U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarter ended March 31, 2001

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (no fee required)

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. employee Identification No.)
801 Fox Lane, San Jose, California	95131
(Address of principal executive offices)	(Zip code)

Issuer's telephone number: (408) 467-1900

Check whether the Issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 [ ]

Number of shares of Common Stock outstanding at May 4, 2001: 18,642,151.

IMMERSION CORPORATION

INDEX

Page

PART I
FINANCIAL INFORMATION

PART II
OTHER INFORMATION

PART I
FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

IMMERSION CORPORATION

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

ASSETS	March 31, 2001 (Unaudited)	December 31, 2000(1)
Current assets:		
Cash and cash equivalents	$ 20,041	$ 23,474
Short-term investments	1,000	2,360
Accounts receivable, (net of allowances for doubtful accounts of: 2001, $227; and 2000, $227)	4,367	3,675
Inventories	1,766	1,709
Prepaid expenses and other current assets	1,129	1,306
Total current assets	28,303	32,524
Property and equipment, net	3,553	3,606
Purchased intangibles and other assets, net	14,066	14,864
Other investments	6,500	6,500
Total assets	$ 52,422	$ 57,494
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,214	$ 1,720
Accrued compensation	910	1,042
Other current liabilities	1,580	2,077
Current portion of long-term debt	102	100
Current portion of capital lease obligation	21	20
Total current liabilities	3,827	4,959
Long-term debt	4,003	3,835

Capital lease obligation, less current portion	63	68
Warrant liability	272	289
Total liabilities	8,165	9,151
Stockholders' equity:		
Common stock - $0.001 par value; 100,000,000 shares authorized; shares issued and outstanding: 18,544,593 and 18,476,061 respectively	89,374	89,334
Warrants	1,990	1,990
Deferred stock compensation	(4,737)	(5,255)
Accumulated other comprehensive income	39	40
Note receivable from stockholder	-	(17)
Accumulated deficit	(42,409)	(37,749)
Total stockholders' equity	44,257	48,343
Total liabilities and stockholders' equity	$ 52,422	$ 57,494

(1) The balance sheet at December 31, 2000 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.

See accompanying Notes to Condensed Consolidated Financial Statements.

IMMERSION CORPORATION

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

(Unaudited)

	Three Months Ended March 31,	
	2001	2000
Revenues:		
Royalty revenue	$ 1,489	$ 875
Product sales	3,007	1,751
Development contracts and other	865	662
Total revenues	5,361	3,288
Costs and expenses:		
Cost of product sales	1,784	836
Sales and marketing	3,058	1,888
Research and development	2,053	1,410
General and administrative	2,060	1,716
Amortization of intangibles and deferred stock compensation *	1,252	709
Acquisition related charges	25	887
Total costs and expenses	10,232	7,446
Operating loss	(4,871)	(4,158)
Interest and other income	398	762
Interest and other expense	(187)	(176)
Net loss	(4,660)	(3,572)
Basic and diluted net loss per share	$ (0.25)	$ (0.21)

Shares used in calculating basic and diluted net loss per share ...	18,448	17,034
	========	========

* Amortization of intangibles and deferred stock compensation		
Amortization of intangibles	$ 966	$ 408
Deferred stock compensation - sales and marketing	(9)	22
Deferred stock compensation - research and development	215	195
Deferred stock compensation - general and administrative ...	80	84
	--------	--------
Total	$ 1,252	$ 709
	========	========

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended March 31,	
	2001	2000
Cash flows from operating activities:		
Net loss	$ (4,660)	$ (3,572)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	308	74
Amortization of intangibles	966	408
Amortization of deferred stock compensation	286	264
Amortization of discounts on notes payable	119	-
Fair value adjustment for warrant liabilities	(17)	-
In-process research and development	-	887
Loss on disposal of equipment	7	-
Stock and options issued for consulting services and other	-	10
Non-cash interest expense	76	-
Changes in operating assets and liabilities:		
Accounts receivable	(694)	(140)
Inventories	(58)	(6)
Prepaid expenses and other assets	10	(300)
Accounts payable	(504)	(144)
Accrued liabilities	(258)	606
Deferred revenue and customer advances	(373)	(587)
	--------	--------
Net cash used in operating activities	(4,792)	(2,500)
	--------	--------
Cash flows from investing activities:		
Purchases of short-term investments	(1,008)	(15,481)
Sales and maturities of short-term investments	2,369	-
Purchases of property and equipment	(262)	(292)
Acquisitions, net of cash acquired	-	(581)
	--------	--------
Net cash provided by (used in) investing activities	1,099	(16,354)
	--------	--------
Cash flows from financing activities:		
Issuance of common stock	185	-
Exercise of stock options	87	33
Payments on notes payable and capital leases	(28)	-
Proceeds from shareholder note	17	-
	--------	--------
Net cash provided by (used in) financing activities	261	33
	--------	--------
Effect of exchange rates on cash and cash equivalents	(1)	-
	--------	--------
Net decrease in cash and cash equivalents	(3,433)	(18,821)
Adjustment for change in HT's fiscal year-end	-	998
Cash and cash equivalents:		
Beginning of the period	23,474	46,606
	--------	--------
End of the period	$ 20,041	$ 28,783
	========	========
Supplemental disclosure of cash flow information :		
Cash paid for taxes	$ 3	$ 1

Cash paid for interest	$ 24	$ -

(Continued)

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

	Three Months Ended March 31, 2001	2000
Supplemental disclosure of noncash investing and financing activities:		
Change in net unrealized gains (losses) from short-term investments	$ 1	$ (51)
Issuance of equity instruments for acquisition	$ -	$ 5,513

See accompanying Notes to Condensed Consolidated Financial Statements.

(Concluded)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation -- The accompanying unaudited condensed consolidated financial statements reflect all the normal recurring adjustments which are, in the opinion of management, necessary to present fairly the condensed consolidated financial position, statements of operations and cash flows for the interim periods presented.

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 2000 Annual Report on Form 10-K.

The results of operations for the interim period ended March 31, 2001 are not necessarily indicative of the results to be expected for the full year.

Recent Accounting Pronouncements -- Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, is effective for all fiscal years beginning after June 15, 2000. SFAS 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. Under SFAS 133, certain contracts that were not formerly considered derivatives may now meet the definition of a derivative. SFAS 133, as amended, requires the recognition of all derivative instruments as either assets or liabilities on the balance sheet measured at fair value. Gains or losses resulting from changes in the values of those derivatives would be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. The Company has adopted SFAS 133 effective January 1, 2001. The Company recorded no transition adjustment because there were no derivative financial instruments held by the Company at January 1, 2001, generally the Company does not utilize derivative financial instruments for any purposes or engage in any hedging activities.

Reclassifications -- Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications had no effect on net loss or stockholders' equity.

2. PURCHASED INTANGIBLES AND OTHER ASSETS, NET

	March 31, 2001	December 31, 2000
	(In thousands)	
Purchased patents and technology, net ..	$ 4,619	$ 4,645
Goodwill and other intangibles, net	9,364	10,136
Other assets	83	83
Total	$14,066	$14,864

3. INVENTORIES

	March 31, 2001	December 31, 2000
	(In thousands)	
Raw materials and subassemblies	$ 1,095	$ 1,287
Work in process	214	168
Finished goods	457	254
Total	$ 1,766	$ 1,709

4. PROPERTY AND EQUIPMENT

	March 31, 2001	December 31, 2000
	(In thousands)	
Computer equipment and purchased software ...	$ 1,905	$ 1,788
Machinery and equipment	1,628	1,601
Furniture and fixtures	1,383	1,314
Leasehold improvements	705	701
Total	5,621	5,404
Less accumulated depreciation	(2,068)	(1,798)
Property and equipment, net	$ 3,553	$ 3,606

5. 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, 2001	2000
Numerator:		
Net loss	$ (4,660)	$ (3,572)
Denominator:		
Weighted average common shares outstanding	18,511	17,123
Weighted average common shares held in escrow ..	(63)	(89)
Shares used in computation, basic and diluted ..	18,448	17,034
Net loss per share, basic and diluted	$ (0.25)	$ (0.21)

The Company's computation of net loss per share excluded 88,770 shares held in escrow until the conditions required to release the shares from escrow were satisfied. As of March 5, 2001 the shares were released from escrow.

6. COMPREHENSIVE LOSS

The following table sets forth the components of comprehensive loss:

	Three Months Ended March 31, 2001	2000
	(In thousands)	
Net loss	$ (4,660)	$ (3,572)
Foreign currency translation adjustment	(2)	-
Change in unrealized gains (losses) on short-term investments	1	(51)
Total comprehensive loss	$ (4,661)	$ (3,623)

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

The Company operates in one business segment, which is the design, development, production, marketing and licensing of products based on touch-enabling technology. These devices are used in computer entertainment, personal computing, medical and other professional computing applications. The Company's acquisitions during 2000 expanded its technology and product offerings and markets. In addition, the Company's CEO, who has been designated as the Company's chief operating decision maker, joined the Company in October 2000 and is currently evaluating the Company's reporting structure. The Company operates primarily in the United States and in Canada where it operates through its wholly-owned subsidiary, Immersion Canada. The following is a summary of revenues by geographic areas. Revenues are broken out geographically by the ship-to location of the customer.

REVENUE BY REGION

Geographic revenue as a percentage of total revenue was as follows:

	Three Months Ended March 31,	
	2001	2000
North America	74%	73%
Europe	12%	20%
Far East	14%	6%
Rest of the world	--%	1%
Total	100%	100%

We derived 71% and 73% of our total revenues from the United States for the three months ended March 31, 2001 and 2000 respectively. Revenues from other countries during the periods presented represented less than 10% individually.

SIGNIFICANT CUSTOMERS

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

	Three Months Ended March 31,	
	2001	2000
Customer A	14%	*
Customer B	12%	*
Customer C	*	18%
Total	26%	18%

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

As of March 31, 2001, customer A accounted for 17% of the Company's outstanding accounts receivables. The remaining

customers accounted for less than 10% of the Company's accounts receivable for the periods presented.

The majority of our 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, 2001 and December 31, 2000.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

This Quarterly Report on Form 10-Q contains 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. Except for the historical information contained in this discussion and analysis of financial condition and results of operations, the matters discussed herein are forward looking statements. These forward-looking statements include but are not limited to the Company's plans regarding increasing royalty revenue, royalty-bearing cursor control products, stimulating demand for touch-enabled products, expectations of gross margin, expenses, new product introduction, and the Company's liquidity and capital needs. These matters involve risks and uncertainties that could cause actual results to differ materially from the statements made. In addition to the risks and uncertainties described below in "Factors that May Affect Future Results," these risks and uncertainties may include consumer trends, business cycles, scientific developments, changes in governmental policy and regulation, currency fluctuations, economic trends in the United States and inflation. These and other factors may cause actual results to differ materially from those anticipated in forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof.

OVERVIEW

We develop hardware and software technologies that enable users to interact with computers using their sense of touch. We focus on four application areas -computing and entertainment, medical simulation, professional and industrial, and three-dimensional capture and interaction. 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 and steering wheels targeted at consumers. In addition, we are currently working on development projects with several automobile manufacturers and have licensed our technology to BMW for use in the controls of certain of its upcoming vehicles.

For lower-volume markets like medical simulation systems and three-dimensional capture and interaction 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 professionals in a variety of procedures. These devices simulate such procedures as intravenous catheterization, endovascular interventions and endoscopy. We also sell three-dimensional capture and interaction products. These consist primarily of our line of computer digitizing products, including the MicroScribe-3D and the LightScribe-3D, and specialized whole-hand sensing gloves, such as the CyberGlove, CyberGrasp and CyberForce, that permit simulated interaction with three-dimensional environments. In all market areas, we engage in development projects for third parties.

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.

In March 2000, we acquired all outstanding shares of Montreal-based Immersion Canada for approximately $6.8 million, consisting of 141,538 shares of our common stock and $338,000 paid in cash. Immersion Canada develops and markets hardware and software that brings the sense of touch to computing environments. As a result of the acquisition, Immersion Canada became a wholly-owned subsidiary of Immersion with operations in Montreal, Canada. The acquisition was accounted for using the purchase method and accordingly the acquired assets and liabilities were recorded at their fair market values at the date of acquisition.

In August 2000, we acquired Virtual Technologies Inc. ("VTI") for approximately $8.0 million, consisting of 320,584 shares of our common stock and $1.2 million paid in cash. VTI develops and markets hardware and software products that are used in high-end simulation, mechanical computer-aided design, visualization and motion-capture applications as well as research. As a result of the acquisition, VTI became a wholly-owned subsidiary of Immersion with operations in Palo Alto, California. The acquisition was accounted for using the purchase method and accordingly the acquired assets and liabilities were recorded at their fair market values at the date of acquisition.

The three-month period ended March 31, 2001 includes a full quarter of expenses related to activities at our wholly-owned subsidiary, Immersion Canada, which was acquired on March 9, 2000 and a full quarter of activity at our wholly-owned subsidiary, VTI, which was acquired on August 31, 2000. The transactions were accounted for under the purchase method and are, accordingly, not reflected in our three months ended March 31, 2000 condensed consolidated statement of operations.

We completed our acquisition of HT Medical Systems, Inc. ("HT"), which has since been renamed Immersion Medical, in September 2000. The merger was accounted for as a pooling of interests. Accordingly, the consolidated financial statements have been restated for all periods presented as if we and HT had always been combined. HT is a developer and manufacturer of medical simulation devices for doctors and other healthcare personnel. We issued a total of approximately 1.335 million shares of our common stock in exchange for all outstanding shares of HT's common stock and preferred stock. We assumed 195,670 common and preferred stock warrants, a promissory note convertible into 226,450 shares of our common stock and reserved approximately 835,000 shares of common stock for issuance upon the exercise of options assumed in the merger or granted after the merger.

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, 2001, we have capitalized patents and technology of $4.6 million, net of accumulated amortization of $1.4 million. We are amortizing these patents and technology over the estimated useful life of the technology of nine years.

Our revenues include royalties and fees from licensing our technology, revenues from product sales and revenues from development projects. On sales by our licensees' of consumer computer peripheral devices, such as touch-enabled mice and joysticks, we receive a per unit royalty that is a percentage of the unit's wholesale selling price. We also receive fees from licensing our touch-enabling technologies for automotive controls, and expect to receive additional per unit royalty revenue from sales of automobiles that include touch-enabled controls incorporating our technology. We receive product revenue from sales of a number of products, including medical simulation hardware devices and software modules used in conjunction with such devices; three-dimensional digitizing products, such as the MicroScribe-3D; hardware and software for our whole-hand sensing gloves, such as the CyberGlove; and Immersion Processors, which are designed for use by our licensees in their touch-enabled computer peripheral devices. Development projects generally involve assisting our licensees in the development of their touch-enabled products for which we receive fixed payments for product-related deliverables or consulting services.

We recognize revenues in accordance with applicable accounting standards including American Institute of Certified Public Accountants' 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. This generally occurs at the time of shipment. We recognize fixed-fee contract revenue under the cost-to-cost percentage-of-completion accounting method based on the actual physical completion of work performed and the ratio of costs incurred to total estimated costs to complete the contract. We recognize allowable fees under cost-reimbursement contracts as costs are incurred. Losses on contracts are recognized when determined. Revisions in estimates are reflected in the period in which the conditions become known. We recognize royalty revenue based on royalty reports or related information received from the licensee. On July 19, 1999, we entered into an irrevocable, perpetual, non-exclusive, worldwide license agreement with Microsoft under which Microsoft paid us a lump sum of $2.35 million to cover all shipments of Microsoft's SideWinder Force Feedback Wheel and its SideWinder Force Feedback Pro Joystick and a replacement version of these specific SideWinder products having essentially similar functional features. Under the terms of the agreement, we recognized the license payment as revenue in equal monthly increments over the twelve-month period that ended in mid-July, 2000.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2001 AND 2000 ARE AS FOLLOWS:

REVENUES	March 31, 2001	March 31, 2000	Change
	($ In thousands)		
Three months ended:			
Royalty revenue	$ 1,489	$ 875	70%
Product sales	3,007	1,751	72%
Development contracts and other	865	662	31%
Total Revenue	$ 5,361	$ 3,288	63%

Total Revenue. Our total revenue for the first quarter of fiscal 2001 increased by $2.1 million or 63% from the first quarter of fiscal 2000. Royalty revenue for the three-month period ended March 31, 2001 increased to $1.5 million from $875,000 for the three-month period ended March 31, 2000, a 70% increase. Royalty revenue is comprised of royalties earned on sales by our TouchSense licensees and license fees charged for our intellectual property portfolio. The three-month period ended March 31, 2001 included a lump-sum royalty fee of $733,000 on past due royalties due from InterAct Accessories as part of a litigation settlement. The three-month period ended March 31, 2000 included $587,000 of amortization of royalties due under the Microsoft agreement where revenue recognition ended mid-July 2000. Excluding the lump sum royalty fee for past due royalties and the amortization of non-recurring Microsoft royalty revenue, recurring royalty revenue in the first quarter of 2001 was $756,000, which increased by 163% as compared to $288,000 in the first quarter of 2000. This increase is mainly due to an increased number of product offerings by our licensees that generate per unit royalties as well as royalties from new licensees. Product sales for the three-month period ended March 31, 2001 increased by 72% to $3.0 million from $1.8 million for the same period ended March 31, 2000. The increase in product sales was due to an increase of $241,000 for our microprocessors, an increase of $584,000 related to 3D products, and an increase of $415,000 related to medical products compared with the three-month period ended March 31, 2000. We anticipate lower microprocessor product sales in the future as we scale back our efforts to develop and sell custom microprocessors. Products sold by our 3D group include the MicroScribe-3D and LightScribe-3D as well as products such as the CyberGlove for use in research in computer-aided design, simulation, training and virtual reality applications sold by our wholly-owned subsidiary VTI. The August 2000 acquisition of VTI was accounted for as a purchase and accordingly our financial statements do not include revenues of VTI prior to August 2000. Sales of computer-based medical simulators and software training modules increased due to new product introductions and an increased sales force during the current period versus the prior period. Development contract and other revenue category is comprised of revenue on commercial and government contracts efforts, which increased during the first quarter of fiscal 2001 from an increase in related development activity on commercial contracts and securing new development contracts.

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 2001, revenue generated in North America, Europe, and Far East represented 74%, 12%, and 14%, respectively compared to 73%, 20%, and 6%, respectively for the first quarter of fiscal 2000. The shift in revenues among regions is mainly due to an increase in microprocessor sales and 3D products sales to customers in the Far East in the first quarter of fiscal 2001 versus the first quarter of fiscal 2000.

COST OF PRODUCT SALES	March 31, 2001	March 31, 2000	Change
	($ In thousands)		

Three months ended:			
Cost of product sales	$ 1,784	$ 836	113%
% of total product revenue	59%	48%	

Cost of Product Sales. Cost of product sales increased by $948,000 or 113% for the three months ended March 31, 2001 as compared to the three months ended March 31, 2000. The increase is primarily due to the 72% increase in product sales volume for the period. Increased overhead costs and mix of products sold also contributed to the increase in cost of product sales during the first quarter of fiscal 2001 versus the first quarter of fiscal 2000. Overhead costs increased by $83,000 due to increased facility costs over the same period last year. The remainder of the increase is mainly due to the mix of products sold. An increase in inventory reserves of $134,000 due to shifting product sales and an increase in products sold for which we pay a per unit or percentage based royalties caused royalties to increase by $86,000 for the three months ended March 31, 2001 versus the three months ended March

31, 2000. Increased sales of our microprocessors which have higher cost of product sales than our other products also contributed to the increase in cost of product sales.

OPERATING EXPENSES AND OTHER	March 31, 2001	March 31, 2000	Change
	($ In thousands)		
Three months ended:			
Sales and marketing	$ 3,058	$ 1,888	62%
% of total revenue	57%	57%	
Research and development	$ 2,053	$ 1,410	46%
% of total revenue	38%	43%	
General and administrative	$ 2,060	$ 1,716	20%
% of total revenue	38%	52%	
Amortization of intangibles and deferred stock compensation	$ 1,252	$ 709	77%
% of total revenue	23%	22%	
Acquisition related charges	$ 25	887	-97%
% of total revenue	0%	27%	

Sales and Marketing. Sales and marketing expenses increased by $1.2 million or 62% in the first quarter of fiscal 2001 compared to the comparable period last year. We continued to grow our sales and marketing team during the first quarter of fiscal 2001 to enable us to proliferate our TouchSense technologies across markets, platforms and applications. The significant increase noted was mainly due to increased headcount and related compensation, benefits, and overhead costs of $636,000. Expenses related to corporate identity, advertising, collateral design and production and expenses incurred under our co-marketing agreement with Logitech contributed $285,000 to the increase for the first quarter of fiscal 2001 over the same period during 2000. The remainder of the increase was associated with developer programs and production of showcase applications of our tools of $152,000, website development and maintenance of $61,000 and increased travel expenses of $77,000.

We anticipate sales and marketing expenses to continue to increase in absolute dollars due to the planned growth of our sales and marketing efforts.

Research and Development. Research and development expenses increased by $643,000 or 46% in the first quarter of fiscal 2001 compared to the same period last year. The increase is primarily due to increased headcount and related compensation, benefits, and overhead costs of $633,000.

General and Administrative. General and administrative expenses increased by $344,000 or 20% in the first quarter of fiscal 2001 compared to the same period last year. The increase is attributed to increased headcount and related compensation, benefits, and overhead costs of $749,000 offset by a decrease in recruiting expenses of $309,000. During the three months ended March 31, 2000 the Company incurred $320,000 for recruitment of employees and board members during a period of high organizational growth for the Company.

Amortization of Intangibles and Deferred Stock Compensation. Amortization of intangibles and deferred stock compensation grew by $543,000 or 77% in the first quarter of fiscal 2001 compared to the same period last year. The increase in amortization of intangibles of $558,000 is mainly comprised of an increase of $238,000 for the amortization of goodwill and other purchased intangibles related to the acquisition of Immersion Canada which completed March 2000, an increase of $416,000 representing the amortization of goodwill and other purchased intangibles related to the acquisition of VTI which completed August 2000, offset by decreased amortization of the Cybernet consulting agreement of $96,000. During the quarter ended March 31, 2001 the Company reversed $201,000 of deferred stock compensation expense related to options repriced in January 2000. The future compensation expense related to the repriced vested and unvested stock option shares is dependent on the market value of the shares at the end of each quarter until the repriced options are exercised, forfeited, or expire. Excluding the reversal noted above deferred stock compensation amortization increased by $216,000 mainly due to an increase in amortization related to the $5.5 million of deferred stock compensation recorded in conjunction with the assumption of Immersion Canada's unvested options at the time of acquisition.

Acquisition Related Charges. Acquisition related charges decreased by $862,000 in the first quarter of fiscal 2001 compared to the same period last year. During the three months ended March 31, 2000 we incurred $887,000 of acquisition related charges for in-process research and development resulting from the March 2000 acquisition of all the outstanding shares of Immersion Canada.

Interest and Other Income. Interest and other income consists primarily of interest income, dividend income and capital gains from cash and cash equivalents and short-term investments. Interest and other income declined by $364,000 in the first quarter of fiscal 2001 compared to the same period last year as a result of reduced cash, cash equivalents and short-term investments invested for the period due to cash used in operating and investing activities.

Interest and Other Expense. Interest and other expense consists primarily of interest expense on the Company's secured convertible promissory note and other notes payable. Interest and other expense increased by $11,000 in the first quarter of fiscal 2001 compared to the same period last year. The increase during the three months ended March 31, 2001 is due to the $500,000 increase to the secured notes payable due to Medtronic in March of 2000 and a new secured note payable to Third Coast Capital in April 2000.

LIQUIDITY AND CAPITAL RESOURCES

Our cash, cash equivalents, and short-term investments consist primarily of money market funds and highly liquid debt instruments. All of our cash equivalents and short-term investments are classified as available-for-sale under the provisions of SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities." The securities are stated at market value with unrealized gains and losses reported as a component of accumulated other comprehensive income within stockholders' equity.

At March 31, 2001 our cash, cash equivalents and short-term investments totaled $21.0 million, down $4.8 million from $25.8 million at December 31, 2000.

Net cash used in operating activities during the first three months of fiscal 2001 was $4.8 million, an increase from the $2.5 million used during the comparable period last year. Cash used in operations during the three-month period ended March 31, 2001 was comprised of our $4.7 million net loss, a decrease due to a change in deferred revenue of $373,000, a decrease due to a $694,000 change in accounts receivable and a decrease of $762,000 due to a change in accounts payable and accrued liabilities mainly due to timing of payments to vendors related to our S-3 filing in January 2001 and microprocessor manufacturers. Cash used in operations was offset by noncash charges and credits of $1.7 million, including amortization of intangibles and deferred compensation of $1.3 million.

Net cash provided by investing activities during the first three months of fiscal 2001 was $1.1 million, as opposed to the $16.4 million used during the same period last year. Net cash provided by investing during the period was made up of $2.4 million purchases of short-term investments offset by sales and maturities of $1.0 million, and $262,000 to purchase capital equipment and leasehold improvements on our corporate facilities and information technology infrastructure. In order to improve our rate of return on cash and still provide short-term liquidity, we periodically purchase or sell short-term investments, which typically are interest-bearing, investment-grade securities with a maturity of greater than 90 days and less than one year.

At March 31, 2000 our cash, cash equivalents and short-term investments totaled $49.0 million, a decrease of $2.4 million from $51.4 million at December 31, 1999.

Net cash used in operating activities during the first three months of fiscal 2000 was $2.5 million. Cash used in operations during the period was comprised of our $3.6 million net loss, a decrease due to a change in deferred revenue of $587,000 attributable to revenue recognized under the Microsoft agreement, and a decrease due to a $300,000 change in prepaid expenses and other assets primarily the result of insurance premiums paid. Cash used in operations was offset by noncash charges of $1.6 million, including the $887,000 one-time charge for in-process research and development relating to the Immersion Canada acquisition and $672,000 of amortization of intangibles and deferred stock compensation, and a $606,000 increase in accrued liabilities.

Net cash used in investing activities during the first three months of fiscal 2000 was $16.4 million which was made up of $15.5 million purchases of short-term investments, $292,000 to purchase capital equipment, and $581,000 related to the Immersion Canada acquisition.

We believe that our cash, cash equivalents and short-term investments will be sufficient to meet our working capital needs and capital expenditure requirements for at least the next 12 months. Per our internal estimates we anticipate to be cashflow breakeven by the fourth quarter of fiscal 2001. We anticipate that capital expenditures for the full year ended December 31, 2001 will total approximately $1.5 million in connection with anticipated growth in operations, infrastructure and personnel. If the Company acquires one or more businesses or products, the Company's capital requirements could increase substantially. In the event of such an acquisition or should any unanticipated circumstances arise which significantly increase the Company's capital requirements, we may elect to raise additional capital through debt or equity financing. Although we may intend to raise additional capital there can be no assurance that necessary additional capital will be available on terms acceptable to the Company, if at all.

RECENT ACCOUNTING PRONOUNCEMENTS

Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, is effective for all fiscal years beginning after June 15, 2000. SFAS 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. Under SFAS 133, certain contracts that were not formerly considered derivatives may now meet the definition of a derivative. SFAS 133, as amended, requires the recognition of all derivative instruments as either assets or liabilities on the balance sheet measured at fair value. Gains or losses resulting from changes in the values of those derivatives would be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. The Company has adopted SFAS 133 effective January 1, 2001. The Company recorded no transition adjustment because there were no derivative financial instruments held by the Company at January 1, 2001, generally the Company does not utilize derivative financial instruments for any purposes or engage in any hedging activities.

In December 1999, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements ("SAB 101"). SAB 101, as amended, summarizes certain of the SEC's views in applying generally accepted accounting principles to revenue recognition in financial statements. The Company adopted SAB 101 in the fourth quarter of 2000. The adoption of SAB 101 did not have a material effect on the financial position, results of operations or cash flows of the Company.

In March 2000, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB 25 ("FIN 44"). Among other things, FIN 44 clarifies the application of APB 25 to modifications to existing stock option awards and the accounting for an exchange of stock compensation awards in a business combination. The Company adopted FIN 44 on dates specified in the Interpretation.

FACTORS THAT MAY AFFECT FUTURE RESULTS

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 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:

- cursor control peripherals, such as touch-enabled mice and trackballs, for use with personal computers;

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

- touch-enabled peripherals for computer gaming on personal computers and dedicated gaming consoles, such as Sony's PlayStation(R) 2;

- touch-enabled automotive interfaces; and

- touch-enabled, whole-hand sensing gloves, such as our CyberForce product.

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.

WE HAD AN ACCUMULATED DEFICIT OF $42.4 MILLION AS OF MARCH 31, 2001, WILL EXPERIENCE LOSSES IN THE FUTURE AND MAY NOT ACHIEVE OR MAINTAIN PROFITABILITY.

Since 1997, we have incurred losses in every fiscal quarter and we expect losses through at least 2001. We will need to generate significant revenue to achieve and maintain profitability. We may not achieve, sustain or increase profitability in the future. Our expenses may increase in the foreseeable future as we:

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

- increase our sales efforts;

- incur additional expenses related to the operation of businesses we have acquired or will acquire;

- continue to develop our technologies;

- pursue strategic relationships; and

- protect and enforce our intellectual property.

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

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.

In the past several months, 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 convince such companies to incorporate a touch-enabled mice product 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.

WE MAY BE UNABLE TO INCREASE SALES OF OUR MEDICAL SIMULATION DEVICES IF, AS A RESULT OF THE CURRENT ECONOMIC SLOWDOWN OR OTHER FACTORS, WE ARE UNABLE TO PERSUADE MEDICAL INSTITUTIONS TO PROVIDE IN THEIR BUDGETS FOR PURCHASES OF THESE NEW MEDICAL SIMULATION DEVICES.

Our medical simulation products, such as our AccuTouch Endoscopy Simulator and our AccuTouch Endovascular Simulator, have only recently begun to be used by hospitals and medical schools to train healthcare professionals. As a result, there is often no allocation in the existing budgets of these training facilities for such simulation devices. To increase sales of our simulation devices, we must, in addition to convincing training facility personnel of the utility of the devices, persuade them to include a significant expenditure in their budgets. If these training facilities are unwilling to budget for simulation devices or reduce their budgets as a result of an economic slowdown, cost-containment pressures or other factors, we may not be able to increase sales of medical simulators at a satisfactory rate.

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

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

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 can be several years after we enter into an agreement with an automobile manufacturer. During the entire product development process, we face the risk that an automobile manufacturer may delay the incorporation 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.

THE MARKET FOR OUR LIGHTSCRIBE-3D PRODUCT, AN OPTICALLY-BASED, THREE-DIMENSIONAL DIGITIZER, IS AT AN EARLY STAGE, AND OUR PRODUCT REVENUES MAY NOT GROW IF MARKET DEMAND DOES NOT DEVELOP.

We recently introduced our LightScribe-3D product, which uses a video camera, hand-held laser stylus, and specialized image processing software to allow users to create three-dimensional images of objects. The LightScribe-3D is being marketed primarily for the creation of high-quality, fully-textured, three-dimensional models that can be displayed and manipulated on Web pages. The market for digitizers to facilitate the creation of such three-dimensional Web content is at an early stage and has been adversely affected by the economic downturn affecting Web-based retailers.

To date, demand for LightScribe-3D has been weaker than expected. If demand does not develop we may not be able to grow our product revenues.

THE INTEGRATION OF IMMERSION MEDICAL AND VIRTUAL TECHNOLOGIES MAY BE DIFFICULT TO ACHIEVE, WHICH MAY ADVERSELY AFFECT OPERATIONS.

In the third quarter of 2000, we completed the acquisition of Immersion Medical, a corporation with approximately 60 employees based in Gaithersburg, Maryland and Virtual Technologies, a corporation with approximately 15 employees based in Palo Alto, California. Immersion, Immersion Medical and Virtual Technologies have operated independently in the past. We recently announced our plan to move the employees of Virtual Technologies from Palo Alto to our headquarters in San Jose. This consolidation is expected to be completed in July 2001.

The combination of these three businesses may be difficult. If we fail to integrate the businesses successfully the operating results of the combined company could be adversely affected and the combined company may not achieve the benefits or operating efficiencies that we hope to obtain from the acquisitions. Moreover, we do not know whether the products, systems and personnel of the three companies will be fully compatible.

WE HAVE LIMITED EXPERIENCE MARKETING AND SELLING THE PRODUCTS OF OUR RECENTLY ACQUIRED SUBSIDIARIES, AND IF WE ARE UNSUCCESSFUL IN MARKETING AND SELLING THESE PRODUCTS WE MAY NOT ACHIEVE OR SUSTAIN PRODUCT REVENUE GROWTH.

Immersion has limited experience marketing and selling medical simulation or high-end simulation products either directly or through distributors. The success of our efforts to sell Immersion Medical's medical simulation products and Virtual Technologies' glove-based simulation products will depend upon our ability to establish a qualified sales force and establish relationships with distributors. Our current sales and marketing staff is very limited, and we must attract and retain qualified personnel to direct the sales and marketing of our simulation products. We may not be successful in attracting and retaining the personnel necessary to sell and market our simulation products successfully. 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.

WE HAVE IN THE PAST, AND MAY IN THE FUTURE, ENGAGE IN ACQUISITIONS THAT 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 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. Moreover, uncertainties as to whether Immersion Medical and Virtual Technologies employees will remain with

Immersion Medical, Virtual Technologies, Immersion and/or the combined company during the integration process may affect the business operations of each company. A number of employees of these subsidiaries have departed since the acquisitions were completed. In addition, we may lose employees of Virtual Technologies as a result of the plan to move their office from Palo Alto to San Jose. It may not be possible to retain enough key employees of Immersion Medical and Virtual Technologies to operate our businesses effectively.

We may hire additional sales, support, marketing and research and development personnel. Competition for these individuals is intense, and 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, as part of an overall cost reduction program, we have announced an employee salary reduction plan that is scheduled to go into effect in June 2001. 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.

WE MAY NEED ADDITIONAL CAPITAL TO FUND OUR BUSINESS OPERATIONS, AND WE CANNOT BE SURE THAT ADDITIONAL FINANCING WILL BE AVAILABLE.

Since 1997, we have experienced negative cash flow from operations and expect to experience significant negative cash flow from operations at least until the fourth quarter of 2001. If our operations do not result in positive cash flow, we may require additional financing for working capital to fund our operations. We cannot be certain that additional financing will be available to us on favorable terms when required, or at all. Changes in equity markets in fiscal 2000 and 2001 have adversely affected the ability 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 involve our issuing additional shares of our common or preferred stock and our stockholders may experience substantial dilution.

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 revenue for us. For the year ended December 31, 2000, 21% of our total revenues was royalty revenue and for the quarter ended March 31, 2001 28% of our total revenues was royalty revenue. However, we do not control or influence the manufacture, 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, 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. If our licensees fail to stimulate and capitalize upon market demand for products that generate royalties for us, our revenues will not grow.

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 second half of the calendar year, we may not receive related royalty revenue.

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 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 WITH OUR PRODUCTS AND OUR LICENSEES' PRODUCTS MAY REDUCE OUR REVENUE.

The markets in which we and our licensees' compete are characterized by rapid technological change, short product life cycles, cyclical market patterns, declining average selling prices and increasing foreign and domestic competition. 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 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, competition from such unlicensed products could limit or reduce our revenues.

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; and

- difficulties in persuading existing and potential licensees to bear the development costs necessary to incorporate our technologies into their products.

A substantial majority of our royalty revenue has been derived from the licensing of our portfolio of touch-enabling technology 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.

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.

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.

For the year ended December 31, 2000, we derived 9% of our total revenues and 41% of our royalty revenue from Logitech, and for the quarter ended March 31, 2001, we derived 12% of our total revenues and 42% of our royalty 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.

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 and Windows Me 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.

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, 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. To date, most of these claims have not led to any litigation. However, in June 2000, we filed an action for patent infringement against InterAct Accessories, Inc. The action, which was based on certain unlicensed gamepad and steering wheel products being marketed by InterAct, was settled in April 2001. 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.

Intellectual property claims against us or our licensees, whether or not they have merit, could be time-consuming to defend, cause product shipment delays, require us to pay damages, 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 field. 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, 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.

WE COULD LOSE SOME OR ALL OF THE INVESTMENT THAT WE HAVE MADE IN SEVERAL EARLY STAGE TECHNOLOGY COMPANIES SHOULD THOSE COMPANIES NOT BE SUCCESSFUL IN DEVELOPING THEIR TECHNOLOGIES OR NOT BE ABLE 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. One or more of these companies 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 any of the companies in which we have invested fails or does not achieve a level of success that permits us to realize the value of our investments, we could experience a complete or partial loss on some or all of the investments. If we

experience a complete or partial loss on some or all of our investments, we will be forced to write off some or all of that investment as an extraordinary loss, which would decrease our assets and increase our losses.

FAILURE TO QUALIFY FOR POOLING-OF-INTERESTS ACCOUNTING TREATMENT WITH RESPECT TO OUR ACQUISITION OF IMMERSION MEDICAL MAY HARM OUR FUTURE OPERATING RESULTS.

We have accounted for our acquisition of Immersion Medical as a pooling-of-interests business combination. Under the pooling-of-interests method of accounting, each of Immersion and Immersion Medical's historical recorded assets and liabilities have been carried forward to the combined company at their recorded amounts. In addition, the operating results of the combined company include Immersion's and Immersion Medical's operating results for all of fiscal 2000, and Immersion's and Immersion Medical's historical reported operating results for prior periods have been combined and restated as the operating results of the combined company.

Events may occur that cause the Immersion Medical merger to no longer qualify for pooling-of-interests accounting treatment. In that case, we would be required to account for the acquisition under the purchase method of accounting. Under that method, we would record the estimated fair value of Immersion common stock issued in the merger as the cost of acquiring the business of Immersion Medical. That cost would be allocated to the net assets acquired, with the excess of the estimated fair value of Immersion common stock over the fair value of net assets acquired recorded as goodwill or other intangible assets. To the extent goodwill and other intangibles are recorded on Immersion's financial statements, Immersion would be required to take a non-cash charge to earnings every year for periods of up to 5 years until the full values of this goodwill and other intangibles have been fully amortized. The fair value of Immersion common stock issued in the merger is much greater than the historical net book value at which Immersion Medical carried its assets in its accounts. Therefore purchase accounting treatment would result in charges to operations of the combined company for several years compared to pooling-of-interests accounting treatment.

OUR REPORTED RESULTS MAY BE ADVERSELY AFFECTED BY CHANGES IN ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA.

We prepare our financial statements in conformity with generally accepted accounting principles (GAAP). GAAP is subject to interpretation by the American Institute of Certified Public Accountants, the Securities and Exchange Commission and various bodies formed to interpret and create appropriate accounting policies. A change in these policies or interpretations can have a significant effect on our reported results, and may even affect the reporting of transactions completed prior to the announcement of a change.

IF OUR SAN JOSE 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 or power outage. California has recently experienced problems with its power supply. 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 have obtained insurance to cover most potential losses at our facilities, our existing insurance may not be adequate for all possible losses.

ROBERT O'MALLEY, OUR CHIEF EXECUTIVE OFFICER AND PRESIDENT, RECENTLY JOINED US AND IF THERE ARE DIFFICULTIES WITH THIS LEADERSHIP TRANSITION IT COULD IMPEDE THE EXECUTION OF OUR BUSINESS STRATEGY.

Robert O'Malley, our Chief Executive Officer and President, joined us in October 2000. Our success will depend to a significant extent on Mr. O'Malley's ability to implement a successful strategy, to successfully lead and motivate our employees, and to work effectively with our executive staff. If this leadership transition is not successful, our ability to execute our business strategy would be impeded.

WE HAVE EXPERIENCED RAPID GROWTH AND CHANGE IN OUR BUSINESS, AND OUR FAILURE TO MANAGE THIS AND ANY FUTURE GROWTH COULD HARM OUR BUSINESS.

In addition to the employees of Immersion Medical and Virtual Technologies that we are currently integrating, we have rapidly increased the number of our employees in our San Jose headquarters. Our business may be harmed if

we do not integrate and train our new employees quickly and effectively. We also cannot be sure that our revenues will continue to grow at a rate sufficient to support the costs associated with an increasing number of employees. Any future periods of rapid growth may place significant strains on our managerial, financial, engineering and other resources. The rate of any future expansion, 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.

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 MICROSOFT'S 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 provides 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. We derived 8% of our total revenues and 40% of our royalty revenues for the year ended December 31, 2000 from 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.

BECAUSE WE NO LONGER RECEIVE ROYALTY REVENUE UNDER OUR CURRENT AGREEMENT WITH MICROSOFT, OUR ROYALTY REVENUES IN FUTURE PERIODS MAY DECLINE.

As described above, revenue recognized under our current agreement with Microsoft ended in mid-July 2000. Because the agreement with Microsoft accounted for a substantial portion of our royalty revenues, our royalty revenues in future periods will decline if we do not either enter into agreements with additional licensees of our touch-enabling technologies or receive larger royalty payments from our existing licensees.

WE DEPEND ON A SINGLE SUPPLIER TO PRODUCE OUR IMMERSION PROCESSORS AND MAY LOSE CUSTOMERS IF THIS SUPPLIER DOES NOT MEET OUR REQUIREMENTS.

We have one supplier of our custom Immersion Processors, which we develop, license and sell to improve the performance and to help reduce the cost of computer peripheral products, such as joysticks and mice, incorporating our touch-enabling technology. We have limited control over delivery schedules, quality assurance, manufacturing capacity, yields, costs and misappropriation of our intellectual property. Although our supplier warrants that microprocessors it supplies to us or to our customers will conform to our specifications and be free from defects in materials and workmanship for a period of one year from delivery, any delays in delivery of the processor, quality problems or cost increases could cause us to lose customers and could damage our relationships with our licensees.

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.

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

In August 1999, we entered into an agreement with Medtronic, Inc., a leading medical device company, in which Medtronic was given a right of first offer for additional development agreements. Under the terms of the right of first offer, we must notify Medtronic if we have received a written offer, or if we are seeking to find a third party to enter

a development agreement to develop a simulation system within a field in which Medtronic is active. If Medtronic is interested in participating in a development agreement with respect to such new simulation system then for a period of thirty days we will negotiate exclusively with Medtronic. If an agreement is not reached within this period, we may enter into an agreement with a third party, provided that the terms of the agreement are more favorable to us than the offer presented by Medtronic. Although the right of first offer has not impeded our ability to interest other medical device companies in our technologies to date, our relationship with Medtronic may impede our ability to enter into development or license agreements with other large medical device companies that compete with Medtronic.

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 acquisitions of technologies or businesses;

- the timing of introductions of new products and product enhancements by us, our licensees and 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 is fixed, a shortfall of revenues can cause significant variations in operating results from period to period.

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; 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.

OUR EXECUTIVE OFFICERS, DIRECTORS AND MAJOR STOCKHOLDERS RETAIN SIGNIFICANT CONTROL OVER US, WHICH MAY LEAD TO CONFLICTS WITH OTHER STOCKHOLDERS OVER CORPORATE GOVERNANCE MATTERS.

Our current directors, officers and non-mutual fund stockholders holding more than 5% of our outstanding stock, as a group, beneficially own more than 38% 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.

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 RISKS

The Company has limited exposure to financial market risks, including changes in interest rates. The fair value of the Company's 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 the Company's debt obligations. The Company's foreign operations are limited in scope and thus the Company is not materially exposed to foreign currency fluctuations.

PART II
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In June 2000, the Company filed a complaint against InterAct Accessories, Inc. in the United States District Court for the Northern District of California (Case No. C-00-20663 JF). The complaint alleged that multiple InterAct products, including InterAct's Dual Impact, Dual Impact 2, Barracuda 2 and Stormchaser gamepads, and its V3FX, V3FX 2, Blue Thunder and Concept 4 steering wheels, infringe three of the Company's United States patents. On January 2, 2001, the Company filed a First Amended Complaint adding STD Manufacturing Limited, a Hong Kong manufacturer of computer peripheral devices and the manufacturer of the accused products, as a defendant in the action.

The action was settled in April 2001. Pursuant to the terms of the settlement agreement, InterAct will take a license and pay royalties to the Company based on sales by InterAct of vibrotactile gamepads and steering wheel peripherals for dedicated gaming consoles such as the Sony PlayStation(R) and PlayStation(R) 2, the Nintendo 64, and the Microsoft(R) Xbox(TM). In addition, InterAct has paid the Company for past sales of such devices by InterAct. Finally, InterAct and Immersion will work together to develop new touch-enabled peripheral devices to be distributed by InterAct.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

The following exhibits are filed herewith:

Exhibit Number	Description

None.

(b) Reports on Form 8-K

The Company filed a Current Report on Form 8-K on January 3, 2001 reporting the historical financial statements of the combined operating results of Immersion Corporation and HT Medical Systems, Inc.

SIGNATURES

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

IMMERSION CORPORATION
Registrant

Date: May 14, 2001 /s/ ROBERT O'MALLEY

Robert O'Malley

President and Chief Executive Officer

Date: May 14, 2001 /s/ VICTOR VIEGAS

Victor Viegas

Vice President, Finance and Chief Financial Officer

INDEX TO EXHIBITS

Exhibit Number	Description
None.	
