

INTERLINK ELECTRONICS INC  
Form DEF 14A  
April 28, 2005

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**SCHEDULE 14A**

**Proxy Statement Pursuant to Section 14(a) of the**  
**Securities Exchange Act of 1934**  
**(Amendment No. \_\_)**

Filed by the Registrant  Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

**Confidential, For Use of the Commission Only** (as permitted by Rule 14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Pursuant to §240.14a-12

**Interlink Electronics, Inc.**

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(Name of Registrant as Specified in Its Charter)

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(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

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No fee required.

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2. Form, Schedule or Registration Statement No.:

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3. Filing Party:

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4. Date Filed:

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May 4, 2005

Dear Stockholder:

You are cordially invited to the Annual Meeting of the Stockholders of Interlink Electronics, Inc. to be held on June 8, 2005 at 11:00 a.m., Pacific Daylight Time, at the Hampton Inn & Suites, 50 West Daily Drive, Camarillo, California 93010. Your attendance will provide you an opportunity to hear management's report on operations and meet with directors and representatives of the Company.

Looking back over 2004, we achieved many of our strategic goals. First, we achieved solid growth in our key markets. Specifically, our Home Entertainment business segment achieved record revenues as we began shipping unique remote controls to manufacturers of advanced viewing devices such as plasma displays, front and rear projection televisions and larger format LCDs. Our E-Transaction business also achieved record revenues as we introduced both new hardware platforms and our first integrated software package targeted at the financial services markets. We also experienced very solid growth in our Specialty Components business as we introduced an entire family of micro-navigator technologies that are targeted at manufacturers of cell phones, PDAs, MP3 players and numerous other handheld consumer products. Based on these achievements, we continue to believe we are well positioned for future growth.

At the same time we were experiencing this growth, we encountered several sizable challenges. Our operating costs were significantly increased as we developed and launched our new products and technologies and more of our manufacturing was shifted from Japan and the United States to China. Additionally, we experienced unprecedented costs related to the new accounting and reporting requirements under the Sarbanes-Oxley Act of 2002. Ultimately, I believe the challenges we faced over the last year will make us an even stronger company and better prepare us for the future. I look forward to discussing in more detail both the challenges and opportunities we see at our upcoming Stockholders' Meeting.

The Secretary's Notice of Meeting and Proxy Statement attached discuss the matters on which action will be taken at the Stockholders' Meeting. It is important that your views are represented at the meeting, whether or not you are able to attend.

The vote of every stockholder is important. You can assure that your shares will be represented and voted at the meeting by signing and returning the enclosed proxy card, by voting by telephone or by voting over the Internet. We have enclosed a postage-paid, pre-addressed envelope, as well as detailed instructions on the proxy card for voting by telephone or over the Internet, to make it convenient for you to vote your shares.

On behalf of the directors and employees of the Company, we value and appreciate your continued support of Interlink Electronics, Inc.

Best regards,

/s/ E. MICHAEL THOBEN, III  
E. Michael Thoben, III

Chairman, CEO & President

# **INTERLINK ELECTRONICS, INC.**

**546 Flynn Road**

**Camarillo, California 93012**

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## **NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

**June 8, 2005**

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To the Stockholders of Interlink Electronics, Inc.:

You are invited to attend the Annual Meeting of Stockholders of Interlink Electronics, Inc., a Delaware corporation. The meeting will be held at the Hampton Inn & Suites, 50 West Daily Drive, Camarillo, California 93010 on June 8, 2005, at 11:00 a.m., Pacific Daylight Time, for the following purposes:

1. To elect two directors, each to serve a term of three years or until a successor has been elected and qualified;
2. To amend the 1996 Stock Incentive Plan to increase the number of shares of common stock that may be issued pursuant to the plan from 6,500,000 to 7,250,000; and
3. To transact any other business that properly comes before the meeting or any adjournment of the meeting.

Only stockholders of record at the close of business on April 18, 2005 are entitled to notice of and to vote at the Annual Meeting or any adjournment of the meeting.

Your vote is important. You may vote by written proxy, by telephone or over the Internet. Instructions for voting by telephone and over the Internet are printed on the proxy card. If you choose to vote in writing, please date and sign the enclosed proxy card and return it in the enclosed postage-paid, pre-addressed envelope as soon as possible. If you attend the meeting, you may, if you wish, revoke the proxy and vote personally on all matters brought before the meeting.

*By Order of the Board of Directors*

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Paul D. Meyer

*Secretary*

Camarillo, California

May 4, 2005

## INTERLINK ELECTRONICS, INC.

546 Flynn Road

Camarillo, California 93012

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### PROXY STATEMENT

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A proxy in the form accompanying this proxy statement is solicited on behalf of the Board of Directors of Interlink Electronics, Inc., a Delaware corporation (the Company), for use at the Annual Meeting of Stockholders to be held at the Hampton Inn & Suites, 50 West Daily Drive, Camarillo, California 93010 on June 8, 2005, at 11:00 a.m., Pacific Daylight Time (the Annual Meeting). This proxy may also be used at any adjournment of the Annual Meeting. We are sending this statement and the enclosed proxy form to you on or about May 4, 2005.

#### Record Date

Only stockholders of record at the close of business on April 18, 2005 (the Record Date) are entitled to notice of, and to vote at, the Annual Meeting.

#### Shares Outstanding and Voting Rights

At the close of business on the Record Date, the Company had 13,699,146 shares of its Common Stock outstanding. Each share of Common Stock issued and outstanding is entitled to one vote on each matter properly presented at the Annual Meeting. There are no cumulative voting rights. The Common Stock is the only outstanding authorized voting security of the Company. The presence, in person or by proxy, of the holders of a majority of the total number of shares of Common Stock outstanding constitutes a quorum for the transaction of business at the Annual Meeting. Abstentions and broker non-votes are counted for purposes of determining whether a quorum exists at the Annual Meeting.

#### Multiple Stockholders Sharing the Same Address

If you and other residents at your mailing address own shares of Common Stock in street name, your broker or bank may have sent you a notice that your household will receive only one annual report and proxy statement. This practice, known as householding, reduces the Company's printing and postage costs. If you did not respond that you did not want to participate in householding, you were deemed to have consented to the process. If any stockholder residing at that address wishes to receive a separate annual report or proxy statement, either now or in the future, write or telephone the Company as follows: Interlink Electronics, Inc., 546 Flynn Road, Camarillo, California 93012, Attention: Corporate Secretary; (805) 484-8855. Contact the Company in the same way if you and other residents at your address are receiving multiple copies of the annual report and proxy statement and wish to receive single copies in the future.

**Proxy Procedure**

You may vote by proxy by completing a proxy card and mailing it in the postage-paid, pre-addressed envelope, by using a toll-free telephone number or by voting over the Internet. Please refer to your proxy card or the information forwarded to you by your bank, broker or other holder of record to see which options are available to you. **Your ability to vote by telephone or by the Internet will close at 5:00 p.m., Pacific Daylight Time, on June 7, 2005.**



Any person giving a proxy in the form accompanying this proxy statement has the power to revoke it at any time before its exercise. You have three ways to revoke your proxy. First, you may do so in writing by notifying Paul Meyer, the Secretary of the Company, at the Company's address listed above prior to our exercise of the proxy at the Annual Meeting or any adjournment of the meeting. Secondly, you can cast another valid proxy in writing, by telephone or over the Internet. Your vote will be cast in accordance with the latest valid proxy. Finally, the proxy may also be revoked by affirmatively electing to vote in person while attending the Annual Meeting. If you choose to vote in person, please let our personnel know that you are revoking a previously given proxy and are now voting in person. A stockholder who attends the Annual Meeting need not revoke the proxy and vote in person unless the stockholder wishes to do so, however. All valid, unrevoked proxies will be voted at the Annual Meeting or any adjournment of the meeting in accordance with the instructions given. If a signed proxy is returned without instructions, it will be voted for the nominees for director, for the approval of the proposal presented and in accordance with the recommendations of management on any other business that may properly come before the meeting or any adjournment of the meeting or matters incident to the conduct of the Annual Meeting.

**PROPOSAL 1: ELECTION OF DIRECTORS**

The Board of Directors currently consists of five directors. Pursuant to the Company's Bylaws, the Board of Directors is divided into three classes, each class serving a three-year term with the term of office of one class expiring each year. Messrs. George Gu and E. Michael Thoben, III are the nominees for re-election at this meeting for a three-year term expiring in 2008. If Messrs. Gu and Thoben become unavailable for election for any reason, we will name a suitable substitute as authorized by your proxy. The Board of Directors has determined that all of the Directors and nominees who would serve after June 8, 2005 meet the independence requirements of Nasdaq Marketplace Rule 4200 except for E. Michael Thoben, III, Chairman, CEO and President of the Company.

The following table briefly describes the Company's nominees for directors and the directors whose terms will continue. Except as otherwise noted, each has held his principal occupation for at least five years.

<b>Name, Principal Occupation, Age and Other Directorships</b>	<b>Director Since</b>	<b>Term Expires</b>
<b>Nominees</b>		
George Gu 58  Chairman of GTM Corporation, a company engaged in semiconductor packaging and testing in Taiwan and China. Mr. Gu also serves as Chairman or as a member of the Board of Directors of GTM's affiliated financial investment, trading, software, biotechnology and land development companies. Mr. Gu is a director of the Shanghai Commercial Savings Bank, Taiwan and Global Wool Alliance Pvt. Ltd. India. He holds a B.S. degree from North Carolina State University and an M.B.A. degree from Columbia University.	1991	2005
E. Michael Thoben, III 51  President, Chief Executive Officer and Chairman of the Board of Directors of the Company. Prior to joining Interlink Electronics in 1990, Mr. Thoben held numerous senior management positions at Polaroid Corporation for eleven years. Mr. Thoben formerly served on the Board of Directors of the American Electronics Association and is currently a member of the boards of two privately held companies. Mr. Thoben holds a B.S. degree from St. Xavier University and has taken graduate management courses at the Harvard Business School and The Wharton School of Business.	1990	2005

Name, Principal Occupation, Age and Other Directorships	Director Since	Term Expires
<b>Continuing Directors</b>		
John A. Buckett, II 57	2000	2006
<p>Vice President, Corporate Development at Scientific-Atlanta, Inc., a leading supplier of broadband communications systems, satellite-based video, voice and data communications networks and worldwide customer service and support, since 1998. He is also a member of the Corporate Management Committee of Scientific-Atlanta, Inc. From 1995 to 1998, Mr. Buckett served as president of the International Division and, before that, as vice president, marketing strategies, for all operating units of Scientific-Atlanta, Inc. He is a member of the Society of Cable Television Engineers and the Cable Television Administration and Marketing Society. Mr. Buckett holds a B.S. degree in electrical engineering from the Georgia Institute of Technology.</p>		
Merritt M. Lutz 62	1994	2006
<p>Chairman of Morgan Stanley Technology Holdings, Inc. Mr. Lutz manages the strategic technology investments and partnerships for Morgan Stanley Technology Holdings, Inc. Previously, he was President of Candle Corporation, a worldwide supplier of systems software from 1989 to November 1993. Mr. Lutz also sits on the boards of three privately held software companies: Algorithmics, Business Engine, and SPSS Inc. He is a former director of the Information Technology Association of America and the NASD Industry Advisory Committee. He holds a bachelors and masters degree from Michigan State University.</p>		
Eugene F. Hovanec 53	1994	2007
<p>Vice President Finance and Chief Financial Officer of Vitesse Semiconductor Corporation, a supplier of high performance integrated circuits and optical modules, principally targeted at system manufacturers in the communications and storage industries. Mr. Hovanec is a member of the New York State Society of CPAs, the AICPA and holds a B.B.A. degree from Pace University.</p>		

#### Board Committees and Meetings

The Board of Directors acted by meeting and by unanimous written consent in lieu of meetings five times during the last fiscal year. The Board of Directors has three standing committees. Each current director attended at least 75 percent of the aggregate of (i) the total number of meetings of the Board of Directors during the period in which he was a director, and (ii) the number of meetings held by all the committees of the Board on which he served. The Directors are encouraged to attend the Annual Meetings of Stockholders, and in 2004, all of the Directors then serving were able to attend.

The Board maintains a standing Audit Committee, which, in 2004, consisted of Messrs. Hovanec, Buckett and Gu. Each member of the Audit Committee is independent, financially literate and is free from any relationship that, in the judgment of the Board of Directors, would interfere with the exercise of his independent judgment as a member of the Audit Committee. The Board of Directors has determined that Mr. Hovanec is an audit committee financial expert, as defined by regulations promulgated by the SEC. The Audit Committee is, and will continue to be, composed of members that meet the independence, knowledge and experience requirements of Nasdaq as set forth in the NASD Listing Standards for Nasdaq-listed companies.

In 2004, the Audit Committee held one meeting in person and six telephonic meetings. Pursuant to the written charter adopted by the Board of Directors, the Audit Committee assists the Board in fulfilling its oversight responsibilities relating to corporate accounting, the Company's reporting practices and the quality and integrity of the Company's financial statements; compliance with law and the maintenance of ethical standards by the Company; and the Company's maintenance of effective internal controls. For additional information about the Audit Committee, see Audit Committee Matters.



The Board of Directors' Compensation Committee, which is currently comprised of Messrs. Hovanec, Gu and Lutz, reviews the compensation levels of the Company's executive officers and makes recommendations to the Board regarding changes in compensation. The Compensation Committee also administers the Company's stock option plans and recommends grants under the plans to the Board of Directors. See Compensation of Executive Officers' Report of the Compensation Committee on Executive Compensation and Option Grants in Last Fiscal Year. In 2004, the Compensation Committee held two meetings, one in person and one telephonically.

The Board also maintains a Corporate Governance and Nominating Committee, which is comprised of Messrs. Buckett and Lutz. The Company believes that all of the members of the Corporate Governance and Nominating Committee are independent as defined under the current listing standards of the National Association of Securities Dealers. The Corporate Governance and Nominating Committee has adopted a charter and corporate guidelines with respect to its governance and a copy of such charter is available at the Company's website (<http://www.interlinkelectronics.com>). The Corporate Governance and Nominating Committee makes recommendations to the Board of Directors concerning nominees to the Board of Directors. In 2004, the Corporate Governance and Nominating Committee met once, by telephone. The Corporate Governance and Nominating Committee will consider nominees recommended by stockholders of the Company. Recommendations for nominees should be sent to: Interlink Electronics, Inc., 546 Flynn Road, Camarillo, California 93012, Attention: Corporate Secretary.

### **Director Compensation**

Any director who is not an employee of the Company and has not, within one year, been an employee of the Company (a Non-Employee Director) is paid a fee of \$500 for each Board meeting and committee meeting attended in person and \$100 per hour (up to a maximum of \$500 per meeting) for each Board meeting and committee meeting attended telephonically. They are also reimbursed for costs incurred attending Board meetings. Each Non-Employee Director is eligible to receive options under our 1996 Stock Incentive Plan, as amended (the Plan). The option price for all options granted to Non-Employee Directors under the Plan is not less than the fair market value of the Common Stock on the date the option is granted. Each person who becomes a Non-Employee Director is automatically granted an option to purchase 30,000 shares of Common Stock at the time he or she becomes a Non-Employee Director. The Plan also provides for the automatic, non-discretionary, annual grant to all continuing Non-Employee Directors of options to purchase up to 7,500 shares of the Company's Common Stock. The options granted to Non-Employee Directors have a ten-year term from the date of grant. Each option becomes exercisable for 33 1/3% of the number of shares covered by the option at the end of each of the first three years of the option term. Options may be exercised while the optionee is a director of the Company, within 30 days after the date the optionee's service as a director is terminated for any reason other than death or disability or prior to the expiration of the options, whichever comes first, or if the optionee's service as a director is terminated as a result of death or disability, within one year after the date of termination or prior to the expiration of the options, whichever comes first. Options are subject to adjustment in the event of certain changes in capital structure of the Company.

### **Recommendation by the Board of Directors**

**The Board of Directors recommends that stockholders vote for the election of the nominees named in this proxy statement.** If a quorum of stockholders is present at the meeting, the nominees for director who receive the greatest number of votes cast at the meeting will be elected directors. We will treat abstentions and broker non-votes as present but not voting.

**PROPOSAL 2: AMENDMENT TO THE 1996 STOCK INCENTIVE PLAN**

The Company maintains the Plan for the benefit of its employees and others who provide services to the Company. The Board of Directors believes the availability of stock incentives is an important factor in the Company's ability to attract and retain experienced and competent employees, directors and service providers and to provide an incentive for them to exert their best efforts on behalf of the Company. As of March 31, 2005, only 239,000 shares remained available for grant out of a total of 6,500,000 shares reserved for issuance under the Plan. The Board of Directors believes additional shares will be needed under the Plan to provide appropriate incentives to key employees and others. Accordingly, on March 26, 2005 the Board of Directors approved an amendment to the Plan, subject to stockholder approval, to reserve an additional 750,000 shares for issuance under the Plan, thereby increasing the total number of shares to 7,250,000 shares.

Approval of the foregoing amendment to the Plan will also constitute reapproval of per-employee limits on the grant of stock and dollar awards under Section 162(m) of the Internal Revenue Code of 1986, as amended (the Code). Shareholder approval of per-employee limits is required every five years for continued compliance with regulations under Section 162(m) in order to permit the grant of stock and dollar awards that will qualify as performance-based compensation. See Tax Consequences.

Certain provisions of the Plan are described below. The complete text of the Plan, marked to show the proposed amendments, is attached to this proxy statement as APPENDIX A.

**Description of the Plan**

*Eligibility.* All employees, officers and directors of the Company and its subsidiaries are eligible to participate in the Plan. Also eligible are non-employee agents, consultants, advisors, persons involved in the sale or distribution of the Company's products and independent contractors of the Company or any subsidiary.

*Administration.* Authority to administer the Plan is placed in the Board of Directors, which may promulgate rules and regulations for the operation of the Plan and generally supervise the administration of the Plan. The Board of Directors has delegated authority to administer the Plan to the Compensation Committee. Any reference to the Board of Directors in this description of the Plan shall also refer to the Compensation Committee except that only the Board of Directors may amend, modify or terminate the Plan.

*Term of Plan.* The Plan will continue until all shares available for issuance under the Plan have been issued and all restrictions on such shares have lapsed. The Board of Directors may suspend or terminate the Plan at any time.

*Stock Options.* The Board of Directors determines the persons to whom options are granted, the option price, the number of shares subject to each option, the period of each option, the times at which options may be exercised and whether the option is an incentive stock option (ISO), as defined in Section 422 of the Code, or an option other than an ISO (a nonqualified stock option or NSO). If the option is an ISO, the option price cannot be less than the fair market value of the Common Stock on the date of grant. If an optionee of an ISO at the time of grant owns stock possessing more than 10% of the combined voting power of the Company, the option price may not be less than 110% of the fair market value of the Common Stock on the date of grant. If the option is an NSO, the option price may be any amount determined by the Board of Directors. No employee may be granted options or stock appreciation rights under the Plan for more than 300,000 shares in any calendar year. In addition, the Plan limits the aggregate fair market value, on the date of grant, of the stock for which ISOs are exercisable for the first time by any employee in any year to \$100,000. No monetary consideration is paid to the Company upon the granting of options.

Options granted under the Plan generally continue in effect for the period fixed by the Board of Directors, except that ISOs are not exercisable after the expiration of 10 years from the date of grant or five years in the

case of 10% stockholders. Options are exercisable in accordance with the terms of an option agreement entered into at the time of grant and, except as otherwise determined by the Board of Directors with respect to an NSO, are nontransferable except on death of a holder. Options may be exercised only while an optionee is employed by or in the service of the Company or a subsidiary or within 12 months following termination of employment by reason of death or disability or 30 days following termination for any other reason. The Plan provides that the Board of Directors may extend the exercise period for any period up to the expiration date of the option and may increase the number of shares for which the option may be exercised up to the total number underlying the option. The purchase price for each share purchased pursuant to exercise of options must be paid in cash, including cash that may be the proceeds of a loan from the Company, in shares of Common Stock valued at fair market value, in restricted stock, in performance units or other contingent awards denominated in either stock or cash, other forms of consideration, as determined by the Board of Directors. Upon the exercise of an option, the number of shares subject to the option and the number of shares available under the Plan for future option grants are reduced by the number of shares with respect to which the option is exercised.

*Stock Option Grants to Non-Employee Directors.* Pursuant to the terms of the Plan, each individual who becomes a non-employee director receives a non-statutory option to purchase 30,000 shares of Common Stock when the individual becomes a director. In addition, pursuant to the terms of the Plan, each non-employee director of the Company will be automatically granted an annual non-discretionary, non-statutory option to purchase 7,500 shares of Common Stock.

*Stock Appreciation Rights.* Stock appreciation rights ( SARs ) may be granted under the Plan. SARs may, but need not, be granted in connection with an option grant or an outstanding option previously granted under the Plan. A SAR gives the holder the right to payment from the Company of an amount equal in value to the excess of the fair market value of a share of Common Stock on the date of exercise over its fair market value on the date of grant, or if granted in connection with an option, the option price per share under the option to which the SAR relates. If a SAR is granted in connection with an option, it is exercisable only to the extent and on the same conditions that the related option is exercisable. Payment by the Company upon exercise of a SAR may be made in Common Stock valued at its fair market value, in cash, or partly in stock and partly in cash, as determined by the Board of Directors. The Board of Directors may withdraw any SAR granted under the Plan at any time and may impose any condition upon the exercise of a SAR or adopt rules and regulations from time to time affecting the rights of holders of SARs.

The existence of SARs, as well as certain bonus rights described below, would require charges to income over the life of the right based upon the amount of appreciation, if any, in the market value of the Common Stock over the exercise price of shares subject to exercisable SARs or bonus rights. No SARs have been granted under the Plan.

*Stock Bonus Awards.* The Board of Directors may award Common Stock as a stock bonus under the Plan. The Board of Directors may determine the recipients of the awards, the number of shares to be awarded and the time of the award. Stock received as a stock bonus is subject to the terms, conditions and restrictions determined by the Board of Directors at the time the stock is awarded. No stock bonuses have been granted under the Plan.

*Restricted Stock.* The Plan provides that the Company may issue restricted stock in such amounts, for such consideration, subject to such restrictions and on such terms as the Board of Directors may determine. No restricted stock has been granted under the Plan.

*Cash Bonus Rights.* The Board of Directors may grant cash bonus rights under the Plan in connection with (i) options granted or previously granted, (ii) SARs granted or previously granted, (iii) stock bonuses awarded or previously awarded and (iv) shares sold or previously sold under the Plan. Bonus rights granted in connection with options entitle the optionee to a cash bonus if and when the related option is exercised. The amount of the bonus is determined by multiplying the excess of the total fair market value of the shares acquired upon the exercise over the total option price for the shares by the applicable bonus percentage. The bonus percentage





applicable to any bonus rights, including a previously granted bonus right, may be changed from time to time at the sole discretion of the Board of Directors but shall in no event exceed 75%. Bonus rights granted in connection with stock bonuses or restricted stock purchases entitle the recipient to a cash bonus in an amount determined by the Board of Directors, at the time the stock is awarded or purchased, or at such time as any restrictions to which the stock is subject may lapse. No bonus rights have been granted under the Plan.

*Performance Units.* The Board of Directors may grant performance units consisting of monetary units that may be earned in whole or in part if the Company achieves goals established by the Board of Directors over a designated period of time, but in any event not more than ten years. Payment of an award earned may be in cash or stock or both and may be made when earned, or vested and deferred, as the Board of Directors determines. No performance units have been granted under the Plan.

*Foreign Qualified Grants.* Awards under the Plan may be granted to eligible persons residing in foreign jurisdictions. The Board of Directors may adopt supplements to the Plan necessary to comply with the applicable laws of foreign jurisdictions and to afford participants favorable treatment under those laws, but no award may be granted under any supplement with terms that are more beneficial to the participants than the terms permitted by the Plan.

*Changes in Capital Structure.* The Plan provides that if the outstanding Common Stock is increased or decreased or changed into or exchanged for a different number or kind of shares or other securities of the Company or of another corporation by reason of any recapitalization, stock split or certain other transactions, appropriate adjustment will be made by the Board of Directors in the number and kind of shares available for awards under the Plan. In addition, the Board of Directors will make appropriate adjustments in the outstanding options. In the event of a merger, consolidation or plan of exchange to which the Company is a party or a sale of all or substantially all of the Company's assets (each a Transaction), the Board of Directors will, in its sole discretion and to the extent possible under the structure of the Transaction, select one of the following alternatives for treating outstanding options under the Plan: (i) outstanding options will remain in effect in accordance with their terms; (ii) outstanding options shall be converted into options to purchase stock in the corporation that is the surviving or acquiring corporation in the Transaction; or (iii) the Board of Directors will provide a 30-day period prior to the consummation of the Transaction during which outstanding options shall be exercisable to the extent exercisable and upon the expiration of such 30-day period, all unexercised options shall immediately terminate. The Board of Directors may, in its sole discretion, accelerate the exercisability of options so that they are exercisable in full during such 30-day period. In the event of the dissolution of the Company, options shall be treated in accordance with clause (iii) above.

*Tax Consequences.* Certain options authorized to be granted under the Plan are intended to qualify as ISOs for federal income tax purposes. Under federal income tax law currently in effect, the optionee will recognize no income upon grant or upon a proper exercise of the ISO. If an employee exercises an ISO and does not dispose of any of the option shares within two years following the date of grant and within one year following the date of exercise, then any gain realized on subsequent disposition of the shares will be treated as income from the sale or exchange of a capital asset. If an employee disposes of shares acquired upon exercise of an ISO before the expiration of either the one-year holding period or the two-year waiting period, any amount realized will be taxable as ordinary compensation income in the year of such disqualifying disposition to the extent that the lesser of the fair market value of the shares on the exercise date or the fair market value of the shares on the date of disposition exceeds the exercise price. The Company will not be allowed any deduction for federal income tax purposes at either the time of the grant or exercise of an ISO. Upon any disqualifying disposition by an employee, the Company will generally be entitled to a deduction to the extent the employee realized ordinary income.

Certain options authorized to be granted under the Plan will be treated as NSOs for federal income tax purposes. Under federal income tax law presently in effect, no income is realized by the grantee of an NSO until the option is exercised. At the time of exercise of an NSO, the optionee will realize ordinary compensation

income, and the Company will generally be entitled to a deduction, in the amount by which the market value of the shares subject to the option at the time of exercise exceeds the exercise price. The Company is required to withhold on the income amount. Upon the sale of shares acquired upon exercise of an NSO, the excess of the amount realized from the sale over the market value of the shares on the date of exercise will be taxable.

An employee who receives stock in connection with the performance of services will generally realize taxable income at the time of receipt unless the shares are substantially nonvested for purposes of Section 83 of the Code and no Section 83(b) election is made. If the shares are not vested at the time of receipt, the employee will realize taxable income in each year in which a portion of the shares substantially vest, unless the employee elects within 30 days after the original transfer to recognize income in connection with the original transfer under Section 83(b). The Company generally will be entitled to a tax deduction in the amount includable as income by the employee at the same time or times as the employee recognizes income with respect to the shares. The Company is required to withhold on the income amount. A participant who receives a cash bonus right under the Plan will generally recognize income equal to the amount of the cash bonus paid at the time of receipt, and the Company will generally be entitled to a deduction equal to the income recognized by the participant.

Section 162(m) of the Code, as adopted in 1993, limits to \$1,000,000 per person the amount that the Company may deduct for compensation paid to any of its most highly compensated officers in any year. Under Internal Revenue Service regulations, compensation received through the exercise of an option or a SAR is not subject to the \$1,000,000 limit if the option or SAR and the plan pursuant to which it is granted meet certain requirements. One requirement is stockholder approval at least once every five years of per-employee limits on the number of shares as to which options and SARs may be granted. Approval of this proposal will constitute approval of the per-employee limit under the Plan. Other requirements are that the option or SAR be granted by a committee of at least two outside directors and that the exercise price of the option or SAR be not less than fair market value of the Common Stock on the date of grant. Accordingly, the Company believes that if this proposal is approved by stockholders, compensation received on exercise of options and SARs granted under the Plan in compliance with all of the above requirements will be exempt from the \$1,000,000 deduction limit.

#### **Recommendation by the Board of Directors**

**The Board of Directors recommends that stockholders vote for the amendment to the Plan increasing the number of shares reserved for issuance from 6,500,000 to 7,250,000.** The proposal to approve the amendment must be approved by the holders of at least a majority of the votes present and entitled to vote on the matter at the meeting. Abstentions and broker non-votes are counted for purposes of determining whether a quorum exists at the meeting. Broker non-votes are deemed to be not present for the purpose of any vote as to which such status applies and will therefore have no effect on the outcome of the vote. Abstentions will be deemed to be present for the purpose of any vote as to which the shareholder has abstained and therefore will have the effect of no votes in determining whether the amendment is approved.

#### **INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

BDO Seidman, LLP audited the Company's financial statements for the fiscal year ended December 31, 2004 and has been appointed to act as independent registered public accounting firm for the review of the Company's first quarter 2005 results. Representatives of BDO Seidman, LLP have been invited to attend the Annual Meeting, will be given the opportunity to make a statement if they wish and will be available to respond to appropriate questions.

## COMPENSATION OF EXECUTIVE OFFICERS

The Compensation Committee of the Board of Directors (the Committee) is composed of three Non-Employee Directors. Pursuant to authority delegated by the Board, the Committee initially determines the compensation to be paid to the Chief Executive Officer and to each of the other executive officers of the Company. This determination is made in conjunction with recommendations from Mr. Thoben as to the appropriate salary and bonus to pay each of the executive officers, other than himself. Mr. Thoben also participates in discussions regarding the compensation of the other executive officers, but he does not vote on compensation matters put before the Committee or the Board. Following the aforementioned determination by the Committee, issues concerning officer compensation are submitted to the Board of Directors for approval. The Committee also is responsible for developing and making recommendations to the Board with respect to the Company's executive compensation policies.

### Report of the Compensation Committee on Executive Compensation

The Company's compensation policies for officers (including the named executive officers) are designed to compensate the Company's executives fairly and to provide incentives for the executives to manage the Company's business effectively for the benefit of its stockholders.

The key objectives of the Company's executive compensation policies are to attract and retain key executives who are important to the long-term success of the Company, and to provide incentives for these executives to achieve high levels of job performance and to strive to enhance stockholder value. The Company seeks to achieve these objectives by paying its executives a competitive level of base compensation for companies of similar size and in similar industries and by providing its executives an opportunity for further reward for outstanding performance in both the short-term and the long-term. It is the current policy of the Committee to set base salaries conservatively and to emphasize opportunities for performance-based rewards through annual cash bonuses and stock option grants. This policy is currently under review as a result of recent changes in accounting rules applicable to stock options.

Options granted to employees, including executive officers, under the Company's 1996 Stock Incentive Plan generally are intended to qualify as incentive stock options. To the extent, however, that the aggregate fair market value of the stock with respect to which options are exercisable for the first time during any calendar year exceeds \$100,000, the options will be treated as nonqualified stock options. The Company receives no tax deduction from the exercise of an incentive stock option unless the optionee disposes of the acquired shares before satisfying certain holding periods. The Committee believes the grant of incentive stock options, despite the general nondeductibility, benefits the Company by encouraging the long-term ownership of the Company's stock by officers and other employees.

Section 162(m) of the Internal Revenue Code of 1986, as amended, limits to \$1,000,000 per person the amount that the Company may deduct for compensation paid to any of its five most highly compensated officers in any year. The levels of salary and bonus paid by the Company generally do not exceed this limit. However, upon exercise of nonqualified stock options, the excess of current market price over the option price (the option spread) is treated as compensation. In addition, if the holder of an incentive stock option disposes of stock received upon exercise of the option before satisfying certain holding period requirements, the optionee will recognize ordinary compensation income for the year of disposition equal to the lesser of the option spread and the amount of gain realized by the optionee upon disposition. Under regulations promulgated by the Internal Revenue Service, the \$1,000,000 cap on deductibility will not apply to option spread compensation from the exercise of either a nonqualified stock option or a disqualifying disposition of an incentive stock option if such exercise meets certain performance-based requirements. One of the performance-based requirements is that an option grant to any individual may not exceed a stockholder-approved maximum number of shares. Accordingly, the option spread compensation from an exercise (in the case of nonqualified stock options) of those options

generally would be treated as compensation for tax purposes and taken into account in determining the \$1,000,000 cap on deductibility. No employee may be granted options under the Company's 1996 Stock Incentive Plan for more than 300,000 shares in any calendar year.

*Executive Officer Compensation Program.* The Company's executive officer compensation program is comprised of three elements: base salary, annual cash bonus and long-term incentive compensation in the form of stock option grants.

*Salary.* The Company attempts to establish base salary levels for the Company's executive officers that are competitive with those established by companies of similar size in the computer electronics and technology industries. In determining individual salaries within the established ranges, the Committee takes into account individual experience, job responsibility and individual performance during the prior year. The Committee does not assign a specific weight to each of these factors in establishing individual base salaries. Each executive officer's salary is reviewed annually, and increases to base salary are made to reflect competitive market increases and the factors described above.

In determining 2004 salaries, the Committee compared the proposed salaries to the ranges established in fiscal 2003, reviewed salaries of executives of similar companies and made specific adjustments as determined by the Committee to be appropriate in the circumstances.

*Cash Bonuses.* The purpose of the cash bonus component of the compensation program is to provide a direct financial incentive to executives and other employees to achieve predetermined Company performance objectives.

Performance objectives for the Company as a whole are determined at the beginning of each fiscal year during the annual budgeting process and are approved by the Board of Directors. These objectives are based upon competitive conditions and general economic circumstances then prevailing in the industries in which the Company does business. Eligibility of an executive officer for a bonus is generally dependent upon the achievement of these predetermined performance objectives. Target bonus amounts are established by the Committee for each executive officer at the beginning of each fiscal year at a percentage of the executive officer's base salary, which in fiscal 2004 was 25% of base salary. If the predetermined performance goals are met, a preliminary bonus amount is calculated under a bonus formula up to a maximum of the target bonus amount determined by the Committee. The final bonus amount paid to an eligible executive officer is determined by the Committee, which has discretion to increase or decrease the formula-derived figure within certain limits based upon the Committee's assessment of the individual's performance and to pay special bonuses in extraordinary circumstances as judged by the Committee.

In determining the 2004 bonuses, the Committee based its decision on the formula derived according to the Committee. The formula employed contains an objective component, linked to the Company's revenue growth and profitability, as well as a subjective component, based upon the Committee's assessment of the individual officer's relative contribution to the Company as a whole. Awarded bonuses, if any, are typically paid in the first or second quarter of the following fiscal year.

*Stock Options.* Under the Company's compensation policy, stock options are the primary vehicle for rewarding long-term achievement of Company goals. The objectives of the program are to align employee and stockholder long-term interests by creating a strong and direct link between compensation and increases in share value. Under the Company's 1996 Stock Incentive Plan, the Board of Directors or the Committee may grant options to purchase Common Stock of the Company to key employees of the Company and its subsidiaries. The Board of Directors makes annual grants of options to purchase the Company's Common Stock at an exercise price equal to the fair market value of the shares on the date of grant (the last sale price as reported on the Nasdaq National Market on the date of grant). Starting in 2000, the Company's options generally vest ratably on a monthly basis for three succeeding years. Prior to 2000, the Company's options generally vested 25% on the

grant date and the remainder vested ratably on a monthly basis thereafter for the three succeeding years. Stock options generally have a ten-year term but terminate earlier if employment is terminated. Option grants to executive officers depend upon the level of responsibility and position, the Committee's subjective assessment of performance, the number of options granted in the past and the exercise price of such grants, among other factors. In fiscal 2004, the Board of Directors, upon recommendation of the Committee, made the following grants of options to purchase Company Common Stock to executive officers of the Company: E. Michael Thoben, III, 100,000 shares; Paul D. Meyer, 75,000 shares; and Michael W. Ambrose, 50,000 shares. The Company's policies relating to option grants are currently under review as a result of recent changes in accounting rules applicable thereto. The Committee expects that in the future, if additional grants are made, consideration will be given to the number of options granted in the past and the exercise price of such grants.

*Chief Executive Officer Compensation.* The Committee determined the Chief Executive Officer's compensation for fiscal 2004, with the final approval of the Board of Directors, employing the same criteria that it used to set compensation for other executive officers. The Chief Executive Officer's base salary was determined based upon a review of both the salaries of chief executive officers for companies of comparable size and in comparable industries and the Chief Executive Officer's performance. Option grants in fiscal 2004 were determined under the criteria described under "Stock Options," above.

**Compensation Committee for 2004**

Merritt Lutz, Chair  
Eugene Hovanec  
George Gu

**Compensation Committee Interlocks and Insider Participation**

The Compensation Committee consists of Messrs. Hovanec, Gu and Lutz. There are no interlocking relationships, as described by the Securities and Exchange Commission, between the Compensation Committee members and executive officers of the Company.

**Summary Compensation Table**

The following table sets forth a summary of all compensation paid to the Chief Executive Officer of the Company and two other executive officers of the Company for services in all capacities to the Company and its subsidiaries during each of the last three fiscal years.

Name and Principal Position	Year	Annual Compensation		Other Annual Compensation	Long-Term Compensation
		Salary	Bonus <sup>(1)</sup>		Securities Underlying Options (#)
E. Michael Thoben, III Chairman of the Board, President and Chief Executive Officer	2004	\$ 220,396	\$ 24,000	\$ 76,920 <sup>(2)(3)</sup>	100,000
	2003	209,063	65,000	184,732 <sup>(2)(3)</sup>	190,000
	2002	202,500	-0-	60,000 <sup>(2)</sup>	
Paul D. Meyer					

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Chief Financial Officer and Secretary	2004	\$ 163,469	\$ 14,000	\$	75,000
	2003	153,761	40,000	54,245 <sup>(3)</sup>	115,000
	2002	150,010	-0-		
Michael W. Ambrose	2004	\$ 146,263	\$ 11,760	\$	50,000
	2003	139,050	20,000	10,600 <sup>(3)</sup>	87,500
	2002	135,000	-0-		
Sr. Vice President, Technology and Product Development	2004				
	2003				
	2002				

- (1) Bonuses listed are paid in the succeeding fiscal year. See Report of Compensation Committee on Executive Compensation-Executive Officer Compensation Program-Cash Bonuses.
- (2) The Company reimbursed Mr. Thoben \$69,000 in 2004 and \$60,000 in each of 2003 and 2002 for the use of his personal airplane to transport him on Company business.
- (3) In fiscal 2004, the Company paid Mr. Thoben \$7,920 for amounts due to him for excess accrued vacation recorded over the tenure of his employment. In addition, in fiscal 2003, the Company paid Mr. Thoben, Mr. Meyer and Mr. Ambrose \$124,732, \$54,245 and \$10,600, respectively, for amounts due to them for excess accrued vacation (recorded over the tenure of their employment). Messrs. Thoben, Meyer and Ambrose applied these amounts to loans due to the Company.

### Option Grants in Last Fiscal Year

The following table provides information regarding grants of stock options to the named executive officers in 2004.

Name	Number of Securities Underlying Options Granted <sup>(1)</sup>	Percent of Total Options Granted to Employees in Fiscal Year <sup>(2)</sup>	Exercise Price Per Share	Expiration Date <sup>(3)</sup>	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term <sup>(4)</sup>	
					5%	10%
E. Michael Thoben, III	100,000	10.5%	\$ 9.40	6/22/2014	\$ 590,000	\$ 1,499,000
Paul D. Meyer	75,000	7.9%	\$ 9.40	6/22/2014	\$ 442,500	\$ 1,124,250
Michael W. Ambrose	50,000	5.3%	\$ 9.40	6/22/2014	\$ 295,000	\$ 749,500

- (1) These options were granted pursuant to the Plan.
- (2) In fiscal 2004, the Company granted options to purchase a total of 948,000 shares of its Common Stock under the Plan, and this number is used in calculating the percentages set forth in this column.
- (3) Options granted under the Plan generally expire on the tenth anniversary of the date of grant. Unless otherwise determined by the Board of Directors, options granted under the Plan expire prior to the tenth anniversary of grant (i) if the optionee's employment (or service as a director, as applicable) is terminated for any reason (other than death or disability), in which case options vested but unexercised at the date of termination may be exercised prior to the expiration date of the option or within 30 days after the date of termination, whichever comes first, or (ii) if the optionee's employment (or service as a director, as applicable) terminates because of death or disability, options vested but unexercised at the date of termination may be exercised within 12 months after the date of termination. If employment (or service as director, as applicable) is terminated by death of the optionee, the option generally may be exercised by persons to whom the optionee's rights pass by will of the laws of descent or distribution.
- (4) The assumed 5% and 10% annual rates of appreciation over the term of the options are set forth in accordance with rules and regulations adopted by the Securities and Exchange Commission and do not represent the Company's estimate of stock price appreciation. Value shown is net of exercise costs.

**Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values**

The following table indicates (on an aggregated basis) (i) stock options exercised by named executive officers during fiscal 2004, including the value realized on the date of exercise (market price on the date of exercise less the exercise price of the options), (ii) the number of shares subject to exercisable and unexercisable stock options as of the Company's fiscal year end, December 31, 2004, and (iii) the value of in-the-money options at December 31, 2004.

Name	Shares Acquired On Exercise	Value Realized	Number of Unexercised Options at Year-End		Value of Unexercised In-the-Money Options At Year-End <sup>(1)</sup>	
			Exercisable	Unexercisable	Exercisable	Unexercisable
E. Michael Thoben, III	75,000	\$ 529,253	433,335	141,665	\$ 2,024,247	\$ 184,528
Paul D. Meyer	37,500	\$ 264,626	229,307	103,193	\$ 1,035,449	\$ 129,290
Michael W. Ambrose	30,780	\$ 173,570	197,668	70,832	\$ 934,069	\$ 92,262

<sup>(1)</sup> Options are in-the-money at the fiscal year-end if the fair market value of the underlying securities on such date exceeds the exercise price of the option. The amounts set forth represent the difference between the fair market value of the securities underlying the options on December 31, 2004, based on the last sale price of \$9.43 per share of Common Stock on that date as reported by the Nasdaq National Market and the exercise price of the options, multiplied by the applicable number of options.

**Equity Compensation Plans**

The following table summarizes equity compensation plans approved by stockholders and equity compensation plans that were not approved by the stockholders as of March 31, 2005 (in thousands except exercise price):

Plan category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by stockholders <sup>(1)</sup>	3,551	\$ 6.11	239
Equity compensation plans not approved by stockholders	-0-		
<b>Total</b>	<b>3,551</b>	<b>\$ 6.11</b>	<b>239</b>

<sup>(1)</sup> Includes options granted and outstanding or available pursuant to the 1996 Stock Incentive Plan.





**Performance Graph<sup>1</sup>**

The following line graph provides a comparison of the annual percentage change in the Company's cumulative total stockholder return on its Common Stock to the cumulative total return of the Nasdaq Composite Index and a peer group consisting of companies included in the Nasdaq Computer Manufacturers Index. The comparison assumes \$100 was invested on January 1, 2000 in the Company's Common Stock and in each of the following indices and, in each case, assumes the reinvestment of dividends.

**Interlink Electronics**

**Cumulative Total Return To Stockholders**

**1/1/00 - 12/31/04**

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<sup>1</sup> This section is not soliciting material, is not deemed filed with the Securities and Exchange Commission, and is not to be incorporated by reference in any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, each as amended, regardless of the date or any other general incorporation language in such filing.

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## AUDIT COMMITTEE MATTERS<sup>1</sup>

The Board of Directors has approved and adopted a written Audit Committee Charter which reflects the standards set forth in the Securities and Exchange Commission regulations and Nasdaq Stock Market listing standards. A copy of the Audit Committee Charter is attached to our 2004 Proxy Statement and can be accessed on-line through [www.sec.gov](http://www.sec.gov). Messrs. Hovanec, Buckett and Gu serve on the Audit Committee. Each member of the Audit Committee is a non-employee director and is independent in accordance with the National Association of Securities Dealers listing standards.

### Report of the Audit Committee

The Audit Committee's role is to provide governance, guidance, and oversight regarding financial information provided by the Company to the public or governmental bodies, the Company's systems of internal controls, and the auditing, accounting, and financial reporting processes in general. The Audit Committee regularly meets with management and the Company's independent registered public accounting firm, BDO Seidman, LLP, to discuss, among other things, the preparation of financial statements, including key accounting and reporting issues. In accordance with the Audit Committee charter, the Audit Committee also oversees the relationship between the Company and its independent registered public accounting firm, including recommending their appointment, reviewing the scope of their services and related fees, and assessing their independence.

The Audit Committee reviewed the audited financial statements for the year ended December 31, 2004 with management and BDO Seidman, LLP. The Audit Committee also discussed with BDO Seidman, LLP matters required to be discussed with audit committees under generally accepted auditing standards, including, among other things, matters related to the conduct of the audit of the Company's consolidated financial statements and the matters required to be discussed by Statement on Auditing Standards No. 61 Communication with Audit Committees, as amended (SAS 61). SAS 61 requires the Company's independent registered public accounting firm to provide the Audit Committee with additional information regarding the scope and results of their audit of the Company's consolidated financial statements, including with respect to:

their responsibility under generally accepted auditing standards;

significant accounting policies;

management judgments and estimates;

any significant audit adjustments;

any disagreements with management; and

any difficulties encountered in performing the audit.

Additionally, the Audit Committee reviewed and discussed, with management and with BDO Seidman, LLP, management's report and BDO Seidman, LLP's report and attestation on internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act of 2002. The Audit Committee specifically discussed with management and BDO Seidman, LLP the material weaknesses<sup>2</sup> noted by management and

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<sup>1</sup> This section is not soliciting material, is not deemed filed with the Securities and Exchange Commission, and is not to be incorporated by reference in any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, each as amended, regardless of the date or any other general incorporation language in such filing.

<sup>2</sup> A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the consolidated financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Seidman, LLP in their respective reports on internal control. Those material weaknesses related to the accounting for bill and hold transactions, the accounting for overhead allocations to inventory balances, accounting procedures in the quarterly and annual financial statement close process and management's review of the accounting at the Company's Japanese subsidiary. The Audit Committee also discussed with management and with BDO Seidman, LLP efforts by management to remediate those material weaknesses and the effect that such material weaknesses had on BDO Seidman, LLP's audit of the 2004 financial statements.

The Audit Committee also discussed with BDO Seidman, LLP their independence, and BDO Seidman, LLP provided the Audit Committee with written disclosures and the letter required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) to the effect that, in their professional judgment, BDO Seidman, LLP is independent of the Company within meaning of the federal securities laws. When considering BDO Seidman, LLP's independence, the Audit Committee discussed whether BDO Seidman, LLP's provision of services to the Company beyond those rendered in connection with their audit and review of the Company's consolidated financial statements was compatible with maintaining their independence. The Audit Committee also reviewed, among other things, the amount of fees paid to BDO Seidman, LLP for audit and non-audit services.

Based on the Audit Committee's review and these meetings, discussions and reports, and subject to the limitations of the Audit Committee's role and responsibilities referred to above and in the Audit Committee Charter, the Audit Committee recommended to the Board that the Company's audited consolidated financial statements for the year ended December 31, 2004 be included in the Company's Annual Report on Form 10-K.

**Audit Committee for 2004**

Eugene F. Hovanec, Chairman  
George Gu  
John A. Buckett, II

**Principal Accounting Fees and Services**

The Company incurred the following fees for services performed by the Company's principal accounting firms for the years ended December 31, 2004 and 2003.

Type of Fees	2004	2003
Audit Fees	\$ 693,829 <sup>(1)</sup>	\$ 99,003 <sup>(2)</sup>
Audit-Related Fees <sup>(3)</sup>	\$ 6,350	\$ 6,183
Tax Fees <sup>(4)</sup>	\$ 9,432	\$ 390
All Other Fees	\$	\$
Total	\$ 709,611	\$ 105,576

- (1) Represents fees for professional services provided in connection with the audit of the Company's annual financial statements and review of the Company's quarterly financial statements, including (i) \$170,353 for the audit of the Company's annual financial statements for the fiscal year ended December 31, 2004 by BDO Seidman, LLP, (ii) \$34,000 for the review of the financial statements included in the Company's first, second and third quarter for 2004 by BDO Seidman, LLP, (iii) \$374,197 for the audit of the Company's internal controls pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 by BDO Seidman, LLP, and (iv) \$115,279 for services performed by BDO Seidman, LLP in connection with the Company's S-3 filing in 2004.
- (2) Represents fees for professional services provided in connection with the audit of the Company's annual financial statements and review of the Company's quarterly financial statements, including (i) \$89,003 for the audit of the Company's annual financial statements for the fiscal year ended December 31, 2003 by BDO Seidman, LLP, and (ii) \$10,000 for the review of the financial statements included in the Company's third quarter for 2003 by BDO Seidman, LLP.
- (3) Represents fees for professional services in connection with matters related to the Company's employee benefit plan, accounting consultations on matters related to internal controls, acquisitions and purchases, and attest services not required by statute or regulation.
- (4) Represents fees for professional services in connection with tax return preparation and tax consulting and review.

**Change in Independent Registered Public Accounting Firm**

On September 12, 2003, the Board of Directors, on the recommendation of its Audit Committee, approved the dismissal of the Company's independent registered public accounting firm, KPMG LLP. KPMG LLP's report on the Company's financial statements for our fiscal year ended December 31, 2002 did not contain an adverse opinion or disclaimer of opinion and was not qualified or modified as to uncertainty, audit scope or accounting principles. During the Company's fiscal year ended December 31, 2002 and during the subsequent interim period through the date of dismissal, September 12, 2003, there were no disagreements between the Company and KPMG LLP on any matters of accounting principles or practices, financial statement disclosure or auditing scope or procedure, or any reportable events as defined under Item 304(a)(1)(v) of Regulation S-K promulgated by the Securities and Exchange Commission.

On September 12, 2003, the Board of Directors, on the recommendation of its Audit Committee, engaged the firm of BDO Seidman, LLP to be the Company's independent registered public accounting firm. The Company did not consult BDO Seidman, LLP at any time prior to September 12, 2003 with respect to the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company's financial statements, or concerning any disagreement or reportable event with KPMG LLP.

**Audit Committee Pre-Approval Policies and Procedures**

The Audit Committee has pre-approved all audit, audit-related and permitted non-audit services provided by BDO Seidman, LLP to the Company and the related fees for such services, and has concluded that such services are compatible with the auditors' independence. The Audit Committee Charter has established policies and procedures under which all audit and non-audit services performed by the Company's principal independent accountants must be approved in advance by the Audit Committee. During the approval process, the Audit Committee considers the impact of the types of services and the related fees on the independence of the auditor. The services and fees must be deemed compatible with the maintenance of the auditor's independence, including compliance with SEC rules and regulations. Throughout the year, the Audit Committee reviews any revisions to the estimates of audit and non-audit fees initially approved.

## SECURITY OWNERSHIP OF CERTAIN BENEFICIAL

## OWNERS AND MANAGEMENT

The following table sets forth information as of February 25, 2005 with respect to the beneficial ownership of the Common Stock by each person, or group of affiliated persons, who is known by us to be the beneficial owner of more than five percent of the Common Stock; each of the directors and the nominees for director; each of the named executive officers; and all of the Company's named executive officers and directors as a group.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Shares of Common Stock issuable on exercise of currently exercisable or convertible securities or securities exercisable or convertible within 60 days of February 25, 2005 are deemed beneficially owned and outstanding for computing the percentage owned by the person holding such securities, but are not considered outstanding for purposes of computing the percentage of any other person. Except as otherwise noted, the address for each stockholder named below is: c/o Interlink Electronics, 546 Flynn Road, Camarillo, CA 93012.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership <sup>(1)</sup>	Percent Of Class
E. Michael Thoben, III	480,387 <sup>(2)</sup>	3.4%
George Gu	327,399 <sup>(3)</sup>	2.4%
Paul D. Meyer	241,766 <sup>(4)</sup>	1.7%
Michael W. Ambrose	219,502 <sup>(5)</sup>	1.6%
Eugene F. Hovanec	105,384 <sup>(6)</sup>	*
Merritt M. Lutz	28,751 <sup>(7)</sup>	*
John A. Buckett, II	43,751 <sup>(8)</sup>	*
Westcliff Capital Management, LLC.	1,407,616 <sup>(9)</sup>	10.3%
Richard S. Spencer, III		
200 Seventh Avenue, Suite 105		
Santa Cruz, CA 95062		
All executive officers and directors as a group (7 people)	1,446,940 <sup>(10)</sup>	9.9%

\* Less than 1%

- (1) Except as modified by applicable community property laws or as otherwise indicated, each stockholder named in the table has sole voting and investment power with respect to the shares set forth opposite that stockholder's name.
- (2) Consists of 42,259 shares of Common Stock and options to purchase 438,128 shares of Common Stock.
- (3) Includes 312,399 shares of Common Stock held by Force Sensor Investment Corporation, which is owned by Mr. Gu's family, and options granted to Mr. Gu to purchase 15,000 shares of Common Stock.
- (4) Consists of 11,251 shares of common stock and options to purchase 230,515 shares of Common Stock.
- (5) Consists of 13,501 shares of Common Stock and options to purchase 206,001 shares of Common Stock.
- (6) Consists of 97,884 shares of Common Stock and options to purchase 7,500 shares of Common Stock. All shares of Common Stock are jointly held with his wife, Victoria Hovanec.
- (7) Consists of 13,751 shares of Common Stock and options to purchase 15,000 shares of Common Stock.
- (8) Consists of 6,251 shares of Common Stock and options to purchase 37,500 shares of Common Stock.
- (9) Based solely on the Schedule 13G dated February 4, 2005.
- (10) Consists of 497,296 shares of Common Stock and options to purchase 949,644 shares of Common Stock.





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**COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT**

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's executive officers, directors and persons who own more than 10% of the Common Stock to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Executive officers, directors and beneficial owners of more than 10% of the Common Stock are required by Securities and Exchange Commission regulations to furnish the Company with copies of all Section 16(a) forms they file. Based solely on a review of the copies of such forms received by the Company and on written representations from certain reporting persons that they have complied with the relevant filing requirements, the Company believes that all Section 16(a) filing requirements applicable to its executive officers and directors have been complied with, except that John A. Buckett, II filed a Form 4, Statement of Changes in Beneficial Ownership, reporting one transaction on June 25, 2004, one day late.

**CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

In late 2000, E. Michael Thoben, III, our President and Chief Executive Officer, Paul D. Meyer, our Chief Financial Officer, and Michael W. Ambrose, our Senior Vice President, Technology and Product Development, exercised certain incentive stock options to purchase Common Stock of Interlink and then sold the Common Stock obtained on that exercise. By early 2001, the price of Interlink's Common Stock had declined significantly and, among others, Messrs. Thoben, Meyer and Ambrose determined that they would purchase Common Stock of Interlink in the open market. To complete the purchase, and after considering the benefit to Interlink and its stockholders, Interlink's Board of Directors, with Mr. Gu, Mr. Thoben and Mr. Lutz each recusing himself from the decision, agreed to accept a promissory note from each of Messrs. Meyer, Ambrose, Gu and Lutz in the amount of \$42,892 and from Mr. Thoben in the amount of \$42,936. Each promissory note is dated May 1, 2001, bears interest at the rate of 5% per annum and is secured by all right, title and interest in the shares purchased with the money borrowed under the note and all distributions received, receivable or otherwise distributed in respect to or in exchange for the shares purchased. As subsequently amended upon the approval of the Board of Directors in June 2002, the notes are due and payable on November 1, 2006. As of December 31, 2004, the outstanding balance of principal and accrued and unpaid interest on the May 1, 2001 notes was \$42,892, \$42,898, \$40,883 and \$2,000 in the case of Messrs. Meyer, Ambrose, Gu and Thoben, respectively. Mr. Lutz has paid the full amount of all principal and interest owing under his note.

As a result of a miscalculation of the time period between the sale of the underlying Common Stock following the exercise of the stock options and the purchase of the Common Stock in the open market, the purchases occurred five months after the date of the sales and, pursuant to Section 16(b) of the Securities Exchange Act of 1934, as amended, resulted in liability of Messrs. Thoben, Meyer and Ambrose to Interlink in the amount of the deemed profit measured by the difference between the sale and purchase prices. The amount of the liabilities as of June 11, 2001 were \$132,652, \$132,109 and \$104,050 for Messrs. Thoben, Meyer and Ambrose, respectively. Because of the amount of these liabilities, Messrs. Thoben, Meyer and Ambrose were unable to make immediate payment without substantial disruption to their personal financial affairs. Accordingly, after considering the matter carefully, and having obtained the advice of counsel, Interlink's Board of Directors, with Mr. Thoben recusing himself from the decision, unanimously agreed to accept promissory notes from the individuals evidencing the debt. Among the factors considered by the Board in reaching this decision was the ongoing contribution to Interlink being made by each of the individuals and the interest of Interlink in avoiding unnecessary pressures and distractions on these individuals at a critical time in Interlink's history. Each promissory note bears interest at the rate of 7% per annum and is secured by Interlink options that had a value as of June 11, 2001 equal to 150% of the principal amount due under the note. As subsequently amended upon the approval of the Board of Directors in June 2002, the notes are due and payable in three equal annual installments beginning on June 11, 2006. As of December 31, 2004, the outstanding balance of principal and accrued and unpaid interest on the June 11, 2001 notes was \$77,864 and \$93,450 in the case of Messrs. Meyer and Ambrose, respectively. Mr. Thoben has paid the full amount of all principal and interest owing under his note.

## **ANNUAL REPORT**

We have included a copy of the Company's Annual Report on Form 10-K with these proxy materials.

### **CODE OF BUSINESS CONDUCT AND ETHICS**

The Interlink Electronics, Inc. Code of Business Conduct and Ethics for Directors, Officers and Employees is available at the Company's website (<http://www.interlinkelectronics.com>) and will be provided in print without charge to any stockholder who submits a request in writing to: Interlink Electronics, Inc., 546 Flynn Road, Camarillo, California 93012, Attention: Corporate Secretary. The Code applies to the Company's chief executive officer and chief financial officer, and to all other Company directors, officers and employees. The Code provides that any waiver of the Code may be made only by the Board.

### **METHOD AND COST OF SOLICITATION**

The Company will pay the cost of preparing and mailing the proxies, the proxy statements and any other materials furnished to the stockholders. In addition to soliciting by mail, the Company's directors, officers and employees, without additional compensation, may personally request, in person or by telephone, the return of proxies. Brokers and persons holding shares for the benefit of others may incur expenses in forwarding proxies and accompanying materials and in obtaining permission from beneficial owners of stock to execute proxies. On request, we will reimburse those expenses.

### **COMMUNICATION WITH THE BOARD OF DIRECTORS**

Stockholders may communicate directly with the full Board of Directors, the Chairman of the Board of Directors, the non-management Directors as a group, or with specified individual Directors by sending their question or concern to: Interlink Electronics, Inc., 546 Flynn Road, Camarillo, California 93012, Attention: Corporate Secretary. The Corporate Secretary will compile the communications, summarize lengthy or repetitive communications and then distribute communications to any or all Directors as appropriate depending upon the individual communications. The Directors have requested that communications that do not directly relate to their duties and responsibilities as directors of the Company be excluded from distribution, including spam; advertisements; mass mailings; form letter campaigns that involve unduly large number of similar communications; solicitations for goods, services, employment or contributions; surveys; and individual product inquiries or complaints.

### **OTHER BUSINESS/DISCRETIONARY AUTHORITY**

The Board of Directors does not know of any other matters that will be presented for action at the meeting. However, if any other matter properly comes before the meeting, the persons named in the accompanying form of proxy intend to vote in accordance with the recommendations of the Board of Directors.

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For this year's Annual Meeting of Stockholders, if notice of a stockholder proposal to be raised at the Annual Meeting was received at the principal executive offices of the Company after March 28, 2005, proxy voting on that proposal when and if raised at the Annual Meeting will be subject to the discretionary voting authority of the designated proxy holders. If notice of any stockholder proposal to be raised at next year's Annual Meeting of Stockholders is received by the Company at its principal executive offices after March 20, 2006, then proxy voting on that proposal when and if raised at the 2006 Annual Meeting, will be subject to the discretionary voting authority of the designated proxy holders.

**STOCKHOLDER PROPOSALS**

Any stockholder proposals to be considered for inclusion in next year's proxy materials must be received by January 4, 2006 at the Company's principal executive offices. Stockholders' proposals should be sent to: Interlink Electronics, Inc., 546 Flynn Road, Camarillo, California 93012, Attention: Corporate Secretary.

Whether you plan to attend the meeting or not, please sign the enclosed proxy form and return it to us in the enclosed stamped, return envelope.

*By Order of the Board of Directors*

Paul D. Meyer  
*Secretary*

**INTERLINK ELECTRONICS, INC.**

**1996 STOCK INCENTIVE PLAN, AS AMENDED\***

1. **Purpose.** The purpose of this Stock Incentive Plan (the *Plan*) is to enable Interlink Electronics, Inc. (the *Company*) to attract and retain the services of (1) selected employees, officers and directors of the Company or of any subsidiary of the Company and (2) selected nonemployee agents, consultants, advisors, persons involved in the sale or distribution of the Company's products and independent contractors of the Company or any subsidiary.

2. **Shares Subject to the Plan.** Subject to adjustment as provided below and in paragraph 13, the shares to be offered under the Plan shall consist of Common Stock of the Company, and the total number of shares of Common Stock that may be issued under the Plan shall not exceed [6,500,000] 7,250,000 shares. The shares issued under the Plan may be authorized and unissued shares or reacquired shares. If an option, stock appreciation right or performance unit granted under the Plan expires, terminates or is canceled, the unissued shares subject to such option, stock appreciation right or performance unit shall again be available under the Plan. If shares sold or awarded as a bonus under the Plan are forfeited to the Company or repurchased by the Company, the number of shares forfeited or repurchased shall again be available under the Plan.

3. **Effective Date and Duration of Plan.**

(a) **Effective Date.** The Plan shall become effective as of April 30, 1996. No option, stock appreciation right or performance unit granted under the Plan to an officer who is subject to Section 16(b) of the Securities Exchange Act of 1934, as amended (an *Officer*), or a director, and no incentive stock option, shall become exercisable, however, until the Plan is approved by the affirmative vote of the holders of a majority of the shares of Common Stock represented at a shareholders meeting at which a quorum is present and any such awards under the Plan prior to such approval shall be conditioned on and subject to such approval. Subject to this limitation, options, stock appreciation rights and performance units may be granted and shares may be awarded as bonuses or sold under the Plan at any time after the effective date and before termination of the Plan.

(b) **Duration.** The Plan shall continue in effect until all shares available for issuance under the Plan have been issued and all restrictions on such shares have lapsed. The Board of Directors may suspend or terminate the Plan at any time except with respect to options, performance units and shares subject to restrictions then outstanding under the Plan. Termination shall not affect any outstanding options, any right of the Company to repurchase shares or the forfeitability of shares issued under the Plan.

4. **Administration.**

(a) **Board of Directors.** The Plan shall be administered by the Board of Directors of the Company, which shall determine and designate from time to time the individuals to whom awards shall be made, the amount of the awards and the other terms and conditions of the awards. Subject to the provisions of the Plan, the Board of Directors may from time to time adopt and amend rules and regulations relating to administration of the Plan, advance the lapse of any waiting period, accelerate any exercise date, waive or modify any restriction applicable to shares (except those restrictions imposed by law) and make all other determinations in the judgment of the Board of Directors necessary or desirable for the administration of the Plan. The interpretation and construction of the provisions of the Plan and related agreements by the Board of Directors shall be final and conclusive. The Board of Directors may correct any defect or supply any omission or reconcile any inconsistency in the Plan

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or in any related agreement in the manner and to the extent it shall deem expedient to carry the Plan into effect, and it shall be the sole and final judge of such expediency.

(b) ***Committee***. The Board of Directors may delegate to a committee of the Board of Directors or specified officers of the Company, or both (the Committee ), any or all authority for administration of the Plan. If

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\* Matter in bold and underline is new; matter in brackets and italics is to be deleted.

authority is delegated to a Committee, all references to the Board of Directors in the Plan shall mean and relate to the Committee except (i) as otherwise provided by the Board of Directors and (ii) that only the Board of Directors may amend or terminate the Plan as provided in paragraphs 3 and 14.

**5. Types of Awards; Eligibility.** The Board of Directors may, from time to time, take the following actions, separately or in combination, under the Plan: (i) grant Incentive Stock Options, as defined in Section 422 of the Internal Revenue Code of 1986, as amended (the Code), as provided in paragraphs 6(a) and 6(b); (ii) grant options other than Incentive Stock Options ( Non-Statutory Stock Options ) as provided in paragraphs 6(a) and 6(c); (iii) award stock bonuses as provided in paragraph 7; (iv) sell shares subject to restrictions as provided in paragraph 8; (v) grant stock appreciation rights as provided in paragraph 9; (vi) grant cash bonus rights as provided in paragraph 10; (vii) grant performance units as provided in paragraph 11 and (viii) grant foreign qualified awards as provided in paragraph 12. Any such awards may be made to employees, including employees who are officers or directors, and to other individuals described in paragraph 1 who the Board of Directors believes have made or will make an important contribution to the Company or any subsidiary of the Company; provided, however, that only employees of the Company or any subsidiary of the Company shall be eligible to receive Incentive Stock Options under the Plan. The Board of Directors shall select the individuals to whom awards shall be made and shall specify the action taken with respect to each individual to whom an award is made. At the discretion of the Board of Directors, an individual may be given an election to surrender an award in exchange for the grant of a new award. No employee may be granted options or stock appreciation rights under the Plan for more than an aggregate of 300,000 shares of Common Stock in connection with the hiring of the employee or 300,000 shares of Common Stock in any calendar year otherwise.

## 6. Option Grants.

### (a) *General Rules Relating to Options.*

(i) *Terms of Grant.* The Board of Directors may grant options under the Plan. With respect to each option grant, the Board of Directors shall determine the number of shares subject to the option, the option price, the period of the option, the time or times at which the option may be exercised and whether the option is an Incentive Stock Option or a Non-Statutory Stock Option. At the time of the grant of an option or at any time thereafter, the Board of Directors may provide that an optionee who exercised an option with Common Stock of the Company shall automatically receive a new option to purchase additional shares equal to the number of shares surrendered and may specify the terms and conditions of such new options.

(ii) *Exercise of Options.* Except as provided in paragraph 6(a)(iv) or as determined by the Board of Directors, no option granted under the Plan may be exercised unless at the time of such exercise the optionee is employed by or in the service of the Company or any subsidiary of the Company and shall have been so employed or provided such service continuously since the date such option was granted. Absence on leave or on account of illness or disability under rules established by the Board of Directors shall not, however, be deemed an interruption of employment or service for this purpose. Unless otherwise determined by the Board of Directors, vesting of options shall not continue during an absence on leave (including an extended illness) or on account of disability. Except as provided in paragraphs 6(a)(iv) and 13, options granted under the Plan may be exercised from time to time over the period stated in each option in such amounts and at such times as shall be prescribed by the Board of Directors, provided that options shall not be exercised for fractional shares. Unless otherwise determined by the Board of Directors, if the optionee does not exercise an option in any one year with respect to the full number of shares to which the optionee is entitled in that year, the optionee's rights shall be cumulative and the optionee may purchase those shares in any subsequent year during the term of the option.

(iii) *Nontransferability.* Each Incentive Stock Option and, unless otherwise determined by the Board of Directors, each other option granted under the Plan by its terms shall be nonassignable and nontransferable by the optionee, either voluntarily or by operation of law, except by will or by the laws of descent and distribution of the state or country of the optionee's domicile at the time of death.





*(iv) Termination of Employment or Service.*

*(A) General Rule.* Unless otherwise determined by the Board of Directors, in the event the employment or service of the optionee with the Company or a subsidiary terminates for any reason other than because of physical disability or death as provided in subparagraphs 6(a)(iv)(B) and (C), the option may be exercised at any time prior to the expiration date of the option or the expiration of 30 days after the date of such termination, whichever is the shorter period, but only if and to the extent the optionee was entitled to exercise the option at the date of such termination.

*(B) Termination Because of Total Disability.* Unless otherwise determined by the Board of Directors, in the event of the termination of employment or service because of total disability, the option may be exercised at any time prior to the expiration date of the option or the expiration of 12 months after the date of such termination, whichever is the shorter period, but only if and to the extent the optionee was entitled to exercise the option at the date of such termination. The term *total disability* means a medically determinable mental or physical impairment which is expected to result in death or which has lasted or is expected to last for a continuous period of 12 months or more and which causes the optionee to be unable, in the opinion of the Company and two independent physicians, to perform his or her duties as an employee, director, officer or consultant of the Company and to be engaged in any substantial gainful activity. Total disability shall be deemed to have occurred on the first day after the Company and the two independent physicians have furnished their opinion of total disability to the Company.

*(C) Termination Because of Death.* Unless otherwise determined by the Board of Directors, in the event of the death of an optionee while employed by or providing service to the Company or a subsidiary, the option may be exercised at any time prior to the expiration date of the option or the expiration of 12 months after the date of death, whichever is the shorter period, but only if and to the extent the optionee was entitled to exercise the option at the date of death and only by the person or persons to whom such optionee's rights under the option shall pass by the optionee's will or by the laws of descent and distribution of the state or country of domicile at the time of death.

*(D) Amendment of Exercise Period Applicable to Termination.* The Board of Directors, at the time of grant or, with respect to an option that is not an Incentive Stock Option, at any time thereafter, may extend the 30-day and 12-month exercise periods any length of time not longer than the original expiration date of the option, and may increase the portion of an option that is exercisable, subject to such terms and conditions as the Board of Directors may determine.

*(E) Failure to Exercise Option.* To the extent that the option of any deceased optionee or of any optionee whose employment or service terminates is not exercised within the applicable period, all further rights to purchase shares pursuant to such option shall cease and terminate.

*(v) Purchase of Shares.* Unless the Board of Directors determines otherwise, shares may be acquired pursuant to an option granted under the Plan only upon receipt by the Company of notice in writing from the optionee of the optionee's intention to exercise, specifying the number of shares as to which the optionee desires to exercise the option and the date on which the optionee desires to complete the transaction, and if required in order to comply with the Securities Act of 1933, as amended, containing a representation that it is the optionee's present intention to acquire the shares for investment and not with a view to distribution. Unless the Board of Directors determines otherwise, on or before the date specified for completion of the purchase of shares pursuant to an option, the optionee must have paid the Company the full purchase price of such shares in cash (including, with the consent of the Board of Directors, cash that may be the proceeds of a loan from the Company (provided that, with respect to an Incentive Stock Option, such loan is approved at the time of option grant)) or, with the consent of the Board of Directors, in whole or in part, in Common Stock of the Company valued at fair market value, restricted stock, performance units or other contingent awards denominated in either stock or cash, promissory notes and other forms of consideration. The fair market value of Common Stock provided in payment of the purchase price shall be determined by the Board of Directors. If the Common Stock of the Company is not publicly traded on the date the option is exercised,



the Board of Directors may consider any valuation methods it deems appropriate and may, but is not required to, obtain one or more independent appraisals of the Company. If the Common Stock of the Company is publicly traded on the date the option is exercised, the fair market value of Common Stock provided in payment of the purchase price shall be the closing price of the Common Stock as reported in *The Wall Street Journal* on the last trading day preceding the date the option is exercised, or such other reported value of the Common Stock as shall be specified by the Board of Directors. No shares shall be issued until full payment for the shares has been made. With the consent of the Board of Directors (which, in the case of an Incentive Stock Option, shall be given only at the time of option grant), an optionee may request the Company to apply automatically the shares to be received upon the exercise of a portion of a stock option (even though stock certificates have not yet been issued) to satisfy the purchase price for additional portions of the option. Each optionee who has exercised an option shall immediately upon notification of the amount due, if any, pay to the Company in cash amounts necessary to satisfy any applicable federal, state and local tax withholding requirements. If additional withholding is or becomes required beyond any amount deposited before delivery of the certificates, the optionee shall pay such amount to the Company on demand. If the optionee fails to pay the amount demanded, the Company may withhold that amount from other amounts payable by the Company to the optionee, including salary, subject to applicable law. With the consent of the Board of Directors an optionee may satisfy this obligation, in whole or in part, by having the Company withhold from the shares to be issued upon the exercise that number of shares that would satisfy the withholding amount due or by delivering to the Company Common Stock to satisfy the withholding amount. Upon the exercise of an option, the number of shares reserved for issuance under the Plan shall be reduced by the number of shares issued upon exercise of the option.

(b) **Incentive Stock Options.** Incentive Stock Options shall be subject to the following additional terms and conditions:

(i) **Limitation on Amount of Grants.** No employee may be granted Incentive Stock Options under the Plan if the aggregate fair market value, on the date of grant, of the Common Stock with respect to which Incentive Stock Options are exercisable for the first time by that employee during any calendar year under the Plan and under all incentive stock option plans (within the meaning of Section 422 of the Code) of the Company or any parent or subsidiary of the Company exceeds \$100,000.

(ii) **Limitations on Grants to 10 Percent Shareholders.** An Incentive Stock Option may be granted under the Plan to an employee possessing more than 10 percent of the total combined voting power of all classes of stock of the Company or of any parent or subsidiary of the Company only if the option price is at least 110 percent of the fair market value, as described in paragraph 6(b)(iv), of the Common Stock subject to the option on the date it is granted and the option by its terms is not exercisable after the expiration of five years from the date it is granted.

(iii) **Duration of Options.** Subject to paragraphs 6(a)(ii) and 6(b)(ii), Incentive Stock Options granted under the Plan shall continue in effect for the period fixed by the Board of Directors, except that no Incentive Stock Option shall be exercisable after the expiration of 10 years from the date it is granted.

(iv) **Option Price.** The option price per share shall be determined by the Board of Directors at the time of grant. Except as provided in paragraph 6(b)(ii), the option price shall not be less than 100 percent of the fair market value of the Common Stock covered by the Incentive Stock Option at the date the option is granted. The fair market value shall be determined by the Board of Directors. If the Common Stock of the Company is not publicly traded on the date the option is granted, the Board of Directors may consider any valuation methods it deems appropriate and may, but is not required to, obtain one or more independent appraisals of the Company. If the Common Stock of the Company is publicly traded on the date the option is granted, the fair market value shall be deemed to be the closing price of the Common Stock as reported in *The Wall Street Journal* on the day preceding the date the option is granted, or, if there has been no sale on that date, on the last preceding date on which a sale occurred or such other value of the Common Stock as shall be specified by the Board of Directors.

(v) *Limitation on Time of Grant.* No Incentive Stock Option shall be granted on or after the tenth anniversary of the last action by the Board of Directors approving an increase in the number of shares available for issuance under the Plan, which action was subsequently approved within 12 months by the Stockholders.

(vi) *Conversion of Incentive Stock Options.* The Board of Directors may at any time without the consent of the optionee convert an Incentive Stock Option to a Non-Statutory Stock Option.

(c) *Non-Statutory Stock Options.* Non-Statutory Stock Options shall be subject to the following terms and conditions in addition to those set forth in Section 6(a) above:

(i) *Option Price.* The option price for Non-Statutory Stock Options shall be determined by the Board of Directors at the time of grant and may be any amount determined by the Board of Directors.

(ii) *Duration of Options.* Non-Statutory Stock Options granted under the Plan shall continue in effect for the period fixed by the Board of Directors.

**7. Stock Bonuses.** The Board of Directors may award shares under the Plan as stock bonuses. Shares awarded as a bonus shall be subject to the terms, conditions, and restrictions determined by the Board of Directors. The restrictions may include restrictions concerning transferability and forfeiture of the shares awarded, together with such other restrictions as may be determined by the Board of Directors. The Board of Directors may require the recipient to sign an agreement as a condition of the award, but may not require the recipient to pay any monetary consideration other than amounts necessary to satisfy tax withholding requirements. The agreement may contain any terms, conditions, restrictions, representations and warranties required by the Board of Directors. The certificates representing the shares awarded shall bear any legends required by the Board of Directors. The Company may require any recipient of a stock bonus to pay to the Company in cash upon demand amounts necessary to satisfy any applicable federal, state or local tax withholding requirements. If the recipient fails to pay the amount demanded, the Company may withhold that amount from other amounts payable by the Company to the recipient, including salary or fees for services, subject to applicable law. With the consent of the Board of Directors, a recipient may deliver Common Stock to the Company to satisfy this withholding obligation. Upon the issuance of a stock bonus, the number of shares reserved for issuance under the Plan shall be reduced by the number of shares issued.

**8. Restricted Stock.** The Board of Directors may issue shares under the Plan for such consideration (including promissory notes and services) as determined by the Board of Directors. Shares issued under the Plan shall be subject to the terms, conditions and restrictions determined by the Board of Directors. The restrictions may include restrictions concerning transferability, repurchase by the Company and forfeiture of the shares issued, together with such other restrictions as may be determined by the Board of Directors. All Common Stock issued pursuant to this paragraph 8 shall be subject to a purchase agreement, which shall be executed by the Company and the prospective recipient of the shares prior to the delivery of certificates representing such shares to the recipient. The purchase agreement may contain any terms, conditions, restrictions, representations and warranties required by the Board of Directors. The certificates representing the shares shall bear any legends required by the Board of Directors. The Company may require any purchaser of restricted stock to pay to the Company in cash upon demand amounts necessary to satisfy any applicable federal, state or local tax withholding requirements. If the purchaser fails to pay the amount demanded, the Company may withhold that amount from other amounts payable by the Company to the purchaser, including salary, subject to applicable law. With the consent of the Board of Directors, a purchaser may deliver Common Stock to the Company to satisfy this withholding obligation. Upon the issuance of restricted stock, the number of shares reserved for issuance under the Plan shall be reduced by the number of shares issued.

**9. Stock Appreciation Rights.**

(a) **Grant.** Stock appreciation rights may be granted under the Plan by the Board of Directors, subject to such rules, terms, and conditions as the Board of Directors prescribes.

A-5

(b) *Exercise.*

(i) Each stock appreciation right shall entitle the holder, upon exercise, to receive from the Company in exchange therefor an amount equal in value to the excess of the fair market value on the date of exercise of one share of Common Stock of the Company over its fair market value on the date of grant (or, in the case of a stock appreciation right granted in connection with an option, the excess of the fair market value of one share of Common Stock of the Company over the option price per share under the option to which the stock appreciation right relates), multiplied by the number of shares covered by the stock appreciation right or the option, or portion thereof, that is surrendered. Payment by the Company upon exercise of a stock appreciation right may be made in Common Stock valued at fair market value, in cash, or partly in Common Stock and partly in cash, all as determined by the Board of Directors.

(ii) A stock appreciation right shall be exercisable only at the time or times established by the Board of Directors. If a stock appreciation right is granted in connection with an option, the following rules shall apply: (1) the stock appreciation right shall be exercisable only to the extent and on the same conditions that the related option could be exercised; (2) the stock appreciation rights shall be exercisable only when the fair market value of the stock exceeds the option price of the related option; (3) the stock appreciation right shall be for no more than 100 percent of the excess of the fair market value of the stock at the time of exercise over the option price; (4) upon exercise of the stock appreciation right, the option or portion thereof to which the stock appreciation right relates terminates; and (5) upon exercise of the option, the related stock appreciation right or portion thereof terminates.

(iii) The Board of Directors may withdraw any stock appreciation right granted under the Plan at any time and may impose any conditions upon the exercise of a stock appreciation right or adopt rules and regulations from time to time affecting the rights of holders of stock appreciation rights. Such rules and regulations may govern the right to exercise stock appreciation rights granted prior to adoption or amendment of such rules and regulations as well as stock appreciation rights granted thereafter.

(iv) For purposes of this paragraph 9, the fair market value of the Common Stock shall be determined as of the date the stock appreciation right is exercised, under the methods set forth in paragraph 6(b)(iv).

(v) No fractional shares shall be issued upon exercise of a stock appreciation right. In lieu thereof, cash may be paid in an amount equal to the value of the fraction or, if the Board of Directors shall determine, the number of shares may be rounded downward to the next whole share.

(vi) Each stock appreciation right granted in connection with an Incentive Stock Option, and unless otherwise determined by the Board of Directors, each other stock appreciation right granted under the Plan by its terms shall be nonassignable and nontransferable by the holder, either voluntarily or by operation of law, except by will or by the laws of descent and distribution of the state or country of the holder's domicile at the time of death, and each stock appreciation right by its terms shall be exercisable during the holder's lifetime only by the holder.

(vii) Each participant who has exercised a stock appreciation right shall, upon notification of the amount due, pay to the Company in cash amounts necessary to satisfy any applicable federal, state and local tax withholding requirements. If the participant fails to pay the amount demanded, the Company may withhold that amount from other amounts payable by the Company to the participant including salary, subject to applicable law. With the consent of the Board of Directors a participant may satisfy this obligation, in whole or in part, by having the Company withhold from any shares to be issued upon the exercise that number of shares that would satisfy the withholding amount due or by delivering Common Stock to the Company to satisfy the withholding amount.

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(viii) Upon the exercise of a stock appreciation right for shares, the number of shares reserved for issuance under the Plan shall be reduced by the number of shares issued. Cash payments of stock appreciation rights shall not reduce the number of shares of Common Stock reserved for issuance under the Plan.

A-6



**10. Cash Bonus Rights.**

(a) **Grant.** The Board of Directors may grant cash bonus rights under the Plan in connection with (i) options granted or previously granted, (ii) stock appreciation rights granted or previously granted, (iii) stock bonuses awarded or previously awarded and (iv) shares sold of previously sold under the Plan. Cash bonus rights will be subject to rules, terms and conditions as the Board of Directors may prescribe. Unless otherwise determined by the Board of Directors, each cash bonus right granted under the Plan by its terms shall be nonassignable and nontransferable by the holder, either voluntarily or by operation of law, except by will or by the laws of descent and distribution of the state or country of the holder's domicile at the time of death. The payment of a cash bonus shall not reduce the number of shares of Common Stock reserved for issuance under the Plan.

(b) **Cash Bonus Rights in Connection With Options.** A cash bonus right granted in connection with an option will entitle an optionee to a cash bonus when the related option is exercised (or terminates in connection with the exercise of a stock appreciation right related to the option in whole or in part if, in the sole discretion of the Board of Directors, the bonus right will result in a tax deduction that the Company has sufficient taxable income to use. If an optionee purchases shares upon exercise of an option and does not exercise a related stock appreciation right, the amount of the bonus, if any, shall be determined by multiplying the excess of the total fair market value of the shares to be acquired upon the exercise over the total option price for the shares by the applicable bonus percentage. If the optionee exercises a related stock appreciation right in connection with the termination of an option, the amount of the bonus, if any, shall be determined by multiplying the total fair market value of the shares and cash received pursuant to the exercise of the stock appreciation right by the applicable bonus percentage. The bonus percentage applicable to a bonus right, including a previously granted bonus right, may be changed from time to time at the sole discretion of the Board of Directors but shall in no event exceed 75 percent.

(c) **Cash Bonus Rights in Connection With Stock Bonus.** A cash bonus right granted in connection with a stock bonus will entitle the recipient to a cash bonus payable when the stock bonus is awarded or restrictions, if any, to which the stock is subject lapse. If bonus stock awarded is subject to restrictions and is repurchased by the Company or forfeited by the holder, the cash bonus right granted in connection with the stock bonus shall terminate and may not be exercised. The amount and timing of payment of a cash bonus shall be determined by the Board of Directors.

(d) **Cash Bonus Rights in Connection With Stock Purchases.** A cash bonus right granted in connection with the purchase of stock pursuant to paragraph 8 will entitle the recipient to a cash bonus when the shares are purchased or restrictions, if any, to which the stock is subject lapse. Any cash bonus right granted in connection with shares purchased pursuant to paragraph 8 shall terminate and may not be exercised in the event the shares are repurchased by the Company or forfeited by the holder pursuant to applicable restrictions. The amount of any cash bonus to be awarded and timing of payment of a cash bonus shall be determined by the Board of Directors.

(e) **Taxes.** The Company shall withhold from any cash bonus paid pursuant to paragraph 10 the amount necessary to satisfy any applicable federal, state and local withholding requirements.

**11. Performance Units.** The Board of Directors may grant performance units consisting of monetary units which may be earned in whole or in part if the Company achieves certain goals established by the Board of Directors over a designated period of time, but not in any event more than 10 years. The goals established by the Board of Directors may include earnings per share, return on shareholders' equity, return on invested capital, and such other goals as may be established by the Board of Directors. In the event that the minimum performance goal established by the Board of Directors is not achieved at the conclusion of a period, no payment shall be made to the participants. In the event the maximum corporate goal is achieved, 100 percent of the monetary value of the performance units shall be paid to or vested in the participants. Partial achievement of the maximum goal may result in a payment or vesting corresponding to the degree of achievement as determined by the Board of Directors. Payment of an award earned may be in cash or in Common Stock or in a combination of both, and may



be made when earned, or vested and deferred, as the Board of Directors determines. Deferred awards shall earn interest on the terms and at a rate determined by the Board of Directors. Unless otherwise determined by the Board of Directors, each performance unit granted under the Plan by its terms shall be nonassignable and nontransferable by the holder, either voluntarily or by operation of law, except by will or by the laws of descent and distribution of the state or country of the holder's domicile at the time of death. Each participant who has been awarded a performance unit shall, upon notification of the amount due, pay to the Company in cash amounts necessary to satisfy any applicable federal, state and local tax withholding requirements. If the participant fails to pay the amount demanded, the Company may withhold that amount from other amounts payable by the Company to the participant, including salary or fees for services, subject to applicable law. With the consent of the Board of Directors a participant may satisfy this obligation, in whole or in part, by having the Company withhold from any shares to be issued that number of shares that would satisfy the withholding amount due or by delivering Common Stock to the Company to satisfy the withholding amount. The payment of a performance unit in cash shall not reduce the number of shares of Common Stock reserved for issuance under the Plan. The number of shares reserved for issuance under the Plan shall be reduced by the number of shares issued upon payment of an award.

**12. Foreign Qualified Grants.** Awards under the Plan may be granted to such officers and employees of the Company and its subsidiaries and such other persons described in paragraph 1 residing in foreign jurisdictions as the Board of Directors may determine from time to time. The Board of Directors may adopt such supplements to the Plan as may be necessary to comply with the applicable laws of such foreign jurisdictions and to afford participants favorable treatment under such laws; provided, however, that no award shall be granted under any such supplement with terms which are more beneficial to the participants than the terms permitted by the Plan.

**13. Changes in Capital Structure.**

(a) **Stock Splits; Stock Dividends.** If the outstanding Common Stock of the Company is hereafter increased or decreased or changed into or exchanged for a different number or kind of shares or other securities of the Company by reason of any stock split, combination of shares or dividend payable in shares, recapitalization or reclassification, appropriate adjustment shall be made by the Board of Directors in the number and kind of shares available for grants under the Plan and in all other share amounts set forth in the Plan. In addition, the Board of Directors shall make appropriate adjustment in the number and kind of shares as to which outstanding options, or portions thereof then unexercised, shall be exercisable, so that the optionee's proportionate interest before and after the occurrence of the event is maintained. Notwithstanding the foregoing, the Board of Directors shall have no obligation to effect any adjustment that would or might result in the issuance of fractional shares, and any fractional shares resulting from any adjustment may be disregarded or provided for in any manner determined by the Board of Directors. Any such adjustments made by the Board of Directors shall be conclusive.

(b) **Mergers, Reorganizations, Etc.** In the event of a merger, consolidation, plan of exchange, acquisition of property or stock, spin-off, split-off, reorganization or liquidation to which the Company or a subsidiary is a party or a sale of all or substantially all of the Company's assets (each, a Transaction), the Board of Directors shall, in its sole discretion and to the extent possible under the structure of the Transaction, select one of the following alternatives for treating outstanding options under the Plan:

(i) Outstanding options shall remain in effect in accordance with their terms.

(ii) Outstanding options shall be converted into options to purchase stock in one or more corporations, including the Company, that are surviving or acquiring corporations in the Transaction. The amount, type of securities subject thereto and exercise price of the converted options shall be determined by the Board of Directors of the Company, taking into account the relative values of the companies involved in the Transaction and the exchange rate, if any, used in determining shares of the surviving corporation to be held by holders of shares of the Company following the transaction. Unless otherwise determined by the Board of Directors, the converted options shall be vested only to the extent that the vesting requirements relating to options granted hereunder have been satisfied.



(iii) The Board of Directors shall provide a 30-day period prior to the consummation of the Transaction during which outstanding options may be exercised to the extent then exercisable, and upon the expiration of such 30-day period, all unexercised options shall immediately terminate. The Board of Directors may, in its sole discretion, accelerate the exercisability of options so that they are exercisable in full during such 30-day period.

(c) **Dissolution of the Company.** In the event of the dissolution of the Company, options shall be treated in accordance with paragraph 13(b)(iii).

(d) **Rights Issued by Another Corporation.** The Board of Directors may also grant options, stock appreciation rights, performance units, stock bonuses and cash bonuses and issue restricted stock under the Plan having terms, conditions and provisions that vary from those specified in this Plan provided that any such awards are granted in substitution for, or in connection with the assumption of existing options, stock appreciation rights, stock bonuses, cash bonuses, restricted stock and performance units granted, awarded or issued by another corporation and assumed or otherwise agreed to be provided for by the Company pursuant to or by reason of a Transaction.

**14. Amendment of Plan.** The Board of Directors may at any time, and from time to time, modify or amend the Plan in such respects as it shall deem advisable because of changes in the law while the Plan is in effect or for any other reason. Except as provided in paragraphs 6(a)(iv), 9, 10 and 13, however, no change in an award already granted shall be made without the written consent of the holder of such award.

**15. Approvals.** The obligations of the Company under the Plan are subject to the approval of state and federal authorities or agencies with jurisdiction in the matter. The Company will use its best efforts to take steps required by state or federal law or applicable regulations, including rules and regulations of the Securities and Exchange Commission and any stock exchange on which the Company's shares may then be listed, in connection with the grants under the Plan. The foregoing notwithstanding, the Company shall not be obligated to issue or deliver Common Stock under the Plan if such issuance or delivery would violate applicable state or federal securities laws.

**16. Employment and Service Rights.** Nothing in the Plan or any award pursuant to the Plan shall (i) confer upon any employee any right to be continued in the employment of the Company or any subsidiary or interfere in any way with the right of the Company or any subsidiary by whom such employee is employed to terminate such employee's employment at any time, for any reason, with or without cause, or to decrease such employee's compensation or benefits, or (ii) confer upon any person engaged by the Company any right to be retained or employed by the Company or to the continuation, extension, renewal, or modification of any compensation, contract, or arrangement with or by the Company.

**17. Rights as a Shareholder.** The recipient of any award under the Plan shall have no rights as a shareholder with respect to any Common Stock until the date of issue to the recipient of a stock certificate for such shares. Except as otherwise expressly provided in the Plan, no adjustment shall be made for dividends or other rights for which the record date occurs prior to the date such stock certificate is issued.

**18. Option Grants to Non-Employee Directors.**

(a) **Initial Board Grants.** Each person who becomes a Non-Employee Director after the Plan is adopted shall be automatically granted an option to purchase 30,000 shares of Common Stock on the date he or she becomes a Non-Employee Director. A Non-Employee Director is a director who is not an employee of the Company or any of its subsidiaries.

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(b) *Additional Grants.* Each Non-Employee Director shall be automatically granted an option to purchase additional shares of Common Stock in each calendar year subsequent to the year in which such Non-Employee Director was granted an option pursuant to paragraph 18(a), such option to be granted as of the date of the

A-9

Company's annual meeting of shareholders held in such calendar year, provided that the Non-Employee Director continues to serve in such capacity as of such date. The number of shares subject to each additional grant shall be 7,500 shares for each Non-Employee Director.

(c) *Exercise Price.* The exercise price of all options granted pursuant to this paragraph 18 shall be equal to 100 percent of the fair market value of the Common Stock determined pursuant to paragraph 6(b)(iv).

(d) *Term of Option.* The term of each option granted pursuant to this paragraph 18 shall be 10 years from the date of grant.

(e) *Exercisability.* Until an option expires or is terminated and except as provided in paragraphs 18(f) and 13, an option granted under this paragraph 18 shall be exercisable according to the following schedule:  $33\frac{1}{3}\%$  for each complete year of continuous service after the date of grant, rounded up to the next full share, until fully vested. For purposes of this paragraph 18(e), a complete year shall be deemed to be the period which starts on the day of grant and ends on the same day of the following calendar year, so that each successive complete year ends on the same day of each successive calendar year.

(f) *Termination As a Director.* If an optionee ceases to be a director of the Company for any reason, including death, the option may be exercised at any time prior to the expiration date of the option or the expiration of 30 days (or 12 months in the event of death) after the last day the optionee served as a director, whichever is the shorter period, but only if and to the extent the optionee was entitled to exercise the option as of the last day the optionee served as a director.

(g) *Nontransferability.* Except as otherwise determined by the Board of Directors, each option by its terms shall be nonassignable and nontransferable by the optionee, either voluntarily or by operation of law, except by will or by the laws of descent and distribution of the state or country of the optionee's domicile at the time of death, and each option by its terms shall be exercisable during the optionee's lifetime only by the optionee.

(h) *Exercise of Options.* Options may be exercised upon payment of either cash or shares of Common Stock of the Company previously acquired by the optionee and held for at least six months, and otherwise in accordance with paragraph 6(a)(v).

Adopted: April 30, 1996

Amended: May 25, 1999

Amended: June 27, 2000

Amended by the Board of Directors: February 13, 2001

Amended: December 20, 2001

Amended: June 22, 2004

**Amended: June 8, 2005**







The shares represented by this proxy will be voted as specified on the reverse hereof, **but if no specification is made, this proxy will be voted for the election of the directors and for the Proposal to amend the 1996 Stock Incentive Plan. The proxies may vote in their discretion as to other matters that may come before this meeting.**

**P** Shares: \_\_\_\_\_  
**R** Date: \_\_\_\_\_, 2005  
**O** Name: \_\_\_\_\_  
**X** Signature(s): \_\_\_\_\_  
**Y** Signature or Signatures \_\_\_\_\_

Please date and sign as name is imprinted hereon, including designation as executor, trustee, etc., if applicable. A corporation must sign its name by the president or other authorized officer.

The Annual Meeting of Stockholders of Interlink Electronics, Inc. will be held on June 8, 2005 at 11:00 a.m., Pacific Daylight Time, at the Hampton Inn & Suites located at 50 West Daily Drive, Camarillo, California 93010.

*Please Note: Any shares of stock of the Company held in the name of fiduciaries, custodians or brokerage houses for the benefit of their clients may only be voted by the fiduciary, custodian or brokerage house itself the beneficial owner may not directly vote or appoint a proxy to vote the shares and must instruct the person or entity in whose name the shares are held how to vote the shares held for the beneficial owner. Therefore, if any shares of stock of the Company are held in street name by a brokerage house, only the brokerage house, at the instructions of its client, may vote or appoint a proxy to vote the shares.*