



Interlink Electronics, Inc. and Subsidiaries

Quarterly Report
for the Three and Six Months Ended
June 30, 2019

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About Our Company

Interlink Electronics, Inc. (“we”, “us”, “our”, “Interlink” or the “Company”) designs, develops, manufactures and sells a range of force-sensing technologies that incorporate our proprietary materials technology, firmware and software into a portfolio of standard products and custom solutions. These include sensor components, subassemblies, modules and products that support effective, efficient cursor control and novel three-dimensional user inputs. Our Human Machine Interface (“HMI”) technology platforms are deployed in a wide range of markets including consumer electronics, automotive, industrial, and medical. The application of our HMI technology platforms includes vehicle entry, vehicle multi-media control interface, rugged touch controls, presence detection, collision detection, speed and torque controls, biological monitoring and others.

Interlink has been a leader in the printed electronics industry for over 30 years with the commercialization of our patented Force Sensing Resistor (“FSR®”) technology that has enabled rugged and reliable HMI solutions. Our solutions have focused on handheld user input, menu navigation, cursor control, and other intuitive interface technologies for the world’s top electronics manufacturers.

Interlink serves our world-wide customer base from our corporate headquarters in Camarillo, California (greater Los Angeles area), our global research and development (“R&D”) and engineering center in Singapore, our printed-electronics manufacturing facility in Shenzhen, China and our global distribution and logistics center in Hong Kong. We also maintain engineering, assembly and prototyping capabilities in Camarillo, California along with technical and sales offices in Japan. We sell our products in a wide range of markets, including consumer electronics, automotive, industrial and medical, to some of the world’s largest companies and most recognizable brands.

We were incorporated in California on February 27, 1985. On July 10, 1996, we re-incorporated into a Delaware corporation and, on July 20, 2012, we again changed our domicile from Delaware to Nevada by completing a merger with a newly formed Nevada corporation named Interlink Electronics, Inc.

Our principal executive office is located at 1267 Flynn Road, Camarillo, California 93012 and our telephone number is (805) 484-8855. Our website address is www.interlinkelectronics.com. Interlink makes available its annual financial statements, quarterly financial statements, and other significant reports and amendments to such reports, free of charge, on its website as soon as reasonably practicable after such reports are prepared.

Results of Operations – Three and Six Months ended June 30, 2019

The following table sets forth certain unaudited condensed consolidated statements of income data for the periods indicated. The percentages in the table are based on net revenues.

	Three months ended June 30,				Six months ended June 30,			
	2019		2018		2019		2018	
	\$	%	\$	%	\$	%	\$	%
	(in thousands, except percentages)				(in thousands, except percentages)			
Revenue, net	\$ 2,006	100.0 %	\$ 2,683	100.0 %	\$ 3,456	100.0 %	\$ 5,256	100.0 %
Cost of revenue	953	47.5 %	1,135	42.3 %	1,703	49.3 %	2,297	43.7 %
Gross profit	1,053	52.5 %	1,548	57.7 %	1,753	50.7 %	2,959	56.3 %
Operating expenses:								
Engineering, research and development	88	4.4 %	237	8.8 %	340	9.8 %	461	8.8 %
Selling, general and administrative	594	29.6 %	881	32.8 %	1,385	40.1 %	1,849	35.1 %
Total operating expenses	682	34.0 %	1,118	41.6 %	1,725	49.9 %	2,310	43.9 %
Income from operations	371	18.5 %	430	16.1 %	28	0.8 %	649	12.4 %
Other income (expense):								
Other income (expense), net	57	2.8 %	62	2.3 %	24	0.7 %	16	0.3 %
Income before income tax expense	428	21.3 %	492	18.4 %	52	1.5 %	665	12.7 %
Income tax expense	319	15.9 %	133	5.0 %	257	7.4 %	188	3.6 %
Net income (loss)	\$ 109	5.4 %	\$ 359	13.4 %	\$ (205)	(5.9) %	\$ 477	9.1 %
Other comprehensive income, net of tax:								
Foreign currency translation adjustments	(55)	(2.7) %	(112)	(4.2) %	(5)	(0.1) %	(27)	(0.5) %
Comprehensive income (loss)	\$ 54	2.7 %	\$ 247	9.2 %	\$ (210)	(6.0) %	\$ 450	8.6 %

Results of Operations for the three months ended June 30, 2019, as compared to the three months ended June 30, 2018

Revenue, net by Market is as follows:

	Three months ended June 30,					
	2019			2018		
	Amount	% of Net Revenue		Amount	% of Net Revenue	
	(in thousands, except percentages)					
Automotive	\$ -	- %	\$ 119	4.4 %	\$ (119)	(100.0) %
Industrial	588	29.3 %	615	22.9 %	(27)	(4.5) %
Medical	744	37.1 %	359	13.4 %	385	107.2 %
Consumer	147	7.3 %	486	18.1 %	(339)	(69.8) %
Standard	527	26.3 %	1,104	41.2 %	(577)	(52.3) %
Revenue, net	\$ 2,006	100.0 %	\$ 2,683	100.0 %	\$ (677)	(25.2) %

We sell our custom products into the following markets: automotive, industrial, medical and consumer. We sell our standard products through various distribution networks. The ultimate customer may come from different markets which are often unknown to us at the time of sale. Each market has different product design cycles. Products with longer design cycles often have much longer product life-cycles. Automotive, industrial, and medical products generally have longer design and life-cycles than consumer products. We currently have products with life-cycles that have exceeded twenty years and are ongoing.

Overall revenues were down significantly in all categories except medical. The decrease in net revenues in the automotive market was driven by a major customer making a design change to their product that eliminated the need for our solution. Once our largest customer, revenues for this customer have steadily eroded from mid-2017 through 2018, and are now exhausted. In addition, a product for another large automotive customer had expectedly reached its end of life cycle. These two product lines represented the vast majority of our penetration into the automotive market.

The decrease in the consumer market was driven by a large power tool customer diversifying their supply chain to protect themselves from tariffs. Many of our products are currently subject to import tariffs imposed on goods manufactured in China, increasing the cost to our customers by up to 25%. We believe many of our existing customers have reduced orders until the uncertainty passes, hoping to avoid tariffs. In the worst case, some of them are seeking alternative domestic suppliers.

Diminution in our custom product sales in other markets was driven by decreased sales to our current customers for use in their ongoing product lines. In the normal cycle, some of our larger customers purchase in bulk quantities and absorption of these products can straddle several financial reporting periods. The timing of orders from our customers is not always predictable and can be concentrated in varying periods during the year to coincide with their project and building plans.

Some of our more recent custom product success for new product lines in the medical market is making its way into the pipeline as part of a long design cycle and revenues are just starting to be realized in 2019. In July 2018, the Company announced purchase orders of \$880,000 from an existing prestigious medical customer. As these revenues begin to materialize, they are replacing revenues from other product lines that reached the end of their normal life cycle in prior reporting periods. Overall, we expect medical related revenues to show short-term growth, then stabilize at historical levels.

	<u>Three months ended June 30,</u>		<u>2019</u>		<u>2018</u>		<u>Change</u>	<u>% Change</u>
	<u>Amount</u>	<u>% of Net Revenue</u>	<u>Amount</u>	<u>% of Net Revenue</u>	<u>Amount</u>	<u>% of Net Revenue</u>		
	(in thousands, except percentages)							
Cost of revenue	\$ 953	47.5 %	\$ 1,135	42.3 %	\$(182)	(16.0)%		

Our cost of revenue is impacted by various factors including product mix, volume, material costs, manufacturing efficiencies, facilities costs, compensation costs and any provisions for excess and obsolete inventories. Cost of revenues decreased compared with the prior year consistent with the decrease in revenues. Cost of revenues increased as a percentage of revenues for the same reason, including less revenue to cover fixed costs and production overhead costs.

	<u>Three months ended June 30,</u>		<u>2019</u>		<u>2018</u>		<u>Change</u>	<u>% Change</u>
	<u>Amount</u>	<u>% of Net Revenue</u>	<u>Amount</u>	<u>% of Net Revenue</u>	<u>Amount</u>	<u>% of Net Revenue</u>		
	(in thousands, except percentages)							
Engineering, research and development	\$ 88	4.4 %	\$ 237	8.8 %	\$(149)	(62.9)%		

Engineering and R&D expenses consist primarily of compensation expenses for employees engaged in research, design and development activities. Our R&D team focuses both on internal design development, as well as design development aimed at addressing customer design challenges, in order to develop our HMI solutions.

Our engineering and R&D costs were significantly lower as compared with the same period in the prior year primarily due to research incentive grant from the Singapore government paid in the quarter ended June 30, 2019. This was offset

slightly by higher costs in the build-out of our Singapore R&D center. We will continue to substantially grow the global R&D center in Singapore over the next several years, including expanding our R&D team, expanding the size of the facility, and investing in additional tools and equipment.

	Three months ended June 30,					
	2019		2018		Change	% Change
	Amount	% of Net Revenue	Amount	% of Net Revenue		
Selling, general and administrative	\$ 594	29.6 %	\$ 881	32.8 %	\$ (287)	(32.5)%

Selling, general and administrative expenses (“SG&A”) consist primarily of compensation expenses, legal and other professional fees, facilities expenses and communication expenses. SG&A expenses decreased as compared with the same period in the prior year driven by internal efficiencies gained during a period of lower revenue, and reduced reliance of third party consultants and professional service providers. We are responding to the contraction in revenues by revamping our global sales organization to reflect broadened technology offerings and geographies.

	Three months ended June 30,					
	2019		2018		Change	% Change
	Amount	% of Pre-tax Income	Amount	% of Pre-tax Income		
Income tax expense	\$ 319	74.5 %	\$ 133	27.0 %	\$ 186	139.8%

Tax expense reflects statutory tax rates in the jurisdictions that we operate adjusted for normal book/tax differences.

Our effective tax rate for continuing operations was 74.5% for the three months ended June 30, 2019, compared to 27.0% for the three months ended June 30, 2018. The higher effective tax rate was primarily due to our estimated \$115,878 withholding tax liability on a repatriation of cash from China to the US. In addition, the Company filed its China income tax returns during the three months ended June 30, 2019, and recorded a \$36,917 provision to return adjustment. Both of these items were recorded as discrete adjustments in the quarter.

Our effective tax rate is directly affected by the relative proportions of revenue and income before taxes in the jurisdictions in which we operate. Based on the expected mix of domestic and foreign earnings, we anticipate our effective tax rate to remain lower than prior periods primarily due to a significant portion of our earnings originating in lower rate foreign jurisdictions, and the reduction of the U.S. federal tax rates under the TCJA. Discrete tax events may cause our effective rate to fluctuate on a quarterly basis. Certain events, including, for example, acquisitions and other business changes, which are difficult to predict, may also cause our effective tax rate to fluctuate. We are subject to changing tax laws, regulations, and interpretations in multiple jurisdictions. Continued corporate tax reform continues to be a priority in the U.S. and other jurisdictions. Additional changes to the tax system in the U.S. could have significant effects, positive and negative, on our effective tax rate, and on our deferred tax assets and liabilities.

Results of Operations for the six months ended June 30, 2019, as compared to the six months ended June 30, 2018

Revenue, net by Market is as follows:

	Six months ended June 30,					
	2019		2018		Change	% Change
	Amount	% of Net Revenue	Amount	% of Net Revenue		
	(in thousands, except percentages)					
Automotive	\$ -	- %	\$ 266	5.1 %	\$ (266)	(100.0)%
Industrial	1,017	29.4 %	1,260	24.0 %	(243)	(19.3) %
Medical	1,146	33.1 %	774	14.7 %	372	48.0%
Consumer	179	5.2 %	934	17.7 %	(755)	(80.8)%
Standard	1,114	32.3 %	2,022	38.5 %	(908)	(44.9)%
Revenue, net	\$ 3,456	100.0 %	\$ 5,256	100.0 %	\$ (1,800)	(34.2)%

We sell our custom products into the following markets: automotive, industrial, medical and consumer. We sell our standard products through various distribution networks. The ultimate customer may come from different markets which are often unknown to us at the time of sale. Each market has different product design cycles. Products with longer design cycles often have much longer product life-cycles. Automotive, industrial, and medical products generally have longer design and life-cycles than consumer products. We currently have products with life-cycles that have exceeded twenty years and are ongoing.

Overall revenues were down significantly in all categories except medical. The decrease in net revenues in the automotive market was driven by a major customer making a design change to their product that eliminated the need for our solution. Once our largest customer, revenues for this customer have steadily eroded from mid-2017 through 2018, and are now exhausted. In addition, a product for another large automotive customer had expectedly reached its end of life cycle. These two product lines represented the vast majority of our penetration into the automotive market.

A decline in industrial market revenue was a result of a customer dual sourcing the product solution which significantly reduced our share of revenue. Similarly, The decrease in the consumer market was driven by a large power tool customer diversifying their supply chain to protect themselves from tariffs. Many of our products are currently subject to import tariffs imposed on goods manufactured in China, increasing the cost to our customers by up to 25%. We believe many of our existing customers have reduced orders until the uncertainty passes, hoping to avoid tariffs. In the worst case, some of them may be seeking alternative domestic suppliers.

Diminution in our custom product sales in other markets was driven by decreased sales to our current customers for use in their ongoing product lines. In the normal cycle, some of our larger customers purchase in bulk quantities and absorption of these products can straddle several financial reporting periods. The timing of orders from our customers is not always predictable and can be concentrated in varying periods during the year to coincide with their project and building plans.

Some of our more recent custom product success for new product lines in the medical market is making its way into the pipeline as part of a long design cycle and revenues are just starting to be realized in 2019. In July 2018, the Company announced purchase orders of \$880,000 from an existing prestigious medical customer. As these revenues begin to materialize, they are replacing revenues from other product lines that reached the end of their normal life cycle in prior reporting periods. Overall, we expect medical related revenues to show short-term growth, then stabilize at historical levels.

	Six months ended June 30,					
	2019		2018		Change	% Change
	Amount	% of Net Revenue	Amount	% of Net Revenue		
Cost of revenue	\$ 1,703	49.3 %	\$ 2,297	43.7 %	\$ (594)	(25.9)%

Our cost of revenue is impacted by various factors including product mix, volume, material costs, manufacturing efficiencies, facilities costs, compensation costs and any provisions for excess and obsolete inventories. Cost of revenues decreased compared with the prior year consistent with the decrease in revenues. Cost of revenues increased as a percentage of revenues for the same reason, including less revenue to cover fixed costs and production overhead costs.

	Six months ended June 30,					
	2019		2018		Change	% Change
	Amount	% of Net Revenue	Amount	% of Net Revenue		
Engineering, research and development	\$ 340	9.8 %	\$ 461	8.8 %	\$(121)	(26.2)%

Engineering and R&D expenses consist primarily of compensation expenses for employees engaged in research, design and development activities. Our R&D team focuses both on internal design development, as well as design development aimed at addressing customer design challenges, in order to develop our HMI solutions.

Our engineering and R&D costs were lower as compared with the same period in the prior year primarily due to research incentive grant from the Singapore government paid in the quarter ended June 30, 2019. This was offset slightly by higher costs in the build-out of our Singapore R&D center. We will continue to substantially grow the global R&D center in Singapore over the next several years, including expanding our R&D team, expanding the size of the facility, and investing in additional tools and equipment.

	Six months ended June 30,					
	2019		2018		Change	% Change
	Amount	% of Net Revenue	Amount	% of Net Revenue		
Selling, general and administrative	\$ 1,385	40.1 %	\$ 1,849	35.1 %	\$ (464)	(25.1)%

Selling, general and administrative expenses (“SG&A”) consist primarily of compensation expenses, legal and other professional fees, facilities expenses and communication expenses. SG&A expenses decreased as compared with the same period in the prior year driven by internal efficiencies gained during a period of lower revenue, and reduced reliance of third party consultants and professional service providers. We are responding to the contraction in revenues by revamping our global sales organization to reflect broadened technology offerings and geographies.

	Six months ended June 30,					
	2019		2018		Change	% Change
	Amount	% of Pre-tax Income	Amount	% of Pre-tax Income		
Income tax expense (benefit)	\$ 257	494.2 %	\$ 188	28.3 %	\$ 69	36.7%

Tax expense reflects statutory tax rates in the jurisdictions that we operate adjusted for normal book/tax differences. The tax benefit for the six months ended June 30, 2019 was a result of the operating loss for the quarter.

Our effective tax rate for continuing operations was 494.2% for the six months ended June 30, 2019, compared to 28.3% for the six months ended June 30, 2018. The higher effective tax rate was primarily due to our estimated \$115,878 withholding tax liability on a repatriation of cash from China to the US. In addition, the Company filed its China income tax returns during the three months ended June 30, 2019, and recorded a \$36,917 provision to return adjustment. Both of these items were recorded as discrete adjustments in the three months ended June 30, 2019. The percentage effect on the annual effective rate was disproportionately high due to a lower denominator for the six months ended June 30, 2019.

Our effective tax rate is directly affected by the relative proportions of revenue and income before taxes in the jurisdictions in which we operate. Based on the expected mix of domestic and foreign earnings, we anticipate our effective tax rate to remain lower than prior periods primarily due to a significant portion of our earnings originating in lower rate foreign jurisdictions, and the reduction of the U.S. federal tax rates under the TCJA. Discrete tax events may cause our effective rate to fluctuate on a quarterly basis. Certain events, including, for example, acquisitions and other business changes, which are difficult to predict, may also cause our effective tax rate to fluctuate. We are subject to changing tax laws, regulations, and interpretations in multiple jurisdictions. Continued corporate tax reform continues to be a priority in the U.S. and other jurisdictions. Additional changes to the tax system in the U.S. could have significant effects, positive and negative, on our effective tax rate, and on our deferred tax assets and liabilities.

Liquidity and Capital Resources

Cash requirements for working capital and capital expenditures have been funded from cash balances on hand and cash generated from operations. As of June 30, 2019, we had cash and cash equivalents of \$5.4 million, working capital of \$7.4 million and no indebtedness. Cash and cash equivalents consist of cash and money market funds. Of the \$5.4 million of cash balances on hand, \$2.5 million was held by foreign subsidiaries. If these funds are needed for our operations in the U.S., we have several methods to repatriate without significant tax effects, including repayment of intercompany loans or distributions of previously taxed income. Other distributions may require us to incur U.S. or foreign taxes to repatriate these funds. However, our intent is to only reinvest these funds outside the U.S. when they have exceeded target balances. During the three months ended June 30, 2019 we repatriated approximately \$1.2 million from our Chinese subsidiary. Cash on hand in China far exceeded capital levels necessary to maintain our operations there. Our current plans do not demonstrate a need to repatriate additional cash.

We believe that our existing cash and cash equivalents balance will be sufficient to maintain our operations considering our current financial condition, obligations, and other expected cash flows for at least the next twelve months following the date these condensed consolidated financial statements were available for issuance. We are proactively pursuing acquisition opportunities. It is possible our cash requirements for one or more acquisition opportunities could exceed our cash balance at the time of closing. If we require additional cash, we may attempt to raise additional capital through equity, equity-linked or debt financing arrangements. If we raise additional funds by issuing equity or equity-linked securities, the ownership of our existing stockholders will be diluted. If we raise additional financing by the incurrence of indebtedness, we will be subject to fixed payment obligations and could also be subject to restrictive covenants, such as limitations on our ability to incur additional debt, and other operating restrictions that could adversely impact our ability to conduct our business. If we are unable to raise additional needed funds, we may also take measures to reduce expenses to offset any shortfall.

Stock Repurchases

On June 22, 2018, we repurchased 867,681 shares of our common stock at a purchase price of \$3.00 per share from an existing stockholder in a private transaction approved by our Board of Directors. The repurchased shares were immediately retired and restored to the status of authorized and unissued shares.

At June 30, 2019, we had 6,560,284 shares of common stock issued and outstanding.

PART I: FINANCIAL INFORMATION
Item 1. Financial Statements

INTERLINK ELECTRONICS, INC.
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INTERLINK ELECTRONICS, INC.
Condensed Consolidated Balance Sheets
(unaudited)

	<u>June 30,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 5,404	\$ 6,102
Restricted cash	32	5
Accounts receivable, net	1,070	780
Inventories	1,251	1,071
Prepaid expenses and other current assets	218	303
Total current assets	7,975	8,261
Property, plant and equipment, net	743	701
Intangibles, net	133	121
Deferred income taxes	422	470
Other assets	59	59
Total assets	<u>\$ 9,332</u>	<u>\$ 9,612</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 189	\$ 304
Accrued liabilities	288	297
Accrued income taxes	55	26
Total current liabilities	532	627
Total liabilities	532	627
Commitments and contingencies (see note 9)	—	—
Stockholders' equity		
Preferred stock, \$0.01 par value: 1,000 shares authorized, no shares issued or outstanding	—	—
Common stock, \$0.001 par value: 30,000 shares authorized, 6,560 and 6,483 shares issued and outstanding at June 30, 2019 and December 31, 2018, respectively	7	7
Additional paid-in-capital	57,896	57,871
Accumulated other comprehensive income	(72)	(67)
Accumulated deficit	(49,031)	(48,826)
Total stockholders' equity	8,800	8,985
Total liabilities and stockholders' equity	<u>\$ 9,332</u>	<u>\$ 9,612</u>

See accompanying notes to these condensed consolidated financial statements.

INTERLINK ELECTRONICS, INC.

Condensed Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)
(*unaudited*)

	<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
	(in thousands, except per share data)		(in thousands, except per share data)	
Revenue, net	\$ 2,006	\$ 2,683	\$ 3,456	\$ 5,256
Cost of revenue	953	1,135	1,703	2,297
Gross profit	<u>1,053</u>	<u>1,548</u>	<u>1,753</u>	<u>2,959</u>
Operating expenses:				
Engineering, research and development	88	237	340	461
Selling, general and administrative	594	881	1,385	1,849
Total operating expenses	<u>682</u>	<u>1,118</u>	<u>1,725</u>	<u>2,310</u>
Income from operations	371	430	28	649
Other income (expense):				
Other income (expense), net	57	62	24	16
Income before income tax expense	428	492	52	665
Income tax expense	319	133	257	188
Net income (loss)	109	359	(205)	477
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	(55)	(112)	(5)	(27)
Comprehensive income (loss)	<u>\$ 54</u>	<u>\$ 247</u>	<u>\$ (210)</u>	<u>\$ 450</u>
Earnings (loss) per share, basic and diluted	<u>\$ 0.02</u>	<u>\$ 0.05</u>	<u>\$ (0.03)</u>	<u>\$ 0.06</u>
Weighted average common shares outstanding - basic	<u>6,540</u>	<u>7,317</u>	<u>6,522</u>	<u>7,322</u>
Weighted average common shares outstanding - diluted	<u>6,581</u>	<u>7,407</u>	<u>6,563</u>	<u>7,410</u>

See accompanying notes to these condensed consolidated financial statements.

INTERLINK ELECTRONICS, INC.
Statement of Changes in Stockholders Equity
(unaudited)

(in thousands)	Common Stock		Additional Paid-in- Capital	Accumulated Other Comprehensive (Loss) Income	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount				
Balance at March 31, 2019	6,523	7	57,894	(17)	(49,140)	8,744
Net income	—	—	—	—	109	109
Foreign currency translation adjustment	—	—	—	(55)	—	(55)
Compensation expense related to equity awards, net of cancellations	37	—	2	—	—	2
Balance at June 30, 2019	<u>6,560</u>	<u>\$ 7</u>	<u>\$ 57,896</u>	<u>\$ (72)</u>	<u>\$ (49,031)</u>	<u>\$ 8,800</u>

(in thousands)	Common Stock		Additional Paid-in- Capital	Accumulated Other Comprehensive (Loss) Income	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount				
Balance at January 1, 2018	7,336	\$ 7	\$ 60,527	\$ 41	\$ (49,448)	\$ 11,127
Net income	—	—	—	—	622	622
Foreign currency translation adjustment	—	—	—	(108)	—	(108)
Stock Repurchase	(901)	—	(2,764)	—	—	(2,764)
Compensation expense related to equity awards, net of cancellations	48	—	108	—	—	108
Balance at December 31, 2018	6,483	7	57,871	(67)	(48,826)	8,985
Net income (loss)	—	—	—	—	(205)	(205)
Foreign currency translation adjustment	—	—	—	(5)	—	(5)
Compensation expense related to equity awards, net of cancellations	77	—	25	—	—	25
Balance at June 30, 2019	<u>6,560</u>	<u>\$ 7</u>	<u>\$ 57,896</u>	<u>\$ (72)</u>	<u>\$ (49,031)</u>	<u>\$ 8,800</u>

The accompanying notes are an integral part of these consolidated financial statements.

INTERLINK ELECTRONICS, INC.

Condensed Consolidated Statements of Cash Flows
(*unaudited*)

	Six months ended June 30,	
	2019	2018
	(in thousands)	
Cash flows from operating activities:		
Net income (loss)	\$ (205)	\$ 477
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	125	85
Stock based compensation	25	39
Changes in operating assets and liabilities:		
Accounts receivable	(290)	160
Inventories	(180)	398
Prepaid expenses and other current assets	85	106
Other assets	—	—
Accounts payable	(115)	(66)
Accrued liabilities	(9)	(22)
Accrued income taxes	29	(71)
Deferred income taxes	48	84
Deferred revenue	—	—
Net cash provided (used) by operating activities	(487)	1,190
Cash flows from investing activities:		
Property, plant and equipment	(148)	(202)
Share repurchase	—	(2,764)
Intangibles	(31)	(31)
Net cash used in investing activities	(179)	(2,997)
Cash flows from financing activities:		
Proceeds from exercise of stock options	—	6
Net cash provided by financing activities	—	6
Effect of exchange rate changes on cash and cash equivalents	(5)	(27)
Net increase (decrease) in cash and cash equivalents	(671)	(1,828)
Cash, cash equivalents and restricted cash, beginning of period	6,107	7,777
Cash, cash equivalents and restricted cash, end of period	\$ 5,436	\$ 5,949
Supplemental disclosure of cash flow information:		
Income taxes paid	\$ 181	\$ 210
Interest paid	-	-

See accompanying notes to these condensed consolidated financial statements.

INTERLINK ELECTRONICS, INC.

Notes to Condensed Consolidated Financial Statements (unaudited)

NOTE 1-THE COMPANY AND ITS SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Interlink Electronics, Inc. (“we,” “us,” “our,” “Interlink” or the “Company”) designs, develops, manufactures and sells a range of force-sensing technologies that incorporate our proprietary materials technology, firmware and software into a portfolio of standard sensor based products and custom sensor system solutions. These include sensor components, subassemblies, modules and products that support effective, efficient cursor control and novel three-dimensional user inputs. Our Human Machine Interface (“HMI”) technology platforms are deployed in a wide range of markets including consumer electronics, automotive, industrial, and medical.

Interlink serves our world-wide customer base from our corporate headquarters in Camarillo, California (greater Los Angeles area), our global research and development (“R&D”) and engineering center in Singapore, our printed-electronics manufacturing facility in Shenzhen, China and our global distribution and logistics center in Hong Kong. We also maintain engineering, assembly and prototyping capabilities in Camarillo, California along with technical and sales offices in Japan and at multiple locations in the United States. Our principal executive office is located at 1267 Flynn Road Camarillo, California 93012 and our telephone number is (805) 484-8855. Our website address is www.interlinkelectronics.com.

Fiscal Year

Our fiscal year is the calendar year reporting cycle beginning January 1 and ending December 31.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). Our reporting currency is the United States dollar.

Our consolidated financial statements include the accounts of Interlink Electronics and our subsidiaries in China, Hong Kong and Singapore. All intercompany accounts and transactions were eliminated in consolidation.

Foreign Currency Translation

The functional currency of our Chinese subsidiary is the Chinese Yuan Renminbi. The functional currency for our Hong Kong and Singapore subsidiaries is the United States dollar. However, our Hong Kong and Singapore subsidiaries also transact business in their local currency. Therefore, assets and liabilities are translated into United States dollars at the exchange rate in effect on the balance sheet date. Revenues and expenses are translated at the average exchange rate prevailing during the respective periods. Foreign currency transaction and translation gains and losses are included in results of operations.

Segment Reporting

We operate in one reportable segment: the manufacture and sale of force sensing technology solutions.

Use of Estimates

The preparation of consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and disclosures made in the accompanying notes to the consolidated financial statements. Management regularly evaluates estimates and assumptions related to revenue recognition, allowances for doubtful accounts, warranty reserves, inventory valuation reserves, stock-based compensation, purchased intangible asset valuations and useful lives, asset retirement obligations, and deferred income tax asset valuation allowances. These estimates and assumptions are based on current facts,

INTERLINK ELECTRONICS, INC.

Notes to Condensed Consolidated Financial Statements - continued (unaudited)

historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying values of assets and liabilities that are not readily apparent from other sources. The actual results we experience may differ materially and adversely from our original estimates. To the extent there are material differences between the estimates and the actual results, our future results of operations will be affected.

Revenue Recognition

We recognize product revenues when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred; (iii) the price to the customer is fixed or determinable; and (iv) collection of the sales price is reasonably assured. Delivery occurs when goods are shipped and title and risk of loss transfer to the customer, in accordance with the terms specified in the arrangement with the customer. Revenue recognition is deferred until the earnings process is complete.

We (i) input orders based upon receipt of a customer purchase order, (ii) confirm pricing through the customer purchase order record, (iii) validate creditworthiness through past payment history, credit agency reports and other financial data, and (iv) recognize revenue upon shipment of goods or when risk of loss and title transfer to the buyer. All customers have warranty rights, and some customers also have explicit or implicit rights of return. We establish reserves for potential customer returns or warranty repairs based on historical experience and other factors that enable us to reasonably estimate the obligation.

A portion of our product sales is made through distributors under agreements allowing for right of return. Our past history with these sell-through right of return provisions allow us to reasonably estimate the amount of inventory that could be returned pursuant to these agreements, and revenue is recognized accordingly.

We recognize revenue for non-recurring engineering or non-recurring tooling fees when there is persuasive evidence of an arrangement, performance obligations are identified, fees are fixed or determinable, delivery has occurred, and collectability is reasonably assured.

Warranty

We establish reserves for future product warranty costs that are expected to be incurred pursuant to specific warranty provisions with our customers. We generally warrant our products against defects for one year from date of shipment, with certain exceptions in which the warranty period can extend to more than one year based on contractual agreements. A warranty reserve is recorded against revenues when products are shipped. At each reporting period, we adjust our reserve for warranty claims based on our actual warranty claims experience as a percentage of net revenue for the preceding 12 months and also consider the effect of known operations issues that may have an impact that differs from historical trends. Historically, our warranty returns have not been material.

Shipping and Handling Fees and Costs

Amounts billed to customers for shipping and handling fees are presented in product revenues. Costs incurred for shipping and handling are included in cost of revenues.

Engineering, Research and Development Costs

Engineering, research and development ("R&D") costs are expensed when incurred. R&D expenses consist primarily of compensation expenses for employees engaged in research, design and development activities. R&D expenses also include depreciation and amortization, and overhead, including facilities expenses.

INTERLINK ELECTRONICS, INC.

Notes to Condensed Consolidated Financial Statements - continued (unaudited)

Marketing Costs

All of the costs related to marketing and advertising our products are expensed as incurred or at the time the marketing takes place.

Stock-based Compensation

All stock-based payments to employees, including grants of employee stock options and employee stock purchase rights, are recognized in the financial statements based on their respective grant date (measurement date) fair values. We calculate the compensation cost of full-value awards such as restricted stock based on the market value of the underlying stock at the date of the grant. We estimate the expected life of a stock award as the period of time that the award is expected to be outstanding. We are required to estimate the fair value of stock-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense ratably over the requisite service periods. We estimate the fair value of each option award as of the date of grant using the Black-Scholes option pricing model, which was developed for use in estimating the value of traded options that have no vesting restrictions and that are freely transferable. The Black-Scholes option pricing model considers, among other factors, the expected life of the award and the expected volatility of our stock price. Although the Black-Scholes option pricing model meets the accounting guidance requirements, the fair values generated by the Black-Scholes option pricing model may not be indicative of the actual fair values of our awards, as it does not consider other factors important to those stock-based payment awards, such as continued employment, periodic vesting requirements, and limited transferability.

We have elected to recognize compensation expense for all stock-based awards on a straight-line basis over the requisite service period for the entire award. The amount of compensation expense recognized through the end of each reporting period is equal to the portion of the grant-date value of the awards that have vested, or for partially vested awards, the value of the portion of the award that is ultimately expected to vest for which the requisite services have been provided. The benefits of tax deductions in excess of recognized compensation cost are reported as a financing cash flow.

Other Income, Net

Other income, net, consists of interest income, foreign exchange gains and losses and other non-operating gains and losses.

Income Taxes

We account for income taxes under the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. We assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not determinable beyond a "more likely than not" standard, we establish a valuation allowance. To the extent we establish a valuation allowance or increase or decrease this allowance in a period, we include an expense or benefit within the tax provision in the statement of operations. We also utilize a "more likely than not" recognition threshold and measurement analysis for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We recognize potential accrued interest and penalties related to unrecognized tax benefits within the consolidated statements of operations as income tax expense.

We operate within multiple tax jurisdictions and are subject to audit in these jurisdictions. Our foreign subsidiaries are subject to foreign income taxes on earnings in their respective jurisdictions. Earnings of our foreign subsidiaries are not

INTERLINK ELECTRONICS, INC.

Notes to Condensed Consolidated Financial Statements - continued (unaudited)

included in our U.S. federal income tax return until earnings are repatriated. We are generally eligible to receive tax credits on repatriated earnings on our U.S. federal income tax return for foreign taxes paid by our subsidiaries.

See Note 8 - Income Taxes for further information and discussion of our income tax provision and balances including discussion of the impacts of the Tax Cuts and Jobs Act (TCJA) enacted in December 2017.

Comprehensive Income

Comprehensive income includes all components of comprehensive income, including net income and any changes in equity during the period from transactions and other events and circumstances generated by non-owner sources.

Earnings per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted average number of diluted common shares, which is inclusive of common stock equivalents from unexercised stock options and restricted stock units. Unexercised stock options and restricted stock units are considered to be common stock equivalents if, using the treasury stock method, they are determined to be dilutive.

Under the two-class method of determining earnings for each class of stock, we consider the dividend rights and participating rights in undistributed earnings for each class of stock.

Risk and Uncertainties

Our future results of operations involve a number of risks and uncertainties. Factors that could affect our business or future results and cause actual results to vary materially from historical results include, but are not limited to, the rapid change in our industry; problems with the performance, reliability or quality of our products; loss of customers; impacts of doing business internationally, including foreign currency fluctuations; potential shortages of the supplies we use to manufacture our products; disruptions in our manufacturing facilities; changes in environmental directives impacting our manufacturing process or product lines; the development of new proprietary technology and the enforcement of intellectual property rights by or against us; our ability to attract and retain qualified employees; and our ability to raise additional capital.

Fair Value Measurements

We determine fair value measurements based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, we follow the following fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) our own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs):

Level 1: Observable inputs such as quoted prices for identical assets or liabilities in active markets;

Level 2: Other inputs observable directly or indirectly, such as quoted prices for similar assets or liabilities or market-corroborate inputs; and

Level 3: Unobservable inputs for which there is little or no market data and which requires the owner of the assets or liabilities to develop its own assumptions about how market participants would price these assets or liabilities.

INTERLINK ELECTRONICS, INC.

Notes to Condensed Consolidated Financial Statements - continued (unaudited)

Our assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of assets and liabilities and their placement within the fair value hierarchy.

Recently Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, “*Revenue from Contracts with Customers (Topic 606)*.” The amendments to this update supersede nearly all existing revenue recognition guidance under GAAP, including the revenue recognition requirements in ASC Topic 605, “*Revenue Recognition*.” The standard was originally set to become effective in annual periods beginning after December 15, 2016 and for interim and annual reporting periods thereafter. In August 2015, the FASB issued ASU 2015-14 “*Revenue from Contracts with Customers; Deferral of the Effective Date*,” which defers the effective date of ASU 2014-09 for all entities by one year, thereby delaying the effective date of the standard to January 1, 2018, with an option that would permit companies to adopt the standard as early as the original effective date. Early adoption prior to the original effective date is not permitted. The core principle of this Topic is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. This Topic defines a five-step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. Effective January 1, 2018, the Company adopted ASU 2014-09 and it did not result in material differences in the amount or timing of recognized revenue.

In January 2016, the FASB issued ASU No. 2016-01, “*Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*”, that amends existing guidance around classification and measurement of certain financial assets and liabilities. Changes to the current GAAP model primarily affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. Under the new guidance, all equity investments in unconsolidated entities (other than those accounted for using the equity method of accounting) will generally be measured at fair value through earnings. For equity investments without readily determinable fair values, the cost method is also eliminated. However, most entities will be able to elect to record equity investments without readily determinable fair values at cost, less impairment, and plus or minus subsequent adjustments for observable price changes. The standard also requires that financial assets and liabilities be disclosed separately in the notes to the financial statements based on measurement principle and form of financial asset. The amendments in this guidance are effective for financial statements issued for interim and annual periods beginning after December 15, 2017. The adoption of this standard did not have a significant impact on our consolidated financial statements or disclosures.

In February 2016, the FASB issued ASU No. 2016-02, “*Leases (Topic 842)*”, and in December 2018, ASU No. 2018-20, *Narrow-Scope Improvements for Lessors*, and in July 2018, ASU No. 2018-10, *Codification Improvements to Topic 842, Leases, and ASU 2018-11, Leases (Topic 842) - Targeted Improvements* (collectively, “the new lease standard” or “ASC 842”). ASC 842 replaces the existing guidance in ASC Topic 840, “*Leases*”. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years and requires retrospective application. The Company is currently evaluating the impact of ASU 2016-02 to its consolidated financial statements. The adoption of Topic 842 had a material impact on our condensed consolidated balance sheet due to the recognition of right-of-use (“ROU”) assets and lease liabilities. As a result of the adoption of the standard, the Company recognized an immaterial amount of assets and lease liabilities as of January 1, 2019. Similarly, the adoption of Topic 842 did not have a material impact on our condensed consolidated statement of operations or our condensed consolidated statement cash flows.

INTERLINK ELECTRONICS, INC.

Notes to Condensed Consolidated Financial Statements - continued (unaudited)

In October 2016, the FASB issued ASU No. 2016-16, *“Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory,”* which reduces the complexity in the accounting standards by allowing the recognition of current and deferred income taxes for an intra-entity asset transfer, other than inventory, when the transfer occurs. Historically, recognition of the income tax consequence was not recognized until the asset was sold to an outside party. This amendment should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. ASU 2016-16 is effective for annual periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. Early adoption is permitted for all entities as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued or made available for issuance. This standard did not have a significant impact on our consolidated financial statements or disclosures.

In May 2017, the FASB issued ASU No. 2017-09, *Modification Accounting for Share-Based Payment Arrangements*, which amends the scope of modification accounting for share-based payment arrangements. 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. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The ASU is effective for annual reporting periods, including interim periods within those annual reporting periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period. The adoption of this new guidance did not have a material impact on our condensed consolidated financial statements.

In August 2018, the FASB issued ASU 2018-07, to simplify the accounting for share-based payments to nonemployees by aligning it with the accounting for share-based payments to employees, with certain exceptions. The new guidance expands the scope of ASC 718 to include share-based payments granted to nonemployees in exchange for goods or services used or consumed in an entity’s own operations and supersedes the guidance in ASC 505-50. The guidance also applies to awards granted by an investor to employees and nonemployees of an equity method investee for goods or services used or consumed in the investee’s operations. The guidance in ASC 718 does not apply to instruments issued to a lender or an investor in a financing (e.g., in a capital raising) transaction. It also does not apply to equity instruments granted when selling goods or services to customers in the scope of ASC 606. However, the guidance states that share-based payments granted to a customer in exchange for a distinct good or service to be used or consumed in the grantor’s own operations are accounted for under ASC 718. The Company adopted ASU 2018-07 effective January 1, 2019. The adoption of this ASU did not have an impact on our condensed consolidated financial statements.

Recently Issued Accounting Pronouncements (Not Yet Adopted)

In June 2016, the FASB issued ASU No. 2016-13, *“Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments”*, that significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income, including trade receivables. The standard requires an entity to estimate its lifetime “expected credit loss” for such assets at inception, and record an allowance that, when deducted from the amortized cost basis of the financial asset, presents the net amount expected to be collected on the financial asset. The standard is effective for annual periods beginning after December 15, 2019, and interim periods therein. Early adoption is permitted for annual periods beginning after December 15, 2018, and interim periods therein. The Company has not opted for early adoption, although this standard is not expected to have a significant impact on our consolidated financial statements or disclosures.

In January 2017, the FASB issued ASU 2017-01, *“Business Combinations (Topic 805): Clarifying the Definition of a Business”*, clarifying the definition of a business, reducing the number of transactions that need to be further evaluated and providing a framework to assist entities in evaluating whether both an input and a substantive process are present. The amendments in the ASU specify that when the fair value of the gross assets acquired or disposed of is concentrated

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Notes to Condensed Consolidated Financial Statements - continued (unaudited)

in a single identifiable asset or a group of similar identifiable assets, the integrated set of assets and activities is not a business. The guidance also requires that an integrated set of assets and activities must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output to be considered a business, and removes the evaluation of whether a market participant could replace the missing elements. The ASU is effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019, with early adoption permitted. The Company has not opted for early adoption, and does not expect the impact on our consolidated financial statements to be material.

We reviewed all other recently issued accounting pronouncements and concluded they are not applicable or not expected to be material to our financial statements.

NOTE 2-INVENTORIES

Inventories, stated at the lower of cost or net realizable value, consist of the following:

	<u>June 30,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
Inventories	(in thousands)	
Raw materials	\$ 457	\$ 667
Work-in-process	258	280
Finished goods	536	124
Total inventories	<u>\$ 1,251</u>	<u>\$ 1,071</u>

NOTE 3-STOCK BASED COMPENSATION

Under the terms of our 2016 Omnibus Incentive Plan (the “2016 Plan”), officers and key employees could be granted restricted stock units, as well as non-qualified or incentive stock options, at the discretion of the Compensation Committee of the Board of Directors. The Plan replaces the 1996 Stock Incentive Plan (the “1996 Plan”) which was terminated in December 2015; however, all grants issued under the 1996 Plan prior to its termination will continue to vest, expire or terminate in accordance with the 1996 Plan document and the terms of each award.

Restricted Stock Units

Our outstanding restricted stock unit grants vest over five years in installments of 50% on the fourth anniversary of the grant date and the remaining 50% on the fifth anniversary of the grant date. Unvested restricted shares are forfeited if the recipient’s employment terminates for any reason other than death, disability or special circumstances as determined by the Compensation Committee of the Board of Directors.

INTERLINK ELECTRONICS, INC.

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Activity for our restricted stock units is as follows:

	<u>Restricted Stock Units</u> (in thousands)	<u>Weighted-Average Grant Date Fair Value</u>	<u>Weighted Average Remaining Contractual Life</u> (years)	<u>Aggregate Intrinsic Value</u> (in thousands)
Restricted stock units, December 31, 2018	120	\$ 3.97	0.70	\$ 252
Awarded	—	\$		
Issued	(78)	\$ 3.05		
Forfeited	(5)	\$ 8.81		
Restricted stock units, June 30, 2019	<u>37</u>	\$ 5.23	0.88	\$ 82

The aggregate intrinsic values in the preceding table for the restricted stock units outstanding represent the total pretax intrinsic value, based on our closing stock price of \$2.19 and \$2.10 as of June 30, 2019 and December 31, 2018, respectively. A total of seventy seven thousand five hundred restricted stock units vested in the six months ended June 30, 2019.

Stock based compensation incurred for the three and six months ended June 30, 2019 was \$2 thousand and \$25 thousand, respectively, as compared to \$9 thousand and \$39 thousand for the comparable periods ended June 30, 2018.

Stock Options

The exercise price of our stock options is the closing price on the date the options are granted. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. Options generally expire 10 years from the date of grant. The following table summarizes the activity for the remaining options outstanding under the Plan:

	<u>Shares</u> (in thousands)	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Life</u> (years)	<u>Aggregate Intrinsic Value</u> (in thousands)
Options outstanding, December 31, 2018	3	\$ 7.40	8.84	\$ —
Granted	—			
Exercised	—			
Cancelled or expired	—			
Options outstanding, June 30, 2019	<u>3</u>	\$ 7.40	8.34	\$ —
Options exercisable, June 30, 2019	<u>3</u>	\$ 7.40	8.34	\$ —

This intrinsic value represents the excess of the fair market value of our common stock on the date of exercise over the exercise price of such options. The aggregate intrinsic values in the preceding table for the options outstanding represent the total pretax intrinsic value, based on our closing stock price of \$2.19 and \$2.10 as of June 30, 2019 and December 31, 2018, respectively, which would have been received by the option holders had those option holders exercised their in-the-money options as of those dates.

The fair value of stock-based option awards is estimated at the date of grant using the Black-Scholes option pricing model; however, the value calculated using an option pricing model may not be indicative of the fair value observed in a willing buyer/willing seller market transaction, or actually realized by the employee upon exercise. Expected volatility used to estimate the fair value of options granted is based on the historical volatility of our common stock. The risk-free

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interest rate is based on the United States Treasury constant maturity rate for the expected life of the stock option. The expected life of a stock award is the period of time that the award is expected to be outstanding.

The following table provides additional information in regards to options outstanding as of June 30, 2019:

Range of Exercise Price	Options Outstanding			Options Exercisable	
	Number Outstanding (in thousands)	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number Exercisable (in thousands)	Weighted Average Exercise Price
\$ 7.40	3	8.34	\$ 7.40	3	\$ 7.40
	3	8.34		3	7.40

NOTE 4-EARNINGS PER SHARE

Basic earnings per share is computed by dividing net income for the period by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income for the period by the weighted average number of common shares outstanding during the period, plus the dilutive effect of outstanding stock options and restricted stock-based awards using the treasury stock method.

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
	(in thousands, except per share data)		(in thousands, except per share data)	
Net income (loss)	\$ 109	\$ 359	\$ (205)	\$ 477
Comprehensive income (loss)	\$ 54	\$ 247	\$ (210)	\$ 450
Weighted average outstanding shares of common stock	6,540	7,317	6,522	7,322
Dilutive potential common shares from stock options and restricted stock units	41	90	41	88
Common stock and common stock equivalents	6,581	7,407	6,563	7,410
Earnings per share, basic and diluted	\$ 0.02	\$ 0.05	\$ (0.03)	\$ 0.06
Comprehensive income per share: basic and diluted	\$ 0.01	\$ 0.03	\$ (0.03)	\$ 0.06
Shares subject to anti-dilutive stock options and restricted stock-based awards excluded from calculation	—	38	—	40

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NOTE 5-EQUITY TRANSACTIONS

In December 2017, our Board of Directors authorized a new program for the repurchase of up to \$1 million of our outstanding common shares. This program authorization expired in December 2018.

Pursuant to this program, on January 17, 2018, we repurchased 34,010 common shares at a purchase price of \$4.75 per share from an unrelated shareholder in a private transaction. The repurchased shares were immediately retired and restored to the status of authorized and unissued shares.

Separate from and in addition to the \$1 million repurchase program, on June 22, 2018, we repurchased 867,681 shares of our common stock at a purchase price of \$3.00 per share from an existing stockholder in a private transaction approved by the Board of Directors. The repurchased shares were immediately retired and restored to the status of authorized and unissued shares.

At June 30, 2019, the Company had 6,560,284 shares of common stock issued and outstanding.

NOTE 6-SIGNIFICANT CUSTOMERS, CONCENTRATION OF CREDIT RISK AND GEOGRAPHIC INFORMATION

We manage and operate our business through one operating segment.

Net revenues from customers equal to or greater than 10% of total net revenues are as follows:

	<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Customer A	37 %	14 %	31 %	15 %
Customer B	14 %	* %	12 %	* %
Customer C	11 %	* %	11 %	* %
Customer D	* %	18 %	* %	18 %

* Less than 10% of total net revenues

Net revenues by geographic area are as follows:

	<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>8</u>
	<u>(in thousands)</u>		<u>(in thousands)</u>	
United States	\$ 998	\$ 1,159	\$ 1,670	\$ 2,421
Asia and Middle East	849	1,247	1,429	2,361
Europe and other	159	277	357	474
Revenue, net	<u>\$ 2,006</u>	<u>\$ 2,683</u>	<u>\$ 3,456</u>	<u>\$ 5,256</u>

Revenues by geographic area are based on the country of shipment destination. The geographic location of distributors and third-party manufacturing service providers may be different from the geographic location of the purchasers and/or ultimate end users.

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Notes to Condensed Consolidated Financial Statements - continued (unaudited)

We provide credit only to creditworthy third parties who are subject to our credit verification procedures. Accounts receivable balances are monitored on an ongoing basis, and accounts deemed to have credit risk are fully reserved. At June 30, 2019, two customers accounted for 54% and 14% of total accounts receivable, respectively. At December 31, 2018, two customers accounted for 35% and 29% of total accounts receivable, respectively. Our allowance for doubtful accounts was \$0 thousand at June 30, 2019 and December 31, 2018, respectively.

Our long-lived assets (property, plant and equipment plus intangibles, net) were geographically located as follows:

	June 30, 2019	December 31, 2018
	(in thousands)	
United States	\$ 167	\$ 142
Asia	709	680
Total long-lived assets	\$ 876	\$ 822

NOTE 7-RELATED PARTY TRANSACTIONS

BKF Capital Group (OTC:BKFG)

We entered into an agreement, dated March 1, 2015 with BKF Capital Group, Inc. (“BKF”). Pursuant to the agreement, BKF occupies and uses one furnished office, telephone and other services, located at our corporate offices in Westlake Village, CA, for a fee of \$1,000 per month. As of February 1, 2017 this agreement was modified as BKF relocated and no longer occupied the furnished office. Accordingly, the fee was reduced to \$250 per month. BKF no longer uses offices in Westlake Village as of June 30, 2019. In addition, we will occasionally pay administrative expenses on behalf of BKF, and BKF will reimburse the Company.

On March 1, 2018, BFK leased executive office space in Charleston, SC. Interlink intends to use a portion of this office space for a fee of \$2,465 per month. Effective September 1, 2018 the square footage dedicated to Interlink was decreased and the fee was lowered to \$1,255 per month. Effective March 31, 2019 Interlink terminated use of leased space in Charleston, SC. Effective March 1, 2018 we entered into a cost-sharing agreement with BKF that calls for a monthly net settlement of all shared costs between the use of the California and the South Carolina offices, including rent, administrative expenses and similar costs.

For the three and six months ended June 30, 2019 BKF paid \$750 and \$1,500, respectively to the Company, as compared to \$750 and \$3,000 comparable period ended June 30, 2018. The Company incurred costs to BKF of \$0 for the three and six months ended June 30, 2019 as compared to \$2,465 and \$7,395 for the three and six months ended June 30, 2018, respectively. Steven N. Bronson, our Chairman of the Board, President and Chief Executive June 30, 2019 and December 31, 2018, there were no unpaid amounts outstanding between the parties.

Qualstar Corporation (NASDAQ:QBAK)

The Company subleases a portion of a Camarillo, California facility leased by Qualstar Corporation (“Qualstar”) for our corporate and distribution functions. In addition, Qualstar or Interlink will occasionally pay administrative expenses on behalf of the other party, and seek reimbursement at cost. Steven N. Bronson, our Chairman of the Board, President and Chief Executive Officer, is also the President and Chief Executive Officer of Qualstar. Transactions with Qualstar are as follows:

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	Three months ended June 30,			
	2019		2018	
	Due from Qualstar	Due to Qualstar	Due from Qualstar	Due to Qualstar
	(in thousands)			
Balance at March 31,	\$ 35	\$ 2	\$ 22	\$ 1
Billed to Qualstar by Interlink	60	—	81	—
Paid by Qualstar to Interlink	(94)	—	(93)	—
Billed to Interlink by Qualstar	—	4	—	4
Paid by Interlink to Qualstar	—	(5)	—	(4)
Balance at June 30,	\$ 1	\$ 1	\$ 10	\$ 1

	Six months ended June 30,			
	2019		2018	
	Due from Qualstar	Due to Qualstar	Due from Qualstar	Due to Qualstar
	(in thousands)			
Balance at January 1,	\$ 3	\$ 2	\$ 17	\$ —
Billed to Qualstar by Interlink	114	—	145	—
Paid by Qualstar to Interlink	(116)	—	(152)	—
Billed to Interlink by Qualstar	—	10	—	8
Paid by Interlink to Qualstar	—	(11)	—	(7)
Balance at June 30,	\$ 1	\$ 1	\$ 10	\$ 1

NOTE 8-INCOME TAXES

Income tax benefit as a percentage of income before income taxes was (16.5%) for the three months ended March 31, 2019 versus tax expense of 31.8% for the comparable period in the prior year. Our income tax expense is primarily impacted by the mix of domestic and foreign pre-tax earnings, as well as our ability to utilize prior net operating loss carryovers (“NOLs”).

During the three months ended June 30, 2019, the Company repatriated approximately \$1.1 million from our China subsidiary. Although the dividend represented previously taxed income and was not subject to income tax in the United States, it did trigger \$115,878 in withholding taxes.

The Company experienced an ownership change under IRC Section 382 in February 2010. In general, a Section 382 ownership change occurs if there is a cumulative change in our ownership by “5% shareholders” (as defined in the Internal Revenue Code of 1986, as amended) that exceeds 50 percentage points over a rolling three-year period. An ownership change generally affects the rate at which NOLs and potential other deferred tax assets are permitted to offset future taxable income. Certain state jurisdictions within which we operate contain similar provisions and limitations. All of the remaining federal and state NOLs as of June 30, 2019 are subject to annual limitations due to the February 2010 ownership change.

Management assesses the available positive and negative evidence to estimate if sufficient future taxable income will be generated to utilize the existing deferred tax assets. We analyzed our need to maintain the valuation allowance against our otherwise recognizable deferred tax assets in the federal, state and foreign jurisdictions and had previously recorded

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a full valuation allowance. During the fourth quarter of 2016, we determined, given our current earnings and anticipated future earnings, that sufficient evidence existed to reach a conclusion that the valuation allowance was no longer warranted.

NOTE 9-COMMITMENTS AND CONTINGENCIES

Operating Leases

We lease certain facilities under non-cancellable operating leases. The leases expire at various dates through fiscal 2021 and frequently include renewal provisions for varying periods of time, provisions which require us to pay taxes, insurance and maintenance costs, and provisions for minimum rent increases. Minimum lease payments, including scheduled rent increases are recognized as rent expenses on a straight-line basis over the term of the lease.

Future minimum lease payments under non-cancellable operating leases that have remaining non-cancellable lease terms in excess of one year are as follows:

	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>Thereafter</u>	<u>Total</u>
			(in thousands)			
Operating Leases	\$ 149	\$ 171	\$ 68	\$ 0	\$ 0	\$ 388

Litigation

We are not party to any legal proceedings at June 30, 2019. We are occasionally involved in legal proceedings in the ordinary course of business, including actions against us which assert or may assert claims or seek to impose fines and penalties in substantial amounts. Related legal defense costs are expensed as incurred.

Warranties

We establish reserves for future product warranty costs that are expected to be incurred pursuant to specific warranty provisions with our customers. We generally warrant our products against defects for one year from date of shipment, with certain exceptions in which the warranty period can extend to more than one year based on contractual agreements. Our warranty reserves are established at the time of sale and updated throughout the warranty period based upon numerous factors including past warranty return rates and expenses over various warranty periods. Historically, our warranty returns have not been material.

Intellectual Property Indemnities

We indemnify certain customers and our contract manufacturers against liability arising from third-party claims of intellectual property rights infringement related to our products. These indemnities appear in development and supply agreements with our customers as well as manufacturing service agreements with our contract manufacturers, are not limited in amount or duration and generally survive the expiration of the contract. Given that the amount of any potential liabilities related to such indemnities cannot be determined until an infringement claim has been made, we are unable to determine the maximum amount of losses that we could incur related to such indemnifications.

Director and Officer Indemnities and Contractual Guarantees

We have entered into indemnification agreements with our directors and executive officers, which require us to indemnify such individuals to the fullest extent permitted by Nevada law. Our indemnification obligations under such agreements are not limited in amount or duration. Certain costs incurred in connection with such indemnifications may be recovered under certain circumstances under various insurance policies. Given that the amount of any potential

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liabilities related to such indemnities cannot be determined until a lawsuit has been filed, we are unable to determine the maximum amount of losses that we could incur relating to such indemnities.

We have also entered into an employment agreement with Steven N. Bronson, our Chairman of the Board, President and Chief Executive Officer. This agreement contains certain severance and change in control obligations. Under the agreement, if Mr. Bronson's employment is terminated due to his death or disability (as such terms are defined in the agreement), Mr. Bronson or his beneficiaries will be entitled to receive: (i) his base compensation to the end of the monthly pay period immediately following the date of termination; (ii) accrued bonus payments; and (iii) all unvested equity and/or options issued by the Company shall immediately fully vest. If Mr. Bronson's employment is terminated by him for good reason (as such term is defined in the agreement), or by us without cause, then Mr. Bronson will be entitled to receive: (i) his base compensation to the date of termination; (ii) a severance payment equal to twelve months of his base compensation; (iii) any earned bonus compensation; (iv) employee benefits for twelve months following the date of termination; (v) any vested company match 401k or other retirement contribution; and (vi) all unvested equity and/or options issued by the Company shall immediately fully vest.

In the event of a change in control of the Company (as such term is defined in the agreement), Mr. Bronson is entitled to receive: (i) a change in control payment in an amount equal to twelve months of his base compensation, payable as of the date the change in control occurs; and (ii) all unvested equity and/or options issued by the Company shall immediately fully vest.

Guarantees and Indemnities

In the normal course of business, we are occasionally required to undertake indemnification for which we may be required to make future payments under specific circumstances. We review our exposure under such obligations no less than annually, or more frequently as required. The amount of any potential liabilities related to such obligations cannot be accurately determined until a formal claim is filed. Historically, any such amounts that become payable have not had a material negative effect our business, financial condition or results of operations. We maintain general and product liability insurance which may provide a source of recovery to us in the event of an indemnification claim.

