

INTERLINK ELECTRONICS, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

AS OF SEPTEMBER 30, 2014 AND DECEMBER 31, 2013

AND FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2014 AND 2013

INTERLINK ELECTRONICS, INC. AND SUBSIDIARIES

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As of September 30, 2014 and December 31, 2013

And for the Three and Nine Months Ended September 30, 2014 and 2013

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INTERLINK ELECTRONICS, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED BALANCE SHEETS

(in thousands, except par value)

	September 30, 2014 (Unaudited)	December 31, 2013 (Audited)
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 1,720	\$ 1,487
Restricted cash	5	5
Accounts receivable.....	1,876	1,547
Inventories.....	981	670
Prepaid expenses and other current assets.....	136	263
Total current assets.....	4,718	3,972
Property and equipment, net.....	163	98
Intangibles, net.....	27	29
Other assets	58	49
Total assets	\$ 4,966	\$ 4,148
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued payables.....	\$ 434	\$ 312
Accrued payroll and other accrued liabilities	302	305
Deferred revenues—current	53	60
Total current liabilities	789	677
Deferred revenues—noncurrent.....	105	145
Total liabilities	894	822
Commitments and Contingencies		
Stockholders' equity:		
Preferred stock, \$0.01 par value (1,000 shares authorized, none issued and outstanding as of September 30, 2014 and December 31, 2013, respectively)	-	-
Common stock, \$0.001 par value (15,000 shares authorized, 2,929 and 2,924 shares issued and outstanding as of September 30, 2014 and December 31, 2013, respectively) ⁽¹⁾	3	1
Additional paid-in capital.....	60,158	60,186
Accumulated other comprehensive income.....	28	26
Accumulated deficit.....	(56,117)	(56,887)
Total stockholders' equity.....	4,072	3,326
Total liabilities and stockholders' equity	\$ 4,966	\$ 4,148

⁽¹⁾ Issued and outstanding share amounts reflect the four-for-one stock split effected on May 29, 2014.

See accompanying notes to the unaudited consolidated financial statements.

INTERLINK ELECTRONICS, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenues, net.....	\$ 2,928	\$ 1,802	\$ 7,321	\$ 5,538
Cost of revenues.....	<u>1,476</u>	<u>1,153</u>	<u>3,830</u>	<u>3,107</u>
Gross profit.....	<u>1,452</u>	<u>649</u>	<u>3,491</u>	<u>2,431</u>
Operating expenses:				
Product development and research	242	194	650	460
Selling, general and administrative	<u>740</u>	<u>558</u>	<u>2,094</u>	<u>2,014</u>
Total operating expenses	<u>982</u>	<u>752</u>	<u>2,744</u>	<u>2,474</u>
Operating income (loss)	<u>470</u>	<u>(103)</u>	<u>747</u>	<u>(43)</u>
Other income (expense):				
Interest income	1	1	2	3
Other income (expense), net.....	<u>(3)</u>	<u>(5)</u>	<u>(4)</u>	<u>(14)</u>
Other income (expense).....	<u>(2)</u>	<u>(4)</u>	<u>(2)</u>	<u>(11)</u>
Income (loss) from continuing operations before provision for income taxes.....	468	(107)	745	(54)
Provision for income taxes	<u>-</u>	<u>-</u>	<u>1</u>	<u>1</u>
Income (loss) from continuing operations, net of tax	468	(107)	744	(55)
Income from discontinued operations, net of tax.....	<u>9</u>	<u>9</u>	<u>26</u>	<u>26</u>
Net income (loss).....	477	(98)	770	(29)
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	<u>-</u>	<u>1</u>	<u>2</u>	<u>2</u>
Comprehensive income (loss)	<u>\$ 477</u>	<u>\$ (97)</u>	<u>\$ 772</u>	<u>\$ (27)</u>
Earnings (loss) per share from continuing operations, net of tax:				
Basic and diluted ⁽¹⁾	<u>\$ 0.16</u>	<u>\$ (0.04)</u>	<u>\$ 0.25</u>	<u>\$ (0.02)</u>
Earnings per share from discontinued operations, net of tax: basic and diluted ⁽¹⁾	<u>\$ 0.00</u>	<u>\$ 0.01</u>	<u>\$ 0.01</u>	<u>\$ 0.01</u>
Net earnings (loss) per share: basic and diluted ⁽¹⁾	<u>\$ 0.16</u>	<u>\$ (0.03)</u>	<u>\$ 0.26</u>	<u>\$ (0.01)</u>
Weighted-average shares used to calculate each of the per-share amounts above: basic and diluted ⁽¹⁾	<u>2,927</u>	<u>2,948</u>	<u>2,926</u>	<u>2,944</u>

(1) All per-share and weighted-average share amounts have been adjusted to retroactively reflect the four-for-one stock split effected on May 29, 2014.

See accompanying notes to the unaudited consolidated financial statements.

INTERLINK ELECTRONICS, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	<u>Nine Months Ended September 30,</u>	
	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Net income (loss)	\$ 770	\$ (29)
Income from discontinued operations, net of tax	<u>26</u>	<u>26</u>
Income (loss) from continuing operations, net of tax.....	744	(55)
Adjustments to reconcile net income to net cash generated (used) in operating activities:		
Decrease in allowance for doubtful accounts	-	(1)
Increase in reserves for excess and obsolete inventories	61	14
Depreciation and amortization	55	100
Issuance (forfeiture) of restricted stock	(42)	30
Changes in operating assets and liabilities		
Accounts receivable	(329)	(372)
Inventories	(372)	(145)
Prepaid expenses and other current assets	127	2
Other assets	(9)	(6)
Accounts payable and accrued payables	122	(2)
Accrued payroll and other accrued liabilities.....	(3)	31
Deferred revenue	<u>(47)</u>	<u>3</u>
Net cash generated (used) in operating activities—continuing operations....	307	(401)
Net cash provided by discontinued operations	<u>26</u>	<u>26</u>
Net cash generated (used) in operations	<u>333</u>	<u>(375)</u>
Cash flows from investing activities:		
Purchases of property and equipment	(106)	(61)
Costs of intangibles	<u>(12)</u>	<u>(6)</u>
Net cash used in investing activities.....	<u>(118)</u>	<u>(67)</u>
Cash flows from financing activities:		
Proceeds from exercise of stock options.....	<u>16</u>	-
Net cash used in financing activities.....	<u>16</u>	-
Effect of exchange rate changes on cash and cash equivalents.....	<u>2</u>	<u>2</u>
Increase (decrease) in cash and cash equivalents.....	233	(440)
Cash and cash equivalents, beginning of period	<u>1,487</u>	<u>2,102</u>
Cash and cash equivalents, end of period	<u>\$ 1,720</u>	<u>\$ 1,662</u>
Supplemental disclosures of cash flow information: income taxes paid	<u>\$ 1</u>	<u>\$ 1</u>

See accompanying notes to the unaudited consolidated financial statements.

INTERLINK ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

As of September 30, 2014 and December 31, 2013

And for the Three and Nine Months Ended September 30, 2014 and 2013

1. Basis of Presentation of Interim Data

Interlink Electronics, Inc. and its subsidiaries are engaged in the development, manufacturing and sale of intuitive sensor technology that incorporates proprietary technologies. Our proprietary sensor technology integrates Force Sensing Restive (“FSR”)-based sensors, subassemblies and modules that support cursor control and other input functions. Our FSR sensors are used in many applications, primarily in the electronic components and medical device markets.

The unaudited consolidated financial statements include our accounts and the accounts of our wholly-owned subsidiaries in Hong Kong, China, Singapore and United Kingdom (collectively “Interlink,” “we,” “us,” “our” or the “Company”). In the opinion of the Company’s management, the accompanying unaudited consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) considered necessary to present fairly the Company’s financial position as of September 30, 2014 and its results of operations for the three and nine months ended September 30, 2014. The results of operations for such periods are not necessarily indicative of results to be expected for the full fiscal year. All significant intercompany accounts and transactions have been eliminated.

On January 29, 2014, the Company established a wholly-owned subsidiary named Interlink Electronics Singapore Private Limited to serve as its Asia-Pacific regional research and development center. On January 31, 2014, the Company established a wholly-owned subsidiary named Interlink Electronics Europe Limited to serve as its European regional sales office.

On April 23, 2014, the board of directors approved a four (4) share for one (1) share forward stock split of Interlink Electronics’ common stock. The record date for the forward stock split is May 29, 2014. The purpose of the forward stock split is to increase the liquidity of the common stock and to enhance Interlink Electronics’ ability to list its shares of common stock on a national exchange.

The board of directors authorized the adoption of an amendment to the Articles of Incorporation to increase the authorized number of shares of capital stock to 16,000,000 shares, consisting of 15,000,000 shares of common stock, par value \$0.001 and 1,000,000 shares of preferred stock, par value \$0.01. The number of authorized shares, common and preferred, and par values for the December 31, 2013 audited consolidated financial statements have been recast to reflect the number of authorized shares and par values.

2. Summary of Significant Accounting Policies

Cash and Cash Equivalents—We invest excess cash in highly liquid interest-bearing instruments, including commercial paper or money market accounts. Investments of original maturities less than ninety days are classified as cash equivalents.

Restricted Cash—We have \$5,000 in restricted cash on our unaudited consolidated balance sheet as of September 30, 2014 and December 31, 2013 related to collateral for our credit card (merchant services) exposure with our bank.

INTERLINK ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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2. Summary of Significant Accounting Policies (Continued)

Accounts Receivable and Allowance for Doubtful Accounts—Our accounts receivable are unsecured and are at risk to the extent such amounts become uncollectible. We continually monitor individual accounts receivable balances and provide for an allowance for doubtful accounts at the time collection may become questionable based on payment performance, due to the age of the receivable or other factors, including the customer's ability to pay and our historical collection experience related to issues not yet specifically identified. We generally offer thirty-day payment terms; however, some international customers require as long as ninety-day payment terms, which do not require collateral and generally charge interest on past due balances. If future collections are not as expected, the allowance is adjusted accordingly.

Inventories—Inventories are stated at the lower of cost or market and include the cost of materials. Cost is determined using the average cost method.

Inventory Reserve—At each balance sheet date, we evaluate ending inventories for excess quantities and obsolescence. This evaluation includes analyses of forecasted sales levels by product and historical demand. We write off inventories that are considered obsolete. Remaining inventory balances are adjusted to approximate the lower of cost or market value and result in a new cost basis in such inventory until sold. If future demand or market conditions are less favorable than internal projections, additional inventory write-downs may be required and would be reflected in "cost of revenues" in the period the revision is made.

Property and Equipment—Property and equipment are carried at cost, less accumulated depreciation and amortization. Depreciation is recorded on the straight-line basis over the estimated useful lives of the assets, which range from three to ten years. Amortization of leasehold improvements is based upon the estimated useful lives of the assets or the term of the lease (including appropriate renewal options), whichever is shorter. Maintenance and repairs are charged to operations as incurred, while significant improvements are capitalized. Upon retirement or disposition of property, the asset and related accumulated depreciation or amortization is removed from the accounts, and any resulting gain or loss is charged to operations. The carrying value of property and equipment is assessed periodically and/or when factors indicating impairment are present. We recognize impairment losses when the expected future cash flows are less than the asset's carrying value, in which case the asset is written down to its estimated fair value.

Intangibles—Our costs to acquire patents and trademarks are amortized on a straight-line basis over their estimated useful lives, which we estimate to be five years. The related carrying value of the intangibles amounted to \$27,000 and \$29,000 as of September 30, 2014 and December 31, 2013, respectively. Amortization expense for the three months ended September 30, 2014 and 2013 was \$4,000 and \$7,000, respectively, and \$14,000 and \$20,000 for the nine months ended September 30, 2014 and 2013, respectively.

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2. Summary of Significant Accounting Policies (Continued)

Foreign Currency Translation/Transactions—The accounts of our Chinese subsidiary have been translated as required by the “Foreign Currency Matters” Topic of Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic No. 830 (“ASC 830”). Management has determined that the functional currency for the Chinese subsidiary is the Chinese Yuan Renminbi, and the functional currency for our Hong Kong, Singapore and United Kingdom subsidiaries is the U.S. Dollar. Translation gains or losses for the Chinese subsidiary are recorded as “accumulated other comprehensive income.” All of the accumulated other comprehensive income represents cumulative translation adjustments. The Chinese subsidiaries’ assets and liabilities are translated into U.S. Dollars using the period-end exchange rate. Revenues and expenses are translated at average rates during the year. Any gains or losses resulting from foreign currency transactions are reflected in the unaudited consolidated statements of comprehensive income (loss) for the period in which they occur.

Revenue Recognition—We recognize revenue in accordance with the “Revenue Recognition” Topic of FASB ASC Topic No. 605 (“ASC 605”). ASC 605 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the fee is fixed and determinable and (4) collectibility is reasonably assured. Determination of criteria (3) and (4) requires management’s judgments regarding the fixed nature of the fee charged for services rendered and products delivered and the collectibility of those fees. To satisfy the criteria, we (1) input orders based upon receipt of a customer purchase order, (2) record revenue upon shipment of goods and when risk of loss and title transfer, (3) confirm pricing through the customer purchase order and (4) validate creditworthiness through past payment history, credit agency reports and other financial data. All customers have warranty rights, and some customers also have explicit or implicit rights of return. We comply with ASC 605 with respect to sell-through and returns and the related recording of reserves for potential customer returns or warranty repairs. Should changes in conditions cause management to determine the revenue recognition criteria are not met for certain future transactions, such as a determination that collectibility was not reasonably assured, revenue could be adversely affected.

We defer revenue on advanced cash receipts until the delivery of the goods or over the service term, whichever is sooner.

Research and Development—Research and development costs are expensed as incurred.

Shipping and Handling—We account for shipping and handling costs as required by the “Revenue Recognition” Topic of FASB ASC Topic No. 605-45, which requires fees billed to customers be included in revenue.

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2. Summary of Significant Accounting Policies (Continued)

Stock-based Compensation—We account for stock-based awards in accordance with the provisions of FASB ASC Topic No. 718, “Compensation—Stock Compensation” (“ASC 718”). Accordingly, we measure stock-based compensation expense at the grant date, based on the fair value of the award, and recognize the expense over the employee’s requisite service period using the straight-line method. The measurement of stock-based compensation expense is based on several criteria, including but not limited to the valuation model used and associated input factors, such as expected term of the award, stock price volatility, risk-free interest rate and award forfeiture rate. We elected to adopt the alternative transition method for calculating the tax effects of stock-based compensation and continue to use the simplified method in developing the expected term used in the valuation of stock-based compensation in accordance with ASC 718.

Income Taxes—Under the “Income Taxes” Topic of FASB ASC Topic No. 740 (“ASC 740”), we are required to estimate income taxes in each of the jurisdictions in which we operate. This process involves estimating actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the accompanying unaudited consolidated balance sheets. ASC 740 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some or all of the net deferred tax assets will not be realized. The valuation allowance is reviewed annually based upon the facts and circumstances known at the time. In assessing this valuation allowance, we review historical and future expected operating results and other factors, including recent cumulative earnings experience, expectations of future taxable income by taxing jurisdiction and the carryforward periods available for tax reporting purposes, to determine whether it is more likely than not that deferred tax assets are realizable.

ASC 740 provides guidance on the minimum threshold that an uncertain income tax benefit is required to meet before it can be recognized in the financial statements and applies to all income tax positions taken by a company. ASC 740 contains a two-step approach to recognizing and measuring uncertain income tax positions.

The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement. If it is not more likely than not that the benefit will be sustained on its technical merits, no benefit will be recorded.

The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above, if any, is reflected as a liability for unrecognized tax benefits along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

The Company is subject to U.S. federal income tax as well as state of California income tax. Federal income tax returns of the Company are subject to IRS examination for the 2011 through 2013 tax years. State of California income tax returns are subject to examination for the 2010 through 2013 tax years.

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2. Summary of Significant Accounting Policies (Continued)

Earnings per Common Share—Basic earnings per common share are computed by dividing net earnings by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share are computed by adjusting outstanding shares, assuming any dilutive effects of options, and restricted stock calculated using the treasury stock method. Under the treasury stock method, an increase in the fair market value of our common stock results in a greater dilutive effect from outstanding options and restricted stock. Additionally, the exercise of employee stock options and the vesting of restricted stock results in a greater dilutive effect on net earnings per share.

Comprehensive Income—Comprehensive income is calculated in accordance with the “Comprehensive Income” Topic of FASB ASC Topic No. 220, which requires the disclosure of all components of comprehensive income, including net income and changes in equity during a period from transactions and other events and circumstances generated from non-owner sources.

Segment Reporting—FASB ASC Topic No. 280, “Segment Reporting” (“ASC 280”), establishes standards for the way that entities report information about operating segments in annual consolidated financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. ASC 280 also establishes standards for related disclosures about products and services, geographic areas and major customers. We operate in one reportable segment: the manufacturing and sale of intuitive sensor technology.

Use of Estimates—The preparation of unaudited consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the unaudited consolidated financial statements and the reported amounts of revenues and expenses during the reported period. Significant estimates by management include the allowance for doubtful accounts, excess and obsolete reserves for inventory, impairment of long-lived assets, including patents, deferred taxes and the valuation allowance. Actual results could materially differ from those estimates.

Concentration of Credit Risk—Financial instruments that potentially subject us to credit risk consist primarily of cash and cash equivalents and accounts receivable. All of our cash and cash equivalents are invested at major financial institutions primarily within the United States, United Kingdom, Hong Kong and China. At September 30, 2014 and December 31, 2013, our cash and cash equivalents were maintained in accounts that are insured up to the limit determined by the appropriate governmental agency. The amounts held in accounts with U.S. banks were insured up to the Federal Deposit Insurance Corporation (“FDIC”) general insurance limit of \$250,000, and approximately \$1,389,000 and \$867,000 was not insured at September 30, 2014 and December 31, 2013, respectively. The amounts held by Hong Kong banks were fully insured at September 30, 2014 and December 31, 2013. Approximately \$73,000 and \$361,000 held at Chinese banks was not insured at September 30, 2014 and December 31, 2013, respectively. To date, we have not suffered any losses to our cash and cash equivalents. The amounts held by United Kingdom bank accounts opened in 2014 were fully insured at September 30, 2014.

INTERLINK ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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2. Summary of Significant Accounting Policies (Continued)

Concentration of Credit Risk (Continued)

With regard to accounts receivable, we trade only with recognized, creditworthy third parties. It is our policy that all customers that wish to trade on credit terms are subject to credit verification procedures. In addition, accounts receivable are monitored on an ongoing basis with the result that the accounts deemed to have a credit risk have been fully reserved for as of September 30, 2014 and December 31, 2013. For the nine months ended September 30, 2014, three customers accounted for approximately 17%, 17% and 10% of total revenues. For the nine months ended September 30, 2013, three customers accounted for approximately 22%, 19% and 16% of total revenues. As of September 30, 2014, four customers accounted for approximately 22%, 18%, 13% and 13% of total accounts receivable. As of December 31, 2013, four customers accounted for approximately 29%, 14%, 14% and 10% of total accounts receivable.

Fair Value Measurements—We comply with the provisions of FASB ASC Topic No. 820, “Fair Value Measurements and Disclosures” (“ASC 820”), in measuring fair value and in disclosing fair value measurements. ASC 820 provides a framework for measuring fair value and expands the disclosures required for fair value measurements of financial assets and liabilities and nonfinancial assets and liabilities.

As of September 30, 2014 and December 31, 2013, the carrying values of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued payables, accrued expenses and other accrued liabilities approximate fair value due to the short-term nature of such items.

Recently Adopted Accounting Pronouncements—In February 2013, the FASB issued Accounting Standards Update (“ASU”) No. 2013-02, “Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income” (“ASU 2013-02”), which requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (“GAAP”) to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. Nonpublic companies are required to comply with the requirements of ASU 2013-02 for all reporting periods beginning after December 15, 2013. The adoption of this guidance did not have a material financial impact on the Company’s financial statements.

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2. Summary of Significant Accounting Policies (Continued)

Recently Issued Accounting Pronouncements—In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09, effective for annual reporting periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018”). The amendments to this Update supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of this Topic is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. This Topic defines a five-step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. A nonpublic entity may elect to apply this guidance earlier, however, only as of the following: (1) an annual reporting period beginning after December 15, 2016, including interim periods within that reporting period (public entity effective date), (2) an annual reporting period beginning after December 15, 2016, and interim periods within annual periods beginning after December 15, 2017, (3) an annual reporting period beginning after December 15, 2017, including interim periods within that reporting period. The Company has not yet assessed the impact of ASU 2014-09 but does not believe it will have a material effect on the Company’s consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, “Compensation—Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (a consensus of the FASB Emerging Issues Task Force)”, effective for annual periods and interim periods within those annual periods, beginning after December 15, 2015. This update is intended to resolve the diverse accounting treatment of share-based payment awards whose performance target may be achieved after the requisite service period. An entity may apply the standards (1) prospectively to all share-based payment awards that are granted or modified on or after the effective date, or (2) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. Earlier application is permitted. The Company has not yet assessed the impact of ASU 2014-12 but does not believe it will have a material effect on the Company’s consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, “Presentation of Financial Statements – Going Concern (Sub-Topic 205-40), which provides guidance in GAAP about management’s responsibility to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern and to provide related footnote disclosures. This Update is effective for annual periods ending after December 15, 2016 and for annual periods and interim periods thereafter. Early application is permitted. The Company has not yet assessed the impact of ASU 2014-15 but does not believe it will have a material effect on the Company’s consolidated financial statements.

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3. Fair Value Measurements

We comply with the provisions of ASC 820 which define fair value, provide a framework for measuring fair value and expand the disclosures required for fair value measurements of financial assets and liabilities and nonfinancial assets and liabilities. ASC 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that is determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, ASC 820 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1— Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets

Level 2— Includes other inputs that are directly or indirectly observable in the marketplace

Level 3— Unobservable inputs which are supported by little or no market activity

The following is a description of the valuation methodologies used for our financial instruments measured at fair value:

The estimated fair values of our accounts receivables, accounts payable and accrued payables, accrued payroll and other accrued liabilities approximate their carrying values because of the short-term maturity of these instruments.

Cash and cash equivalents and restricted cash are estimated at fair value and valued primarily using quoted market prices utilizing market-observable inputs.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis as of September 30, 2014 and the year ended December 31, 2013 (in thousands):

	Level 1	Level 2	Level 3	Total
September 30, 2014				
Cash and cash equivalents	\$ 1,720	\$ -	\$ -	\$ 1,720
Restricted cash	5	-	-	5
December 31, 2013				
Cash and cash equivalents	\$ 1,487	\$ -	\$ -	\$ 1,487
Restricted cash	5	-	-	5

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4. Inventories

Inventories consisted of the following as of September 30, 2014 and December 31, 2013 (in thousands):

	September 30, 2014	December 31, 2013
Raw material	\$ 469	\$ 350
Work in process.....	243	160
Finished goods	<u>269</u>	<u>160</u>
Total inventories.....	<u>\$ 981</u>	<u>\$ 670</u>

5. Property and Equipment

Property and equipment consisted of the following as of September 30, 2014 and December 31, 2013 (in thousands):

	September 30, 2014	December 31, 2013
Furniture, machinery and equipment	\$ 2,101	\$ 1,993
Leasehold improvements.....	<u>598</u>	<u>600</u>
	2,699	2,593
Less accumulated depreciation and amortization	<u>(2,536)</u>	<u>(2,495)</u>
Property and equipment, net.....	<u>\$ 163</u>	<u>\$ 98</u>

Depreciation expense charged to operations amounted to \$15,000 and \$25,000 for the three months ended September 30, 2014 and 2013, respectively, and \$41,000 and \$80,000 for the nine months ended September 30, 2014 and 2013, respectively.

6. Stockholders' Equity

Stock Split— On April 23, 2014, the board of directors approved a four (4) share for one (1) share forward stock split of Interlink Electronics' common stock. The record date for the forward stock split is May 29, 2014. The purpose of the forward stock split is to increase the liquidity of the common stock and to enhance Interlink Electronics' ability to list its shares of common stock on a national exchange. References to shares and exercise prices of our common stock and stock options (and associated dollars amounts) in the unaudited consolidated financial statements for the three and nine months ended September 30, 2014 are provided on post split basis.

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6. Stockholders' Equity (Continued)

Stock Split—The board of directors authorized the adoption of an amendment to the Articles of Incorporation to increase the authorized number of shares of capital stock to 16,000,000 shares, consisting of 15,000,000 shares of common stock, par value \$0.001 and 1,000,000 shares of preferred stock, par value \$0.01. The number of authorized shares, common and preferred, and par values for the September 30, 2014 unaudited consolidated financial statements and the December 31, 2013 audited consolidated financial statements have been recast to reflect the number of authorized shares and par values.

Restricted Stock—On March 15, 2012, the board of directors approved the issuance of 40,000 shares each of restricted stock to two employees (\$0.001 par value, valued at \$67,500 for each employee based on the Company's stock closing price on March 15, 2012 of \$1.6875). One employee has left the Company and the other individual employment agreement was revised which resulted in forfeiture of the restricted stock. As a result, the 80,000 shares were forfeited and \$57,400 is subtracted from stock compensation expense which is reflected in "additional paid-in capital" in the unaudited consolidated balance sheet.

The board of directors, in accordance with the employment agreement dated March 6, 2012, approved the issuance of 20,000 shares of restricted stock to one employee (\$0.001 par value, valued at \$42,750, based on the Company's stock closing price on July 23, 2012 of \$2.1375). The employee was terminated in July 2013. As a result of the termination, 20,000 shares were forfeited and \$10,700 is subtracted from stock compensation expense which is reflected in "additional paid-in capital" in the unaudited consolidated balance sheet.

On July 13, 2012, the board of directors approved that the chairman of each committee (the audit committee and compensation committee) will be paid \$5,000 per annum on July 15 of each year through the issuance of common stock, \$0.001 par value, valued at \$5,000, based on the Company's stock closing price on July 13, 2012 of \$2.125. The shares vested at the rate of 1/12th per month on the 15th day of each month during the period from July 15, 2012 through June 14, 2013. As of September 30, 2014, 4,720 shares are vested, and the \$10,000 of the shares is reflected in "common stock" and "additional paid-in capital" in the unaudited consolidated balance sheet.

On February 5, 2013, the board of directors approved the issuance of 20,000 shares of restricted stock to an employee (\$0.001 par value, valued at \$57,500 based on the Company's stock closing price on February 5, 2013 of \$2.875). The employee was terminated in September 2014. As a result of the termination, 20,000 shares were forfeited and \$18,200 is subtracted from stock compensation expense which is reflected in "additional paid-in capital" in the unaudited consolidated balance sheet.

On July 12, 2013, the board of directors approved that the chairman of each committee (the audit committee and compensation committee) will be paid \$5,000 per annum on July 15 of each year through the issuance of common stock (\$0.001 par value, valued at \$5,000, based on the Company's stock closing price on July 12, 2013 of \$3.375). The shares vested at the rate of 1/12th per month on the 15th day of each month during the period from July 15, 2013 through June 14, 2014. As of September 30, 2014, 3,000 shares are vested, and the \$10,000 of the shares is reflected in "common stock" and "additional paid-in capital" in the unaudited consolidated balance sheet.

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6. Stockholders' Equity (Continued)

Restricted Stock—The board of directors, in accordance with the employment agreement dated January 31, 2014, approved the issuance of 32,000 shares of restricted stock to one employee (\$0.001 par value, valued at \$80,000, based on the Company's stock closing price on January 31, 2014 of \$2.50). The first 16,000 shares will vest after four years, on January 31, 2018, and the remaining 16,000 shares will vest on January 31, 2019. As of September 30, 2014, the Company recorded \$10,700 of stock compensation expense, which is reflected in "additional paid-in capital" in the unaudited consolidated balance sheet.

A summary of our restricted stock activity for the nine months ended September 30, 2014 is presented below:

	Restricted Stock	Weighted- average Grant Date Fair Value ⁽¹⁾
Non-vested as of January 1, 2014	101,700	\$ 1.95
Granted	32,000	2.50
Vested	(1,700)	3.38
Forfeited.....	<u>(100,000)</u>	1.93
Non-vested as of September 30, 2014	<u>32,000</u>	\$ 2.50

⁽¹⁾ Issued and outstanding share amounts and weighted-average grant date fair values reflect the four-for-one stock split effected on May 29, 2014.

Stock Options—Under the terms of our 1996 Stock Incentive Plan (the "Plan"), officers and key employees may be granted non-qualified or incentive stock options, and outside directors and independent contractors may be granted non-qualified stock options. The aggregate number of shares that may be issued under the Plan is 7,250,000. New options are granted at fair market value on the date of grant, generally vest ratably over thirty-six months and have a ten-year term, but terminate earlier if employment is terminated. As of September 30, 2014, options for 149,500 shares of stock have been granted (8,750 are outstanding, and 140,750 have been exercised, forfeited or expired).

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6. Stockholders' Equity (Continued)

Stock Options (Continued)—Activity under the Plan for the nine months ended September 30, 2014 is summarized as follows:

	Options	Weighted-average Exercise Price ⁽¹⁾
Outstanding, beginning of period, January 1, 2014	33,300	\$ 18.25
Granted	-	-
Exercised	(4,000)	3.90
Forfeited or expired	<u>(20,550)</u>	22.81
Outstanding, end of period, September 30, 2014.....	<u>8,750</u>	\$ 14.10
Exercisable, end of period, September 30, 2014	<u>8,750</u>	\$ 14.10

⁽¹⁾ Issued and outstanding share amounts and weighted-average exercise prices reflect the four-for-one stock split effected on May 29, 2014.

The following table summarizes information about stock options outstanding and vested as of September 30, 2014:

Range of Exercise Prices	Employee Options Outstanding and Vested			Employee Options Exercisable	
	Shares	Weighted- average Remaining Contractual Life (Years)	Weighted- average Exercise Price ⁽¹⁾	Shares	Weighted- average Exercise Price ⁽¹⁾
\$0.00 – \$11.25	1,600	3.52	\$ 3.90	1,600	\$ 3.90
\$12.00 – \$27.80	6,550	1.93	14.55	6,550	14.55
\$30.75 – \$39.10	<u>600</u>	0.41	36.32	<u>600</u>	36.32
	<u>8,750</u>	2.12	\$ 14.10	<u>8,750</u>	\$ 14.10

⁽¹⁾ Issued and outstanding share amounts and weighted-average exercise prices reflect the four-for-one stock split effected on May 29, 2014.

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6. Stockholders' Equity (Continued)

There is no intrinsic value for the stock options outstanding and vested as of September 30, 2014.

Stock-based Compensation Expense—For the three and nine months ended September 30, 2014 and 2013, we recorded the following charges within our unaudited consolidated statements of comprehensive income for stock-based compensation: \$0 and \$0 in cost of revenues, \$0 and \$0 in product development and research expenses and \$0 and \$0 in selling, general and administrative expenses, respectively.

As of September 30, 2014, we do not have any unrecognized stock-based compensation cost related to non-vested stock options to be recognized. There were no stock options granted and 4,000 stock options exercised during the three and nine months ended September 30, 2014.

Share Forfeitures—As stock-based compensation expense recognized in the unaudited consolidated statements of comprehensive income for the nine months ended September 30, 2014 and 2013 is based on awards expected to vest, ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. For the nine months ended September 30, 2014 and 2013, forfeitures for employees were calculated to be 18.24%, while forfeitures for executives were calculated to be 10.03%. Forfeitures for the nine months ended September 30, 2014 and 2013 totaled \$0 and \$0, respectively.

7. Earnings per Share

For all periods presented, per-share information was computed pursuant to provisions of the "Earnings per Share" Topic of FASB ASC Topic No. 260. The computation of earnings per share—basic is based upon the weighted-average number of common shares outstanding during the periods presented. Earnings per share—diluted also includes the effect of common shares contingently issuable from options and warrants (in periods in which they have a dilutive effect).

Common stock equivalents are calculated using the treasury stock method. Under the treasury stock method, the proceeds from the assumed conversion of options and warrants are used to repurchase outstanding shares using a yearly average market price.

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7. Earnings per Share (Continued)

The following table contains information necessary to calculate earnings per share (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Weighted-average shares outstanding	2,927	2,948	2,926	2,944
Effect of dilutive securities; options ⁽¹⁾	-	-	-	-
Weighted-average shares—diluted	<u>2,927</u>	<u>2,948</u>	<u>2,926</u>	<u>2,944</u>

⁽¹⁾ During the three and nine months ended September 30, 2014 and 2013, 41,000 and 136,000 common stock equivalents were not added to the basic common shares outstanding, as our average stock price during these periods was lower than the conversion price of all common stock equivalents.

8. Geographic Information

Geographic Information—We attribute revenues to different geographic areas on the basis of customer location. Our revenues and long-lived assets by geographic area for the nine months ended September 30, 2014 and 2013 are as follows (in thousands):

	2014		2013	
	Revenues	Long-lived Assets	Revenues	Long-lived Assets
United States.....	\$ 4,252	\$ 48	\$ 3,943	\$ 86
Japan	373	-	388	-
Asia (other than Japan)	1,328	142	256	49
Europe and other	<u>1,368</u>	<u>-</u>	<u>951</u>	<u>-</u>
Total.....	<u>\$ 7,321</u>	<u>\$ 190</u>	<u>\$ 5,538</u>	<u>\$ 135</u>

9. Related Party

The Company paid fees to a related party for consulting services of \$18,750 for the three months ended September 30, 2014 and 2013. The Company paid fees to a related party for consulting services of \$56,250 for the nine months ended September 30, 2014 and 2013.

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10. Subsequent Events

Subsequent events have been evaluated through November 14, 2014, which is the date the unaudited consolidated financial statements were available to be issued.