2003 compared to the same period in 2002. The increase is primarily due to an increase of $250,000 in product sales and an increase of $24,000 in royalty and licensing revenue offset by a decrease of $70,000 in development contract revenue. Net loss for the quarter ended March 31, 2003 decreased by $979,000 or 71% compared to the same period in 2002. The decrease is primarily due to decreased compensation expense and related benefits of $637,000 including severance of $317,000 incurred during the first quarter of fiscal 2002. Interest expense for the period decreased by $196,000 compared to the same period in 2002 due to repayments of debt obligations during 2002, and professional services expenses decreased by $153,000.

LIQUIDITY AND CAPITAL RESOURCES

Our cash and cash equivalents consist primarily of money market funds. All of our cash and cash equivalents are classified as available-for-sale under the provisions of SFAS 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 (loss) within stockholders’ equity.

At March 31, 2003 our cash and cash equivalents totaled $5.8 million, down $2.9 million from $8.7 million at December 31, 2002.

Net cash used in operating activities during the first three months of fiscal 2003 was $2.7 million, an increase of $1.7 million from $1.0 million used during the comparable period in 2002. Cash used in operations during the three month period ended March 31, 2003 comprised primarily of our $3.7 million net loss offset by noncash charges and credits of $938,000, which consists primarily of amortization of intangibles and deferred stock compensation, an increase in inventory of $254,000, a decrease in accounts payable of $406,000 offset by a decrease in accounts receivable of $533,000 and a decrease in prepaids and other assets of $176,000.

Net cash used in investing activities during the first three months of fiscal 2003 was $484,000. Capitalization of external patent costs accounted for $404,000 and purchases of capital equipment accounted for $80,000 of cash used in investing activities during the quarter ended March 31, 2003. For the comparable period in 2002, net cash provided in investing activities was $2.3 million, which was primarily the result of a sale of short-term securities offset by purchases of capital equipment of $126,000 and capitalized patent costs of $72,000.

Net cash used by financing activities during the first three months of fiscal 2003 was $24,000 due mainly to payments on debt obligations as opposed to the net cash provided by financing activities of $225,000 during the comparable period during 2002.

Management believes its cash and cash equivalents plus cash generated through the Company’s operations as well as future expense reductions are sufficient to meet its operating needs for the next twelve months. However, we may elect to raise additional capital over the next twelve months to address any unanticipated circumstances that significantly increase our cash or capital requirements. Our plans to raise additional capital may include possible customer prepayments of certain royalty obligations in exchange for a royalty discount and/or other negotiated concessions, entering into new license agreements that require up-front license payments, and potentially through debt or equity financing. We have taken measures to control our costs and will continue to monitor these efforts. We do, however, expect our legal costs to increase during 2003 and 2004 as a result of our lawsuit against Sony and Microsoft. We anticipate that capital expenditures for the year ended December 31, 2003 will total approximately $500,000 in connection with anticipated upgrades to operations and infrastructure. To the extent we raise additional capital through debt or equity financing, this could result in substantial dilution for our stockholders. If we acquire one or more businesses, patents or products, our cash or capital requirements could increase substantially. In the event of such an acquisition or should any unanticipated circumstances arise which significantly increase our capital requirements, we may elect to raise additional capital through debt or equity financing. Although we expect to be able to raise additional capital, 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, 2002 (in thousands):

Contractual Obligations	Total	Less than 1year	1 - 3 years	4 - 5 years	After 5 years
Long-Term Debt	$ 87	$ 61	$ 20	$ 6	$ —
Capital Lease Obligations	53	30	23	—	—
Operating Leases	4,417	1,214	2,065	653	485
Total Contractual Cash Obligations	$4,557	$1,305	$2,108	$659	$485

There were no material changes to our contractual cash obligations and other commercial commitments during the quarter ended March 31, 2003.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). The preparation of these 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, including those related to revenue recognition, bad debts, warranty obligations, patents and intangible assets, inventories, contingencies, and litigation. We base our estimates 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.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

We recognize revenues in accordance with applicable accounting standards including Staff Accounting Bulletin (“SAB”) No. 101, “Revenue Recognition in Financials Statements” and the American Institute of Certified Public Accountants’ (the “AICPA”) Statement of Position 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 principle sources: royalties, product sales, and development contracts. We recognize royalty and license revenue based on royalty reports or related information received from the licensee as well as time-based licenses of our intellectual property portfolio. Up-front payments under license agreements are deferred and recognized as revenue based on either the royalty reports received or amortized over the license period depending on the nature of the agreement. Advance payments under license agreements that also require the Company to provide future services to the licensee are deferred and recognized over the service period when vendor specific objective evidence related to the value of the services does not exist. If the information received from our licensees regarding royalties is incorrect or inaccurate, it could adversely affect revenue in future periods. To date all information received from our licensees has caused no material reduction in future period revenues. We recognize revenues from product sales when the product is shipped provided collection is determined to be probable and no significant obligation remains. Development contract revenues are recognized under the cost-to-cost percentage of completion accounting method based on physical completion of the work to be performed. Losses on contracts are recognized when determined. Revisions in estimates are reflected in the period in which the conditions become known. Our revenue recognition policies are significant because our revenue is 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.

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 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.

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

We have acquired patents and other intangibles. Our business acquisitions typically result in goodwill and other intangible assets. We assess the recoverability of our goodwill and other intangible assets and we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets that affect our consolidated financial statements. If these estimates or related assumptions change in the future, we may be required to record impairment charges for these assets, in addition, changes could affect the amount of future period amortization expense that we will incur.

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 generally accepted accounting principles in the United States of America, 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. See our consolidated financial statements included elsewhere in this Annual Report which contains accounting policies and other disclosures required by GAAP.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2002, the FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities," which addresses accounting for restructuring and similar costs. SFAS 146 supersedes previous accounting guidance, principally Emerging Issues Task Force Issue No. 94-3. The Company has adopted the provisions of SFAS 146 for restructuring activities initiated after December 31, 2002. SFAS 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under issue 94-3, a liability for an exit cost would be recognized at the date of the Company's commitment to an exit plan. SFAS 146 also establishes that the liability should be measured and recorded at fair value. Accordingly, SFAS 146 may affect the timing of recognizing future restructuring costs as well as the amounts recognized. The adoption of SFAS 146 did not impact our financial position, results of operations or cash flows.

In November 2002, the EITF reached a consensus on Issue No. 00-21 "Accounting for Revenue Arrangements with Multiple Deliverables". The EITF concluded that revenue arrangements with multiple elements should be divided into separate units of accounting if the deliverables in the arrangement have value to the customer on a standalone basis, if there is objective and reliable evidence of fair value of the undelivered elements, and as long as there are no rights of return or additional performance guarantees by the Company. The provisions of EITF Issue No. 00-21 are applicable to agreements entered into in fiscal periods beginning after June 15, 2003. We are currently determining what effect, if any, the provisions of EITF Issue No. 00-21 will have on our operating results or financial condition.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure." The statement amends SFAS No. 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. We adopted the disclosure provisions of SFAS No. 148 at December 31, 2002. We have not yet determined the effect that the transition provisions of SFAS No. 148 would have on our operating results or financial position, if any.

FACTORS THAT MAY AFFECT FUTURE RESULTS

WE HAD AN ACCUMULATED DEFICIT OF $80 MILLION AS OF MARCH 31, 2003, HAVE A HISTORY OF LOSSES, WILL EXPERIENCE LOSSES IN THE FUTURE AND MAY NOT ACHIEVE OR MAINTAIN PROFITABILITY.

Since 1997, we have incurred losses in every fiscal quarter. We will need to generate significant revenue to achieve and maintain profitability. We anticipate that our expenses will increase in the foreseeable future as we:

- protect and enforce our intellectual property, including the costs of our litigation against Sony and Microsoft;
- continue to develop our technologies;
- attempt to expand the market for touch-enabled products;
- increase our sales efforts; and
- pursue strategic relationships.

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

OUR CURRENT LITIGATION AGAINST MICROSOFT AND SONY IS EXPENSIVE, DISRUPTIVE AND TIME CONSUMING AND WILL CONTINUE TO BE, AND IF WE ARE NOT SUCCESSFUL, COULD ADVERSELY AFFECT OUR BUSINESS.

On February 11, 2002, we filed a complaint against Microsoft Corporation, Sony Computer Entertainment, Inc., and Sony Computer Entertainment of America, Inc. in the U.S. District Court for the Northern District Court of California alleging infringement of U.S. Patent Nos. 5,889,672 and 6,275,213. The case was assigned to United States District Judge Claudia Wilken. On April 4, 2002, Sony Computer Entertainment and Microsoft 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. The process of discovery and exchanging information and documents on infringement, invalidity, and claim construction, is ongoing. On October 8, 2002, we filed an amended complaint, withdrawing the claim under the ‘672 patent and adding claims under a new patent, U.S. Patent No. 6,424,333. On October 10, 2002, the Court entered an Amended Case Management Order that set, among other dates in the case, April 25, 2003 for a hearing to construe the claims of the asserted patents and April 5, 2004 for the start of trial. On October 28, 2002, Sony Computer Entertainment and Microsoft answered the amended complaint and alleged similar counterclaims for declaratory relief that the asserted patents are invalid, unenforceable, or not infringed. On March 21, 2003, Sony Computer Entertainment filed a motion for summary judgment of non-infringement. At Immersion’s request, the Court ordered this motion stricken, without prejudice to its being refiled at a later date after the Court rules on claim construction. On April 25, 2003, the Court held the scheduled claim construction hearing. It is anticipated that the Court will issue a written claim construction decision, though the timing of when the Court issues its ruling is within the Court’s discretion. Due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation. We anticipate that the litigation will continue to be costly, and there can be no assurance that we will be able to recover the costs we incur in connection with the litigation. The 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, the litigation could adversely affect our business. Further, any unfavorable outcome could adversely affect our business.

WE MAY ELECT TO RAISE ADDITIONAL CAPITAL IN THE FUTURE WHICH MAY RESULT IN SUBSTANTIAL DILUTION TO OUR STOCKHOLDERS.

Should any unanticipated circumstances arise which significantly increase our cash or capital requirements we may elect to raise additional capital to have a supply of cash for such events or future periods. Our plans to raise additional capital may include possible customer prepayments of certain royalty obligations in exchange for a royalty discount and/or other negotiated concessions, entering into new license agreements that require up-front license payments, and through debt or equity financing. We have taken measures to control our costs and will continue to monitor these efforts. We cannot be certain that additional financing will be available to us on favorable terms when required, or at all. Changes in equity markets over the past two years have adversely affected the ability of companies to raise equity financing and have adversely affected the markets for financing for companies with a history of losses such as ours. Additional financing may require us to issue additional shares of our common or preferred stock such that our existing stockholders may experience substantial dilution.

THE MARKET FOR 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 our touch-enabling technologies, and 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. We are currently working to increase the demand for these technologies and products in the following five principal application areas:

- touch-enabled medical simulators that can be used for training and skills assessment for procedures such as catheterization, bronchoscopy, colonoscopy, sigmoidoscopy and laparoscopic procedures;

- touch-enabled peripherals for computer gaming on personal computers and dedicated gaming consoles;

- touch-enabled automotive interfaces;
- touch-enabled, whole-hand sensing gloves, such as our CyberForce product;
- cursor control peripherals, such as touch-enabled mice and trackballs, for use with personal computers; and
- touch-enabled personal electronics, such as cell phones and PDAs.

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 and end users about the uses and benefits of our technologies and to persuade software developers to create software that utilizes our technologies.

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 of payments under fixed and/or up-front license agreements;
- the timing of our expenses, including costs related to litigation, acquisitions of technologies or businesses;
- the timing of introductions of new products and product enhancements by us, our licensees or their competitors;
- our ability to develop and improve our technologies;
- our ability to attract, integrate and retain qualified personnel; and
- seasonality in the demand for our licensees' products.

Accordingly, we believe that period-to-period comparisons of our operating results should not be relied upon as an indicator of our future performance. In addition, because a high percentage of our operating expenses are fixed, a shortfall of revenues can cause significant variations in operating results from period to period.

IF WE ARE UNABLE TO ENTER INTO NEW LICENSING ARRANGEMENTS WITH OUR EXISTING LICENSEES AND WITH ADDITIONAL THIRD-PARTY MANUFACTURERS FOR OUR TOUCH-ENABLING TECHNOLOGY, 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 licensing arrangements will cause our operating results to suffer. We face numerous risks in obtaining new licenses on terms consistent with our business objectives and in maintaining, expanding and supporting our relationships with our current licensees. These risks include:

- the lengthy and expensive process of building a relationship with potential licensees;
- the fact that we may compete with the internal design teams of existing and potential licensees;
- difficulties in persuading consumer 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 in persuading existing and potential licensees to bear the development costs necessary to incorporate our technologies into their products; and
- challenges in demonstrating the compelling value of our technologies in new applications like cell phones and automobiles.

A substantial majority of our current royalty revenue has been derived from the licensing of our portfolio of touch-enabling technologies for personal computer gaming peripherals, such as joysticks and steering wheels. The market for joysticks and steering wheels for use with personal computers is a substantially smaller market than either the mouse market or the dedicated gaming console market and is characterized by declining average selling prices. If we are unable to gain market acceptance beyond the personal computer gaming peripherals market, we may not achieve royalty revenue growth.

OUR RELATIONSHIP WITH MEDTRONIC, A LEADING MEDICAL DEVICE COMPANY, MAY INTERFERE WITH OUR ABILITY TO ENTER INTO DEVELOPMENT AND LICENSING RELATIONSHIPS WITH MEDTRONIC'S COMPETITORS.

In February 2003, we entered into an agreement with Medtronic, a leading medical device company, in which Medtronic was granted a right of first negotiation. The right of first negotiation applies to any agreement ("Proposed Agreement") under which we would grant a third party, rights to use specified Immersion intellectual property in specified fields of use. Under the terms of the right of first negotiation, we must notify Medtronic if we have received a written offer from a third party to enter into a Proposed Agreement, or if we are seeking to find a third party to enter into a Proposed Agreement. Medtronic has the exclusive right, for a period of forty days, to negotiate with us regarding the material terms of the Proposed Agreement. If during such forty-day period, Medtronic and Immersion fail to reach agreement in principle upon the material terms of the Proposed Agreement, then we will have twelve months after the expiration of such forty day period to enter into an agreement with the applicable third party, provided that the terms of such agreement are in the aggregate more favorable to Immersion than the offer presented by Medtronic or the terms under which we initially sought to find a third party to enter into the Proposed Agreement. The right of first negotiation ceases to apply to any Proposed Agreement for which Medtronic and Immersion reach agreement in principle upon the material terms during the applicable forty-day period, but thereafter do not execute a definitive agreement within 145 days after the expiration of such forty-day period. In addition, Medtronic's right of first negotiation terminates upon the second anniversary of the completion of a development project to be undertaken by us for Medtronic. Although the right of first negotiation has not impeded our ability to interest other medical device companies in our technologies to date, this right of first negotiation or our relationship with Medtronic may impede, restrict or delay our ability to enter into development or license agreements with large medical device companies that compete with Medtronic. Any restriction in our ability to enter into development or license agreements with other medical device companies would adversely affect our revenues.

MEDTRONIC ACCOUNTS FOR A LARGE PORTION OF OUR REVENUES AND A REDUCTION IN SALES TO MEDTRONIC, A REDUCTION IN DEVELOPMENT WORK, OR A DECISION NOT TO RENEW EXISTING LICENSES BY MEDTRONIC MAY REDUCE OUR TOTAL REVENUE.

For the quarters ended March 31, 2003 and 2002 we derived 4% and 11%, respectively, of our net revenues from Medtronic. If our product sales to Medtronic decline, and/or Medtronic reduces the development activities we perform then our total revenues may decline. In addition, under our recent agreements with Medtronic, monies advanced by Medtronic are subject to refund provisions under certain circumstances. These circumstances have not arisen to date, but we cannot predict whether these circumstances will arise in the future.

LOGITECH ACCOUNTS FOR A LARGE PORTION OF OUR ROYALTY REVENUE AND THE FAILURE OF LOGITECH TO ACHIEVE SALES VOLUMES FOR ITS GAMING AND CURSOR CONTROL PERIPHERAL PRODUCTS THAT INCORPORATE OUR TOUCH-ENABLING TECHNOLOGIES MAY REDUCE OUR ROYALTY REVENUE.

Logitech has in the past and may in the future account for a large portion of our royalty revenue. For the quarter ended March 31, 2003 our revenues from Logitech significantly declined as compared to the same period during 2002. For the quarter ended March 31, 2003 we derived 0% of our net revenues and 1.9% of our royalty and license revenue from Logitech, and for the quarter ended March 31, 2002, we derived 9% of our net revenue and 36% of our royalty and license revenue from Logitech. We expect that a significant portion of our total revenues will continue to be derived from Logitech. If Logitech fails to achieve anticipated sales volumes for its computer peripheral products that incorporate our technologies, our royalty revenue would be reduced.

THE RECENT SLOWDOWN IN PERSONAL COMPUTER SALES MAY LEAD TO A REDUCTION IN SALES OF OUR LICENSEES' TOUCH-ENABLED PERIPHERAL PRODUCTS, SUCH AS TOUCH-ENABLED MICE AND JOYSTICKS, WHICH MAY ADVERSELY AFFECT OUR ROYALTY REVENUE.

Over the past year, large personal computer manufacturers have announced slower than anticipated sales of personal computers. This slowdown in personal computer sales may adversely affect sales of our licensees' royalty bearing, touch-enabled peripheral products, such as touch-enabled mice and joysticks, that are used with personal computers. The slowdown affecting personal computer companies may also make it more difficult to persuade such manufacturers to incorporate more costly touch-enabled mice products into their product lines. The impact of this downturn on our royalty revenue may be more pronounced if a significant cause of this trend is a reduction in the amount that individuals and companies have budgeted for personal computer-related devices, such as touch-enabled mice, rather than saturation of the market for personal computers generally. As a result, our results of operations and financial condition may be adversely affected.

WE MAY BE UNABLE TO INCREASE SALES OF OUR MEDICAL SIMULATION DEVICES IF, AS A RESULT OF THE CURRENT ECONOMIC SLOWDOWN OR OTHER FACTORS, MEDICAL INSTITUTIONS DO NOT BUDGET FOR SUCH DEVICES.

Our medical simulation products, such as our AccuTouch Endoscopy Simulator, the AccuTouch Endovascular Simulator and our Laparoscopic Surgical Workstation, have only recently begun to be used by hospitals and medical schools to train healthcare professionals. As a result, many of these medical institutions do not budget for such simulation devices. To increase sales of our simulation devices, we must, in addition to convincing medical institution personnel of the utility 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 the economic slowdown, cost-containment pressures or other factors, we may not be able to increase sales of medical simulators at a satisfactory rate. As a result of the terrorist attacks against the United States on September 11, 2001 and the continuing threat of terrorist acts, hospitals may have assigned priority in their capital expenditure budgets to equipment that will enable them to respond more effectively to catastrophic emergencies, and federal, state and local governments may have delayed certain funding for medical and educational institutions, in which case purchases of medical simulators may have been deferred. If we are unable to increase sales of our medical simulation products, our results of operations and financial condition may be adversely affected. We believe that medical device companies may also decrease their expenditures in corporate research and development budgets and this may adversely affect our contract and development revenue generated by the medical segment.

WE DO NOT CONTROL OR INFLUENCE OUR LICENSEES’ MANUFACTURING, PROMOTION, DISTRIBUTION OR PRICING OF THEIR PRODUCTS INCORPORATING OUR TOUCH-ENABLING TECHNOLOGIES, UPON WHICH WE ARE DEPENDENT TO 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 quarters ended March 31, 2003 and 2002, 22% and 26% of our total revenues were royalty and license revenues. However, we do not control or influence the manufacture, quality control, promotion, distribution or pricing of products that are manufactured and sold by our licensees. In addition, we generally do not have commitments from our licensees that they will continue to use our technology in 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 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.

Peak demand for products that incorporate our technologies, especially in the computer gaming peripherals market, typically occurs in the third and fourth calendar quarters as a result of increased demand during the year-end holiday season. If our licensees do not ship licensed products 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.

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

We believe that the current economic downturn has led to a reduction in corporations’ budgets for research and development in several sectors, including the automotive and aerospace sectors, which use our three-dimensional and professional products. Sales of our three-dimensional and professional products, including our CyberGlove line of whole-hand sensing gloves and our MicroScribe G2 line of three-dimensional digitizers may be adversely affected by these cuts in corporate research and development budgets.

WE HAVE LIMITED DISTRIBUTION CHANNELS AND RESOURCES TO MARKET AND SELL OUR MEDICAL SIMULATION AND THREE-DIMENSIONAL SIMULATION 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 or three-dimensional simulation 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 and three-dimensional simulation products will depend upon our ability to retain and develop a qualified sales force and effective distributor channels. We may not be successful in attracting and retaining the personnel necessary to sell and market our simulation products. A number of our distributors represent small-specialized companies that may not have sufficient capital or human resources to support the complexities of selling and supporting simulation products. There is no assurance that our direct selling efforts will be effective, distributors will market our products successfully or, if our relationships with distributors terminate, we will be able to establish relationships with other distributors on satisfactory terms, if at all. Any disruption in the distribution, sales or marketing network for our simulation products could have a material adverse effect on our product revenues.

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, could result in the expenditure of significant financial resources and the diversion of 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 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 technology or require us to enter into royalty or license agreements even before the issue of infringement has been decided on the merits. If any litigation were not resolved in our favor, we could become subject to substantial damage claims from third parties and indemnification claims from our licensees. We and our licensees could be enjoined from the continued use of the technology at issue without a royalty or license agreement. Royalty or license agreements, if required, might not be available on acceptable terms, or at all. If a third party claiming infringement against us prevailed and we could not develop non-infringing technology or license the infringed or similar technology on a timely and cost-effective basis, our expenses would increase and our revenues could decrease.

We attempt to avoid infringing known proprietary rights of third parties. However, third parties may hold, or may in the future be issued, patents that could be infringed by our products or technologies. Any of these third parties might make a claim of infringement against us with respect to the products that we manufacture and the technologies that we license. From time to time, we have received letters from companies, several of which have significantly greater financial resources than we do, asserting that some of our technologies, or those of our licensees, infringe their intellectual property rights. Certain of our licensees have received similar letters from these or other companies. Such letters may influence our licensees’ decisions whether to ship products incorporating our technologies. Although none of these matters has resulted in litigation to date, any of these notices, or additional notices that we could receive in the future from these or other companies, could lead to litigation.

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 technology 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 technology unless we can enter into royalty or licensing agreements. Royalty or licensing agreements might not be available on terms acceptable to us or at all. Furthermore, claims could also result in claims from our licensees under the indemnification provisions of their agreements with us.

IF WE FAIL TO PROTECT AND ENFORCE OUR INTELLECTUAL PROPERTY RIGHTS, OUR ABILITY TO

LICENSE OUR TECHNOLOGIES AND TO 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. If we are not able to protect and enforce those rights, our ability to obtain future licenses and royalty revenue could be impaired. In addition, if a court were to limit the scope of, declare unenforceable or invalidate any of our patents, current licensees may refuse to make royalty payments or may themselves choose to challenge one or more of our patents. Also it is 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 our licensees do business.

We also rely on licenses, confidentiality 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 products and trademarks would be difficult, expensive and time-consuming, particularly overseas.

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

Claims that our products or our licensees’ products have flaws or other defects that lead to personal or other injury are common in the computer peripherals industry and medical fields. If products that we or our licensees sell cause personal 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 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, such as computer mice and 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.

BECAUSE WE HAVE A FIXED PAYMENT LICENSE WITH MICROSOFT, OUR ROYALTY REVENUE FROM LICENSING JOYSTICKS AND STEERING WHEELS IN THE GAMING MARKET MIGHT DECLINE IF MICROSOFT INCREASES ITS VOLUME OF SALES OF TOUCH-ENABLED JOYSTICKS AND STEERING WHEELS AT THE EXPENSE OF OUR OTHER LICENSEES.

Under the terms of our present agreement with Microsoft, Microsoft receives a perpetual, worldwide, irrevocable, non-exclusive license under our patents for Microsoft’s SideWinder Force Feedback Pro Joystick and its SideWinder Force Feedback Wheel, and for a future replacement version of these specific SideWinder products having essentially similar functional features. Instead of an ongoing royalty on Microsoft’s sales of licensed products, the agreement provided for a payment of $2.35 million, which we recognized in equal monthly increments over a one-year period that ended in mid-July 2000. We will not receive any further revenues or royalties from Microsoft under our current agreement with Microsoft. At the present time, we do not have a license agreement with Microsoft for products other than the SideWinder joystick and steering wheel. Microsoft has a significant share of the market for touch-enabled joysticks and steering wheels for personal computers. Microsoft has significantly greater financial, sales and marketing resources, as well as greater name recognition and a larger customer base, than our other licensees. In the event that Microsoft increases its share of this market, our royalty revenue from other licensees in this market segment might decline.

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

Personal computer gaming peripherals, computer mice and automotive controls incorporating our touch-enabling technologies are more expensive than similar competitive products that are not touch-enabled. Although major manufacturers, such as Logitech, Microsoft, ALPS Electric Co. and BMW, have licensed our technology, the greater expense of products containing our touch-enabling technologies as compared to non-touch-enabled products may be a significant barrier to the widespread adoption and sale of touch-enabled products.

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, which they believe do not require a license under our intellectual property. These potential competitors may have significantly greater financial, technical and marketing resources than we do, and the costs associated with asserting our intellectual property rights against such products and such potential competitors could be significant. Moreover, if such alternative designs were determined by a court not to require a license under our intellectual property rights, competition from such unlicensed products could limit or reduce our revenues.

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

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

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

Our initiatives to develop new and enhanced technologies and to commercialize these technologies for new applications and new platforms may not be successful. Any new or enhanced technologies may not be favorably received by consumers and could damage our reputation or our brand. Expanding our technology could also require significant additional expenses and strain our management, financial and operational resources. Moreover, technology products generally have relatively short product life cycles and our current products may become obsolete in the future. Our ability to generate revenues will be harmed if we:

- fail to develop new technologies;
- our new technologies fail to gain market acceptance; or
- our current products become obsolete.

WE DEPEND ON A SINGLE SUPPLIER TO PRODUCE SOME OF OUR MEDICAL SIMULATORS AND MAY LOSE CUSTOMERS IF THIS SUPPLIER DOES NOT MEET OUR REQUIREMENTS.

We have one supplier for some of our custom medical simulators. Our custom Immersion Medical simulators improve the performance and training of medical personnel. Any disruption in the manufacturing process from our sole supplier could adversely affect the Company's ability to deliver our products, ensure quality workmanship and could result in a reduction of the Company's product sales.

MEDICAL LICENSING AND CERTIFICATION AUTHORITIES MAY NOT ENDORSE OR REQUIRE USE OF

OUR TECHNOLOGIES FOR TRAINING 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 endorsing particular medical methodologies, including medical training methodologies, for use by medical professionals. In the event that the ABIM and the ACC, as well as other, similar bodies, do not endorse our medical simulation training products as a training vehicle, market penetration for our products could be significantly and adversely affected.

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

The product development process for automobiles is very lengthy. We do not earn per unit royalty revenue on our automotive technologies unless, and until, automobiles featuring our technologies are shipped to customers, which may not occur until several years after we enter into an agreement with an automobile manufacturer. Throughout the product development process, we face the risk that an automobile manufacturer or supplier may delay the incorporation of, or choose not to incorporate, our technologies into its automobiles, making it difficult for us to predict the per unit automotive royalties we may receive, if any.

VICTOR VIEGAS, OUR PRESIDENT, CHIEF EXECUTIVE OFFICER, CHIEF FINANCIAL OFFICER AND DIRECTOR, RECENTLY BECAME THE CHIEF EXECUTIVE OFFICER AND DIRECTOR OF THE COMPANY AND IF THERE ARE DIFFICULTIES WITH THIS LEADERSHIP TRANSITION IT COULD IMPEDE THE EXECUTION OF OUR BUSINESS STRATEGY

Victor Viegas, our President, Chief Executive Officer, Chief Financial Officer and Director, took over the duties of Chief Executive Officer and Director in October 2002. Our success will depend to a significant extent on his ability to implement a successful strategy, to successfully lead and motivate our employees, and to work effectively with our executive staff and board of directors. If this leadership transition is not successful, our ability to execute our business strategy would be impeded.

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

Our ability to develop and deploy our technologies and to sustain our revenue growth depends upon the continued service of our executive officers and other key personnel and upon hiring additional key personnel. A number of employees of our subsidiaries, including several members of these subsidiaries senior management, have departed since the acquisitions were completed. It may not be possible to retain enough key employees of our subsidiaries to operate these businesses effectively.

We may hire additional sales, support, marketing and research and development personnel. We may not be able to attract, assimilate or retain additional highly qualified personnel in the future. Our executive officers and key employees hold stock options with exercise prices considerably above the current market price of our common stock. In addition, merit increases were suspended for fiscal 2002. Each of these factors may impair our ability to retain the services of our executive officers and key employees. Our technologies are complex and we rely upon the continued service of our existing engineering personnel to support licensees, enhance existing technology and develop new technologies.

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.

Certain stockholders hold a substantial amount of our outstanding common 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.

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

Our hardware and software technology for personal computer peripheral products that incorporate our touch-enabling technologies is currently compatible with Microsoft's Windows 98, Windows 2000, Windows Me and Windows XP operating systems software, including DirectX, Microsoft's entertainment applications programming interface. If Microsoft modifies its operating system, including DirectX, we may need to modify our technologies 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 be increased and our revenues could decline.

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

There have been regulatory changes, including the Sarbanes-Oxley Act of 2002, and there may potentially be new accounting pronouncements or additional regulatory rulings which will have an impact on our future financial position and results of operations. The Sarbanes-Oxley Act of 2002 and other rule changes as well as proposed legislative initiatives following the Enron bankruptcy are likely to increase general and administrative costs. In addition, insurers are likely to increase premiums as a result of high claims rates over the past year, which we expect will increase our premiums for our various insurance policies. Further, proposed initiatives are expected to result in changes in certain accounting rules, including legislative and other proposals to account for employee stock options as a compensation expense. These and other potential changes could materially increase the expenses we report under generally accepted accounting principles, and adversely affect our operating results.

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. 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. In addition, 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. Any such loss at our facilities could disrupt our operations, delay production, shipments and revenue 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.

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 change may place significant strains on our managerial, financial, engineering and 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.

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 acquired, 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 an exchange of our securities, our stockholders could suffer significant dilution. Acquisitions could also create risks for us, including:

- unanticipated costs associated with the acquisitions;
- use of substantial portions of our available cash to consummate the acquisitions;
- diversion of management's attention from other business concerns;
- difficulties in assimilation of acquired personnel or operations; and
- potential intellectual property infringement claims related to newly acquired product lines.

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

WE COULD LOSE SOME OR ALL OF THE INVESTMENT THAT WE HAVE MADE IN AN EARLY STAGE TECHNOLOGY COMPANY IF THAT COMPANY IS NOT SUCCESSFUL IN DEVELOPING ITS TECHNOLOGIES OR UNABLE TO OBTAIN ADDITIONAL FINANCING IF AND WHEN NEEDED.

From time to time we have made strategic investments in early stage technology companies that are developing technologies that we believe could complement or enhance our own technologies, if successful. We have made these investments to provide funding for the development of these companies technologies primarily because of the anticipated benefits to Immersion of the availability of these technologies. The prospect of realizing a substantial return on these investments was a secondary, though important, consideration. We wrote down $1.2 million of these investments in the third quarter of 2002, and in the third quarter of 2001 we wrote down $4.3 million of these investments and approximately $239,000 of interest receivable from these companies, and do not expect to realize any return on these amounts. Our remaining investment may not succeed in developing its technology, might be unsuccessful in marketing its technology or products based on its technology or might fail for any number of other reasons, including an inability to obtain additional capital if required to fund operations, including the completion of the development of its technology. In the event that this company in which we have invested fails or does not achieve a level of success that permits us to realize the value of this investment, we could experience a complete or partial loss on some or all of this investment. If we experience additional losses and related write-downs on the carrying value of our remaining investment, it would decrease our assets and increase our losses.

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

In re Immersion Corporation

We are involved in legal proceedings relating to a class action lawsuit filed on November 9, 2001. The case is now designated as 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 action was filed in the United States District Court, Southern District of New York, against defendants Immersion Corporation, Louis Rosenberg (former Chief Executive Officer, President and Chairman of the Company), Victor Viegas (current President, Chief Executive Officer and Chief Financial Officer), Bruce Schena (former Chief Technology Officer and Director); and certain underwriters of Immersion's November 12, 1999 initial public offering. Subsequently, two of the individual defendants stipulated to a dismissal without prejudice. The case is purportedly brought on behalf of all persons who purchased the Company's common stock from November 12, 1999 through December 6, 2000.

The lawsuit has been consolidated for pretrial purposes with similar lawsuits relating to more than 300 other initial public offerings conducted in 1999 and 2000 before the Honorable Judge Shira A. Scheindlin. On May 29, 2002, plaintiffs electronically served an amended complaint. The amended complaint alleges violations of 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 prospectus incorporated in the registration statement for the Company's initial public offering failed to disclose, among other things, that (i) the underwriter had solicited and received excessive and undisclosed commissions from certain investors in exchange for which the underwriter allocated to those investors material portions of the shares of the Company's stock sold in the offering; and (ii) the underwriter had entered into agreements with customers whereby the underwriter agreed to allocate shares of the Company's stock sold in the offering to those customers in exchange for which the customers agreed to purchase additional shares of the Company's stock in the aftermarket at pre-determined prices. The amended complaint appears to allege that false or misleading analyst reports were issued. The amended complaint does not claim any specific amount of damages.

On July 15, 2002, the Company (as well as the other issuers and their affiliated individual defendants) filed a motion to dismiss. On February 19, 2003, the motion was granted in part and denied in part. The motion was denied as to claims under the Securities Act of 1933 in the case involving the Company, as well as all other cases (except for 10 cases). The motion was denied as to the claim under Section 10(b) of the Securities Exchange Act of 1934 as to the Company, on the basis that the complaint alleged that the Company had made acquisition(s) following the initial public offering. The motion was granted as to the claim under Section 10(b) of the Securities Exchange Act, but denied as to the claim under Section 20(a) of that Act, as to the remaining individual defendant. We intend to vigorously defend against this litigation.

OUR STOCK MAY BE VOLATILE.

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; new products or new contracts; sales or the perception in the market of possible sales of large number of shares of Immersion common stock by insiders or others; changes in securities analysts' recommendations; changing circumstances regarding competitors or their customers; governmental regulatory action; developments with respect to patents or proprietary rights; inclusion in or exclusion from various stock indices; and general market conditions. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has been initiated against that company, such as the suit currently filed against us.

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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

We have equity investments in several privately-held companies. We intend to hold our equity investments for the long term and will monitor whether there has been other-than-temporary declines in their values based on management's estimates of their net realizable value taking into account the companies respective financial condition and ability to raise third-party financing. If the decline in fair value is determined to be other-than-temporary, an impairment loss is recorded and the individual security is written down to a new cost basis. As a result of our review, of the fair value of these investments, we recorded an impairment loss of $1.2 million in the third quarter of 2002. The remaining cost basis of these investments on our Consolidated Balance Sheet is $1.0 million. We will monitor the remaining value of these investments, and may determine that there could be other impairment losses in the future. As of March 31, 2003 management has determined that the carrying value of these investments at $1.0 million is appropriate.

ITEM 4. CONTROLS AND PROCEDURES

(a) Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined under Rule 13a-14(c) promulgated under the Securities Exchange Act of 1934, as amended, within the 90 day period prior to the filing date of this report. Based on their evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective.

(b) There have been no significant changes (including corrective actions with regard to significant deficiencies or material weaknesses) in our internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation referenced in paragraph (a) above.

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. The case is now designated as 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 action was filed in the United States District Court, Southern District of New York, against defendants Immersion Corporation, Louis Rosenberg (former Chief Executive Officer, President and Chairman of the Company), Victor Viegas (current President, Chief Executive Officer and Chief Financial Officer), Bruce Schena (former Chief Technology Officer and Director); and certain underwriters of Immersion's November 12, 1999 initial public offering. Subsequently, two of the individual defendants stipulated to a dismissal without prejudice. The case is purportedly brought on behalf of all persons who purchased the Company's common stock from November 12, 1999 through December 6, 2000.

The lawsuit has been consolidated for pretrial purposes with similar lawsuits relating to more than 300 other initial public offerings conducted in 1999 and 2000 before the Honorable Judge Shira A. Scheindlin. On May 29, 2002, plaintiffs electronically served an amended complaint. The amended complaint alleges violations of 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 prospectus incorporated in the registration statement for the Company's initial public offering failed to disclose, among other things, that (i) the underwriter had solicited and received excessive and undisclosed commissions from certain investors in exchange for which the underwriter allocated to those investors material portions of the shares of the Company's stock sold in the offering; and (ii) the underwriter had entered into agreements with customers whereby the underwriter agreed to allocate shares of the Company's stock sold in the offering to those customers in exchange for which the customers agreed to purchase additional shares of the Company's stock in the aftermarket at pre-determined prices. The amended complaint appears to allege that false or misleading analyst reports were issued. The amended complaint does not claim any specific amount of damages.

On July 15, 2002, the Company (as well as the other issuers and their affiliated individual defendants) filed a motion to dismiss. On February 19, 2003, the motion was granted in part and denied in part. The motion was denied as to claims under the Securities Act of 1933 in the case involving the Company, as well as to all other cases (except for 10 cases). The motion was denied as to the claim under Section 10(b) of the Securities Exchange Act of 1934 as to the Company, on the basis that the complaint alleged that the Company had made acquisition(s) following the initial public offering. The motion was granted as to the claim under Section 10(b) of the Securities Exchange Act, but denied as to the claim under Section 20(a) of that Act, as to the remaining individual defendant. Management believes that the claims against the Company and individual defendants are without merit and intends to vigorously defend against them.

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

On February 11, 2002, we filed a complaint against Microsoft Corporation, Sony Computer Entertainment, Inc., and Sony Computer Entertainment of America, Inc. in the U.S. District Court for the Northern District Court of California alleging infringement of U.S. Patent Nos. 5,889,672 and 6,275,213. The case was assigned to United States District Judge Claudia Wilken. On April 4, 2002, Sony Computer Entertainment and Microsoft 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. The process of discovery and exchanging information and documents on infringement, invalidity, and claim construction, is ongoing. On October 8, 2002, we filed an amended complaint, withdrawing the claim under the '672 patent and adding claims under a new patent, U.S. Patent No. 6,424,333. On October 10, 2002, the Court entered an Amended Case Management Order that set, among other dates in the case, April 25, 2003 for a hearing to construe the claims of the asserted patents and April 5, 2004 for the start of trial. On October 28, 2002, Sony Computer Entertainment and Microsoft answered the amended complaint and alleged similar counterclaims for declaratory relief that the asserted patents are invalid, unenforceable, or not infringed. On March 21, 2003, Sony Computer Entertainment filed a motion for summary judgement of non-infringement. At Immersion's request, the Court ordered this motion stricken, without prejudice to its being refiled at a later date after the Court rules on claim construction. On April 25, 2003, the Court held the scheduled claim construction hearing. It is anticipated that the Court will issue a written claim construction decision, though the timing of when the Court issues its ruling is within the Court's discretion. Due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation. We anticipate that the litigation will continue to be costly, and there can be no assurance that we will be able to recover the costs we incur in connection with the litigation. The 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, the litigation could adversely affect our business. Further, any unfavorable outcome could adversely affect our business.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

The following exhibits are filed herewith:

Exhibit Number	Description
99.1	Certification of Victor Viegas, President, Chief Executive Officer, Chief Financial Officer and Director, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

None

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.

IMMERSION CORPORATION
Registrant

Date: May 14, 2003

/s/ Victor Viegas

Victor Viegas
President, Chief Executive Officer,
Chief Financial Officer and Director

CERTIFICATIONS

I, Victor Viegas, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Immersion Corporation;

2 Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ Victor Viegas

Victor Viegas
President, Chief Executive Officer,
Chief Financial Officer and Director

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EXHIBIT INDEX

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Exhibit 99.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Immersion Corporation (the “Company”) on Form 10-Q for the period ending March 31, 2003 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Victor Viegas, President, Chief Executive Officer, Chief Financial Officer and Director of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that based on my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Victor Viegas

Victor Viegas
President, Chief Executive Officer,
Chief Financial Officer and Director

May 14, 2003