



CAPSTONE INVESTMENTS

IMMR

Lower Rating & Higher Target

Rating: **Buy**

Target Price: **\$13.00**

May 5, 2008

For Institutional Consideration Only

Immersion Corporation
(IMMR-NASDAQ)

Recent Price: \$ 10.32

52 week range: \$ 6.43 - \$ 20.68

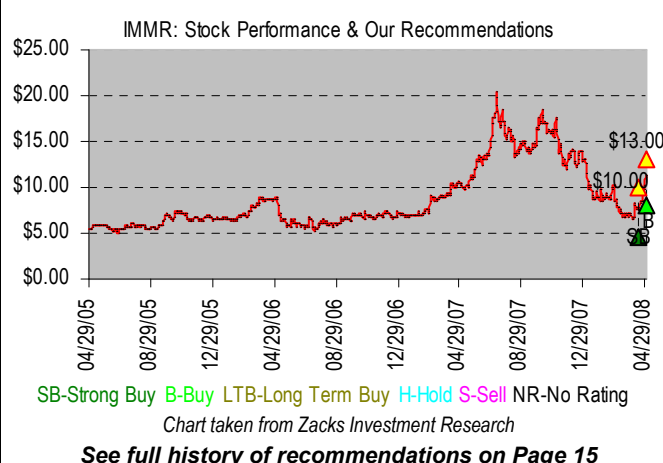
Shares Outstanding: 30.51M

Fully Diluted S/O: 31.67M

Float: 30.34M

Average Daily Volume 610,000

Market Cap: \$ 314.86M



Company Information:

Location: San Jose, CA
CEO: Clent Richardson
Phone: (408) 467-1900
Industry: Computer Periph.
Web: immersion.com
Auditors: Deloitte & Touche

Financial Information

(As of 3/31/08)

Cash: \$ 140.0M
Long Term Debt: NA
LT Debt/Equity: 0.0%
Net Profit Margin: - 17.01%
Revenue (TTM): \$ 36.4M
ROE: N/A
Book Value: \$ 4.63
Current P/E (TTM): NA

Institutional Own: 46.30%
Insider Own: 2.27%
Insider Activity:
• None in the last 3 months

Dividend: \$ 0.00
Dividend Yield: N/A
Short Interest: 3.3M
Short as % of Float: 10.80%

Technical Analysis

- Support at \$10.00
- Resistance at \$12.00

Business Summary: Immersion Corporation develops, manufactures, licenses, and supports a range of hardware and software technologies, and products that enhance digital devices with touch interaction. Its Immersion Computing, Entertainment, and Industrial segment offers touch-enabling technologies for consumer gaming peripherals; mobile communications portable devices and automobile systems. The Company's Immersion Medical segment offers various simulation technologies that can be used for medical training and testing.

Fiscal Year End: December 31

Revenue (in millions):	2006A	2007A	2008e	2009e
Q1 March	\$ 6.03	\$ 6.41	\$ 8.16A	\$ 11.95
Q2 June	\$ 6.65	\$ 8.60	\$ 10.28	\$ 13.91
Q3 Sept	\$ 6.56	\$ 9.80	\$ 10.87	\$ 15.28
Q4 Dec	\$ 8.61	\$ 9.89	\$ 12.39	\$ 18.79
Year End	\$ 27.85	\$ 34.70	\$ 41.70	\$ 59.93

Earnings:	2006A	2007A	2008e	2009e
Q1 March	(\$ 0.11)	(\$ 0.61)	(\$ 0.05)A	\$ 0.01
Q2 June	(\$ 0.08)	\$ 0.04	\$ 0.02	\$ 0.08
Q3 Sept	(\$ 0.10)	\$ 0.05	\$ 0.04	\$ 0.15
Q4 Dec	(\$ 0.05)	\$ 0.05	\$ 0.08	\$ 0.18
Year End	(\$ 0.33)	(\$ 0.45)	\$ 0.09	\$ 0.42

Current P/E NA NA 114.67x 24.57x

Diluted EPS and EPS Estimates exclude stock compensation expense, amortization of intangibles and one-time expenses

CY07 Pro-Forma EPS excludes \$135m one-time gain

IMPORTANT DISCLOSURES REGARDING THE ANALYST AND THE MEMBER FIRM MAY BE FOUND ON THE FINAL 3 PAGES OF THE REPORT

Jeffrey A Schreiner, Analyst

650-689-5315

jschreiner@capstoneinvestments.com

Significant Developments

IMMR Q108 earnings recap

	<u>Mar-08A</u>	<u>Mar-07A</u>	<u>Chg %</u>	<u>Capstone</u>	<u>Variance</u>
Revenues	\$8	\$6	27%	\$9	-11%
Gross Margin	74%	76%	-200bps	76%	-202bps
EBIT	(\$5)	\$131	NA	(\$2)	-70%
Pro-forma EPS	(\$0.05)	(\$0.61)	NA	\$0.04	NA

Thursday, after the market close, IMMR reported Q108 revenues of \$8.2m which represented 27% y-y growth. Our estimate of \$9.2m assumed stronger contribution from the gaming unit. Revenue by business unit in Q108 was: 1) Mobile—\$1.1m 2) Gaming—\$2m 3) Medical—\$3m 4) 3D—\$1.2m 5) Touch interface—\$870k. IMMR's gross margin was lower y-y, and lower than our estimate of 76%, due primarily to obsolescent write-offs from prior periods. Management stated that these charges equaled 150bps-200bps. Excluding the charges, gross margin would be in-line y-y and in-line with our Q108 estimate. Operating expenses were higher driven primarily by increased headcount. Management conveyed the increase in headcount is across all business units. Sales/Sales management personnel are being hired within the Medical unit to expand the Company's "on-ground" presence in Europe/Asia. During the quarter Immersion hired Leslie Mulligan to head its Gaming unit, and added Chuck Joseph as SVP of the Touch Interface unit. Management also noted several other hires, highlighting two or three new business development personnel. Immersion reported a loss of (\$0.05) on a pro-forma basis. This was unfavorable when compared to our Q108 estimate of \$0.04. As stated above the significant variances related to lower reported Gaming revenues, coupled with increased spending related to headcount expansion.

March quarter highlights

- **Medical continues expansion into new markets:** Management has been aggressively hiring top tier personnel within Europe and Asia to help expand its "on-ground" presence. Asia/India offer strong near-term prospects. Current legislation within Europe more than likely provides longer-term growth opportunities.
- **Mobile continues its advance:** Mobile revenues were \$1.1m in the quarter, or 13% of revenues. In Q407 Mobile revenues equaled 10% of total, while in Q107 it was merely 2%. On its earnings call management stated that its Business Development personnel is currently working on 70 handset models with its three current licensees (NOK, LG, Samsung). Based on discussions with industry professionals, we would expect additional adoption of Haptics beyond current licensees. We believe the handset market offers strong growth potential over the next 12-24 months.
- **No share buy-back:** Management acknowledged that no shares were repurchased by the Company during Q108. Criteria relating to implementation of the buy-back was not in place during the quarter. We believe utilization of the Company's buy-back potentially adds \$0.20-\$0.25 to our pro-forma EPS estimate in CY08.
- **Automotive activity remains strong:** Comments relating to the Automotive unit, within Touch Interface, continued to be upbeat. Management stated they have secured a new design win with a new customer. Based on volumes and integration the Company can receive anywhere from \$3-\$5 per vehicle. Management made investments in qualified personnel whom were directed to increase penetration of Haptics within automotives, and secure new design wins. We believe that after one year noticeable progress within automotive has occurred. We would focus investors on the investments made in personnel within automotive as a potential proxy for current investments being made in other units.
- **3M relationship "going quite well":** Immersion's relationship with 3M relating to touchscreen casino gaming consoles continues to proceed in-line. 3M continues to qualify products and Immersion expects acceptance within the next 3-6 months. After acceptance the company continues to target 2H08 as timeframe for first shipments. We view the relationship with 3M as an example of touchscreen expansion, benefiting from the unique Haptic feedback technology.

Significant Developments

iPhone: What impact could an AAPL/IMMR partnership have?

	<u>CY08</u>	<u>CY09</u>
iPhone Shipments	25m	50m
IMMR Royalty	\$0.05	\$0.05
Add'l Revenue	\$1	\$3
Tax Rate	28%	28%
Incr. Net Income	\$0.9	\$1.8
Diluted Shares	30	29
Incremental EPS	\$0.03	\$0.06
Multiple	30x	30x
Per share Impact	\$0.90	\$1.90

Much speculation and chatter has surrounded shares of Immersion over the last two weeks. The focal point of this chatter has related to a potential IMMR/AAPL partnership. A recent internet article quoted individuals within AAPL as saying negotiations between IMMR and AAPL were underway. In addition the article highlighted newly appointed CEO Clent Richardson's previous employment within AAPL. We currently have no insight into any potential IMMR/AAPL licensing agreement. Many iPhone users have clambered about the difficulty in the AAPL UI without the inclusion of IMMR Haptic Feedback. We certainly see value in a IMMR/AAPL partnership, but are hesitant that such an agreement would merit a significant increase in IMMR value.

We have tried to provide investors our opinion of what an IMMR/AAPL agreement may have in relation to share value. Focusing on CY09, we assume 50m iPhone units. Currently, Piper Jaffray expects 45m units in CY09 iPhone shipments. Assuming a similar royalty rate to Immersion's licensing deal with NOK, and applying a 30x multiple, we believe the incremental value in an IMMR/AAPL licensing agreement potentially equals ~\$2 per diluted share.

Estimate revisions

	<u>Jun-08</u>	<u>Prior</u>	<u>Sep-08</u>	<u>Prior</u>	<u>CY08</u>	<u>Prior</u>	<u>CY09</u>	<u>Prior</u>
Revenues	\$10	\$10	\$11	\$11	\$42	\$43	\$60	\$55
Gross Margin	76%	74%	77%	75%	76%	76%	77%	77%
EBIT	(\$2)	(\$1)	(\$2)	(\$1)	(\$9)	(\$5)	\$3	\$8
Pro-forma EPS	\$0.02	\$0.05	\$0.04	\$0.04	\$0.09	\$0.19	\$0.42	\$0.49

We have adjusted our June quarter estimates to reflect a period of hiring spending as the Company ramps key personnel across several units. This increase in OPEX causes a reduction to our June '08 pro-forma EPS estimates. Our new estimate of \$0.02 is lower than our initial June quarter estimate of \$0.05.

Our CY08 revenue estimates have been lowered to reflect Q108 actual. Due to higher spending levels based primarily on new headcount addition, we have reduced our CY08 pro-forma EPS estimate. Our new estimate of \$0.09 is much lower than our first pass of \$0.19. The significant contributors to the decrease in our estimate were: 1) higher spending 2) tax rate adjusted higher to 28%.

CY09 revenues have been revised higher reflecting increased strength within Mobile. Our new estimate of \$60m is higher than prior estimates of \$55m. Our CY09 pro-forma EPS estimate has been revised lower to \$0.42, versus \$0.49, primarily due to spending increases. Prior to Q108 we believed the Company could obtain significant operating leverage in CY09, and perhaps require less personnel. We now believe that headcount increases could continue, and costs associated with these increases more than likely continue in CY09.

Catalysts

- IMMR maintains a significant IP portfolio with over 700 patents issued or pending. Companies such as MSFT and SNE have litigated and lost, thus settling with the Company in relation to its IP. A recent study done by 1790 Analytics for IEEE ranked IMMR patent portfolio in the top five percent of 1300 various companies. In the same study, IMMR was ranked #1 for patent pipeline among 181 other various companies. The Company has formed an IP strategy team to help with development, and future strategies, related to its IP portfolio.
- IMMR announced that it had expanded personnel in Europe and Asia within its medical business. The medical simulation markets within both Europe and Asia are equivalent to the U.S. We view expansion into additional large-end markets as positive for IMMR. Expansion in new markets typically takes a period of introduction, ramp and then growth. We believe that IMMR is only in the introduction phase but see strong growth prospects in future years.
- Sony PS3 joysticks incorporating IMMR haptic technology have begun shipping in Asia. We believe that bundled PS3 will incorporate haptic technology in 2H08. While incrementally not beneficial to IMMR, we believe Sony's willingness to adopt IMMR technology into PS3 could signal a willingness to license additional 3rd party vendors.
- IMMR has selected its broker and instituted as 10-5b1c plan with relation to its \$50m share buyback. At current price levels, this buyback could add around an estimated \$0.20-0.25 to our current CY08 pro-forma estimates. We believe the Company will be active in share buybacks during Q208. Per management, cash balances may be used for potential future acquisitions in addition to share buybacks.
- Recent discussions with industry participants have provided real endorsement of the Company's technology. Industry management we spoke with see it as a critical value add in expanding touch functionality.
- We view automotive as a strong long-term opportunity. To date the company has seen significant traction with both BMW, Mercedes-Benz and Volkswagen. Management announced a new customer design win on its Q108 earnings conference call, and we believe additional developments within automotive will continue to unfold. Market dynamics such as Volkswagen's comments relating to its plans for all Volkswagens to have touchscreen capabilities in the next few years provides additional favorable catalysts.
- IMMR relationship with 3M relating to touchscreen casino gaming consoles provides upside opportunity and end market expansion. In our opinion the 3M relationship more than likely ramps during the CY09-CY10 timeframe. We believe this relationship alone has the potential to generate ~\$6m in CY10 compared to \$0m in CY08. We view the use of Haptic technology within the 3M casino gaming console market as evidence of market expansion within touchscreen. As touchscreen expansion continues we believe Immersion's Haptic technology will see increased adoption across several new end markets.



Business Strategy

IMMR – Immersion Corporation

IMMR is a publicly traded company with shares listed on NASDAQ. The Company generated revenues of \$35m in CY07 and has 152 employees as of December 31, 2007, and boasts a large IP portfolio with over 700 patents issued or pending. The Company first went public 10 years ago. At that time, Immersion's primary offering was based on haptic technology found in video game controllers. Since this time, the Company has expanded its end markets now serving mobile, medical, automotive, touchscreen, 3D controls, video games, and royalty agreements.

What is Haptics?

"Haptics" is a Greek word meaning "the science of touch." Haptics is the science of physiology of the sense of touch and provides sensations similar to texture, vibration, and bumps. Haptics help give direction and guides our movements. Haptic vibration type feedback or simulation can offer life-like interaction triggering senses to react naturally. As more devices become intuitive and offer touch based technology, Haptics provides interaction with recognizable responses and a touch-and-feel similar to non-digital interaction. IMMR is the only company currently offering Haptic based technology.

Mobile

The handset opportunity is a royalty based relationship. The Company has previously received around \$0.07-\$0.09 per handset. After its announced relationship with NOK, management has guided this ASP closer to \$0.05 per phone. In our opinion, CY07 has been the first full year with handsets offering Haptic based technology. To date Samsung and LG have about 20 phones shipping with IMMR technology. Management believes these two vendors have 30-40 additional phones entering the market within 12-18 months. Investors should expect the first NOK based phone in 2H08. We believe NOK will begin to ramp adoption through CY09 as its license with IMMR offers volume discounts. Management has publicly stated that the license would be very expensive if NOK were to adopt limited Haptic based handsets. The NOK contract specifies a minimum payment per annum. Typically, any announced relationship with a handset OEM offers upfront NRE revenues then transfers to a royalty based license upon shipments. Typical Haptic based features within handsets can be "push back" or vibration. Based on our analysis, each incremental 1% penetration of our CY08/CY09 total handset/smartphone estimates would add an incremental \$0.02 to our earnings estimates. We believe that the gross margin profile of the mobile market is equivalent to 90%. However our assumptions assume that the handset based royalty equals gross margins above this blended average.

Mobile – Incremental Haptic Penetration

	CY08e	CY09e
Total Market	1,347	1,624
Incr. Penetration	1%	1%
Incr. Units	13	16
Royalty per phone	\$0.07	\$0.06
Add'l Revenue	\$0.9	\$1.0
Tax Rate	28%	28%
Incr. Net Income	\$0.7	\$0.7
Diluted Shares	30	29
Incremental EPS	\$0.02	\$0.02

Units in millions - \$ in millions, except royalty and EPS estimate

Mobile download offers an additional revenue opportunity within the large handset end market. IMMR typically captures around \$0.05-0.10 per download. This royalty can be derived from ringtones, mobile games, and make alerts more discernable. During CY06 we believe this market equaled around \$3B. It is our expectations that this end market could grow to \$20B by CY11. We estimate that exiting CY07 IMMR captured only 0.02% of this market. As mobile game adoption becomes prevalent throughout the world we believe that IMMR will be able to grow its share to around 0.25% by CY11. This market offers significant upside potential based on incremental gain of share.

Medical

IMMR's medical business currently represents the majority of the Company's revenues (CY07: 44%). This division focuses on selling large simulators to healthcare centers, hospitals, education institutions, and medical device companies. The value proposition offers institutions the ability to have surgeons train with "hands-on" life-like training prior to their first operation. In addition, skilled surgeons are able to practice common surgeries improving technique. It is common place for first-time surgeons to have had no real-world experience before embarking on their first operation. IMMR based medical products offer benefit to medical device companies as they are able to demonstrate their products to potential clients showing improved surgical procedure. Current estimates forecast 15k medical training institutions worldwide. Only a few of these institutions have been adopted IMMR's medical simulation products. Customers include Medtronic, John Hopkins University, Mayo Clinic – Rochester, Duke University Medical Center, Yale University and others. IMMR is working with customers and other medical device companies to drive new legislation regarding training hours needed prior to first-time surgeons performing an actual procedure, or continuing educa-

Business Strategy

tion for veteran surgeons. Such legislation could accelerate the adoption of virtual-reality based medical simulators. IMMR offers two types of simulators. Its intravenous based products typically cover procedures such as vascular access and phlebotomy. These products sell for around \$15-20k and require software modules which offer annuity based opportunities. The non-intravenous products sell for around \$100-120k and also present an annuity based opportunity due to the need for software modules and future software updates. We believe the medical division will continue to offer strong top-line growth, but acceleration in unit sales will be needed to see strong bottom-line contribution.

Touchscreen

Other opportunities within kiosks, point of sale, and medical/industrial will be predicated on a transition from a resistive based technology to a capacitive approach with feedback offering onscreen buttons feeling less mechanical and recognizable confirmations. Market estimates state 3 million new touchscreens are sold worldwide. We believe any incremental penetration within this market would not currently be reflected in our estimates. While we believe that some related applications would benefit from the use of haptic based technology, we would like to see more developments within these end market opportunities.

SNE-MSFT: Royalties from licensing

Many investors will recognize IMMR based technology as the "shaking" within your Playstation 2 joystick during play of various video games. Due to this unique technology SNE and IMMR became embroiled in a long-standing patent lawsuit which eventually was settled by SNE. SNE paid IMMR the following; 1) \$97.2m – jury award 2) \$32.3m previously paid for compulsory license fees 3) \$22.5m for new rights with respect to all Playstation versions. In addition, IMMR crafted an agreement to allow MSFT to use its haptic based technology with additional incentives of \$15m if IMMR were to settle with SNE. After the announced settlement with SNE, IMMR recognized this additional \$15m. Currently IMMR recognizes \$750k per quarter relating to SNE based royalties. SNE has also been provided an option to license future SNE products within gaming. We view these two settlements as critical in determining the strength of IMMR's IP portfolio. Both MSFT and SNE are large innovative companies with significant patent portfolios and access to high-powered patent attorneys. IMMR licensing both companies shows potentially significant barriers to entry within the haptic

based market. IMMR has stated publicly that the Company feels in order to offer true haptics based technology any other company would need a license to its patents. We view IMMR's patent portfolio as a significant competitive advantage and presents additional high-margin licensing within several end markets.

Video Games

IMMR offers game console manufacturers and 3rd party peripheral companies access to haptic feedback technology used primarily in joysticks. This business has been offering haptic based technology to the market for over 10 years. Both MSFT and SNE have licensed IMMR technology for use within their console offerings. This market also serves the PC gaming market place. IMMR typically licenses its technology to OS Support (APPL, MSFT), PC Peripherals, Console platform (MSFT, SNE) and Console peripherals (MadCatz, LOGI). These licensees then work with software developers to integrate haptic feedback within game play. IMMR typically receives 5-10% of peripheral hardware selling price. We believe additional upside opportunity exists. IMMR has not yet negotiated a license with Nintendo for its very popular Wii platform. In addition we believe the penetration of haptics within games could increase allowing for additional license revenue. We view the video game market as a mature opportunity with potential upside from new relationships and licensing expansion.

3D Products

This business offers glove and measuring type devices incorporating haptic based technology. Management classifies this business as a "cash cow" but understands growth prospects are limited. Currently this business contributes about \$1m per quarter in revenues. We believe this number will decline over time as focus is shifted to other high-growth markets such as mobile and touchscreen.

Competition

IMMR currently has no direct competitors. Its Haptic technology is protected by court-tested patents. End users of Haptic based technology could implement less functional, or non-compliant Haptic functionality, as a way to offset costs to IMMR. An example of this implementation would be MOT's new ROKR E8. This implementation did not utilize IMMR technology, but also was not a fully functional haptic offering. We see competitive risks as potential customers not utilizing fully functional haptic technology.

Valuation

We value shares of IMMR based on our CY09 pro-forma EPS estimates. In our opinion IMMR is at the base of a significant ramp in revenues due to expansion into new markets and gaining momentum in other businesses. We believe that the significant growth profile, offered by IMMR deserves a higher forward multiple than industry peers. IMMR could potentially grow pro-forma EPS over 100% year-over-year during CY08/CY09. In addition, Immersion currently has over \$4.50 per share in cash. We believe a 30x multiple appropriately recognizes the significant growth opportunity, while still providing some discount to potential risks related to revenue acceleration and/or push-out of opportunities. Applying a 30x multiple to our CY09 pro-forma EPS estimates of \$0.42, we arrive at a target price of \$13.00. Our target is around 26% above IMMR's prior closing price.

	\$13.00
Multiple	30x
Difference from close	26%
Share Price: (Mkt open)	\$10.32
Share Outstanding:	30.5

Market Capitalization	\$315
Less: Cash	\$138
ST Investments	\$2
Add: Debt	\$0

Enterprise Value	\$175

Valuation Comparison

(as of 5-02-08)

Company	Ticker	Market Cap	Price	EPS(ttm)	P/E	P/S	P/B
Cypress Semiconductor	CY	\$ 4.1 B	\$ 27.47	\$ 0.45	61.0x	2.4x	2.8x
Immersion Corporation	IMMR	\$ 314.86 M	\$ 10.32	(\$ 0.52)	N/A	9.7x	2.4x
Interlink	LINK	\$ 10.5 M	\$ 0.76	(\$ 0.81)	N/A	0.4x	0.8x
Atmel	ATML	\$ 1.9 B	\$ 4.18	\$ 0.10	42.2x	1.1x	2.2x
Synaptics, Inc.	SYNA	\$ 849.03 M	\$ 36.62	\$ 1.33	27.6x	2.5x	5.9x

News Releases

April 24, 2008 - Immersion announced the appointment of Clent Richardson to President and CEO, effective April 28, 2008. Immersion also expects that Richardson will be appointed to the Company's Board of Directors. Most recently, Richardson, 46, was chief marketing officer of TiVo, and earlier, of Nortel Networks.

April 16, 2008 - Immersion announced its wholly owned subsidiary, Immersion Medical, Inc., filed a lawsuit for patent infringement in the U.S. District Court for the Eastern District of TX against Mentice AB, Mentice SA, Simbionix USA Corp., and Simbionix Ltd. The complaint alleges that each of the defendants infringe U.S. patents nos. '301, '920, '837 and '392. The complaint seeks damages and injunctive relief.

March 14, 2008 - Immersion announced its chairman, president and CEO, Victor Viegas, and its CFO and VP of Finance, Stephen Ambler, have entered into stock trading plans in accordance with Rule 10b5-1c of the Securities and Exchange Act of 1934.

February 28, 2008 - Announced Q407/FY07 earnings, revenues were \$9.9m, 15% higher compared to \$8.6m for Q406. Reported Q407 GAAP diluted EPS were \$0.02 versus a loss of (\$0.08) in Q406. Full year revenues were \$34.7m, increasing 25% over FY06 revenues of \$27.9m. Reported FY07 GAAP diluted EPS equaled \$4.23 compared to a loss of (\$0.42) in FY06.

February 25, 2008 - Immersion announced that over 10m mobile phones with VibeTonz technology have been shipped by licenses, including 5.5m shipped in CY07. Three of the four top mobile phone manufacturers in the world - LG, Nokia and Samsung - are VibeTonz licensees.

November 1, 2007 - Board of Directors announced an authorized repurchase of up to \$50m of the Company's common stock. As of October '07 there were approximately 30.1m shares of common stock outstanding.

	2005A	2006A	2007A	2008e
Shares Outstanding	24.03M	24.56M	31.67M	30.13M
Cash Flow	\$ 0.09	\$ 0.22	\$ 3.06	\$ 0.07
Price/Cash Flow	114.67	46.91	3.37	147.43
Free Cash Flow	\$ 0.05	\$ 0.17	\$ 3.00	\$ 0.01
Book Value	(\$ 0.69)	(\$0.93)	\$ 4.67	\$ 4.35
Tangible Book Value	(\$ 0.98)	(\$ 1.24)	\$ 4.21	\$ 4.08

Management & Directors

Management

Clent Richardson, President and CEO. Served as chief marketing officer of TiVo, Inc. and Nortel Networks. Prior to these positions, he was chief sales and marketing officer and a member of the board of directors of T-Mobile U.K.. Previously, at Apple, he reported to the co-founder and CEO as vice president of worldwide developers relations and worldwide solutions marketing.

Stephen Ambler, VP/CFO. Joined IMMR in '05. Prior to joining IMMR, Mr. Ambler held the position of chief financial officer of Bam! Entertainment, a producer of interactive video games, from '01-'05.
Salary (\$208,000 - CY06), Shares Held (99,477 - as of 12/31/06)

Richard Vogel, SVP/GM. Served in current position since '04. Prior to that Mr. Vogel served as CEO of SpectraLife, a medical device company specializing in products for the management of diabetes.
Salary (\$210,000 - CY06), Shares Held (183,800 - as of 12/31/06)

Directors

Clent Richardson, see above

Victor Viegas, elected Chairman of the Board in October '07. Prior to joining IMMR, Mr. Viegas worked at Macrovision, a developer and licensor of video software copy protection technologies, as CFO from '96-'99.

Anne DeGheest, 52, Ms. DeGheest has served as a director since '07. Prior to IMMR she served as Founder and a Principal at MedStars, an investment and executive management firm specializing in starting and developing new life sciences companies with innovative products and services.

Jack Saltich, 63, Mr. Saltich has served as a director since '02. Since '05, Mr. Saltich has served as the Chairman of Vitex Systems, Inc. a developer of transparent ultra-thin barrier films for use in the manufacture of next-generation flat panel displays.

Jonathan Rubinstein, 50, Mr. Rubinstein has served as a director since '99. Mr. Rubinstein previously worked at Apple Computer, Inc. as their SVP, iPod Division and prior to that as SVP of Hardware Engineering from '97-'06.

Robert Van Naarden, 60, Mr. Van Naarden has served as a director since '02. Since '06, Mr. Van Naarden has served as Executive Vice President of Verdasys, Inc., an enterprise software company.

John Hodgman, 52, Mr. Hodgman has served as a director since '02. He currently is SVP and CFO of InterMune, Inc., a biotechnology company focused on pulmonology and hepatology therapies.

Emily Liggett, 51, Ms. Liggett has served as a director since '06. She is currently the President/CEO, of Apexon, Inc., a provider of supply performance management software for manufacturers.

Immersion Corporation (in millions of US Dollars, except earnings per share)

	2007/ Q1A	2007/ Q2A	2007/ Q3A	2007/ Q4A	2007A	2008/ Q1A	2008/ Q2e	2008/ Q3e	2008/ Q4e	2008e	2009/ Q1e	2009/ Q2e	2009/ Q3e	2009/ Q4e	2009e
Total revenues	6.41	8.60	9.80	9.89	34.70	8.16	10.28	10.87	12.39	41.70	11.95	13.91	15.28	18.79	59.93
Cost of sales	1.54	2.43	2.56	2.28	8.81	2.09	2.47	2.50	2.85	9.90	2.75	3.20	3.52	4.32	13.78
Gross profit	4.87	6.17	7.24	7.62	25.89	6.07	7.81	8.37	9.54	31.79	9.20	10.71	11.77	14.47	46.15
Sales and marketing	2.70	3.03	2.83	2.94	11.49	3.44	3.29	3.26	3.10	13.09	4.18	3.06	3.06	3.76	14.06
R&D	2.54	2.51	2.48	2.52	10.06	3.23	3.08	3.26	3.10	12.67	3.58	3.48	3.06	3.38	13.50
G&A	3.26	3.12	2.78	3.41	12.57	4.26	3.60	3.26	3.10	14.22	4.18	4.17	3.06	3.66	15.07
Amortization of intangibles	0.25	0.24	0.24	0.26	1.00	0.24	0.27	0.26	0.25	1.01	0.24	0.23	0.23	0.22	0.92
Litigation settlement	(134.90)	-	-	-	(134.90)	-	-	-	-	-	-	-	-	-	-
Total costs and expenses	(126.14)	8.91	8.33	9.12	(99.78)	11.17	10.24	10.04	9.54	40.99	12.19	10.94	9.40	11.03	43.56
Operating income - EBIT	131.01	(2.74)	(1.09)	(1.51)	125.68	(5.10)	(2.42)	(1.67)	(0.00)	(9.20)	(2.99)	(0.23)	2.37	3.44	2.59
Add: Depreciation	0.21	0.22	0.23	0.25	0.91	0.23	0.25	0.29	0.32	1.09	0.35	0.38	0.42	0.44	1.60
Add: Amortization of intangibles	0.25	0.24	0.24	0.26	1.00	0.24	0.27	0.26	0.25	1.01	0.24	0.23	0.23	0.22	0.92
Add: Stock compensation	0.61	0.63	0.70	0.79	2.73	0.96	0.80	0.80	0.80	3.36	1.00	1.00	1.00	1.00	4.00
EBITDA	2.38	4.21	(3.70)	(11.72)	(8.82)	(3.67)	(1.10)	(0.33)	1.36	(3.74)	(1.39)	1.38	4.02	5.11	9.11
Interest and other income, net	(0.05)	1.41	1.65	1.82	4.83	1.51	1.82	1.74	1.69	6.76	1.83	1.86	1.80	1.77	7.26
Pre-tax income	130.97	(1.33)	0.55	0.31	130.51	(3.59)	(0.60)	0.07	1.69	(2.43)	(1.16)	1.63	4.17	5.22	9.85
Provision/(benefit) for taxes	15.13	(1.50)	0.06	(0.20)	13.49	(1.01)	(0.17)	0.02	0.47	(0.68)	(0.33)	0.46	1.17	1.46	2.76
Net Income - GAAP	115.84	0.18	0.49	0.51	117.02	(2.59)	(0.43)	0.05	1.22	(1.75)	(0.84)	1.17	3.00	3.76	7.09
Net Income - Pro Forma	(18.19)	1.05	1.44	1.56	(14.15)	(1.39)	0.63	1.11	2.27	2.62	0.40	2.41	4.23	4.98	12.02
Diluted EPS - GAAP	\$ 3.90	\$ 0.01	\$ 0.02	\$ 0.02	\$ 3.70	\$(0.08)	\$(0.01)	\$ 0.00	\$ 0.04	\$ (0.06)	\$(0.03)	\$ 0.04	\$ 0.11	\$ 0.13	\$ 0.25
Diluted EPS - ProForma	\$ (0.61)	\$ 0.04	\$ 0.05	\$ 0.05	\$ (0.45)	\$(0.05)	\$ 0.02	\$ 0.04	\$ 0.08	\$ 0.09	\$ 0.01	\$ 0.08	\$ 0.15	\$ 0.18	\$ 0.42
Diluted shares outstanding	29.68	28.62	31.40	32.49	31.67	30.48	30.20	29.92	29.92	30.13	28.92	28.67	28.42	28.42	28.61

	2007/ Q1A	2007/ Q2A	2007/ Q3A	2007/ Q4A	2007A	2008/ Q1A	2008/ Q2e	2008/ Q3e	2008/ Q4e	2008e	2009/ Q1e	2009/ Q2e	2009/ Q3e	2009/ Q4e	2009e
Operating Margin	2042%	-31%	-11%	-15%	362%	-62.54%	-23.58%	-15.36%	-0.01%	-22.05%	-25.02%	-1.69%	15.51%	18.33%	4.32%
EBITDA Margin	37%	49%	-37%	-118%	-25%	-44.99%	-10.74%	-3.01%	11.01%	-8.96%	-11.67%	9.94%	26.29%	27.18%	15.21%
Net Margin - GAAP	1806%	2%	5%	5%	337%	-31.70%	-4.23%	0.49%	9.83%	-4.19%	-7.01%	8.44%	19.63%	19.98%	11.83%
Net Margin - ProForma	-283%	12%	14%	15%	-40%	-17.01%	6.14%	10.21%	18.30%	6.29%	3.38%	17.32%	27.67%	26.48%	20.05%

Source: IMMR documents filed with the SEC and CapStone Investments Estimates

ProForma EPS excludes stock compensation expense, amortization of intangibles, and other one-time expenses

Income Statement					
Fiscal Period:	2007	2006	2005	2004	2003
Period End Date:	12/31/2007	12/31/2006	12/31/2005	12/31/2004	12/31/2003
Period Length:	12 Months	12 Months	12 Months	12 Months	12 Months
Originally Reported Unit:	Thousands	Thousands	Thousands	Thousands	Thousands
Reporting Currency:	USD	USD	USD	USD	USD
Royalty	11,881	7,304	8,888	8,778	6,088
Product Sales	18,541	17,083	12,762	11,644	9,455
Contracts/Other	4,280	3,466	2,627	3,341	4,680
Total Revenue	34,702	27,853	24,277	23,763	20,223
Cost of Sales	8,808	7,193	6,446	6,255	5,276
Sales/Marketing	11,493	12,609	11,649	11,312	7,768
Research/Development	10,056	7,609	6,003	7,985	7,899
General/Admin.	12,567	10,076	10,638	17,133	12,511
Amort. Intangibles	1,002	969	1,256	1,470	1,619
Litigation	(134,900)	(1,650)	0	--	--
Restructuring Costs	0	0	185	0	0
Total Operating Expense	(90,974)	36,806	36,177	44,155	35,073
Interest/Oth. Income	5,854	275	490	168	126
Interest and other expense	(1,024)	(1,602)	(1,506)	(41)	(50)
Other Income	--	0	(11)	(624)	(2,046)
Net Income Before Taxes	130,506	(10,280)	(12,927)	(20,889)	(16,820)
Provision for Income Taxes	13,488	144	158	(151)	154
Net Income	117,018	(10,424)	(13,085)	(20,738)	(16,974)
Basic EPS	4.23	(0.42)	(0.54)	(0.91)	(0.83)
Basic Weighted Average Shares	27,662	24,556	24,027	22,698	20,334
Diluted EPS	3.71	(0.42)	(0.54)	(0.91)	(0.83)
Diluted Weighted Average Shares	31,667	24,556	24,027	22,698	20,334

Balance Sheet					
Fiscal Period:	2007	2006	2005	2004	2003
Period End Date:	12/31/2007	12/31/2006	12/31/2005	12/31/2004	12/31/2003
Originally Reported Unit:	Thousands	Thousands	Thousands	Thousands	Thousands
Reporting Currency:	USD	USD	USD	USD	USD
Cash/Equivalents	86,493	2,146	1,847	1,053	21,738
Shortterm investments	51,619	29,866	26,324	24,485	--
Accounts Rcvbl.	5,579	5,292	5,033	5,594	5,074
Doubtful Account	(85)	(139)	(383)	(159)	(147)
Raw Materials	2,843	2,267	2,369	1,555	1,539
Work in Process	179	110	55	8	247
Finished Goods	652	262	231	242	313
Deferred income taxes	3,351	0	--	--	--
Prepaid/Other	3,036	1,179	1,131	1,280	1,099
Total Current Assets	153,667	40,983	36,607	34,058	29,863
Computer Equip.	3,195	2,980	2,974	2,395	2,251
Machinery/Equip.	2,532	2,817	2,235	2,132	2,010
Furn./Fixtures	1,212	1,280	1,229	1,337	1,320
Leasehold Improv	1,267	824	798	692	692
Depreciation	(6,094)	(6,254)	(5,870)	(5,382)	(4,819)
Intangible Assets	15,272	13,116	11,561	16,284	--
Accumulated Amortization	(6,714)	(5,731)	(4,774)	(9,266)	--
Intangibles and other assets net	--	--	--	--	6,596
Deferred tax assets net	4,031	0	--	--	--
Total Assets	168,368	50,015	44,760	42,250	37,913
Accounts Payable	1,657	2,334	2,179	4,038	1,752
Accrued Comp.	1,828	1,526	1,193	1,499	864
Other Accrued	2,095	1,750	1,604	2,002	2,066
Deferred Revenue	4,478	1,716	2,741	3,420	3,116
Current LTD	--	0	5	10	10
Current Leases	--	--	--	1	23
Income taxes payable	534	0	--	--	--
Total Current Liabilities	10,592	7,326	7,722	10,970	7,831
Long term debt	0	18,122	17,490	16,917	16
Total Long Term Debt	0	18,122	17,490	16,917	16
Deferred Revenue	14,269	31,784	21,294	5,154	4,235
LT Advance MSFT	0	15,000	15,000	15,000	27,050
Other long term liabilities	1,720	775	49	176	0
Total Liabilities	26,581	73,007	61,555	48,217	39,132
Common Stock & paid-in capital	160,147	110,501	106,277	104,027	89,903
Warrants	1,731	3,686	3,686	3,686	1,974
Deferred Comp.	--	--	0	(2)	(130)
Accumu. Other	137	67	64	59	33
Accum. Deficit	(20,228)	(137,246)	(126,822)	(113,737)	(92,999)
Total Equity	141,787	(22,992)	(16,795)	(5,967)	(1,219)
Total Liabilities & Equity	168,368	50,015	44,760	42,250	37,913

Cash Flow Statement					
Fiscal Period:	2007	2006	2005	2004	2003
Period End Date:	12/31/2007	12/31/2006	12/31/2005	12/31/2004	12/31/2003
Period Length:	12 Months	12 Months	12 Months	12 Months	12 Months
Originally Reported Unit:	Thousands	Thousands	Thousands	Thousands	Thousands
Reporting Currency:	USD	USD	USD	USD	USD
Net Income	117,018	(10,424)	(13,085)	(20,738)	(16,974)
Depreciation	911	772	730	874	1,040
Amort. Intangibles	1,002	969	1,256	1,470	1,619
Amort. Stock Comp.	2,729	2,937	2	128	861
Int. & Other MSFT	--	0	0	598	1,050
FV Adj. Warrant. Liab	--	--	0	0	(2)
Interest Expense on Debentures	535	632	634	--	--
Other Non-Cash	--	--	--	15	16
Fair Value Adj. of Put Option	(15)	(34)	(128)	0	0
Excess tax benefits from stock comp	(13,505)	(36)	0	0	4
Sale of Equipment	15	15	10	4	3
Write-down Investmt.	--	69	0	0	1,000
Deferred Revenue	(29,753)	9,465	15,461	1,223	(722)
Accounts Receivable	(317)	(503)	791	(500)	(1,257)
Deferred income taxes	(7,382)	0	0	--	--
Inventories	(965)	79	(814)	293	29
Other assets	(62)	0	0	--	--
Prepaid/Other	(1,842)	(71)	149	(154)	26
Accounts Payable	(618)	191	(2,087)	805	(207)
Accrued Liab.	15,804	516	(709)	432	933
Other Long Term Liability	960	760	0	--	--
Cash from Operating Activities	84,515	5,337	2,210	(15,550)	(12,580)
Purchases of short term investments	(96,719)	0	0	0	0
Sale/Maturities STI	45,110	0	0	0	0
Capital Expenditures	(1,438)	(1,130)	(962)	(623)	(441)
Other Assets	(2,113)	(1,614)	(1,025)	(1,918)	(1,573)
Cash from Investing Activities	(55,160)	(2,744)	(1,987)	(2,541)	(2,014)
Issue 5% Conv. Debt	--	0	0	20,000	0
Issu. Common IPO	317	242	233	170	35
Stock Options	12,738	1,009	2,017	1,587	858
LT Advance from MSFT	--	--	0	0	26,000
Div. to Ser. A Rdmb. Pref.	--	0	0	(281)	0
Payment Note/Leases	(1,400)	(5)	(11)	(32)	(102)
Issuance cost Convertible Debenture	0	0	(55)	--	--
Tax Benefit from Stock- Based Comp.	13,505	36	0	--	--
Cash from Financing Activities	25,160	1,282	2,184	21,444	26,791
Foreign Exchange Effects	(34)	(34)	226	447	824
Net Change in Cash	54,481	3,841	2,633	3,800	13,021
Net Cash - Beginning Balance	32,012	28,171	25,538	21,738	8,717
Net Cash - Ending Balance	86,493	32,012	28,171	25,538	21,738

Important Disclosures

Concluding Opinion

We are downgrading Immersion Corporation to Buy on valuation as our target is no longer 30% above market and raising our price target to \$13.00 from \$10.00. Our price target is based primarily on accelerated adoption of Haptic based technology within several new markets. We use approximately 30x our CY09 pro-forma EPS estimates to derive our target price.

Risks

- **Adoption of Haptic based technology is slower than our estimates.** We believe that Haptic based technology will see an acceleration in adoption during CY08. Our estimates assume a gradual growth during CY08, with strong acceleration in CY09. If our estimates are "pushed-out" or prove too aggressive our forecasted target price could be mis-valued.
- **New competition offers similar offering while not incorporating patents.** We believe a key investment thesis in shares of IMMR relates to the Company's strong, tested, IP portfolio. If new competition were to enter the market offering similar quality products without infringing on IMMR technology our investment thesis could prove incorrect. In addition, APPL has recently filed a patent application with Haptic-like functionality. If IMMR were unable to defend its IP against new competition our investment thesis regarding IP would be incorrect.
- **Relationships with NOK and other handset OEMs see limited adoption.** If relationships within mobile handsets with NOK, LG and Samsung were to see limited or slower adoption than our estimate future revenue assumptions could potentially be misstated.
- **Additional patent litigation.** If IMMR were to be forced into additional litigation it could substantially increase the Company's operating expenses and reduce future profits. Currently only a contract negotiation dispute is pending with MSFT, however if other large innovative companies challenge IMMR it could cause us to review our valuation. In addition, APPL has recently filed a patent application with Haptic-like functionality. If IMMR were unable to defend its IP our investment thesis regarding IP would be incorrect.
- **Microsoft - Breach of contract claims.** MSFT and IMMR settled claims related to MSFT's use of IMMR's haptic technology in '03. Within the settlement, MSFT required IMMR to pay \$15m if it were to achieve a victory in its litigation versus Sony. After the conclusion of the Sony litigation IMMR recognized the \$15m, as it believed its contract only mandated the return of the \$15m if IMMR was victorious "in court" and Sony and IMMR settled patent claims via settlement. This case is pending in the U.S. District Court for the Western District of Washington. If IMMR were to lose its claims, the company more than likely would be required to pay \$15m to MSFT and potentially legal fees/damages.

Analyst Certification

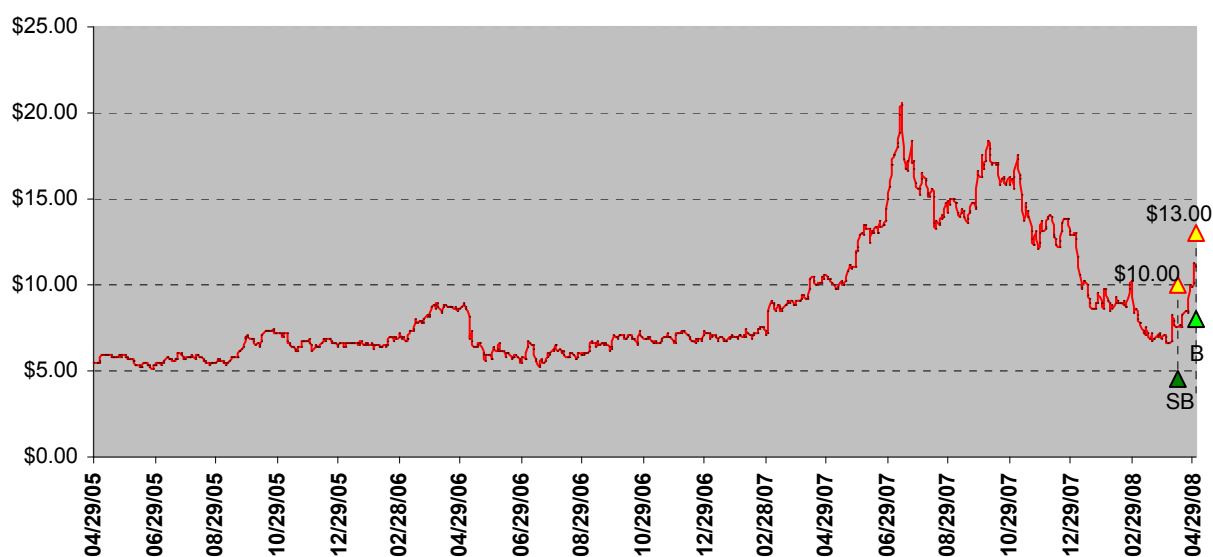
I, Jeffrey Schreiner, hereby certify that the views expressed in this research report accurately reflect my personal views about the stock of Immersion Corporation and Immersion Corporation. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Other Important Disclosures

- CapStone Investments was not making a market in the subject company's securities at the time that this research report was published.
- CapStone Investments and or persons material to the preparation of this report including the research analyst, have not received compensation for investment banking services from Immersion Corporation in the past 12 months but does expect to receive and intends to seek compensation for investment banking services from Immersion Corporation in the next three months.

Important Disclosures (continued..)

IMMR: Stock Performance & Our Recommendations



SB - Strong Buy B - Buy LTB - Long Term Buy H - Hold S - Sell
 NR - No Rating TPR - Target Price Removed

Time Period: 04/29/05 - 05/01/08

Chart taken from Zacks Investment Research

Recommendation History

04/18/08—Initiated Coverage with Strong Buy and \$10.00 Target

05/05/08—Downgraded to Buy, Raised Target to \$13.00

Important Disclosures (continued..)**Explanation of Ratings**

- **Strong Buy:** describes stocks we believe have the potential to appreciate by 30% or more over the next twelve months.
- **Buy:** describes stocks we believe have the potential to appreciate by 15% to 30% over the next twelve months.
- **Hold:** describes stocks we believe could change plus or minus 15% over the next twelve months.
- **Sell:** describes stocks we believe could decline by more than 15% over the next twelve months.
- **Long-Term Buy:** describes stocks we believe have tremendous upside potential, but are also a significant investment risk. Long term recommendations are based on a two to four year period.
- **No Rating:** describes stocks we cover on which adequate information to make a recommendation is not available.

Distribution of Ratings

- **Buy:** 96% of stocks have this rating (15% were investment banking clients within the last 12 months)
- **Hold:** 4% of stocks have this rating (0% were investment banking clients within the last 12 months)
- **Sell:** 0% of stocks have this rating (0% were investment banking clients within the last 12 months)
- **No Rating:** 0% of stocks have this rating (0% were investment banking clients within the last 12 months)

Other Disclosures

- CapStone Investments will effect agency transactions in the securities mentioned, on behalf of its clients submitting orders to buy or sell.
- This report is for information purposes only. Under no circumstances is it to be used or considered as a solicitation to buy or sell any securities. While the information contained herein has been obtained from sources we believe to be reliable, CapStone Investments, a FINRA Member Firm and a Member of SIPC, does not represent that it is accurate or complete, and accordingly, should not be relied upon as such. Notwithstanding this, CapStone Investments verifies that the information provided regarding its registration status and other material facts, including disclosures made on behalf of its relevant persons and entities, are in fact accurate. Risk factors and actual results may differ significantly from the information contained herein.
- CapStone Investments makes its research reports available in real-time to institutional investors through Bloomberg, Reuters, Thomson Financial-First Call, FactSet, Capital IQ, and Zack's Investment Research.

Research:

Jackson Spears
 Director of Research
 CapStone Investments
 789 N. Water Street
 Suite 470
 Milwaukee, WI 35202
 414-223-4403

Corporate:

Steve Capozza
 President
 CapStone Investments
 12760 High Bluff Drive
 Suite 120
 San Diego, CA 92130
 1-800-327-5566

Investment Banking:

Jason Diamond
 Partner
 CapStone Investments
 789 N. Water Street
 Suite 400
 Milwaukee, WI 53202
 414-223-4401

Institutional Services:

Mike Delaney
 Director of Institutional Sales
 CapStone Investments
 200 S. Wacker Drive
 Suite 3100
 Chicago, IL 60606
 312-242-3399