

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	\$	