

IMMERSION CORP

Form 10-Q

November 02, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended September 30, 2018

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 001-38334

IMMERSION CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 94-3180138

(State or other jurisdiction of (I.R.S. Employer incorporation or organization) Identification No.)

50 Rio Robles, San Jose, California 95134

(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  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes  No

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

Large accelerated filer  Accelerated filer

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

Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes  No

Number of shares of common stock outstanding at October 26, 2018: 37,529,629.

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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, 2018	December 31, 2017
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 112,633	\$ 24,622
Short-term investments	17,835	21,916
Accounts and other receivables	1,260	806
Prepaid expenses and other current assets	7,802	736
Total current assets	139,530	48,080
Property and equipment, net	2,540	3,150
Deferred income tax assets	371	401
Other assets	4,254	344
Total assets	\$ 146,695	\$ 51,975
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 758	\$ 6,647
Accrued compensation	2,573	4,133
Other current liabilities	5,703	3,896
Deferred revenue	4,694	4,424
Total current liabilities	13,728	19,100
Long-term deferred revenue	31,407	22,303
Other long-term liabilities	1,163	915
Total liabilities	46,298	42,318
Contingencies (Note 12)		
Stockholders' equity:		
Common stock and additional paid-in capital — \$0.001 par value; 100,000,000 shares authorized; 37,526,910 and 35,950,518 shares issued, respectively; 30,800,525 and 29,263,828 shares outstanding, respectively	243,110	228,046
Accumulated other comprehensive income	107	99
Accumulated deficit	(95,379 )	(171,616)
Treasury stock at cost: 6,726,385 shares	(47,441 )	(46,872 )
Total stockholders' equity	100,397	9,657
Total liabilities and stockholders' equity	\$ 146,695	\$ 51,975
See accompanying Notes to Condensed Consolidated Financial Statements.		

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IMMERSION CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 AND COMPREHENSIVE INCOME (LOSS)

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues:				
Royalty and license	\$8,462	\$11,636	\$99,789	\$27,427
Development, services, and other	90	227	323	690
Total revenues	8,552	11,863	100,112	28,117
Costs and expenses:				
Cost of revenues	61	61	190	158
Sales and marketing	1,664	3,376	4,454	10,142
Research and development	2,110	3,116	7,152	9,138
General and administrative	9,880	10,753	31,669	41,885
Total costs and expenses	13,715	17,306	43,465	61,323
Operating income (loss)	(5,163 )	(5,443 )	56,647	(33,206 )
Interest and other income	545	200	1,151	504
Income (loss) before provision for income taxes	(4,618 )	(5,243 )	57,798	(32,702 )
Provision for income taxes	(22 )	(44 )	(313 )	(295 )
Net income (loss)	\$(4,640)	\$(5,287)	\$57,485	\$(32,997)
Basic net income (loss) per share	\$(0.15 )	\$(0.18 )	\$1.89	\$(1.13 )
Shares used in calculating basic net income (loss) per share	30,780	29,245	30,340	29,155
Diluted net income (loss) per share	\$(0.15 )	\$(0.18 )	\$1.83	\$(1.13 )
Shares used in calculating diluted net income (loss) per share	30,780	29,245	31,334	29,155
Other comprehensive income (loss), net of tax:				
Change in unrealized gains (losses) on short-term investments	(2 )	10	8	(14 )
Total other comprehensive income (loss)	(2 )	10	8	(14 )
Total comprehensive income (loss)	\$(4,642)	\$(5,277)	\$57,493	\$(33,011)

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,	
	2018	2017
Cash flows provided by (used in) operating activities:		
Net income (loss)	\$57,485	\$(32,997)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization of property and equipment	647	709
Stock-based compensation	6,266	4,073
Deferred income taxes	67	(75 )
Loss on disposal of equipment	26	1
Changes in operating assets and liabilities:		
Accounts and other receivables	(454 )	(5,096 )
Prepaid expenses and other current assets	(1,870 )	(101 )
Other assets	(3,910 )	(146 )
Accounts payable	(5,889 )	(1,116 )
Accrued compensation and other current liabilities	466	(3,209 )
Income tax payable	(219 )	—
Deferred revenue	22,713	(4,082 )
Other long-term liabilities	211	(78 )
Net cash provided by (used in) operating activities	75,539	(42,117 )
Cash flows provided by investing activities:		
Purchases of short-term investments	(17,693 )	(23,807 )
Proceeds from maturities of short-term investments	22,000	28,000
Purchases of property and equipment	(63 )	(121 )
Net cash provided by investing activities	4,244	4,072
Cash flows provided by financing activities:		
Issuance of common stock under employee stock purchase plan	218	328
Exercise of stock options	8,010	443
Purchases of treasury stock	—	(328 )
Net cash provided by financing activities	8,228	443
Net increase (decrease) in cash and cash equivalents	88,011	(37,602 )
Cash and cash equivalents:		
Beginning of period	24,622	56,865
End of period	\$112,633	\$19,263
Supplemental disclosure of cash flow information:		
Cash paid for taxes	\$139	\$128
Supplemental disclosure of noncash operating, investing, and financing activities:		
Amounts accrued for treasury stocks	\$569	\$—
Release of Restricted Stock Units and Awards under company stock plan	\$2,806	\$2,524
See accompanying Notes to Condensed Consolidated Financial Statements.		

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IMMERSION CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2018

(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Immersion Corporation (the “Company”) was incorporated in 1993 in California and reincorporated in Delaware in 1999. The Company focuses on the creation, design, development, and licensing of innovative haptic technologies that allow people to use their sense of touch more fully as they engage with products and experience the digital world around them. The Company has adopted a “hybrid” business model, under which it provides advanced tactile software, related tools, and technical assistance to certain customers; and offers licenses to the Company's patented intellectual property (“IP”) to other customers.

Principles of Consolidation and Basis of Presentation

The accompanying condensed consolidated financial statements include the accounts of Immersion Corporation and its wholly owned subsidiaries: Immersion Canada Corporation; Immersion International, LLC; Immersion Medical, Inc.; Immersion Japan K.K.; Immersion Ltd.; Immersion Software Ireland Ltd.; Haptify, Inc.; Immersion (Shanghai) Science & Technology Company, Ltd.; and Immersion Technology International Ltd. All intercompany accounts, transactions, and balances have been eliminated in consolidation.

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all information and footnotes necessary for a complete presentation of the financial position, results of operations, and cash flows, in conformity with GAAP. The accompanying 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, 2017. 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 nine months ended September 30, 2018 are not necessarily indicative of the results to be expected for the full year.

Segment Information

The Company develops, licenses, and supports a wide range of software and IP that more fully engage users’ sense of touch as they engage with products and experience the digital world around them. The Company currently focuses on the following target application areas: mobility, automotive, gaming, medical and wearables. The Company’s chief operating decision maker (“CODM”) is the Chief Executive Officer. The CODM allocates resources to and assesses the performance of the Company using information about its financial results as one operating and reporting segment.

Revenue Recognition

In May 2014, the Financial Accounting Standards Board (“FASB”) issued an Accounting Standards Update (“ASU”) 2014-09 “Revenue from Contracts with Customers (Topic 606)” (“Accounting Standard Codification 606”, “ASC 606”), which superseded most prior revenue recognition guidance under ASC Topic 605, “Revenue Recognition” (“ASC 605”) including industry-specific guidance. The underlying principle of ASC 606 is that an entity will recognize revenue to depict the transfer of promised goods or services to customers at an amount that the entity expects to be entitled in exchange for those goods or services. The new standard provides a five-step analysis of transactions to determine when and how revenue is recognized, and shall be applied retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption if the modified retrospective transition method is elected. The new standard also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers.

The Company adopted the new revenue standard effective January 1, 2018 using the modified retrospective transition method where the cumulative effect of the initial application is recognized as an adjustment to the opening balance of the accumulated deficit at January 1, 2018, the date of adoption. Therefore, comparative prior periods have not been

adjusted and continue to be presented under ASC 605. Refer to Note 2 to the condensed consolidated financial statements for the Company's revised revenue recognition accounting policy and a summary of the impact of adoption of ASC 606.

Recent Accounting Pronouncements

Adopted

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In March 2018, the FASB issued ASU2018-05 "Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 (SEC Update)", which updates Securities and Exchange Commission ("SEC") guidance released in December 2017 when the Tax Cuts and Jobs Act (the "Tax Act") was signed into law. Additional information regarding the adoption of this ASU and its material impact on the Company's condensed consolidated financial statements is contained in Note 10 to the condensed consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09 "Stock Compensation: Scope of Modification Accounting". The ASU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under ASC 718. For public business entities, the amendments in this update are effective for annual periods beginning after December 15, 2017. The Company adopted the standard effective January 1, 2018. The adoption of this ASU did not have a material impact on its condensed consolidated financial statements.

In December 2016, the FASB issued ASU 2016-19 "Technical Corrections and Improvements". The amendments in this update affect a wide variety of topics in the Accounting Standards Codification. For public business entities, the amendments in this update are effective for annual periods beginning after December 15, 2017, and interim periods in the annual period beginning after December 15, 2018. The Company adopted the standard effective January 1, 2018. The adoption of this ASU did not have a material impact on its condensed consolidated financial statements.

Not yet adopted

In July 2018, the FASB issued ASU 2018-09 "Codification Improvement" ("ASU 2018-09"). This ASU amends a wide variety of Topics in the Codification issued by FASB with technical corrections, clarifications, and other minor improvements, and should eliminate the need for periodic agenda requests for narrow and incremental items. Many of the amendments in this ASU are effective for annual reporting periods beginning after December 15, 2018 for public entities. The Company is currently assessing when it will adopt this ASU, but does not expect material impact on its condensed consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07 "Compensation-- Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting" ("ASU 2018-07"). The amendments in this ASU expand the scope of Topic 718 to include share-based payment transaction for acquiring goods and services from nonemployees and supersede subtopic 505-50. For public entities, the guidance is effective for annual reporting periods beginning after December 15, 2018 and interim periods within those fiscal years, and early adoption is permitted but no earlier than adoption of Topic 606. The Company is currently in the process of evaluating the impact of this standard on its condensed consolidated financial statements, and expects to adopt this ASU as of January 1, 2019.

In February 2018, the FASB issued ASU 2018-02 "Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" ("ASU 2018-02"). The amendments in this ASU allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act. The guidance is effective for annual reporting periods beginning after December 15, 2018 and interim periods within those fiscal years, and early adoption is permitted. The Company is currently assessing when it will adopt this ASU and its potential impact on the Company's condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02 "Leases: Topic 842" ("ASU 2016-02" "Topic 842"), which supersedes the existing guidance for lease accounting in Topic 840, Leases. The FASB issued the ASU to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. ASU 2016-02 requires lessees to recognize a lease liability and a right-of-use asset for all leases. Lessor accounting remains largely unchanged. This ASU is effective for periods beginning after December 15, 2018 for public entities with early adoption permitted. An entity will be required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. In July 2018, the FASB issued ASU 2018-10 "Codification Improvement to Topic 842, Leases" ("ASU 2018-10"). The FASB issued this separate ASU for the improvements related to ASC 2016-02 to increase stakeholders' awareness of the amendments and to expedite the improvements. In July 2018, the FASB issued ASU 2018-11 "Leases (Topic 842) Target Improvement" ("ASU 2018-11"). This ASU introduces a lessee model that will bring most leases of property, plant and equipment onto the balance sheet. It requires a lessee to recognize a lease



obligation (present value of future lease payments) and also a “right of use asset” for all leases, although certain short-term leases are exempted from the standard. The ASU introduces two models for the subsequent measurement of the lease asset and liability, depending on whether the lease qualifies as a “finance lease” or an “operating lease”. This distinction focuses on whether or not effective control of the asset is being transferred from the lessor to the lessee. Both effective date and transition requirements will be the same as the effective date and transition requirements in Topic 842. The Company plans to adopt the standard on January 1, 2019. The Company expects that its operating lease commitments will be subject to the new standard, and will record a lease liability and a right to use lease asset on its condensed consolidated balance sheet upon adoption.

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2. REVENUE RECOGNITION

Revised Revenue Recognition Accounting Policy

On January 1, 2018, the Company adopted ASC 606 using the modified retrospective transition method. The new revenue standard has been applied to all contracts that were not completed as of the date of adoption. To the extent that modifications occurred prior to the adoption of ASC 606, the Company has reflected the aggregate impact of any modification when evaluating the impact of the adoption.

The Company's revenue is primarily derived from fixed fee license agreements and per-unit royalty agreements, along with less significant revenue earned from development, services and other revenue. The adoption of ASC 606 affected the Company's revenue recognition model for both fixed fee license revenue and per-unit royalty revenue presented as "royalty and license revenue" on the Company's condensed consolidated statements of operations and comprehensive income (loss). All of the Company's revenue in the periods presented have been derived from contracts with customers and consequently have been recognized under ASC 606.

Fixed fee license revenue

In applying ASC 606, the Company is required to recognize revenue from a fixed fee license agreement when it has satisfied its performance obligations, which typically occurs upon the transfer of rights to the Company's technology upon the execution of the license agreement. However, in certain contracts, the Company grants a license to its existing patent portfolio at the inception of the license agreement as well as rights to the portfolio as it evolves throughout the contract term. For such arrangements, the Company has concluded that it has two separate performance obligations:

- Performance Obligation A: to transfer rights to the Company's patent portfolio as it exists when the contract is executed;
  - Performance Obligation B: to transfer rights to the Company's patent portfolio as it evolves over the term of the contract, including access to new patent applications that the licensee can benefit from over the term of the contract.
- Under the Company's previous accounting practices under ASC 605, fixed license fees were generally recognized on a straight-line basis over the contract term. As a result of the adoption of ASC 606, if a fixed fee license agreement contains only Performance Obligation A, the Company will recognize most or all of the revenue from the agreement at the inception of the contract. For fixed fee license agreements that contain both Performance Obligation A and B, the Company will be required to allocate the transaction price based on the standalone price for each of the two performance obligations. The Company has developed a process, and established internal controls around such process, to estimate standalone prices related to Performance Obligation A and B using a number of factors primarily related to the attributes of its patent portfolio. Once the transaction price is allocated, the portion of the transaction price allocable to Performance Obligation A will be recognized in the quarter the license agreement is signed and the customer can benefit from rights provided in the contract, and the portion allocable to Performance Obligation B will be recognized on a straight-line basis over the contract term. For such contracts, a contract liability account will be established and included within "deferred revenue" on the condensed consolidated balance sheet. As the rights and obligations in a contract are interdependent, contract assets and contract liabilities that arise in the same contract have been presented on a net basis.

Historically, certain of the Company's license agreements contained fixed fees related to past infringements for which the fixed fees were recognized as revenue or recorded as a deduction to its operating expense in the quarter the license agreement was signed. After the adoption of ASC 606, the Company will recognize revenue from such fixed fees related to past infringements in the same manner in the quarter the license agreement is signed.

Payments for fixed fee license contracts typically are due in full within 30 - 45 days from execution of the contract. From time to time, the Company enters into a fixed fee license contract with payments due in a number of installments payable throughout the contract term. In such cases, the Company will determine if a significant financing component exists and if it does, the Company will recognize more or less revenue and corresponding interest expense or income, as appropriate.

Per-unit Royalty revenue

Under the Company's previous accounting practices under ASC 605, it recognized revenue from per-unit royalty agreements in the period in which the related royalty report was received from its licensees, generally one quarter in

arrears from the period in which the underlying sales occurred (i.e. on a "quarter-lag"). ASC 606 requires an entity to record per-unit royalty revenue in the same period in which the licensee's underlying sales occur. As the Company generally does not receive the per-unit licensee royalty reports for sales during a given quarter within the time frame that allows the Company to adequately review the reports and include the actual amounts in its quarterly results for such quarter, the Company accrues the related revenue based on estimates of its licensees' underlying sales, subject to certain constraints on its ability to estimate such amounts. The Company's estimates are developed based on a combination of available data including, but not limited to,

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approved customer forecasts, a lookback at historical royalty reporting for each of its customers, and industry information available for the licensed products.

As a result of accruing per-unit royalty revenue for the quarter based on such estimates, adjustments will be required in the following quarter to true up revenue to the actual amounts reported by its licensees. During the three months ended September 30, 2018, the Company trueed up approximately \$(333,000) per-unit royalty revenue, as compared to \$(326,000) for the three months ended June 30, 2018. The true-up represents the difference between per-unit royalty based on its licensees' actual sales reported in a quarter-lag, and the estimate of per-unit royalty that was reported in the same quarter as the underlying sales occurred. The Company had no true-ups for the three months ended March 31, 2018.

Certain of the Company's per-unit royalty agreements contains a minimum royalty provision which sets forth minimum amounts to be received by the Company during the contract term. Per the Company's previous accounting policy under ASC 605, such minimum royalties were recognized as revenue at the end of each reporting period (usually a calendar year) if the actual royalties reported by the customer for that reporting period were below the minimum threshold set forth in the contract. Under ASC 606, minimum royalties are considered a fixed transaction price to which the Company will have an unconditional right once all other performance obligations, if any, are satisfied. Therefore, the Company recognizes all minimum royalties as revenue at the inception of the license agreement, or in the period in which all remaining revenue recognition criteria have been met. The Company will establish contract assets for the unbilled minimum royalties on a contract basis. Such contract asset balance will be reduced by the actual royalties reported by the licensee during the contract term until fully utilized, after which point any excess per-unit royalties reported will be recognized as revenue. As the rights and obligations in a contract are interdependent, contract assets and contract liabilities that arise in the same contract have been presented on a net basis.

Payments of per-unit royalties typically are due within 30 to 60 days from the end of the calendar quarter in which the underlying sales took place.

#### Development, services, and other revenue

With little change from its previous accounting practices related to development, service and other revenue, the Company will continue to recognize revenue from this stream when it has satisfied service obligations. Consistent with the Company's previous accounting practices under ASC 605, the performance obligation related to its development, service and other revenue is satisfied over a period of time, and such revenue is recognized evenly over the period of performance obligation, which is generally consistent with the contractual term.

#### Adjustments upon Adoption of ASC 606

The following table summarizes adjustments related to the Company's adoption of ASC 606.

(in thousands)	Balance at December 31, 2017 as Reported under ASC 605	Adjustment for Fixed Fee License Revenue *	Elimination of Quarter-Lag Per-Unit Royalties	Total Adjustments upon Adoption of ASC 606	Balance at January 1, 2018 (ASC 606)
Prepaid expenses and other current assets	\$ 736		\$ 4,996	\$ 4,996	\$5,732
Deferred revenue - current	(4,424 )	1,766		1,766	(2,658 )
Long-term deferred revenue	(22,303 )	11,573		11,573	(10,730)
Accumulated deficit	171,616	(13,339 )	(4,996 )	(18,335 )	153,281

\* Adjustment for fixed fee license revenue includes both the recognition of Performance Obligation A upon the adoption of ASC 606, which had previously been deferred under ASC 605, and the change in the transaction price allocated to Performance Obligation B and consequently the revenue recognized as of January 1, 2018.

#### Disaggregated Revenue

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The following table presents the disaggregation of the Company's revenue for the three and nine months ended September 30, 2018 under ASC 606. Revenues for the three and nine months ended September 30, 2017 are presented in accordance with ASC 605.

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(in thousands)	Three Months Ended September 30,			Increase (Decrease)	
	2018	2017			
Fixed fee license revenue	\$4,317	\$6,881	\$(2,564)	(37)%	
Per-Unit royalty revenue	4,145	4,755	(610)	(13)%	
Total royalty and license revenue	8,462	11,636	(3,174)	(27)%	
Development, services, and other revenue	90	227	(137)	(60)%	
Total revenues	\$8,552	\$11,863	\$(3,311)	(28)%	

	Nine Months Ended September 30,			Increase (Decrease)	
	2018	2017			
Fixed fee license revenue	\$81,955	\$11,156	\$70,799	635%	
Per-Unit royalty revenue	17,834	16,271	1,563	10%	
Total royalty and license revenue	99,789	27,427	72,362	264%	
Development, services, and other revenue	323	690	(367)	(53)%	
Total revenues	\$100,112	\$28,117	\$71,995	256%	

For the three and nine months ended September 30, 2018, the Company recognized \$1.2 million and \$2.3 million, respectively, as revenue that had been included in deferred revenue as of the beginning of the period. As of September 30, 2018, the Company had contract assets of \$7.1 million and \$4.0 million included within prepaid expenses and other current assets and other assets on the condensed consolidated balance sheet, respectively. During the three and nine months ended September 30, 2018, the balance of contract assets increased by \$1.8 million and \$6.0 million, respectively, primarily related to certain contracts entered into during the periods which included a minimum royalty arrangement. During the three months ended September 30, 2018, there was no evidence that would have indicated impairment of the contract assets.

#### Impact of Adoption of ASC 606

Presented in the tables below is disclosure of the impact of adoption on the Company's condensed consolidated statements of operations and comprehensive income (loss) for the three and nine months ended September 30, 2018, as well as balance sheet as of September 30, 2018, in accordance with the requirements of ASC 606. The Company believes that this additional information is vital during the transition year to allow readers of its financial statements to compare financial results from the preceding financial year given the use of the modified retrospective method of adoption. The adoption of ASC 606 did not affect the Company's reported total amounts of cash flows from operating, investing and financing activities. Therefore, tables for this separate financial statement have not been provided. Amounts contained in the tables below are in thousands, except per share data.

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(in thousands, except per share amounts)	Three Months Ended September 30,			
	2018 As Reported (ASC 606)	Adjustments	ASC 605	2017 As Reported (ASC 605)
Revenues:				
Fixed fee license revenue	\$4,317	\$ (499 )	\$3,818	\$6,881
Per-unit royalty revenue	4,145	(21 )	4,124	4,755
Total royalty and license revenue	8,462	(520 )	7,942	11,636
Development, services, and other revenue	90	—	90	227
Total revenues	\$8,552	\$ (520 )	\$8,032	\$11,863
Operating expenses	13,715		13,715	17,306
Operating loss	(5,163 )	(520 )	(5,683 )	(5,443 )
Interest and other income	545	—	545	200
Loss before provision for income taxes	(4,618 )	(520 )	(5,138 )	(5,243 )
Income tax provision	(22 )	—	(22 )	(44 )
Net loss	\$(4,640 )	\$(520 )	\$(5,160 )	\$(5,287 )
Basic net loss per share	\$(0.15 )	\$(0.02 )	\$(0.17 )	\$(0.18 )
Diluted net loss per share	\$(0.15 )	\$(0.02 )	\$(0.17 )	\$(0.18 )

	Nine Months Ended September 30,			
	2018 As Reported (ASC 606)	Adjustments	ASC 605	2017 As Reported (ASC 605)
Revenues:				
Fixed fee license revenue	\$81,955	\$ (70,409 )	\$11,546	\$11,156
Per-unit royalty revenue	17,834	(4,274 )	13,560	16,271
Total royalty and license revenue	99,789	(74,683 )	25,106	27,427
Development, services, and other revenue	323	—	323	690
Total revenues	\$100,112	\$ (74,683 )	\$25,429	\$28,117
Operating expenses	43,465		43,465	61,323
Operating income (loss)	56,647	(74,683 )	(18,036 )	(33,206 )
Interest and other income	1,151	—	1,151	504
Income (loss) before provision for income taxes	57,798	(74,683 )	(16,885 )	(32,702 )
Income tax provision	(313 )	—	(313 )	(295 )
Net income (loss)	\$57,485	\$(74,683 )	\$(17,198 )	\$(32,997 )
Basic net income (loss) per share	\$1.89	\$(2.46 )	\$(0.57 )	\$(1.13 )
Diluted net income (loss) per share	\$1.83	\$(2.46 )	\$(0.57 )	\$(1.13 )

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	September 30, 2018			December 31, 2017
	As Reported (ASC 606)	Adjustments	ASC 605	As Reported (ASC 605)
Prepaid expenses and other current assets	\$7,802	\$ (7,079 )	\$723	\$ 736
Other non-current assets	4,254	(3,963 )	291	344
Other current liabilities	(5,703 )	180	(5,523 )	(3,896 )
Deferred revenue - current	(4,694 )	(10,715 )	(15,409 )	(4,424 )
Long-term deferred revenue	(31,407 )	(72,161 )	(103,568 )	(22,303 )
Accumulated deficit	\$95,379	\$ 93,435	\$188,814	\$ 171,616

## Contracted Revenue

Based on contracts signed and payments received as of September 30, 2018, the Company expects to recognize \$36.1 million revenue related to Performance Obligation B under its fixed fee license agreements, which is satisfied over time, including \$14.0 million over one to three years and \$22.1 million over more than three years.

## 3. 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 fixed income available-for-sale securities consist of high quality, investment grade securities. The Company values these securities based on pricing from pricing vendors, who may use quoted prices in active markets for identical assets (Level 1) or inputs other than quoted prices that are observable either directly or indirectly (Level 2) in determining fair value.

The types of instruments valued based on quoted market prices in active markets include money market accounts. Such instruments are generally classified within Level 1 of the fair value hierarchy.

The types of instruments valued based on quoted prices in markets that are less active, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency are generally classified within Level 2 of the fair value hierarchy and include U.S. treasury securities.

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. The Company had no Level 3 instruments as of September 30, 2018 and December 31, 2017.

Financial instruments measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017 are classified based on the valuation technique in the table below:

(in thousands)	September 30, 2018			
	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	
Assets:				
U.S. Treasury securities	\$—	\$ 17,835	\$	—\$17,835
Money market accounts	86,983	—	—	86,983



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Total assets at fair value \$86,983 \$ 17,835 \$ —\$104,818

The above table excludes \$25.7 million of cash held in banks.

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(in thousands)	December 31, 2017			
	Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total

Assets:				
U.S. Treasury securities	\$—	\$ 21,916	\$	—\$21,916
Money market accounts	1,117	—	—	1,117
Total assets at fair value	\$1,117	\$ 21,916	\$	—\$23,033

The above table excludes \$23.5 million of cash held in banks.

U.S. Treasury securities are classified as short-term investments and money market accounts are classified as cash equivalents on the Company's condensed consolidated balance sheets.

## Short-term Investments

(in thousands)	September 30, 2018			
	Amortized Cost	Gross Holding Gains	Gross Holding Losses	Fair Value
U.S. Treasury securities	\$17,850	\$	—\$ (15 )	\$17,835
Total	\$17,850	\$	—\$ (15 )	\$17,835

(in thousands)	December 31, 2017			
	Amortized Cost	Gross Holding Gains	Gross Holding Losses	Fair Value
U.S. Treasury securities	\$21,939	\$	—\$ (23 )	\$21,916
Total	\$21,939	\$	—\$ (23 )	\$21,916

The contractual maturities of the short-term investments (classified as available-for-sale securities) on September 30, 2018 and December 31, 2017 were all due within one year. There were no transfers of instruments between Level 1 and 2 during the nine months ended September 30, 2018 and the year ended December 31, 2017.

## 4. ACCOUNTS AND OTHER RECEIVABLES

(in thousands)	September 30, 2018	December 31, 2017
Trade accounts receivable	\$ 937	\$ 458
Other receivables	323	348
Accounts and other receivables	\$ 1,260	\$ 806

There was no estimated allowance for doubtful accounts as of September 30, 2018 and December 31, 2017.

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## 5. PROPERTY AND EQUIPMENT

(in thousands)	September 30, 2018	December 31, 2017
Computer equipment and purchased software	\$ 3,151	\$ 3,206
Machinery and equipment	843	834
Furniture and fixtures	1,146	1,274
Leasehold improvements	3,920	3,920
Total	9,060	9,234
Less accumulated depreciation	(6,520 )	(6,084 )
Property and equipment, net	\$ 2,540	\$ 3,150

## 6. OTHER CURRENT LIABILITIES

(in thousands)	September 30, 2018	December 31, 2017
Accrued legal	\$ 4,477	\$ 2,202
Income taxes payable	—	219
Other current liabilities	1,226	1,475
Total other current liabilities	\$ 5,703	\$ 3,896

## 7. RESTRUCTURING COSTS

In the fourth quarter of 2017, the Company executed a series of restructuring actions designed to sharpen the Company's strategic focus and establish a more cost-efficient operating structure. The restructuring activities primarily focused on a reduction of the Company's global workforce in conjunction with steps taken to:

- Significantly reduce the Company's presence in China and focus its efforts on Mobile OEM licensing in that region;
- Cease its Mobile Advertising activities; and
- Narrow its focus in the Gaming and VR/AR markets on development efforts to bolster its IP licensing model in these markets

The restructuring plan is expected to increase internal efficiencies through the consolidation of certain sites of operation and has resulted in the elimination of approximately 56 positions, or 41%, of the worldwide employee base. For the year ended December 31, 2017, the Company recorded restructuring expenses of \$1.6 million. There were no additional restructuring activities during the three and nine months ended September 30, 2018. There were \$44,000 adjustments to the 2017 restructuring costs that were reflected in the condensed consolidated statements of operations for the three months ended March 31, 2018. There were no restructuring costs for the three and nine months ended September 30, 2017.

Employee separation costs are associated with worldwide headcount reductions. Asset-related charges consist primarily of accelerated depreciation costs related to the closure of one of the Company's offices in China. Accelerated depreciation costs represent the difference between the depreciation expense as determined using the useful life of the assets prior to the restructuring activities and the revised useful life resulting from the restructuring activities. Other expenses consist primarily of lease termination expenses related to the closure of one of the Company's offices in China.

Substantially all accrued amounts related to the 2017 restructuring activities were paid during the first quarter of 2018. The following table presents a reconciliation of the restructuring reserve recorded within other current liabilities on the Company's condensed consolidated balance sheet as of September 30, 2018:

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(in thousands)	Employee Separation Costs	Asset-Related Charges	Other	Total
Balance as of December 31, 2017	\$ 1,522	\$ —	\$ 57	\$ 1,579
Charges	—	—	—	—
Adjustments	(44 )	—	—	(44 )
Non-cash activity	(10 )	—	(29 )	(39 )
Cash payments	(1,468 )	—	—	(1,468 )
Balance as of September 30, 2018	—	—	28	28

## 8. STOCK-BASED COMPENSATION

## Stock Options and Awards

The Company's equity incentive program is a long-term retention program that is intended to attract, retain, and provide incentives for talented employees, consultants, officers, and directors and to align stockholder and employee interests. The Company may grant time based options, market condition based options, stock appreciation rights, restricted stock, restricted stock units ("RSUs"), performance shares, performance units, and other stock-based or cash-based awards to employees, officers, directors, and consultants. Under this program, stock options may be granted at prices not less than the fair market value on the date of grant for stock options. These options generally vest over four years and expire from seven to ten years from the date of grant. In addition to time based vesting, market condition based options are subject to a market condition: the closing price of the Company stock must exceed a certain level for a number of trading days within a specified timeframe or the options will be cancelled before the expiration of the options. On June 2, 2017, the Company's stockholders approved an increase to the number of shares reserved for issuance by 3,476,850 shares. Restricted stock generally vests over one year. RSUs generally vest over three years. Awards granted other than an option or stock appreciation right reduce the common stock shares available for grant under the program by 1.75 shares for each share issued.

	September 30, 2018
Common stock shares available for grant	1,714,531
Standard and market condition stock options outstanding	2,322,517
Restricted stock awards outstanding	62,556
RSUs outstanding	1,090,938

## Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan ("ESPP"). Under the ESPP, eligible employees may purchase common stock through payroll deductions at a purchase price of 85% of the lower of the fair market value of the Company's common stock at the beginning of the offering period or the purchase date. Participants may not purchase more than 2,000 shares in a six-month offering period or purchase stock having a value greater than \$25,000 in any calendar year as measured at the beginning of the offering period. A total of 1,000,000 shares of common stock has been reserved for issuance under the ESPP. As of September 30, 2018, 724,822 shares had been purchased since the inception of the ESPP in 1999. Under ASC 718-10, the ESPP is considered a compensatory plan and the Company is required to recognize compensation cost related to the fair value of the award purchased under the ESPP. Shares purchased under the ESPP for the nine months ended September 30, 2018 are listed below. Shares purchased under the ESPP for the nine months ended September 30, 2017 are 48,750.

The intrinsic value listed below is calculated as the difference between the market value on the date of purchase and the purchase price of the shares.

Nine  
Months  
Ended  
September

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	30, 2018
Shares purchased under ESPP	26,689
Average price of shares purchased under ESPP	\$ 8.17
Intrinsic value of shares purchased under ESPP	\$ 106,000

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## Summary of Standard Stock Options

The following table sets forth the summary of activity with respect to standard stock options granted under the Company's stock option plans for the nine months ended September 30, 2018:

	Nine Months Ended September 30, 2018
Beginning outstanding balance	3,277,991
Granted	207,500
Exercised	(1,326,718 )
Forfeited	(50,140 )
Expired	(58,197 )
Ending outstanding balance	2,050,436
Aggregate intrinsic value of options exercised	\$7,905,000
Weighted average fair value of options granted	\$5.82

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the exercise price of the Company's common stock for the options that were in-the-money.

Information regarding these standard stock options outstanding at September 30, 2018 is summarized below:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in millions)
September 30, 2018				
Options outstanding	2,050,436	\$ 9.31	2.97	\$ 3.3
Options vested and expected to vest using estimated forfeiture rates	1,956,894	9.27	2.82	3.1
Options exercisable	1,511,605	\$ 9.11	2.00	\$ 2.5

## Summary of Market Condition Based Stock Options

The Company continued to have an outstanding balance of 272,081 market condition based stock options as of both December 31, 2017 and September 30, 2018. No activity noted in the period presented.

## Summary of Restricted Stock Units

RSU activity for the nine months ended September 30, 2018 was as follows:

	Nine Months Ended September 30, 2018
Beginning outstanding balance	508,880
Awarded	922,443
Released	(178,447 )
Forfeited	(161,938 )
Ending outstanding balance	1,090,938
Weighted average fair value on grant date of RSUs	\$11.83
Total fair value of RSUs released	\$2,133,000

Information regarding RSUs outstanding at September 30, 2018 is summarized below:



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	Number of Shares	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in millions)
September 30, 2018			
RSUs outstanding	1,090,938	0.90	\$ 11.5
RSUs vested and expected to vest using estimated forfeiture rates	915,934	0.80	\$ 9.7

## Summary of Restricted Stock Awards

Restricted stock award activity for the nine months ended September 30, 2018 was as follows:

	Nine Months Ended September 30, 2018
Beginning outstanding balance	44,538
Awarded	62,556
Released	(44,538 )
Forfeited	—
Ending outstanding balance	62,556
Weighted average grant date fair value of restricted stock awarded	\$ 13.32
Total fair value of restricted stock awards released	\$ 673,000

## Stock Plan Assumptions

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

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Standard Stock Options				
Expected life (in years)	4.5	4.6	4.4	4.5
Volatility	55 %	53 %	55 %	53 %
Interest rate	2.7 %	1.7 %	2.5 %	1.7 %
Dividend yield	N/A	N/A	N/A	N/A

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Market Condition Based Stock Options				
Expected life (in years)	N/A	N/A	7.0	7.0
Volatility	N/A	N/A	55 %	55 %
Interest rate	N/A	N/A	2.0 %	2.0 %
Dividend yield	N/A	N/A	N/A	N/A





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	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Employee Stock Purchase Plan				
Expected life (in years)	0.5	0.5	0.5	0.5
Volatility	39 %	46 %	58 %	48 %
Interest rate	2.2 %	1.1 %	1.9 %	0.9 %
Dividend yield	N/A	N/A	N/A	N/A

## Compensation Costs

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

(in thousands)	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Statement of Operations Classifications				
Sales and marketing	\$377	\$317	\$675	\$808
Research and development	561	231	1,382	780
General and administrative	1,576	790	4,209	2,485
Total	\$2,514	\$1,338	\$6,266	\$4,073

As of September 30, 2018, there was \$8.5 million of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock options, restricted stock awards and RSUs granted to the Company's employees and directors. This cost will be recognized over an estimated weighted-average period of approximately 2.64 years for standard options, 1.36 years for RSUs, and 0.72 years for restricted stock awards. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

## 9. STOCKHOLDERS' EQUITY

## Accumulated Other Comprehensive Income

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

(in thousands)	Nine Months Ended September 30, 2018		
	Unrealized Gains and Foreign Losses on Short-term Investments	Currency Items	Total
Beginning balance	\$(23)	\$ 122	\$99
Other comprehensive income before reclassifications	8	—	8
Amounts reclassified from accumulated other comprehensive income	—	—	—
Net current period other comprehensive income	8	—	8
Ending Balance	\$(15)	\$ 122	\$107

## Stock Repurchase Program

On November 1, 2007, the Company announced its Board of Directors (the "Board")' authorized the repurchase of up to \$50.0 million of the Company's common stock ("Stock Repurchase Program"). In addition, on October 22, 2014, the Board authorized another \$30.0 million under the share repurchase program. The Company may repurchase its

common stock for cash in the open market in accordance with applicable securities laws. The timing and amount of any stock repurchase will depend on share price, corporate and regulatory requirements, economic and market conditions, and other factors. The stock repurchase

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authorization has no expiration date, does not require the Company to repurchase a specific number of shares, and may be modified, suspended, or discontinued at any time.

There were no stock repurchases during the three and nine months ended September 30, 2018. During the three and nine months ended September 30, 2017, the Company repurchased 48,687 shares for \$328,000 at an average cost of \$6.73 per share, net of transaction costs through open market repurchases. As of September 30, 2018, the Stock Repurchase Program remains available with approximately \$33.4 million that may yet be purchased under the program.

**Stockholders Rights Plan**

On December 26, 2017, the Board declared a dividend of one right (a "Right") for each of the Company's issued and outstanding shares of common stock, par value \$0.001 per share. The dividend was paid to the stockholders of record at the close of business on January 8, 2018 (the "Record Date"). Each Right entitles the holder to purchase from the Company one one-thousandth of a share of the Company's Series B Junior Participating Preferred Stock (the "Preferred Stock") at a price of \$30.00 (the "Exercise Price"), subject to certain adjustments and contingently issuable. The Rights expire December 26, 2018 if not earlier redeemed, exchanged or terminated.

There were no rights exercised during the three and nine months ended September 30, 2018 and the nine months ended September 30, 2017.

**10. INCOME TAXES**

Income tax provisions consisted of the following:

(in thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Income (loss) before provision for income taxes	\$(4,618)	\$(5,243)	\$57,798	\$(32,702)
Provision for income taxes	\$(22 )	\$(44 )	\$(313 )	\$(295 )
Effective tax rate	(0.5 )%	(0.8 )%	0.5 %	(0.9 )%

The provision for income tax for the three and nine months ended September 30, 2018 resulted primarily from estimated foreign taxes included in the calculation of the effective tax rate. The Company continues to carry a full valuation allowance on its federal deferred tax assets. As a result, no provision for U.S. sourced income was included in the calculation, the primary reason for the difference between the statutory tax rate and effective tax rate. The provision for income tax for the three and nine months ended September 30, 2017 resulted primarily from estimated foreign taxes and foreign withholding tax expense.

On July 27, 2015, a U.S. Tax Court opinion (Altera Corporation et. al v. Commissioner) concerning the treatment of stock-based compensation expense in an intercompany cost sharing arrangement was issued. In its opinion, the U.S. Tax Court accepted Altera's position of excluding stock-based compensation from its intercompany cost sharing arrangement. On February 19, 2016, the IRS appealed the ruling to the U.S. Court of Appeals for the Ninth Circuit. On July 24, 2018, the U.S. Court of Appeals for the Ninth Circuit reversed the 2015 decision of the U.S. Tax Court that had found certain Treasury regulations related to stock-based compensation to be invalid. On August 7, 2018, the U.S. Court of Appeals for the Ninth Circuit withdrew its July 24, 2018 opinion to allow a reconstituted panel to confer on the decision. This reconstituted panel will reconsider the validity of the cost sharing regulations at issue. The regulations at issue require related entities to share the cost of employee stock compensation in order for their cost-sharing arrangements to be classified as "qualified cost-sharing arrangements" and to avoid potential IRS adjustment. The Company will evaluate the implications of the final decision, when rendered.

On December 22, 2017, the U.S. Tax Cuts and Jobs Act (the "Tax Act") was passed into law. The Act reduces the US federal corporate income tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign sourced earnings. In addition, the Act introduced the Base Erosion and Anti-Abuse Tax ("BEAT"), which creates a new tax on certain related party payments.

During December 2017, the SEC staff issued Staff Accounting Bulletin No. 118 (“SAB 118”), which provided guidance on accounting for the federal tax rate change and other tax effects of the Tax Act. SAB 118 provided a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740, Income Taxes. In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Tax Act for which the accounting under ASC 740 is complete. To the extent that a company’s accounting for certain income tax effects

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of the Tax Act is incomplete, but the company is able to determine a reasonable estimate, it must record a provisional estimate in its financial statements. If a company cannot determine a provision estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax laws that were in effect immediately before the enactment of the Tax Act.

In connection with the Company's adoption of the Tax Act and consideration of SAB 118, the following updates have been made to the Company's income tax provision. In the fourth quarter of 2017, due to the federal tax rate change, the Company recorded a \$12.9 million reduction to deferred tax assets and related valuation allowance in connection with the re-measurement of certain deferred tax assets and liabilities, resulting in no impact to its results of operations. The Company estimated that no current tax expense should be recorded in connection with the transition tax on the mandatory deemed repatriation of foreign earnings, a provisional estimate at December 31, 2017. There have been no changes as of September 30, 2018. Additional work is necessary to complete a more detailed analysis of the Company's deferred tax assets and liabilities and historical foreign earnings as well as potential correlative adjustments.

For the Global Intangible Low-Taxed Income ("GILTI") provisions of the Tax Act, the Company has not yet completed its assessment or elected an accounting policy to either recognize deferred taxes for basis differences expected to reverse as GILTI or to record GILTI as period costs if and when incurred. At September 30, 2018, because the Company is still evaluating the GILTI provisions and the analysis of future taxable income that is subject to GILTI, the Company has included GILTI related to current-year operations only in its annual effective tax rate calculation and has not provided additional GILTI on deferred items. Additionally, the Company has determined that it has not met the threshold requirements of the BEAT.

The Company has made a reasonable estimate of the effects of the Act as of September 30, 2018 in accordance with guidance in SAB 118. The Company will continue to monitor the estimated impacts as additional guidance is released. Any adjustments recorded to the provisional amounts through fourth quarter 2018 may be included in net income as an adjustment to tax expense.

As of September 30, 2018, the Company had unrecognized tax benefits under ASC 740 "Income Taxes" of approximately \$4.8 million and applicable interest of \$16,000. The total amount of unrecognized tax benefits that would affect the Company's effective tax rate, if recognized, is \$405,000. The Company's policy is to account for interest and penalties related to uncertain tax positions as a component of income tax provision. We do not expect to have any significant changes to unrecognized tax benefits during the next twelve months.

As of September 30, 2018, the Company had net deferred income tax assets of \$371,000 consisting primarily of foreign net operating loss carryforwards, and deferred income tax liabilities of \$80,000. Because the Company had net operating loss and credit carryforwards, there are open statutes of limitations in which federal, state, and foreign taxing authorities may examine the Company's tax returns for all years from 1998 through the current period.

The Company maintains a valuation allowance of \$37.6 million against certain of its deferred tax assets, including all federal, state, and certain foreign deferred tax assets as a result of uncertainties regarding the realization of the asset balance due to historical losses, the variability of operating results, and uncertainty regarding near term projected results. In the event that the Company determines the deferred tax assets are realizable based on its assessment of relevant factors, an adjustment to the valuation allowance may increase income in the period such determination is made. The valuation allowance does not impact the Company's ability to utilize the underlying net operating loss carryforwards.

#### 11. NET INCOME (LOSS) PER SHARE

Basic and diluted net income (loss) per share is computed using the weighted average number of common shares outstanding for the period, excluding unvested restricted stock and RSUs. The following is a reconciliation of the numerators and denominators used in computing basic and diluted net loss per share.

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(in thousands, except per share amounts)	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Numerator:				
Net income (loss)	\$ (4,640)	\$ (5,287)	\$ 57,485	\$ (32,997)
Denominator:				
Shares used in computation of basic net income (loss) per share (weighted average common shares outstanding)	30,780	29,245	30,340	29,155
Dilutive potential common shares:				
Stock options, ESPP, restricted stock awards and RSUs	—	—	994	—
Shares used in computation of diluted net income (loss) per share	30,780	29,245	31,334	29,155
Basic net income (loss) per share	\$ (0.15 )	\$ (0.18 )	\$ 1.89	\$ (1.13 )
Diluted net income (loss) per share	\$ (0.15 )	\$ (0.18 )	\$ 1.83	\$ (1.13 )

The Company includes the underlying market condition stock options in the calculation of diluted earnings per share if the performance condition has been satisfied as of the end of the reporting period and excludes such options if the performance condition has not been met.

For the nine months ended September 30, 2018, standard stock options to purchase approximately 261,667 shares of common stock, with exercise prices greater than the average fair market value of the Company's stock of \$12.04 per share, were not included in the calculation because the effect would have been anti-dilutive.

As of September 30, 2018 and 2017, the Company had securities outstanding that could potentially dilute basic earnings per share in the future, but these were excluded from the computation of diluted net loss per share for the three months ended September 30, 2018 and 2017, and nine months ended September 30, 2017, since their effect would have been anti-dilutive. These outstanding securities consisted of the following:

	September 30,	
	2018	2017
Standard and market condition based stock options outstanding	2,322,517	3,815,784
Restricted stock awards outstanding	62,556	44,538
RSUs outstanding	1,090,938	627,454
ESPP	7,529	10,152

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12. CONTINGENCIES

From time to time, the Company receives claims from third parties asserting that the Company's technologies, or those of its licensees, infringe on the other parties' IP rights. Management believes that these claims are without merit.

Additionally, periodically, the Company is involved in routine legal matters and contractual disputes incidental to its normal operations. In management's opinion, the resolution of such matters will not have a material adverse effect on the Company's consolidated financial condition, results of operations, or liquidity.

In the normal course of business, the Company provides indemnification of varying scope to customers, most commonly to licensees in connection with licensing arrangements that include our IP, although these provisions can cover additional matters. Historically, costs related to these guarantees have not been significant, and the Company is unable to estimate the maximum potential impact of these guarantees on its future results of operations.

As discussed in Part II, Item 1 (Legal Proceedings), on April 28, 2017, the Company and Immersion Software Ireland Limited (collectively, "Immersion") received a letter from Samsung Electronics Co. ("Samsung") requesting that Immersion reimburse Samsung with respect to withholding tax and penalties imposed on Samsung by the Korean tax authorities following an investigation where the tax authority determined that Samsung failed to withhold taxes on Samsung's royalty payments to Immersion Software Ireland from 2012 to 2016. On July 12, 2017, Immersion filed an appeal with the Korea Tax Tribunal regarding their findings with respect to the withholding taxes and penalties.

On September 29, 2017, Samsung filed an arbitration demand with the International Chamber of Commerce against Immersion demanding that Immersion reimburse Samsung for the imposed tax and penalties that Samsung paid to the Korean tax authorities. We deny liability, and, as discussed in Part II, Item 1 (Legal Proceedings), the arbitration matter is ongoing. Immersion believes that there are valid defenses to all of the claims from the Korean tax authorities and that Samsung's claims are without merit. Immersion intends to vigorously defend against these claims and as a result, Immersion has concluded that the likelihood of a material charge resulting from this claim is remote. In the event Samsung were to prevail in the arbitration in advance of the conclusion of the appeal with the Korea Tax Tribunal, Immersion could be required to make a payment to Samsung even though it would later be reimbursed should Immersion prevail in the appeal.

On October 16, 2017, the Company received a letter from LG Electronics Inc. ("LGE") requesting that the Company reimburse LGE with respect to withholding tax imposed on LGE by the Korean tax authorities following an investigation where the tax authority determined that LGE failed to withhold on LGE's royalty payments to Immersion Software Ireland from 2012 to 2014. On November 3, 2017, the Company filed an appeal with the Korea Tax Tribunal regarding their findings with respect to the withholding taxes. The Company believes that there are valid defenses to the claims raised by the Korean tax authorities and that LGE's claims are without merit. The Company intends to vigorously defend itself against these claims and as a result, has concluded that the likelihood of a material charge resulting from the claim from LGE to be remote.



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

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The forward-looking statements involve risks and uncertainties. Forward-looking statements are identified by words such as "anticipates," "believes," "expects," "intends," "may," "will," "places," and other similar expressions. However, these words are not the only way we identify forward-looking statements. In addition, any statements, which refer to expectations, projections, or other characterizations of future events, or circumstances, are forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, including those set forth below in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors", those described elsewhere in this report, and those described in our other reports filed with the SEC. We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report, and we undertake no obligation to update these forward-looking statements after the filing of this report. You are urged to review carefully and consider our various disclosures in this report and in our other reports publicly disclosed or filed with the SEC that attempt to advise you of the risks and factors that may affect our business.

OVERVIEW

We are a premier licensing company focused on the creation, design, development, and licensing of innovative haptic technologies that allow people to use their sense of touch more fully as they engage with products and experience the digital world around them. Our mission is to innovate touch technology that informs, humanizes, and excites while working with customers and partners to bring these tactile experiences to consumers. Our technologies are designed to facilitate the creation of high-quality haptic experiences, enable their widespread distribution, and ensure that their playback is optimized for end users. Our primary business is currently in the mobility, gaming, automotive and medical markets, but we believe our technology is broadly applicable and see opportunities in evolving new markets, including wearables and virtual and augmented reality.

We have adopted a hybrid business model, under which we provide advanced tactile software, related tools, and technical assistance designed to help integrate our patented technology into our customers' products or enhance the functionality of our patented technology, and offer licenses of our patented technology to our customers. Our licenses allow our customers to deploy haptically-enabled devices, content and other offerings, which they typically sell under their own brand names. We and our wholly owned subsidiaries hold more than 3,210 issued or pending patents worldwide, covering a wide range of digital technologies and including many of the ways in which touch-related technology can be incorporated into and between hardware products and components, systems software, application software, and digital content.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

Our critical accounting policies and estimates are important to the portrayal of our financial condition and results of operations, and require us to make judgments and estimates about matters that are inherently uncertain. With the exception of our adoption of ASC 606, there have been no material changes during the nine months ended September 30, 2018 to the items we disclosed in the section "Critical Accounting Policies and Estimates" included in Item 7 and the section "Significant Accounting Policies" (Note 1) included in Item 8 of our Annual Report on Form

10-K for the fiscal year ended December 31, 2017. Refer to Note 1 and Note 2 to the condensed consolidated financial statements for our revised policies related to revenue recognition and related estimates after our adoption of ASC 606.

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## RESULTS OF OPERATIONS FOR THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017

## Overview

For the three months ended September 30, 2018, total revenues decreased \$3.3 million, or 28%, compared to the three months ended September 30, 2017.

Net loss was \$4.6 million for the three months ended September 30, 2018 compared to a net loss of \$5.3 million for the three months ended September 30, 2017. The decrease was primarily attributable to lower operating expenses and higher interest and other income, partially offset by the decreased total revenue during the third quarter in 2018 compared to the same period in 2017.

For the nine months ended September 30, 2018, total revenue increased \$72.0 million, or 256%, compared to the nine months ended September 30, 2017. The increase was mainly driven by the \$70.8 million increase in fixed fee license revenue and the \$1.6 million increase in per-unit royalty revenue.

Net income was \$57.5 million for the nine months ended September 30, 2018 as compared to a net loss of \$33.0 million for the nine months ended September 30, 2017. The \$90.5 million change was primarily related to the increase in total revenue and the decrease in operating expenses for the first nine months in 2018 compared to the same period in 2017.

As discussed above, we adopted the new revenue standard, ASC 606, effective January 1, 2018. Consistent with the modified retrospective transaction method, our results of operations for periods prior to our adoption of ASC 606 remain unchanged. As a result, the changes in total revenues for the three and nine months ended September 30, 2018 compared to the same periods a year ago reflected the component of accounting policy changes arising from the adoption of ASC 606. For the three-month period, the impact of the adoption included revenue of \$0.5 million primarily related to fixed fee license agreements which would not have been reported as revenue under the previous standard. Such impact for the nine-month period included \$70.4 million related to fixed fee license agreements and \$4.3 million related to per-unit royalty agreements.

## REVENUES

(in thousands)	September 30,		Change	% Change	Components of Changes		
	2018	2017			Due to ASC 606 Adoption	Net of ASC 606 Adoption Effect	Total Change
Three months ended							
Fixed fee license revenue	\$4,317	\$6,881	\$(2,564)	(37)%	\$499	\$(3,063)	\$(2,564)
Per-unit royalty revenue	4,145	4,755	\$(610)	(13)%	21	(631)	(610)
Total royalty and license revenue	8,462	11,636	\$(3,174)	(27)%	520	(3,694)	(3,174)
Development, services, and other	90	227	\$(137)	(60)%	—	(137)	(137)
Total revenues	\$8,552	\$11,863	\$(3,311)	(28)%	\$520	\$(3,831)	\$(3,311)
Nine months ended							
Fixed fee license revenue	\$81,955	\$11,156	\$70,799	635%	\$70,409	\$390	\$70,799
Per-unit royalty revenue	17,834	16,271	1,563	10%	4,274	(2,711)	1,563
Total royalty and license revenue	99,789	27,427	72,362	264%	74,683	(2,321)	72,362
Development, services, and other	323	690	(367)	(53)%	—	(367)	(367)
Total revenues	\$100,112	\$28,117	\$71,995	256%	\$74,683	\$(2,688)	\$71,995

## Total Revenues - Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017

Royalty and license revenue — Royalty and license revenue is composed of per unit royalties earned based on usage or net sales by licensees and fixed payment license fees charged for our IP and software. Royalty and license revenue for the three months ended September 30, 2018 decreased by \$3.2 million, or 27%, compared to \$11.6 million for the

three months ended September 30, 2017. Royalty and license revenue for the three months ended September 30, 2018 would be \$(3.7) million

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lower, if reported under ASC 605, than the reported royalty and license revenue for the three months ended September 30, 2017, reflecting operational changes during the three months ended September 30, 2018 compared to the same period a year ago.

Per-unit royalty revenue decreased by \$0.6 million, or 13%, from \$4.8 million for the three months ended September 30, 2017 to \$4.1 million for the three months ended September 30, 2018. Per-unit royalty revenue for the three months ended September 30, 2018 would be \$(0.6) million lower, if reported under ASC 605, than per-unit royalty revenue for the three months ended September 30, 2017.

Fixed fee license revenue decreased \$2.6 million, or 37%, from \$6.9 million for the three months ended September 30, 2017 to \$4.3 million for the three months ended September 30, 2018. Fixed fee license revenue for the three months ended September 30, 2018 would be \$(3.1) million lower, if reported under ASC 605, than fixed fee license revenue for the three months ended September 30, 2017. The decrease was primarily due to a non-recurring fixed license fee from a mobility licensee recognized during the three months ended September 30, 2017, partially offset by fixed license fees from new customers, including Fitbit, recognized in the three months ended September 30, 2018.

We expect royalty and license revenue to continue to be a major component of our future revenue as our technology is included in products and we succeed in our efforts to monetize our IP. Our fixed fee license revenue could fluctuate depending upon the timing of execution of new fixed license fee arrangements under ASC 606. We also anticipate that our royalty revenue will fluctuate relative to our customers unit shipments. We historically experienced seasonally higher royalty revenue from our gaming and mobility customers due to the reporting of holiday sales in the first calendar quarter compared to other calendar quarters. Due to the elimination of the one-quarter lag in reporting royalty income, we now expect to experience this seasonal impact in the fourth calendar quarter. We anticipate a continuous reduction in royalty and license revenue in the future from our medical customers as a percentage of our consolidated royalty and license revenue, as this line of business is a less significant portion of our market focus. Refer to Note 1 and Note 2 to the condensed consolidated financial statements for our revised revenue recognition policies and the impact of the adoption of ASC 606.

Geographically, revenues generated in North America, Asia, and Europe for the three months ended September 30, 2018 represented 57%, 35%, and 8%, respectively, of our total revenue as compared to 9%, 79%, and 12%, respectively, for the three months ended September 30, 2017. The increase in revenue attributable to North America as a percentage of total revenue was due primarily to increased revenues from commercial & industrial, mobility and gaming customers. The decrease in revenue attributable to Asia as a percentage of total revenue was primarily caused by declining revenues from mobility, gaming and commercial & industrial customers, partially offset by increased revenue from automotive customers in the region. The decrease in revenue attributable to Europe as a percentage of total revenue was mainly caused by decreased revenues from gaming and medical customers, partially offset by increased revenue from automotive customers in the region.

**Total Revenues - Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017**  
 Royalty and license revenue — Royalty and license revenue is composed of per unit royalties earned based on usage or net sales by licensees and fixed payment license fees charged for our IP and software. Royalty and license revenue for the nine months ended September 30, 2018 increased by \$72.4 million, or 264%, compared to \$27.4 million for the nine months ended September 30, 2017. Royalty and license revenue for the nine months ended September 30, 2018 would be \$(2.3) million lower, if reported under ASC 605, than the reported royalty and license revenue for the nine months ended September 30, 2017.

Per-unit royalty revenue increased by \$1.6 million, or 10%, from \$16.3 million for the nine months ended September 30, 2017 to \$17.8 million for the nine months ended September 30, 2018. Per-unit royalty revenue for the nine months ended September 30, 2018 would be \$(2.7) million lower, if reported under ASC 605, than per-unit royalty revenue for the nine months ended September 30, 2017. The decrease was primarily caused by lower volume of shipments experienced by our mobility, medical and gaming customers during the nine months ended September 30, 2018 as compared to the same period a year ago.

Fixed fee license revenue increased by \$70.8 million, or 635%, from \$11.2 million for the nine months ended September 30, 2017 to \$82.0 million for the nine months ended September 30, 2018. The increase primarily stemmed

from new customer agreements executed during the first nine months in 2018 for which we recorded revenue in accordance with ASC 606.

We expect royalty and license revenue to continue to be a major component of our future revenue as our technology is included in products and we succeed in our efforts to monetize our IP. Our fixed fee license revenue could fluctuate depending upon the timing of execution of new fixed license fee arrangements under ASC 606. We also anticipate that our royalty revenue will fluctuate relative to our customers unit shipments. We historically experienced seasonally higher royalty revenue from our gaming and mobility customers due to the reporting of holiday sales in the first calendar quarter compared to other calendar quarters. Due to the elimination of the one-quarter lag in reporting royalty income, we now expect to experience this seasonal impact in the fourth calendar quarter. We anticipate a continuous reduction in royalty and license revenue in the future from our

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medical customers as a percentage of our consolidated royalty and license revenue, as this line of business is a less significant portion of our market focus. Refer to Note 1 and Note 2 to the condensed consolidated financial statements for our revised revenue recognition policies and the impact of the adoption of ASC 606.

Geographically, revenues generated in North America, Europe, and Asia for the nine months ended September 30, 2018 represented 82%, 9%, and 9%, respectively, of our total revenue as compared to 23%, 13%, and 64%, respectively, for the nine months ended September 30, 2017. The increase in revenue attributable to North America as a percentage of total revenue was due mainly to increased revenue from mobility customers, partially offset by decreased revenues from gaming and medical customers in the region. The decrease in revenue attributable to Europe as a percentage of total revenue was caused primarily by lower revenues from gaming and medical customers, partially offset by increased revenue from automotive customers in the region. The decrease in revenue attributable to Asia as a percentage of total revenue was related to declining revenues from mobility, gaming and automotive customers in the region.

## OPERATING EXPENSES

(in thousands)	September 30,		Change	% Change
	2018	2017		
Three months ended				
Sales and marketing	\$1,664	\$3,376	\$(1,712 )	(51 )%
% of total revenue	19	% 28	% (9	)%
Research and development	\$2,110	\$3,116	\$(1,006 )	(32 )%
% of total revenue	25	% 26	% (1	)%
General and administrative	\$9,880	\$10,753	\$(873 )	(8 )%
% of total revenue	116	% 91	% 25	%
Nine months ended				
Sales and marketing	\$4,454	10,142	\$(5,688 )	(56 )%
% of total revenue	4	% 36	% (32	)%
Research and development	\$7,152	9,138	\$(1,986 )	(22 )%
% of total revenue	7	% 32	% (25	)%
General and administrative	\$31,669	41,885	\$(10,216)	(24 )%
% of total revenue	32	% 149	% (117	)%

**Sales and Marketing** — Our sales and marketing expenses are composed primarily of employee compensation and benefits, sales commissions, advertising, trade shows, collateral marketing materials, market development funds, travel, and an allocation of facilities costs. Sales and marketing expenses decreased \$1.7 million, or 51%, for the three months ended September 30, 2018 compared to the three months ended September 30, 2017, including \$1.2 million decrease in compensation, benefits, and other related costs due to reduced headcount following our restructuring actions in December 2017, \$211,000 decrease in travel costs, and \$161,000 decrease in marketing and advertising costs. Sales and marketing expenses decreased \$5.7 million, or 56%, for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017, including \$3.9 million decrease in compensation, benefits, and other related costs due to reduced headcount following our restructuring actions in December 2017, \$777,000 decrease in marketing and advertising costs, and \$704,000 decrease in travel costs. We believe that continued investment in sales and marketing is critical to our future success, and we expect to continue making targeted investments to expand market acceptance for our touch technologies across the markets we serve.

**Research and Development** — Our research and development expenses are composed primarily of employee compensation and benefits, consulting fees, tooling and supplies, and an allocation of facilities costs. Research and development expenses decreased \$1.0 million, or 32%, for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. The decrease was primarily related to \$382,000 decrease in compensation, benefits, and other related costs due to reduced headcount, \$363,000 decrease in outside services

reflecting redirected development efforts, and \$118,000 decrease in facilities costs. Research and development expenses decreased \$2.0 million, or 22%, for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. The decrease was primarily related to \$824,000 decrease in compensation, benefits, and other related costs due to reduced headcount, \$617,000 decrease in outside services



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reflecting redirected development efforts, \$278,000 decrease in facilities costs, and \$214,000 decrease in travel costs. We believe that continued investment in research and development is critical to our future success, and we expect to continue making targeted investments in areas of research and technology development to support future growth in key markets.

**General and Administrative** — Our general and administrative expenses are composed primarily of employee compensation and benefits; legal and professional fees; external legal costs for patents; office supplies; travel; and an allocation of facilities costs. General and administrative expenses decreased \$873,000, or 8%, for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. The decrease was primarily related to \$1.4 million decrease in legal expenses, partially offset by \$555,000 increase in compensation, benefits, and other related costs mainly due to higher stock compensation expense. The decrease in legal expenses was primarily due to \$2.4 million decrease in litigation expense relating to ongoing proceedings including our recently settled and concluded litigation against Apple and AT&T Mobility and Fitbit, partially offset by increases of \$567,000 in general legal services, \$322,000 in patent related legal, filing, and maintenance costs, and \$140,000 in licensing fee expenses. General and administrative expenses decreased \$10.2 million, or 24%, for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. The decrease was mainly related to \$11.5 million decrease in legal expenses and \$256,000 decrease in outside service costs, partially offset by \$1.5 million increase in compensation, benefits, and other related costs mainly due to higher stock compensation expense. The decreased in legal expenses was primarily due to \$13.8 million decrease in litigation expense relating to ongoing proceedings including our recently settled and concluded litigation against Apple and AT&T Mobility and Fitbit, and \$1.1 million decrease in licensing fee expenses, partially offset by increases of \$1.8 million in patent related legal, filing, and maintenance costs, and \$1.7 million in general legal services. Our general and administrative expenses will continue to be significant in 2018 as we manage our business and strategic opportunities and continue to file, maintain, license, and enforce our IP and contractual rights, and defend any lawsuits brought against us or that we initiate against others to enforce our IP or contractual rights.

**PROVISION FOR TAXES**

(in thousands)	September 30,		Change % Change	
	2018	2017		
Three months ended:				
Provision for income taxes	\$(22)	\$(44)	\$ 22	(50 )%
Loss from continuing operations before provision for income taxes	(4,618)	(5,243)		
Effective tax rate	(0.5 )%	(0.8 )%		
Nine months ended				
Provision for income taxes	(313)	(295)	\$ (18 )	6 %
Income (loss) from continuing operations before provision for income taxes	57,798	(32,702)		
Effective tax rate	0.5 %	(0.9 )%		

The provision for income tax for the three and nine months ended September 30, 2018 resulted primarily from estimated foreign taxes included in the calculation of the effective tax rate. We continue to carry a full valuation allowance on our federal deferred tax assets. As a result, no provision for U.S. sourced income was included in the calculation, the primary reason for the difference between the statutory tax rate and effective tax rate. The provision for income tax for the three and nine months ended September 30, 2017 resulted primarily from estimated foreign taxes and foreign withholding tax expense.

The year-over-year change in provision for income taxes resulted primarily from the change in mix of income (loss) from continuing operations across various tax jurisdictions, including the United States.

On July 27, 2015, a U.S. Tax Court opinion (Altera Corporation et. al v. Commissioner) concerning the treatment of stock-based compensation expense in an intercompany cost sharing arrangement was issued. In its opinion, the U.S. Tax Court accepted Altera's position of excluding stock-based compensation from its intercompany cost sharing

arrangement. On February 19, 2016, the IRS appealed the ruling to the U.S. Court of Appeals for the Ninth Circuit. On July 24, 2018, the U.S. Court of Appeals for the Ninth Circuit reversed the 2015 decision of the U.S. Tax Court that had found certain Treasury regulations related to stock-based compensation to be invalid. On August 7, 2018, the U.S. Court of Appeals for the Ninth Circuit withdrew its July 24, 2018 opinion to allow a reconstituted panel to confer on the decision. This reconstituted panel will

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reconsider the validity of the cost sharing regulations at issue. The regulations at issue require related entities to share the cost of employee stock compensation in order for their cost-sharing arrangements to be classified as “qualified cost-sharing arrangements” and to avoid potential IRS adjustment. The Company will evaluate the implications of the final decision, when rendered.

On December 22, 2017, the U.S. Tax Cuts and Jobs Act (the “Tax Act”) was passed into law. The Act includes many provisions; including reducing the US federal corporate income tax rate from 35% to 21%, requiring companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creating new taxes on certain foreign sourced earnings. We have made a reasonable estimate of the effects of the Act as of September 30, 2018, in accordance with guidance in SAB 118. We will continue to monitor the estimated impacts as additional guidance is released. Any adjustments recorded to the provisional amounts through fourth quarter 2018 will be included in net income as an adjustment to tax expense.

We continue to maintain a valuation allowance of \$37.6 million against certain of our deferred tax assets, including all federal, state, and certain foreign deferred tax assets as a result of uncertainties regarding the realization of the asset balance due to historical losses, the variability of operating results, and uncertainty regarding near term projected results. In the event that we determine the deferred tax assets are realizable based on an assessment of relevant factors, an adjustment to the valuation allowance may increase income in the period such determination is made. The valuation allowance does not impact our ability to utilize the underlying net operating loss carryforwards.

We also maintain liabilities for uncertain tax positions. As of September 30, 2018, we had unrecognized tax benefits under ASC 740 “Income Taxes” of approximately \$4.8 million and applicable interest of \$16,000. The total amount of unrecognized tax benefits that would affect our effective tax rate, if recognized, is \$405,000.

**LIQUIDITY AND CAPITAL RESOURCES**

Our cash, cash equivalents, and short-term investments consist primarily of money market funds and treasury bills and government agency securities. All of our short-term investments are classified as available-for-sale. The securities are stated at market value, with unrealized gains and losses reported as a component of accumulated other comprehensive income within stockholders’ equity.

On September 30, 2018, our cash, cash equivalents, and short-term investments totaled \$130.5 million, an increase of \$84.0 million from \$46.5 million on December 31, 2017.

**Cash provided by (used in) operating activities**

Net cash provided by operating activities was \$75.5 million during the nine months ended September 30, 2018 compared to \$42.1 million cash used in operating activities during the nine months ended September 30, 2017. The \$117.6 million change was primarily related to \$90.5 million increase from \$33.0 million net loss for the nine months ended September 30, 2017 to \$57.5 million net income for the nine months ended September 30, 2018 and \$26.8 million increase in the year-over-year change in deferred revenue, partially offset by \$3.8 million increase in the year-over-year change in other non-current assets. The increases in the year-over-year changes in deferred revenue and other non-current assets primarily reflected the effect of the adoption of ASC 606 on January 1, 2018. Cash provided by operating activities was also affected by an increase in non-cash charges of \$2.2 million primarily related to higher stock-based compensation expense incurred for the nine months ended September 30, 2018 compared to the same period last year.

**Cash provided by investing activities**

Net cash provided by investing activities during the nine months ended September 30, 2018 was \$4.3 million, an increase of \$172,000 compared to \$4.1 million cash provided by investing activities during the nine months ended September 30, 2017. Net cash provided by investing activities during the current period consisted of maturities of short-term investments of \$22.0 million, partially offset by purchases of short-term investments of \$17.7 million and purchases of property, plant, and equipment of \$63,000.

**Cash provided by financing activities**

Net cash provided by financing activities during the nine months ended September 30, 2018 was \$8.2 million, an increase of \$7.8 million compared to \$443,000 cash provided by financing activities during the nine months ended September 30, 2017. Net cash provided by financing activities during the current period consisted primarily of

exercises of stock options of \$8.0 million and the issuance of common stock under our ESPP of \$218,000.

We believe that our cash, cash equivalents, and short-term investments will be sufficient to meet our working capital needs for at least the next twelve months. Of our total cash, cash equivalents, and short-term investments of \$130.5 million on September 30, 2018, 7% was held by our foreign subsidiaries and subject to repatriation tax effects. Our intent is to

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permanently reinvest all of our earnings from foreign operations, and current plans do not anticipate that we will need funds generated from foreign operations to fund our domestic operations. We will continue to invest in, protect, and defend our extensive IP portfolio, which is expected to result in the continued use of cash during period of active litigation. At September 30, 2018, there was \$33.4 million remaining under our previously-approved share repurchase program. We anticipate that capital expenditures for property and equipment for the year ended December 31, 2018 will be less than \$1.0 million. Cash from operations could also be affected by various risks and uncertainties, including but not limited to the risks detailed in Part II, Item 1A titled “Risk Factors”. Additionally, if we acquire businesses, patents, or technology, our cash or capital requirements could increase substantially. In the event of such an acquisition, or should any unanticipated circumstances arise that significantly increase our capital requirements, we may elect to raise additional capital through debt or equity financing. Any of these events could result in substantial dilution to our stockholders. There is no assurance that such additional capital will be available on terms acceptable to us, if at all.

**SUMMARY DISCLOSURES ABOUT CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS**

We presented our contractual obligations in our Annual Report on Form 10-K for the year ended December 31, 2017. Our principal commitments as of September 30, 2018 consisted of obligations under operating leases. There have been no material changes in those obligations during the nine months ended September 30, 2018.

As of September 30, 2018, we had a liability for unrecognized tax benefits totaling \$4.8 million including interest of \$16,000, of which approximately \$405,000 could be payable in cash.

**RECENT ACCOUNTING PRONOUNCEMENTS**

See Note 1 and Note 2 to the Condensed Consolidated Financial Statements for information regarding the effect of new accounting pronouncements on our financial statements, in particular the impact of ASC 606 adoption.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

**Cash Equivalents and Short-term Investments** — We had cash equivalents and short-term investments of \$104.8 million as of September 30, 2018, which are subject to interest rate fluctuations. An increase in interest rates could adversely affect the market value of our cash equivalents and short-term investments. A hypothetical 100 basis point increase in interest rates would result in a decrease of approximately \$71,000 in the fair value of our cash equivalents and short-term investments as of September 30, 2018.

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

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

**ITEM 4. CONTROLS AND PROCEDURES**

**EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

Based on their evaluation as of September 30, 2018, our management with the participation of our Interim Chief Executive Officer and Chief Financial Officer, have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) were effective to ensure that the information required to be disclosed by us in this quarterly report on Form 10-Q was (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and (ii) accumulated and communicated to our management, including our Interim Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Effective January 1, 2018, in connection with our adoption of ASC 606, we implemented changes to certain controls and related procedures designed to provide reasonable assurance that our condensed consolidated financial statements reflect the proper application of the guidance within ASC 606. Those changes in internal controls included the revision of our revenue recognition accounting policies in accordance with ASC 606 and the development of new controls to support in our estimation of per unit royalties and allocation of transaction price between performance obligations under fixed fee license contracts with respect to the adoption of ASC 606. There were no other changes to internal controls over financial reporting that occurred during the quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

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



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PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Immersion Corporation vs. Apple, Inc., AT&T Inc., and AT&T Mobility LLC

On February 11, 2016, we filed a complaint against Apple, Inc. (“Apple”), AT&T, Inc. (“AT&T”), and AT&T Mobility LLC (“AT&T Mobility”) with the U.S. International Trade Commission (the “ITC”) and a complaint against Apple, AT&T and AT&T Mobility in the U.S. District Court for the District of Delaware alleging that the Apple iPhone 6, iPhone 6 Plus, iPhone 6s, iPhone 6s Plus, Apple Watch, Apple Watch Sport and Apple Watch Edition infringe certain of our patents that cover haptic feedback systems and methods.

In the February 2016 ITC complaint, we sought an exclusion order preventing the importation, sale for importation, and sale after importation of infringing Apple devices into the United States by the defendants and appropriate cease and desist orders. In the U.S. District Court suit, we alleged infringement of the same patents.

The complaints asserted infringement by the Apple iPhone 6, Apple iPhone 6 Plus, Apple iPhone 6s, Apple iPhone 6s Plus, Apple Watch, Apple Watch Sport and Apple Watch Edition of the following two Immersion patents:

U.S. Patent No. 8,619,051 (the ‘051 patent): “Haptic Feedback System with Stored Effects”

U.S. Patent No. 8,773,356 (the ‘356 patent): “Method and Apparatus for Providing Tactile Sensations”

The complaints also asserted infringement by the iPhone 6s and iPhone 6s Plus of the following Immersion patent:

U.S. Patent No. 8,659,571 (the ‘571 patent): “Interactivity Model for Shared Feedback on Mobile Devices”

On March 14, 2016, the ITC issued a Notice of Institution of Investigation stating that the ITC instituted an investigation to investigate our allegations of infringement with respect to the ‘051, ‘356, and ‘571 patents and determine whether violations of section 337 of the Tariff Act of 1930 have occurred. The investigation bears the designation Inv. No. 337-TA-990 (“990 Investigation”). On April 6, 2016, the Chief Administrative Law Judge (“ALJ”) entered an order terminating Respondent AT&T from the investigation, based on the stipulation and joint motion of the parties to terminate AT&T in a manner that preserved our ability to obtain discovery and compliance with any relief the ITC may order. On April 4, 2016, Respondents Apple and AT&T Mobility served responses to the complaint denying the material allegations of the complaint and alleging affirmative defenses, including among others that the asserted patents are not infringed, invalid and unenforceable. Respondents also alleged that the ‘356 patent is unenforceable for alleged inequitable conduct before the United States Patent and Trademark Office. We responded to the allegations of Respondents during the investigation on the procedural schedule set by the Chief ALJ.

On March 21, 2016, pursuant to 28 U.S.C. § 1659(a), the U.S. District Court entered an order staying the U.S. District Court case pending a final determination in the ITC investigation.

On May 5, 2016, we filed another complaint against Apple, AT&T and AT&T Mobility with the ITC and a complaint against Apple, AT&T and AT&T Mobility in the U.S. District Court for the District of Delaware alleging that the Apple iPhone 6s, iPhone 6s Plus, MacBook and MacBook Pro with Retina Display infringed certain of our patents, including patents covering pressure-related haptics.

In the May 2016 ITC complaint, we sought an exclusion order preventing the importation, sale for importation, and sale after importation of infringing Apple devices into the United States by the defendants and appropriate cease and desist orders. In the U.S. District Court suit, we alleged infringement of the same patents.

The complaints asserted against Apple, AT&T and AT&T Mobility claims of infringement by the Apple iPhone 6s and Apple iPhone 6s Plus of the following three Immersion patents:

U.S. Patent No. 8,749,507 (the ‘507 patent), “Systems and Methods for Adaptive Interpretation of Input from a Touch-Sensitive Input Device”;

U.S. Patent No. 7,808,488 (the ‘488 patent), “Method and Apparatus for Providing Tactile Sensations”

U.S. Patent No. 8,581,710 (the ‘710 patent), “Systems and Methods for Haptic Confirmation of Commands”

The complaints also asserted against Apple claims of infringement by the Apple MacBook and Apple MacBook Pro with Retina display of Immersion’s U.S. Patent No. 7,336,260 (the ‘260 patent), “Method and Apparatus for Providing Tactile Sensations.”





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On May 9, 2016, Immersion and AT&T entered into a stipulation to terminate AT&T as a Proposed Respondent, on the same terms to which the parties agreed to terminate AT&T from the 990 Investigation.

On June 6, 2016, the ITC issued a Notice of Institution of Investigation stating that the ITC instituted an investigation to investigate our allegations of infringement with respect to the '507, '488, '710, and '260 patents and determine whether violations of section 337 of the Tariff Act of 1930 have occurred. The investigation was designated Inv. No. 337-TA-1004 ("1004 Investigation"). On June 9, 2016, the Chief ALJ entered an order consolidating the 990 and 1004 Investigations. On June 15, 2016, the Chief ALJ granted a joint motion by the parties to stay the 990 Investigation deadlines until a new procedural schedule could be entered in the consolidated Investigation.

On June 16, 2016, pursuant to 28 U.S.C. § 1659(a), the U.S. District Court entered an order staying the U.S. District Court case pending a final determination in the ITC investigation.

On June 27, 2016, Respondents Apple and AT&T Mobility served responses to the complaint denying the material allegations of the complaint and alleging affirmative defenses, including among others that the asserted patents are not infringed, invalid and unenforceable. Respondents also alleged that the '710 patent is unenforceable for alleged inequitable conduct before the United States Patent Office. We responded to the allegations of Respondents during the investigation on the procedural schedule set by the Chief ALJ. On June 29, 2016, the Chief ALJ entered an order setting the Markman hearing in the consolidated case for October 18, 2016, and the evidentiary hearing for April 27-May 5, 2017. On July 12, 2016, the Chief ALJ entered the procedural schedule in the consolidated Investigation. The procedural schedule in the Investigation included, among other things, deadlines for the parties to conduct three required settlement conferences. On July 26, 2016, representatives for Immersion and Respondent AT&T conducted their first settlement conference. On July 28, 2016, representatives for Immersion and Respondent Apple conducted their first settlement conference. The parties did not reach an agreement to settle the dispute underlying the Investigation at that time.

In September 2016, Respondent Apple released additional products, including the iPhone 7 and 7 plus and the Apple Watch Series 2. We served discovery responses and contentions identifying these newly released products as products at issue in the Investigation.

On October 18, 2016, the Chief ALJ conducted a Markman hearing with respect to the construction of terms of the Asserted Patents. The Chief ALJ indicated at the hearing that a ruling could be expected in approximately three months.

On December 15, 2016, Respondents filed a motion for summary determination that the asserted claims 1 and 2 of the '260 patent are invalid under 35 U.S.C. § 101 for an alleged failure to recite patentable subject matter. On December 27, 2016, we filed our opposition to the motion. On December 27, 2016, the Commission Investigative Staff submitted a response to the motion stating that the Staff supports the motion. On April 6, 2017, the Chief ALJ issued an order denying the motion.

On January 18, 2017, the parties participated in a one-day mediation session. The parties did not reach an agreement to resolve the dispute at the mediation.

On February 1, 2017, Respondents Apple and AT&T filed three motions for summary determination on certain issues in the Investigation. In particular, the motions requested that Chief ALJ determine:

- that prosecution history estoppel precludes Immersion from asserting that the accused products and the technical domestic industry products satisfy certain limitations of the asserted patents under the doctrine of equivalents;
- that (1) Respondents do not infringe claims 7 and 17 of the '356 patent and claims 7, 11 and 15 of the '051 patent; and (2) the Apple Watch products do not infringe the '356 patent and Apple's iPhone 6, 6 Plus and SE products do not infringe the '051 patent; and
- that claims 2-5, 10-12, and 15-17 of the '507 patent are invalid under 35 U.S.C. § 112 for failing to comply with the written description requirement.

On February 2, 2017, Chief ALJ Bullock issued his Markman ruling, Order No. 27 Construing the Terms of the Asserted Claims. The Chief ALJ adopted Immersion's proposed constructions for some disputed terms. On other terms, the Chief ALJ adopted constructions that Respondents or Staff had proposed, and on other terms the Chief ALJ fashioned his own construction.

On February 3, 2017, Immersion brought an unopposed motion for partial termination of the investigation with respect to certain contentions that were no longer being pursued. These include Immersion's allegations of infringement as to (1) claims 7 and 17 of the '356 patent, (2) claims 7, 11, and 15 of the '051 patent, (3) the Apple Watch products solely with respect to the '356 patent, and (4) the Apple iPhone 6, 6 Plus, and SE products solely with respect to the '051 patent. Immersion also stated in the motion its position that the request for termination as to the withdrawn allegations rendered Respondents motion for summary determination on these particular issues moot. On February 9, 2017 the Chief ALJ issued an order granting partial termination of the Investigation as to certain asserted claims of the '356 patent and the '051 patent as described above.

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On February 10, 2017, Respondents filed a notice of withdrawal of their motion for summary determination as to the particular contentions under the '356 patent and '051 patent that had been withdrawn during the Investigation. On February 13, 2017, Immersion filed its oppositions to those motions for summary determination that remained pending. On February 14 and 16, 2017, the Chief ALJ issued orders denying each of Respondents' motions for summary determination.

On March 21, 2017, Immersion brought an unopposed motion for partial termination of the investigation with respect to all claims of the '571 patent and claims 7-10 of the '710 patent. On March 23, 2017, the Chief ALJ issued an order granting partial termination as to the '571 patent and certain claims of the '710 patent as described above. On March 23, 2017, the Chief ALJ also issued a notice that the evidentiary hearing would begin on April 27, 2017 and conclude on May 4, 2017 (as opposed to May 5, 2017).

The evidentiary hearing with respect to the consolidated investigation by the United States International Trade Commission bearing the designation Inv. No. 337-TA-990/1004 commenced on April 27, 2017 and concluded on May 4, 2017. On May 31, 2017, the parties and the Office of Unfair Import Investigations ("OUII") Staff submitted their initial post-hearing briefs, and on June 7, 2017, the parties and OUII Staff submitted their post-hearing reply briefs. Before submitting these briefs, we provided a notice on May 11, 2017 that we would not be pursuing in our Post-Hearing Brief claims 3, 13, and 23 of the '356 patent. On October 20, 2017, Immersion brought an unopposed motion for partial termination of the investigation with respect to claims 3, 13, and 23 of the '356 patent. On October 23, 2017, the Chief ALJ issued an order granting partial termination as to claims 3, 13, and 23 of the '356 patent as described above.

The due date for the Chief ALJ's initial determination was scheduled for August 11, 2017. On July 13, 2017, the Chief ALJ entered an order extending the due date for the Chief ALJ's initial determination from August 11, 2017 to November 13, 2017 and extending the target date for the completion of the investigation from December 11, 2017 to March 12, 2018. On October 30, 2017, the Chief ALJ issued an order extending the final initial determination date to no later than the close of business on January 31, 2018 and the final determination date to no later than May 31, 2018. On January 29, 2018, we announced that we reached a settlement with Apple resolving the Investigation. On January 30, 2018, the Chief ALJ issued an Order Extending Target Date By Two Months in which he extended the target date two months in order to allow the parties sufficient time to prepare and submit a joint motion to terminate the investigation. The Chief ALJ also issued an order staying and suspending all dates and deadlines. On February 8, 2018, the parties submitted to the ITC a Joint Motion to Terminate Based on Settlement. The parties also requested confidential treatment of the settlement agreement. On February 13, 2018, the OUII Staff filed a response expressing the Staff's support for the motion. On February 20, 2018, the Chief ALJ entered an order entitled "Initial Determination Granting Joint Motion to Terminate The Investigation Based On A Settlement Agreement." The Chief ALJ found good cause to terminate the investigation based on the settlement and granted the parties' motion to terminate the investigation. The Chief ALJ also granted the parties' motion to limit service of the confidential settlement agreement to only Apple and Immersion (and not to counsel for AT&T).

On March 15, 2018, the Commission issued a notice stating that the Commission has determined not to review the Chief ALJ's decision granting the motion to terminate the investigation based on settlement. As a result of this decision and the underlying settlement agreement, the ITC proceedings have concluded.

As noted above, on January 29, 2018, we announced that we reached a settlement with Apple resolving the above-described litigation. As part of the settlement, the parties agreed to submit joint stipulations in the District Court actions to dismiss those actions in their entirety with prejudice. On February 6, 2018, the Parties filed the Stipulations of Dismissal with the District Court. In addition to requesting the dismissal of the action with prejudice, the stipulations provide that each party shall bear its own fees and costs. On February 7, 2018, the District Court issued orders dismissing the above-described litigation pursuant to the stipulations of the parties.

On July 7, 2016, Apple filed in the United States Patent and Trademark Office a petition for inter partes review of the '051 patent. The petition bears Case No. IPR2016-01371. The petition challenged the patentability of certain claims of the '051 patent in light of alleged prior art references. On October 13, 2016, we filed a Patent Owner's Preliminary Response responding to the petition's challenges to patentability of claims of the '051 patent. On January 11, 2017, the Patent Trial and Appeal Board ("PTAB" or "Board") issued a decision denying the Petition and declining to institute the

IPR. On February 10, 2017, Apple submitted in the United States Patent and Trademark Office a second IPR petition challenging the patentability of certain claims of the '051 patent in light of alleged prior art references. This Petition bears Case No. IPR2017-00887. We filed our Patent Owner's Preliminary Response in this IPR on May 30, 2017. On August 25, 2017, the PTAB issued a decision denying Apple's petition and declining to institute the second IPR. On July 7, 2016, Apple filed in the United States Patent and Trademark Office a petition for inter partes review of the '571 patent. The petition bears Case No. IPR2016-01372. The petition challenged the patentability of certain claims of the '571 patent in light of alleged prior art references. On October 13, 2016, we filed a Patent Owner's Preliminary Response responding to the

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petition's challenges to patentability of claims of the '571 patent. On January 11, 2017, the PTAB issued its decision instituting the IPR on certain grounds raised in the Petition. The Board's decision also declined to institute the IPR as to certain claims of the '571 patent. The Board set a schedule of certain due dates in the IPR. On May 31, 2017, we submitted our Patent Owner's Response to the IPR. Apple filed its Reply to the Patent Owner's Response on August 4, 2017. On August 31, 2017, we submitted a Motion for Observation regarding the testimony of Apple's expert on cross-examination at deposition. Apple responded to these observations on September 5, 2017. On October 5, 2017, the PTAB conducted the Oral Hearing in this IPR. On January 10, 2018, the PTAB issued a Final Written Decision finding claims 1-4, 6, 23-26, and 28 of the '571 patent unpatentable. On February 1, 2018, the parties emailed the PTAB and requested authorization to file a joint motion to vacate final decision and terminate proceeding in IPR2016-1372 in light of the settlement between the parties. On February 2, 2018, the PTAB denied the parties' request to file such a motion. On March 14, 2018, Immersion filed with the United States Patent and Trademark Office ("USPTO") and the U.S. Court of Appeal for the Federal Circuit notices of appeal from the Board's final written decision in IPR2016-1372 for the '571 patent. On March 27, 2018, Immersion filed in the Federal Circuit the required Certificates of Interest and Docketing Statements. Apple also filed in the Federal Circuit notices stating that it will not be participating in the appeals. On April 23, 2018, the USPTO filed the certified list of documents that comprise the record in IPR2016-1372. Our opening brief in the appeal was due on June 22, 2018. On May 10, 2018, we filed a motion seeking a 30-day extension to file the brief and the motion was granted on May 11, 2018. The USPTO entered a notice of intervention on April 25, 2018. On July 6, 2018 Immersion filed an unopposed motion to voluntarily dismiss its appeal. The Federal Circuit granted Immersion's motion and dismissed the appeal on July 9, 2018. On or about February 12, 2017, Apple submitted in the United States Patent and Trademark Office a second IPR petition challenging the patentability of certain claims of the '571 patent in light of alleged prior art references. This Petition bears Case No. IPR2017-00896. We filed our Patent Owner's Preliminary Response in this IPR on May 22, 2017. On August 17, 2017, the PTAB issued a decision denying Apple's petition and declining to institute the second IPR. On July 8, 2016, Apple filed in the United States Patent and Trademark Office a petition for inter partes review of the '356 patent. The petition bears Case No. IPR2016-01381. The petition challenged the patentability of certain claims of the '356 patent in light of alleged prior art references. On October 12, 2016, we filed a Patent Owner's Preliminary Response responding to the petition's challenges to patentability of claims of the '356 patent. On January 11, 2017, the PTAB issued its decision instituting the IPR on certain grounds raised in the Petition. The Board set a schedule of certain due dates in the IPR. On May 31, 2017, we submitted our Patent Owner's Response to the IPR. Apple filed its Reply to the Patent Owner's Response on July 28, 2017. On August 31, 2017, we submitted a Motion for Observation regarding the testimony of Apple's expert on cross-examination at deposition. Apple responded to these observations on September 5, 2017. On October 5, 2017, the PTAB conducted the Oral Hearing in this IPR. On January 10, 2018, the PTAB issued a Final Written Decision finding claims 1-3, 5, 7, 9-13, 15, 17, 19-23, 25, and 26 of the '356 patent unpatentable. On January 10, 2018, Apple submitted to the Chief ALJ in the ITC proceeding a Notice of Supplemental Authority Regarding the '356 Patent to inform the Chief ALJ of the Board's decision in this IPR. On February 1, 2018, the parties emailed the PTAB and requested authorization to file a joint motion to vacate final decision and terminate proceeding in IPR2016-1381 in light of the settlement between the parties. On February 2, 2018, the PTAB denied the parties' request to file such a motion. On March 14, 2018, Immersion filed with the USPTO and the U.S. Court of Appeal for the Federal Circuit notices of appeal from the Board's final written decision in IPR2016-1381 for the '356 patent. On March 27, 2018, Immersion filed in the Federal Circuit the required Certificates of Interest and Docketing Statements. Apple also filed in the Federal Circuit notices stating that it will not be participating in the appeals. On April 23, 2018, the USPTO filed the certified list of documents that comprise the record in IPR2016-01381. Our opening brief in the appeal was due on June 22, 2018. On May 10, 2018, we filed a motion seeking a 30-day extension to file the brief and the motion was granted on May 11, 2018. The USPTO entered a notice of intervention on April 25, 2018. On July 6, 2018 Immersion filed an unopposed motion to voluntarily dismiss its appeal. The Federal Circuit granted Immersion's motion and dismissed the appeal on July 9, 2018. On or about February 12, 2017, Apple submitted in the United States Patent and Trademark Office a second IPR petition challenging the patentability of certain claims of the '356 patent in light of alleged prior art references. This IPR bears Case No. 2017-00897. We filed our Patent Owner's Preliminary Response in this IPR on May 22, 2017. On August 17, 2017, the PTAB issued a

decision denying Apple's petition and declining to institute the second IPR.

On August 12, 2016, Apple filed in the United States Patent and Trademark Office a petition for inter partes review of the '710 patent. The petition bears Case No. IPR2016-01603. The petition challenged the patentability of certain claims of the '710 patent in light of alleged prior art references. On November 28, 2016, we filed a Patent Owner's Preliminary Response responding to the petition's challenges to patentability of claims of the '710 patent. On February 23, 2017, the PTAB issued its decision instituting the IPR on certain grounds raised in the petition. The Board set a schedule of certain due dates in the IPR. On June 28, 2017, we submitted our Patent Owner's Response in the IPR. Apple filed its Reply to the Patent Owner's Response on August 24, 2017. On October 16, 2017, we submitted a Motion for Observation regarding testimony of Apple's expert on cross-examination at deposition. On November 16, 2017, the PTAB conducted the Oral Hearing in this IPR. On February 1, 2018, the parties emailed the PTAB and requested authorization to file a joint motion to terminate IPR2016-1603 in light of the settlement between the parties. On February 2, 2018, the PTAB granted the request. On February 8, 2018, the parties filed a joint motion to terminate the IPR. The parties also requested confidential treatment of the settlement agreement. On February 12, 2018, the PTAB granted

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the parties' joint motion to terminate the IPR as well as the parties' joint request for confidential treatment of the settlement agreement. On or about May 4, 2017, Apple submitted in the United States Patent and Trademark Office a second IPR petition challenging the patentability of certain claims of the '710 patent in light of alleged prior art references. This IPR bears Case No. 2017-01368. We filed our Patent Owner's Preliminary Response on August 24, 2017. On November 7, 2017, the PTAB issued a decision denying Apple's petition and declining to institute the second IPR.

On September 12, 2016, Apple filed in the United States Patent and Trademark Office a petition for inter partes review of the '507 patent. The petition bears Case No. IPR2016-01777. The petition challenged the patentability of certain claims of the '507 patent in light of alleged prior art references. On December 27, 2016, we filed a Patent Owner's Preliminary Response responding to the petition's challenges to patentability of claims of the '507 patent. On March 23, 2017, the Board issued its decision denying the Petition and declining to institute the IPR. On May 9, 2017, Apple submitted in the United States Patent and Trademark Office a second IPR petition challenging the patentability of certain claims of the '507 patent in light of alleged prior art references. This IPR bears Case No. 2017-01310. We filed our Patent Owner's Preliminary Response on August 9, 2017. On November 2, 2017, the PTAB issued a decision denying Apple's petition and declining to institute the second IPR.

On September 23, 2016, Apple filed in the United States Patent and Trademark Office a petition for inter partes review of the '260 patent. The petition bears Case No. IPR2016-01884. The petition challenged the patentability of certain claims of the '260 patent in light of alleged prior art references. On January 4, 2017, we filed a Patent Owner's Preliminary Response responding to the petition's challenges to patentability of claims of the '260 patent. In response to a request of the Petitioner, the Board also authorized the parties to file Reply and Sur-Reply briefs on certain issues. Petitioner filed a Reply Brief on January 31, 2017. We filed our Patent Owner's Sur-Reply brief on February 14, 2017. On April 3, 2017, the Board issued a decision instituting the IPR on certain grounds raised in the petition. The Board set a schedule of certain due dates in the IPR. On July 3, 2017, we submitted our Patent Owner's Response in the IPR. Apple filed its Reply to the Patent Owner's Response on October 10, 2017. The Oral Hearing took place on January 10, 2018. On February 1, 2018, the parties emailed the PTAB and requested authorization to file a joint motion to terminate IPR2016-1884 in light of the settlement between the parties. On February 2, 2018, the PTAB granted the request. On February 8, 2018, the parties filed a joint motion to terminate the IPR. The parties also requested confidential treatment of the settlement agreement. On March 22, 2018, the Board issued a decision granting the joint motion to terminate. The Board also granted the joint motion to treat the underlying settlement agreement as confidential business information and kept separate from the rest of the file. On or about May 4, 2017, Apple submitted in the United States Patent and Trademark Office a second IPR petition challenging the patentability of certain claims of the '260 patent in light of alleged prior art references. This IPR bears Case No. 2017-01369. We filed our Patent Owner's Preliminary Response on August 24, 2017. On November 21, 2017, the PTAB issued a decision denying Apple's petition and declining to institute the second IPR.

On September 29, 2016, Apple filed in the United States Patent and Trademark Office a petition for inter partes review of the '488 patent. The petition bears Case No. IPR2016-01907. The petition challenged the patentability of certain claims of the '488 patent in light of alleged prior art references. On January 5, 2017, we filed a Patent Owner's Preliminary Response responding to the petition's challenges to patentability of claims of the '488 patent. In response to a request of the Petitioner, the Board authorized the parties to file Reply and Sur-Reply briefs. Petitioner filed a Reply Brief on January 31, 2017. We filed our patent owner's Sur-Reply brief on February 14, 2017. On April 3, 2017, the Board issued a decision instituting the IPR on certain grounds raised in the petition. The Board set a schedule of certain due dates in the IPR. On July 3, 2017, we filed our Patent Owner's Response in the IPR. Apple filed its Reply to the Patent Owner's Response on October 10, 2017. The Oral Hearing took place on January 10, 2018. On February 1, 2018, the parties emailed the PTAB and requested authorization to file a joint motion to terminate IPR2016-1907 in light of the settlement between the parties. On February 2, 2018, the PTAB granted the request. On February 8, 2018, the parties filed a joint motion to terminate the IPR. The parties also requested confidential treatment of the settlement agreement. On March 22, 2018, the Board issued a decision granting the joint motion to terminate. The Board also granted the joint motion to treat the underlying settlement agreement as confidential business information and kept separate from the rest of the file. On or about May 4, 2017, Apple submitted in the United States Patent and



Trademark Office a second IPR petition challenging the patentability of certain claims of the '488 patent in light of alleged prior art references. This IPR bears Case No. 2017-01371. We filed our Patent Owner's Preliminary Response on August 24, 2017. On November 21, 2017, the PTAB issued a decision denying Apple's petition and declining to institute the second IPR.

On October 26, 2017, we filed a patent infringement lawsuit in the Beijing High People's Court against Apple Computer Trading (Shanghai) Co., Ltd., Apple Electronic Product Commerce (Beijing) Co., Ltd., and Apple Trading (Shanghai) Co., Ltd. alleging that the iPhone 6s, iPhone 6s Plus, iPhone 7, iPhone 7 Plus, iPhone 8 and iPhone 8 Plus infringe our Chinese patents ZL02821854.X and ZL200810008845.X. We sought a permanent injunction preventing the importation, sale and offering for sale of the iPhone products noted above in China as well as damages. As noted above, on January 29, 2018, we announced that we reached a settlement with Apple resolving the above-described litigation. The Beijing High People's Court has approved the withdrawal of this case.

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Immersion Corporation v. FitBit and Runtong International Trade Co., Ltd. (Shanghai Intellectual Property Court)  
On June 29, 2017, local counsel for Immersion filed a patent infringement lawsuit against Fitbit, Inc. (“Fitbit”) in the Shanghai Intellectual Property Court alleging that Fitbit infringed three of our Chinese patents. The three patents at issue were Chinese Patent No. CN101305416B, entitled “methods and systems for providing haptic messaging to handheld communication devices”; No. CN102187647B, entitled “systems and methods for mapping message contents to virtual physical properties for sending vibrotactile messaging”; and No. CN102160366B, entitled “systems and methods for transmitting haptic messages.” The Shanghai Intellectual Property Court accepted the case on July 7, 2017. Thereafter, the reseller defendant, Rui Jin Lin (Dalian) Information Technology Co., Ltd. filed an objection to the Court’s jurisdiction. The court held an inter-party hearing on April 11, 2018 to discuss, among other things, whether to incorporate Rui Jin Lin as a defendant along with Runtong, and the Court affirmed its jurisdiction over the reseller defendant.

Relatedly, Petitions for Invalidation were filed with the Patent Reexamination Board by FitBit for Chinese Patent Nos. CN101305416B, CN102160366B, and CN102187647B. A hearing for FitBit’s Petition for Invalidation of Chinese Patent No. CN102160366B took place on April 16, 2018, a hearing for Chinese Patent No. CN101305416B took place on April 26, 2018, and a hearing for Chinese Patent No. CN102187647B took place on June 13, 2018. On June 29, 2018, the Patent Reexamination Board invalidated Chinese Patent No. CN102160366B.

On July 8, 2018, we reached a global settlement with Fitbit, and requested to withdraw the patent litigation suit in the Shanghai Intellectual Property Court on July 17, 2018. The Shanghai Intellectual Property Court granted the request on July 30, 2018. Fitbit requested withdrawal of the remaining invalidity petitions on July 11, 2018. The Patent Reexamination Board granted the withdrawal motion with respect to CN101305416B on July 13, 2018 and with respect to CN102187647B on July 24, 2018, and as a result, both patents remain valid.

Immersion Corporation v. Fitbit, Inc., Case No. 5:17-cv-03886-LHK (N.D. Cal.)

On July 10, 2017, we filed a patent infringement lawsuit against Fitbit in the U.S. District Court for the Northern District of California alleging that Fitbit has infringed three of our U.S. Patents. The three patents at issue were U.S. Patent No. 8,351,299, entitled “Apparatus and Method for Providing Condition-Based Vibrotactile Feedback”; No. 8,059,105, entitled “Haptic Feedback for Touchpads and Other Touch Controls”; and No. 8,638,301, entitled “Systems and Methods for Transmitting Haptic Messages.” Generally, these U.S. patents cover “touch-feedback” - or haptic feedback - devices, systems and methods. Fitbit devices alleged to infringe include the Fitbit Flex, Fitbit Flex 2, Fitbit Alta, Fitbit Alta HR, Fitbit Charge, Fitbit Charge 2, Fitbit Charge HR, Fitbit Blaze and Fitbit Surge. We served Fitbit with the Complaint, among other papers, on July 11, 2017. On October 4, 2017, in lieu of answering, Fitbit filed a Motion to Dismiss pursuant to 12(b)(6) based on 35 USC § 101. The hearing on Fitbit’s Motion to Dismiss was set for February 15, 2018. The parties attended an Initial Case Management Conference on October 18, 2017. The claim construction hearing was originally scheduled for May 10, 2018, and the trial date was originally scheduled for May 6, 2019. On November 1, 2017, we filed our response to Fitbit’s motion to dismiss. On February 8, 2018, the parties participated in Court-ordered mediation of the U.S. district court case. On February 13, 2018, the Court took Fitbit’s Motion to Dismiss under submission without oral argument and vacated the hearing previously set for February 15, 2018. The Court denied Fitbit’s Motion to Dismiss under 35 USC 101 with respect to the ’105 Patent and ’299 Patent, but granted with respect to the ’301 Patent, leaving two patents-in-suit remaining. On March 19, 2018, Fitbit filed an Answer and Counterclaims, seeking declaratory judgment of invalidity and non-infringement for each of the patents-in-suit. Immersion answered Fitbit’s counterclaims on April 9, 2018. The parties exchanged proposed claim constructions and exchanged claim construction briefs in April 2018. Fitbit alleged that two of the claim terms were indefinite, and that the asserted claims were therefore invalid. The claim construction hearing took place on June 21, 2018, but the Court did not issue a final order.

On July 8, 2018, we reached a global settlement with Fitbit, and jointly requested dismissal, without prejudice, of each party’s claims for relief, with each party bearing its own fees and costs. The Court issued an Order on July 9, 2018, granting the joint motion for dismissal.

On February 7, 2018, Fitbit filed in the United States Patent and Trademark Office two petitions for inter partes review (IPR) of the '105 patent (Case Nos. IPR2018-00588 and IPR2018-00590); a petition for IPR of the '299 patent (Case No. IPR2018-00591); and two petitions for IPR of the '301 patent (Case Nos. IPR2018-00592 and IPR2018-00593). The last days for the Patent Trial and Appeal Board to decide whether to institute IPR are August 15, 23, and September 17, 2018, respectively. As discussed above, on July 8, 2018, we reached a global settlement with Fitbit, and on July 18, Fitbit requested permission to withdraw each of the petitions for IPR. On July 23, 2018 the Patent Trial and Appeal Board authorized the parties to file a Joint Motion to Dismiss the Petitions, a true copy of any agreement settling their dispute regarding the patents at issue, and a Joint Request that the Settlement Agreement be Treated as Business Confidential Information, pursuant to 37 C.F.R. § 317 and 37 C.F.R. § 42.74. On July 26, 2018

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the parties jointly filed Motions to Terminate/Dismiss Petitions for each IPR and a Joint Request that the Settlement Agreement be Treated as Business Confidential Information, and on August 1, 2108, the Patent Trial and Appeal Board granted such motions and request.

Immersion Corporation vs. Samsung Electronics Co., Ltd. and Samsung Electronics America, Inc. (C.A. No. 17-cv-572)

On August 3, 2017, we filed a complaint against Samsung Electronics Co., Ltd. and Samsung Electronics America, Inc. (collectively, “Samsung”) in the United States District Court for the Eastern District of Texas alleging that certain Samsung touchscreen phones, including those phones that Samsung had not commenced commercially producing, distributing and selling before January 1, 2016 (the “Accused Phones”), infringe certain of our patents that cover haptic feedback systems and methods. In the complaint, we are seeking to stop Samsung from further infringement as well as the recovery of damages. The complaints assert infringement by the Accused Phones of the following patents:

U.S. Patent No 6,429,846 (the ’846 patent): “Haptic Feedback for Touchpads and Other Touch Controls”

U.S. Patent No 7,969,288 (the ’288 patent): “Force Feedback System Including Multi-Tasking Graphical Host Environment and Interface Device”

U.S. Patent No 9,323,332 (the ’332 patent): “Force Feedback System Including Multi-Tasking Graphical Host Environment”

U.S. Patent No 7,982,720 (the ’720 patent): “Haptic Feedback for Touchpads and Other Touch Controls”

U.S. Patent No 8,031,181 (the ’181 patent): “Haptic Feedback for Touchpads and Other Touch Controls”

Samsung filed a response to the Complaint on October 24, 2017.

On December 15, 2017, the Court issued a Docket Control Order setting the claim construction hearing for August 15, 2018 and the first day of jury selection for February 4, 2019. On March 5, 2018, the Court issued an order resetting the first day of jury selection for February 19, 2019.

On June 8, 2018, the Court granted Samsung’s motion to consolidate the case filed on March 8, 2018, with this previously-filed case. On July 10, 2018, the Court entered a new scheduling order for the consolidated cases, setting the claim construction hearing for October 9, 2018, and the first day of jury selection for May 6, 2019. On July 24, 2018, we filed an amended complaint in the consolidated cases. On October 15, 2018, the Court issued its Claim Construction Memorandum and Order.

Immersion Corporation vs. Samsung Electronics Co., Ltd. and Samsung Electronics America, Inc. (C.A. No. 18-cv-55)

On March 8, 2018, we filed a complaint against Samsung Electronics Co., Ltd. and Samsung Electronics America, Inc. (collectively, “Samsung”) in the United States District Court for the Eastern District of Texas alleging that certain Samsung touchscreen phones, including those phones that Samsung had not commenced commercially producing, distributing and selling before January 1, 2016 (the “Accused Phones”), infringe U.S. Patent No 8,619,051, entitled “Haptic Feedback System with Stored Effects,” which covers haptic feedback systems and methods. In the complaint, we are seeking to stop Samsung from further infringement as well as the recovery of damages.

Samsung filed a response to the Complaint on April 20, 2018. On April 27, 2018, Samsung filed a motion to consolidate this case with the previously-filed case that we filed on August 3, 2017. On May 11, 2018, we filed an opposition to the motion to consolidate. On June 8, 2018, the Court granted Samsung’s motion to consolidate this case with the previously-filed case. On July 10, 2018, the Court entered a new scheduling order for the consolidated cases, setting the claim construction hearing for October 9, 2018, and the first day of jury selection for May 6, 2019. On July 24, 2018, we filed an amended complaint in the consolidated cases. On October 15, 2018, the Court issued its Claim Construction Memorandum and Order.

Samsung Petitions for Inter Partes Review (USPTO)

On August 6, 2018, Samsung filed in the United States Patent and Trademark Office two petitions for inter partes review (“IPR”) of the ’846 patent (Case Nos. IPR2018-01467 and IPR2018-01468). In each of the IPR petitions, Samsung asserts that certain claims of the ’846 patent are invalid over alleged prior art patents and publications.

Immersion may optionally file a Patent Owner's Response in IPR2018-01467 by November 22, 2018, and in IPR2018-01468 by November 23, 2018; and the last days for the PTAB to decide whether to institute such IPRs of the '846 patent are February 22 and 23, 2019, respectively.

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On August 6, 2018, Samsung filed in the United States Patent and Trademark Office two petitions for IPR of the '720 patent (Case Nos. IPR2018-01469 and IPR2018-01470). In each of the IPR petitions, Samsung asserts that certain claims of the '720 patent are invalid over alleged prior art patents and publications. Immersion may optionally file a Patent Owner's Response in both IPR2018-01469 and IPR2018-01470 by December 10, 2018; and the last day for the PTAB to decide whether to institute such IPRs of the '720 patent is March 10, 2019.

On August 6, 2018, Samsung filed in the United States Patent and Trademark Office a petition for IPR of the '288 patent (Case No. IPR2018-01499). In the IPR petition, Samsung asserts that certain claims of the '288 patent are invalid over alleged prior art patents and publications. Immersion may optionally file a Patent Owner's Response by December 11, 2018; the last day for the PTAB to decide whether to institute such IPR of the '288 patent is March 11, 2019.

On August 6, 2018, Samsung filed in the United States Patent and Trademark Office two petitions for IPR of the '181 patent (Case Nos. IPR2018-01500 and IPR2018-01501). In each of the IPR petitions, Samsung asserts that certain claims of the '181 patent are invalid over alleged prior art patents and publications. Immersion may optionally file a Patent Owner's Response in both IPR2018-01500 and IPR2018-01501 by January 5, 2019; and the last day for the PTAB to decide whether to institute such IPRs of the '181 patent is April 5, 2019.

On August 6, 2018, Samsung filed in the United States Patent and Trademark Office a petition for IPR of the '332 patent (Case No. IPR2018-01502). In the IPR petition, Samsung asserts that certain claims of the '332 patent are invalid over alleged prior art patents and publications. Immersion may optionally file a Patent Owner's Response in IPR2018-01502 by January 5, 2019; and the last day for the PTAB to decide whether to institute such IPR of the '332 patent is April 5, 2019.

**Immersion Corporation vs. Motorola Mobility LLC and Motorola Mobility Holdings LLC**

On August 3, 2017, we filed a complaint against Motorola Mobility LLC and Motorola Mobility Holdings LLC (collectively, "Motorola") in the United States District Court for the District of Delaware alleging that certain Motorola touchscreen phones, including the Moto G4, Moto G4 Play, Moto G4 Plus, Moto G5, Moto G5 Plus, Moto Z, Moto Z Force and Moto Z Play (the "Accused Phones"), infringe certain of our patents that cover haptic feedback systems and methods. In the complaint, we are seeking to stop Motorola from further infringement as well as the recovery of damages. The complaints assert infringement by the Accused Phones of the following patents:

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

U.S. Patent No 7,969,288: "Force Feedback System Including Multi-Tasking Graphical Host Environment and Interface Device"

U.S. Patent No 9,323,332: "Force Feedback System Including Multi-Tasking Graphical Host Environment"

U.S. Patent No 7,982,720: "Haptic Feedback for Touchpads and Other Touch Controls"

U.S. Patent No 8,031,181: "Haptic Feedback for Touchpads and Other Touch Controls"

On September 25, 2017, Motorola filed its Answer to the Complaint.

On December 5, 2017, the Court issued a Scheduling Order setting the claim construction hearing for September 12, 2018, and the trial date for September 23, 2019.

On February 5, 2018, the Court entered an order setting a mediation conference for August 7, 2018. The mediation conference was rescheduled to October 8 at the request of the parties. The mediation conference was conducted on October 8, 2018 as rescheduled, but did not result in a settlement. On October 25, 2018, the Court issued its Claim Construction Memorandum and Order.

**Samsung Electronics Co. v. Immersion Corporation and Immersion Software Ireland Limited**

On April 28, 2017, we received a letter from Samsung requesting that we reimburse Samsung with respect to withholding tax and penalties imposed on Samsung by the Korean tax authorities following an investigation where the tax authority determined that Samsung failed to withhold taxes on Samsung's royalty payments to Immersion Software Ireland from 2012 to 2016. On July 12, 2017, we filed an appeal with the Korea Tax Tribunal regarding their findings with respect to the withholding taxes and penalties.



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On September 29, 2017, Samsung filed an arbitration demand with the International Chamber of Commerce against us demanding that we reimburse Samsung for the imposed tax and penalties that Samsung paid to the Korean tax authorities. Samsung is requesting that we pay Samsung the amount of KRW 7,841,324,165 (approximately \$6.9 million) plus interest from and after May 2, 2017, plus the cost of the arbitration including legal fees. We deny liability, and asked the International Chamber of Commerce to postpone the arbitration until the tax appeal is resolved. The arbitration panel conducted an initial status conference on February 7, 2018. The International Chamber of Commerce denied our motion to postpone the arbitration, and on March 2, 2018, issued a Procedural Order setting the hearing date for July 23, 2018. We filed our Statement of Defense and Counterclaim on April 16, 2018. A short discovery phase followed, and each side produced documents in May. Samsung filed its Reply to our Statement of Defense on June 11, 2018, and we filed our Surreply on June 25, 2018. The evidentiary hearing took place in Hawaii from July 23, 2018 to July 24, 2018. The parties submitted supplemental legal authorities on August 8, 2018, and submitted cost submissions on October 15, 2018. On August 15, 2018, the Secretariat of the International Court of Arbitration of the International Chamber of Commerce extended the time for rendering the final award until October 31, 2018. On October 31, 2018, the Secretariat of the International Court of Arbitration of the International Chamber of Commerce again extended the time for rendering the final award until November 30, 2018.

We believe that there are valid defenses to all of the claims from the Korean tax authorities and that Samsung's claims are without merit. We intend to vigorously defend against these claims and as a result, we have concluded that the likelihood of a material charge resulting from this claim is remote. In the event Samsung were to prevail in the arbitration in advance of the conclusion of the appeal with the Korea Tax Tribunal, we could be required to make a payment to Samsung even though it would later be reimbursed should we prevail in the appeal.

We cannot predict the ultimate outcome of the above-mentioned actions, and we are unable to estimate any potential liability we may incur. Please also refer to our disclosures in Contingencies, Note 12 to the condensed consolidated financial statements.

Immersion Corporation vs. Samsung (China) Investment Co., Ltd., Huizhou Samsung Electronics Co., Ltd and Fujian Province Min Xin Household Electrical Appliances Technology Service Co., Ltd. (Fuzhou Intellectual Property Court - Case: Min 01 Min Chu No. 342 (2018))

On March 8, 2018, we filed a complaint against Samsung (China) Investment Co., Ltd. ("Samsung China"), Huizhou Samsung Electronics Co., Ltd. ("Samsung Huizhou") (together with Samsung China, "Samsung"), and Fujian Province Min Xin Household Electrical Appliances Technology Service Co., Ltd. in the Fuzhou Intermediate Court in Fuzhou, China alleging that certain Samsung touchscreen phones, including the Galaxy S8, S8+, and Note8, infringe three Immersion Chinese patents. The three patents at issue, covering haptic feedback systems and methods in electronic devices, are Chinese Patent No. ZL02821854.X, entitled "Method and Apparatus for Providing Tactile Feedback Sensations"; Chinese Patent No. ZL201210005785.2, entitled "Method and Apparatus for Providing Tactile Feedback Sensations"; and Chinese Patent No. ZL201310253562.2, entitled "Method and Apparatus for Providing Tactile Feedback Sensations." Immersion's complaint seeks to stop defendants from using patented methods during manufacturing; to stop defendants from manufacturing, offering to sell, selling, or jointly selling infringing products; as well as the recovery of damages. The Fuzhou Intellectual Property Court accepted the case on March 8, 2018. Samsung China filed a jurisdictional objection on April 10, 2018 in which it asked the court to move the case to Beijing IP court. Samsung Huizhou filed a jurisdictional objection on April 10, 2018 in which it asked the court to move the case to Guangzhou IP court. On May 8, 2018, the court rejected both jurisdictional objections. Samsung Huizhou and Samsung China appealed and the pretrial conference originally scheduled for June 14-15, 2018 was postponed pending a ruling from the Fujian High Court. On September 20, 2018 the Fujian High Court rejected the jurisdictional objection appeals. Samsung China and Samsung Huizhou filed Petitions for Invalidation on April 16, 2018 with the Chinese Patent Office ("SIPO") for all three patents. Samsung China and Samsung Huizhou supplemented their petitions in May, and we responded on June 1, 2018. A hearing on the petition for Chinese Patent No. ZL02821854.X occurred on July 18, 2018. Hearings on the petitions for Chinese Patent No. ZL201210005785.2 and Chinese Patent No. ZL201310253562.2 occurred on September 28, 2018. Trial was originally scheduled for November 12, and 14, 2018; the Fuzhou Intellectual Property Court granted the Company's request to postpone trial



but has not yet set revised dates. The Company and Samsung each submitted evidence for use at trial on or before October 26, 2018.

#### ITEM 1A. RISK FACTORS

As previously discussed, our actual results could differ materially from our forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to those discussed below. These and many other factors described in this report could adversely affect our operations, performance and financial condition.

#### Company Risks

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If we are unable to enter into new and renewed licensing arrangements with our existing licensees and with additional third-parties for our touch-enabling technologies, our royalty and license revenue may not grow and could decline. Our revenue growth is largely dependent on our ability to enter into new and renew existing licensing arrangements. Our failure to enter into new or renewed licensing arrangements will cause our operating results to suffer. Further, upon adoption of ASC 606 effective January 1, 2018, a substantial portion of the revenue from our fixed license fee contracts was recognized up front after execution of the license, with the portion that relates to our future performance obligations to be transferred during the contract term being recognized over time. Previously, our fixed license fee revenue was usually recognized ratably over time in accordance with revenue recognition guidance under ASC 605. This change in accounting policy for fixed license fees revenue will further provide less predictability in our future revenue when compared to historical periods. We face numerous risks in obtaining new or renewed licenses on terms consistent with our business objectives and in maintaining, expanding, and supporting our relationships with our current licensees. These risks include:

- difficulties in persuading device manufacturers to take a license or renew a license to our intellectual property without the expenditure of significant resources;
  - difficulties in persuading existing customers that they still need a license to the portfolio as individual patents expire or become limited in scope, declared unenforceable or invalidated;
  - reluctance of device manufacturers to take a license or renew a license to our intellectual property because other larger device manufacturers are not licensed;
  - difficulties in entering into or renewing gaming licenses if video game console makers choose not to license third parties to make peripherals for their new consoles, if video console makers no longer require peripherals to play video games, if video console makers no longer utilize technology in the peripherals that are covered by our patents or if the overall market for video consoles deteriorates substantially;
  - the competition we may face from third parties and/or the internal design teams of existing and potential licensees;
  - difficulties in achieving and maintaining consumer and market demand or acceptance for our products;
  - difficulties in persuading third parties to work with us, to rely on us for critical technology, and to disclose to us proprietary product development and other strategies;
  - difficulties in persuading existing licensees who compensate us for including our software in certain of their touch-enabled products to also license and compensate us for our patents that cover other touch-enabled products of theirs that do not include our software;
  - challenges in demonstrating the compelling value of our technologies and challenges associated with customers' ability to easily implement our technologies; and
  - inability of current or prospective licensees to ship certain devices if they are involved in IP infringement claims by third parties that ultimately prevent them from shipping products or that impose substantial royalties on their products;
- A limited number of customers account for a significant portion of our revenue, and the loss of major customers could harm our operating results.

One customer accounted for more than 10% of our total revenues for the nine months ended September 30, 2018, as compared to the nine months ended September 30, 2017 where three customers accounted for 20%, 17% and 10% of our total revenues, respectively. In the quarter ended September 30, 2016, we entered into an additional amendment to our License Agreement with Samsung pursuant to which we agreed to permit Samsung to exercise its rights to continue to sell products that were licensed under the agreement as of December 31, 2015 for the life of such products in exchange for \$19 million. We have not entered into a renewal agreement with Samsung for any products released after December 31, 2015, and on August 3, 2017, we filed the first patent infringement suit against Samsung in the U.S. District Court in the Eastern District of Texas. See Part I, Item 3, "Legal Proceedings". Because we have not renewed our agreement with Samsung, there is no assurance that Samsung will generate similar revenue in any future period; and even if we were to renew our agreement with Samsung, our revenue could be adversely impacted by recalls or poorly performing mobile devices.

In addition, we cannot be certain that other customers that have accounted for significant revenue in past periods, individually or as a group, will continue to generate similar revenue in any future period.

If we fail to renew or lose a major customer or group of customers, or if a customer decides that our intellectual property is no longer relevant and stops paying us royalties, our revenue could decline if we are unable to replace the lost revenue with revenue from other sources. In addition, if potential customers or customers with expiring agreements view the loss of one of our major

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customers as an indicator of the value of our software and/or the strength of our intellectual property, they may choose not to take or renew a license which could adversely affect our operating results.

If we fail to protect and enforce our IP rights or if we fail to continuously develop or acquire successful innovations and obtain patents on these innovations, our ability to license our technologies and generate revenues would be impaired.

Our business depends on generating revenues by licensing our IP rights and by customers selling products that incorporate our technologies. We rely on our significant patent portfolio to protect our proprietary rights. If we are not able to protect and enforce those rights, our ability to obtain future licenses or maintain current licenses and royalty revenue could be impaired. In addition, if a court or patent office were to limit the scope, declare unenforceable, or invalidate any of our patents, current licensees may refuse to make royalty payments, or they may choose to challenge one or more of our patents. It is also possible that:

- our pending patent applications may not result in the issuance of patents;
- our patents may not be broad enough to protect our proprietary rights;
- effective patent protection may not be available in every country, particularly in Asia, where we or our licensees do business; and
- our pending litigation against Samsung and Motorola may be unsuccessful or may result in one or more of the patents asserted becoming limited in scope, declared unenforceable or invalidated.

In addition, our patents will continue to expire according to their terms which may have an adverse effect on our business. For example, certain of our U.S. gaming patents expired in 2015, and as a result, Sony has ceased paying royalties for sales. Our failure to continuously develop or acquire successful innovations and obtain patents on those innovations could significantly harm our business, financial condition, results of operations, or cash flows. In addition, we also rely on licenses, confidentiality agreements, other contractual agreements, and copyright, trademark, and trade secret laws to establish and protect our proprietary rights. It is possible that:

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

We have in the past initiated legal proceedings to protect our intellectual property and may need to continue to do so in the future, and we are currently in litigation against Samsung and Motorola for patent infringement and we recently settled our litigation with Apple and Fitbit. We may need to continue to initiate legal proceedings in the future. Any legal or administrative proceeding initiated by us to protect or enforce our IP rights has, and may in the future result in material amounts of legal expenses and risk, could lead to counterclaims and adverse rulings affecting our patents, and may divert our management's time and attention away from our other business operations, which could significantly harm our business.

Our current or any future litigation, arbitration and administrative proceedings to enforce or defend our intellectual property rights and to defend our licensing practices is expensive, disruptive, and time consuming, and will continue to be, until resolved, and regardless of whether we are ultimately successful, could adversely affect our business.

We have been in the past and are currently a party to various legal proceedings with companies that have significantly greater financial resources than us to enforce or defend our intellectual property rights and to defend our licensing practices. For example, on August 3, 2017, we initiated patent infringement litigation against Samsung and Motorola claiming that they are infringing five of our US patents. Due to the inherent uncertainties of litigation and administrative proceedings, we cannot accurately predict how these proceedings will ultimately be resolved. We anticipate that currently pending or any future legal proceedings will continue to be costly, given the significant resources available to our current adverse parties, and that future legal proceedings will result in additional legal expenses, resulting in the decrease of cash available for other parts of our business, and there can be no assurance that we will be successful or be able to recover the costs we incur in connection with the legal proceedings. Although protecting our intellectual property is a fundamental part of our business, at times, our legal proceedings have diverted, and could continue to divert, the efforts and attention of some of our key management and personnel away from our licensing transactions and other aspects of our business. As a result, until such time as it is resolved or

concluded, litigation, arbitration and administrative proceedings could cause our technology to be perceived as less valuable in the marketplace, which could reduce our sales and adversely affect our business. Further, any unfavorable outcome could adversely affect our business. For additional background on our litigation, please see Part I, Item 3, “Legal Proceedings”.

Potential patent and litigation reform legislation, potential USPTO and international patent rule changes, potential legislation affecting mechanisms for patent enforcement and available remedies, and potential changes to the intellectual

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property rights (“IPR”) policies of worldwide standards bodies, as well as rulings in legal proceedings may affect our investments in research and development and our strategies for patent prosecution, licensing and enforcement and could have a material adverse effect on our licensing business as well as our business as a whole.

Potential changes to certain U.S. and international patent laws, rules and regulations may occur in the future, some or all of which may affect our research and development investments, patent prosecution costs, the scope of future patent coverage we secure, remedies that we may be entitled to in patent litigation, and attorneys’ fees or other remedies that could be sought against us, and may require us to reevaluate and modify our research and development activities and patent prosecution, licensing and enforcement strategies.

Similarly, legislation designed to reduce the jurisdiction and remedial authority of the USITC has periodically been introduced in Congress. Any potential changes in the law, the IPR policies of standards bodies or other developments that reduce the number of forums available or the type of relief available in such forums (such as injunctive relief), restrict permissible licensing practices (such as our ability to license on a worldwide portfolio basis) or that otherwise cause us to seek alternative forums (such as arbitration or state court), would make it more difficult for us to enforce our patents, whether in adversarial proceedings or in negotiations. Because we have historically depended on the availability of certain forms of legal process to enforce our patents and obtain fair and adequate compensation for our investments in research and development and the unauthorized use of our intellectual property, developments that undermine our ability to do so could have a negative impact on future licensing efforts.

Rulings in our legal proceedings as well as those of third parties may affect our strategies for patent prosecution, licensing and enforcement. For example, in recent years, the United States International Trade Commission (the “USITC”) and U.S. courts, including the U.S. Supreme Court and the U.S. Court of Appeals for the Federal Circuit, have taken some actions that have been viewed as unfavorable to patentees. Decisions that occur in U.S. or in international forums may change the law applicable to various patent law issues, such as, for example, patentability, validity, patent exhaustion, patent misuse, remedies, permissible licensing practices, claim construction, and damages, in ways that are detrimental to the abilities of patentees to enforce patents and obtain damages awards.

We continue to monitor and evaluate our strategies for prosecution, licensing and enforcement with regard to these developments; however, any resulting change in such strategies may have an adverse impact on our business and financial condition.

If companies choose to implement haptics without our software or a license to our patents, we could have to expend significant resources to enforce or defend our intellectual property rights and to defend our licensing practices which may have a negative impact on our business.

To sell our software, we must win competitive selection processes, known as “design wins,” before our haptic software technologies are included in our customers’ products. These selection processes can be lengthy and can require us to incur significant design and development expenditures with no assurance that we will be selected. As a small company, we may not have the resources to reach every company who is introducing or planning to introduce haptics into the market. In addition, as a small company, we have limited engineering resources that may make it difficult to support every type of haptic implementation with our software offerings or to introduce new technologies in a timely manner. In the instances where a potential customer is not using our software but implements unlicensed haptic capability, we may need to seek to enforce our intellectual property. If the customer is unwilling to enter into a license agreement, we have and may continue to elect to pursue litigation which would harm our relationship with the customer and could harm our relationships with other licensees or our ability to gain new customers, who may postpone licensing decisions pending the outcome of the litigation or dispute, or who may, as a result of such litigation, choose not to adopt our technologies. In addition, these legal proceedings could be very expensive and could have a negative impact on our financial results.

We also license to semiconductor manufacturers who incorporate certain of our less fully-featured software into their integrated circuits for use in certain electronic devices. While our relationships with these semiconductor manufacturers increases our distribution channels by leveraging their sales channels, it is possible that customers may elect to implement haptics using less fully-featured software integrated circuit solutions rather than the higher-end solutions we offer directly, which may negatively impact our financial results. It is also possible that when a customer uses the integrated circuit, it is doing so in violation of our intellectual property rights and we may seek to enforce our

IP.

Our restructuring efforts may not be successful, and may negatively impact our business.

In December 2017, we completed a restructuring of our business to exit the Mobile Advertising market, and significantly reduced the size of our workforce and consolidated some of our operations. We also began to largely focus on IP licensing for the gaming and Virtual Reality ("VR")/Augmented Reality ("AR") markets, and move to a mobile OEM licensing model for China. Consolidations and business restructurings involve numerous risks and uncertainties, including, but not limited to: the potential loss of key employees, customers and business partners; market uncertainty related to our future business plans; the incurrence of unexpected expenses or charges; diversion of management attention from other key areas of our business; negative impacts on

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employee morale; and other potential dislocations and disruptions to the business. In addition, if our business expands, it may be more difficult for us to attract additional personnel and develop the resources we would need to support a larger customer base. Accordingly, if we are unable to manage this consolidation and transition effectively, our overall business and operating results could be materially and adversely affected.

If we do not achieve increased tax benefits as a result of our corporate restructuring, our financial condition and operating results could be adversely affected.

We completed a reorganization of our corporate organization in 2015. The purpose of this reorganization was to more closely align our corporate structure with the international nature of our business activities. This corporate restructuring activity is anticipated to allow us to reduce our overall effective tax rate through changes in how we develop and use our intellectual property and the structure of our international sales operations, including by entering into transfer-pricing arrangements that establish transfer prices for our intercompany transactions.

There can be no assurance that the taxing authorities of the jurisdictions in which we operate or to which we are otherwise deemed to have sufficient tax nexus will not challenge the restructuring or the tax position that we take. From time to time, we enter into license agreements with our licensees pursuant to which we may agree to indemnify a customer for certain taxes imposed on the customer by an applicable tax authority and related expense. As discussed in Part II, Item 1 (Legal Proceedings), on April 28, 2017, we received a letter from Samsung requesting that we reimburse Samsung with respect to withholding tax and penalties imposed on Samsung by the Korean tax authorities as a result of its determination that withholding taxes should have been withheld from certain payments made from Samsung to Immersion Software Limited. Samsung filed an arbitration demand with the International Chamber of Commerce against us demanding that we reimburse Samsung for the imposed tax and penalties that Samsung paid to the Korean tax authorities. We deny liability, and, as discussed in Part II, Item 1 (Legal Proceedings), the arbitration matter is ongoing.

In addition, on October 16, 2017, we received a letter from LG Electronics Inc. (“LGE”) requesting that we reimburse LGE with respect to withholding tax imposed on LGE by the Korean tax authorities following an investigation where the tax authority determined that LGE failed to withhold on LGE’s royalty payments to Immersion Software Ireland from 2012 to 2014. On November 3, 2017, Immersion filed an appeal with the Korea Tax Tribunal regarding their findings with respect to the withholding taxes. In the event that it is determined that we are obligated to indemnify Samsung and/or LGE for such withholding taxes imposed by the Korean tax authorities, we would incur significant expenses. In addition, future changes to U.S. or non-U.S. tax laws, including legislation to reform U.S. or other countries’ taxation of international business activities, could negatively impact the anticipated tax benefits of the restructuring.

Any benefits to our tax rate will also depend on our ability to operate our business in a manner consistent with the reorganization of our corporate organization and applicable tax provisions, as well as on our achieving our forecasted revenue growth rates. If the intended tax treatment is not accepted by the applicable taxing authorities, changes in tax law negatively impact the structure or we do not operate our business consistent with the intended reorganization and applicable tax provisions, we may fail to achieve the financial efficiencies that we anticipate as a result of the reorganization and our future operating results and financial condition may be negatively impacted.

Our international operations subject us to additional risks and costs.

We currently have sales personnel in Japan, Korea, and China. International revenues accounted for approximately 18% of our total revenue for the nine months ended September 30, 2018. International operations are subject to a number of difficulties, risks, and special costs, including:

- compliance with multiple, conflicting and changing governmental laws and regulations;
- laws and business practices favoring local competitors;
- foreign exchange and currency risks;
- changing import and export restrictions, duties, tariffs, quotas and other barriers;
- difficulties staffing and managing foreign operations;
- difficulties and expense in establishing and enforcing IP rights;
- business risks, including fluctuations in demand for our technologies and products and the cost and effort to conduct international operations and travel abroad to promote international distribution and overall global economic



conditions;

- multiple conflicting tax laws and regulations;

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- political and economic instability; and
- the possibility of an outbreak of hostilities or unrest in markets where major customers are located, including Korea.

Our international operations could also increase our exposure to international laws and regulations, which are subject to change. If we cannot comply with foreign laws and regulations, which are often complex and subject to variation, differing or inconsistent government interpretation, and unexpected changes, we could incur unexpected costs and potential litigation. For example, the governments of foreign countries might attempt to regulate our products or levy sales or other taxes relating to our activities. In addition, foreign countries may impose tariffs, duties, price controls, or other restrictions on foreign currencies or trade barriers, any of which could make it more difficult for us to conduct our business. Our international operations could also increase our exposure to complex international tax rules and regulations. Changes in, or interpretations of, tax rules and regulations may adversely affect our income tax provision. In addition, our operations outside the United States may be affected by changes in trade protection laws, policies and measures, and other regulatory requirements affecting trade and investment, including the Foreign Corrupt Practices Act and local laws prohibiting corrupt payments by our employees, vendors, or agents.

We had an accumulated deficit of approximately \$95 million as of September 30, 2018, and may not return to consistent profitability in the future.

As of September 30, 2018, we had an accumulated deficit of approximately \$95 million. We need to generate significant ongoing revenue to return to consistent profitability. We will continue to incur expenses as we:

- incur costs related to litigation;
- increase our sales and marketing efforts;
- engage in research and develop our technologies; and
- protect and enforce our IP;

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

The terms in our agreements may be construed by our licensees in a manner that is inconsistent with the rights that we have granted to other licensees, or in a manner that may require us to incur substantial costs to resolve conflicts over license terms.

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

Due to the continuing evolution of market sectors, product categories, and licensee business models, and to the compromises inherent in the drafting and negotiation of License Provisions, our licensees may interpret License Provisions in their agreements in a way that is different from our interpretation of such License Provisions, or in a way that is in conflict with the rights that we have granted to other licensees. Such interpretations by our licensees may lead to claims that we have granted rights to one licensee that are inconsistent with the rights that we have granted to another licensee. Many of our customers report royalties to us based on their shipments or their revenues and their interpretation and allocation of contracted royalty rates. It is possible that the originally reported royalties could differ materially from those determined by either a customer self-reported correction or from an audit we have performed. These interpretations may also cause disagreements arising during customer audits, may lead to claims or litigation, and may have an adverse effect on the results of our operations. Further, although our agreements generally give us the right to audit books and records of our licensees, audits can be expensive, time consuming, and may not be cost justified based on our understanding of our licensees’ businesses. Pursuant to our license compliance program, we audit certain licensees to review the accuracy of the information contained in their royalty reports in an effort to decrease the risk of our not receiving royalty revenues to which we are entitled, but we cannot give assurances that such audits will be effective.

In addition, after we enter into an agreement, it is possible that markets and/or products, or legal and/or regulatory environments, will evolve in an unexpected manner. As a result, in any agreement, we may have granted rights that will preclude or restrict our exploitation of new opportunities that arise after the execution of the agreement.

We may not be able to continue to derive significant revenues from makers of peripherals for popular video gaming platforms.

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A significant portion of our gaming royalty revenues comes from third-party peripheral makers who make licensed gaming products designed for use with popular video game console systems from Microsoft, Sony, and Nintendo. Video game console systems are closed, proprietary systems, and video game console system makers typically impose certain requirements or restrictions on third-party peripheral makers who wish to make peripherals that will be compatible with a particular video game console system. If third-party peripheral makers cannot or are not allowed to satisfy these requirements or restrictions, our gaming royalty revenues could be significantly reduced. Furthermore, should a significant video game console maker choose to omit touch-enabling capabilities from its console systems or somehow restrict or impede the ability of third parties to make touch-enabling peripherals, it could lead our gaming licensees to stop making products with touch-enabling capabilities, thereby significantly reducing our gaming royalty revenues. Also, if the gaming industry changes such that mobile or other platforms increase in popularity at the expense of traditional video game consoles, our gaming royalty revenues could be substantially reduced if we are unable to enter into replacement arrangements enabling us to license our software or IP in connection with gaming on such mobile or other platforms. Although Immersion has a significant software and IP position with respect to Virtual Reality peripherals and systems, the market may not become large enough to generate material revenues. Finally, as some of our litigated patents have expired related to video game peripherals, our gaming royalty revenues will likely decline until we are successful in proving the relevance of our IP for this market.

Because we have a fixed payment license with Microsoft, our royalty revenue from licensing in the gaming market and other consumer markets has previously declined and may further do so if Microsoft increases its volume of sales of touch-enabled products at the expense of our other licensees.

Under the terms of our present agreement with Microsoft, Microsoft receives a royalty-free, perpetual, irrevocable license (including sublicense rights) to our worldwide portfolio of patents. This license permits Microsoft to make, use, and sell hardware, software, and services, excluding specified products, covered by our patents. We will not receive any further revenues or royalties from Microsoft under our current agreement with Microsoft, including with respect to Microsoft's Xbox One gaming product or any other haptic related product. Microsoft has a significant share of the market for touch-enabled console gaming computer peripherals and is pursuing other consumer markets such as mobile devices, tablets, personal computers, and virtual and augmented reality. Microsoft has significantly greater financial, sales, and marketing resources, as well as greater name recognition and a larger customer base than some of our other licensees. In the event that Microsoft increases its share of these markets, our royalty revenue from other licensees in these market segments may decline.

Automobiles incorporating our touch-enabling technologies are subject to lengthy product development periods, making it difficult to predict when and whether we will receive royalties for these product types.

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

We have little or no control or influence on our licensees' design, manufacturing, quality control, promotion, distribution, or pricing of their products incorporating our touch-enabling technologies, upon which we generate royalty revenue.

A key part of our business strategy is to license our software and IP to companies that manufacture and sell products incorporating our touch-enabling technologies. For the nine months ended September 30, 2018, substantially all of our total revenues were royalty and license revenues, as compared to 98% for the same period in 2017. We do not control or influence the design, manufacture, quality control, promotion, distribution, or pricing of products that are manufactured and sold by our licensees, nor can we control consolidation within an industry which could either reduce the number of licensable products available or reduce royalty rates for the combined licensees. In addition, we generally do not have commitments from our licensees that they will continue to use our technologies in current or

future products. As a result, products incorporating our technologies may not be brought to market, achieve commercial acceptance, or otherwise generate meaningful royalty revenue for us. For us to generate royalty and license revenue, licensees that pay us per-unit royalties must manufacture and distribute products incorporating our touch-enabling technologies in a timely fashion and generate consumer demand through marketing and other promotional activities. If our licensees' products fail to achieve commercial success, or if their products are recalled because of quality control problems or if they do not ship products incorporating our touch-enabling technologies in a timely fashion or fail to achieve strong sales, our revenues will not grow and could decline. Our business may suffer if third parties assert that we violate their IP rights.

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Third parties have previously claimed and may in the future claim that we or our customers are infringing upon their IP rights. Even if we believe that such claims are without merit or that we are not responsible for them under the indemnification or other terms of our customer license agreements, they can be time-consuming and costly to defend against and may divert management's attention and resources away from our business. Furthermore, third parties making such claims may be able to obtain injunctive or other equitable relief that could block our ability to further develop or commercialize some or all of our software technologies or services in the United States and abroad. Claims of IP infringement also might require us to enter into costly settlement or license agreements or pay costly damage awards. Even if we have an agreement that provides for a third party to indemnify us against such costs, the indemnifying party may be unable or unwilling to perform its contractual obligations.

We license some technologies from third parties. We must rely upon the owners of these technologies for information on the origin and ownership of the technologies. As a result, our exposure to infringement claims may increase. We generally obtain representations as to the origin and ownership of acquired or licensed technologies and indemnification to cover any breach of these representations. However, representations may not be accurate and indemnification may not provide adequate compensation for breach of the representations. If we cannot or do not license the infringed IP at all or on reasonable terms, or substitute similar technology from another source, our business, financial position, results of operations or cash flows could suffer.

Our business and operations could suffer in the event of security breaches.

Attempts by others to gain unauthorized access to our information technology systems are becoming more sophisticated. These attempts, which might be related to industrial or other espionage, include covertly introducing malware to our computers and networks and impersonating authorized users, among others. We might be unaware of an incident or its magnitude and effects. The theft, unauthorized use or publication of our intellectual property and/or confidential business information could harm our competitive position and reputation, reduce the value of our investment in research and development and other strategic initiatives or otherwise adversely affect our business. To the extent that any future security breach results in inappropriate disclosure of our customers' confidential information, we may incur liability.

In addition, our business involves the storage and transmission of customers' proprietary information, and security breaches could expose us to a risk of loss of this information, litigation and possible liability. These security measures may be breached as a result of third-party action, employee error, malfeasance or otherwise, during transfer of data, and result in someone obtaining unauthorized access to our data or our customers' data. Additionally, third parties may attempt to fraudulently induce employees or customers into disclosing sensitive information such as user names, passwords or other information in order to gain access to our data or our customers' data. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. In addition, our customers may authorize third party technology providers, to access their customer data. Because we do not control the transmissions between our customers and third-party technology providers, or the processing of such data by third-party technology providers, we cannot ensure the complete integrity or security of such transmissions or processing. Any security breach could result in a loss of confidence in the security of our service, damage our reputation, lead to legal liability and negatively impact our future sales.

If we are unable to develop open source compliant products, our ability to license our technologies and generate revenues would be impaired.

We have seen, and believe that we will continue to see, an increase in customers requesting that we develop products that will operate in an "open source" environment. Developing open source compliant products without imperiling the IP rights upon which our licensing business depends may prove difficult under certain circumstances, thereby placing us at a competitive disadvantage for new product designs. Some of our proprietary technologies incorporate open source software that may be subject to open source licenses. These open source licenses may require that source code subject to the license be released or made available to the public. Such open source licenses may mandate that software developed based on source code that is subject to the open source license, or combined in specific ways with such open source software, become subject to the open source license. We take steps to ensure that proprietary software we do not wish to disclose is not combined with, or does not incorporate, open source software in ways that

would require such proprietary software to be subject to an open source license. However, few courts have interpreted open source licenses, and the manner in which these licenses may be interpreted and enforced is therefore subject to some uncertainty. We often take steps to disclose source code for which disclosure is required under an open source license, but it is possible that we have made or will make mistakes in doing so, which could negatively impact our brand or our adoption in the community, or could expose us to additional liability. In addition, we rely on multiple software programmers to design our proprietary products and technologies. Although we take steps to ensure that our programmers (both internal and outsourced) do not include open source software in products and technologies we intend to keep proprietary, we cannot be certain that open source software is not incorporated into products and technologies we intend to keep proprietary. In the event that portions of our proprietary technology are determined to be subject to an open source license, or are intentionally released under an open source license, we could be required to publicly release the relevant portions of our source code, which could reduce or eliminate our ability to commercialize our products and technologies. As a result, our revenues may not grow and could decline.

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Our business depends in part on access to third-party platforms and technologies, and if the access is withdrawn, denied, or is not available on terms acceptable to us, or if the platforms or technologies change, our business and operating results could be adversely affected.

Many of our current and future software technologies are designed for use with third-party platforms and technologies. Our business relies on our access to these platforms and technologies of third parties, which can be withdrawn, denied or not be available on terms acceptable to us.

Our access to third-party platforms and technologies may require paying royalties or other amounts, which lowers our margins, or may otherwise be on terms that are not acceptable to us. In addition, the third-party platforms or technologies used to interact with our software technologies can be delayed in production or can change in ways that negatively impact the operation of our software.

If we are unable to access third-party platforms or technologies, or if our access is withdrawn, denied, or is not available on terms acceptable to us, or if the platforms or technologies are delayed or change, our business and operating results could be adversely affected.

The uncertain economic and political environment could reduce our revenues and could have an adverse effect on our financial condition and results of operations.

The current global economic conditions and political climate could materially hurt our business in a number of ways, including longer sales and renewal cycles, exchange rate volatility, delays in adoption of our products or technologies or those of our customers, increased risk of competition, higher taxes and tariffs on goods incorporating out technologies, higher overhead costs as a percentage of revenue, delays in signing or failing to sign customer agreements or signing customer agreements with reduced royalty rates. In addition, our customers, potential customers, and business partners would likely face similar challenges, which could materially and adversely affect the level of business they conduct with us or the sales volume of products that include our technology.

We might be unable to retain or recruit necessary personnel, which could slow the development and deployment of our technologies.

Our technologies are complex, and we rely upon the continued service of our existing personnel to support licensees, enhance existing technologies, and develop new technologies. Accordingly, our ability to develop and deploy our technologies and to sustain our revenue growth depends upon the continued service of our management and other key personnel, many of whom would be difficult to replace. Furthermore, we believe that there are a limited number of engineering and technical personnel that are experienced in haptics. Management and other key employees may voluntarily terminate their employment with us at any time without notice. The loss of management or key personnel could delay product development cycles or otherwise harm our business.

We believe that our future success will also depend largely on our ability to attract, integrate, and retain sales, support, marketing, and research and development personnel. In addition, our current Chief Executive Officer is interim and we need to recruit and retain a permanent replacement. Competition for such personnel is intense, and we may not be successful in attracting, integrating, and retaining such personnel. Given the protracted nature of, if, how, and when we collect royalties on new design contracts, it may be difficult to craft compensation plans that will attract and retain the level of salesmanship needed to secure these contracts. Additionally, our compensation packages need to be competitive in the Silicon Valley where the stock component of compensation is an important factor that candidates and employees consider. Some of our executive officers and key employees hold stock options with exercise prices that may be above the current market price of our common stock or that are largely vested. Each of these factors may impair our ability to retain the services of our executive officers and key employees.

Our technologies are complex and may contain undetected errors, which could harm our reputation and future sales. Any failure to provide high quality and reliable technologies, whether caused by our own failure or failures of our suppliers or customers, could damage our reputation and reduce demand for our technologies. Our technologies have in the past contained, and may in the future contain, undetected errors or defects. Some errors in our technologies may only be discovered after a customer's product incorporating our technologies has been shipped to customers. Any errors or defects discovered in our technologies after commercial release could result in product recalls, loss of revenue, loss of customers, and increased service and warranty costs, any of which could adversely affect our business.



Catastrophic events, such as natural disasters, war, and acts of terrorism could disrupt the business of our customers, which could harm our business and results of operations.

The production processes and operations of our customers are susceptible to the occurrence of catastrophic events, such as natural disasters, war, and acts of terrorism, all of which are outside of our control. Any such events could cause a serious business

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disruption to our customers' ability to manufacture, distribute and sell products incorporating our touch-enabling technologies, which may adversely affect our business and results of operation.

If our facilities were to experience catastrophic loss, our operations would be seriously harmed.

Our facilities could be subject to a catastrophic loss such as fire, flood, earthquake, power outage, or terrorist activity. A substantial portion of our research and development activities, our corporate headquarters, and other critical business operations are located near major earthquake faults in San Jose, California, an area with a history of seismic events. An earthquake at or near our facilities could disrupt our operations and result in large expenses to repair and replace the facility. While we believe that we maintain insurance sufficient to cover most long-term potential losses at our facilities, our existing insurance may not be adequate for all possible losses including losses due to earthquakes. If we fail to establish and maintain proper and effective internal controls, our ability to produce accurate financial statements on a timely basis could be impaired, which would adversely affect our consolidated operating results, our ability to operate our business and our stock price.

We have in the past had material weaknesses in our internal control over financial reporting. Ensuring that we have adequate internal financial and accounting controls and procedures in place to produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. Any failure on our part to remedy identified material weaknesses, or any additional delays or errors in our financial reporting controls or procedures, could cause our financial reporting to be unreliable and could have a material adverse effect on our business, results of operations, or financial condition and could have a substantial adverse impact on the trading price of our common stock.

We do not expect that our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within our company will have been detected.

The nature of some of our products may also subject us to export control regulation by the U.S. Department of State and the Department of Commerce. Violations of these regulations can result in monetary penalties and denial of export privileges.

Our sales to customers or sales by our customers to their end customers in some areas outside the United States could be subject to government export regulations or restrictions that prohibit us or our licensees from selling to customers in some countries or that require us or our licensees to obtain licenses or approvals to export such products internationally. Delays or denial of the grant of any required license or approval, or changes to the regulations, could make it difficult or impossible to make sales to foreign customers in some countries and could adversely affect our revenue. In addition, we could be subject to fines and penalties for violation of these export regulations if we were found in violation. Such violation could result in penalties, including prohibiting us from exporting our products to one or more countries, and could materially and adversely affect our business.

**Investment Risks**

Our quarterly revenues and operating results are volatile, and if our future results are below the expectations of public market analysts or investors, the price of our common stock is likely to decline.

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

These factors include:

- the establishment or loss of licensing relationships;
- the timing and recognition of payments under our license agreements, as well as other multi-element arrangements;
- seasonality in the demand for our technologies or products or our licensees' products;
- the timing of our expenses, including costs related to litigation, stock-based awards, acquisitions of technologies, or businesses;
- developments in and costs of pursuing or settling any pending litigation;
- the timing of introductions and market acceptance of new technologies and products and product enhancements by us, our licensees, our competitors, or their competitors;



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- the timing of work performed under development agreements; and
- errors in our licensees' royalty reports, and corrections and true-ups to royalty payments and royalty rates from prior periods.

Changes in financial accounting standards or policies may affect our reported financial condition or results of operations and, in certain cases, could cause a decline and/or fluctuations in the price of our common stock.

From time to time, financial and accounting standard setters such as the FASB and the SEC change certain guidance governing the form and content of registrants' external financial statements, or update their previous interpretations with regard to the application of certain General Accepted Accounting Principles ("GAAP"). Such change in GAAP or their interpretation can have a significant effect on our reported financial condition and/or results of operations. If applicable to Immersion, we would be required to apply a new or revised guidance, which may result in retrospective adjustments to our financial statements, and change the way we account for certain transaction than under the existing guidance. Changes in GAAP and reporting standards could substantially change our reporting practices in a number of areas, including revenue recognition and recording of assets and liabilities, and consequently affect our reported financial condition or results of operations.

Our business is subject to changing regulations regarding corporate governance and other compliance areas that will increase both our costs and the risk of noncompliance.

As a public company, we are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act of 2002, and the rules and regulations of The NASDAQ Stock Market and other regulations that may be enacted from time-to-time. The requirements of these and other rules and regulations have increased and we expect will continue to increase our legal, accounting and financial compliance costs, will make some activities more difficult, time-consuming and costly, and may also place undue strain on our personnel, systems and resources.

Our stock price may fluctuate regardless of our performance.

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

Our stock repurchase program could affect our stock price and add volatility.

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

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

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

- our board of directors is classified into three classes of directors with staggered three-year terms which will be phased out over time through 2019;

- only our chairperson of the board of directors, a majority of our board of directors or 10% or greater stockholders are authorized to call a special meeting of stockholders;
- our stockholders can only take action at a meeting of stockholders and not by written consent;

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- vacancies on our board of directors can be filled only by our board of directors and not by our stockholders;
- our restated certificate of incorporation authorizes undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval;
- advance notice procedures apply for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders; and
- we have implemented a stockholder rights plan.

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 6. EXHIBITS

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

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## EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed Herewith
		Form	File No.	Exhibit Filing Date	
<u>10.1</u> **	<u>Letter Agreement between Tom Lacey and Board of Directors dated August 21, 2018</u>	8-K	001-38334	99.1 August 22, 2018	
<u>31.1</u>	<u>Certification of Tom Lacey, Interim Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>				X
<u>31.2</u>	<u>Certification of Nancy Erba, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>				X
<u>32.1</u> *	<u>Certification of Tom Lacey, Interim Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>				X
<u>32.2</u> *	<u>Certification of Nancy Erba, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>				X
101.INS	XBRL Report Instance Document				X
101.SCH	XBRL Taxonomy Extension Schema Document				X
101.CAL	XBRL Taxonomy Calculation Linkbase Document				X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document				X
101.LAB	XBRL Taxonomy Label Linkbase Document				X
101.PRE	XBRL Presentation Linkbase Document				X

This certification is deemed not filed for purposes of section 18 of the Exchange Act or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act or the Exchange Act.

\*\* Constitutes a management contract or compensatory plan.

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SIGNATURES

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

Date: November 2, 2018

IMMERSION CORPORATION

By/s/ Nancy Erba

Nancy Erba

Chief Financial Officer and Principal Accounting Officer

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