CYIOS CORP
Form 10-K
April 02, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

X ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: December 31, 2011

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________ to ________

Commission File No. **000-53098**

CYIOS Corporation

(Name of Registrant in its charter)

Nevada 03-7392107

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

1300 Pennsylvania Avenue, Suite 700, Washington, DC 20004

(Address of principal executive offices) (Zip Code)

Issuer’s telephone number: (202) 204 -3006

Securities registered under Section 12(b) of the Exchange Act:

None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, par value $0.001 per share

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes X No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes X No

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.

X Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

X Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.
X Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company X

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes X No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of CYIOS Corporation (consisting solely of 16,085,346 shares of common stock, $0.001 par value) was approximately $804,267 based on the average bid and asked price of such common stock ($.05) as of June 30, 2011.

APPLICABLE ONLY TO REGISTRANTS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

(APPLICABLE ONLY TO CORPORATE REGISTRANTS)

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date. At April 2, 2012 there were 36,311,640 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None

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PART I

Forward-Looking Statements

This annual report on Form 10-K, press releases and certain information provided periodically in writing or verbally by our officers or our agents contain statements which constitute forward-looking statements. The words "may", "would", "could", "will", "expect", "estimate", "anticipate", "believe", "intend", "plan", "goal", and similar expressions and variations thereof are intended to specifically identify forward-looking statements. These statements appear in a number of places in this Form 10-K and include all statements that are not statements of historical fact regarding the intent, belief or current expectations of us, our directors or our officers, with respect to, among other things: (i) our liquidity and capital resources; (ii) our financing opportunities and plans; (iii) our ability to generate revenues; (iv) market and other trends affecting our future financial condition or plan of operation; and (v) our growth and operating strategy.

Investors and prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those projected in the forward-looking statements as a result of various factors. The factors that might cause such differences include, among others, those set forth in Part II, Item 6 of this annual report on Form 10-K, entitled "Management's Discussion and Analysis or Plan of Operation", and including, without limitation, the "Risk Factors" beginning on page 5 of this annual report. Except as required by law, we undertake no obligation to update any of the forward-looking statements in this Form 10-K after the date of this report.

Item 1. Description of Business.

Corporate History

CYIOS® Corporation ("we", "us", "our", "CYIOS®" or the "Company") was incorporated under the laws of the state of Neva on October 13, 1997 as Halo Holdings of Nevada, Inc., for purposes of acquiring Halo Holdings, Inc., a Delaware corporation, operating in the aviation and extreme sports entertainment industries. In March 1999, we sold our extreme sports division. Between February 1999 and April 1999 we acquired three operating entities engaged in the business of providing integrated internet access and professional consulting services, and, on July 9, 1999, we changed our name to A1 Internet.com, Inc. to more accurately reflect our then-current operations. In June 2000, in addition to our other operations, we entered into the business of providing long distance services. In December 2000, we discontinued the operations of several of our subsidiaries which were not focused on our then-core competencies,

and on October 15, 2001 we changed our name to WorldTeq Group International, Inc. (“WorldTeq”).

Effective April 7, 2005 we completed a 1-for-30 reverse stock split of our outstanding shares of common stock and changed our name to China Print, Inc., in anticipation of entering into an agreement and plan of merger with Harbin Yinhai Technology Development Company Ltd., a People’s Republic of China company (“HYT”). In June of 2005, the transaction with HYT was terminated.

On September 19, 2005, we entered into an agreement with CYIOS Corporation, a District of Columbia corporation (“CYIOS® DC”), and Timothy Carnahan, whereby we acquired 100% of the issued and outstanding capital stock of CYIOS® DC in exchange for 19,135,000 shares or our common stock. On September 27, 2005 we changed our name to CYIOS® Corporation.

Overview of Principal Products and Services

CYIOS® is a holding company made up of two operating subsidiaries: CYIOS Corporation, a District of Columbia corporation (“CYIOS® DC”), and CKO Inc., a District of Columbia corporation (“CKO”). CYIOS® DC builds knowledge management solutions, supports organizations with business continuity and IT services for the Department of Defense (“DoD”) community. CKO is the product arm of CYIOS® that offers CYIPRO™, a business transformation tool that utilizes the first project-based operating system to build knowledge centric organizations. CYIPRO™ provides a virtual work space for collaboration, project management, and document management to help manage people, processes and information. CYIPRO™ also provides key solutions for compliance with Securities and Exchange Commission (“SEC”) Sarbanes-Oxley regulations and compliance with Defense Contract Audit Agency (“DCAA”) and performance based contracting for government contractors.

CYIOS® DC

We believe CYIOS® DC is recognized as a premier knowledge management solution provider for the DoD. Established in 1994, we have worked closely with the United States military as a small business contractor providing innovative and comprehensive solutions for the Army’s General Officers and high-level military agencies. We pioneered what we believe to be the largest knowledge management portal, U.S. Army Knowledge Online (“AKO”). We win our business through bidding against other companies for government contracts. These bids may be done independently or through teaming arrangements with other contractors.

Timothy Carnahan, our president and Chief Executive Officer, has over 14 years of executive and technical experience with the highest levels of the U.S. government. When supporting the Army General Officer Management Office, Mr. Carnahan designed and implemented the first Knowledge Management (“KM”) system for the Army, America’s Army Online, which became the core for AKO, the portal that supports over 1.8 million soldiers and civilians worldwide. We believe that AKO has become the KM paradigm for the DoD. The DoD intends to increase its KM spending from $387 million in the fiscal year 2005 to $524 million in the fiscal year 2010, representing a growing potential market for CYIOS®, where KM is our core competency in both product and service support.

With KM as a major focal point for us, the term and market need further explanation. KM is the name of a concept in which an enterprise consciously and comprehensively gathers, organizes, shares, and analyzes its information in terms of resources, documents, and people skills. In early 1998, it was believed that few enterprises actually had a comprehensive knowledge management practice (by any name) in operation. Advances in technology and the way we access and share information have changed that; it has been proven that successful organizations have some kind of knowledge management framework in place. KM involves data mining and a method or operation to share information among users.

We use our expertise in KM, performance-based contracting, enterprise management, and web-based application development to bid on U.S. government contracts. Historically the company has focused on supporting the U.S.

Army, but under its new growth strategy, it is beginning to look at bids from other DoD agencies as well as all U.S. government agencies.

CKO

CKO Inc. markets and sells the software product CYIPRO™. CYIPRO™ is a secure, web-based virtual office that uses an array of tools to give any organization the ability to manage and retain knowledge, collaborate data and ideas, and securely store and share information, all for the purpose of making an organization more efficient and therefore more successful. Using the features of CYIPRO™, users can access and manage their entire organization online from any computer with an Internet connection and web browser or from a mobile device with Internet capability. The result: connected, organized and effective business practices.

The tools of our full online office suite include e-mail, document and file management, calendar, tasks, meetings, contacts, project management, reporting, and timesheet management. The power of managing knowledge and collaboration is unleashed when all of these individual components are shared and used within an entire organization, a division, or a project team. We believe CYIPRO™ will remove the dependency of working from an organization's office, which will free employees to access their e-mail, documents, projects, contacts, and reports from any geographic location at any time. We believe operational costs are also reduced as CYIPRO™ helps small businesses eliminate the burdensome expenses of owning and maintaining servers, associated software, and an internal or outsourced IT staff.

Recent Developments

CYIPRO will be a dominant factor moving forward in revenue growth and its target is the government telework initiative. During 2011, we continued to publicize and market CYIPRO. CYIOS signed a term sheet for line of equity for 7 million dollars and filed and S1 that became effective August 31, 2010 and we are now in the process of filing our Post-Effective Amendment to the S-1, so that we may begin to raise funds via our line of equity. We posted a profit in 2011.

Competition

As a small business, we have eliminated discussions of the mid to large size companies. In the small business space, there are generally about 300 IT contractors that bid against us. We further separate ourselves with our security clearance to an estimated 150 IT contractors. As we get into our specific field of KM, we estimate our competition is narrowed to under 50 companies.

Dependence on Few Major Customers

We are either a prime or sub contractor on contracts with Titan Corporation, Information Management Support Center and GOMO/SLD. Loss of these contracts could have a material adverse effect upon our financial condition and results of operations. We believe that federal governmental agencies will continue to be the source of all or substantially all of our revenues for the foreseeable future.

Government Regulations

All work performed in our space is governed by the federal acquisition regulation. There are small deviations from this named defense federal acquisition regulation.

Intellectual Property

Overview

We rely on a combination of trademarks, trade secrets and contract law rights in order to protect our brand, intellectual property assets and confidential or proprietary information (our “Proprietary Rights”). Our Proprietary Rights are among the most important assets we possess and we depend significantly on these Proprietary Rights in being able to effectively compete in our industry. We cannot be certain that the precautions we have taken to safeguard our Proprietary Rights will provide meaningful protection from the unauthorized use by others. If we must pursue litigation in the future to enforce or otherwise protect our Proprietary Rights, or to determine the validity and scope of the rights of others, we may not prevail and will likely have to make substantial expenditures and divert valuable resources in the process. Moreover, we may not have adequate remedies if our Proprietary Rights are appropriated or disclosed.

Trademarks

As of the fiscal year ended December 31, 2011, CYIOS DC has registered the CYIOS®, and CKO has applied for registration of the CYIPRO™ logo with the United States Patent and Trademark Office in order to establish and protect our brand name and logo as part of our Proprietary Rights.

Copyrights

We claim copyright protection and rights to our CYIPRO™ software and operating system.

Trade Secrets

Whenever we deem it important for purposes of maintaining competitive advantages, we will require parties with whom we share, or who otherwise are likely to become privy to, our trade secrets or other confidential information to execute and deliver to us confidentiality and/or non-disclosure agreements. Among others, this may include employees, consultants and other advisors, each of whom we would require execute such an agreement upon commencement of their employment, consulting or advisory relationships. These agreements will generally provide that all confidential information developed or made known to the individual by us during the course of the individual’s relationship with us is to be kept confidential and not to be disclosed to third parties except under specific circumstances.

As of the fiscal year ended December 31, 2011, we have entered into no confidentiality and/or non-disclosure agreements with our employees, consultants or advisors.

Employees

As of December 31, 2011, we had 15 full-time employees, with 2 in executive management and administration, 1 in product development and technical operations, and 13 on service contracts on either prime or subcontracted contracts with the United States federal government. We also had 2 independent contractors working in accounting, human resources and administration.

We are not subject to any collective bargaining agreements and believe our relationships with our employees to be excellent.

Item 1A. Risk Factors

Our business entails a significant degree of risk and uncertainty, and an investment in our securities should be considered highly speculative. What follows is a general description of the material risks and uncertainties, which may adversely affect our business, our financial condition, including liquidity and profitability, and our results of operations, ultimately affecting the value of an investment in shares of our common stock. In addition to other

information contained in this annual report on Form 10-K, you should carefully consider the following cautionary statements and risk factors:

General Business Risks

Our limited operating history may not serve as an adequate basis upon which to judge our future prospects and results of operations.

We were incorporated in October 1997, but only began our present operation in September 2005, and, as such, we have a limited operating history, and our historical operating activities may not provide a meaningful basis upon which to evaluate our business, financial performance or future prospects. We may not be able to achieve similar operating results in future periods, and, accordingly, you should not rely on our results of operation for prior periods as indications of our future performance.

Our liquidity and capital resources are very limited.

Our ability to fund working capital and anticipated capital expenditures will depend on our future performance, which is subject to general economic conditions, our ability to win government contracts, our private customers, actions of our competitors and other factors that are beyond our control. Our ability to fund operating activities is also dependent upon (i) the extent and availability of bank and other credit facilities, (ii) our ability to access external sources of financing, and (iii) our ability to effectively manage our expenses in relation to revenues. There can be no assurance that our operations and access to external sources of financing will continue to provide resources sufficient to satisfy liabilities arising in the ordinary course of our business.

Our accumulated deficit makes it more difficult for us to borrow funds.

As of the fiscal year ended December 31, 2011, and as a result of historical operating losses from prior years, our accumulated deficit was $24,210,983. Lenders generally regard an accumulated deficit as a negative factor in assessing creditworthiness, and for this reason, the extent of our accumulated deficit coupled with our historical operating losses will negatively impact our ability to borrow funds if and when required. Any inability to borrow funds, or a reduction in favorability of terms upon which we are able to borrow funds, including the amount available to us, the applicable interest rate and the collateralization required, may affect our ability to meet our obligations as they come due, and adversely effect on our business, financial condition, and results of operations, raising substantial doubts as to our ability to continue as a going concern.

Risks Associated with our Business and Industry

We depend on contracts with federal government agencies for all of our revenue, and if our relationships with these agencies were harmed our future revenues and growth prospects would be adversely affected.

Revenues derived from contracts with federal government agencies accounted for all of our revenues for the fiscal year ended December 31, 2011, and we believe that federal government agencies will continue to be the source of all or substantially all of our revenues for the foreseeable future. For this reason, any issues that compromise our relationship with agencies of the federal government in general, or with the Department of Defense in particular, would have a substantial adverse effect on our business. Key among the factors in maintaining our relationships with federal government agencies are our performance on individual contracts, the strength of our professional reputation and the relationships of our key executives with government personnel. To the extent that our performance does not meet expectations, or our reputation or relationships with one or more key personnel are impaired, our business, financial condition and results of operations will be negatively affected and we may not be able to meet our obligations as they come due, raising substantial doubts as to our ability to continue as a going concern.

The federal government may modify, curtail or terminate our contracts at any time prior to their completion, which would have a material adverse effect on our business.

Federal government contracts are highly regulated and federal laws and regulations require that our contracts contain certain provisions which allow the federal government to, among other things:

· terminate current contracts at any time for the convenience of the government, provided such termination is made in good faith;

· cancel multi-year contracts and related orders if funds for contract performance for any subsequent year become unavailable;

· curtail or modify current contracts if requirements or budgetary constraints change; and

· adjust contract costs and fees on the basis of audits done by its agencies.

Should the federal government modify, curtail or terminate our contracts for any reason, we may only recover our costs incurred and profit on work completed prior to such modification, curtailment or termination. The federal government regularly reviews our costs and performance on its contracts, as well as our accounting and general business practices. The federal government may reduce the reimbursement for our fees and contract-related costs as a result of such an audit. There can be no assurance that one or more of our federal government contracts will not be modified, curtailed or terminated under these circumstances, or that we would be able to procure new federal government contracts to offset the revenue lost as a result of any modification, curtailment or termination. As our revenue is dependent on our procurement, performance and receipt of payment under our contracts with the federal government, the loss of one or more critical contracts could have a material adverse effect on our business, financial condition and results of operations and we may not be able to meet our obligations as they come due, raising substantial doubts as to our ability to continue as a going concern.

The federal government has increasingly relied upon contracts that are subject to a competitive bidding process. If we are unable to consistently win new awards under these contracts our business may be adversely affected.

We obtain many of our contracts with the federal government through a process of competitive bidding and, as the federal government has increasingly relied upon contracts that are subject to competitive bidding, we expect that much of the business we are awarded in the foreseeable future will be through such a process. There are substantial costs and a number of risks inherent in the competitive bidding process, including the costs associated with management time necessary to prepare bids and proposals that we may not be awarded, our failure to accurately estimate the resources and costs required to service contracts that we are awarded, and the risk that we may encounter unanticipated expenses, delays or modifications to contracts previously awarded. Our failure to effectively compete and win contracts through, or manage the costs and risks inherent in the competitive bidding process could have a material adverse effect on our business, financial condition and results of operations.

Our revenues and growth prospects may be adversely affected if we or our employees are unable to obtain the requisite security clearances or other qualifications needed to perform services for our customers.

Many federal government programs require contractors to have security clearances. Depending on the level of required clearance, security clearances can be difficult and time-consuming to obtain. If we or our employees are unable to obtain or retain necessary security clearances, we may not be able to win new business, and our existing customers could terminate their contracts with us or decide not to renew them. To the extent we cannot obtain or maintain the required security clearances for our employees working on a particular contract, we may not derive the revenue anticipated from the contract. Employee misconduct, including security breaches, or our failure to comply with laws or regulations applicable to our business could cause us to lose customers or our ability to contract with the

federal government, which would have a material adverse effect on our business, financial condition and results of operations and we may not be able to meet our obligations as they come due, raising substantial doubts as to our ability to continue as a going concern.

Because we are a federal government contractor, misconduct, fraud or other improper activities by our employees or our failure to comply with applicable laws or regulations could have a material adverse effect on our business and reputation.

Because we are a federal government contractor, misconduct, fraud or other improper activities by our employees or our failure to comply with applicable laws or regulations could have a material adverse effect on our business and reputation. Such misconduct could include the failure to comply with federal government procurement regulations, regulations regarding the protection of classified information, legislation regarding the pricing of labor and other costs in federal government contracts and any other applicable laws or regulations. Many of the systems we develop involve managing and protecting information relating to national security and other sensitive government functions. A security breach in one of these systems could prevent us from having access to such critically sensitive systems. Other examples of potential employee misconduct include time card fraud and violations of the Anti-Kickback Act. The precautions we take to prevent and detect these activities may not be effective, and we could face unknown risks or losses. Our failure to comply with applicable laws or regulations or misconduct by any of our employees could subject us to fines and penalties, loss of security clearance and suspension or debarment from contracting with the federal government, any of which would have a material adverse effect on our business, financial condition and results of operations and we may not be able to meet our obligations as they come due, raising substantial doubts as to our ability to continue as a going concern.

We must comply with laws and regulations relating to the formation, administration and performance of federal government contracts.

We must comply with laws and regulations relating to the formation, administration and performance of federal government contracts, which affect how we do business with our customers. Such laws and regulations may potentially impose added costs on our business and our failure to comply with applicable laws and regulations may lead to penalties and the termination of our federal government contracts. Some significant regulations that affect us include:

· the Federal Acquisition Regulations and their supplements, which regulate the formation, administration and performance of federal government contracts;

· the Truth in Negotiations Act, which requires certification and disclosure of cost and pricing data in connection with contract negotiations; and

· the Cost Accounting Standards, which impose accounting requirements that govern our right to reimbursement under certain cost-based government contracts.

Additionally, our contracts with the federal government are subject to periodic review and investigation. Should such a review or investigation identify improper or illegal activities, we may be subject to civil or criminal penalties or administrative sanctions, including the termination of our contracts, forfeiture of profits, the triggering of price reduction clauses, suspension of payments, fines and suspension or debarment from doing business with federal government agencies. We could also suffer harm to our reputation, which would impair our ability to win awards of contracts in the future or receive renewals of existing contracts. Although we have never had any material civil or criminal penalties or administrative sanctions imposed upon us, it is not uncommon for companies in our industry to have such penalties and sanctions imposed on them. If we incur a material penalty or administrative sanction in the future, our business, financial condition and results of operations could be adversely affected.

Our business is subject to routine audits and cost adjustments by the federal government, which, if resolved unfavorably to us, could adversely affect our financial condition.

Federal government agencies routinely audit and review their contractors' performance, cost structure and compliance with applicable laws, regulations and standards. They also review the adequacy of, and a contractor's compliance with, its internal control systems and policies, including the contractor's purchasing, property, estimating, compensation and management information systems. Such audits may result in adjustments to our contract costs, and any costs found to be improperly allocated will not be reimbursed.

We incur significant pre-contract costs that if not reimbursed would deplete our cash balances and adversely affect our financial condition.

We often incur costs on projects outside of a formal contract when customers ask us to begin work under a new contract that has yet to be executed, or when they ask us to extend work we are currently doing beyond the scope of the initial contract. We incur such costs at our risk, and it is possible that the customers will not reimburse us for these costs if we are ultimately unable to agree on a formal contract which could have an adverse effect on our business, financial condition and results of operations.

Our intellectual property may not be adequately protected from unauthorized use by others, which could increase our litigation costs and adversely affect our business.

Our intellectual properties, including our brands, are some of the most important assets that we possess in our ability to generate revenues and profits and we rely significantly on these intellectual property assets in being able to effectively compete in our markets. However, our intellectual property rights may not provide meaningful protection from unauthorized use by others, which could result in an increase in competing products and services and a reduction in our own ability to generate revenue. Moreover, if we must pursue litigation in the future to enforce or otherwise protect our intellectual property rights, or to determine the validity and scope of the proprietary rights of others, we may not prevail and will likely have to make substantial expenditures and divert valuable resources in any case.

We face substantial competition in attracting and retaining qualified senior management and key personnel and may be unable to develop and grow our business if we cannot attract and retain as necessary, or if we were to lose our existing, senior management and key personnel.

Our success, to a large extent, depends upon our ability to attract, hire and retain highly qualified and knowledgeable senior management and key personnel who possess the skills and experience necessary to execute our business strategy. Our ability to attract and retain such senior management and key personnel will depend on numerous factors, including our ability to offer salaries, benefits and professional growth opportunities that are comparable with and competitive to those offered by more established companies operating in our industries and market segments. We may be required to invest significant time and resources in attracting and retaining, as necessary, additional senior management and key personnel, and many of the companies with which we will compete for any such individuals have greater financial and other resources, affording them the ability to undertake more extensive and aggressive hiring campaigns, than we can. Furthermore, an important component to overall compensation offered to senior management and key personnel may be equity. If our stock prices do not appreciate over time, it may be difficult for us to attract and retain senior management and key personnel. Moreover, should we lose our key personnel, we may be unable to prevent the unauthorized disclosure or use of our trade secrets, including our practices, procedures or client lists. The normal running of our operations may be interrupted, and our financial condition and results of operations negatively affected, as a result of any inability on our part to attract or retain the services of qualified and experienced senior management and key personnel, our existing key personnel leaving and a suitable replacement not being found, or should any former member of senior management or key personnel disclose our trade secrets.

The loss of our Chief Executive Officer could have a material adverse effect on our business.

Our success depends to a large degree upon the skills, network and professional business contacts of our Chief Executive Officer, Timothy Carnahan. We presently do not maintain key person life insurance on, and have no employment agreement with, Timothy Carnahan, and there can be no assurance that we will be able to retain him or, should he choose to leave us for any reason, to attract and retain a replacement or additional key executives. The loss of our Chief Executive Officer would have a material adverse effect on our business, our financial condition, including liquidity and profitability, and our results of operations, raising substantial doubts as to our ability to continue as a going concern.

Risks Associated with an Investment in our Common Stock

Unless an active trading market develops for our securities, you may not be able to sell your shares.

Although, we are a reporting company and our common shares are quoted on the OTC Bulletin Board (owned and operated by the Nasdaq Stock Market, Inc.) under the symbol "CYIO", there is not currently an active trading market for our common stock and an active trading market may never develop or, if it does develop, may not be maintained. Failure to develop or maintain an active trading market will have a generally negative effect on the price of our common stock, and you may be unable to sell your common stock or any attempted sale of such common stock may have the effect of lowering the market price and therefore your investment could be a partial or complete loss.

Since our common stock is thinly traded it is more susceptible to extreme rises or declines in price, and you may not be able to sell your shares at or above the price paid.

Since our common stock is thinly traded its trading price is likely to be highly volatile and could be subject to extreme fluctuations in response to various factors, many of which are beyond our control, including:

- the trading volume of our shares;
- the number of securities analysts, market-makers and brokers following our common stock;
- changes in, or failure to achieve, financial estimates by securities analysts;
- new products or services introduced or announced by us or our competitors;
- actual or anticipated variations in quarterly operating results;
- conditions or trends in our business industries;
- announcements by us of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- additions or departures of key personnel;
- sales of our common stock; and
- general stock market price and volume fluctuations of publicly-traded, and particularly microcap, companies.

You may have difficulty reselling shares of our common stock, either at or above the price you paid, or even at fair market value. The stock markets often experience significant price and volume changes that are not related to the operating performance of individual companies, and because our common stock is thinly traded it is particularly susceptible to such changes. These broad market changes may cause the market price of our common stock to decline regardless of how well we perform as a company. In addition, securities class action litigation has often been initiated

following periods of volatility in the market price of a company's securities. A securities class action suit against us could result in substantial legal fees, potential liabilities and the diversion of management's attention and resources from our business. Moreover, and as noted below, our shares are currently traded on the OTC Bulletin Board and, further, are subject to the penny stock regulations. Price fluctuations in such shares are particularly volatile and subject to manipulation by market-makers, short-sellers and option traders.

Trading in our common stock on the OTC Bulletin Board may be limited thereby making it more difficult for you to resell any shares you may own.

Our common stock is quoted on the OTC Bulletin Board (owned and operated by the Nasdaq Stock Market, Inc.). The OTC Bulletin Board is not an exchange and, because trading of securities on the OTC Bulletin Board is often more sporadic than the trading of securities listed on a national exchange or on the Nasdaq National Market, you may have difficulty reselling any of the shares of our common stock that you may own.

Our common stock is subject to the "penny stock" regulations, which are likely to make it more difficult to sell.

Our common stock is considered a "penny stock," which generally is a stock trading under $5.00 and not registered on a national securities exchange or quoted on the Nasdaq National Market. The SEC has adopted rules that regulate broker-dealer practices in connection with transactions in penny stocks. These rules generally have the result of reducing trading in such stocks, restricting the pool of potential investors for such stocks, and making it more difficult for investors to sell their shares once acquired. Prior to a transaction in a penny stock, a broker-dealer is required to:

- deliver to a prospective investor a standardized risk disclosure document that provides information about penny stocks and the nature and level of risks in the penny stock market;

- provide the prospective investor with current bid and ask quotations for the penny stock;

- explain to the prospective investor the compensation of the broker-dealer and its salesperson in the transaction;

- provide investors monthly account statements showing the market value of each penny stock held in the their account; and

- make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction.

These requirements may have the effect of reducing the level of trading activity in the secondary market for a stock that is subject to the penny stock rules. Since our common stock is subject to the penny stock rules, investors in our common stock may find it more difficult to sell their shares.

Future issuances by us or sales of our common stock by our officers or directors may dilute your interest or depress our stock price.

We may issue additional shares of our common stock in future financings or may grant stock options to our employees, officers, directors and consultants under our 2006 Employee Stock Option Plan and 2007 Equity Incentive Plan. Any such issuances could have the effect of depressing the market price of our common stock and, in any case, would dilute the interests of our common stockholders. Such a depression in the value of our common stock could reduce or eliminate amounts that would otherwise have been available to pay dividends on our common stock (which are unlikely in any case) or to make distributions on liquidation. Furthermore, shares owned by our officers or directors which are registered in a registration statement, or which otherwise may be transferred without registration pursuant to an applicable exemptions under the Securities Act of 1933, as amended, may be sold. Because of the

perception by the investing public that a sale by such insiders may be reflective of their own lack of confidence in our prospects, the market price of our common stock could decline as a result of a sell-off following sales of substantial amounts of common stock by our officers and directors into the public market, or the mere perception that these sales could occur.

We do not intend to pay any common stock dividends in the foreseeable future.

We have never declared or paid a dividend on our common stock and, because we have very limited resources and a substantial accumulated deficit, we do not anticipate declaring or paying any dividends on our common stock in the foreseeable future. Rather, we intend to retain earnings, if any, for the continued operation and expansion of our business. It is unlikely, therefore, that the holders of our common stock will have an opportunity to profit from anything other than potential appreciation in the value of our common shares held by them. If you require dividend income, you should not rely on an investment in our common stock.

Item 2. Description of Property.

All of our property is leased and we do not own any real property.

Our headquarters are located at The Ronald Reagan Building, 1300 Pennsylvania Ave, Suite 700 Washington D.C. 20004. We lease this 150 square foot space for a term of 12 months at a rate of $450 per month. 1 employee is based in our headquarters, the remaining employees work on-site at our customers' locations, and, as such we do not maintain separate office or other space for these employees.

Item 3. Legal Proceedings.

As of the date of this annual report on Form 10-K for the fiscal year ended December 31, 2011, there were no pending material legal proceedings to which we were a party and we are not aware that any were contemplated.

In addition, during the past ten years, none of our directors, executive officers or control persons has been involved in any of the following events:

· any bankruptcy petition filed by or against any business of which such person was an executive officer either at the time of the bankruptcy or within two years prior to that time;

· any conviction in a criminal proceeding or being subject to a pending criminal proceeding (excluding traffic violations and other minor offenses);

· being subject to any order, judgment, or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction, permanently or temporarily enjoining, barring, suspending or otherwise limiting his involvement in any type of business, securities or banking activities; and

· being found by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission or the Commodity Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended, or vacated.

· Any judicial or administrative proceedings resulting from involvement in mail or wire fraud or fraud in connection with any business entity;

· Any judicial or administrative proceedings based on violations of federal or state securities, commodities, banking or insurance laws and regulations, or any settlement114 to such actions; and

· Any disciplinary sanctions or orders imposed by a stock, commodities or derivatives

· Exchange or other self-regulatory organization.

Item 4. Mine Safety Disclosure.

N/A

PART II

Item 5. Market for Common Equity and Related Stockholder Matters and Registrant Purchases of Equity Securities.

Our shares of common stock trade on the OTC Bulletin Board under the symbol “CYIO”. The following is a summary of the high and low bid prices of our common stock on the OTC Bulletin board during the periods presented, as reported by the NASDAQ Stock Market, Inc. Such prices represent inter-dealer prices, without retail mark-up, mark-down or commissions, and may not necessarily accurately represent actual transactions.

	Year Ended December 31, 2011		**Year Ended December 31, 2010**	
	High	**Low**	**High**	**Low**
First Quarter	$0.02	$0.02	$0.05	$0.05
Second Quarter	$0.03	$0.03		

	$0.04
	$0.04
Third Quarter	
	$0.09
	$0.07
	$0.03
	$0.03
Fourth Quarter	
	$0.05
	$0.04
	$0.02
	$0.02

As of the fiscal year ended December 31, 2011 we had approximately 103 shareholders of record (excluding the number of persons or entities holding shares of our common stock in nominee or street name through one or more brokerage firms).

Dividends

We have neither declared nor paid any cash dividends on our shares of common stock and do not anticipate declaring or paying any dividends in the foreseeable future. The decision to declare future dividends, if any, will depend upon our results of operations, financial condition, current and future anticipated capital requirements, contractual restrictions, restrictions imposed by applicable law and other factors that our board of directors may deem relevant. Although it is our intention to retain future earnings, if any, for use in our business operations, there are currently no restrictions in place that would limit our ability to pay dividends.

Reverse Stock Split

Effective April 7, 2005 we completed a 1-for-30 reverse stock split of our outstanding shares of common and preferred stock, unless otherwise indicated all references to our outstanding shares of common stock in this annual report on Form 10-K reflect the reverse stock split.

Equity Incentive Plans

On April 21, 2006, the sole member of our board of directors approved the adoption of our 2006 Employee Stock Option Plan (the “2006 Plan”). The 2006 Plan provides for the issuance of a maximum of 3,000,000 shares of common stock in connection with stock options granted there under, plus an annual increase to be added on the first nine anniversaries of the effective date of the 2006 Plan, equal to at least (i) 1% of the total number of shares of common stock then outstanding, (ii) 350,000 shares, or (iii) a number of shares determined by our board of directors prior to such anniversary date. The 2006 Plan has a term of 10 years and may be administered by our board of directors or by a

committee made up of not less than 2 members of appointed by our board of directors. Participation in the 2006 Plan is limited to employees, officer, directors and consultants of the Company and its subsidiaries. Incentive stock options granted pursuant to the 2006 Plan must have an exercise price per share not less than 100%, and non-qualified stock options not less than 85%, of the fair market value of our common stock on the date of grant. Awards granted pursuant to the 2006 Plan may not have a term exceeding 10 years and will vest upon conditions established by our board of directors.

On November 12, 2007, the sole member of our board of directors approved the adoption of our 2007 Equity Incentive Plan (the "2007 Plan"). The 2007 Plan provides for the issuance of a maximum of 3,500,000 shares of common stock in connection with awards granted there under, which may include stock options, restricted stock awards and stock appreciation rights. The 2007 Plan has a term of 10 years and may be administered by our board of directors or by a committee appointed by our board of directors (the "Committee"). Participation in the 2007 Plan is limited to employees, officer, directors and consultants of the Company and its subsidiaries. Incentive stock options granted pursuant to the 2007 Plan must have an exercise price per share not less than 100%, and non-qualified stock options not less than 85%, of the fair market value of our common stock on the date of grant. Awards granted pursuant to the 2007 Plan may not have a term exceeding 10 years and will vest upon conditions established by the Committee.

The following table sets forth information as of the fiscal year ended December 31, 2011 with respect to the shares of our common stock that may be issue under each of our 2006 Plan and 2007 Plan.

Equity Compensation Plan Information

Number of securities

remaining available for

future issuance under

Number of securities

Weighted-average

equity compensation

to be issued upon

exercise price of

plans (excluding

exercise of

outstanding options,

securities reflected in

outstanding options, warrants

warrants and rights

column (a))

Plan Category	(a)	(b)	(c)
Equity compensation plans approved by security holders	-	-	-
Equity compensation plans not approved by security holders	-	-	35,700
Total	**-**	**-**	**35,700**

Recent Sales of Unregistered Securities

There were no previously unreported sales of unregistered securities during the fiscal years ended December 31, 2011 and 2010. All sales of securities during 2011 and 2010 are outlined in Note E of the notes to the audited financial statements and all of those sales were registered securities.

Purchases of Equity Securities

There were no repurchases of equity securities during the fourth quarter of the fiscal year ended December 31, 2011.

Item 6. Selected Financial Data

If the registrant qualifies as a smaller reporting company as defined by Rule 229.10(f)(1), it is not required to provide the information required by this Item.

Item 7. Management's Discussion and Analysis of Financial Conditions and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our audited consolidated financial statements, related notes, and other detailed information included elsewhere in this annual report on Form 10-K. Our financial statements have been prepared in accordance with United States generally accepted accounting principles ("GAAP"), contemplate that we will continue as a going concern, and do not contain any adjustments that might result if we were unable to continue as a going concern. Certain information contained below and elsewhere in this annual report on Form 10-K, including information regarding our plans and strategy for our business, constitute forward-looking statements. See "Note Regarding Forward-Looking Statements."

Overview

We are a leading systems integrator and knowledge management solutions provider presently with the U.S. Department of Defense and we have one of the largest knowledge management systems. We have been working to expand into the non-governmental sector by marketing our product CYIPROTM in hopes to generate revenue. This product is in the CKO Inc. subsidiary company and has generated no income during the process of building the product. We intend on offering the product for sale during 2012 in hopes that this product will make us a leading systems integrator and knowledge management solutions provider in the non-governmental market. All of our revenue is derived from the services provided pursuant to single and multiple year awards to different U.S. Army and federal government agencies. CKO, Inc., one of our operating subsidiaries, provides a designed online office management product which is known as CYIPRO™. For the years ended December 31, 2011 and 2010, we received no revenue from CYIPRO™.

Results of Operations

Sales/Net Profit

The total sales for our active subsidiary, CYIOS Corporation, a District of Columbia corporation, for the fiscal year ended December 31, 2011, were $1,926,324 compared to $1,849,804 for the fiscal year ended December 31, 2010; an increase in sales of $76,520 or 4.14%. Our other active subsidiary, CKO, Inc., a District of Columbia corporation, produced no revenue for the fiscal years ended December 31, 2011 and 2010. Net income for the year ended December 31, 2011 was $118,907, a net income per share of $0.00, compared to a net loss for the fiscal year ended December 31, 2010 of $394,051 or a net operating loss per share of $0.01. Included in the net loss for the year ended December 31, 2010 is a non-cash expense for stock compensation in the amount of $416,167. This non-cash expense in the amount of $416,167 is the aggregate market value for the issuance of stock to the President and CEO in the amount of $350,000 for a bonus for past performance and the remaining $66,167 was issued to consultants for their services performed during 2010.

In 2006, management made the decision to expand our operations by attempting to increase our business with the Department of Defense and the rest of the federal government. In order to achieve this goal, we have actively bid on request for proposals by different departments and their agencies. We have, and will continue to invest all of our earnings into additional personnel to help achieve this goal. We believe that our efforts in working to achieve the aforementioned goals have helped us achieve a net profit in the year 2011. We are also aggressively marketing the sale of our product CYIPRO™ to Department of Defense, government and small businesses. In the latter part of 2010 and in early 2011 we launched a new marketing campaign to inform the public about our product CYIPRO™.

Cost of Sales

Cost of sales for the fiscal year ended December 31, 2011 was $1,015,366 compared to cost of sales for the fiscal year ended December 31, 2010 in the amount of $1,078,841; a decrease of $63,475 or approximately 5.88%.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the fiscal years ended December 31, 2011 and 2010 were $135,168 and $94,931, respectively; an increase of $40,237 or 42.39%.

Other Expenses/Stock Compensation

Total other expenses for the fiscal years ended December 31, 2011 and 2010 were $698,712 and $663,557, respectively; an increase of $35,155 or 5.30%. The total other expenses of $698,712 in the fiscal year ended December 31, 2011 consisted of $585,196 in indirect labor and $113,516 in professional services and consulting fees. The total other expenses of $663,557 for the fiscal year ended December 31, 2010 consisted primarily of $595,592 in indirect labor and $67,181 in professional services fees, consulting services and $784 in depreciation.

Total Stock Compensation for the fiscal years ended December 31, 2011 and 2010 were $9,000 and $416,167, respectively. In the first quarter of 2011, a consultant returned 1,400,000 shares of stock that were valued at $0.07 per share (a total value of $98,000) for services not performed. Of the $98,000, $57,167 was reversed out of prepaid expense and the remaining $40,833 was booked as an entry to other income as “Cancellation of shares issued under consulting agreement”. The total stock compensation in December 31, 2010 consisted of a $350,000 stock bonus granted to the President and CEO and stock for compensation for marketing consultants in the amount of $66,167.

Liquidity and Capital Resources

At December 31, 2011, we had cash and cash equivalents of $16,675, compared to $27,603 at December 31, 2010, a decrease of $10,928.

During the fiscal year ended December 31, 2011, cash provided by operating activities was $43,612, consisting primarily of the Net Income of $118,907 offset by:

· Non-cash charges related to the Valuation of Shares returned for consulting services not performed of $40,833 and Loss on Disposal of Computer Equipment of $1,436; and

· Working capital changes of $35,898, consisting primarily of a net increase in Accounts Receivable, Other Assets in the amount of $6,817 offset by a net decrease in Payroll Taxes Payable, Accounts Payable, and Accruals in the amount of $29,081.

Cash used in financing activities for the fiscal year ended December 31, 2011 was $54,540; consisting primarily of:

· Payoff of Convertible Note Payable in the amount of $36,000; and

· Payments made on the Line of Credit in the amount of $18,540.

Our long-term working capital and capital requirements will depend upon numerous factors, including our efforts to continue to improve operational efficiency and conserve cash. We are not aware of any known trends or demands, commitments, events or uncertainties that will result in or will reasonably likely result in our liquidity increasing or decreasing in a material way. We do not have any material commitments for capital expenditures as of the fiscal year end December 31, 2011. And, we are not aware of any material trends favorable/unfavorable in our capital resources that may materially change our equity or debt. We do not believe that changes in the spending policies of the U.S. government, such as potential decreases in the budgets of federal agencies, including the Department of Defense, or

delays in the passage of the U.S. Government budget to be uncertainties that are reasonably likely to have a material impact on our liquidity and results of operations. Many budget cuts have been made since 2001 and we have not been materially impacted at all by those budget changes.

Off-Balance Sheet Arrangements

As of the fiscal year ended December 31, 2011, we did not have any off-balance sheet arrangements.

Critical Accounting Policies

The preparation of 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, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods.

Our management routinely makes judgments and estimates about the effects of matters that are inherently uncertain. As the number of variables and assumptions affecting the probable future resolution of the uncertainties increase, these judgments become even more subjective and complex. We have identified the following accounting policies, described below, as the most critical to an understanding of our current financial condition and results of operations.

Revenue Recognition

We recognize revenue when persuasive evidence of an arrangement exists, services have been rendered or goods delivered, the contract price is fixed or determinable, and it is reasonably assured to be collectible. We follow Statement of Position ("SOP") 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, as it applies to time-and-material contracts. Revenue on time-and-materials contracts is recognized based on the hours actually incurred at the negotiated contract billing rates, plus the cost of any allowable material costs and out-of-pocket expenses. Revenue on fixed-price contracts pursuant to which a client pays us a specified amount to provide only a particular service for a stated time period, or so-called fee-for-service arrangement, is recognized as amounts become billable, assuming all other criteria for revenue recognition are met. We recognize revenue from government contracts.

Recent Accounting Pronouncements

In July 2010, the FASB issued Accounting Standard Update No. 2010-20 (ASU No. 2010-20) "Receivables" (Topic 310). ASU No. 2010-20 provides financial statement users with greater transparency about an entity's allowance for credit losses and the credit quality of its financing receivables. This update is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. The amendments in this update apply to both public and nonpublic entities with financing receivables, excluding short-term trade accounts receivable or receivables measured at fair value or lower of cost or fair value. The objective of the amendments in ASU No. 2010-20 is for an entity to provide disclosures that facilitate financial statement users' evaluation of (1) the nature of credit risk inherent in the entity's portfolio of financing receivables, (2) How that risk is analyzed and assessed in arriving at the allowance for credit losses and (3) The changes and reasons for those changes in the allowance for credit losses. The entity must provide disclosures about its financing receivables on a disaggregated basis. For public entities ASU No. 2010-20 is effective for interim and annual reporting periods ending on or after December 15, 2010. For nonpublic entities ASU No. 2010-20 will become effective for annual reporting periods ending on or after December 15, 2011. The Company is evaluating the impact ASU No. 2010-20 will have on the financial statements.

In August 2010, the FASB issued Accounting Standard Updates No. 2010-21 (ASU No. 2010-21) "Accounting for Technical Amendments to Various SEC Rules and Schedules" and No. 2010-22 (ASU No. 2010-22) "Accounting for

Various Topics – Technical Corrections to SEC Paragraphs". ASU No 2010-21 amends various SEC paragraphs pursuant to the issuance of Release no. 33-9026: Technical Amendments to Rules, Forms, Schedules and Codification of Financial Reporting Policies. ASU No. 2010-22 amends various SEC paragraphs based on external comments received and the issuance of SAB 112, which amends or rescinds portions of certain SAB topics. Both ASU No. 2010-21 and ASU No. 2010-22 are effective upon issuance. The amendments in ASU No. 2010-21 and No. 2010-22 will not have a material impact on the Company's financial statements.

Other ASUs not effective until after December 31, 2011, are not expected to have a significant effect on the Company's consolidated financial position or results of operations.

Item 8. Financial Statements.

CYIOS Corporation and Subsidiaries

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors

CYIOS Corporation

Washington, DC

We have audited the accompanying consolidated balance sheets of CYIOS Corporation (the *"Company"*) as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CYIOS Corporation as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Silberstein Ungar, PLLC

Silberstein Ungar, PLLC

Bingham Farms, Michigan

March 28, 2012

CYIOS Corporation and Subsidiaries

Consolidated Balance Sheet

As of

As of

Deccember 31

December 31,

	2011	2010
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 16,675	$ 27,603
Accounts Receivable	176,651	172,937
Related Party Interest Receivable	43,434	25,903
Prepaid and Other Current Assets	5,122	76,717
TOTAL CURRENT ASSETS	241,882	303,160
FIXED ASSETS, NET	-	1,436
OTHER ASSETS		
Related Party Loan	219,284	219,284

TOTAL OTHER ASSETS	219,284	219,284
TOTAL ASSETS	$ 461,166	$ 523,880
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Current Liabilities:		
Line of Credit	$ 32,928	$ 51,468
Convertible Note Payable	-	36,000
Accounts Payable	17,275	9,452
Accruals and Other Payables	23,984	60,888
TOTAL LIABILITIES	74,187	157,808
STOCKHOLDERS' EQUITY		
Convertible Preferred Stock ($.001 par value, 5,000,000 authorized: 29,713 and 29,713 issued and outstanding)		

30

30

Common Stock ($.001 par value, 100,000,000 shares authorized: 36,311,640 and 37,711,640 shares issued and outstanding)

36,311

37,711

Additional Paid-in-Capital

24,496,376

24,592,976

Accumulated Deficit

(24,145,738)

(24,264,645)

TOTAL STOCKHOLDERS' EQUITY

386,979

366,072

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY

$ 461,166

$ 523,880

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

CYIOS Corporation and Subsidiaries

Consolidated Statement of Operations

Statement of Operations for the years ended

December 31,

2011

2010

SALES AND COST OF SALES

Sales	$ 1,926,324	$ 1,849,804
Cost of Sales	1,015,366	1,078,841
Gross Profit	910,958	770,963
OPERATING EXPENSES		
Selling, general and administrative	135,168	94,931
Payroll Expense--Indirect Labor	585,196	595,592
Consulting and Professional Fees Expense	113,516	67,181
Payroll Expense--Stock Compensation	-	350,000
Consulting Expense--Stock Compensation	9,000	66,167
Depreciation		

	-	784
TOTAL OPERATING EXPENSES	842,880	1,174,655
Income/(Loss) from Operations	68,078	(403,692)
OTHER INCOME/(EXPENSE)		
Interest Income--Related Party	17,531	17,741
Interest Expense	(6,098)	(8,100)
Cancellation of shares issued under Consulting Agreement	40,833	-
Loss on Disposal of Equipment	(1,437)	-
NET OTHER INCOME/(EXPENSE)	50,829	9,641
INCOME/(LOSS) BEFORE PROVISION FOR INCOME TAXES	118,907	

(394,051)

PROVISION FOR INCOME TAXES

-

-

NET INCOME/(LOSS)

118,907

(394,051)

Net income/(loss) per share--basic and fully diluted

$ 0.00

$ (0.01)

Weighted average shares outstanding--basic and fully diluted

36,341,353

36,806,829

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

CYIOS Corporation and Subsidiaries

Consolidated Statement of Stockholders' Deficit

Preferred

Common

Additional

Shares

Stock

Paid-in

Accumulated

(000's)

$

Capital

Deficit

Totals

Beginning Balances, December 31, 2009

$ 30

$ 30,149

$ 24,199,038

$ (23,870,594)

$ 358,623

Beginning Balances (in shares) at December 31, 2009

29,713

30,148,877

-

-

-

Shares issued for consulting services (in shares)

-

1,000,000

-

-

-

Shares issued for consulting services

-

1,000

36,500

-

37,500

Shares issued to executive officer as a bonus (in shares)

-

5,000,000

-

-

-

Shares issued to executive officer as a bonus

-

5,000

345,000

-

350,000

Portion of Note Payable converted to Shares (in shares)

-

1,562,763

-

-

-

Portion of Note Payable converted to Shares

-

1,562

12,438

-

14,000

Net Income (loss)

-

-

(394,051)

(394,051)

Ending Balances at December 31, 2010 (in shares)

29,713

37,711,640

-

-

-

Ending Balances at December 31, 2010

$ 30

$ 37,711

$ 24,592,976

$ (24,264,645)

$ 366,072

Return of Shares issued for consulting services (in shares)

-

(1,400,000)

-

-

-

Return of Shares issued for consulting services

-

(1,400)

(96,600)

-

(98,000)

Net Income (loss)

-

-

-

118,907

118,907

Ending Balances at December 31, 2011 (in shares)

29,713

36,311,640

-

-

-

Ending Balances at December 31, 2011

$ 30

$ 36,311

$ 24,496,376

$ (24,145,738)

$ 386,979

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

CYIOS Corporation and Subsidiaries

Consolidated Statements of Cash Flows

For the years ended

December 31,

2011

2010

CASH FLOWS FROM OPERATING ACTIVITIES:

Net Income/(loss)

$ 118,907

$ (394,051)

Adjustments to reconcile net loss to net cash provided by (used in)

operating activities:

Depreciation

-

784

Loss on Disposal of Computer Equipment

1,436

-

Note Payable Converted into Shares

-

14,000

Value of Shares returned for services not performed

(40,833)

387,500

Changes in Assets and Liabilities:

(Increase)/Decrease in Accounts Receivable

(3,714)

(58,341)

(Increase) in Interest Receivable--Related Party

(17,531)

-

Decrease in Prepaid and Other Current Assets

14,428

(923)

(Decrease) in Accruals and Other Payables

7,823

(34,588)

(Decrease) in Accounts Payable

(36,904)

5,407

NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES

43,612

(80,212)

CASH FLOWS FROM INVESTING ACTIVITIES:

(Increase)/Decrease in Related Party Loan

-

15,000

NET CASH PROVIDED BY OPERATING ACTIVITIES

-

15,000

CASH FLOWS FROM FINANCING ACTIVITIES:

Proceeds from Issuance of Convertible Note Payable

-

50,000

Principal Reduction on Convertible Note Payable--shares issued

-

(14,000)

Payoff of Convertible Note Payable

(36,000)

-

Principal Payments Made on line of Credit

(18,540)

(19,633)

NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES

(54,540)

16,367

NET INCREASE IN CASH AND

CASH EQUIVALENTS

(10,928)

(48,845)

CASH AND CASH EQUIVALENTS:

Beginning of Period

27,603

76,448

End of Period

$ 16,675

$ 27,603

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

CASH PAID DURING THE PERIOD FOR:

Interest

$ 6,098

$ 8,100

Taxes

$ -

$ -

NON CASH INVESTING AND FINANCING ACTIVITIES:

Shares of Common Stock Returned for Consulting Services not Performed

$ 98,000

$ -

Shares of Common Stock Issued for Prepaid Consulting Services

$ -

$ 37,500

Stock Issued for Consulting Services/Employee Bonus

$ -

$ 356,000

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

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business Activity—The consolidated financial statements of CYIOS Corporation (The Company), formerly China Print, Inc. include its subsidiary by the same name CYIOS Corporation and CKO, Inc. The Company, through its subsidiary CYIOS Corporation does business as a leading systems integrator and Knowledge Management Solutions provider supporting the DoD and Government. The Company contracts its services for single and multiple year awards to different DoD and US Government agencies. CKO Inc. owns a custom designed online office management product. The Company launched this product in November of 2005 to the general public and commercial businesses.

Consolidation—The consolidated financial statements include the accounts of the Company and its Subsidiaries, after all eliminations of all intercompany accounts and transactions.

Cash and Cash Equivalents—The Company considers liquid investments with an original maturity of three months or less to be cash equivalents.

Management's Use of Estimates—The preparation of 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 disclosures of contingent assets and liabilities at the date of consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition—The Company derives revenue primarily from the sale and service of information technology services to the government. In accordance with SEC Staff Accounting Bulletin No. 104, "Revenue Recognition" ("SAB 104"), revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed and determinable, collectability is reasonably assured, contractual obligations have been satisfied and title and risk of loss have been transferred to the customer.

Revenues are recognized on a monthly basis when hours are billed to the customer for the work performed.

Selecting the appropriate revenue recognition method involves judgment based on the contract and can be complex depending upon the structure and terms and conditions of the contract.

Contract claims are unanticipated additional costs incurred but not provided for in the executed contract price that we seek to recover from the customer. Such costs are expensed as incurred. Additional revenue related to contract claims is recognized when the amounts are awarded by the customer.

Comprehensive Income (Loss)—The Company adopted Financial Accounting Standards Board Statement of Financial Accounting Standards (SFAS) No. 130, *"Reporting Comprehensive Income"*, which establishes standards for the reporting and display of comprehensive income and its components in the consolidated financial statements. There were no items of comprehensive income (loss) applicable to the Company during the periods covered in the consolidated financial statements.

Advertising Costs—Advertising costs are expensed as incurred. For the years ended December 31, 2011 and 2010, the company incurred $17,537 and $9,690 respectively.

Accounting Basis—The Company uses the accrual basis of accounting and accounting principles generally accepted in the United States of America ("GAAP" accounting). The Company has adopted a December 31 fiscal year end.

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Income Taxes—Income taxes are provided in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, *"Accounting for Income Taxes."* A deferred tax asset or liability is recorded for all temporary differences between financial and tax reporting and net operating loss-carryforwards.

Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that, and some portion or the entire deferred tax asset will not be realized. Deferred tax assets and liabilities are adjusted for the effect of changes in tax laws and rates on the date of enactment.

Fair Value of Financial Instruments/Line of Credit—The carrying amounts reported in the consolidated balance sheet for cash, accounts receivable and payables approximate fair value based on the short-term maturity of these instruments.

Accounts Receivable—Accounts deemed uncollectible are written off in the year they become uncollectible. Outstanding Accounts Receivable as of December 31, 2011 was $176,651 (CYIOS Subsidiary) and as of December 31, 2010 was $172,937 (CYIOS Subsidiary).

Impairment of Long-Lived Assets—. Using the guidance of Statement of Financial Accounting Standards (SFAS) No. 144, *"Accounting for the Impairment or Disposal of Long-Lived Assets"*, the Company reviews the carrying value of property, plant, and equipment for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends and prospects, the manner in which the property is used, and the effects of obsolescence, demand, competition, and other economic factors.

Property and Equipment—Property and equipment is stated at cost. Depreciation is provided by the straight-line method over the estimated economic life of the property and equipment remaining from five to seven years. New

computer equipment assets in the amount of $3,917 were purchased in 2007 and in 2011 this equipment was disposed of and written off as a loss in the amount of 1,437.

Recent Accounting Pronouncements—In August 2010, the FASB issued Accounting Standard Updates No. 2010-21 (ASU No. 2010-21) "Accounting for Technical Amendments to Various SEC Rules and Schedules" and No. 2010-22 (ASU No. 2010-22) "Accounting for Various Topics – Technical Corrections to SEC Paragraphs". ASU No 2010-21 amends various SEC paragraphs pursuant to the issuance of Release no. 33-9026: Technical Amendments to Rules, Forms, Schedules and Codification of Financial Reporting Policies. ASU No. 2010-22 amends various SEC paragraphs based on external comments received and the issuance of SAB 112, which amends or rescinds portions of certain SAB topics. Both ASU No. 2010-21 and ASU No. 2010-22 are effective upon issuance. The amendments in ASU No. 2010-21 and No. 2010-22 will not have a material impact on the Company's financial statements.

Other ASUs not effective until after December 31, 2011, are not expected to have a significant effect on the Company's consolidated financial position or results of operations.

NOTE B—FINANCING FACILITY

During the year ended December 31, 2003 the Company entered into an accounts receivable financing facility for a maximum of $500,000 with an unrelated third party. Collateral for the facility is a first security interest in all corporate assets and a personal guarantee of the Company's majority shareholder. The Company pays a 2% fee for each advance and interest accrues on all advances at a floating rate, at the prime rate published in the Wall Street Journal plus 2% (5.25% at December 31, 2011). The Company is advanced 90% of all government contract invoices. The advances are used for general corporate working capital. Residual, or holdback amounts, less fees and interest, are remitted to the Company when payments are received from the government. All of the Company's revenue stream and accounts receivables are factored through this facility.

NOTE C—INCOME TAXES

Due to the prior years' operating losses and the inability to recognize an income tax benefit therefrom, there is no provision for current or deferred federal or state income taxes for the year ended December 31, 2011.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amount used for federal and state income tax purposes.

The Company's total deferred tax asset, calculated using federal and state effective tax rates, as of December 31, 2011 is as follows:

Total Deferred Tax Asset

$ 2,231,203

Valuation Allowance

(2,231,203)

Net Deferred Tax Asset

-

The reconciliation of income taxes computed at the federal statutory income tax rate to total income taxes for the years ended December 31, 2011 and 2010 is as follows:

	2011	2010
Income tax computed at the federal statutory rate	34%	34%
State income tax, net of federal tax benefit	0%	0%
Total	34%	34%
Valuation allowance	-34%	-34%
Total deferred tax asset	0%	0%

NOTE C—INCOME TAXES (CONT'D)

Because of the Company's lack of earnings history, the deferred tax asset has been fully offset by a valuation allowance. The valuation allowance increased (decreased) by $(26,545) and $(6,579) in 2011 and 2010, respectively. No tax benefits have been recorded for the nondeductible (tax) expenses (including stock for services) totaling $17,583,375.

As of December 31, 2011, the Company had federal and state net operating loss carryforwards as follows of $6,562,363 which will expire at various times through the year 2031.

NOTE D—CONCENTRATION

All of the Company's revenue are generated from either a prime or sub contractor on contracts with the Information Management Support Center U.S. Army and GOMO/SLD. Loss of these contracts could have a material effect upon the Company's financial condition and results of operations.

NOTE E—EQUITY

Common Shares

The Company is authorized to issue 100,000,000 shares of $.001 par value stock and as of December 31, 2011 the Company had 36,311,640 shares outstanding. During 2011 and 2010, the Company issued the following shares of common stock:

During 2011, the only stock activity was for the return of 1,400,000 shares of stock from a consultant who did not perform the agreed upon consulting services (see note G for details of the transaction).

During 2010, the Company issued 7,562,763 common shares to investors, employees, and consultants. The shares issued as stock compensation were valued at the fair market value price at date of issuance and were registered securities. The issuance of the shares and the value is detailed in the following table:

Month/Description of transaction	Number of shares	Price per share	Total Value
March 17, 2010—Officer Stock Bonus	5,000,000	$ 0.0700	$ 350,000
March 24, 2010—Consulting Services	100,000	$ 0.0600	$ 6,000
March 31, 2010—Consulting Services	450,000	$ 0.0400	$ 18,000
August 20, 2010—Debt Conversion	133,333	$ 0.0150	

			$ 2,000
October 19, 2010—Debt Conversion	540,541	$ 0.0074	$ 4,000
October 27, 2010—Consulting Services	450,000	$ 0.0300	$ 13,500
December 13, 2010—Debt Conversion	888,889	$ 0.0090	$ 8,000
Total	**7,562,763**		**$ 401,500**

Preferred Shares

The Company is authorized to issue 5,000,000 shares of $.001 par value, non-voting, convertible preferred shares. The preferred shares are convertible to common shares at a 1 to 1 ratio. As of December 31, 2011, the Company had 29,713 preferred shares outstanding. During 2011 and 2010, the Company did not issue any preferred shares of stock.

NOTE F—Stock options and warrants

Employee Stock Option Plan

On April 21, 2006, the Company's board of directors approved the 2006 Employee Stock Option Plan (the "2006 Plan"). The 2006 Plan provides for the issuance of a maximum of 3,000,000 shares of common stock in connection with stock options granted thereunder, plus an annual increase to be added on the first nine anniversaries of the effective date of the 2006 Plan, equal to at least (i) 1% of the total number of shares of common stock then outstanding, (ii) 350,000 shares, or (iii) a number of shares determined by the Company's board of directors prior to such anniversary date. The 2006 Plan has a term of 10 years and may be administered by the Company's board of directors or by a committee made up of not less than 2 members of appointed by the Company's board of directors. Participation in the 2006 Plan is limited to employees, officer, directors and consultants of the Company and its subsidiaries. Incentive stock options

granted pursuant to the 2006 Plan must have an exercise price per share not less than 100%, and non-qualified stock options not less than 85%, of the fair market value of our common stock on the date of grant. Awards granted pursuant to the 2006 Plan may not have a term exceeding 10 years and will vest upon conditions established by the Company's board of directors.

NOTE F—Stock options and warrants (CONT'D)

On April 21, 2006 the Company filed a registration statement on Form S-8 with the SEC registering 3,000,000 shares of common stock for issuance upon exercise of options granted pursuant to the 2006 Plan. As of December 31, 2011, options to acquire 1,812,300 shares of common stock were granted and exercised and there are 1,187,700 shares available for issuance under the 2006 Plan.

On November 12, 2007, the Company's board of directors approved the 2007 Equity Incentive Plan (the "2007 Plan"). The 2007 Plan provides for the issuance of a maximum of 3,500,000 shares of common stock in connection with awards granted thereunder, which may include stock options, restricted stock awards and stock appreciation rights. The 2007 Plan has a term of 10 years and may be administered by the Company's board of directors or by a committee appointed by the Company's board of directors (the "Committee"). Participation in the 2007 Plan is limited to employees, officer, directors and consultants of the Company and its subsidiaries. Incentive stock options granted pursuant to the 2007 Plan must have an exercise price per share not less than 100%, and non-qualified stock options not less than 85%, of the fair market value of the Company's common stock on the date of grant. Awards granted pursuant to the 2007 Plan may not have a term exceeding 10 years and will vest upon conditions established by the Committee.

On November 29, 2007 the Company filed a registration statement on Form S-8 with the SEC registering 3,500,000 shares of common stock for issuance upon exercise of options granted and exercised pursuant to the 2007 Plan. As of December 31, 2011, options to acquire 2,054,000 shares of common stock were granted and exercised and there are 1,210,700 shares available for issuance under the 2007 Plan.

Stock Options and Warrants

During the years ended December 31, 2011 and 2010, no stock options were granted or exercised.

During 2011, prepaid stock compensation in the amount of $9,000 was expensed. In October 2010, a consulting contract was signed with a marketing/public relations group. The group was issued 450,000 shares of stock on October 27, 2010 at a fair market value per share of $.03 ($13,500 total value) in exchange for 6 months of consulting services. The $13,500 was booked to prepaid expense and amortized over 6 months. The total stock compensation expensed for this transaction during the years December 31, 2011 and 2010 were $9,000 and $4,500, respectively.

Valuation of Stock-based Compensation on Common Stock

Under the fair value recognition provisions of SFAS No. 123(R), stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized as expense over the requisite service period of the award. The Company has awarded stock-based compensation as restricted stock.

The method used to estimate the fair value of the awards granted under the share-based payment arrangements is calculated as the value of the stock at the date the stock option is exercised.

Valuation of Stock-based Compensation on Common Stock (cont'd)

Compensation expense for common stock is recognized on the date of the grant at the closing price of the stock on the date of the grant.

Our statement of operations for the years ended December 31, 2011 and 2010 included stock-based compensation of $9,000 and $416,167, respectively.

The Company does not have any unrecognized stock-based compensation expense at December 31, 2011.

NOTE G—Cancellation of Shares Issued under Consulting Agreement

In the first quarter of 2011, a consultant returned 1,400,000 shares of stock that were valued at $0.07 per share (a total value of $98,000) for services not performed. Of the $98,000, $57,167 was reversed out of prepaid expense and the remaining $40,833 was booked as an entry to other income as "Cancellation of shares issued under consulting agreement".

NOTE H—PENSION PLAN

The Company has a 401(k) plan which is administered by a third-party administrator. Individuals who have been employed for one month and reached the age of 21 years are eligible to participate. Employees may contribute up to the legal amount allowed by law. The Company matches one-fourth of the employee's contribution up to a maximum of 4% of the employee's wages. Employees are vested in the Company's contribution 25% a year and are fully vested after four years. The Company's contributions for the years ended December 31, 2011 and 2010 were $14,978 and $14,768 respectively.

NOTE I—COMMITMENTS/LEASES

The Company entered into a lease agreement on July 8, 2005 for office space. The current lease agreement is in effect for 12 months. Under this agreement the monthly fees are $350 per month. The Company's estimated future yearly minimum lease obligations are as follows:

Year	Amount
2012	$4,200
2012	$4,620
2013	$5,082
2014	$5,590

2015	$6,150
Total	$25,642

Total rent expense for 2011 and 2010 was $4,124 and $12,905 respectively.

NOTE J—RELATED PARTIES

The Company has a Note Receivable with one of its officers and major shareholders. The note is payable on demand and bears 8% interest per annum. The outstanding balance as of December 31, 2011 is $219,284.

Annual payments including principal and interest are as follows:

Year	**Interest and Principal Payments**
2012	$ 31,926
2013	31,926
2014	31,926
2015	31,926
2016	31,926
2016 and thereafter	122,977
Total Interest and Principal Payments	$ 282,608

Interest Income for the years December 31, 2011 and 2010 were $17,531 and $17,741.

NOTE K—LINE OF CREDIT

Two of the Company's subsidiaries have lines of credit with Bank of America. The line of credit for CKO is 10.75% interest and the line of credit for China Print, Inc. is 14.75%. The line of credit for China Print was paid off in the 3rd quarter of 2011. The outstanding balances of the line of credit by Subsidiary as of December 31, 2011 are as follows:

CKO	$32,928
China Print	-
	$ 32,928

NOTE L—NET INCOME/ (LOSS) PER COMMON SHARE

The Company's reconciliation of the numerators and denominators of the basic and fully diluted income per shares is as follows for the years ended December 31, 2011 and 2010 are as follows:

For the year ended December 31, 2011

	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Net Income/(Loss)	$ 118,907		
Basic EPS			
Income available to common stockholders	118,907	36,311,640	$ 0.00
Effect of Dilutive Securities			

Warrants

Convertible preferred stock

29,713

Diluted EPS

Net Income/(Loss)

118,907

36,341,353

$ 0.00

The computation of basic earnings per common share is computed using the weighted average number of common shares outstanding during the year. The computation of diluted earnings per common share is based on the weighted average number of shares outstanding during the year plus common stock equivalents which would arise from the exercise of warrants outstanding using the treasury stock method and the average market price per share during the year. Options warrants and convertible preferred stock which are common stock equivalents are not included in the diluted earnings per share calculation for December 31, 2010 since their effect is anti-dilutive.

NOTE M—CONVERTIBLE NOTE PAYABLE

On January 5, 2010, the company received proceeds from a Note Payable ("Note") due to an outside party in the amount of $50,000. A total of 4,761,905 shares were placed in reserve if the Note Payable was converted. On August 20, 2010, $2,000 of the principal balance was converted into 133,333 common shares of CYIOS Corporation stock. On October 19, 2010, $4,000 of the principal balance was converted into 540,541 common shares of CYIOS Corporation stock. On December 13, 2010, $8,000 of the principal balance was converted into 888,889 common shares of CYIOS Corporation stock. As of December 31, 2010 the total Note Payable outstanding was $36,000.

The Company subsequently paid off the remaining principal balance of $36,000 on January 26, 2011 in full satisfaction of the outstanding Note Payable. The remaining shares not issued for conversion in the amount of 3,199,142 were removed from reserve.

NOTE N—SUBSEQUENT EVENTS

In accordance with ASC 855-10, the Company has analyzed its operations subsequent to December 31, 2011 to the date these financial statements were issued, and has determined that it does not have any material subsequent events to disclose in these financial statements other than those events described above.

Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure.

There were no events or disagreements requiring disclosure under Item 304(b) of Regulation S-B during the fiscal year ended December 31, 2011. For additional information regarding the change in our certifying accountants,

reference is made to our Current Report on Form 8-K/A filed on March 31, 2011.

Item 9A(T). Controls and Procedures.

Our management is responsible for establishing and maintaining adequate control over our financial reporting, as defined in Rule 13a-15(f) of the Exchange Act. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in reports filed under the Securities Exchange Act of 1934 ("Exchange Act") is recorded, processed, summarized and reported within the specified time periods. Our Chief Executive Officer and Principal Financial Officer, Timothy Carnahan is responsible for establishing and maintaining our disclosure controls and procedures. The controls and procedures established by us are designed to provide reasonable assurance that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms.

Our disclosure controls and procedures were designed to provide reasonable assurance that the information required to be disclosed in reports filed Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time period specified and that it is accumulated and communicated to our management, including certifying officers, as appropriate to allow timely decisions regarding timely disclosure.

Under the supervision and with the participation of our management, including the Chief Executive Officer and Principal Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective at the reasonable assurance level.

Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected. Our annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting pursuant to the temporary rules set forth by the Securities and Exchange Commission that permit the Company to provide only management's report on the annual report.

We evaluated and assessed the effectiveness of our internal control over financial reporting as of December 31, 2007, using criteria set forth in the *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The Chief Executive Officer and Principal Financial Officer has also concluded, based on his evaluation of our controls and procedures that as of December 31, 2011, our internal controls over financial reporting are effective and provide a reasonable assurance of achieving their objective.

The Chief Executive Officer and Principal Financial Officer has also concluded that there were no change in our internal controls over financial reporting identified in connection with the evaluation that occurred during our fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

During the year 2008, we became aware of the fact that the Shareholder Loan outstanding to our CEO and major

shareholder is considered to be a prohibited transaction according to Section 402 of the Sarbanes-Oxley Act of 2002. However, Section 402 does contain a grandfather clause exempting from the prohibition any loans maintained by the issuer on July 30, 2002; provided, however, that there are no material modifications to, or renewal of the terms of, such loans following that date. A portion of the Shareholder Loan does meet the exemption rules of the grandfather clause; however, after that date additional amounts were added to the Shareholder Loan. The Company has addressed this issue and is disclosing the matter here and has executed a new promissory note for the full amount owed to the Company of $262,512 (the original amount). The terms of the promissory note state that the payoff of the note must be made within a reasonable amount of time and bears an interest rate of 8% per annum. The Company will no longer make payments to the CEO or any other executive officer or director that would be classified as a loan.

Item 9B. Other Information.

None

PART III

Item 10. Directors, Executive Officers, Promoters, Control Persons and Corporate Governance; Compliance with Section 16(a) of the Exchange Act.

Executive Officers and Directors

The following table sets forth information regarding our executive officers and directors as of December 31, 2011.

Name	**Age**	**Position**
Timothy W. Carnahan	44	Director, Chief Executive Officer and Treasurer

Timothy Carnahan has served as our Chief Executive Officer, Treasurer and Chairman of our board of directors since September 2005. Previously, from July 2004 through September 2005 Mr. Carnahan served as the President and founder of CKO, Inc., a District of Columbia corporation (“CKO”), and from April 1995 through September 2005 as the President and founder of CYIOS Corporation, a DistYLE="font-size:1px">

Net cash used in operating activities continuing operations	(6,632)	(2,744)
Net cash provided from discontinued operations	351	525

Net cash used in operations

(6,281) (2,219)

Cash flows from investing activities:

Sales of marketable securities, net

1,600

Purchases of property and equipment

(272) (98)

Costs of patents and trademarks

(24) (27)

Net cash provided by (used in) investing activities continuing operations

(296) 1,475

Net cash provided by (used in) investing activities discontinued operations

Net cash provided by (used in) investing activities

(296) 1,475

Cash flows from financing activities:

Restricted cash related to sale of assets

1,767

Short term borrowings

1,500

Principal payments on notes payable

(80)

Net cash provided by financing activities continuing operations

1,767 1,420

Net cash provided by (used in) financing activities discontinued operations

Net cash provided by financing activities	1,767	1,420
Effect of exchange rate changes on cash and cash equivalents	2	(37)
Increase (decrease) in cash and cash equivalents	(4,808)	639
Cash and cash equivalents:		
Beginning of period	12,659	1,344
End of period	$7,851	$1,983
Supplemental disclosures of cash flow information:		
Interest paid	$201	$48
Income taxes paid	$2	$53

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

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INTERLINK ELECTRONICS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007, RESPECTIVELY AND AS OF JUNE 30, 2008 AND DECEMBER 31, 2007 (UNAUDITED)

1. Basis of Presentation of Interim Financial Data

The financial information as of June 30, 2008, and for the three and six month periods ended June 30, 2008 and 2007, respectively, in the accompanying Condensed Consolidated Financial Statements is unaudited. Such information does, however, reflect 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. These Condensed Consolidated Financial Statements should be read in conjunction with the audited financial statements and related notes for the fiscal year ended December 31, 2007, which are included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2008.

The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full year. Certain prior year amounts have been reclassified to conform to the current period presentation.

On August 31, 2007, we completed the sale of our OEM Remotes and Branded Products business segments for an aggregate cash purchase price of $11,500,000, subject to certain post-closing price adjustments. In connection with the sale of these business segments, we paid legal and investment banking fees of $890,000. Please see Note 3 for additional information regarding this sale. As a result of the sale, the financial information included in the accompanying Condensed Consolidated Financial Statements is presented in accordance with Statement of Financial Accounting Standards No. 144 Accounting for Impairment or Disposal of Long-Lived Assets, which requires us to present the sale of these assets on a discontinued operations basis. The balance sheets have been adjusted to reflect the assets and liabilities of the OEM Remotes and Branded Products segments as held for sale for all periods presented. Additionally, the statements of operations and cash flows have been adjusted to reflect the results of these segments as discontinued operations for the periods presented.

2. Significant Accounting Policies

Revenue Recognition. We recognize revenue in accordance with SEC Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition. SAB No. 104 requires that four basic criteria be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services rendered; (3) a fee applies that is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criteria (3) and (4) require management s judgment regarding the fixed nature of the fee charged for services rendered and products delivered and the collectibility of those fees. To satisfy these 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 a customer purchase order; and (4) assess 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 Statement of Financial Accounting Standards No. 48 with respect to sell-through and returns and the related recording of reserves for potential customer returns. Should changes in conditions cause management to determine the revenue recognition criteria are not met for future transactions, such as a determination that collectibility was not reasonably assured, revenue could be adversely affected.

In our eTransactions business segment, a portion of our revenues are derived from the sale, service and support of software. Our software support revenues consist of post contract customer support and maintenance (PCS). Accordingly, when applicable, we recognize revenue by applying the provisions of the American Institute of Certified Public Accountants Statement of Position (SOP) 97-2, Software Revenue Recognition as amended by SOP 98-9, Software Revenue Recognition with Respect to Certain Arrangements.

When eTransactions sales involve multiple elements or multiple products, and we have vendor-specific objective evidence (VSOE) of fair value for each element in the arrangement, we recognize revenue based on the relative fair value of all elements within the arrangement. We determine VSOE based on sales prices charged to customers when the same element is sold separately or based upon renewal pricing for PCS. If VSOE cannot be determined for all undelivered elements of an arrangement, we defer revenue until the earlier of (i) the delivery of all elements or (ii) the establishment of VSOE for all undelivered elements, provided that if the only undelivered element is PCS or a service, the total fee of the arrangement is recognized as revenue over the PCS or service term.

Disposal of Long Lived Assets. On August 31, 2007, we completed the sale of our OEM Remotes and Branded Products business segments. As a result of the sale, the financial information included in the accompanying Condensed Consolidated Financial Statements is presented in accordance with Statement of Financial Accounting Standards No. 144 Accounting for Impairment or Disposal of Long-Lived Assets, which requires us to present the sale of these assets on a discontinued operations basis. The balance sheet at December 31, 2007 reflects the assets and liabilities of the OEM Remotes and Branded Products segments as held for sale. Additionally, the statements of operations and cash flows have been adjusted to reflect the results of these segments as discontinued operations for the periods presented. Certain assumptions were used in determining amounts being presented as assets held for sale and discontinued operations. These assumptions were based on an analysis and review of costs associated with operating the ongoing business subsequent to the asset sale as compared with costs of operations prior to the asset sale.

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 account receivable balances and add to our allowance for doubtful accounts when collection of an individual account becomes questionable based on payment performance or age of the receivable and other factors related to the customer s ability to pay. We generally offer 30-day payment terms; however, some distributors in the divested Branded Products business segment and some of our Japanese OEM customers require as long as 120-day payment terms.

Reserve for Estimated Product Returns. While not an explicit part of our terms and conditions of product sales, we do, on a discretionary basis, grant product exchanges for our distribution and reseller customers in our divested Branded Products business segment for similar products of equal value if these exchanges meet defined criteria. We estimate future product returns based on recent return history, inventory status and product sell-through statistics received from our major distributors, discussions regarding product sales activity with our major reseller customers, and current industry product and technology trends. Management judgment is required in evaluating the relative significance of this data and in determining the estimated value of the returns reserve. If actual returns are greater than management s estimate, revenues in the subsequent period will be adversely affected. Product returns and allowance as of June 30, 2008 and December 31, 2007 were $54,000 and $105,000, respectively.

Inventories. Inventories are stated at the lower of cost or market and include material, labor, and factory overhead. Cost is determined using the first in first out 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 based on 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 our cost of sales in the period the revision is made.

Provision for Income Tax. As part of the process of preparing financial statements, as required by Statement of Financial Accounting Standards Accounting For Income Taxes (SFAS 109), 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 Consolidated Balance Sheet. We must then assess the likelihood that deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, must establish a valuation reserve. To the extent we establish a reserve or increase this reserve in a period, we must include an expense within the tax provision in the statements of operations.

In June 2006, the Financial Accounting Standards Board issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. We adopted FIN 48 effective January 1, 2007. We file income tax returns in the U.S. federal jurisdiction, and various state, local and foreign jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2000. As a result of the implementation of FIN 48, we did not recognize any increase in the liability for unrecognized tax benefits. In addition, we did not record a cumulative effect adjustment related to the adoption of FIN 48.

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In the first quarter of 2007, the Inland Revenue Department (IRD) of Hong Kong commenced an examination of our Hong Kong income tax returns for 2003 through 2005. The examination is anticipated to be completed in the 2008 fiscal year. Due to delinquencies in filing annual tax returns for the 2003, 2004 and 2005 fiscal years, the IRD has assessed certain adjustments to our overall reported losses in Hong Kong for those periods stated above. These adjustments, all of which have been paid by us prior to 2007, have resulted in additional income tax assessments and cash payments that have been made for 2003, 2004 and 2005 totaling $456,000 as of the date of this filing. We do not anticipate any further adjustments will be made.

Significant management judgment is required in determining our provision for income taxes, deferred tax asset and liabilities and any valuation reserve recorded against net deferred tax assets. Management continually evaluates its deferred tax asset as to whether it is likely that the deferred tax asset will be realized.

When tax returns are filed, it is highly likely that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely to be realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest and penalties associated with unrecognized tax benefits are classified as interest and other expense in the statement of income.

***Foreign Exchange Exposure*.** We have established relationships with non-U.S. OEM customers of our Specialty Components business segment. Certain of these customers have been based in Japan and approximately 19%, 6% and 3% of our revenues for the years ended December 31, 2007, 2006 and 2005, respectively, came from Japanese customers. Revenues from these customers are denominated in Japanese yen, subjecting us to fluctuations in the yen/dollar exchange rate. From time to time, we use foreign currency forward and average rate option contracts to hedge this exposure. We use revenue forecasts from our Japanese subsidiary to determine the amount of forward or option contracts to purchase and we attempt to enter into these contracts when we believe the yen value is relatively strong against the U.S. dollar. To the extent that our revenue forecast may be inaccurate or the timing of forecasting the yen s strength is wrong, our actual hedge gains or losses may not necessarily correlate with the effect of foreign currency rate fluctuations on our revenues. We mark these contracts to market value and the gain or loss from these contracts is recorded as revenue of our Specialty Components business segment. These hedge transactions are classified as economic hedges and do not qualify for hedge accounting under Statement of Financial Accounting Standards No. 133 (SFAS 133). In addition, because our Japanese subsidiary s functional currency is the yen, the translation of the net assets of that subsidiary into the consolidated results will fluctuate with the yen/dollar exchange rate.

Valuation of Derivative Instruments. SFAS 133 requires bifurcation of embedded derivative instruments and measurement of their fair value for accounting purposes. Derivative liabilities are adjusted to reflect fair value at each period end, with any increase or decrease in the fair value being recorded in results of operations under the heading Adjustments to Fair Value of Derivatives. The effects of interactions between embedded derivatives are calculated and accounted for in arriving at the overall fair value of the financial instruments. In addition, the fair values of freestanding derivative instruments such as warrant derivatives are valued using lattice models.

Stock-based Compensation. On January 1, 2006, we adopted SFAS 123(R), which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and directors based on estimated fair values. SFAS 123(R) supersedes previous accounting under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees for periods beginning in fiscal 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123(R). We have applied the provisions of SAB 107 in our adoption of SFAS 123(R).

We adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006. Our financial statements as of and for the three and six months ended June 30, 2008 and 2007 reflect the impact of SFAS 123(R). Stock-based compensation expense recognized under SFAS 123(R) for employees and directors for the quarter ended June 30, 2008 and 2007 were $115,000 and $793,000 respectively, with the effect on basic and diluted earnings per share of $(0.01) and $(0.06), respectively. Stock-based compensation expense recognized under SFAS 123(R) for employees and directors for the six months ended June 30, 2008 and 2007 were $847,000 and $1,769,000 respectively, with the effect on basic and diluted earnings per share of $(0.06) and $(0.13), respectively. As of June 30, 2008, we have $1,402,000 of unrecognized stock-based compensation cost related to non-vested stock options. This cost is expected to be recognized over a weighted average period of 1.08 years.

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During the quarters and six months ended June 30, 2008 and 2007, we granted options to purchase 429,000 and 897,000 shares, respectively of our Common Stock at an average exercise price of $0.76 and $2.45, respectively, with estimated fair values of $250,000 and $1,272,000, respectively, of which $19,000 and $215,000 was recorded as of June 30, 2008 and 2007, respectively. No stock options were exercised during these periods. SFAS 123(R) requires companies to estimate the fair value of stock-based payment awards to employees and directors on the date of grant using one of several option pricing models. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our statement of operations. Stock-based compensation expense recognized in the statement of operations for the quarters and six months ended June 30, 2008 and 2007 included compensation expense for stock-based payment awards granted prior to, but not yet vested as of January 1, 2006 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123, and included compensation expense for the stock-based payment awards granted subsequent to January 1, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). For stock-based awards issued to employees and directors, stock-based compensation is attributed to expense using the straight-line single option method, which is consistent with the presentation of prior period pro forma information. Because stock-based compensation expense recognized in the statement of operations for the quarters and six months ended June 30, 2008 was based on awards that vest over time, SFAS 123(R) 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 quarters ended June 30, 2008 and 2007, forfeitures for employees were calculated to be 12.34% while forfeitures for executives were estimated to be 3%, with total forfeitures of $11,000 and $82,000, respectively. For the six months ended June 30, 2008 and 2007, forfeitures for employees were also calculated to be 12.34% and forfeitures for executives were estimated to be 3%, with total forfeitures of $95,000 and $114,000, respectively.

For the three and six months ended June 30, 2008 we recorded the following charges within our statement of operations for stock-based compensation: $16,000 and $77,000 in cost of sales, $55,000 and $125,000 in product development and research expenses, and $44,000 and $645,000 in selling, general and administrative expenses, respectively. For the three and six months ended June 30, 2007, we recorded the following charges within our statement of operations for stock-based compensation: $133,000 and $311,000 in cost of sales, $116,000 and $249,000 in product development and research expenses, $276,000 and $581,000 in selling, general and administrative expenses, and $268,000 and $628,000 of stock-based compensation is included in the loss from discontinued operations, net of tax, respectively. The $645,000 charge in selling, general and administrative expenses for the six months ended June 30, 2008 include $339,000 of charges related to a modification of certain stock options due to the acceleration of 164,000 stock options for our former CEO, who retired on January 4, 2008.

Our determination of fair value of stock-based payment awards to employees and directors on the date of grant uses the Black-Scholes model, which is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include, but are not limited to, the expected price volatility of our stock over the expected term of the awards, and actual and projected employee stock option exercise behaviors. We estimate expected volatility using historical data. The expected term is estimated using the safe harbor provisions under SAB 107.

A summary of our non-vested options as of June 30, 2008 and changes during the six months ended June 30, 2008 is presented below:

	Options	Wgt. Avg. Exercise Price
Nonvested as of December 31, 2007	1,003	$ 2.70
Granted	429	0.76
Vested	(346)	3.07
Forfeited or expired	(62)	2.26
Nonvested as of June 30, 2008	1,024	$ 2.09

We have adopted the simplified method provided in SFAS 123(R) for calculating the beginning balance of the additional paid in capital pool (APIC pool) related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and Statement of Cash Flows of the tax effects of employee stock-based compensation awards that were outstanding upon adoption of SFAS 123R. We have not recognized excess tax benefits related to employee stock-based compensation and, therefore, do not currently have an APIC pool.

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3. Discontinued Operations and Assets Held for Sale

As part of an overall strategy to focus our efforts on higher margin emerging markets, we sold our OEM Remotes and Branded Products business segments (the Sale) in August of 2007. The Sale has enabled us to advance our strategic business initiatives and allowed us to focus on the two business segments we feel have the greatest potential for long-term profitable growth: eTransactions and Specialty Components. The Sale was structured as an asset sale, and included the inventory, accounts receivable, fixed assets, intangibles, accounts payable, related intellectual property rights and other assets that constituted the operations of the divested units.

Our Condensed Consolidated Financial Statements have been reclassified for all periods presented to reflect the OEM Remotes and Branded Products business segments as discontinued operations in accordance with SFAS 144. Accordingly, the revenues, costs and expenses directly associated with the OEM Remotes and Branded Products business segments have been reclassified as discontinued operations on the Statement of Operations for all periods presented. Additionally, assets and liabilities of the OEM Remotes and Branded Products business segments have been reclassified as held for sale on our Balance Sheets for all periods presented, and our Statements of Cash Flows have been reclassified to reflect the OEM Remotes and Branded Products business segments as discontinued operations for all periods presented. Corporate expenses such as general corporate overhead and interest have not been allocated to discontinued operations.

Income (loss) from discontinued operations, net of tax is summarized as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Net revenue from discontinued operations	$	$ 4,181	$	$ 8,886
Loss from discontinued operations before income tax benefit		(419)		$ (1,496)
Income tax benefit, net of reserve				$
Loss from discontinued operations	$	$ (419)	$	$ (1,496)

There were no amounts on the Condensed Consolidated Balance Sheets as of June 30, 2008 attributable to the discontinued operations related to the Sale. Amounts at December 31, 2007 attributable to the discontinued operations related to the Sale are as follows (in thousands):

	December 31, 2007
Assets	
Accounts receivable	$ 437
Assets held for sale	437
Liabilities	
Accounts payable	(86)
Liabilities held for sale	(86)
Total net assets held for sale	$ 351

4. Restricted Cash

As part of the Sale, we entered into an escrow agreement that required $1,400,000 of the purchase price to be put into an escrow account to provide for, among other things, a source of recovery for any amounts owing to the purchaser pursuant to indemnification and post-closing adjustment provisions of the asset purchase agreement. Of this amount, $250,000 was released in March 2008

according to the terms of the escrow agreement. As a result, $1,400,000 and $1,170,000 of this restricted cash remained on the balance sheet as of December 31, 2007 and June 30, 2008 respectively. 70% and 30% of the remaining $1,170,000, net of any disputed amounts, if any, will be released 12 months and 18 months from the date of the Sale, respectively. Additionally, $1,537,000 of cash was recorded as due to the acquiring company on December 31, 2007 for certain post closing activities, including the collection of certain purchased accounts receivables and payment of certain purchased accounts payables which resulted in a total of $2,937,000 in restricted cash as of December 31, 2007.

5. Inventories

Net inventories consisted of the following (in thousands):

	June 30, 2008	December 31, 2007
Raw material	$ 4,579	$ 4,277
Work in process	545	457
Finished goods	1,073	811
Reserve for excess and obsolete inventory	(646)	(394)
Total inventories	$ 5,551	$ 5,151

6. Line of Credit

On November 8, 2007, we executed an amended and restated Loan and Security Agreement (the Agreement) with Silicon Valley Bank that provides for a line of credit with a maximum borrowing limit of $5 million. The line of credit is secured by our accounts receivable and other assets and expires in December 2009. Under the terms of the Agreement, we have the ability to borrow against the line in amounts up to 80% of our eligible accounts receivable. At June 30, 2008 and June 30, 2007, we had drawn $0 and $1.5 million on the line of credit, respectively.

7. Convertible Notes and Warrants

On July 19, 2007, we issued 8% convertible notes, in an aggregate principal amount of $5,000,000, and warrants exercisable for up to 1,984,125 shares of Common Stock in a private placement (the Financing) exempt from registration under Regulation D of the Securities Act, as amended. The notes mature on July 19, 2010, and some or all of the outstanding principal balance and unpaid interest may be converted into common stock at any time before the maturity date at a conversion price of $1.26 per share (subject to adjustment). Interest on the notes accrues and is payable semiannually on January 15th and July 15th of each year. The warrants expire on July 19, 2012, and may be exercised at any time prior to expiration on a cash or cashless basis at an exercise price of $1.51 per share (subject to adjustment). We received net proceeds of approximately $4,796,000 from the sale of the notes and warrants, which take into account estimated legal and other fees of $204,000 incurred in connection with the Financing.

The conversion price under the notes and the exercise price under the warrants are subject to adjustment upon the occurrence of specified events including the issuance of stock dividends to existing common stock holders, or a stock split. Also, the holders of notes and warrants are entitled to receive the economic benefit of any reorganization, consolidation or merger of Interlink which results in a payment in shares, other securities or property to our common stock holders.

In connection with the placement of the notes and warrants, we entered into a registration rights agreement with the selling securityholders under which we agreed to register with the Securities and Exchange Commission (the SEC) the common stock underlying the notes and warrants for resale to the public. The registration rights agreement requires us to pay the investors liquidated damages under certain circumstances, including if the registration statement covering the shares to be registered was not declared effective, except under specified conditions, on or prior to October 18, 2007. Such liquidated damages are calculated as 1.5% of the aggregate amount invested by each such investor for each 30-day period (or pro rata portion of such 30-day period) of such delinquency. One of the specified conditions in the registration rights agreement that precludes the accrual of liquidated damages (the Damages Exception) is an assertion by the SEC that the offering of some or all of the shares underlying the notes and warrants is not eligible to be made on a delayed or continuous basis pursuant to Rule 415 promulgated under the

Securities Act. The SEC staff did raise the Rule 415 issue and, as a result, the registration statement was not declared effective until April 29, 2008. The investors previously sent us a letter demanding payment of liquidated damages as a result of the failure of effectiveness to occur by October 18. We are currently discussing the issue with the investors, including a possible reduction in the amount of liquidated damages otherwise payable under the registration rights agreement.

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We evaluated the warrants under Emerging Issues Task Force Issue 00-19 (EITF 00-19) and determined that the warrants qualified for liability treatment and have recorded the warrants as a derivative liability under FAS 133. The initial fair value of the warrants was $1,146,000 which has been recorded with an offset to discount on the note payable. We determined that the conversion feature on the notes qualified for exemption from bifurcation and liability treatment as it is considered a conventional convertible instrument under EITF 00-19. We calculated a beneficial conversion feature, resulting in a discount of $480,000 at the time of the transaction and a value of $413,000 as of December 31, 2007. The value of the beneficial conversion feature, net of the discount at June 30, 2008, was $333,000.

The original values of the Parisian feature of the derivative liabilities for the notes and warrants were $6,000 and $12,000 respectively on July 19, 2007. These amounts are being amortized and charged as interest expense over the three-year term of the notes. In addition, the adjustment to fair value of these Parisian features will be made each reporting period. Accordingly, $27,000 of increased fair value for the derivative liability on the notes was recorded as interest charges for the six month period ended June 30, 2008 and $21,000 was recorded as interest income for the derivative liability on the warrants for the six month period ended June 30, 2008. Each of these amounts was included in the net fair value of the notes.

We amortize our discounts using the interest method, which resulted in an interest expense of $274,000 for the period from January 1, 2008 to June 30, 2008.

The warrants and embedded derivatives outstanding at June 30, 2008 were valued at fair value using a lattice fair value model, resulting in an net decrease in the fair value of the related liabilities for the six months ended June 30, 2008 of approximately $1,388,000, from $0.98 per warrant as of December 31, 2007 to $0.24 per warrant as of June 30, 2008. The change in value of the warrants was recorded in our statement of operations as a charge to net other income. Variables used to value the warrants as of June 30, 2008 are as follows:

	June 30, 2008
Expected term (years)	4.0
Risk free interest rate	3.1%
Weighted Average Volatility	74.6%
Expected dividend yield	0%

The following table summarizes the activity of notes, warrants and discounts outstanding at June 30, 2008, (in thousands):

	June 30, 2008
Notes at fair value, net of amortized origination costs	$ 4,847
Notes derivative discounts, net	(808)
Notes beneficial conversion feature discount, net	(333)
Net fair value of the Notes	3,706
Warrants and derivative liabilities at fair value, net of accretion	591
Notes and warrants fair value	4,297
Less current portion	
Notes and Warrants and embedded derivatives-long term	$ 4,297

8. Stockholders Equity

On March 11, 2008 we entered into a restricted stock grant agreement with John A. Buckett, II, our Interim Chief Executive Officer, pursuant to which we granted Mr. Buckett 50,000 restricted shares of our Common Stock. The restricted shares will vest and be issued to Mr. Buckett, subject to his continued employment with us as our interim Chief Executive Officer, on regular monthly vesting dates through December 31,

2008. The value per share of any restricted shares issued to Mr. Buckett will be the market value per share of our Common Stock as of the applicable vesting date. As of June 30, 2008, 25,000 restricted shares had vested representing a value of $19,000, which is shown in the stockholders equity in the accompanying Condensed Consolidated Balance Sheet.

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9. Stock Options

Under the terms of our 1996 Stock Incentive 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 of Common Stock for which options may be granted under the Plan is 7,250,000. New stock options are granted at fair market value on the date of grant and generally vest ratably over 24 or 36 months and have a ten-year term but terminate earlier if employment is terminated. As of June 30, 2008, options for 6,004,000 shares of Common Stock have been granted (3,103,000 are outstanding and 2,902,000 have been exercised, forfeited or expired) and 1,246,000 options were available for grant. Activity under the Plan for the first six months of 2008 is summarized as follows (in thousands, except per share information):

	Options	Wgt. Avg. Exercise Price
Outstanding beginning of period January 1, 2008	3,277	$ 4.40
Granted	429	0.76
Exercised		
Forfeited or expired	(603)	3.09
Outstanding end of period June 30, 2008	3,103	$ 4.14
Exercisable end of period June 30, 2008	2,079	$ 5.15

The following table summarizes information about stock options outstanding as of June 30, 2008 (in thousands, except contractual life and exercise price per share information):

	Employee Options Outstanding			Employee Options Exercisable	
Range of Exercise Prices	Shares	Weighted Avg. Remaining Contractual Life (Years)	Weighted Avg. Exercise Price	Shares	Weighted Avg. Exercise Price
$0.00 -1.39	405	9.75	0.77	14	0.77
$1.40 - 1.65	105	0.11	1.51	6	1.41
$2.25 - 2.80	803	1.44	2.53	356	2.60
$3.15 - $3.25	653	1.24	3.15	634	3.15
$5.49 - $5.70	348	1.00	5.69	301	5.69
$6.14 - $6.45	355	0.53	6.33	375	6.34
$7.54 - $7.98	18	0.04	7.71	18	7.71
$9.40 - $10.60	416	1.69	9.45	375	9.45
	3,103	2.31	$ 4.13	2,079	$ 5.15

There is no intrinsic value for the stock options outstanding and vested as of June 30, 2008.

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10. Income (Loss) Per Share

For all periods presented, per share information was computed in accordance with the provisions of the Statement of Financial Accounting Standards No. 128, Earnings Per Share, issued by the Financial Accounting Standards Board (FASB). The computation of basic earnings per share is based upon the weighted average number of common shares outstanding during the periods presented. Earnings per share on a diluted basis includes, in addition, 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 the average market price for the period.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Weighted average shares outstanding basic	13,764	13,749	13,757	13,749
Effect of dilutive securities (employee/director stock options) [1]				
Effect of convertible notes and warrants [1]				
Weighted average shares diluted	13,764	13,749	13,757	13,749

[1] Due to the net loss for the three and six months ended June 30, 2008 and 2007, any diluted share calculation would be anti-dilutive. Thus, the basic weighted average shares were used and shares of common stock equivalents of 9.0 million and 4.3 million for 2007 and 2006, respectively, were excluded from the diluted share calculation because they were anti-dilutive.

11. Comprehensive Loss

The following table provides the data required to calculate comprehensive loss (in thousands):

	Accumulated Other Comprehensive Loss	Comprehensive Loss
Balance at December 31, 2006	$ (505)	
Translation adjustment	(38)	$ (38)
Net loss		(4,698)
Balance at June 30, 2007	$ (543)	$ (4,736)
Balance at December 31, 2007	$ (440)	
Translation adjustment	2	$ 2
Net loss		(2,631)
Balance at June 30, 2008	$ (438)	$ (2,629)

12. Segment Information

After the Sale (described in Note 3) we have two remaining business segments: eTransactions and Specialty Components. We evaluate the performance of these segments based on their revenue and gross profit. We do not consistently allocate any other income, expenses or assets to these segments nor do we track revenue by product. Reportable segment information for the six months ended June 30, 2008 and 2007 is as follows (in thousands):

Six Months Ended:	eTransactions	Specialty Components	Total
June 30, 2008			
Revenue	$ 5,780	$ 6,702	$ 12,482
Gross profit	2,643	2,393	5,036
June 30, 2007			
Revenue	$ 4,290	$ 3,715	$ 8,005
Gross profit	2,223	895	3,118

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Geographic Information We attribute revenues to different geographic areas on the basis of the location of the customer. Our revenues and long-lived assets by geographic area for the six months ended June 30, 2008 and 2007, respectively, are as follows (in thousands):

	Six Months Ended and as of June 30,			
	2008		2007	
	Revenues	Long Lived Assets	Revenues	Long Lived Assets
United States	$ 6,334	$ 738	$ 3,705	$ 730
Japan	2,940	78	1,289	132
Asia (other than Japan)	1,216	328	1,134	380
Europe and other	1,992		1,877	
	$ 12,482	$ 1,144	$ 8,005	$ 1,242

Major Customers For the first six months of fiscal 2008 we had one customer representing more than 10% of total revenues. For the first six months of fiscal 2007 we did not have any customers represent more than 10% of total revenues. One customer accounted for 15% and one customer accounted for 16% of accounts receivable at June 30, 2008, while two different customers each accounted for 18% and 10% of the accounts receivable at June 30, 2007.

Major Suppliers We buy some dies and adhesives that are used in various products from single source suppliers. Due to a limited number of suppliers for these items, a sudden change to a different supplier could cause delays in manufacturing.

13. Income Taxes

In June 2006, the Financial Accounting Standards Board issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (FAS 109). This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. We adopted FIN 48 effective January 1, 2007. We or one of our subsidiaries files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2000. As a result of the implementation of Interpretation No. 48, we did not recognize any increase in the liability for unrecognized tax benefits. In addition, we did not record a cumulative effect adjustment related to the adoption of FIN 48.

In the first quarter of 2007, the Inland Revenue Department (IRD) of Hong Kong commenced an examination of our Hong Kong income tax returns for 2003 through 2005. The examination is anticipated to be completed in the 2008 fiscal year. Due to delinquencies in filing annual tax returns for the 2003, 2004 and 2005 fiscal years, the IRD has assessed certain adjustments to our overall reported losses in Hong Kong for those periods stated above. These adjustments, all of which have been paid by us prior to 2007, have resulted in additional income tax assessments and cash payments that have been made for 2003, 2004 and 2005 totaling $456,000 as of the date of this filing. We do not anticipate any further adjustments will be made.

14. Contingencies

Legal Matters On November 15, 2005, a class action alleging violations of the federal securities laws was filed against Interlink and two of our former officers in the United States District Court for the Central District of California. In connection with our announcement in November 2005 that we would restate certain of our prior financial results, plaintiffs in the action allege that Interlink s financial and various other public statements made during the period from April 24, 2003 through November 1, 2005 were materially false and misleading when made. Plaintiffs have asserted claims under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended.

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The Court appointed the current lead plaintiffs and lead counsel in November 2006 and subsequently entered an order staying any discovery in the action until motions to dismiss were adjudicated. In September 2007, the Court granted in part and denied in part the Company s motion to dismiss the lead plaintiffs operative complaint. The lead plaintiffs filed an amended complaint in May 2008, which the Company has moved to dismiss in part. That motion to dismiss is currently pending. In June 2008, the Court entered a scheduling order instructing the parties to meet and confer regarding discovery.

On April 24, 2008, the parties participated in a mediation with Justice Howard B. Wiener (Retired) in Los Angeles. The parties were unable to reach resolution. In connection with the class action, we have recorded approximately $263,000 in expenses for 2006, $40,000 in expenses in 2007 and $5,000 in expenses to date in 2008. Because the class action is at a preliminary stage, it is not possible to predict with reasonable certainty the final outcome.

On January 24, 2006, a shareholder s derivative action (now pending in the United States District Court for the Central District of California) was filed against several of Interlink s former officers and directors, alleging the same or similar facts as those alleged in the class action. On January 9, 2007, the Court stayed the derivative action pending final adjudication of any motions to dismiss in the class action. In June 2008, after the Company in the class action filed a motion to dismiss plaintiffs operative complaint, the Court entered a scheduling order in the derivative action, instructing the parties to meet and confer regarding discovery. The parties have filed a stipulation with the Court, requesting that the Court continue to stay the derivative action until motions to dismiss in the class action are resolved. Because the derivative action is at a preliminary stage, it is not possible to predict with reasonable certainty the final outcome.

In connection with the class action and the derivative action, Interlink voluntarily contacted the SEC in 2006 to inform the SEC of both actions. The SEC responded with several inquiries, to which we responded promptly. On November 16, 2007, we were advised by letter from the SEC that it does not intend to recommend any enforcement action by the Commission. We have not received any further inquiries from the SEC. The SEC may, however, choose to resume its inquiries at any time.

We cannot estimate the possible loss or range of loss, if any, associated with the resolution of the class and derivative actions. While we intend to vigorously defend the actions, we cannot predict their final disposition, or whether we will be liable for amounts not covered by insurance. There is no assurance that the ultimate resolutions of the actions will not result in a material adverse effect on our business, financial condition, or results of operations.

In addition to the matters identified above, from time to time, Interlink is involved in various legal actions that arise in the ordinary course of business.

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

We develop, manufacture, market and sell intuitive interface devices and components for a variety of business applications worldwide. We generate revenues from the sale of our hardware products, including pen input and signature pads and integrated cursor control. Some of these products, particularly our eTransactions products, incorporate software that we have developed internally or that we license from third parties.

We record our revenues in two business segments: eTransactions (input devices for the electronic signature markets) and Specialty Components (integrated FSR-based sensors, subassemblies and modules that support cursor control and other input functions). We have addressed our Specialty Components market since our inception in 1985 and our eTransactions market since 1999.

In August 2007, we sold our OEM Remote and Branded Products business segments, which had historically accounted for more than half of our revenues. Unless otherwise indicated, all operating trends and comparisons in this Item 2 reflect the operations of our continuing business segments or components thereof. Information with respect to the performance in 2007 and prior years of our discontinued operations is reflected in the line item so captioned in our Consolidated Statements of Operations.

Gross profit margins in our business segments fluctuate significantly from quarter to quarter due to various factors, including the allocation of unabsorbed overhead costs and the mix of products produced and sold. We expect quarterly gross profit margins to continue to fluctuate in the future.

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We continue to incur losses as a result of various factors, including fluctuating quarterly sales levels due to market conditions and customer ordering patterns, fluctuations in gross profit margins described above, increases in operating costs, inventory reserve adjustments, and increased compliance and regulatory costs.

The relative revenue and gross profit contributions of our continuing business segments is provided below in *Results of Operations-Business Segment Overview Three and Six Months Ended June 30, 2008 Compared to Three and Six Months Ended June 30, 2007.*

Current Opportunities and Challenges

As part of an overall strategy to deemphasize our declining margin businesses and focus our efforts on higher margin emerging markets, we sold our OEM Remotes and Branded Products business segments in August of 2007. The sale of these business segments has enabled us to advance our strategic business initiatives and allow us to focus on our eTransactions and Specialty Components business segments, which we feel have the greatest potential for long-term profitable growth. While the higher margins in our retained businesses are anticipated to result in improved cash flow by the end of fiscal 2008 and into the future, we support a constant level of fixed general and administrative expenses with a revenue base that has been reduced by half, which is likely to result in continued net losses and may affect our ability to generate positive cash flow. In this regard, we evaluate our cost structure on a regular basis and continue to make efforts to reduce fixed costs where appropriate. Our principal and ongoing challenge, therefore, is to grow our eTransactions and Specialty Components business segments to achieve the revenue levels, cost efficiencies and profitability that will sustain and justify our continued investments in these segments. Our ability to manage this challenge will define the level of our success over the next two to three years. Managing this challenge may also require further divestitures or other reorganizations to realize increased organizational efficiencies.

A considerable portion of our effort has been, and will continue to be, directed at emerging markets, such as our eTransactions market, where our success depends, in part, on our ability to accurately forecast the nature, amount and timing of market requirements in an environment in which historical precedent is limited or non-existent. We rely on information generated by our internal staff and industry partners and on independent market studies for forecasts of market demand in our focus areas, but these studies are themselves based on limited empirical data. An inaccurate forecast of market demand in any of our core market areas would impact our short-term performance and could impact our competitive position and, consequently, our long-term performance.

We are making significant efforts to develop new and improved products for our Specialty Components markets that use our proprietary FSR technology. The inability to develop and deliver these products to our customers on a timely basis would impact our ability to become profitable in our Specialty Components business segment in the timeframe we are anticipating.

Management faces the constant challenge of balancing our investment in new technology, product development and marketing initiatives against the objective of steady earnings growth. A decision to make a significant investment in a new technology, product or marketing effort may have a short-to-medium term negative impact on cash and earnings even if the investment proves to be justified. We may make investments in new business opportunities that will increase operating costs, decrease margins and negatively impact earnings until the investment produces significant revenue growth.

Our revenues from continuing operations were $6.7 million and $12.4 million for the three and six months ended June 30, 2008, respectively, representing a 76% and 56% increase over the three and six months ended June 30, 2007, respectively. Our current projections show that revenue will continue to grow in both the eTransactions and Specialty Components business segments for the fiscal year ended December 31, 2008 when compared to the fiscal year ended December 31, 2007. If revenues grow as projected in 2008, operating expenses will experience a relatively lower growth rate, with the result that operating expenses, as a percentage of revenues, should decrease.

Our quarterly results are often affected by volatility in orders for a particular product. Sales of our eTransactions products to large institutions are typically made pursuant to large purchase orders, which can be one-time events or can occur at widely dispersed intervals. Sales of our Specialty Components products typically depend on our ability to design the product required by our customer and on the product life of the product of its customer. Both of these factors could result in large quarterly and annual revenue fluctuations. Other factors that could cause our estimates to be wrong or could result in trends that are not apparent from our financial statements are described under Risk Factors in Part II, Item 1(A) below.

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Business Segment Overview   Three and Six Months Ended June 30, 2008 Compared To Three and Six Months Ended June 30, 2007:

For the Three and Six Months Ended June 30, 2008 and 2007, revenue and gross profit by market segment are shown in the following table:

	Three Months Ended June 30, 2008		Three Months Ended June 30, 2007		Six Months Ended June 30, 2008		Six Months Ended June 30, 2007	
Market Segment	**$000 s**	**Percent of Total Sales**	**$000 s**	**Percent of Total Sales**	**$000 s**	**Percent of Total Sales**	**$000 s**	**Percent of Total Sales**
eTransactions:								
- Revenue	$ 3,450	51%	$ 2,159	56%	$ 5,780	46%	$ 4,290	54%
- Gross Profit	1,802		1,106		2,643		2,223	
- Gross Profit % of segment Revenue	52%		51%		46%		52%	
Specialty Components:								
- Revenue	$ 3,263	49%	$ 1,666	44%	$ 6,702	54%	$ 3,715	46%
- Gross Profit	1,295		209		2,393		895	
- Gross Profit % of Segment Revenue	40%		13%		36%		24%	
All Segments:								
- Revenue	$ 6,713	100%	$ 3,825	100%	$ 12,482	100%	$ 8,005	100%
- Gross Profit	3,097		1,315		5,036		3,118	
- Gross Profit %	46%		34%		40%		39%	

All Segments

Our revenues increased 76% in the second quarter of 2008 compared to the second quarter of 2007, attributable to a 60% and 96% increase in eTransactions and Specialty Components revenues, respectively. Our gross margin increased to 46% for the three months ended June 30, 2008 compared to 34% for the three months ended June 30, 2007, which was attributable to a 1% and 27% improvement in eTransactions and Specialty Components gross margins, respectively.

Our revenues increased 56% in the first six months of 2008 compared to the first six months of 2007, attributable to a 35% and 80% increase in eTransactions and Specialty Components revenues, respectively. Our gross margin increased to 40% for the six months ended June 30, 2008 compared to 39% for the six months ended June 30, 2007, which was attributable to a 12% improvement in Specialty Components gross margins, due to improved manufacturing efficiencies, offset by a 6% reduction in eTransactions due to higher unabsorbed manufacturing costs compared the first six months of 2007.

eTransactions

In our eTransactions segment, we sell electronic signature capture devices and, depending on the customer requirement, signature-capture software. We offer annual software maintenance agreements and hardware upgrade programs to our existing customers; however, historically we have not recorded significant revenues from those types of sales.

For the three and six months ended June 30, 2008, our revenues increased 60% and 35%, respectively compared to the three and six months ended June 30, 2007 primarily due to higher sales of our hardware products. eTransactions revenues will continue to see fluctuations in revenue growth from period to period based on the large revenue size of the transactions generated by this business segment. eTransactions gross profit margin for the three and six months ended June 30, 2008 was 52% and 46%, respectively, compared with 51% and 52% for the three and six months ended June 30, 2007.

Specialty Components

In our Specialty Components business, we sell our *MicroNav* products and custom Force Sensing Resistors (FSR) and FSR-based subassemblies to many types of customers in several vertical markets, such as medical devices, industrial input and military input products.

Specialty Components revenues for the three and six months ended June 30, 2008 increased 96% and 80%, respectively, compared to the three and six months ended June 30, 2007. The increase was primarily due to higher sales related to key customers added in the latter part of 2007. Specialty Component gross profit margin for the three and six months ended June 30, 2008 was 40% and 36%, respectively, compared to 13% and 24% for the three and six months ended June 30, 2007. As the Specialty Components business segment increases its revenues and operational efficiencies, scales its operations, reduces its manufacturing costs in the United States and builds its infrastructure in China, gross profit margin should continue to increase.

Operating Expenses From Continuing Operations

Operating expenses for the three months ended June 30, 2008 increased to $4,069,000, from $3,061,000 for the three months ended June 30, 2007. This $1,008,000 increase in operating expenses was primarily due to $606,000 in increased selling, general and administrative expenses and $402,000 in increased product development and research costs. In selling, general and administrative expenses, $692,000 was attributable to increased payroll and related costs, which included $288,000 in severance costs related to a reduction of employees in the second quarter of 2008, and an aggregate of $123,000 in increased consulting, bad debt expense and other general activities. These costs were offset by a decrease of $232,000 in non-cash compensation costs related to SFAS 123(R). Product development and research costs, which include internal engineering labor, contract engineering and outside processing costs for the design and development of our products and the research of our technologies, increased $402,000, from $710,000 for the three months ended June 30, 2007 to $1,112,000 for the three months ended June 30, 2008. This increase was due primarily to $484,000 in increased payroll and related costs, which included the realignment of certain personnel from manufacturing to product development, and $47,000 in increased patent legal fees, partially offset by a decrease of $61,000 in non-cash compensation costs related to SFAS 123(R).

Operating expenses for the six months ended June 30, 2008 increased to $8,715,000, from $6,248,000 for the six months ended June 30, 2007. This $2,467,000 increase in operating expenses was primarily due to $1,635,000 in increased selling, general and administrative expenses and $832,000 in increased product development and research costs. In selling, general and administrative expenses, $1,327,000 was attributable to increased payroll and related costs, including recruiting expenses, $149,000 in various general and administrative activities including repairs and maintenance, and travel and entertainment. We also had a decrease of $64,000 in non-cash compensation costs related to SFAS 123(R). Product development and research costs increased $832,000, from $1,506,000 for the six months ended June 30, 2007 to $2,338,000 for the six months ended June 30, 2008. This increase was due primarily to $826,000 in increased payroll and related costs, which, as discussed in the preceding paragraph, includes the realignment of personnel and increased professional services, and by $85,000 in increased patent legal fees. This was offset by $76,000 less in costs moved to cost of sales to align with service revenues and a decrease of $124,000 in non-cash compensation costs related to SFAS 123(R).

Net interest expense for the three months ended June 30, 2008 was $166,000, compared to $24,000 for the three months ended June 30, 2007. Net interest expense for the six months ended June 30, 2008 was $281,000 compared to $7,000 for the six months ended June 30, 2007. These increases in 2008 compared to 2007 were attributable to interest expenses related the $5,000,000 convertible notes we issued to existing shareholders in July 2007.

Net other income for the three months ended June 30, 2008 was $616,000, compared to $10,000 for the three months ended June 30, 2007. Net other income for the six months ended June 30, 2008 was $1,329,000, compared to a net other loss of $13,000 for the six months ended June 30, 2007. These increases were primarily attributable to the change in fair value calculations of the convertible notes and warrants from the beginning of the year to June 30, 2008.

Operating Results From Continuing Operations

The primary factors attributable to the $774,000 decrease in our operating loss from continuing operations, net of tax, to $972,000 for the three months ended June 30, 2008, from $1,746,000 for the three months ended June 30, 2007, were (i) a 76% increase in revenues attributable to growth in both business segments and (ii) an increase in gross margin from 34% to 46%, with both segments showing increases, each of which were offset by a $1,008,000 increase in operating expenses that was primarily related to payroll and associated costs.

The primary factors attributable to the $549,000 increase in our operating loss from continuing operations, net of tax, to $3,679,000 for the six months ended June 30, 2008, from $3,130,000 for the six months ended June 30, 2007 were (i) a 56% increase in revenues attributable to growth

in both business segments and (ii) an increase in gross margin from 39% to 40%, each of which were offset by a $2,467,000 increase in operating expenses that was primarily related to payroll and associated costs.

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For the three and six months ended June 30, 2008 and for the three months ended June 30, 2007, there was no provision for income taxes from continuing operations. We do have a $51,000 provision for income taxes for the six months ended June 30, 2007, which relates to statutory tax filings of our Hong Kong subsidiary.

Loss from Discontinued Operations

As a result of the sale of our OEM Remote and Branded Products business segments, we have included in the Condensed Consolidated Financial Statements financial information presented in accordance with Statement of Financial Accounting Standards 144 Accounting for Impairment or Disposal of Long-Lived Assets which requires us to present the sale of these assets on a discontinued operations basis. We recorded a net loss from discontinued operations, net of tax, for the three and six months ended June 30, 2007 of $419,000 ($0.03 loss per share) and $1,496,000 ($0.11 loss per share), respectively.

Liquidity and Capital Resources

Our primary cash needs have been for working capital and general corporate purposes. Working capital decreased to $15.7 million at June 30, 2008 from $18.7 million at December 31, 2007. This $3.0 million decrease is due primarily to our $2.6 million loss from continuing operations.

Cash used in continuing operations was $6.6 million for the first six months of 2008 as compared to cash used in operations of $2.7 million in the first six months of 2007. This $4.0 million increase in cash used in continuing operations is due primarily to net payments made that were associated with the sale of assets in August 2007 and reflected in accrued payroll and other accrued expenses. We spent $272,000 in the first six months of 2008 to purchase additional manufacturing and computer equipment compared to $98,000 in the first six months of 2007.

There were no proceeds from the exercise of employee and director stock options during the six months ended June 30, 2008 and 2007. We made $48,000 in interest payments, $53,000 in income tax payments and $80,000 in principal payments on long-term debt during the first six months of 2007. We made no principal payments and incurred interest payments of $201,000 on the long term note payable during the first six months of 2008.

On November 8, 2007, we executed an Amended and Restated Loan and Security Agreement with Silicon Valley Bank that provides for a line of credit with a maximum borrowing limit of $5 million. The line of credit is secured by our accounts receivable and other assets and expires in December 2009. Under the terms of the Security Agreement, we have the ability to borrow against the line in amounts up to 80% of our eligible accounts receivable. At June 30, 2008 and June 30, 2007, we had drawn $0 and $1.5 million on the line of credit, respectively.

We currently have modest commitments for capital expenditures and no material purchase obligations.

In February 2007, we signed a new software licensing agreement with a company for the continued use of software in certain of our products. This agreement supersedes a previous agreement with the same software company and became effective April 1, 2007. The agreement provides for payments of $15 per set of software sold packaged with certain of our electronic signature pads. Minimum payments under the agreement are $300,000 per quarter, and quarterly minimum amounts are permitted to be carried forward and applied to future product shipments. The agreement allows us to purchase the software from the software company at any time during the agreement, which is effective through September 30, 2011.

Our minimum long-term debt, licensing and operating lease obligations as of December 31, 2007 were as follows (in thousands):

	Total	Less Than 1 Year	2-3 Years	3-5 Years	More than 5 Years
Software license	$ 3,900	$ 1,200	$ 2,400	$ 300	$
Operating lease obligations	854	414	440		
Convertible notes and interest	6,017	400	5,617		
Total	$ 10,771	$ 2,014	$ 8,457	$ 300	$

The amounts attributable to our software license and operating lease obligation may increase as we pursue our growth strategy, but the size of any increase will depend on the particular requirements of any growth commitment, the availability and attractiveness of equity capital

arrangements and our general liquidity position. The $5 million in convertible notes that we issued to existing

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investors in July 2007 accrue interest at 8% per annum, have a three year term and mature on July 19, 2010. Interest on the notes is payable semi-annually, and the outstanding principal balance and all accrued and unpaid interest is convertible into Common Stock at any time during the term of the notes at the election of the note holder. If the notes are not converted into Common Stock before maturity, the principal balance and all outstanding interest become immediately due and payable, in cash, at maturity.

Disclosure Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that involve substantial risks and uncertainties and which are intended to be covered by the safe harbors created thereby. These statements can be identified by the fact that they do not relate strictly to historical information and may include the words expects , believes , anticipates , plans , may , will , intends , estimates , continue or expressions. These forward-looking statements are subject to various risks and uncertainties that could cause actual results to differ materially from those currently anticipated. These risks and uncertainties include, but are not limited to, items discussed earlier in this Item 2 under the headings Overview , Current Opportunities and Challenges and Business Segment Overview three and six months ended June 30, 2008 compared to three and six months ended June 30, 2007. Forward-looking statements speak only as of the date made. We undertake no obligation to publicly release or update forward-looking statements, whether as a result of new information, future events or otherwise.

Application of Critical Accounting Policies and Estimates

Management s Discussion and Analysis of Financial Condition and Results of Operations are based upon the consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, management evaluates estimates, including those related to the valuation of inventory and the allowance for uncollectible accounts receivable. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

Revenue Recognition. We recognize revenue in accordance with SEC Staff Accounting Bulletin No. 104, Revenue Recognition (SAB No. 104) requires that four basic criteria be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services rendered; (3) a fee applies that is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criteria (3) and (4) require management s judgment regarding the fixed nature of the fee charged for services rendered and products delivered and the collectibility of those fees. To satisfy these 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 customer purchase order; and (4) assess 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 Statement of Financial Accounting Standards No. 48 with respect to sell-through and returns and the related recording of reserves for potential customer returns. Should changes in conditions cause management to determine the revenue recognition criteria are not met for future transactions, such as a determination that collectibility was not reasonably assured, revenue could be adversely affected.

In our eTransactions business segment, a portion of our revenues are derived from the sale, service and support of software. Our software support revenues consist of post contract customer support and maintenance (PCS). Accordingly, when applicable, we recognize revenue by applying the provisions of the American Institute of Certified Public Accountants Statement of Position (SOP) 97-2, Software Revenue Recognition as amended by SOP 98-9, Software Revenue Recognition with Respect to Certain Arrangements .

When a eTransactions sales involve multiple elements or multiple products, and we have vendor-specific objective evidence (VSOE) of fair value for each element in the arrangement, we recognize revenue based on the relative fair value of all elements within the arrangement. We determine VSOE based on sales prices charged to customers when the same element is sold separately or based upon renewal pricing for PCS. If VSOE cannot be determined for all undelivered elements of an arrangement, we defer revenue until the earlier of (i) the delivery of all elements or (ii) the establishment of VSOE for all undelivered elements, provided that if the only undelivered element is PCS or a service, the total fee of the arrangement is recognized as revenue over the PCS or service term.

Disposal of Long Lived Assets. On August 31, 2007, we completed the sale of our OEM Remotes and Branded Products business segments. As a result of the sale, the financial information included in the accompanying Condensed Consolidated Financial Statements is presented in accordance with Statement of Financial Accounting Standards 144 Accounting for Impairment or Disposal of Long-Lived Assets (SFAS 144), which requires us to present the sale of these assets on a discontinued operations basis. The balance sheet at December 31, 2006 has been adjusted to reflect the assets and liabilities of the OEM Remotes and Branded Products segments as held for sale. Additionally, the statements of operations and cash flows have been adjusted to reflect the results of these segments as discontinued operations for the periods presented. Certain assumptions were used in determining amounts being presented as assets held for sale and discontinued operations. These assumptions were based on an analysis and review of costs associated with operating the ongoing business subsequent to the asset sale as compared with costs of operations prior to the asset sale.

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 account receivable balances and add to our allowance for doubtful accounts at the time collection becomes questionable based on payment performance or age of the receivable and other factors related to the customer s ability to pay. We generally offer 30-day payment terms; however, some distributors in the divested Branded Products business segment and some of our Japanese OEM customers require as long as 120-day payment terms.

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 based on 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-down may be required and would be reflected in our cost of sales in the period the revision is made.

Valuation of Derivative Instruments. SFAS 133 requires bifurcation of embedded derivative instruments and measurement of their fair value for accounting purposes. Derivative liabilities are adjusted to reflect fair value at each period end, with any increase or decrease in the fair value being recorded in results of operations under the heading Adjustments to Fair Value of Derivatives. The effects of interactions between embedded derivatives are calculated and accounted for in arriving at the overall fair value of the financial instruments. In addition, the fair values of freestanding derivative instruments such as warrant derivatives are valued using lattice models.

Stock-based compensation. We account for stock-based compensation in accordance with Statement of Financial Accounting Standards No. 123R, *Share-Based Payment (SFAS 123(R)).* Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Determining the fair value of stock-based awards at the grant date requires judgment, including estimating expected dividends. In addition, judgment is also required in estimating the amount of stock-based awards that are expected to be forfeited. If actual results differ significantly from these estimates, stock-based compensation expense and our results of operations could be materially impacted. For the three and six months ended June 30, 2008, forfeitures for employees were estimated to be 12.34% while forfeitures for executives were estimated to be 3%, with total forfeitures for the three and six months ended June 30, 2008 totaling $11,000 and $95,000, respectively. Stock-based compensation expense recognized under SFAS 123(R) for employees and directors for the three and six months ended June 30, 2008 was $115,000 and 847,000 respectively. The effect on basic and diluted earnings per share for the three and six months ended June 30, 2008 was $(0.01) per share and $(.05) per share, respectively. As of June 30, 2008, we have $1,401,000 of unrecognized stock-based compensation cost related to non-vested stock options. This cost is expected to be recognized over a weighted average period of 1.08 years, of which $326,000 will be recognized in the remaining six months of our 2008 fiscal year.

Provision for Income Tax. As part of the process of preparing financial statements, as required by Statement of Financial Accounting Standards (SFAS) No. 109 Accounting For Income Taxes , we are required to estimate income taxes in each jurisdiction 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 Consolidated Balance Sheet. We must then assess the likelihood that deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely, establish a valuation reserve. To the extent we establish a reserve or increase this reserve in a period, we must include an expense within the tax provision in the statements of operations.

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes (FAS 109). This interpretation prescribes a

recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. We adopted FIN 48 effective January 1, 2007. We file income tax returns in the U.S. federal jurisdiction, and various state, local and foreign jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2000. As a result of the implementation of Interpretation No. 48, we did not recognize any increase in the liability for unrecognized tax benefits. In addition, we did not record a cumulative effect adjustment related to the adoption of FIN 48.

In the first quarter of 2007, the Inland Revenue Department (IRD) of Hong Kong commenced an examination of our Hong Kong income tax returns for 2003 through 2005. The examination is anticipated to be completed in the 2008 fiscal year. Due to delinquencies in filing annual tax returns for the 2003, 2004 and 2005 fiscal years, the IRD has assessed certain adjustments to our overall reported losses in Hong Kong for those periods stated above. These adjustments, all of which have been paid by us prior to 2007, have resulted in additional income tax assessments and cash payments that have been made for 2003, 2004 and 2005 totaling $456,000 as of the date of this filing. We do not anticipate any further adjustments will be made.

Significant management judgment is required in determining our provision for income taxes, deferred tax asset and liabilities and any valuation reserve recorded against net deferred tax assets. Management continually evaluates its deferred tax asset to determine whether it is likely that the deferred tax asset will be realized.

When tax returns are filed, it is likely that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely to be realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest and penalties associated with unrecognized tax benefits are classified as other interest and expense in the statement of income.

Foreign Exchange Exposure. We have established relationships with non-U.S. OEM customers of our Specialty Components business segment. Certain of these customers have been based in Japan and approximately 19%, 6% and 3% of our revenues for the years ended December 31, 2007, 2006 and 2005, respectively, came from Japanese customers. Revenues from these customers are denominated in Japanese yen, subjecting us to fluctuations in the yen/dollar exchange rate. From time to time, we use foreign currency forward and average rate option contracts to hedge this exposure. We use revenue forecasts from our Japanese subsidiary to determine the amount of forward or option contracts to purchase and we attempt to enter into these contracts when we believe the yen value is relatively strong against the U.S. dollar. To the extent that our revenue forecast may be inaccurate or the timing of forecasting the yen s strength is wrong, our actual hedge gains or losses may not necessarily correlate with the effect of foreign currency rate fluctuations on our revenues. We mark these contracts to market value and the gain or loss from these contracts is recorded as revenue of our Specialty Components business segment. These hedge transactions are classified as economic hedges and do not qualify for hedge accounting under SFAS 133. In addition, because our Japanese subsidiary s functional currency is the yen, the translation of the net assets of that subsidiary into the consolidated results will fluctuate with the yen/dollar exchange rate.

We calculate the increase (decrease) in revenues resulting from foreign currency fluctuations by calculating the U.S. dollar equivalent of our yen-denominated revenues for the year using the yen/dollar exchange rate at the beginning of the year. The resulting product is compared to our yen-denominated revenues converted to United States dollars according to Generally Accepted Accounting Principles and the difference is shown in the table above.

Sale of Assets. On August 31, 2007, we completed the sale of our OEM Remotes and Branded Products business segments for an aggregate cash purchase price of $11,500,000, subject to certain post-closing price adjustments. As a result of this sale, we have included in these consolidated financial statements financial information presented in accordance with SFAS144 which requires us to present the sale of these assets on a discontinued operations basis.

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Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 (SFAS No. 159). This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value, nor does it eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS No. 157, Fair Value Measurements and SFAS No. 107, Disclosures about Fair Value of Financial Instruments. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS No. 157, Fair Value Measurements. SFAS 159 is effective as of the beginning of an entity s first fiscal year that begins after November 2007. The adoption of this statement does not have a material effect on our financial conditions, its results of operations or its liquidity.

In December 2007, FASB issued Statement of Financial Accounting Standards No. 141R, *Business Combinations* (SFAS 141R). SFAS 141R requires most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination to be recorded at full fair value. SFAS 141R applies to all business combinations, including combinations among mutual entities and combinations by contract alone. Under Statement 141R, all business combinations will be accounted for by applying the acquisition method. Statement 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We are currently evaluating SFAS 141R to understand the impact it may have on future consolidated financial statements.

In December 2007, FASB issued Statement of Financial Accounting Standards No. 160, *Non-controlling Interests in Consolidated Financial Statements* (SFAS 160). SFAS 160 requires the ownership interests in subsidiaries held by parties other than the parent to be treated as a separate component of equity and be clearly identified, labeled, and presented in the consolidated financial statements. SFAS 160 is effective for periods beginning on or after December 15, 2008. Earlier adoption is prohibited. We are currently evaluating SFAS 160 to understand its impact it may have on future consolidated financial statements.

In January 2008, the SEC issued Staff Accounting Bulletin No. 110, *Certain Assumptions Used in Valuation Methods* (SAB 110) which amends Staff Accounting Bulletin No. 107, *Share-Based Payment* (SAB 107). SAB 110 allows for the continued use, under certain circumstances, of the simplified method in developing an estimate of expected term of so-called plain vanilla stock options accounted for under FAS 123R. SAB 110 amends SAB 107 to permit the use of the simplified method beyond December 31, 2007. The adoption of SAB 110 did not have a significant effect on the Company s consolidated financial statements.

In March 2008, FASB issued Statement of Financial Accounting Standards No. 161 , *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (FAS 161). The standard requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit-risk related contingent features in derivative agreements. FAS 161 is effective for financial statements issued after November 15, 2008. The adoption of FAS 161 will not have a significant effect on the Company s consolidated financial statements.

In May of 2008, FASB issued Statement of Financial Accounting Standards No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS No. 162). The pronouncement mandates that the Generally Accepted Accounting Principles (GAAP) hierarchy reside in the accounting literature as opposed to in the audit literature. This has the practical impact of elevating FASB Statements of Financial Accounting Concepts in the GAAP hierarchy. This pronouncement will become effective 60 days following SEC approval, which has not yet occurred. The adoption of SFAS No. 162 will not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

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Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Exchange Rate Risk. Our Japanese subsidiary, Interlink Electronics K.K., generally makes sales and collects its accounts receivable in Japanese yen. To hedge these revenues against future movements in exchange rates, we may purchase foreign exchange forward and average rate option contracts. When we do purchase foreign exchange forward and average rate option contracts, gains or losses are offset by gains or losses on the underlying revenue exposure and consequently a sudden or significant change of foreign exchange rates would not have a material impact on net income or cash flows to the extent future revenues are protected by forward currency contracts. These contracts, however, typically have a three month duration. Thus, yen/dollar fluctuations lasting more than three months will have an impact on our revenues. For the three month periods ended June 30, 2008 and 2007, we did not enter into foreign currency exchange contracts in the normal course of business to manage our exposure against foreign currency fluctuations on revenues denominated in foreign currencies. The principal objective of such contracts is to minimize the risks and costs associated with financial and global operating activities. We do not utilize financial instruments for trading or other speculative purposes. The fair value of foreign currency exchange contracts is estimated by obtaining quotes from bankers. During the three month period ended June 30, 2008, we recognized no gains on foreign currency exchange contracts which are reflected in revenue in the accompanying Consolidated Statements of Operations. Our hedging policies are designed to offset the effect of a yen devaluation on our revenues; thus, a hypothetical 10% devaluation of the yen would reduce our yen denominated revenues by 10%; but our theoretical hedging gains would offset that effect for a period of time, to the extent we have such foreign currency exchange contacts outstanding. As of June 30, 2008, we do not have any contracts outstanding to hedge our foreign exchange exposure and thus we are exposed to foreign currency exchange rate risk.

Interest Rate Exposure. Based on our overall international interest rate exposure at June 30, 2008, a hypothetical 10% change in interest rates applied to our international outstanding debt as of June 30, 2008, would have no material impact on earnings or cash flows over a one-year period.

Item 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures. Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report pursuant to Rule 13a-15(b) under the Securities Exchange Act. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that (i) information required to be disclosed by us is accumulated and communicated to our management as appropriate to allow timely decisions regarding required disclosure and (ii) information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Notwithstanding the preceding sentence, we continue to engage in efforts to improve our disclosure controls and procedures.

Changes in Internal Control Over Financial Reporting. There have been no changes in our internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on the Effectiveness of Controls. Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or internal control over financial reporting will prevent all error and all fraud. A control system no matter how well designed and implemented, can provide only reasonable, not absolute, assurance that the control system s objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues within a company are detected. The inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

We continue to defend ourselves in a class action and a shareholder derivative action. Each of these proceedings alleges violations of federal and state securities laws. Note 14 to the Financial Statements included in Item 1 of Part I of this Form 10-Q, which is hereby incorporated by reference, contains additional information about these legal proceedings and other legal maters concerning Interlink.

Item 1(A). Risk Factors

We have incurred net losses and negative cash flow from operations for the past five fiscal years and expect to experience future quarterly losses. Continued losses and negative cash flow would reduce our internal resources, limit our growth options, require additional cash infusions and could ultimately place our continued viability in question.

We have incurred losses and negative cash flow from operations in each of the previous five fiscal years. These losses resulted from various factors, including declining gross profit margins in our divested OEM Remotes business segment, increases in operating costs, increased compliance and regulatory costs, inventory reserve adjustments and internal investigation costs, some of which will continue to affect future results.

As part of an overall strategy to deemphasize our declining margin businesses and focus our efforts on higher margin emerging markets, we sold our OEM Remotes and Branded Products business segments in August of 2007. While we expect the higher margins in our retained businesses to result in positive cash flow by the end of fiscal 2008, we support a constant level of fixed general and administrative expenses with a revenue base that has been reduced by half, which is likely to result in continued net losses and may affect our ability to generate positive cash flow. The report of our independent registered public accounting firm contained in our fiscal 2006 audited financial statements included a going concern qualification. The going concern qualification has been eliminated in our 2007 fiscal year audited financial statements.

Despite our projections and best efforts, we cannot assure you that we will achieve or sustain profitability or positive cash flow. If we do not achieve profitability and positive cash flow, our financial resources will be adversely affected and we may be forced to curtail or discontinue certain operations, which could result in the allocation of fixed costs over an even smaller revenue base or affect our future competitiveness. If we were to require additional financing, such financing could prove dilutive to the interests of existing investors, or we may be required to divest additional business assets.

Our former President and Chief Executive Officer retired on January 4, 2008. Our ability to execute our business strategy may be impaired if we are unable to find and retain a new Chief Executive Officer with necessary skills and experience. The loss of the services of other key personnel, or if we are unable to recruit other qualified managers and key personnel in the future, may also impair our ability to operate effectively.

E. Michael Thoben, III, our former President and Chief Executive Officer, retired on January 4, 2008. Mr. Thoben had been with Interlink for the past seventeen years and has substantial experience with our business and technology. John Buckett, Chairman of the Board, has been appointed our interim Chief Executive Officer until a permanent replacement is found. Our Board of Directors is conducting a search for a replacement and is in discussions with a prospective new Chief Executive Officer. If we are unable to find a permanent replacement for Mr. Thoben with the combination of skills and industry experience necessary to execute our business plan and manage our company, our business may suffer. We also may incur significant costs in identifying, hiring, training and retaining Mr. Thoben s permanent replacement.

Our success also will depend, in part, on our ability to attract and retain additional qualified professional, technical, production, managerial and marketing personnel, both domestically and internationally. The loss of other key employees during this transition period would be particularly difficult and could cause significant delays in the implementation of our business plan and an adverse effect on our operations.

Business divestitures, acquisitions and partnering arrangements may disrupt our business, dilute stockholder value and distract management s attention.

In August 2007 we completed the sale of our OEM Remotes and Branded Products business segments. As part of our business strategy to focus on higher margin emerging markets, we may consider additional divestitures or acquisitions or discontinue other aspects of our business. Such

strategic decisions involve numerous risks, including:

- unanticipated costs and liabilities;
- difficulty of separating or combining the operations, products and personnel of the divested or acquired business;

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- difficulties in maintaining customer relationships and managing the strategic position of products and technologies;
- diversion of management s attention;
- inability to maintain uniform standards, controls, policies and procedures;
- accounting results that are unrelated to the performance of either business;
- amortization of fixed costs over a smaller revenue base;
- goodwill and other intangible assets that are subject to potential impairments in the future;
- dilution of the ownership of existing shareholders, to the extent that acquisitions are financed with convertible debt or stock; and
- other changes that consume resources and management s attention.

We may fail to replace divested operations with new business segments that contribute to our financial health and strategic objectives. If we fail to properly evaluate and execute acquisitions, investments or divestitures, we may not achieve the anticipated additional benefit to our business and we may incur costs in excess of what we anticipate, which could damage the viability of our ongoing operations.

Our MicroNav sensor sales are dependent on a relatively small number of relatively large contracts; our failure to obtain contracts that we expect to obtain or any event that results in the loss or reduction in size of a contract below our expectations could have a material adverse effect on our results of operation.

The focus of our *MicroNav* sales effort targets a small number of large OEM manufacturers of handheld products and relates to specific products for which the OEM manufacturer is developing product specifications. We expend considerable effort in preparing for and bidding these contracts and make capacity planning decisions based on our expectations as to the number and size of contracts on which we will be the successful bidder. If our expectations are too optimistic, we are at risk of incurring expense in preparation for sales that we are not able to make. If our expectations are too pessimistic, we are at risk of being unprepared to perform on a contract that we could otherwise have obtained. In addition, the value of any OEM contract to us depends in part on the success of the device in which our products are included. We rely on the OEM customer s estimates as to the size of the market for their individual products and these estimates are often inaccurate. We cannot assure you that we will be successful in predicting volume and timing in this aspect of our business.

We are a public company and are therefore required to incur costs and to disclose information that private companies are not required to incur or disclose.

As a public company, we are required to comply with complex and costly accounting and disclosure requirements that do not apply to foreign companies that are not public in the United States, private companies or to subsidiaries or divisions of very large companies for whom the results of the subsidiary or division are not material. These costs impact our profitability and therefore constitute a competitive disadvantage vis-à-vis much of our competition, especially in light of the recent divestiture of two of our four business segments, which has caused these costs to increase substantially as a percentage of our revenues. These requirements also consume substantial management time that could otherwise be focused on other areas of our business. In addition, our public status requires us to disclose publicly information that can afford a competitor an advantage. If we are unable to maintain costs associated with our public company status within reasonable parameters, or if we are required to disclose information that our competitors can use to compete with us, our ability to remain competitive in our markets could be adversely affected.

A limited number of investors own a majority of our stock and, working together, could control us.

The majority of our stock is owned by institutions managed by a small number of fund managers. To our best knowledge, neither these stockholders nor their fund managers have any agreement or understanding under which they have agreed to act together with respect to the voting of our stock. However, they have expressed common views with respect to various matters relating to our management and governance and these views have influenced related decisions of our Board of Directors. If they were to act together as a group, these fund managers would have the ability to control various aspects of our business and governance, including the replacement of our Board of Directors. Accordingly, other investors may not have the practical ability to oppose management and/or governance decisions that have the support of our institutional investors.

We are facing litigation based on our restatements of historical financial statements, which may have a material adverse impact on our cash reserves and may impair our ability to achieve our business objectives.

Certain former Interlink stockholders have filed a class action lawsuit claiming damages under various federal securities laws based on our restatement of historical financial statements. Other stockholders have brought a derivative action against our former Chief Executive Officer and our former Chief Financial Officer that alleges, among other things, securities-related violations of the California Corporations Code. These actions will require a vigorous defense and could result in a settlement or adverse award that is not covered by insurance or that exceeds applicable insurance limits. The time and expense required to defend these claims may also affect our ability to pursue our business strategy. There is also no assurance that additional lawsuits will not be filed or that the ultimate resolution of these matters will not result in a material adverse effect on our financial condition or results of operations.

We are emphasizing new markets and if we fail to accurately predict the growth of these new markets, we may suffer reduced earnings.

Historically, the largest contributor to our consolidated sales was our OEM Remotes business segment. In late 2005, we deemphasized and reorganized segments of this business, and in August 2007 we sold this business, together with our Branded Products business. We have devoted significant resources to the development of products and the support of marketing and sales

efforts in new markets, such as the *MicroNav* family of file navigation products in our Specialty Components business, and the biometric input pads in our eTransactions business. As we transition to becoming a company with two, rather than four, business units and focus on our remaining businesses, we expect to continue to identify and develop products for new markets. These markets change rapidly and may not all prove to be attractive. We cannot assure you that they will grow or that we will be able to accurately forecast market demand in time to respond appropriately. Our investment of resources in these markets may either be insufficient to meet actual demand or result in expenses that are excessive in light of actual sales volumes. Failure to accurately predict successful new products and markets and the growth and demand in new markets may cause us to suffer substantial losses or reduced earnings.

Failure to increase market awareness and acceptance of eTransactions and our eTransaction products may cause our revenues in this market to fall short of our expectations.

We are focusing considerable resources on developing our eTransactions market. The prospects for growth of our eTransactions business depend in part on the acceptance by our target markets of electronic signatures as a replacement for traditional pen and ink signatures. The market for eTransactions is new and emerging and we cannot be certain that it will continue to develop or grow in a timely manner or that businesses will elect to adopt our products rather than competitive products or to continue to rely on traditional pen and ink signatures. Businesses that have invested substantial resources in traditional infrastructures may be reluctant to adopt an electronic approach to replace their existing systems. Concerns about privacy and fraud may cause businesses not to adopt eTransactions or our eTransaction products. We expect that we will need to continue to pursue intensive marketing and sales efforts to educate prospective customers about the benefits of eTransactions and our eTransaction products. If market awareness and acceptance of eTransactions do not occur, our revenues and profitability in this market will fall short of our expectations.

If we are unable to keep pace with rapid technological developments, we may not be able to compete effectively.

Technology in our target markets is undergoing rapid change. In order to maintain our position in our existing markets and succeed in new markets, we will have to develop and support innovative technologies. Doing so will require, among other things, that we accomplish the following:

- accurately predict customer needs and develop, in a timely manner, the technology required to support those needs;
- provide products that are not only technologically sophisticated and well supported but are also available at a price within market tolerances and competitive with comparable products;
- establish and effectively defend our ownership of the intellectual property supporting our products; and
- enter into relationships with other companies that have developed complementary technology on which our products also depend.

We cannot assure you that we will be able to achieve any of these objectives.

If our products do not support evolving industry standards, they may not achieve or maintain market acceptance and our revenues may decline.

Our eTransactions business customers expect our products to enable them to comply with applicable requirements relating to electronic signatures, such as the Electronic Signatures in Global Commerce Act and procedures adopted by the National Notary Association. If our eTransactions products do not support these requirements, they will not be competitive and will not be adopted by the market.

We rely on others for aspects of our technology development.

Our in-house research and development expertise is focused on our sensor and communication technologies. We do not have broadly based expertise in software development, chip design or other critical technological aspects of a complete product. We rely on other companies with whom we may contract or enter into joint development agreements to provide these aspects of our product technologies. We cannot assure you that we will be able to contract or otherwise arrange for these services in the future or on a consistent basis. We also cannot assure you that a

developer with whom we contract for technology will not use or permit others to use similar technology in competition with us.

If we are not able to protect our intellectual property or if we infringe on the intellectual property of others, our business and operating results could be adversely affected.

We consider our intellectual property to be a key element of our ability to compete in our chosen markets. We rely on a combination of patents, trade secrets and proprietary software to establish and protect our intellectual property rights. We cannot assure you that patents will be issued from any of our pending applications or that any claims allowed from existing or pending patents will be sufficiently broad to protect our technology. We also cannot assure you that any patents issued to us will not be challenged, invalidated or circumvented, or that the rights granted will provide proprietary protection. Litigation may be necessary to enforce our patents, trade secrets and other intellectual property rights, to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement. Such litigation could result in substantial costs and diversion of resources and could have a material adverse effect on our business, regardless of the final outcome of the litigation.

We are not currently engaged in any patent infringement suits but we have been threatened with one such suit in recent years. Despite our efforts to maintain and safeguard our proprietary rights, we cannot assure you that we will be successful in doing so or that our competitors will not independently develop or patent technologies that are substantially equivalent or superior to our technologies. If any of the holders of these patents assert claims that we are infringing on them, we could be forced to incur substantial litigation expenses, and if we were found to have infringed a third-party patent, we could be required to pay substantial damages, pay royalties in the future or be enjoined from infringing in the future.

Sales of simple signature capture devices are growing rapidly and the manufacturers of these devices could broaden their product range to include products that compete with our ePad.

Simple signature capture devices, distinct from our more sophisticated ePad products, have recently become a common sight at retail checkout counters and a number of companies manufacture and sell these devices. While our ePad product is targeted at a more advanced market, signature capture device manufacturers could elect to expand their existing product lines in an effort to compete in our markets. Such competition could reduce margins or otherwise adversely affect our prospects in our eTransactions market.

Our markets are intensely competitive and many of our potential competitors have resources that we lack.

Our markets are competitive and we expect competition to increase. Our competitors include companies with similar products or technologies and companies that sell complementary products to our target markets. Our competitors and potential competitors may have established business relationships that afford them a competitive advantage or may create technologies that are superior to ours or that set a new industry standard that will define the successful product for that market. If any of our competitors establish a close working relationship with our customers, they may obtain advance knowledge of our customers technology choices or may be afforded an opportunity to work in partnership to develop compatible technologies and may therefore achieve a competitive advantage. We may be unable to compete successfully against current and future competitors.

We identified material weaknesses in our internal control over financial reporting in prior fiscal periods and have been required to restate our historical financial statements.

In our Annual Reports for the years ended December 31, 2005 and 2006, we reported material weaknesses in our internal control over financial reporting. As a result of the errors caused by these material weaknesses, we were required to restate our historical financial statements for the fiscal years 2001 through 2004, as well as for the first and second quarters of fiscal 2005. We have taken significant measures to improve our financial reporting process and as of June 30, 2008, we had identified no material weaknesses that remained to be remediated.

Despite our substantial efforts to ensure the integrity of our financial reporting process, we cannot guarantee that we will not identify additional weaknesses as we continue to work with the new systems that we have implemented over the past year and a half. Any continuing material weaknesses in our internal control over financial reporting could result in errors in our financial statements. Such errors could cause our internal planning and assessment of our business to be based on false information and could cause our published financial statements to fail to fairly present our financial condition and results of operations, which could erode market confidence in our company, cause the price of our stock to be based on false or misleading information and result in litigation based on such false or misleading information.

We rely on third parties for the materials that we use to manufacture our products and a shortage of supply could adversely affect our revenues, operating results and customer relationships.

We rely on third-party suppliers for the raw material components of our products. We cannot assure you that our suppliers will be able to maintain an adequate supply of these raw materials to enable us to fulfill all of our customers   orders on a timely basis. A failure to obtain an adequate supply of the materials for our products could increase our costs of goods sold, cause us to fail to meet

delivery commitments and cause our customers to purchase from our competitors, which could adversely affect our operating results and customer relationships. In some situations, we rely on a single supplier for raw material components of our products. Any disruption in these supplier relationships could prevent us from maintaining an adequate supply of materials and could adversely affect our results of operation and financial position.

Disruptions in our manufacturing facilities or arrangements could cause our revenues and operating results to decline.

We currently manufacture FSR sensors at our Camarillo, California facility. This facility is vulnerable to damage from earthquakes, floods, fires, power loss and similar events. It could also be subject to break-ins, sabotage and intentional acts of vandalism. Our insurance may not cover such events and, if the event is covered, our insurance may not be sufficient to compensate us for any losses that may occur. Despite any precautions we may take, the occurrence of a natural disaster or other unanticipated problem at our manufacturing facility could result in delayed shipment of products, missed delivery deadlines and harm to our reputation, which may cause our revenues and operating results to decline.

Manufacturing is also being done by our China subsidiary and by third parties in China that are identified and managed through our Hong Kong and China subsidiaries. We rely on our subsidiaries to select and contract with contract manufacturers with suitable manufacturing facilities and appropriately trained employees. An interruption in our current manufacturing arrangements could adversely affect our revenues, operating results and customer relationships.

International sales and manufacturing risks could adversely affect our operating results.

Our revenues from international sales accounted for approximately 54%, 62% and 34% of net sales for the years ended December 31, 2007, 2006 and 2005, respectively. We believe that international sales will represent a substantial portion of our sales for the foreseeable future. Our manufacturing is currently performed in China and Camarillo. Our international operations involve a number of risks, including:

- import-export license requirements, tariffs, taxes and other trade barriers;
- difficulty in staffing and managing foreign operations;
- ability to secure credit and funding;
- difficulty in maintaining an effective system of internal controls at our foreign manufacturing facility;
- foreign collection problems;
- foreign exchange exposure
- reduced protection of intellectual property rights;
- international unrest and terrorism;
- political and economic instability; and

transportation risks.

Any of the above factors could adversely affect our operating results.

Our operating results could be adversely affected by fluctuations in the value of foreign currencies.

International sales made through our Japanese subsidiary are generally denominated in yen. A weak yen would materially affect total revenue and could result in a decrease in dollar revenue even though sales remained constant or increased. We also contract for most of our large-volume, non-technical manufacturing in China. Although we contract in U.S. dollars, a weakening of the dollar could cause existing contracts to be uneconomic to the vendor and therefore require a renegotiation. Over the past two years, the valuations of many foreign currencies have fluctuated significantly relative to the U.S. dollar. The Japanese yen, in particular, has fluctuated in value due in part to the economic problems experienced by Asian countries and the depreciation of the U.S. dollar. Although we at times engage in currency hedging transactions in order to protect ourselves from risks of Japanese yen currency fluctuations, we cannot assure you that these activities will protect us from such risks.

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Environmental directives could increase our costs and/or require us to reserve against inventory.

Environmental directives that affect our manufacturing processes and inventory may be enacted from time to time in the United States and abroad. Any such directives could require us to increase our inventory reserves due to obsolescence or otherwise increase the cost of doing business. In 2006, the Restriction on Hazardous Substances Directive (ROHS) went into effect which limited the use of hazardous raw materials in the production of electronic and electrical goods that we sell in the European Union and certain other European countries. While we currently believe our inventory reserve is adequate, we may have additional inventory write downs due to ROHS or other similar restrictions implemented by other markets. In 2007, the Waste Electrical and Electronic Equipment became effective and required companies that sell electronic equipment on the EU market to register with individual member states, mark their products, submit annual reports, provide recyclers with information about product recycling, and either recycle their products or participate in or fund mandatory recycling schemes.

Failure to maintain, develop and expand our OEM relationships could cause demand for our products to decrease.

Our Specialty Components products are sold to OEM customers. If we fail to maintain, develop and expand our relationships with our OEM customers or if those customers are not successful in their marketing and sales efforts, demand for our products may decrease.

Our ability to generate increased revenues also depends significantly on the extent to which our OEM customers develop, promote and sell products that incorporate our technology and products. If our OEM customers do not successfully develop and market products that incorporate our products, sales of our products to our OEM customers would be adversely affected. The extent to which our OEM customers develop, promote and sell our products is based on a number of factors that are largely beyond our ability to control.

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

At the Annual Meeting of Stockholders of the Company held on June 24, 2008, the holders of our outstanding Common Stock took actions described below. At April 28, 2008, the record date, 13,761,810 shares of Common Stock were outstanding and eligible to vote at the Annual Meeting of Stockholders.

The only matter submitted to the stockholders for a vote was the election of two nominees to serve as directors. By the votes indicated below, the stockholders voted to re-elect Messrs. George Gu and Lawrence S. Barker to the Board of Directors:

	George Gu	Lawrence S. Barker
Shares in favor:	9,858,756	10,223,946
Shares against:		
Shares withheld:	512,810	147,620

E. Michael Thoben III did not stand for re-election as a director and his term as director expired at the close of the 2008 Annual Meeting of Stockholders. In addition to Messrs. Gu and Barker, Messrs. Edward Hamburg, Tom Thimot and John A. Buckett, II continued to serve as directors after the meeting.

Item 6. Exhibits

The following exhibits are filed herewith or incorporated by reference as indicated below:

Exhibit Number	
3.1	Certificate of Incorporation, as amended (incorporated by reference to Exhibit 3.1 to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2000).
3.2	Bylaws (incorporated by reference to Exhibit 3.1 to the Registrant s Current Report on Form 8-K dated September 26, 2007).
10.1	Change in Control Agreement by and between the Registrant and Rodney G. Vesling, dated April 22, 2008 (incorporated by reference to Exhibit 10.1 to the Registrant s Current Report on Form 8-K dated April 23, 2008).
10.2	Change in Control Agreement by and between the Registrant and Rostamian Farhad, dated April 22, 2008 (incorporated by reference to Exhibit 10.5 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended March 31, 2008).
31.1	Certification of Chief Executive Officer of Registrant Pursuant to SEC Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer of Registrant Pursuant to SEC Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer of Registrant Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer of Registrant Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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 13, 2008	/s/ Charles C. Best Charles C. Best Chief Financial Officer

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Exhibit Index.

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10.2	Change in Control Agreement by and between the Registrant and Rostamian Farhad, dated April 22, 2008 (incorporated by reference to Exhibit 10.5 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended March 31, 2008).
31.1	Certification of Chief Executive Officer of Registrant Pursuant to SEC Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer of Registrant Pursuant to SEC Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer of Registrant Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer of Registrant Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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EXHIBIT 31.1

I, John A. Buckett, II, certify that:

1. I have reviewed this report on Form 10-Q of Interlink Electronics, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and we have:

a) designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant s internal control over financial reporting that occurred during the registrant s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant s internal control over financial reporting; and

5. The registrant s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant s auditors and the audit committee of the registrant s board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weakness in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant s ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal control over financial reporting.

Date: August 13, 2008

/s/ John A. Buckett, II
John A. Buckett, II

Chairman and Interim Chief Executive Officer

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EXHIBIT 31.2

I, Charles C. Best, certify that:

1. I have reviewed this report on Form 10-Q of Interlink Electronics, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and we have:

a) designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant s internal control over financial reporting that occurred during the registrant s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant s internal control over financial reporting; and

5. The registrant s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant s auditors and the audit committee of the registrant s board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weakness in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant s ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal control over financial reporting.

Date: August 13, 2008

/s/ Charles C. Best

Charles C. Best
Chief Financial Officer

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Exhibit 32.1

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Interlink Electronics, Inc. (the Company) on Form 10-Q for the quarterly period ended June 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the Report), I, John A. Buckett, II, Chairman and Interim Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ John A. Buckett, II
John A. Buckett, II
Chairman and Interim Chief Executive Officer
August 13, 2008

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Exhibit 32.2

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Interlink Electronics, Inc. (the Company) on Form 10-Q for the quarterly period ended June 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the Report), I, Charles C. Best, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Charles C. Best
Charles C. Best
Chief Financial Officer
August 13, 2008

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of

the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): August 13, 2008

INTERLINK ELECTRONICS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	0-21858	77-0056625
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

546 Flynn Road, Camarillo, California **93012**
(Address of principal executive offices) **(Zip Code)**
Registrant s telephone number, including area code: (805) 484-8855

No Change

(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

¨ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

¨ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

¨ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

¨ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

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ITEM 2.02. RESULTS OF OPERATIONS AND FINANCIAL CONDITION.
On August 13, 2008, Interlink Electronics, Inc. issued a press release announcing financial results for its second quarter ended June 30, 2008. A copy of the press release is attached as Exhibit 99.1 and is incorporated by reference herein.

This information is furnished pursuant to Item 2.02 and shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act) or otherwise subject to the liability of such section, nor shall such information be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act, regardless of the general incorporation language of such filing, except as shall be expressly set forth by specific reference in such filing.

ITEM 9.01. FINANCIAL STATEMENTS AND EXHIBITS.

(d) Exhibits.

99.1 Press Release dated August 13, 2008.

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SIGNATURE

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 hereunto duly authorized.

Date: August 13, 2008

INTERLINK ELECTRONICS, INC.

By /s/ CHARLES C. BEST
Charles C. Best
Chief Financial Officer

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Exhibit 99.1

Interlink Electronics Reports 2008 Second Quarter and First Half Results

CAMARILLO, CA (USA), August 13, 2008 Interlink Electronics, Inc. (OTC: LINK.PK), a worldwide provider of intuitive interface components and solutions, today announced results for the quarter and six-month period ended June 30, 2008.

The company reported total second quarter revenues of $6.7 million, up 76 percent from $3.8 million in the second quarter of 2007. Gross profit increased to $3.1 million from $1.3 million in the same quarter last year. The Company s operating loss was $972,000, down from $1.7 million in the second quarter of 2007. These results include charges for share-based compensation of $115,000 and $525,000 in the second quarters of 2008 and 2007, respectively. Interlink s net loss in the second quarter of 2008 was $522,000, with a basic and diluted loss per share of ($0.04), compared to a net loss of $2.2 million and a loss per share of ($0.16) in the same quarter last year.

We made progress on multiple fronts, said John Buckett, Interlink chairman and interim CEO. Revenues were up substantially in both our eTransactions and Specialty Components business segments, gross margins improved, and our operating loss was reduced. We are continuing to improve in terms of cash flow and profitability. With our recent cost reductions, better execution, and continued revenue growth, we should be in a position to be cash-flow positive by year end.

Interlink reported total revenues for the first six months of 2008 of $12.5 million, up 56 percent from $8.0 million in the same period in 2007. Gross profit increased to $5.0 million from $3.1 million for the first six months of 2007. The company s operating loss was $3.7 million, compared to $3.1 million in the first six months of 2007. These results include charges for share-based compensation of $847,000 and $1,141,000 in the first half of 2008 and 2007, respectively. Interlink s net loss in the first half of 2008 was $2.6 million, with a basic and diluted loss per share of (0.19), down from a net loss of $4.7 million and a loss per share of ($0.34) in the same period last year.

The Company anticipates a timely Form 10-Q filing for the quarter ended June 30, 2008. A conference call to discuss its 2008 second quarter results will be held on Wednesday, August 13, 2008 at 4:30 p.m. EDT. To access the live conference call, dial 1-888-459-0938 (pass code is LINK); for international callers dial +1-210-839-8571 (pass code is LINK). For live web cast access, go to www.interlinkelectronics.com. A telephonic replay of the call will be available until 6:00 a.m. ET on September 14, 2008 at 1-888-566-0458; international callers may dial +1-402-998-0628. Webcast replay will be available at www.interlinkelectronics.com.

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INTERLINK ELECTRONICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(IN THOUSANDS, EXCEPT PER SHARE DATA)

	Three Month Period Ended June 30,		Six Month Period Ended June 30,	
	2008	2007	2008	2007
Revenues	$ 6,713	$ 3,825	$ 12,482	$ 8,005
Cost of revenues (includes stock-based compensation of $16 and $133 for the three months ended June 30, 2008 and 2007, respectively and $77 and $311 for the six months ended June 30, 2008 and 2007, respectively)	3,616	2,510	7,446	4,887
Gross profit	3,097	1,315	5,036	3,118
Operating expenses:				
Product development and research (includes stock-based compensation of $55 and $116 for the three months ended June 30, 2008 and 2007, respectively and $125 and $249 for the six months ended June 30, 2008 and 2007, respectively)	1,112	710	2,338	1,506
Selling, general and administrative (includes stock-based compensation of $44 and $276 for the three months ended June 30, 2008 and 2007, respectively and $645 and $581 for the six months ended June 30, 2008 and 2007, respectively)	2,957	2,351	6,377	4,742
Total operating expenses	4,069	3,061	8,715	6,248
Operating loss	(972)	(1,746)	(3,679)	(3,130)
Other income (expense):				
Interest income	72	21	194	42
Interest expense	(238)	(45)	(475)	(49)
Total net interest expense	(166)	(24)	(281)	(7)
Other income	655	24	1,645	57
Other expense	(39)	(14)	(316)	(70)
Total net other income (expense)	616	10	1,329	(13)
Loss from continuing operations before provision for income taxes	(522)	(1,760)	(2,631)	(3,150)
Provision for income taxes expense				52
Loss from continuing operations, net of tax	(522)	(1,760)	(2,631)	(3,202)
Loss from discontinued operations, net of tax		(419)		(1,496)
Net loss	$ (522)	$ (2,179)	$ (2,631)	$ (4,698)
Loss per share from continuing operations, net of tax:				
Basic and diluted	$ (0.04)	$ (0.13)	$ (0.19)	$ (0.23)
Loss per share on discontinued operations, net of tax:				
Basic and diluted	$ ( )	$ (0.03)	$ ( )	$ (0.11)
Net loss per share:				

Basic and diluted	$ (0.04)	$ (0.16)	$ (0.19)	$ (0.34)
Weighted average shares used for loss from continuing operations, net of tax:				
Basic and diluted	13,764	13,749	13,757	13,749
Weighted average shares used for loss on discontinued operations, net of tax:				
Basic and diluted	13,764	13,749	13,757	13,749
Weighted average shares used for net loss:				
Basic and diluted	13,764	13,749	13,757	13,749

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INTERLINK ELECTRONICS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(IN THOUSANDS, EXCEPT PAR VALUE)

	June 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 7,851	$ 12,659
Restricted cash	1,170	2,937
Accounts receivable, less allowance for doubtful accounts of $124 and $199 at June 30, 2008 and December 31, 2007, respectively	4,475	3,918
Inventories, net of reserves of $646 and $394 at June 30, 2008 and December 31, 2007, respectively	5,551	5,151
Prepaid expenses and other current assets	666	1,754
Assets held for sale		437
Total current assets	19,713	26,856
Property and equipment, net	1,026	999
Patents and trademarks, net	118	113
Other assets	451	364
Total assets	$ 21,308	$ 28,332
Liabilities And Stockholders Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 1,737	$ 1,600
Accrued payroll and related expenses	1,602	5,836
Deferred revenue	658	646
Liabilities related to assets held for sale		86
Total current liabilities	3,997	8,168
Convertible note, net of discounts of $1,141 and $1,415 at June 30, 2008 and December 31, 2007, respectively	3,706	3,413
Warrants and embedded derivatives	591	1,974
Total liabilities	8,294	13,555
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $5.00 par value (100 shares authorized, none issued and outstanding)		
Common stock, $0.00001 par value (50,000 shares authorized, 13,774 and 13,749 shares issued and outstanding at June 30, 2008 and December 31, 2007, respectively)	59,329	58,463
Accumulated other comprehensive loss	(438)	(440)
Accumulated deficit	(45,877)	(43,246)
Total stockholders equity	13,014	14,777
Total liabilities and stockholders equity	$ 21,308	$ 28,332

About Interlink Electronics, Inc.

Interlink Electronics, Inc. (OTC: LINK.PK), is a worldwide provider of intuitive interface components and solutions. Setting tomorrow s standards for electronic signature, e-notarization products and interface components for consumer electronics, Interlink has established itself as one of the world s leading innovators of intuitive interface design. With more than 41 patents around the world protecting its technologies and products, Interlink Electronics serves a world-class customer-base from its corporate headquarters in Camarillo, California and offices in Japan, Hong Kong and China. For more information, see http://www.interlinkelectronics.com.

This release contains forward-looking statements that involve a number of risks and uncertainties. The following are among the factors that could cause actual results to differ materially from the forward-looking statements: historical losses and negative cash flow, the appointment of a new Chief Executive Officer, the success of business divestitures and acquisitions, the expense of being a public company, the ownership of the majority of our stock by a small group of investors, our success in predicting new markets and the acceptance of our new products, efficient management of our infrastructure, the pace of technological developments and industry standards evolution and their effect on our target product and market choices, the effect of outsourcing technology development, changes in the ordering patterns of our customers, a decrease in the quality and/or reliability of our products, protection of our proprietary intellectual property, competition by alternative sophisticated as well as generic products, pending litigation against Interlink, historical weaknesses in internal controls over financial accounting, the continued availability at competitive prices of raw materials for our products, disruptions in our manufacturing facilities, risks of international sales and operations including fluctuations in exchange rates, compliance with regulatory requirements applicable to our manufacturing operations, and customer concentrations. These risks are discussed in greater detail in our quarterly report on Form 10-Q filed with the U.S. Securities and Exchange Commission. The forward-looking statements contained in this document regarding Interlink s financial results, industry and revenue trends, the filing of reports with the Securities and Exchange Commission and future business activities should be considered in light of these factors.

Contact:

Investor Relations Contact: Charles Best

cbest@interlinkelectronics.com 805-484-8855 ext. 151

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): **August 13, 2008**

INTERLINK ELECTRONICS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**0-21858**	**77-0056625**
(State or other jurisdiction of incorporation)	**(Commission File Number)**	**(IRS Employer Identification No.)**

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

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

No Change

(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

¨ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

¨ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

¨ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

¨ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

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ITEM 5.02. DEPARTURE OF DIRECTORS OR CERTAIN OFFICERS; ELECTION OF DIRECTORS; APPOINTMENT OF CERTAIN OFFICERS; COMPENSATORY ARRANGEMENTS OF CERTAIN OFFICERS.

On August 13, 2008, Kevin J. Wiley was appointed as Interlink s Chief Executive Officer. Mr. Wiley will replace John A. Buckett, II, who has served as interim Chief Executive Officer since January 4, 2008.

Prior to joining Interlink, Mr. Wiley, 48, served as Chief Executive Officer of Woosh Wireless, a competitive broadband access provider operating a broadband wireless network in New Zealand, from October 2006 to February 2008. From January through December 2005, Mr. Wiley served as Vice President, Mergers and Acquisitions and then as Vice President, Regional Mobile of Cable & Wireless. In his capacity as Vice President, Mergers and Acquisitions, Mr. Wiley was responsible for all business development activities in the company s Caribbean region. In his capacity as Vice President, Regional Mobile, Mr. Wiley was responsible for the mobile business in the Caribbean region, which included driving customer growth and financial performance. Prior to joining Cable & Wireless, Mr. Wiley was a consultant to Clarity Wireless from February to December 2004, where he provided business development services, including determining the viability of developing a broadband wireless business in European and Asian markets and managing investment transactions. Mr. Wiley was employed with Next Level Communications, a Motorola company, as Vice President of Sales and then as Vice President of Business Development, from April 2001 through April 2003. Mr. Wiley earned a BSBA in Finance and Management from Creighton University in 1982.

Mr. Wiley will receive an annual salary of $200,000, will be entitled to an annual performance-based bonus up to 30% of his annual salary and may earn an additional bonus upon the accomplishment of certain strategic objectives. Mr. Wiley is entitled to participate in Interlink s employee benefits package, which includes medical insurance, life insurance and company-matching 401(k) contributions.

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SIGNATURE

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 hereunto duly authorized.

Date: August 14, 2008

INTERLINK ELECTRONICS, INC.

By /s/ CHARLES C. BEST
Charles C. Best
Chief Financial Officer