INTERLINK ELECTRONICS INC
Form 10-Q
August 13, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2001

OR

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

For the transition period from _____________ to _______________

Commission File No. 0-21858

INTERLINK ELECTRONICS, INC.
(Exact name of registrant as specified in its charter)

Delaware	77-0056625
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

546 Flynn Road Camarillo, California	93012
(Address of principal executive offices)	(Zip Code)

(805) 484-8855
(Registrant's telephone number, including area code)

Not applicable.
(Former name, former address and former fiscal year if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports); and (2) has been subject to such filing requirements for the past 90 days.

Yes X No __

Shares of Common Stock Outstanding, at July 30, 2001: 9,738,759

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements

INTERLINK ELECTRONICS, INC.
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)

	December 31, 2000	June 30 2001 (Unaudit
Assets		
Current assets:		
Cash and cash equivalents	$10,506	$ 9,704
Accounts receivable, less allowance for doubtful accounts of $722 and $771 in 2000 and 2001, respectively	8,613	6,693
Inventories	9,435	8,294
Deferred tax asset	600	1,301
Prepaid expenses and other current assets	661	496
Total current assets	29,815	26,488
Property and equipment, net	1,632	1,736
Patents and trademarks, less accumulated amortization of $860 and $920 in 2000 and 2001, respectively	235	175
Other assets	92	536
Total assets	$31,774	$28,935
Liabilities and Stockholders' Equity		
Current liabilities:		
Current maturities of long-term debt and capital lease obligations	$ 2,079	$ 1,504
Accounts payable	3,305	2,214
Accrued payroll and related expenses	936	940
Other accrued expenses	367	303
Total current liabilities	6,687	4,961
Minority interest	56	68
Long-term debt, net of current portion	2,547	2,099
Capital lease obligations, net of current portion	51	-
Commitments and contingencies	-	-
Stockholders' equity:		
Common stock, $0.00001 par value (50,000 shares authorized 9,249 and 9,740 shares outstanding at December 31, 2000 and June 30, 2001, respectively)	27,630	28,591
Accumulated other comprehensive income (loss)	(168)	(670
Accumulated deficit	(5,029)	(6,114
Total stockholders' equity	22,433	21,807
Total liabilities and stockholders' equity	$31,774	$28,935

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

INTERLINK ELECTRONICS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(IN THOUSANDS EXCEPT PER SHARE DATA)

	Three Month Period Ended June 30,		Six Month Period Ended June 30,	
	2000	2001	2000	2001
Revenues	$ 8,257	$ 6,539	$15,942	$13,928
Cost of revenues	4,661	5,685	9,432	9,802
Gross profit	3,596	854	6,510	4,126
Operating expense:				
Product development and research	955	1,001	1,574	1,845
Selling, general and administrative	1,790	2,183	3,301	4,182
Total operating expense	2,745	3,184	4,875	6,027
Operating income (loss)	851	(2,330)	1,635	(1,901)
Other income (expense):				
Interest income (expense), net	12	56	21	115
Cost of cancelled equity offering	(769)	-	(769)	-
Other income (expense)	(26)	1	37	52
Total other income (expense)	(783)	57	(711)	167
Income (loss) before provision for income taxes	68	(2,273)	924	(1,734)
Provision (benefit) for income taxes	-	(455)	144	(649)
Net income (loss)	$ 68	$(1,818)	$ 780	$(1,085)
Earnings (loss) per share - basic	$ .01	$ (.19)	$ .09	$ (.11)
Earnings (loss) per share - diluted	$ .01	$ (.19)	$ .07	$ (.11)
Weighted average shares - basic	8,778	9,640	8,677	9,525
Weighted average shares - diluted	11,311	9,640	11,250	9,525

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

INTERLINK ELECTRONICS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(IN THOUSANDS)

	Six Month Period Ended June 30, 2000	Six Month Period Ended June 30, 2001
Cash flows from operating activities:		
Net income (loss)	$ 780	$(1,085)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Provision for bad debts	20	49
Depreciation and amortization	430	352
Minority interest	-	12
Deferred tax asset	-	(701)
Changes in operating assets and liabilities:		
Accounts receivable	1,117	763
Inventories	(1,365)	1,141
Prepaid expenses and other current assets	(829)	165
Other assets	98	(41)
Accounts payable	(215)	17
Accrued payroll and expenses	(84)	(59)
Net cash provided by (used in) operating activities	(48)	613
Cash flows from investing activities:		
Purchases of property and equipment	(503)	(397)
Costs of patents and trademarks	(38)	-
Net cash used in investing activities	(541)	(397)
Cash flows from financing activities:		
Borrowings on notes payable to bank	1,305	-
Principal payments on notes payable to bank	(215)	(1,007)
Principal payments on capital lease obligations	(105)	(67)
Proceeds from issuance of common stock, net	530	961
Due from stockholder	-	(403)
Net cash provided by (used in) financing activities	1,515	(516)
Effect of exchange rate changes on cash	(260)	(502)
Increase (decrease) in cash and cash equivalents	666	(802)
Cash and cash equivalents:		
Beginning of period	7,492	10,506
End of period	$ 8,158	$ 9,704
Supplemental disclosures of cash flow information:		
Interest paid	$ 42	$ 70
Income taxes paid	$ 1	$ 29

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

INTERLINK ELECTRONICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30,2001 (UNAUDITED)

1. Basis of Presentation of Interim Financial Data

The financial information for the three and six month periods ended June 30, 2000 and 2001 included in this report is unaudited; however, such information reflects all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of results for the interim periods. The interim statements should be read in conjunction with the financial statements and the related notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2000.

The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full year.

2. Comprehensive Income

The following table provides the data required to calculate comprehensive income:

	(In Thousands)	
	Accumulated Other Comprehensive Income	Comprehensive Income
Balance at December 31, 2000	$(168)	
Translation adjustment	(502)	$ (502)
Net loss		(1,085)
Balance at June 30, 2001	$(670)	$(1,587)

3. Due From Stockholders

In May 2001, the Company advanced an aggregate total of $403,000 to certain of its officers and directors to purchase shares of the Company's common stock on the public market. Each of the loans, which carry interest rates of 5% per annum and are due on November 1, 2002, is secured by the shares of stock purchased by the officer or director.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are a leader in the development of intuitive interface devices for a variety of home and business applications. We were incorporated in California in February 1985 and reincorporated in Delaware in July 1996. From 1985 to 1992, we developed and refined our Force Sensing Resistor, or FSR, technology and sold it to customers for electronic, musical, medical and other applications, which we now refer to as the Specialty Components market. In 1992, we introduced our first branded computer pointing device, PortaPoint, and in 1994, we introduced our first wireless pointing device, RemotePoint. With the advent of this latter device, we established ourselves as a leading supplier to OEMs in the computerized presentation system market, which we now call the Business Communications market. In 1999, we introduced the ePad product for E-Transactions applications and IntuiTouch technology for the Home Entertainment market.

Revenue, net of allowances for returns and warranty, is recognized upon shipment of product. Royalty revenue is recorded when earned. Revenues have increased steadily during the last six years as we have established ourselves in new markets and built a base of OEM customers in the computer, computer peripheral and business communications industry. Gross profit, as a percentage of revenues, varies depending on product and licensing revenue mix. Product development and research expenditures, which include engineering, contract engineering and development and material costs of development, have generally increased as revenue has increased but have remained relatively consistent as a percentage of revenues, reflecting our continuing commitment to the technological and design innovation required to maintain a leadership position in existing markets and to develop new ones. Selling, general and administrative expense, which includes sales, marketing and administrative personnel, advertising, sales commissions, reseller incentives, tradeshow costs and other sales expenses, declined through 1999 and stabilized in 2000 as a percentage of sales, reflecting the amortization of a relatively fixed expense requirement over a larger revenue base offset in 2000 by the creation of sales and marketing teams for the E-Transactions and Home Entertainment segments. Because of net operating loss carryforwards available both for our U.S.-based and Japan-based operations, we historically have not paid income tax. Beginning in 1999, some of these loss carryforwards began to expire or became fully utilized; therefore income taxes are expected to increase on both a percentage and absolute dollar basis. Other income (expense) was significant in 1998 and 2000 as the result of a non-recurring legal settlement expense and cost related to a cancelled equity offering.

Prior to 1999, operations was a net user of cash and we funded this through existing cash balances, private placements of equity and to a lesser extent, bank and lease financing. In 1999, operations was a net provider of cash, generating $2.9 million and was essentially break-even in 2000.

Sales of business communications intuitive interface devices accounted for 61% of our total sales in 2000 and 62% of our total sales in the three years ended December 31, 2000. Our business communications sales in dollars grew at an average annualized rate of 20% in 2000. Because our market share for business communications interface devices is approximately 80%, we expect that our ability to achieve further revenue growth in this market will largely depend on growth in the market itself. The Home Entertainment and E-Transactions segments accounted for 8% and 3% of 2000 consolidated revenue respectively and will become a greater contributor to consolidated revenue growth as we penetrate those markets.

We have established relationships with most of the major OEMs in the business communications market. Many of these OEMs are based in Japan and approximately 43% of our 2000 revenues came from Japanese customers. As a result we are subject to foreign currency exchange rate fluctuations, primarily in the yen/dollar exchange rate.

We have licensed certain technology related to the production of FSR sensors to International Electronics and Engineering, a former affiliate based in Luxembourg, for use in connection with sales of sensors to the automotive industry. We are entitled to royalties in connection with sales of automotive sensors outside Europe through the third quarter of 2001. We have occasionally licensed other aspects of our technology in connection with the settlement of intellectual property disputes and expect to continue to do so in the future.

In June 1998 and June 1999, the AICPA issued Statement of Financial Accounting Standards, or SFAS, No. 133 "Accounting for Derivative Instruments and Hedging Activities" and SFAS No. 137, which delayed the effective date of SFAS No. 133 and required its adoption beginning January 1, 2001. We adopted this standard in January 2001, however, we do not expect its implementation to have a significant impact on our financial position or results of operations.

In December 1999, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" (SAB No. 101). SAB No. 101 expresses the views of the SEC staff in applying accounting principles generally accepted in the United Sates to certain revenue recognition issues. We adopted the provisions of SAB No. 101 in the fourth quarter of fiscal 2000 and its adoption did not have a material impact on our financial position or results of operations.

Results of Operations

Revenues declined 21% from $8.3 million in the three month period ended June 30, 2000 to $6.5 million in the three month period ended June 30, 2001 and declined 13% from $15.9 million in the six month period ended June 30, 2000 to $13.9 million in the six month period ended June 30, 2001. The revenue decline resulted from the general slowdown in the global economy, especially in the U.S. and Japan. Our Business Communications segment, which consisted 67% of second quarter 2001 consolidated revenues, was additionally impacted by the devaluation of the Japanese Yen in relation to the U.S. Dollar. Our other segments, Specialty Components, Home Entertainment and E-Transactions equaled 22%, 5% and 6% of consolidated revenues respectively.

Gross profit decreased from $3.6 million in the three month period ended June 30, 2000 to $854,000 in the same period in 2001 and declined 37% from $6.5 million in the six month period ended June 30, 2000 to $4.1 million in the six month period ended June 30, 2001. As a percentage of revenues, gross profit decreased from 43.5% for the three month period ended June 30, 2000 to 13.0% for the same period in 2001 and decreased from 40.8% for the six month period ended June 30, 2000 to 29.6% for the same period in 2001. In second quarter 2001, we increased our inventory reserves by $2 million to anticipate potential write-offs as a result of the worldwide economic downturn. Excluding the reserve adjustment, gross profit percentages were consistent with the prior year.

Product development and research expense increased 5% from $955,000 for the three month period ended June 30, 2000 to $1 million for the same period in 2001 and increased 17% from $1.6 million for the six month period ended June 30, 2000 to $1.8 million for the same period in 2001. As a percent of revenues, product development and research expense increased from 11.5% for the three month period ended June 30, 2000 to 15.3% for the same period in 2001 and from 9.9% for the six month period ended June 30, 2000 to 13.2% for the same period in 2001. These increases resulted primarily from continued investment in our IntuiTouch interface technology, which we market to companies in the Home Entertainment market, and our VersaPad technology, which we sell to customers in the E-Transaction market.

Selling, general and administrative expense increased from $1.8 million for the three month period ended June 30, 2000 to $2.2 million for the same period in 2001 and increased from $3.3 million for the six month period ended June 30, 2000 to $4.2 million for the same period in 2001. As a percent of revenue, SG&A expense increased from 21.7% for the three month period ended June 30, 2000 to 33.4% for the same period in 2001 and increased from 20.7% for the six month period ended June 30, 2000 to 30.0% for the same period in 2001. The increase is the result of establishing sales and marketing teams for products we sell to customers in the E-Transaction and Home Entertainment markets coupled with the decrease in revenues.

Operating income decreased from $851,000 for the three month period ended June 30, 2000 to an operating loss of $2.3 million for the same period of 2001 and decreased from $1.6 million for the first six months of 2000 to an operating loss of $1.9 million for the same period in 2001. The decline in operating income is the result of the revenue decline coupled with the inventory reserve adjustment.

Income taxes decreased from a zero expense for the three month period ended June 30, 2000 to a benefit of $455,000 for the same period in 2001 as a result of the negative operating results.

Net income decreased from $68,000 for the three month period ended June 30, 2000 to a loss of $1.8 million for the same period in 2001 and decreased from income of $780,000 for the six month period ended June 30, 2000 to a loss of $1.1 million for the same period in 2001 due to the factors discussed above.

Liquidity and Capital Resources

At June 30, 2001, working capital totaled $21.5 million as compared to $23.1 million at December 31, 2000. This decrease is a result of the negative operating results coupled with the purchase of capital equipment.

For the six month period ended June 30, 2001, investing activities consumed $397,000 in cash, consisting primarily of the purchase of production equipment.

For the six month period ended June 30, 2001, financing activities consumed $516,000. Our U.S. line of credit was unused at June 30, 2001 and had $5 million of availability as of that date. We have a $1 million equipment lease line, unused at June 30, 2001. The exercise of outstanding stock options is a potential source of equity capital that may be available to us. We believe that our current cash balances and lines of credit will allow us to fund our operations for at least the next 12 months. However, an unforeseen downturn in our results of sufficient magnitude could adversely affect our ability to meet that forecast.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We entered into six-month foreign exchange forward contracts to hedge certain revenue exposures against future movements in foreign exchange rates. Gains and losses on the forward contracts are largely offset by gains and losses on the underlying exposure and consequently we would not expect a sudden or significant change in foreign exchange rates to have a material impact on future net income or cash flows. However, a foreign exchange movement with a duration of over six months could impact financial performance.

Forward-Looking Statements

This Report on Form 10-Q contains statements that constitute "forward-looking statements" within the meaning of section 27A of the Securities Act of 1933 and section 21E of the Securities Exchange Act of 1934. These forward-looking statements may be adversely affected by a number of factors. These factors may include the following:

- Our inability to predict the amount or timing of growth in markets where we expect our future revenue growth to occur.
- Our operating results continuing to fluctuate and not meeting published analyst forecasts.
- Our sales being concentrated with one or more customers or in limited market or geographic areas.
- Our business strategy of developing products for the home entertainment and e-transaction markets not being successfully implemented.
- International sales and manufacturing risks.
- Fluctuations in the value of foreign currencies.

- Our inability to develop and introduce new products to respond to evolving industry requirements in a timely manner.
- The home entertainment and e-transaction markets not adopting our technology.
- Our markets being intensely competitive and many of our potential competitors having resources that exceed our own.
- Failure to attract and retain qualified individuals for critical positions.
- Failure to manage our growth effectively.
- Our inability to overcome price advantages of low-cost remote control products that compete with our products.
- Changing standards or regulations.
- Interruption of our contract manufacturing arrangements.
- Interruption in the supply of any significant Force Sensing Resistor sensor or other component causing us to miss shipment deadlines.
- Performance, reliability or quality problems with our products.
- Federal, state and international legislation and regulations affecting e-commerce.
- Failure to protect our intellectual property.
- Proprietary technologies of our competitors creating barriers to entry.
- Adoption of technologies and standards by electronics manufacturers and service providers.
- Risks associated with manufacturing certain of our products at a

single facility.

- Reliance on others for significant aspects of our technology development.
- Industry downturns in the markets we serve.
- Volatility in our stock price.

PART II: OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders

On June 19, 2001 at the Company's Annual Meeting of Stockholders, the holders of the Company's outstanding common stock took the actions described below. At April 16, 2001, the record date, 9,556,651 shares of common stock were outstanding and eligible to vote at the Annual Meeting of Stockholders.

1. By the vote indicated below, the stockholders re-elected Eugene F. Hovanec to the Company's Board of Directors to serve for a three year term:

   For Eugene F. Hovanec:

8,451,216	Shares in favor
0	Shares against
9,226	Shares withheld

2. By the vote indicated below, the stockholders ratified the appointment of Arthur Andersen LLP as the Company's independent auditors for the fiscal year ending December 31, 2001.

8,443,076	Shares in Favor
15,046	Shares against
2,320	Shares withheld

Item 6. Exhibits And Reports On Form 8-K

a. Exhibits

   None.

b. Reports on Form 8-K

   No Reports on Form 8-K were filed during the period for which this Quarterly Report on Form 10-Q is filed.

SIGNATURES

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

INTERLINK ELECTRONICS, INC.

DATE: August 10, 2001

/s/ Paul D. Meyer

Paul D. Meyer
Chief Financial Officer
(Principal Financial and Accounting Officer)

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