INTRUSION INC
Form 10-K
March 29, 2016
Table of Contents

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-K

**(Mark One)**

| | |
|---|---|
| ý | **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** |

**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2015**

**OR**

| | |
|---|---|
| o | **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** |

**For the transition period from to**

**COMMISSION FILE NUMBER 0-20191**

# Intrusion Inc.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **DELAWARE**<br>(State or other jurisdiction of incorporation or organization) | **75-1911917**<br>(I.R.S. Employer Identification No.) |
| **1101 EAST ARAPAHO ROAD, SUITE 200**<br>**RICHARDSON, TEXAS**<br>(Address of principal executive offices) | **75081**<br>(Zip Code) |

Registrant s telephone number, including area code: **(972) 234-6400**

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:

**Common Stock, $0.01 par value**

(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 o No ý

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

Yes o No ý

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the 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. ý

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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act:

| | |
|---|---|
| Large Accelerated Filer o | Accelerated Filer o |
| Non-Accelerated Filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company ý |

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

Yes o No ý

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of June 30, 2015: $17,088,000.

As of March 29, 2016, 12,747,836 shares of the issuer s Common Stock were outstanding.

Table of Contents

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant s definitive Proxy Statement filed in connection with the Registrant s 2015 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

**INTRUSION INC.**

**INDEX**

Table of Contents

## PART I

### Item 1. Description of Business.

In addition to the historical information contained herein, the discussion in this Annual Report on Form 10-K contains certain forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that involve risks and uncertainties, such as statements concerning:

- growth and anticipated operating results;
- developments in our markets and strategic focus;
- new products and product enhancements;
- potential acquisitions and the integration of acquired businesses, products and technologies;
- strategic relationships and future economic and business conditions.

The cautionary statements made in this Form 10-K should be read as being applicable to all related forward-looking statements whenever they appear in this Form 10-K. Our actual results could differ materially from the results discussed in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed under the section captioned Risk Factors in Item 1A of this Form 10-K as well as those cautionary statements and other factors set forth elsewhere herein.

**General**

We develop, market and support a family of entity identification, high speed data mining, cybercrime and advanced persistent threat detection products. Our product families include:

- TraceCop for identity discovery and disclosure,
- Savant for network data mining and advanced persistent threat detection.

We market and distribute our products through a direct sales force to:

- end-users,
- value-added resellers,
- system integrators,
- managed service providers, and
- distributors.

Our end-user customers include:

- U.S. federal government entities,
- local government entities,
- banks,
- airlines,
- credit unions,
- other financial institutions,
- hospitals and other healthcare providers, and
- other customers.

Essentially, our end-users can be defined as any end-users requiring network security solutions for protecting their mission critical data.

We were organized in Texas in September 1983 and reincorporated in Delaware in October 1995. Our principal executive offices are located at 1101 East Arapaho Road, Suite 200, Richardson, Texas 75081, and our telephone number is (972) 234-6400. Our website URL is www.intrusion.com. References to the Company , we , us , our , Intrusion or Intrusion Inc. refer to Intrusion Inc. and its subsidiaries. Trac and Savant are trademarks of Intrusion Inc.

On March 29, 2006, we entered into a Loan and Security Agreement with Silicon Valley Bank ( SVB ) to establish a $1.0 million line of credit (the 2006 Credit Line ). On June 30, 2008, we entered into an Amended and Restated Loan and Security Agreement with SVB to, among other things, replace the 2006 Credit Line with a $2.5 million line of credit (the 2008 Credit Line ).

Table of Contents

On June 23, 2015, we entered into the Seventh Amendment to the Amended and Restated Loan and Security Agreement (as amended, the Loan Agreement ) with SVB to replace our expiring line with a $0.625 million line of credit (the Current Line of Credit ). Our obligations under the Loan Agreement are secured by substantially all of our assets, including all of our intellectual property. In addition, G. Ward Paxton, the Company s Chairman, President and Chief Executive Officer, has established a Guaranty Agreement with SVB securing all outstanding balances under the Current Line of Credit. Borrowings under the Current Line of Credit are based on advances (each an Advance ) against certain of our accounts receivable that are approved by SVB (each an Eligible Account ). SVB may make an Advance of up to eighty percent (80%) of each Eligible Account, or such other percentage SVB may determine in its sole discretion. As of December 31, 2015, the borrowing base was $380,000. Each Advance is subject to a finance charge calculated as a daily rate that is based on a 360-day annual rate of the greater of the prime rate plus 2.0% or 7.0%. Finance charges are payable at the same time its related Advance is due. Each Advance is also subject to a monthly collateral handling fee of 0.5% of all outstanding Advances, depending on certain qualifying financial factors specified in the Loan Agreement. The collateral handling fee is payable at the same time its related Advance is due. Each Advance must be repaid at the earliest of (a) the date that the Eligible Account related to the Advance is paid, (b) the date the Eligible Account is no longer eligible under the Loan Agreement, or (c) the date on which any Adjustment (as defined in the Loan Agreement) is asserted to the Eligible Account. We have certain non-financial and financial covenants, including a liquidity coverage ratio and a rolling EBITDA computation, as defined in the Loan Agreement. On June 21, 2016, the Loan Agreement terminates and all outstanding Advances, accrued but unpaid finance charges, outstanding collateral handing fees, and other amounts become due under the Loan Agreement and related documents. As of December 31, 2015 and 2014, we had no borrowings outstanding under the Current Line of Credit and are within limits of all debt covenants. The Company expects to renew the Loan Agreement before the termination date.

On February 5, 2015, the Company entered into an unsecured revolving promissory note to borrow up to $2,200,000 from G. Ward Paxton, the Company s Chief Executive Officer. Under the terms of the note, the Company may borrow, repay and reborrow on the loan as needed up to an outstanding principal balance due of $2,200,000 at any given time through March 2016.

On February 4, 2016, the Company renewed the CEO note described above on the same terms, with the Company being able to borrow, repay and reborrow on the note as needed up to an outstanding principal balance due of $2,200,000 at any given time through March 2018.

Amounts borrowed from this officer accrue interest at a floating rate per annum equal to SVB s prime rate plus 1% (5% at December 31, 2015). All outstanding borrowings and accrued but unpaid interest is due on March 31, 2018. As of December 31, 2015, the borrowings outstanding totaled $1,530,000 and accrued interest totaled $76,500.

**Government Sales**

Sales to U.S. government customers accounted for 54.7% of our revenues for the year ended December 31, 2015, compared to 51.4% of our revenue in 2014. We expect to continue to derive a substantial portion of our revenues from sales to governmental entities in the future as we continue to market our entity identification products and data mining products to the government. Sales to the government present risks in addition to those involved in sales to commercial customers that could adversely affect our revenues, including potential disruption due to irregularities in or interruptions to appropriation and spending patterns, delays in approving a federal budget and the government s reservation of the right to cancel contracts and purchase orders for its convenience.

Generally, we make our sales under purchase orders and contracts. Our customers, including government customers, may cancel their orders or contracts with little or no prior notice and without penalty. Although we transact business with various government entities, we believe that the cancellation of any particular order in itself could have a material adverse effect on our financial results. Because we derive and expect to continue to derive a substantial portion of our revenue from sales to government entities, a large number of cancelled or renegotiated government orders or contracts could have a material adverse effect on our financial results. Currently, we are not aware of any proposed cancellation or renegotiation of any of our existing arrangements with government entities.

**Industry Background**

We develop, market and support a family of entity identification products, data mining and advanced persistent threat detection products. Our product families include:

- TraceCop for entity identification;
- Savant for data mining and advanced persistent threat detection.

Intrusion s products help protect critical information assets by quickly detecting, protecting, analyzing and reporting attacks or misuse of classified, private and regulated information for government and enterprise networks.

Table of Contents

**Products**

*TraceCop*

Our TraceCop product family includes a database of worldwide IP addresses which are regularly updated. In addition, other information and analysis results, such as geo-location data, may also be included. Customers use the TraceCop data to aid in the identification and location of individuals involved in cybercrime. In addition to the IP database, the TraceCop family includes analysis software and a GUI interface to assist analysts in locating cybercriminals and other bad guys. We license TraceCop to our customers for a fee and offer continuing maintenance and upgrade services for the TraceCop database. We either install and service the database at the Intrusion facility or install the TraceCop database on a customer server onsite.

*Savant*

Savant is a high-speed network data mining product which organizes the data into networks of relationships and associations. Savant operates on networks with data flows of up to 20 gigabits without dropping packets. Savant provides corporate CIOs and CISOs with the ability to assess and mitigate many of todays cybersecurity threats and challenges. The Savant solution provides real-time access and insight into a company s own indisputable and quantifiable network data for more effective, unbiased decision making. Uses of the Savant product include data mining, data loss prevention, advanced persistent threat detection and identification of Internet habits of network users. Savant is a software product which we license to our customers and for which we sell maintenance, upgrades and data interpretation services. We also re-sell the server required to implement Savant into the customer s network.

**Third-Party Products**

We currently resell standard commercially available computers and servers from various vendors which we integrate with our different software products for implementation into our customer networks. We do not consider any of these third party relationships to be material to the Company s business or results of operations.

**Customer Services**

In addition to offering our listed products, we also offer a wide range of services, including design and configuration, project planning, training, installation, maintenance and threat data interpretation.

**Product Development**

The network security industry is characterized by rapidly changing technology, standards and customer demands all shaped by the current state of the economy. We believe that our future success depends in large part upon the timely enhancement of existing products as well as the development of new technologically advanced products that meet cybersecurity industry standards, perform successfully and efficiently. We are currently marketing TraceCop and Savant products to meet emerging market requirements and are continuously engaged in testing to ensure that our products interoperate with other manufacturers products, which comply with industry standards.

During 2015 and 2014, our research and development expenditures were approximately $2.3 and $1.9 million, respectively. All of our expenditures for research and development have been expensed as incurred. At December 31, 2015, we had 24 employees engaged in research, product development and engineering.

**Manufacturing and Supplies**

Our internal manufacturing operations consist primarily of software, packaging, testing and quality control of finished units.

The hardware we sell are standard off-the-shelf products, which we sell directly to OEM customers or resell from our suppliers.

**Intellectual Property and Licenses**

Our success and our ability to compete are dependent, in part, upon our proprietary technology. We principally rely on a combination of contractual rights, trade secrets and copyright laws to establish and protect our proprietary rights in our products. In addition, we have received two patents. We have also entered into non-disclosure agreements with our suppliers, resellers and certain customers to limit access to and disclosure of proprietary information. There can be no assurance that the steps taken by us to protect

Table of Contents

our intellectual property will be adequate to prevent misappropriation of our technology or that our competitors will not independently develop technologies that are substantially equivalent or superior to our technology.

We have entered into software and product license agreements with various suppliers. These license agreements provide us with additional software and hardware components that add value to our security products. These license agreements do not provide proprietary rights that are unique or exclusive to us and are generally available to other parties on the same or similar terms and conditions, subject to payment of applicable license fees and royalties. We do not consider any of the product license, software or supplier agreements to be material to our business, but rather complementary to our business and product offerings.

**Sales, Marketing and Customers**

***Field Sales Force.*** Our direct sales organization focuses on major account sales, channel partners including distributors, value added resellers (VARs) and integrators; promotes our products to current and potential customers; and monitors evolving customer requirements. The field sales and technical support force provides training and technical support to our resellers and end users and assists our customers in designing cyber secure data networking solutions. We currently conduct sales and marketing efforts from our principal office in Richardson (Dallas), Texas. In addition, we have sales personnel, sales engineers or sales representatives located in Virginia, California, Europe and Asia.

***Distributors.*** We have signed distribution agreements with distributors in the United States, Europe and Asia. In general, these relationships are non-exclusive.

***Resellers.*** Resellers such as domestic and international system integrators and VARs sell our products as stand-alone solutions to end users and integrate our products with products sold by other vendors into network security systems that are sold to end users. Our field sales force and technical support organization provide support to these resellers. Our agreements with resellers are non-exclusive, and our resellers generally sell other products that may compete with our products. Resellers may place higher priority on products of other suppliers who are larger and have more name recognition, and there can be no assurance that resellers will continue to sell and support our products.

***Foreign Sales.*** We believe that rapidly evolving international markets are potential sources of future sales. Our export sales are currently planned to be made through an indirect sales force comprised of international resellers in Europe and Asia. Export sales did not account for any revenue in 2015 and 2014. See Management s Discussion and Analysis of Financial Condition and Results of Operations included in this report for a geographic breakdown of our revenue in 2015 and 2014.

***Marketing.*** We have implemented several methods to market our products, including participation in trade shows and seminars, telemarketing, distribution of sales literature and product specifications and ongoing communication with our resellers and installed base of end-user customers.

***Customers.*** Our end-user customers include U.S. federal government entities, banks, credit unions, other financial institutions, hospitals and healthcare providers. Sales to certain customers and groups of customers can be impacted by seasonal capital expenditure approval cycles, and sales to customers within certain geographic regions can be subject to seasonal fluctuations in demand.

In 2015, 54.7% of our revenue was derived from a variety of U.S. government entities through direct sales and indirectly through system integrators and resellers. These sales are attributable to three U.S. Government customers through direct and indirect channels, all exceeded 8% of total revenue individually in 2015. Comparatively, sales to the U.S. Government through direct and indirect channels totaled 51.4% of total revenues for 2014. These sales are attributable to four U.S. Government customers through direct and indirect channels, all exceeded 10% of total revenue individually in 2014. A reduction in our sales to U.S. government entities could have a material adverse effect on our business and operating results if not replaced.

***Backlog.*** We believe that only a small portion of our order backlog is non-cancelable and that the dollar amount associated with the non-cancelable portion is immaterial. We purchase, or contract for the purchase of, our inventory based upon our forecast of customer demand and we maintain inventories in advance of receiving firm orders from customers. Commercial orders are generally fulfilled within two days to two weeks following receipt of an order. Certain orders may be scheduled over several months, generally not exceeding one year.

***Customer Support, Service and Warranty.*** We service, repair and provide technical support for our products. Our field sales and technical support force works closely with resellers and end-user customers on-site and by telephone to assist with pre- and post-sales support services such as network security design, system installation and technical consulting. By working closely with our customers, our employees increase their understanding of end-user requirements and provide input to the product development process.

Table of Contents

We warrant all of our products against defects in materials and workmanship for periods ranging from 90 days to 12 months. Before and after expiration of the product warranty period, we offer both on-site and factory-based support, parts replacement and repair services. Extended warranty services are separately invoiced on a time and materials basis or under an annual maintenance contract.

**Competition**

The market for network and data protection security solutions is intensely competitive and subject to frequent product introductions with new technologies, improved price and performance characteristics. Industry suppliers compete in areas such as conformity to existing and emerging industry standards, interoperability with networking and other security products, management and security capabilities, performance, price, ease of use, scalability, reliability, flexibility, product features and technical support. The market for identity identification and data mining is more fragmented and thus allows more opportunities for small companies to compete in.

There are numerous companies competing in various segments of the data security markets. At this time, we have limited competitors for TraceCop; however, we expect competitors to emerge in the future. These competitors perform only a portion of the functions that we currently perform with TraceCop. Also, we have been collecting the TraceCop data continuously for more than six years. We believe that none of our current or future competitors have the ability to provide this historical data. In our newest market segment, data mining and advanced persistent threat detection, we compete with several companies including Niksun, NetScout, Fireeye (Mandiant) and Palo Alto Networks.

Furthermore, some of our competitors have substantially greater financial, technical, sales and marketing resources, better name recognition and a larger customer base than we do. Even if we do introduce advanced products that meet evolving customer requirements in a timely manner, there can be no assurance that our new products will gain market acceptance.

Certain companies in the network security industry have expanded their product lines or technologies in recent years as a result of acquisitions. Further, more companies have developed products which conform to existing and emerging industry standards and have sought to compete on the basis of price. We anticipate increased competition from large networking equipment vendors, which are expanding their capabilities in the network security market. In addition, we anticipate increased competition from private start-up companies that have developed, or are developing, advanced security products. Increased competition in the security industry could result in significant price competition, reduced profit margins or loss of market share, any of which could have a material adverse effect on our business, operating results and financial condition. There can be no assurance that we will be able to compete successfully in the future with current or new competitors.

**Employees**

As of December 31, 2015, we employed a total of 36 full time persons, including 8 in sales, marketing and technical support, 24 in research, product development and engineering, and 4 in administration and finance.

None of our employees are represented by a labor organization, and we are not a party to any collective bargaining agreement. We have not experienced any work stoppages and consider our relations with our employees to be good.

Competition in the recruiting of personnel in the networking and data security industry is intense. We believe that our future success will depend in part on our continued ability to hire, motivate and retain qualified management, sales, marketing, and technical personnel. To date, we have not experienced significant difficulties in attracting or retaining qualified employees.

**Item 1A. Risk Factors**

In addition to the other information in this Form 10-K, the following factors should be considered in evaluating Intrusion Inc. and our business.

***We may not have sufficient cash to operate our business and may not be able to maintain certain liquidity requirements under our existing debt instruments. Additional debt and equity offerings to fund future operations may not be available and, if available, may significantly dilute the value of our currently outstanding common stock.***

As of December 31, 2015, we had cash and cash equivalents of approximately $102,000, down from approximately $1,006,000 as of December 31, 2014. We generated a net loss of $1,249,000 for the year ended December 31, 2015 compared to net loss of $274,000 for the year ended December 31, 2014. As of December 31, 2015, in addition to cash and cash equivalents of $102,000, we had $380,000 in funding available under our $0.625 million line of credit at Silicon Valley Bank ( SVB ) and $670,000 funding available from a promissory note to borrow up to $2.2 million from G. Ward Paxton, the Company s Chief Executive Officer.

Table of Contents

We are obligated to make payments of accrued dividends on all our outstanding shares of preferred stock that will reduce our available cash resources. Based on projections of growth in revenue and net income in the coming quarters, and the borrowings available previously mentioned, we believe that we will have sufficient cash resources to finance our operations and expected capital expenditures for the next twelve months. We expect to fund our operations through anticipated Company profits, our line of credit, borrowings from the Company s CEO, and possibly additional investments of private equity and debt, which, if we are able to obtain, will have the effect of diluting our existing common stockholders, perhaps significantly. Any equity or debt financings, if available at all, may be on terms which are not favorable to us and, in the case of equity financings, may result in dilution to our stockholders. If our operations do not generate positive cash flow in the upcoming year, or if we are not able to obtain additional debt or equity financing on terms and conditions acceptable to us, if at all, we may be unable to implement our business plan, fund our liquidity needs or even continue our operations.

***We had a net loss of $1.25 million for the year ended December 31, 2015 and have an accumulated deficit of $59.9 million as of December 31, 2015. To achieve sustainable profitability, we must continue to generate increased revenue.***

For the year ended December 31, 2015, we had a net loss of $1.25 million and had an accumulated deficit of approximately $59.9 million as of December 31, 2015, compared to a net loss of $0.3 million and an accumulated deficit of approximately $59.0 million as of December 31, 2014. We need to generate greater revenue from the sales of our products and services if we are to achieve profitability. If we are unable to generate greater revenue, net losses may continue and we may never be able to sustain profitability or generate positive cash flow from operations in the future.

***If our newer products do not achieve market acceptance, our revenue growth may suffer.***

Our new network security products, advanced persistent threat and entity identification products have been in the market place for a limited period of time and may have longer sales cycles than our previous products. Accordingly, we may not achieve the meaningful revenue growth needed to sustain operations. We can provide no assurances that sales of our newer products will continue to grow or generate sufficient revenues to sustain our business. If we are unable to recognize revenues due to longer sales cycles or other problems, our results of operations will be adversely affected, perhaps materially.

We have not yet received broad market acceptance for our newer products. We cannot assure you that our present or future products will achieve market acceptance on a sustained basis. In order to achieve market acceptance and achieve future revenue growth, we must introduce complementary security products, incorporate new technologies into our existing product lines and design, develop and successfully commercialize higher performance products in a timely manner. We cannot assure you that we will be able to offer new or complementary products that gain market acceptance quickly enough to avoid decreased revenues during current or future product introductions or transitions.

***A large percentage of our revenues are received from U.S. government entities, and the loss of any one of these customers could reduce our revenues and materially harm our business and prospects.***

A large percentage of our revenues result from sales to U.S. government entities. If we were to lose one or more of these key relationships, our revenues could decline and our business and prospects may be materially harmed. We expect that even if we are successful in developing relationships with non-governmental customers, our revenues will continue to be concentrated among government entities. For the years ended December 31, 2013, 2014 and 2015, sales to U.S. government entities collectively accounted for 50.1%, 51.4% and 54.7% of our total net revenues, respectively. The loss of any of these key relationships may send a negative message to other U.S. government entities or non-governmental customers concerning our product offering. We cannot assure you that U.S. government entities will be customers of ours in future periods or that we will be able to diversify our customer portfolio to adequately mitigate the risk of loss of any of these customers.

***Government customers involve unique risks, which could adversely impact our revenues.***

We expect to continue to derive a substantial portion of our revenues from U.S. government customers in the future. Sales to the government present risks in addition to those involved in sales to commercial customers, including potential disruption due to appropriation and spending patterns, delays in approving a federal budget and the government s right to cancel contracts and purchase orders for its convenience. General political and economic conditions, which we cannot accurately predict, directly and indirectly may affect the quantity and allocation of expenditures by federal departments. In addition, obtaining government contracts may involve long purchase and payment cycles, competitive bidding, qualification requirements, delays or changes in funding, budgetary constraints, political agendas, extensive specification development and price negotiations and milestone requirements. Each government entity also maintains its own rules and regulations with which we must comply and which can vary significantly among departments. As a result, cutbacks or re-allocations in the federal budget or losses of government sales due to other factors could have a material adverse effect on our revenues and operating results.

Table of Contents

***We are highly dependent on sales made through indirect channels, the loss of which would materially adversely affect our operations.***

For the years ended December 31, 2013, 2014 and 2015, we derived 32.4%, 55.7% and 74.7% of our revenues from sales through indirect sales channels, such as distributors, value-added resellers, system integrators, original equipment manufacturers and managed service providers. We must expand our sales through these indirect channels in order to increase our revenues. We cannot assure you that our products will gain market acceptance in these indirect sales channels or that sales through these indirect sales channels will increase our revenues. Further, many of our competitors are also trying to sell their products through these indirect sales channels, which could result in lower prices and reduced profit margins for sales of our products.

***The payment of dividends on our preferred stock may strain our cash resources.***

On March 25, 2004, we completed a $5,000,000 private placement pursuant to which we issued 1,000,000 shares of our 5% Convertible Preferred Stock (the Series 1 Preferred Stock ) and warrants to acquire 556,619 shares of our common stock. The conversion price for the Series 1 Preferred Stock is $3.144 per share. As of February 29, 2016, there were 200,000 shares of the Series 1 Preferred Stock outstanding, representing approximately 318,065 shares of common stock upon conversion.

On March 28, 2005, we completed a $2,663,000 private placement pursuant to which we issued 1,065,200 shares of our Series 2 5% Convertible Preferred Stock (the Series 2 Preferred Stock ) and warrants to acquire 532,600 shares of our common stock. The conversion price for the Series 2 Preferred Stock is $2.50 per share. As of February 29, 2016, there were 460,000 shares of the Series 2 Preferred Stock outstanding, representing 460,000 shares of common stock upon conversion.

On December 2, 2005, we completed a $1,230,843 private placement pursuant to which we issued 564,607 shares of our Series 3 5% preferred stock (the Series 3 Preferred Stock ) and warrants to acquire 282,306 shares of our common stock. The conversion price for the Series 3 Preferred Stock is $2.18 per share. As of February 29, 2016, there were 289,377 shares of Series 3 Preferred Stock outstanding, representing 289,377 shares of common stock upon conversion.

***If we are unable to pay scheduled dividends on shares of our preferred stock it could potentially result in additional consequences, some of them material.***

Delaware law provides that we may only pay dividends out of our capital surplus or, if no surplus is available, out of our net profits for the fiscal year the dividend is declared and/or the preceding fiscal year. We currently have dividend payments that are past due because we do not currently have a capital surplus or fiscal year net profits. We cannot assure you that our net assets will exceed our stated capital or that we will have sufficient net profits in order to pay these dividends in the future. These dividends continue to accrue on all our outstanding shares of preferred stock, regardless of whether we are legally able to pay them. If we continue to be unable to pay dividends on our preferred stock, we will be required to accrue an additional late fee penalty of 18% per annum on the unpaid dividends for the Series 2 Preferred Stock and Series 3 Preferred Stock. Our CEO, CFO and one outside board member who are invested in Series 2 and Series 3 Preferred Stock have waived any possible late fee penalties. In addition to this late penalty, the holders of our Series 2 Preferred Stock and Series 3 Preferred Stock could elect to present us with written notice of our failure to pay dividends as scheduled, in which case we would have 45 days to cure such a breach. In the event that we failed to cure the breach, the holders of these shares of preferred stock would then have the right to require us to redeem their shares of preferred stock for a cash amount calculated in accordance with their respective certificates of designation. If we were required to redeem all shares of Series 2 Preferred Stock and Series 3 Preferred Stock as of February 29, 2016 the aggregate redemption price we would owe would be $2.0 million.

***You will experience substantial dilution upon the conversion or redemption of the shares of preferred stock or in the event we raise additional funds through the issuance of new shares of our common stock or securities convertible or exercisable into shares of common stock.***

On February 29, 2016, we had 12,747,836 shares of common stock outstanding. Upon conversion of all outstanding shares of preferred stock, we will have 13,815,279 shares of common stock outstanding, approximately an 8.4% increase in the number of shares of our common stock outstanding.

In addition, management may issue additional shares of common stock or securities exercisable or convertible into shares of common stock in order to finance our continuing operations. Any future issuances of such securities would have additional dilutive effects on the existing holders of our Common Stock.

Further, the occurrence of certain events could entitle holders of our Series 2 Preferred Stock and Series 3 Preferred Stock to require us to redeem their shares for a certain number of shares of our common stock. Assuming (i) we have paid all liquidated damages and other amounts to the holders, (ii) paid all outstanding dividends, (iii) a volume weighted average price of $0.75, which

Table of Contents

was the ten-day volume weighted average closing price of our common stock on February 26, 2016, and (iv) our 12,747,836 shares of common stock outstanding on February 29, 2016, upon exercise of their redemption right by the holders of the Series 3 Preferred Stock and the Series 2 Preferred Stock, we would be obligated to issue approximately 4,291,000 shares of our common stock. This would represent an increase of approximately 33.6% in the number of shares of our common stock as of February 29, 2016.

***The conversion of preferred stock we issued in the private placements may cause the price of our common stock to decline.***

The holders of the shares of our 5% Preferred Stock may freely convert their shares of preferred stock and sell the underlying shares of common stock pursuant to Rule 144 of the Securities and Exchange Commission. As of February 29, 2016, 800,000 shares of our 5% Preferred Stock had converted into 1,272,263 shares of common stock.

The holders of the shares of Series 2 5% Preferred Stock may freely convert their shares of preferred stock and sell the underlying shares of common stock pursuant to Rule 144 of the Securities and Exchange Commission. As of February 29, 2016, 605,200 shares of Series 2 Preferred Stock had converted into 605,200 shares of common stock.

The holders of the shares of Series 3 5% Preferred Stock may freely convert their shares of Series 3 Preferred Stock and sell the underlying shares of common stock pursuant to Rule 144 of the Securities and Exchange Commission. As of February 29, 2016, 275,230 shares of Series 3 Preferred Stock had converted into 275,230 shares of common stock.

For the four weeks ended on February 26, 2016, the average daily trading volume of our common stock on the OTCQB was 590 shares. Consequently, if holders of preferred stock elect to convert their remaining shares and sell a material amount of their underlying shares of common stock on the open market, the increase in selling activity could cause a decline in the market price of our common stock. Furthermore, these sales, or the potential for these sales, could encourage short sales, causing additional downward pressure on the market price of our common stock.

***Certain rights of the holders of our preferred stock and the terms of our secured credit line may hinder our ability to raise additional financing.***

Under the terms of our preferred stock instruments, we cannot issue shares of capital stock with rights senior to those of our existing 5% Preferred Stock, Series 2 5% Preferred Stock or Series 3 5% Preferred Stock without the approval of at least a majority of the holders of our 5% Preferred Stock, all of the holders of our Series 2 5% Preferred Stock, and holders of at least 75% of our Series 3 5% Preferred Stock voting or acting as separate classes. We also cannot incur certain indebtedness without the approval of at least a majority of the holders of each class of our Preferred Stock. Furthermore, the terms of our secured credit line with SVB include covenants which restrict our ability to incur additional debt and pay certain dividends. The combination of these provisions could hinder or delay our ability to raise additional debt or equity financing.

***You will experience substantial dilution upon the exercise of certain stock options currently outstanding.***

On February 29, 2016, we had 12,747,836 shares of common stock outstanding. Upon the exercising of current options issued at or below the exercise price of $1.10, we will have approximately 14,907,000 shares of common stock outstanding, a 16.9% increase in the number of shares of our common stock outstanding.

***We resemble a developmental stage company and our business strategy may not be successful.***

From our founding in 1983 until 2000, we derived substantially all of our revenue from the design, manufacture and sale of local area networking equipment. In order to permit us to focus our resources solely on developing and marketing our network security products, we sold our local area networking assets and related networking divisions. We now depend exclusively on revenues generated from the sale of our network security products, which have received limited market acceptance. We have recently introduced our entity identification, data mining and advanced persistent threat detection products, the market for these products has only begun to emerge. We can provide no assurances that our newly introduced products will ever achieve widespread market acceptance or that an adequate market for these products will ever emerge. Consequently, we resemble a developmental stage company and will face the following inherent risks and uncertainties:

- the need for our entity identification, data mining and advanced persistent threat detection products to achieve market acceptance and produce a sustainable revenue stream;
- our ability to manage costs and expenses;
- our dependence on key personnel;
- our ability to obtain financing on acceptable terms; and

Table of Contents

- our ability to offer greater value than our competitors.

Our business strategy may not successfully address these risks. If we fail to recognize significant revenues from the sales of our entity identification, data mining and advanced persistent threat detection products, our business, financial condition and operating results would be materially adversely affected.

***Our management and larger stockholders exercise significant control over our Company and have the ability to approve or take actions that may be in conflict to your interests.***

As of February 29, 2016, our executive officers, directors and preferred stockholders beneficially own approximately 29% of our voting power. In addition, other related parties control approximately 30% of our voting power. As a result, these stockholders will be able to exercise significant control over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, which could delay or prevent someone from acquiring or merging with us. These stockholders may use their influence to approve or take actions that may be adverse to the interests of other holders of our Common Stock. Further, we contemplate the possible issuance of shares of our Common Stock or of securities exercisable or convertible into shares of our Common Stock in the future to our Chief Executive Officer and Chief Financial Officer. Any such issuance will increase the percentage of stock our Chief Executive Officer, Chief Financial Officer and our management group beneficially hold.

***We face intense competition from both start-up and established companies that may have significant advantages over us and our products.***

The market for our products is intensely competitive. There are numerous companies competing with us in various segments of the data security markets, and their products may have advantages over our products in areas such as conformity to existing and emerging industry standards, interoperability with networking and other security products, management and security capabilities, performance, price, ease of use, scalability, reliability, flexibility, product features and technical support.

Our principal competitors in the data mining and advanced persistent threat market include Niksun, NetScout, Fireeye (Mandiant) and Palo Alto Networks. Our current and potential competitors may have one or more of the following significant advantages over us:

- greater financial, technical and marketing resources;
- better name recognition;
- more comprehensive security solutions;

- better or more extensive cooperative relationships; and
- larger customer base.

We cannot assure you that we will be able to compete successfully with our existing or new competitors. Some of our competitors may have, in relation to us, one or more of the following: longer operating histories, longer-standing relationships with OEM and end-user customers and greater customer service, public relations and other resources. As a result, these competitors may be able to more quickly develop or adapt to new or emerging technologies and changes in customer requirements, or devote greater resources to the development, promotion and sale of their products. Additionally, it is likely that new competitors or alliances among existing competitors could emerge and rapidly acquire significant market share.

***If we fail to respond to rapid technological changes in the network security industry, we may lose customers or our products may become obsolete.***

The network security industry is characterized by frequent product introductions, rapidly changing technology and continued evolution of new industry standards. We must also introduce upgrades to our products rapidly in response to customer needs such as new computer viruses or other novel external attacks on computer networks. In addition, the nature of the network security industry requires our products to be compatible and interoperable with numerous security products, networking products, workstation and personal computer architectures and computer and network operating systems offered by various vendors, including our competitors. As a result, our success depends upon our ability to develop and introduce in a timely manner new products and enhancements to our existing products that meet changing customer requirements and evolving industry standards. The development of technologically advanced network security products is a complex and uncertain process requiring high levels of innovation, rapid response and accurate anticipation of technological and market trends. We cannot assure you that we will be able to identify, develop, manufacture, market or support new or enhanced products successfully in a timely manner. Further, we or our competitors may introduce new products or product enhancements that shorten the life cycle of our existing products or cause our existing products to become obsolete.

Table of Contents

***Our products are highly technical and if they contain undetected errors, our business could be adversely affected and we might have to defend lawsuits or pay damages in connection with any alleged or actual failure of our products and services.***

Our products are highly technical and complex, are critical to the operation of many networks and, in the case of our security products, provide and monitor network security and may protect valuable information. Our products have contained and may contain one or more undetected errors, defects or security vulnerabilities. Some errors in our products may only be discovered after a product has been installed and used by end customers. Any errors or security vulnerabilities discovered in our products after commercial release could result in loss of revenues or delay in revenue recognition, loss of customers and increased service and warranty cost, any of which could adversely affect our business and results of operations. In addition, we could face claims for product liability, tort or breach of warranty. Defending a lawsuit, regardless of its merit, is costly and may divert management s attention. In addition, if our business liability insurance coverage is inadequate or future coverage is unavailable on acceptable terms or at all, our financial condition could be harmed.

***A breach of network security could harm public perception of our security products, which could cause us to lose revenues.***

If an actual or perceived breach of network security occurs in the network of a customer of our security products, regardless of whether the breach is attributable to our products, the market perception of the effectiveness of our products could be harmed. This could cause us to lose current and potential end customers or cause us to lose current and potential value-added resellers and distributors. Because the techniques used by computer hackers to access or sabotage networks change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques.

***If our products do not interoperate with our customers networks, installations will be delayed or cancelled and could harm our business.***

Our products are designed to interface with our customers existing networks, each of which have different specifications and utilize multiple protocol standards and products from other vendors. Many of our customers networks contain multiple generations of products that have been added over time as these networks have grown and evolved. Our products will be required to interoperate with many or all of the products within these networks as well as future products in order to meet our customers requirements. If we find errors in the existing software or defects in the hardware used in our customers networks, we may have to modify our software or hardware to fix or overcome these errors so that our products will interoperate and scale with the existing software and hardware, which could be costly and negatively impact our operating results. In addition, if our products do not interoperate with those of our customers networks, demand for our products could be adversely affected, orders for our products could be cancelled or our products could be returned. This could hurt our operating results, damage our reputation and seriously harm our business and prospects.

***Our products can have long sales and implementation cycles, which may result in us incurring substantial expenses before realizing any associated revenues.***

The sale and implementation of our products to large companies and government entities typically involves a lengthy education process and a significant technical evaluation and commitment of capital and other resources. This process is also subject to the risk of delays associated with customers internal budgeting and other procedures for approving capital expenditures, deploying new technologies within their networks and testing and accepting new technologies that affect key operations. As a result, sales and implementation cycles for our products can be lengthy, and we may expend significant time and resources before we receive any revenues from a customer or potential customer.  Our quarterly and annual operating results could be materially harmed if orders forecast for a specific customer and for a particular period are not realized.

***Consolidation in the network security industry may limit market acceptance of our products.***

Several of our competitors have acquired security companies with complementary technologies in the past.  We expect consolidation in the network security industry to continue in the future.  These acquisitions may permit our competitors to accelerate the development and commercialization of broader product lines and more comprehensive solutions than we currently offer.  Acquisitions of vendors or other companies with which we have a strategic relationship by our competitors may limit our access to commercially significant technologies.  Further, business combinations in the network security industry are creating companies with larger market shares, customer bases, sales forces, product offerings and technology and marketing expertise, which may make it more difficult for us to compete.

***We must adequately protect our intellectual property in order to prevent loss of valuable proprietary information.***

We rely primarily on a combination of patent, copyright, trademark and trade secret laws, confidentiality procedures and non-disclosure agreements to protect our proprietary technology.  However, unauthorized parties may attempt to copy or reverse-engineer aspects of our products or to obtain and use information that we regard as proprietary.  Policing unauthorized use of our products is difficult, and we cannot be certain that the steps we have taken will prevent misappropriation of our intellectual property.  This is particularly true in foreign countries where the laws may not protect proprietary rights to the same extent as the laws of the United

Table of Contents

States and may not provide us with an effective remedy against unauthorized use. If our protection of our intellectual property proves to be inadequate or unenforceable, others may be able to use our proprietary developments without compensation to us, resulting in potential cost advantages to our competitors.

***We may incur substantial expenses defending ourselves against claims of infringement.***

There are numerous patents held by many companies relating to the design and manufacture of network security systems. Third parties may claim that our products infringe on their intellectual property rights. Any claim, with or without merit, could consume our management s time, result in costly litigation, cause delays in sales or implementations of our products or require us to enter into royalty or licensing agreements. Royalty and licensing agreements, if required and available, may be on terms unacceptable to us or detrimental to our business. Moreover, a successful claim of product infringement against us or our failure or inability to license the infringed or similar technology on commercially reasonable terms could seriously harm our business.

***Fluctuations in our quarterly revenues may cause the price of our common stock to decline.***

Our operating results have varied significantly from quarter to quarter in the past, and we expect our operating results to vary from quarter to quarter in the future due to a variety of factors, many of which are outside of our control. Significant portions of our expenses are not variable in the short term and we cannot reduce them quickly to respond to unexpected decreases in revenues. Therefore, if revenues are below our expectations, this shortfall is likely to adversely and disproportionately affect our operating results. Accordingly, we may not attain positive operating margins in future quarters. Any of these factors could cause our operating results to be below the expectations of securities analysts and investors, which likely would negatively affect the price of our common stock.

***The price of our common stock has been volatile in the past and may continue to be volatile in the future due to factors outside of our control.***

The market price of our common stock has been highly volatile in the past and may continue to be volatile in the future. For example, in fiscal year 2015, the market price of our common stock on the OTCQB Marketplace ( OTCQB ) fluctuated between $0.75 and $2.87 per share. The market price of our common stock may fluctuate significantly in the future in response to a number of factors, many of which are outside our control, including:

- variations in our quarterly operating results;
- changes in estimates of our financial performance by securities analysts;

- changes in market valuations of our competitors;
- thinly traded common stock;
- announcements by us or our competitors of new products, significant contracts, acquisitions, strategic relationships, joint ventures or capital commitments;
- product or design flaws, product recalls or similar occurrences;
- additions or departures of key personnel;
- sales of common stock in the future; and
- fluctuations in stock market prices and volume, which are relatively typical for high technology companies.

***Our acquisition of complementary products or businesses may adversely affect our financial condition.***

We have made acquisitions in the past and, in the future we may acquire or invest in additional companies, business units, product lines or technologies to accelerate the development of products and sales channels complementary to our existing products and sales channels. Negotiation of potential acquisitions and integration of acquired products, technologies or businesses could divert our management s time and resources. Future acquisitions could cause us to issue equity securities that would dilute your ownership of us, incur debt or contingent liabilities, amortize intangible assets or write off in-process research and development, goodwill and other acquisition-related expenses that could seriously harm our financial condition and operating results. Further, if we are not able to properly integrate acquired products, technologies or businesses with our existing products and operations, train, retain and motivate personnel from the acquired business or combine potentially different corporate cultures, we may not receive the intended benefits of our acquisitions, which could adversely affect our business, operating results and financial condition.

Table of Contents

***Compliance with export regulations may hinder our sales to foreign customers.***

Certain of our data security products incorporate encryption and other technology that may require clearance and export licenses from the U.S. Department of Commerce under United States export regulations. Any inability to obtain these clearances or licenses or any foreign regulatory approvals, if required, on a timely basis could delay sales and have a material adverse effect on our operating results.

## Item 2. Properties.

Our headquarters are located in a two-story building in Richardson, Texas. We occupy approximately 28,000 square feet of floor space in this facility. This facility houses our corporate administration, operations, marketing, research and development, engineering, sales and technical support personnel. The lease for this facility extends through April 2017.

Approximately thirty percent of our security software research and development and engineering staff are located in two separate small facilities in San Diego, California. The leases for these facilities are currently set to expire in March 2017.

We believe that the existing facilities at December 31, 2015, will be adequate to meet our operational requirements through 2016. We believe that all such facilities are adequately covered by appropriate property insurance. See Note 4 to our Consolidated Financial Statements for additional information regarding our obligations under leases.

## Item 3. Legal Proceedings.

We are subject to legal proceedings and claims that arise in the ordinary course of business. We do not believe that any claims exist where the outcome of such matters would have a material adverse effect on our consolidated financial position, operating results or cash flows. However, there can be no assurance such legal proceedings will not have a material impact on future results.

Table of Contents

## PART II

### Item 5. Market for Common Equity and Related Stockholder Matters and Business Issuer Purchases of Equity Securities.

Our common stock trades on the OTCQB, where it is currently listed under the symbol INTZ. As of February 29, 2016, there were approximately 180 registered holders of record of our common stock. The following table sets forth, for the periods indicated, the high and low bid prices per share of our common stock, as reported by the OTCQB. These quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

| | 2015 (high/low bid prices per share) | | 2014 (high/low bid prices per share) | |
|---|---|---|---|---|
| | High | Low | High | Low |
| First Quarter | $ 2.86 | $ 1.63 | $ 2.35 | $ 1.54 |
| Second Quarter | 2.04 | 1.61 | 2.50 | 1.70 |
| Third Quarter | 1.87 | 1.31 | 3.00 | 1.58 |
| Fourth Quarter | 1.58 | 0.90 | 2.99 | 2.65 |

We have not declared or paid cash dividends on our common stock in our two most recent fiscal years. We intend to retain any earnings for use in our business and do not anticipate paying any cash dividends on our common stock in the foreseeable future. Future dividends on common stock, if any, will be determined by our Board of Directors. However, shares of our 5% convertible preferred stock accrue cash dividends equal to $0.25 per share per annum, payable in arrears on March 31 and September 30 of each year, and shares of our Series 2 5% and Series 3 5% convertible preferred stock accrue cash dividends equal to $0.125 and $0.109 per share per annum, respectively, payable in arrears on the first business day of March, June, September and December of each year. During the fiscal year ended December 31, 2015, we accrued $51,000 in dividends to the holders of our 5% Preferred Stock, $57,000 in dividends to the holders of our Series 2 5% Preferred Stock and $33,000 in dividends to the holders of our Series 3 5% Preferred Stock. Delaware law provides that we may only pay dividends out of our capital surplus or, if no surplus is available, out of our net profits for the fiscal year the dividend is declared and/or the preceding fiscal year.

All stock option plans under which our common stock is reserved for issuance have previously been approved by our stockholders. The following table provides summary information as of December 31, 2015 for all of our equity compensation plans (in thousands, except per share data). See Note 9 to our consolidated financial statements for additional discussion.

| | Number of shares of common stock to be issued upon exercise of outstanding options | Weighted average exercise price of outstanding options. | No. of shares of common stock remaining available for future issuance under equity compensation plans. |
|---|---|---|---|
| Equity compensation plans approved by security holders | 2,598.3(1) | $ 0.63 | 597.0 |

| | | | | |
|---|---|---|---|---|
| Equity compensation plans not approved by security holders | | | | |
| Total | 2,598.3 | $ | 0.63 | 597.0 |

(1) Included in the outstanding options are 2,595,334 from the 2005 Stock Incentive Plan and 3,000 from the 2015 Stock Option Plan.

Table of Contents

## Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

**Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995**

This Annual Report on Form 10-K, including the sections entitled Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations, and Description of Business, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 . These statements relate to future events or to our future financial performance, and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. In some cases, you can identify forward-looking statements by the use of words such as may, could, expect, intend, plan, seek, anticipate, estimate, predict, potential, continue, or the negative of these terms or other comparable terminology. You should not place undue reliance on forward-looking statements since they involve known and unknown risks, uncertainties and other factors which are, in some cases, beyond our control and which could materially affect actual results, levels of activity, performance or achievements. Factors that may cause actual results to differ materially from current expectations, which we describe in more detail elsewhere in this Annual Report on Form 10-K under the heading Risk Factors, include, but are not limited to:

- failure to respond to rapid technological changes in the network security industry;
- failure of our regulated information compliance, and entity identification products to achieve market acceptance;
- our status as a developmental stage company;
- our need to generate substantially greater revenues from sales in order to achieve profitability;
- intense competition from both start-up and established companies that may have significant advantages over us and our products;
- disruption to our business due to military actions;
- long sales and implementation cycles of our products;

- insufficient cash to operate our business;
- the effect of consolidation in the network security industry;
- risks involved with Government customers;
- our inability to expand our sales;
- failure to adequately protect our intellectual property; or
- the rights of the holders of our preferred stock and the terms of our secured credit line.

If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary significantly from what we projected. Any forward-looking statement you read in this filing reflects our current views with respect to future events and is subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. We assume no obligation to publicly update or revise these forward-looking statements for any reason, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

**Overview**

We develop, market and support a family of entity identification products, data mining and advanced persistent threat detection products. Our product families include:

- TraceCop for identity identification;
- Savant for data mining/advanced persistent threat detection.

Table of Contents

Intrusion s products help protect critical information assets by quickly detecting, protecting, analyzing and reporting attacks or misuse of classified and private data for government and enterprise networks.

Our revenues have been fairly consistent over the past few years due primarily to our focus on our TraceCop and Savant product lines. To date, we have not encountered significant competition in the TraceCop and Savant markets that has caused us to decrease our sales prices when compared to sales prices in previous years. To help keep our operation expenses under control, we held our employee headcount at a reasonable level in 2015 compared to 2014. At December 31, 2014, we employed 36 full time persons and at December 31, 2015, we employed 36 full time persons. Our margins were fairly consistent at 64.7% in 2014, and 62.9% in 2015.

In order for us to operate and grow our business, we must generate and sustain sufficient operating profits and cash flow in future periods. This will require us to generate additional revenues from sales of our entity identification software, data mining and advanced persistent threat products. In order to obtain these sales, our products must gain acceptance in a competitive industry. We believe our ability to market and sell our TraceCop and Savant products into the marketplace in a timely manner and our efforts to effectively control spending levels will help us achieve these results.

**Critical Accounting Policies and Estimates**

Management s discussion and analysis of financial condition and results of operations are based upon our 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 us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to product returns, bad debts, inventories, income taxes, warranty obligations, maintenance contracts and contingencies. 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 generally recognize product revenue upon shipment. These products include both hardware and perpetual software licenses, as we do not currently offer software on a subscription basis. We accrue for estimated warranty costs and sales returns at the time of shipment based on our experience. There is a risk that technical issues on new products could result in unexpected warranty costs and returns. To the extent that our warranty costs exceed our expectations, we will increase our warranty reserve to compensate for the additional expense expected to be incurred. We review these estimates periodically and determine the appropriate reserve percentage. However, to date, warranty costs and sales returns have not been material. The customer may return a product only under very limited circumstances during the first thirty days from delivery for a replacement if the product is damaged or for a full refund if the product does not perform as intended. Historically, most or our sales returns were related to hardware-based products. As we continue to migrate away from such hardware-based products, these returns have declined.

We recognize software revenue from the licensing of our software products in accordance with FASB ASC Topic 605 whereby revenue from the licensing of our products is not recognized until all four of the following have been met:

i) execution of a written agreement;

ii) ii) delivery of the product has occurred;

iii) iii) the fee is fixed and determinable; and

iv) iv) collectability is probable.

Bundled hardware and software product revenue is recognized at time of delivery, as our licenses are not sold on a subscription basis. Product sales which include maintenance and customer support allocate revenue in an arrangement using estimated selling prices of the delivered goods and services based on a selling price hierarchy using the relative selling price method. All of our product offering and service offering market values are readily determined based on current and prior stand-alone sales. We defer and recognize maintenance and support revenue over the term of the contract period, which is generally one year.

Service revenue, primarily including maintenance, training and installation are recognized upon delivery of the service and typically are unrelated to product sales. To date, training and installation revenue has not been material. These revenues are included in net customer support and maintenance revenues in the statement of operations.

Table of Contents

Our normal payment terms offered to customers, distributors and resellers are net 30 days domestically and net 45 days internationally. We do not offer payment terms that extend beyond one year and rarely do we extend payment terms beyond our normal terms. If certain customers do not meet our credit standards, we do require payment in advance to limit our credit exposure.

Shipping and handling costs are billed to the customer and included in product revenue. Our costs of shipping and handling are included in cost of product revenue.

*Allowances for Doubtful Accounts*

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. Our receivables are uncollaterized, and we expect to continue this policy in the future. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Historically, our estimates for sales returns and doubtful accounts have not differed materially from actual results.

*Inventory*

We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Historically, our estimates for inventory obsolescence have not differed materially from actual results.

*Fair Value of Financial Instruments*

We calculate the fair value of our assets and liabilities which qualify as financial instruments and include additional information in the notes to consolidated financial statements when the fair value is different than the carrying value of these financial instruments. The estimated fair value of accounts receivable, accounts payable and accrued expenses, and dividends payable approximate their carrying amounts due to the relatively short maturity of these instruments. The carrying value of the line of credit payable approximates fair value since this instrument bears market interest rates. Loans payable to officer are with a related party and as a result do not bear market rates of interest. Management believes based on its current financial position that it could not obtain comparable amounts of third party financing, and as such cannot estimate the fair value of the loans payable to officer. None of these instruments are held for trading purposes.

**Results of Operations**

The following tables set forth, for the periods indicated, certain financial data as a percentage of net revenue.

| | Year Ended December 31, 2015 | 2014 |
|---|---|---|
| Net product revenue | 99.6% | 99.0% |
| Net customer support and maintenance revenue | 0.4 | 1.0 |
| Total revenue | 100.0 | 100.0 |
| Cost of product revenue | 36.9 | 34.9 |
| Cost of customer support and maintenance revenue | 0.2 | 0.2 |
| Total cost of revenue | 37.1 | 35.1 |
| Gross profit | 62.9 | 64.9 |
| Operating expenses: | | |
| Sales and marketing | 27.7 | 24.0 |
| Research and development | 33.9 | 26.9 |
| General and administrative | 18.0 | 17.1 |
| Operating loss | (16.7) | (3.1) |
| Interest expense, net | (1.6) | (1.5) |
| Other income, net | | 0.8 |
| Loss from operations before income taxes | (18.3) | (3.8) |
| Income tax provision | | |
| Net loss | (18.3) | (3.8) |
| Preferred stock dividends accrued | (2.0) | (1.9) |
| Net loss attributable to common stockholders | (20.3)% | (5.7)% |

Table of Contents

**2015 compared with 2014**

***Net Revenue***

Total revenue decreased 5.5% to $6.8 million in 2015 from $7.2 million in 2014. The decrease in revenue was related to slower than anticipated sales growth from our Savant and TraceCop product lines. Our customer support and maintenance revenue decreased 58.0% from $0.07 million in 2014 to $0.03 million in 2015. This decline is mainly due to the expiration of maintenance contracts related to our Compliance Commander product line. Our product revenues decreased 5.0% from $7.2 million in 2014 to $6.8 million in 2015. We expect our product revenues to increase in the future as the market acceptance of our TraceCop and Savant product lines increase.

There were no export sales in 2015 and 2014 primarily due to our focus on domestic revenue sales. Sales of our products internationally may be subject to currency exchange risk, which may cause our products to effectively increase in price, if the exchange rate moves significantly and the dollar gains value over the foreign currency.

Historically, due to the timing of our sales cycle, a significant portion of our monthly sales occurs in the second half of the month. Accordingly, our receivables increase at the end of each month, which causes a higher accounts receivable balance at month end. This monthly trend also causes an inflated comparative relationship between revenue and accounts receivable. We believe that this monthly trend will continue because monthly sales forecast and planning meetings are held in the first week of every month, the middle of the month is focused on sales calls to customers and the latter half of the month on closing sales.

***Gross Profit***

Gross profit decreased 8.4% to $4.3 million in 2015 from $4.7 million in 2014. As a percentage of net revenue, gross profit decreased from 64.9% in 2014 to 62.9% in 2015. Gross profit on products decreased from 64.7% in 2014 to 63.0% in 2015. Gross profit as a percentage of revenue, decreased in 2015 compared to 2014 because of lower TraceCop and Savant sales. Gross profit on customer support and maintenance decreased from 84.1% in 2014 to 55.2% in 2015.

Gross profit as a percentage of net revenue is impacted by several factors, including shifts in product mix, changes in channels of distribution, sales volume, fluctuations in manufacturing costs, pricing strategies, and fluctuations in sales of integrated third-party products.

***Sales and Marketing***

Sales and marketing expenses increased to $1.9 million or 27.8% of net revenue in 2015, compared to $1.7 million or 23.6% of net revenue in 2014. The increase in sales and marketing expense was due to a planned increase in sales personnel. We expect sales and marketing expenses to increase as net revenue levels increase in 2016.

***Research and Development***

Research and development expenses increased to $2.3 million or 33.9% of net revenue in 2015 compared to $1.9 million or 26.4% of net revenue in 2014. Our research and development costs are expensed in the period in which they are incurred. We expect research and development expenses to increase as net revenue levels increase in 2016.

***General and Administrative***

General and administrative expenses remained constant at $1.2 million, or 18.0% of net revenue in 2015 compared to $1.2 million or 16.7% of net revenue in 2014 as a result of continuing efforts to keep spending under control. We expect general and administration expenses to increase as net revenue levels increase in 2016.

***Interest Expense***

Interest expense remained constant at $107 thousand in 2015 and 2014. Interest expense will vary in the future based on our cash flow and borrowing needs.

***Income Taxes***

Our effective income tax rate was 0% in 2015 and 2014 as valuation allowances have been recorded for the entire amount of the net deferred tax assets due to uncertainty of realization.

Table of Contents

**Liquidity and Capital Resources**

Our principal source of liquidity at December 31, 2015 was $0.1 million of cash and cash equivalents. As of December 31, 2015, we do not hold investments with a stated maturity beyond one year. Working capital at December 31, 2015 was a deficiency of $0.8 million, while at December 31, 2014, it was $0.4 million.

Net cash used in operations in 2015 was $638 thousand, due to a net loss of $1.2 million and the following uses of cash: $56 thousand decrease in deferred revenue, a $33 thousand increase in inventory, and a $22 thousand decrease in accounts payable and accrued expenses. This was partially offset by the following sources of cash and non-cash items: a $157 thousand increase in accounts receivable, $48 thousand increase in prepaid expenses and other assets, $206 thousand in stock-based compensation, $211 thousand in amortization expense of capital leases, $86 thousand in depreciation expense, and $6 thousand in penalties and waived penalties on dividends. Net cash provided by operations for the year ended December 31, 2014, was $571 thousand due to the following sources of cash and non-cash items: $303 thousand increase in deferred revenue, $79 thousand decrease in accounts receivable, $7 thousand decrease in inventories, $174 thousand in amortization expense of capital leases, $375 thousand in stock-based compensation, $62 thousand in depreciation expense, and $6 thousand in penalties and waived penalties on dividends. This was partially offset by the net loss of $274 thousand and the following uses of cash: $25 thousand increase in prepaid expenses and other assets, and $136 thousand decrease in accounts payable and accrued expenses. Future fluctuations in accounts receivable, inventory balances and accounts payable will be dependent upon several factors, including quarterly sales, timely collection of accounts receivable, and the accuracy of our forecasts of product demand and component requirements.

Net cash used in investing activities in 2015 was $121 thousand for purchases of property and equipment. Net cash used in investing activities in 2014 was $55 thousand for purchases of property and equipment.

Cash used in financing activities in 2015 was $145 thousand primarily due to $211 thousand payment on principal on capital leases. This was offset by a provision of cash of $66 thousand on the exercise of stock options. Net cash used in financing activities in 2014 was $649 thousand due to $558 thousand payment of preferred stock dividends, $453 thousand payment to line of credit, and $168 thousand payment on principal on capital leases. This was offset by the following provisions of cash: $453 thousand from the line of credit and $77 thousand on the exercise of stock options.

At December 31, 2015, we had a commitment of $355 thousand for future capital lease expenditures. Operating lease commitments of $0.6 million are detailed in the Contractual Obligations section below. During 2015, we funded our operations through the use of available cash, cash equivalents and investments, our line of credit and loans from our Company s CEO.

As of December 31, 2015, we had cash, cash equivalents and investments in the amount of approximately $102 thousand, decreasing from $1.0 million as of December 31, 2014.

On February 5, 2015, the Company entered into an unsecured revolving promissory note to borrow up to $2,200,000 from G. Ward Paxton, the Company s Chief Executive Officer. Under the terms of the note, the Company may borrow, repay and reborrow on the loan as needed up to an outstanding principal balance due of $2,200,000 at any given time through March 2016.

On February 4, 2016, the Company renewed the CEO note described above on the same terms, with the Company being able to borrow, repay and reborrow on the note as needed up to an outstanding principal balance due of $2,200,000 at any given time through March 2018.

Amounts borrowed from this officer accrue interest at a floating rate per annum equal to SVB s prime rate plus 1% (5% at December 31, 2015). All outstanding borrowings and accrued but unpaid interest is due on March 31, 2018. As of December 31, 2015, the borrowings outstanding totaled $1,530,000 and accrued interest totaled $76,500.

On March 29, 2006, we entered into a Loan and Security Agreement with Silicon Valley Bank ( SVB ) to establish a $1.0 million line of credit (the 2006 Credit Line ). On June 30, 2008, we entered into an Amended and Restated Loan and Security Agreement with SVB to, among other things, replace the 2006 Credit Line with a $2.5 million line of credit (the 2008 Credit Line ). On June 23, 2015, we entered into the Seventh Amendment to the Amended and Restated Loan and Security Agreement (as amended, the Loan Agreement ) with SVB to replace our expiring line with a $0.625 million line of credit (the Current Line of Credit ). Our obligations under the Loan Agreement are secured by substantially all of our assets, including all of our intellectual property. In addition, G. Ward Paxton, the Company s Chairman, President and Chief Executive Officer, has established a Guaranty Agreement with SVB securing all outstanding balances under the Current Line of Credit. Borrowings under the Current Line of Credit are based on advances (each an Advance ) against certain of our accounts receivable that are approved by SVB (each an Eligible Account ). SVB may make an Advance of up to eighty percent (80%) of each Eligible Account, or such other percentage SVB may determine in its sole discretion. As of December 31, 2015, the borrowing base was $380,000. Each Advance is subject to a finance charge

Table of Contents

calculated as a daily rate that is based on a 360-day annual rate of the greater of the prime rate plus 2.0% or 7.0%. Finance charges are payable at the same time its related Advance is due. Each Advance is also subject to a monthly collateral handling fee of 0.5% of all outstanding Advances, depending on certain qualifying financial factors specified in the Loan Agreement. The collateral handling fee is payable at the same time its related Advance is due. Each Advance must be repaid at the earliest of (a) the date that the Eligible Account related to the Advance is paid, (b) the date the Eligible Account is no longer eligible under the Loan Agreement, or (c) the date on which any Adjustment (as defined in the Loan Agreement) is asserted to the Eligible Account. We have certain non-financial and financial covenants, including a liquidity coverage ratio and a rolling EBITDA computation, as defined in the Loan Agreement. On June 21, 2016, the Loan Agreement terminates and all outstanding Advances, accrued but unpaid finance charges, outstanding collateral handing fees, and other amounts become due under the Loan Agreement and related documents. As of December 31, 2015 and 2014, we had no borrowings outstanding under the Current Line of Credit and are within limits of all debt covenants.

As of December 31, 2015, we had cash and cash equivalents of approximately $102,000, down from approximately $1,006,000 as of December 31, 2014. We generated a net loss of $1,249,000 for the year ended December 31, 2015 compared to net loss of $274,000 for the year ended December 31, 2014. As of December 31, 2015, in addition to cash and cash equivalents of $102,000, we had $380,000 in funding available under our $0.625 million line of credit at Silicon Valley Bank ( SVB ) and $670,000 funding available from a promissory note to borrow up to $2.2 million from G. Ward Paxton, the Company s Chief Executive Officer. We are obligated to make payments of accrued dividends on all our outstanding shares of preferred stock that will reduce our available cash resources. Based on projections of growth in revenue and net income in the coming quarters, and the borrowings available previously mentioned, we believe that we will have sufficient cash resources to finance our operations and expected capital expenditures for the next twelve months. We expect to fund our operations through anticipated Company profits, our line of credit, borrowings from the Company s CEO, and possibly additional investments of private equity and debt, which, if we are able to obtain, will have the effect of diluting our existing common stockholders, perhaps significantly. Any equity or debt financings, if available at all, may be on terms which are not favorable to us and, in the case of equity financings, may result in dilution to our stockholders. If our operations do not generate positive cash flow in the upcoming year, or if we are not able to obtain additional debt or equity financing on terms and conditions acceptable to us, if at all, we may be unable to implement our business plan, fund our liquidity needs or even continue our operations.

We may explore the possible acquisitions of businesses, products and technologies that are complementary to our existing business. We are continuing to identify and prioritize additional security technologies, which we may wish to develop, either internally or through the licensing, or acquisition of products from third parties. While we may engage from time to time in discussions with respect to potential acquisitions, there can be no assurances that any such acquisitions will be made or that we will be able to successfully integrate any acquired business. In order to finance such acquisitions and working capital it may be necessary for us to raise additional funds through public or private financings. Any equity or debt financings, if available at all, may be on terms, which are not favorable to us and, in the case of equity financings, may result in dilution to our stockholders.

**Contractual Obligations**

The following table sets forth certain information concerning the future contractual obligations under our leases at December 31, 2015. We had no other significant contractual obligations at December 31, 2015.

**Future minimum lease obligations consisted of the following at December 31, 2015 (in thousands):**

| Year ending December 31, | Operating Leases | Capital Lease Obligations | Total |
|---|---|---|---|
| 2016 | 409 | 211 | 620 |
| 2017 | 133 | 122 | 255 |
| 2018 and thereafter | | 22 | 22 |
| | $ 542 | $ 355 | $ 897 |

**Off-Balance Sheet Arrangements**

As of December 31, 2015, we did not have any significant off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K.

Table of Contents

## Item 9A. Controls and Procedures

Evaluation of Effectiveness of Disclosure Controls and Procedures

The Company s management, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of the Company s disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act ). Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company s disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and is accumulated and communicated to management, including the Company s principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Management Report on Internal Control over Financial Reporting

The Company s management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) to provide reasonable assurance regarding the reliability of the Company s financial reporting and the preparation of consolidated financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

The Company s management, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the Company s internal control over financial reporting based on criteria established in *2013 Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management s evaluation included an assessment of elements such as the design and operating effectiveness of key financial reporting controls, process documentation, accounting policies, and the Company s overall control environment. Based on its evaluation, management concluded that the Company s internal control over financial reporting was effective as of the year ended December 31, 2015 to provide reasonable assurance regarding the reliability of the Company s financial reporting and the preparation of consolidated financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles. The Company reviewed the results of management s assessment with the Audit Committee of the Board of Directors.

This Annual Report does not include an attestation report of the Company s registered public accounting firm regarding internal control over financial reporting. Management s report was not subject to attestation by the Company s registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Company to provide only management s report in this Annual Report. This report shall not be deemed to be filed for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities of that section, and is not incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

Inherent Limitations on Effectiveness of Controls

The Company s management, including the Chief Executive Officer and Chief Financial Officer, does not expect that the Company s disclosure controls or internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system s objectives will be met. 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. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of the effectiveness of controls to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

Changes in Internal Control over Financial Reporting

During the quarter ended December 31, 2015, there were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

# PART III

Certain information required by Part III is omitted from this Form 10-K because we will file a definitive Proxy Statement for our 2015 annual meeting of stockholders pursuant to Regulation 14A (the Proxy Statement ) no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K, and certain information to be included therein is incorporated herein by reference.

## Item 10. Directors, Executive Officers and Corporate Governance.

The information called for by this item is incorporated herein by reference to the Proxy Statement.

## Item 11. Executive Compensation.

The information called for by this item is incorporated herein by reference to the Proxy Statement.

## Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information called for by this item is incorporated herein by reference to the Proxy Statement.

## Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information called for by this item is incorporated herein by reference to the Proxy Statement.

## Item 14. Principal Accounting Fees and Services.

The information called for by this item is incorporated herein by reference to the Proxy Statement.

**Item 15.** **Exhibits and Financial Statement Schedules.**

(a) 1. **Consolidated Financial Statements.**

The following consolidated financial statements of Intrusion Inc. and subsidiaries, are submitted as a separate section of this report (See F-pages):

Table of Contents

(b) **Exhibits**

The following Exhibits are filed herewith pursuant to Item 601 of Regulation S-K or incorporated herein by reference to previous filings as noted:

| Exhibit Number | Description of Exhibit |
|---|---|
| 3.1(5) | Restated Certificate of Incorporation of the Registrant |
| 3.2(7) | Certificate of Amendment to Certificate of Incorporation of Registrant |
| 3.3(8) | Certificate of Designations for the Registrant s 5% Convertible Preferred Stock |
| 3.4(10) | Certificate of Designations of the Registrant s Series 2 5% Convertible Preferred Stock |
| 3.5(11) | Certificate of Designations for the Registrant s Series 3 5% Convertible Preferred Stock |
| 3.6(4) | Bylaws of the Registrant |
| 4.1(9) | Specimen Common Stock Certificate |
| 4.2(8) | Specimen 5% Convertible Preferred Stock Certificate |
| 4.3(10) | Specimen Series 2 5% Convertible Preferred Stock Certificate |
| 4.4(11) | Specimen Series 3 5% Convertible Preferred Stock Certificate |
| 4.5(8) | Form of Warrant to Purchase Shares of Common Stock issued to the investors in the Registrant s March 25, 2004 private placement |
| 4.6(8) | Warrant to Purchase Common Stock dated March 25, 2004, issued by the Registrant to Black Point Partners |
| 4.9(10) | Form of Common Stock Purchaser Warrant issued to the investors in the Registrant s March 28, 2005 private placement |
| 4.10(10) | Form of Representative s Warrant for the Purchase of Shares of Common Stock issued to certain affiliates of Stonegate Securities, Inc. on March 28, 2005 |
| 4.15(11) | Form of Common Stock Purchaser Warrant issued to the investors in the Registrant s December 2, 2005 private placement |
| 4.16(11) | Form of Representative s Warrant for the Purchase of Shares of Common Stock issued to certain affiliates of Stonegate Securities, Inc. on December 2, 2005 |
| 10.2(24) | 1995 Stock Option Plan of the Registrant, as amended |
| 10.3(1) | Form of Indemnification Agreement |
| 10.4(2) | 1995 Non-Employee Directors Stock Option Plan of the Registrant (amended and restated as of January 10, 2002) |
| 10.5(9) | Lease Agreement between CalWest Industrial Holdings Texas, L.P. and Intrusion Inc. |
| 10.6(8) | Securities Purchase Agreement dated as of March 25, 2004, by and among the Registrant and the purchasers listed on Exhibit A thereto |
| 10.7(4) | Amended and Restated 401(k) Savings Plan of the Registrant |
| 10.8(4) | 1997 Employee Stock Purchase Plan of the Registrant, as amended January 17, 2001 |
| 10.9(6) | Intrusion Inc. 401(k) Savings Plan Summary of Material Modifications |
| 10.10(12) | 2005 Stock Incentive Plan of the Registrant (amended and restated as of May 30, 2007) |
| 10.10(23) | Amended 2005 Stock Incentive Plan of the Registrant |
| 10.11(12) | Form of Notice of Grant of Stock Option |
| 10.12(12) | Form of Stock Option Agreement |
| 10.13(12) | Form of Stock Issuance Agreement |
| 10.14(12) | Form of Notice of Grant of Non-Employee Director Automatic Stock Option (Initial Grant) |
| 10.15(12) | Form of Notice of Grant of Non-Employee Director Automatic Stock Option (Annual Grant) |
| 10.16(12) | Form of Automatic Stock Option Agreement |
| 10.17(10) | Securities Purchase Agreement dated as of March 28, 2005, by and among the Registrant and the investors listed on Exhibit A thereto |
| 10.18(11) | Securities Purchase Agreement dated as of December 2, 2005, by and among the Registrant and the investors listed on Exhibit A thereto |
| 10.19(14) | Loan and Security Agreement dated as of March 29, 2006, by and between the Registrant and Silicon Valley Bank (extended on March 28, 2008) |
| 10.20(14) | Intellectual Property Security Agreement dated as of March 29, 2006, by and between the Registrant and Silicon Valley Bank |

| | |
|---|---|
| 10.21(15) | Subscription and Investment Representation Agreement by and between Intrusion Inc. and G. Ward Paxton, dated December 28, 2006. |
| 10.21(15) | Subscription and Investment Representation Agreement by and between Intrusion Inc. and Michael L. Paxton, dated December 28, 2006. |
| 10.21(16) | Subscription and Investment Representation Agreement by and between Intrusion Inc. and G. Ward Paxton, dated March 15, 2007. |

| | |
|---|---|
| 10.21(16) | Subscription and Investment Representation Agreement by and between Intrusion Inc. and Michael L. Paxton, dated March 15, 2007. |
| 10.21(17) | Subscription and Investment Representation Agreement by and between Intrusion Inc. and G. Ward Paxton, dated June 27, 2007. |
| 10.21(17) | Subscription and Investment Representation Agreement by and between Intrusion Inc. and Michael L. Paxton, dated June 27, 2007. |
| 10.21(18) | Subscription and Investment Representation Agreement by and between Intrusion Inc. and G. Ward Paxton, dated September 26, 2007. |
| 10.21(19) | Promissory Note dated as of January 30, 2008, by and between the Registrant and G. Ward Paxton |
| 10.22(20) | Amended and Restated Loan and Security Agreement dated as of June 30, 2008, by and between the Registrant and Silicon Valley Bank |
| 10.23(21) | Intellectual Property Security Agreement dated as of June 30, 2008, by and between the Registrant and Silicon Valley Bank |
| 10.24(22) | Second Amendment to Lease, executed on September 21, 2012, by and between Intrusion Inc. and CWTX Corporate Place 87, LP |
| 10.25(27) | Promissory Note dated as of February 4, 2016, by and between the Registrant and G. Ward Paxton |
| 16.1(25) | Letter of KBA Group LLP dated June 5, 2009 |
| 21(5) | List of Subsidiaries of Registrant |
| 23.1(27) | Consent of Whitley Penn LLP, Independent Registered Public Accounting Firm |
| 31.1(27) | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Exchange Act |
| 31.2(27) | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Exchange Act |
| 32.1(27) | Certification of Chief Executive Officer Pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2(27) | Certification of Chief Financial Officer Pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS(27) | XBRL Instance Document. |
| 101.SCH(27) | XBRL Taxonomy Extension Schema Document. |
| 101.CAL(27) | XBRL Taxonomy Extension Calculation Linkbase Document. |
| 101.DEF(27) | XBRL Taxonomy Extension Definition Linkbase Document. |
| 101.LAB(27) | XBRL Taxonomy Extension Label Linkbase Document. |
| 101.PRE(27) | XBRL Taxonomy Extension Presentation Linkbase Document. |

---

(1) Filed as an Exhibit in the Registrant s Registration Statement on Form S-1, as amended (File No. 33-6899), which was declared effective on May 21, 1992, by the Securities and Exchange Commission, which Exhibit is incorporated herein by reference.

(2) Filed as an Exhibit to the Registrant s Definitive Proxy Statement on Schedule 14A in connection with the solicitation of proxies for its 2002 Annual Meeting of Stockholders, which Exhibit is incorporated herein by reference.

(3) Filed as an Exhibit to the Registrant s Definitive Proxy Statement on Schedule 14A in connection with the solicitation of proxies for its 2002 Annual Meeting of Stockholders, which Exhibit is incorporated herein by reference.

(4) Filed as an Exhibit to the Registrant s Annual Report on Form 10-K, for the fiscal year ended

December 31, 2000.

(5) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated June 15, 2010, which Exhibit is incorporated herein by reference.

(6) Filed as an Exhibit to the Registrant s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, which Exhibit is incorporated herein by reference.

(7) Filed as an Exhibit to the Registrant s Definitive Proxy Statement on Schedule 14A in connection with the solicitation of proxies for its Special Meeting of Stockholders held March 18, 2004, which Exhibit is incorporated herein by reference.

(8) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated March 26, 2004 (as amended), which Exhibit is incorporated by reference.

(9) Filed as an Exhibit to the Registrant s Annual Report on Form 10-K for the fiscal year ended December 31, 2003 (as amended), which Exhibit is incorporated herein by reference.

Table of Contents

(10) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated March 29, 2005, which Exhibit is incorporated herein by reference

(11) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated December 6, 2005, which Exhibit is incorporated herein by reference.

(12) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated June 15, 2005, which Exhibit is incorporated herein by reference.

(13) Filed as an Exhibit to the Registrant s Quarterly Report on Form 10-Q for the quarter ended September 30, 2004, which Exhibit is incorporated herein by reference.

(14) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated March 29, 2006, which Exhibit is incorporated herein by reference.

(15) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated January 4, 2007, which Exhibit is incorporated herein by reference.

(16) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated March 16, 2007, which Exhibit is incorporated herein by reference.

(17) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated June 28, 2007, which Exhibit is incorporated herein by reference.

(18) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated September 27, 2007, which Exhibit is incorporated herein by reference.

(19) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated January 31, 2008, which Exhibit is incorporated herein by reference.

(20) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated July 1, 2008, which Exhibit is incorporated herein by reference.

(21) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated November 13, 2008, which Exhibit is incorporated herein by reference.

(22) Filed as an Exhibit to the Registrant s Annual Report on Form 10-K for the fiscal year ended December 31, 2012, which Exhibit is incorporated herein by reference.

(23) Filed as Appendix A to the Registrant s Definitive Proxy Statement on Schedule 14A in connection with the solicitation of proxies for its 2009 Annual Meeting of Stockholders, which Appendix is incorporated herein by reference.

(24) Filed as an Exhibit to the Registrant s Definitive Proxy Statement on Schedule 14A in connection with the solicitation of proxies for its 1995 Annual Meeting of Stockholders, which Exhibit is incorporated herein by reference.

(25) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated June 5, 2009, which Exhibit is incorporated herein by reference.

(26) Filed as an Exhibit to the Registrant s Current Report on Form 8-K dated September 16, 2009, which Exhibit is incorporated herein by reference.

(27) Filed herewith.

Table of Contents

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

| | | |
|---|---|---|
| Dated: March 29, 2016 | INTRUSION INC.<br>(Registrant) | |
| | By: | /s/ G. WARD PAXTON<br>G. Ward Paxton<br>*Chairman, President, and Chief Executive Officer*<br>*(Principal Executive Officer)* |

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| **Signature** | **Title** | **Date** |
|---|---|---|
| /s/ G. WARD PAXTON<br>G. Ward Paxton | Chairman, President,<br>Chief Executive Officer, and Director<br>(Principal Executive Officer) | March 29, 2016 |
| /s/ T. JOE HEAD<br>T. Joe Head | Vice Chairman, Vice President<br>and Director | March 29, 2016 |
| /s/ MICHAEL L. PAXTON<br>Michael L. Paxton | Vice President, Chief Financial<br>Officer, Treasurer and Secretary<br>(Principal Financial and Accounting Officer) | March 29, 2016 |
| /s/ JAMES F. GERO<br>James F. Gero | Director | March 29, 2016 |
| /s/ DALE BOOTH<br>Dale Booth | Director | March 29, 2016 |
| /s/ DONALD M. JOHNSTON<br>Donald M. Johnston | Director | March 29, 2016 |

Table of Contents

**ANNUAL REPORT ON FORM 10-K**

**ITEM 8**

**FINANCIAL STATEMENTS**

**YEARS ENDED DECEMBER 31, 2015 and 2014**

**INTRUSION INC.**

**RICHARDSON, TEXAS**

Table of Contents

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of

Intrusion Inc.

We have audited the accompanying consolidated balance sheets of Intrusion Inc. and subsidiaries (the Company ), as of December 31, 2015 and 2014, and the related consolidated statements of operations, changes in stockholders deficit, and cash flows for the years then ended. The Company s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated 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 audit 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 audit 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Intrusion Inc. and subsidiaries, as of December 31, 2015 and 2014, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Whitley Penn LLP

Dallas, Texas

March 29, 2016

Table of Contents

**INTRUSION INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

**(In thousands, except par value amounts)**

| | December 31, 2015 | | December 31, 2014 | |
|---|---|---|---|---|
| **Assets** | | | | |
| Current Assets: | | | | |
| Cash and cash equivalents | $ | 102 | $ | 1,006 |
| Accounts receivable | | 580 | | 737 |
| Inventories, net | | 45 | | 12 |
| Prepaid expenses | | 69 | | 105 |
| Total current assets | | 796 | | 1,860 |
| Property and Equipment: | | | | |
| Equipment | | 1,602 | | 1,207 |
| Furniture and fixtures | | 43 | | 43 |
| Leasehold improvements | | 42 | | 42 |
| | | 1,687 | | 1,292 |
| Accumulated depreciation and amortization | | (1,201) | | (901) |
| | | 486 | | 391 |
| Other assets | | 43 | | 61 |
| **TOTAL ASSETS** | $ | 1,325 | $ | 2,312 |
| | | | | |
| **Liabilities and Stockholders Deficit** | | | | |
| Current Liabilities: | | | | |
| Accounts payable, trade | $ | 220 | $ | 193 |
| Accrued expenses | | 620 | | 669 |
| Dividends payable | | 160 | | 20 |
| Obligations under capital lease, current portion | | 197 | | 145 |
| Deferred revenue | | 386 | | 442 |
| Total current liabilities | | 1,583 | | 1,469 |
| | | | | |
| Loan payable to officer | | 1,530 | | 1,530 |
| Obligations under capital lease, noncurrent portion | | 139 | | 130 |
| | | | | |
| Commitments and contingencies | | | | |
| | | | | |
| Stockholders Deficit: | | | | |
| Preferred stock, $0.01 par value: | | | | |
| Authorized shares 5,000 | | | | |
| Series 1 shares issued and outstanding 200 in 2015 and 2014 | | | | |
| Liquidation preference of $1,063 in 2015 and $1,013 in 2014 | | 707 | | 707 |
| Series 2 shares issued and outstanding 460 in 2015 and 2014 | | | | |
| Liquidation preference of $1,212 in 2015 and $1,155 in 2014 | | 724 | | 724 |
| Series 3 shares issued and outstanding 289 in 2015 and 2014 | | | | |
| Liquidation preference of $665 in 2015 and $634 in 2014 | | 412 | | 412 |
| Common stock, $0.01 par value: | | | | |
| Authorized shares 80,000 | | | | |
| Issued shares 12,622 in 2015 and 12,471 in 2014 | | | | |
| Outstanding shares 12,612 in 2015 and 12,461 in 2014 | | 126 | | 125 |
| Common stock held in treasury, at cost 10 shares | | (362) | | (362) |
| Additional paid-in-capital | | 56,520 | | 56,382 |

| | | | | |
|---|---|---|---|---|
| Accumulated deficit | | (59,947) | | (58,698) |
| Accumulated other comprehensive loss | | (107) | | (107) |
| Total stockholders deficit | | (1,927) | | (817) |
| **TOTAL LIABILITIES AND STOCKHOLDERS DEFICIT** | $ | 1,325 | $ | 2,312 |

See accompanying notes.

Table of Contents

**INTRUSION INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**(In thousands, except per share amounts)**

| | Year Ended December 31, 2015 | 2014 |
|---|---|---|
| Net product revenue | $ 6,795 | $ 7,150 |
| Net customer support and maintenance revenue | 29 | 69 |
| Total revenue | 6,824 | 7,219 |
| Cost of product revenue | 2,517 | 2,521 |
| Cost of customer support and maintenance revenue | 13 | 11 |
| Total cost of revenue | 2,530 | 2,532 |
| Gross profit | 4,294 | 4,687 |
| Operating expenses: | | |
| Sales and marketing | 1,894 | 1,735 |
| Research and development | 2,315 | 1,941 |
| General and administrative | 1,227 | 1,232 |
| Operating loss | (1,142) | (221) |
| Interest expense, net | (107) | (107) |
| Other income | | 54 |
| Loss from operations before income taxes | (1,249) | (274) |
| Income tax provision | | |
| Net loss | (1,249) | (274) |
| Preferred stock dividends accrued | (139) | (141) |
| Net loss attributable to common stockholders | $ (1,388) | $ (415) |
| | | |
| Net loss per share attributable to common stockholders, basic | $ (0.11) | $ (0.03) |
| Net loss per share attributable to common stockholders, diluted | $ (0.11) | $ (0.03) |
| | | |
| Weighted average common shares outstanding: | | |
| Basic | 12,598 | 12,393 |
| Diluted | 12,598 | 12,393 |

See accompanying notes.

Table of Contents

**INTRUSION INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS DEFICIT**

**(In thousands)**

| | Year Ended December 31, 2015 | | Year Ended December 31, 2014 | |
|---|---|---|---|---|
| **NUMBER OF PREFERRED SHARES ISSUED AND OUTSTANDING** | | | | |
| Balance, beginning of year | | 949 | | 1,034 |
| Conversion of preferred stock to common | | | | (85) |
| Balance, end of year | | 949 | | 949 |
| **PREFERRED STOCK** | | | | |
| Balance, beginning of year and end of year | $ | 1,843 | $ | 2,006 |
| Conversion of preferred stock to common | | | | (163) |
| Balance, end of year | | 1,843 | | 1,843 |
| **NUMBER OF COMMON SHARES ISSUED** | | | | |
| Balance, beginning of year | | 12,471 | | 12,182 |
| Exercise of stock options | | 151 | | 193 |
| Conversion of preferred stock to common | | | | 96 |
| Balance, end of year | | 12,622 | | 12,471 |
| **COMMON STOCK** | | | | |
| Balance, beginning of year | $ | 125 | $ | 122 |
| Exercise of stock options | | 1 | | 2 |
| Conversion of preferred stock to common | | | | 1 |
| Balance, end of year | $ | 126 | $ | 125 |
| **TREASURY SHARES** | | | | |
| Balance, beginning of year and end of year | $ | (362) | $ | (362) |
| **ADDITIONAL PAID-IN-CAPITAL** | | | | |
| Balance, beginning of year | $ | 56,382 | $ | 55,905 |
| Stock-based compensation | | 206 | | 375 |
| Exercise of stock options | | 66 | | 75 |
| Conversion of preferred stock to common | | | | 162 |
| Preferred stock dividends declared, net of waived penalties by shareholders | | (134) | | (135) |
| Balance, end of year | $ | 56,520 | $ | 56,382 |
| **ACCUMULATED DEFICIT** | | | | |
| Balance, beginning of year | $ | (58,698) | $ | (58,424) |
| Net loss | | (1,249) | | (274) |
| Balance, end of year | $ | (59,947) | $ | (58,698) |
| **ACCUMULATED OTHER COMPREHENSIVE LOSS** | | | | |
| Balance, beginning of year and end of year | $ | (107) | $ | (107) |
| **TOTAL STOCKHOLDERS DEFICIT** | $ | (1,927) | $ | (817) |

See accompanying notes.

Table of Contents

**INTRUSION INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**

| | Year Ended December 31, 2015 | | Year Ended December 31, 2014 | |
|---|---|---|---|---|
| Operating Activities: | | | | |
| Net loss | $ | (1,249) | $ | (274) |
| Adjustments to reconcile net loss to net cash provided by (used) operating activities: | | | | |
| Depreciation and amortization | | 305 | | 236 |
| Stock-based compensation | | 206 | | 375 |
| Penalties and waived penalties on dividends | | 6 | | 6 |
| Changes in operating assets and liabilities: | | | | |
| Accounts receivable | | 157 | | 79 |
| Inventories | | (33) | | 7 |
| Prepaid expenses and other assets | | 48 | | (25) |
| Accounts payable and accrued expenses | | (22) | | (136) |
| Deferred revenue | | (56) | | 303 |
| Net cash provided by (used in) operating activities | | (638) | | 571 |
| Investing Activities: | | | | |
| Purchases of property and equipment | | (121) | | (55) |
| Financing Activities: | | | | |
| Proceeds from line of credit | | | | 453 |
| Payments on line of credit | | | | (453) |
| Payments of dividends | | | | (558) |
| Principal payments on capital lease equipment | | (211) | | (168) |
| Proceeds from stock options exercised | | 66 | | 77 |
| Net cash used in financing activities | | (145) | | (649) |
| Net decrease in cash and cash equivalents | | (904) | | (133) |
| Cash and cash equivalents at beginning of year | | 1,006 | | 1,139 |
| Cash and cash equivalents at end of year | $ | 102 | $ | 1,006 |
| | | | | |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | | | |
| Interest paid on leased assets | $ | 24 | $ | 23 |
| Income taxes paid | $ | | $ | |
| | | | | |
| SUPPLEMENTAL DISCLOSURE OF NON CASH FINANCING ACTIVITIES: | | | | |
| Preferred stock dividends accrued | $ | 160 | $ | 141 |
| Purchase of equipment through capital lease | $ | 273 | $ | 270 |