IMMERSION CORP
Form 10-Q
November 07, 2011
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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 September 30, 2011

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

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

Large accelerated filer [ ]　　Accelerated filer [ X ]

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ]　　No [ X ]

Number of shares of common stock outstanding at October 31, 2011: 28,863,334.

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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)**

**(Unaudited)**

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 14,509 | $ 12,243 |
| Short-term investments | 48,979 | 48,961 |
| Accounts and other receivables (net of allowances for doubtful accounts as of: September 30, 2011 $25 and December 31, 2010 $97) | 779 | 815 |
| Inventories | 579 | 406 |
| Deferred income taxes | 342 | 342 |
| Prepaid expenses and other current assets | 704 | 3,821 |
| Total current assets | 65,892 | 66,588 |
| Property and equipment, net | 1,279 | 1,931 |
| Intangibles and other assets, net | 13,771 | 12,356 |
| Total assets | $ 80,942 | $ 80,875 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 550 | $ 393 |
| Accrued compensation | 2,722 | 3,507 |
| Other current liabilities | 1,129 | 1,488 |
| Deferred revenue and customer advances | 4,459 | 4,429 |
| Total current liabilities | 8,860 | 9,817 |
| Long-term deferred revenue | 14,010 | 16,494 |
| Deferred income tax liabilities | 342 | 342 |
| Other long-term liabilities | 455 | 538 |
| Total liabilities | 23,667 | 27,191 |
| Commitments and Contingencies (Notes 9 and 16) | | |
| Stockholders equity: | | |
| Common stock and additional paid-in capital $0.001 par value; 100,000,000 shares authorized; shares issued: September 30, 2011 31,760,085 and December 31, 2010 31,016,812; shares outstanding: September 30, 2011 28,940,662 and December 31, 2010 28,228,603 | 181,609 | 176,515 |
| Accumulated other comprehensive income | 139 | 120 |
| Accumulated deficit | (105,887) | (104,553) |

| | | |
|---|---|---|
| Treasury stock at cost: September 30, 2011 2,819,423 shares and December 31, 2010 2,788,209 shares | (18,586) | (18,398) |
| Total stockholders equity | 57,275 | 53,684 |
| Total liabilities and stockholders equity | $ 80,942 | $ 80,875 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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**IMMERSION CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

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

**(Unaudited)**

| | Three Months Ended September 30, 2011 | Three Months Ended September 30, 2010 | Nine Months Ended September 30, 2011 | Nine Months Ended September 30, 2010 |
|---|---|---|---|---|
| Revenues: | | | | |
| Royalty and license | $ 5,875 | $ 5,141 | $ 20,110 | $ 17,848 |
| Product sales | 345 | 1,217 | 1,892 | 6,035 |
| Development contracts and other | 275 | 189 | 943 | 848 |
| Total revenues | 6,495 | 6,547 | 22,945 | 24,731 |
| Costs and expenses: | | | | |
| Cost of revenues (exclusive of amortization, impairment, and abandonment of intangibles shown separately below) | 192 | 457 | 913 | 2,587 |
| Sales and marketing | 1,643 | 1,813 | 5,402 | 6,077 |
| Research and development | 2,183 | 2,007 | 6,525 | 6,473 |
| General and administrative | 3,195 | 3,008 | 9,367 | 11,808 |
| Amortization and impairment or abandonment of intangibles | 324 | 211 | 1,016 | 650 |
| Total costs and expenses | 7,537 | 7,496 | 23,223 | 27,595 |
| Operating loss | (1,042) | (949) | (278) | (2,864) |
| Interest and other income | 58 | 70 | 172 | 212 |
| Loss from continuing operations before provision for income taxes | (984) | (879) | (106) | (2,652) |
| Provision for income taxes | (428) | (336) | (1,289) | (1,098) |
| Loss from continuing operations | (1,412) | (1,215) | (1,395) | (3,750) |
| Discontinued operations (Note 11) : | | | | |
| Gain on sales of discontinued operations net of provision for income taxes of $0, $18, $39 and $18 | 0 | 82 | 61 | 143 |
| Net loss | $ (1,412) | $ (1,133) | $ (1,334) | $ (3,607) |
| Basic and diluted net loss per share | | | | |
| Continuing operations | (0.05) | (0.04) | (0.05) | (0.13) |
| Discontinued operations | 0.00 | 0.00 | 0.00 | 0.00 |
| Total | $ (0.05) | $ (0.04) | $ (0.05) | $ (0.13) |
| Shares used in calculating basic and diluted net loss per share | 28,918 | 28,134 | 28,595 | 28,087 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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**IMMERSION CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands) (unaudited)**

| | Nine Months Ended September 30, 2011 | Nine Months Ended September 30, 2010 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net loss | $ (1,334) | $ (3,607) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization of property and equipment | 717 | 842 |
| Amortization and impairment or abandonment of intangibles | 1,016 | 650 |
| Stock-based compensation | 2,705 | 2,430 |
| Allowance (recovery) for doubtful accounts | (25) | (120) |
| Loss on disposal of equipment | 3 | 90 |
| Loss on divestiture | 0 | 43 |
| Gain on sales of discontinued operations | (61) | (143) |
| Changes in operating assets and liabilities: | | |
| Accounts and other receivables | 61 | 2,259 |
| Inventories | (173) | 860 |
| Prepaid expenses and other current assets | 3,117 | 53 |
| Other assets | (89) | 0 |
| Accounts payable | 32 | (315) |
| Accrued compensation and other current liabilities | (1,282) | (829) |
| Deferred revenue and customer advances | (2,454) | (3,583) |
| Other long-term liabilities | (56) | 121 |
| Net cash provided by (used in) operating activities | 2,177 | (1,249) |
| Cash flows used in investing activities: | | |
| Purchases of available-for-sale investments | (44,910) | (34,880) |
| Proceeds from maturities of available-for-sale investments | 45,000 | 30,000 |
| Net proceeds from divestiture | 0 | 964 |
| Additions to intangibles | (2,406) | (1,584) |
| Proceeds from sale of property and equipment | 0 | 160 |
| Purchases of property and equipment | (84) | (336) |
| Proceeds from sales of discontinued operations | 100 | 142 |
| Net cash used in investing activities | (2,300) | (5,534) |
| Cash flows provided by financing activities: | | |
| Issuance of common stock under employee stock purchase plan | 145 | 0 |
| Exercise of stock options | 2,244 | 83 |
| Net cash provided by financing activities | 2,389 | 83 |
| Net increase in cash and cash equivalents | 2,266 | (6,700) |
| Cash and cash equivalents: | | |
| Beginning of the period | 12,243 | 19,828 |

| | | |
|---|---|---|
| End of the period | $ 14,509 | $ 13,128 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid (received) for taxes | $ (3,302) | $ 6 |
| Supplemental disclosure of non-cash investing and financing activities: | | |
| Amounts accrued for property and equipment, and intangibles | $ 636 | $ 377 |
| Shares issued under company stock plan | $ 1,305 | $ 34 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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**IMMERSION CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2011**

**(Unaudited)**

1. SIGNIFICANT ACCOUNTING POLICIES

*Description of Business*

Immersion Corporation (the Company ) was incorporated in 1993 in California and reincorporated in Delaware in 1999 and develops, manufactures, licenses, and supports a wide range of hardware and software technologies and products that enhance digital devices with touch interaction.

*Principles of Consolidation and Basis of Presentation*

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

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all information and footnotes necessary for a complete presentation of the financial position, results of operations, and cash flows, in conformity with accounting principles generally accepted in the United States of America. These condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements included in the Company s Annual Report on Form 10-K, for the fiscal year ended December 31, 2010. In the opinion of management, all adjustments consisting of only normal and recurring items necessary for the fair presentation of the financial position and results of operations for the interim periods presented have been included.

The results of operations for the interim periods ended September 30, 2011 are not necessarily indicative of the results to be expected for the full year.

*Revenue Recognition*

The Company recognizes revenues in accordance with applicable accounting standards, including Accounting Standards Codification ( ASC ) 605-10-S99, Revenue Recognition ( ASC 605-10-S99 ); ASC 605-25, Multiple Element Arrangements ( ASC 605-25 ); and ASC 985-60 Software-Revenue Recognition ( ASC 985-605 ). The Company derives its revenues from three principal sources: royalty and license fees, product sales, and development contracts. As described below, significant management judgments and estimates must be made and used in connection with the revenue recognized in any accounting period. Material differences may result in the amount and timing of revenue for any period based on the judgments and estimates made by management. Specifically, in connection with each transaction, the Company must evaluate whether: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable, and (iv) collectibility is probable. The Company applies these criteria as discussed below.

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

*Delivery has occurred.* The Company delivers software and product to customers physically and also delivers software electronically. For physical deliveries not related to software, the transfer terms typically include transfer of title and risk of loss at the

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Company s shipping location. For electronic deliveries, delivery occurs when the Company provides the customer access codes or keys that allow the customer to take immediate possession of the software.

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

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

*Royalty and license revenue* The Company recognizes royalty revenue based on royalty reports or related information received from the licensee and when collectibility is deemed probable. The terms of the royalty agreements generally require licensees to give the Company notification of royalties within 30 to 45 days of the end of the quarter during which the sales occur. The Company recognizes license fee revenue for licenses to intellectual property when earned under the terms of the agreements, which is generally recognized when all deliverables including services are completed or recognized on a straight-line basis over the expected term of the license.

*Development contracts and other revenue* Development contracts and other revenue is comprised of professional services (consulting services and/or development contracts). Professional services revenues are recognized under the proportional performance accounting method based on physical completion of the work to be performed or completed performance method. A provision for losses on contracts is made, if necessary, in the period in which the loss becomes probable and can be reasonably estimated. Revisions in estimates are reflected in the period in which the conditions become known. To date, such losses have not been significant.

*Multiple element arrangements* The Company enters into multiple element arrangements in which customers purchase a time-based license which include a combination of software and/or intellectual property licenses, professional services and in limited cases, post contract customer support. For arrangements that are software based and include software and professional services, the services are generally not essential to the functionality of the software, and customers may purchase consulting services to facilitate the adoption of the Company s technology, but they may also decide to use their own resources or appoint other professional service organizations to perform these services. For these arrangements, including those with post contract customer support, revenue is recognized either over the period of the ongoing obligation which is generally consistent with the contractual term, or when all deliverables including services have been completed.

*Product sales* The Company recognizes revenue from the sale of products and the license of associated software if any, and expenses all related costs of products sold, once delivery has occurred and customer acceptance, if required, has been achieved. The Company has determined that the license of software for its medical simulation products is incidental to the product as a whole. The Company typically grants to customers a warranty which guarantees that products will substantially conform to the Company s current specifications for generally twelve months from the delivery date pursuant to the terms of the arrangement. Historically, warranty-related costs have not been significant. Separately priced extended warranty contract revenues are recognized ratably over the contractual period.

*Recent Accounting Pronouncements*

In September 2009, the Financial Accounting Standards Board ( FASB ) ratified Accounting Standards Update ( ASU ) 2009-13 (update to ASC 605), Revenue Arrangements with Multiple

Deliverables ( ASU 2009-13 (update to ASC 605) ). This guidance addresses criteria for separating the consideration in multiple-element arrangements. ASU 2009-13 (update to ASC 605) requires companies to allocate the overall consideration to each deliverable by using a best estimate of the selling price of individual deliverables in the arrangement in the absence of vendor-specific objective evidence or other third-party evidence of the selling price. ASU 2009-13 (update to ASC 605) will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 and early adoption will be permitted. The Company adopted ASU 2009-13 (update to ASC 605) as of January 1, 2011, and its application had no impact on the Company s condensed consolidated financial statements as no material new agreements or materially modified contracts in the nine months ended September 30, 2011 came under this guidance.

In September 2009, the FASB ratified ASU 2009-14 (update to ASC 605), Certain Revenue Arrangements That Include Software Elements ( ASU 2009-14 (update to ASC 605) ). ASU 2009-14 (update to ASC 605) provides guidance to exclude (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product s essential functionally. ASC 2009-14 (update to ASC 605) has an effective date that is consistent with ASU 2009-13 (update to ASC 605) above. The Company adopted ASC 2009-14 (update to ASC 605) as of January 1, 2011, and its application had no impact on the Company s condensed consolidated financial statements as no material new agreements or materially modified contracts in the nine months ended September 30, 2011 came under this guidance.

In June 2011, the FASB ratified ASU 2011-05 Comprehensive Income (Topic 220): Presentation of Comprehensive Income. ASU 2011-05 requires that all nonowner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements, eliminating the option to present other comprehensive income in the statement of changes in equity. Under either choice, items that are reclassified from other comprehensive income to net income are required to be presented on the face of the financial statements where the components of net income and the components of other comprehensive income are presented. This amendment is effective for reporting periods beginning after December 15, 2011, and will be applied retrospectively. This amendment will change the manner in which the Company presents comprehensive income.

2. FAIR VALUE MEASUREMENTS

*Cash Equivalents and Short-term Investments*

The financial instruments of the Company measured at fair value on a recurring basis are cash equivalents and short-term investments. The Company s cash equivalents and short-term investments are classified within Level 1 or Level 2 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The Company did not have any transfers between Level 1 and Level 2 fair value measurements during the periods presented.

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

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

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

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In January 2010, the FASB ratified ASU 2010-06 Fair Value Measurements and Disclosures Improving Disclosures about Fair Value Measurements ( ASU 2010-06 ). ASU 2010-06 requires new disclosures for significant transfers in and out of Level 1 and 2 of the fair value hierarchy and the level of disaggregation of assets or liabilities and the valuation techniques and inputs used to measure fair value. The Company adopted the updated guidance which was effective for the Company s annual reporting period at December 31, 2009, with the exception of new Level 3 activity disclosures, which was adopted January 1, 2011. The adoption of this guidance did not have a material impact on its condensed consolidated results of operations and financial condition.

Financial instruments measured at fair value on a recurring basis as of September 30, 2011 and December 31, 2010 are classified based on the valuation technique in the table below:

| | September 30, 2011 Fair value measurements using | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
| | (In thousands) | | | |
| **Assets:** | | | | |
| U.S. Treasury securities | $ 48,979 | $ 0 | $ 0 | $ 48,979 |
| Money market accounts | 11,423 | 0 | 0 | 11,423 |
| Total assets at fair value | $ 60,402 | $ 0 | $ 0 | $ 60,402 |

The above table excludes $3.1 million of cash held in banks.

| | December 31, 2010 Fair value measurements using | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
| | (In thousands) | | | |
| **Assets:** | | | | |
| U.S. Treasury securities | $ 48,961 | $ 0 | $ 0 | $ 48,961 |
| Money market accounts | 7,356 | 0 | 0 | 7,356 |
| Total assets at fair value | $ 56,317 | $ 0 | $ 0 | $ 56,317 |

The above table excludes $4.9 million of cash held in banks.

*Short-term Investments*

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| | September 30, 2011 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Holding Gains | Gross Unrealized Holding Losses | Fair Value |
| | (In thousands) | | | |
| U.S. Treasury securities | $ 48,949 | $ 30 | $ 0 | $ 48,979 |
| Total | $ 48,949 | $ 30 | $ 0 | $ 48,979 |

| | December 31, 2010 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Holding Gains | Gross Unrealized Holding Losses | Fair Value |
| | (In thousands) | | | |
| U.S. Treasury securities | $ 48,942 | $ 19 | $ 0 | $ 48,961 |
| Total | $ 48,942 | $ 19 | $ 0 | $ 48,961 |

The contractual maturities of the Company s available-for-sale securities on September 30, 2011 and December 31, 2010 were all due within one year.

3. ACCOUNTS AND OTHER RECEIVABLES

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| | (In thousands) | |
| Trade accounts receivable | $ 337 | $ 459 |
| Receivables from vendors and other | 442 | 356 |
| Accounts and other receivables | $ 779 | $ 815 |

4. INVENTORIES

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| | (In thousands) | |
| Raw materials and subassemblies | $ 310 | $ 281 |
| Finished goods | 269 | 125 |
| Inventories | $ 579 | $ 406 |

5. PROPERTY AND EQUIPMENT

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| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| | (In thousands) | |
| Computer equipment and purchased software | $ 3,681 | $ 3,807 |
| Machinery and equipment | 711 | 815 |
| Furniture and fixtures | 634 | 630 |
| Leasehold improvements | 886 | 881 |
| Total | 5,912 | 6,133 |
| Less accumulated depreciation | (4,633) | (4,202) |
| Property and equipment, net | $ 1,279 | $ 1,931 |

6. INTANGIBLES AND OTHER ASSETS

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| | (In thousands) | |
| Patents and trademarks | $ 23,122 | $ 21,074 |
| Other assets | 286 | 295 |
| Gross intangibles and other assets | 23,408 | 21,369 |
| Accumulated amortization of patents and trademarks | (9,637) | (9,013) |
| Intangibles and other assets, net | $ 13,771 | $ 12,356 |

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, | | September 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| | (In thousands) | | (In thousands) | |
| Amortization of Intangibles - excluding impairments or abandonments | $ 333 | $ 211 | $ 747 | $ 630 |

The table below includes estimated remaining annual amortization expense for intangible assets as of September 30, 2011. The table includes patents which are in process and the amounts are subject to change based on management s estimate.

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| | Estimated Amortization Expense |
|---|---|
| | (In thousands) |
| Remainder of 2011 | $ |