

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2021

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission File Number 001-39608

INTRUSION INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

75-1911917
(I.R.S. Employer
Identification No.)

101 East Park Blvd, Suite 1200, Plano, Texas 75074
(Address of principal executive offices)
(Zip Code)

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

101 East Park Blvd, Suite 1200, Plano, Texas 75074
(Former name, former address and former fiscal year, if changed since last report)

* * * * *

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value \$0.01 per share	INTZ	Nasdaq Capital Market

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

Yes ☒ No ☐

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

Yes ☒ No ☐

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

Large, accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated Filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes ☐ No ☒

The number of shares outstanding of the Registrant's Common Stock, \$0.01 par value, on November 2, 2021, was 18,793,046

INTRUSION INC.

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PART I – FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

INTRUSION INC. AND SUBSIDIARIES **UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS** (In thousands, except par value amounts)

	September 30, 2021	December 31, 2020
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 7,153	\$ 16,704
Accounts receivable	1,048	1,233
Prepaid expenses	617	370
Other current assets	19	–
Total current assets	8,837	18,307
Non-Current Assets:		
Property and Equipment:		
Equipment	2,502	1,453
Furniture and fixtures	43	43
Leasehold improvements	67	67
Property, plant and equipment, gross	2,612	1,563
Accumulated depreciation and amortization	(1,417)	(1,097)
Property and equipment, net	1,195	466
Finance leases, right-of-use assets, net	1,696	20
Operating leases, right-of-use assets, net	882	1,010
Other assets	167	79
Total non-current assets	3,940	1,575
TOTAL ASSETS	\$ 12,777	\$ 19,882
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable, trade	\$ 747	\$ 408
Accrued expenses	957	628
Finance lease liabilities, current portion	582	21
Operating lease liabilities, current portion	860	487
PPP loan payable, current portion	–	421
Deferred revenue	822	177
Total current liabilities	3,968	2,142
Non-Current Liabilities:		
PPP loan payable, noncurrent portion	–	212
Finance lease liabilities, noncurrent portion	620	–
Operating lease liabilities, noncurrent portion	1,412	1,867
Total non-current liabilities	2,032	2,079
Commitments and contingencies		
Stockholders' equity:		
Common stock \$0.01 par value: Authorized shares — 80,000 Issued shares — 18,803 in 2021 and 17,428 in 2020 Outstanding shares — 18,793 in 2021 and 17,418 in 2020	188	174
Common stock held in treasury, at cost – 10 shares	(362)	(362)
Additional paid-in capital	83,240	77,187
Accumulated deficit	(76,246)	(61,295)
Accumulated other comprehensive loss	(43)	(43)
Total stockholders' equity	6,777	15,661
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 12,777	\$ 19,882

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

INTRUSION INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	September 30, 2021	September 30, 2020	September 30, 2021	September 30, 2020
Revenue	\$ 1,819	\$ 1,588	\$ 5,632	\$ 5,039
Cost of revenue	690	652	2,048	2,050
Gross profit	1,129	936	3,584	2,989
Operating expenses:				
Sales and marketing	3,782	885	10,123	1,880
Research and development	1,863	1,081	4,862	2,741
General and administrative	1,592	377	4,261	962
Operating loss	(6,108)	(1,407)	(15,662)	(2,594)
Interest and other income	19	—	87	8
Interest expense	(8)	(2)	(11)	(4)
Gain on the extinguishment of debt	—	—	635	—
Net loss	<u>\$ (6,097)</u>	<u>\$ (1,409)</u>	<u>\$ (14,951)</u>	<u>\$ (2,590)</u>
Preferred stock dividends accrued	—	(13)	—	(79)
Net loss attributable to common stockholders	<u>\$ (6,097)</u>	<u>\$ (1,422)</u>	<u>\$ (14,951)</u>	<u>\$ (2,669)</u>
Net loss per share attributable to common stockholders:				
Basic	<u>\$ (0.34)</u>	<u>\$ (0.10)</u>	<u>\$ (0.85)</u>	<u>\$ (0.19)</u>
Diluted	<u>\$ (0.34)</u>	<u>\$ (0.10)</u>	<u>\$ (0.85)</u>	<u>\$ (0.19)</u>
Weighted average common shares outstanding:				
Basic	17,909	14,450	17,692	13,981
Diluted	17,909	14,450	17,692	13,981

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

INTRUSION INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(In thousands, except share amounts)
For the Nine Months Ended September 30, 2021

	Common Stock		Treasury Stock		Accumulated Other Comprehensive Loss	Additional Paid-In- Capital	Accumulated Deficit	Total
	Dollars	Shares	Dollars	Shares	Dollars	Dollars	Dollars	Dollars
Balance, December 31, 2020	\$ 174	17,427,779	\$ (362)	10,000	\$ (43)	\$ 77,187	\$ (61,295)	\$ 15,661
Share-based compensation expense	—	—	—	—	—	204	—	204
Exercise of stock options	2	197,227	—	—	—	159	—	161
Net loss	—	—	—	—	—	—	(3,903)	(3,903)
Balance, March 31, 2021	176	17,625,006	(362)	10,000	(43)	77,550	(65,198)	12,123
Share-based compensation expense	—	—	—	—	—	806	—	806
Exercise of stock options	—	6,000	—	—	—	7	—	7
Net loss	—	—	—	—	—	—	(4,951)	(4,951)
Balance, June 30, 2021	176	17,631,006	(362)	10,000	(43)	78,363	(70,149)	7,985
Share-based compensation expense	—	—	—	—	—	62	—	62
Public offering, net of fees	11	1,118,540	—	—	—	4,740	—	4,751
Exercise of stock options	1	53,500	—	—	—	75	—	76
Net loss	—	—	—	—	—	—	(6,097)	(6,097)
Balance, September 30, 2021	<u>\$ 188</u>	<u>18,803,046</u>	<u>\$ (362)</u>	<u>10,000</u>	<u>\$ (43)</u>	<u>\$ 83,240</u>	<u>\$ (76,246)</u>	<u>\$ 6,777</u>

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

INTRUSION INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(In thousands, except share amounts)
For the Nine Months Ended September 30, 2020

	Preferred Stock		Common Stock		Treasury Stock		Accumulated Other Comprehensive Loss	Additional Paid-In- Capital	Accumulated Deficit	Total
	Dollars	Shares	Dollars	Shares	Dollars	Shares	Dollars	Dollars	Dollars	Dollars
Balance, December 31, 2019	\$ 1,843	949,377	\$ 136	13,552,236	\$ (362)	10,000	\$ (43)	\$ 56,759	\$ (54,777)	\$ 3,556
Conversion of preferred stock to common	(96)	(63,194)	1	63,194	—	—	—	95	—	—
Preferred stock dividends declared, net of waived penalties by shareholders	—	—	—	—	—	—	—	(33)	—	(33)
Share-based compensation expense	—	—	—	—	—	—	—	19	—	19
Exercise of stock options	—	—	1	172,600	—	—	—	74	—	75
Net loss	—	—	—	—	—	—	—	—	(465)	(465)
Balance, March 31, 2020	1,747	886,183	138	13,788,030	(362)	10,000	(43)	56,914	(55,242)	3,152
Dividends accrued	—	—	—	—	—	—	—	(33)	—	(33)
Share-based compensation expense	—	—	—	—	—	—	—	55	—	55
Exercise of stock options	—	—	—	14,000	—	—	—	10	—	10
Net loss	—	—	—	—	—	—	—	—	(715)	(715)
Balance, June 30, 2020	1,747	886,183	138	13,802,030	(362)	10,000	(43)	56,946	(55,957)	2,469
Conversion of preferred stock to common	(1,747)	(886,183)	10	1,004,249	—	—	—	1,738	—	—
Dividends accrued	—	—	—	—	—	—	—	(13)	—	(13)
Share-based compensation expense	—	—	—	—	—	—	—	100	—	100
Exercise of stock options	—	—	1	133,000	—	—	—	106	—	107
Net loss	—	—	—	—	—	—	—	—	(1,409)	(1,409)
Balance, September 30, 2020	<u>\$ —</u>	<u>—</u>	<u>\$ 149</u>	<u>14,939,279</u>	<u>\$ (362)</u>	<u>10,000</u>	<u>\$ (43)</u>	<u>\$ 58,877</u>	<u>\$ (57,367)</u>	<u>\$ 1,254</u>

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

INTRUSION INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Nine Months Ended	
	September 30, 2021	September 30, 2020
Operating Activities:		
Net loss	\$ (14,951)	\$ (2,590)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	466	164
Bad debt expense	26	—
Stock-based compensation	1,072	174
Noncash lease costs	169	186
Gain on extinguishment of debt	(635)	—
Gain on modification of lease	(17)	—
Changes in operating assets and liabilities:		
Accounts receivable	159	536
Prepaid expenses and other assets	(273)	(514)
Accounts payable and accrued expenses	564	134
Deferred revenue	645	(457)
Net cash used in operating activities	(12,775)	(2,367)
Investing Activities:		
Purchases of property and equipment	(1,048)	(153)
Proceeds from sale of equipment	1	—
Purchases of intangible assets – domain name	(85)	—
Net cash used in investing activities	(1,132)	(153)
Financing Activities:		
Proceeds from PPP loan payable	—	629
Proceeds from stock options exercised	244	193
Proceeds from public stock offering net of fees	4,751	—
Payments of dividends	—	(99)
Reduction of finance lease liability	(639)	(32)
Net cash provided by financing activities	4,356	691
Net decrease in cash and cash equivalents	(9,551)	(1,829)
Cash and cash equivalents at beginning of period	16,704	3,334
Cash and cash equivalents at end of period	\$ 7,153	\$ 1,505

SUPPLEMENTAL DISCLOSURE OF CASH FLOW ACTIVITIES:

Cash paid for interest	\$ 3	\$ 2
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SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING ACTIVITIES:

Preferred stock dividends accrued	\$ —	\$ 79
Conversion of preferred stock to common	\$ —	\$ 1,843
Assets acquired under a Right of Use (“ROU”) operating lease	\$ 212	\$ —
Assets acquired under a ROU finance lease	\$ 1,820	\$ —

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

INTRUSION INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business

Intrusion, Inc. (together with its consolidated subsidiaries, the “Company”, “Intrusion”, “Intrusion Inc.”, “we”, “us”, “our”, or similar terms) was organized in Texas in September 1983 and reincorporated in Delaware in October 1995. Our principal executive offices are located at 101 East Park Boulevard, Suite 1200, Plano, Texas 75074, and our telephone number is (972) 234-6400. Our website URL is www.intrusion.com.

We develop, sell and support products that protect any-sized company or government organization by fusing advanced threat intelligence with real-time artificial intelligence to kill cyberattacks as they occur – including Zero-Days. We market and distribute our solutions through a direct sales force and value-added resellers. Our end-user customers include U.S. federal government entities, state and local government entities, and companies ranging in size from mid-market to large enterprises.

TraceCop “(TraceCop™)” and Savant (“Savant™”) are registered trademarks of Intrusion Inc. We have applied for trademark protection for our new **INTRUSION Shield** cybersecurity solution.

2. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with Generally Accepted Accounting Principles in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Item 10-01 of Regulation S-X. Accordingly, they do not include all the information and disclosures required by GAAP for complete financial statements. All adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations for the interim periods have been made and are of a recurring nature unless otherwise disclosed herein. The results of operations for such interim periods are not necessarily indicative of results of operations for a full year. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2020, filed with the U.S. Securities and Exchange Commission (the “SEC”) on March 9, 2021. All significant intercompany balances and transactions have been eliminated in consolidation.

The Company calculates the fair value of its assets and liabilities which qualify as financial instruments and includes this additional information in the notes to consolidated financial statements when the fair value is different from the carrying value of these financial instruments. The estimated fair value of accounts receivable, accounts payable and accrued expenses approximate their carrying amounts due to the relatively short maturity of these instruments. Financing leases and Paycheck Protection Program (“PPP”) loan approximate fair value as they bear market rates of interest. None of these instruments are held for trading purposes.

In July 2021, the Company determined that the combination of increased expenses primarily related with management’s accelerated increase in staffing its sales and administrative resources together with decreased revenue expectations related to its **INTRUSION Shield** offering has created significant concerns about the Company’s ability to meet its current and short-term cash-flow and liquidity needs, over the next 12 months. In recognition of this determination, the Company has been actively considering strategic alternatives for the funding and implementation of its long-term business plan. For example, the Company has engaged B. Riley Securities, Inc. to act as sales agent under its at-the-market program, which allows the Company to potentially sell up to \$50.0 million of its common stock on a delayed or continuous basis through the use of a shelf-registration statement on Form S-3, which the Company initially filed on August 5, 2021. The shelf registration became effective on August 16, 2021. As of September 30, 2021, the Company received net proceeds in the amount of \$4.8 million net of fees from the sale of its common stock related to this program.

Management believes that this plan may continue to provide the Company with the financing required to continue as a going concern; however, the Company can offer no assurances that this at-the-market program will continue to generate the proceeds necessary to finance future operating needs. Accordingly, the Company is currently evaluating a variety of other potential funding and longer-term strategic options.

3. Accounting for Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with ASC 718, *Compensation – Stock Compensation*, which requires that compensation related to all stock-based awards be recognized in the condensed consolidated financial statements. Stock-based compensation cost is valued at fair value at the date of grant, and the grant date fair value is recognized as expense over each award's requisite service period with a corresponding increase to equity or liability based on the terms of each award and the appropriate accounting treatment under ASC 718.

During 2021, the Company added a new incentive plan (the "2021 Omnibus Incentive Plan"). The purpose of the 2021 Omnibus Incentive Plan is to provide a means through which the Company may attract and retain key personnel and to provide a means whereby directors, officers, employees, consultants and advisors of the Company can acquire and maintain an equity interest in the Company, or be paid incentive compensation, including incentive compensation measured by reference to the value of common stock, thereby strengthening their commitment to the welfare of the Company and aligning their interests with those of the Company's stockholders.

The aggregate number of shares of Common Stock that may be issued or used for reference purposes or with respect to which Awards may be granted under the 2021 Omnibus Incentive Plan shall not exceed 2,500,000 shares and is subject to any increase or decrease, which shares may be either authorized and unissued Common Stock or Common Stock held in or acquired for the treasury of the Company or both.

During the nine-month period ended September 30, 2021, the Company issued new Restricted Stock Awards (RSAs) under the 2021 Omnibus Incentive Plan in the amount of \$70,000 in value of restricted stock to each of the Company's outside directors, with a valuation to be based on the closing price of the Company's common stock on the Nasdaq Capital Market (the "Outside Director Awards"). Accordingly, 27,540 shares were granted and are expected to fully vest on the anniversary of the grant date.

The following table summarizes the activities for the Company's unvested RSAs in Intrusion Inc. stock for the nine months ended September 30, 2021:

	Unvested Restricted Stock Units	
	Number of Shares	Weighted-Average Grant-Date Fair Value
Unvested as of December 31, 2020	–	\$ –
Granted	27,540	12.71
Vested	–	–
Forfeited/canceled	–	–
Unvested as of September 30, 2021	27,540	\$ 12.71

The Company recognized compensation expense related to its RSAs of \$88,000 and \$130,000, respectively, during the three- and nine-month periods ended September 30, 2021. As of September 30, 2021, there was \$220,000 of unrecognized compensation cost related to unvested RSAs. This amount is expected to be recognized over a weighted-average period of eight months.

During the nine-month period ended September 30, 2021, the Company also granted new option awards under the 2021 Omnibus Incentive Plan to its employees with the option price for each option set at the closing price for the Company's Common Stock on the Nasdaq Capital Market on the grant date (the "May 2021 Option Awards"). Accordingly, 480,000 options were granted under this plan during the nine-month period ended September 30, 2021.

During the nine months ended September 30, 2021, the Company granted 65,000 stock options under its 2015 Stock Incentive Plan (the "2015 Plan"). The Company did not grant any options under the 2015 Plan during the three months ended September 30, 2021. The Company did not grant any options under its 2005 Stock Incentive Plan (the "2005 Plan") during the three- and nine-month periods ended September 30, 2021. During the three- and nine-month periods ended September 30, 2020, the Company granted 10,000 and 333,000, respectively, of stock options under these plans to employees or directors.

During the three-month periods ended September 30, 2021 and 2020, 53,500 (24,000 under the 2015 Plan and 29,500 under the 2005 Plan) and 133,000 (30,000 under the 2015 Plan and 103,000 under the 2005 Plan) options were exercised, respectively. During the nine-month periods ended September 30, 2021, and 2020, 256,727 (25,000 under the 2015 Plan and 231,727 under the 2005 Plan) and 319,600 (45,000 under the 2015 Plan and 274,600 under the 2005 Plan) options were exercised, respectively. With recent employee resignations, terminations, and departures, a number of unexercised and unvested options were forfeited resulting in an addition of 420,333 (270,333 under the 2015 Plan and 150,000 under the 2021 Omnibus Incentive Plan) and 505,333 (305,333 under the 2015 Plan and 200,000 under the 2021 Omnibus Incentive Plan) option shares during the three and nine months ended September 30, 2021, respectively, that are now available for re-granting under each respective plan.

During the nine months ended September 30, 2021, the Board of Directors (“Board”) approved a new clause to the 2015 Plan, to accelerate the vesting of any unvested equity grants held by outside directors upon their retirement from the Board. Pursuant to the approval of the acceleration clause, during the second quarter of 2021, the equity awards held by two outside board members who retired from the Board in May 2021 became fully vested. The Company accounts for the acceleration of the related stock options as a modification of the option award under ASC 718. Accordingly, the Company recognized incremental stock compensation expense of approximately \$237,000 during the nine-month period ended September 30, 2021.

The following table summarizes the activities for the Company’s stock options for the nine months ended September 30, 2021:

	September 30, 2021	
	Number of Options	Weighted-Average Exercise Price
Outstanding at beginning of year	1,035,000	\$ 2.87
Granted	545,000	14.00
Exercised	(256,727)	0.97
Forfeited	(505,333)	9.29
Cancelled	—	—
Expired	(90,000)	2.12
Outstanding at September 30, 2021	727,940	\$ 7.49
Options exercisable at September 30, 2021	349,610	1.64

The Company recognized compensation (benefit) expense related to its stock option awards of (\$26,000) and \$100,000, for the three months ended September 30, 2021, and 2020, respectively, and \$943,000 and \$174,000, for the nine months ended September 30, 2021, and 2020, respectively.

Valuation Assumptions

The fair values of employee and director option awards were estimated at the date of grant using a Black-Scholes option-pricing model with the following assumptions:

	For Three Months Ended September 30, 2021	For Three Months Ended September 30, 2020	For Nine Months Ended September 30, 2021	For Nine Months Ended September 30, 2020
Weighted average grant date fair value	\$ —	\$ 4.98	\$ 8.99	\$ 2.86
Weighted average assumptions used:				
Expected dividend yield	—	0.0%	0.0%	0.0%
Risk-free interest rate	—	0.23%	0.80%	0.42%
Expected volatility	—	70.85%	81.81%	76.85%
Expected life (in years)	—	5.0	5.0	6.1

Expected volatility is based on historical volatility and in part on implied volatility. The expected term considers the contractual term of the option as well as historical exercise and forfeiture behavior. The risk-free interest rate is based on the rates in effect on the grant date for U.S. Treasury instruments with maturities matching the relevant expected term of the award. Options granted to non-employees are valued using the fair market value on each measurement date of the option.

4. Revenue Recognition

The Company generally recognizes product revenue upon shipment or after meeting certain performance obligations. These products can include hardware, perpetual software licenses and data sets. Most of the Company's sales are data set updates. Warranty costs and sales returns have not been material.

The Company recognizes sales of its data sets in accordance with FASB ASC Topic 606 whereby revenue from contracts with customers are recognized once the criteria under the five steps below have been met:

- i) identification of the contract with a customer;
- ii) identification of the performance obligations in the contract;
- iii) determination of the transaction price;
- iv) allocation of the transaction price to each separate performance obligations; and
- v) recognition of revenue upon satisfaction of a performance obligation.

Data updates are typically done monthly, and revenue is matched accordingly. Product sales may include maintenance and customer support allocated 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 product offering and service offering market values are readily determined based on current and prior stand-alone sales. The Company may defer and recognize maintenance, updates and support revenue over the term of the contract period, which is generally one year.

Normal payment terms offered to customers, distributors and resellers are net 30 days domestically and net 45 days internationally. The Company does not offer payment terms that extend beyond one year and rarely does it extend payment terms beyond its normal terms. If certain customers do not meet the Company's credit standards, the Company typically requires payment in advance on some of its smaller sized customers to limit its credit exposure.

Shipping and handling costs are billed to the customer and included in revenue. Shipping and handling expenses are included in cost of revenue. The Company has elected to account for shipping and handling costs as fulfillment costs after the customer obtains control of the goods.

With the Company's newest product, **Shield**, Intrusion began offering software on a subscription basis. Shield is a hosted arrangement subject to software as a service ("SaaS") guidance under ASC 606. SaaS arrangements are accounted for as service obligations, not arrangements that transfer a license of IP.

The Company utilizes the five-step process, mentioned above, per FASB ASC Topic 606 to recognize sales and will follow that directive, also, to define revenue items as individual and distinct. **Shield** services provided to the Company's customers for a fixed monthly subscription fee include:

- Access to Intrusion's proprietary software and database to detect and prevent unauthorized access to its clients' information networks;
- Use of all software, associated media, printed materials, data, files, online documentation, and any equipment that Intrusion provides for customers to access the **INTRUSION Shield**; and
- Tech support, post contract customer support (PCS) includes daily program releases or corrections provided by Intrusion without additional charge.

The contract provided for no other services, and our customers have no rebates or return rights, nor are any such rights anticipated to be offered as part of this service.

The Company satisfies its performance obligation when the *Shield* solution is available to detect and prevent unauthorized access to a client's information networks. Revenue should be recognized monthly over the term of the contract. The Company's standard initial contract terms automatically renew unless notice is given 30 days before renewal. Upfront payment of fees are deferred and amortized into income over the period covered by the contract.

The Company's accounts receivable represents unconditional contract billings for sales per contracts with customers and are classified as current. As of September 30, 2021, and December 30, 2020, the Company had accounts receivable balance of \$1,048,000 and \$1,233,000, respectively. Accounts receivable is net of \$26,000 of allowance of doubtful accounts as of September 30, 2021. The Company did not recognize an allowance for doubtful accounts as of December 31, 2020.

The Company had no material contract assets as of September 30, 2021, and December 31, 2020.

Contract liabilities consist of cash payments in advance of the Company satisfying performance obligations and recognizing revenue. The Company currently classifies deferred revenue as a contract liability.

The following table presents changes in the Company's contract liability during the nine months ended September 30, 2021, and the year ended December 31, 2020 (in thousands):

	September 30, 2021	December 31, 2020
Balance at beginning of period	\$ 177	\$ 516
Additions	1,750	353
Revenue recognized	(1,105)	(692)
Balance at end of period	<u>\$ 822</u>	<u>\$ 177</u>

5. Net Loss Per Share

Basic net loss per share is computed by dividing net loss attributable to common stockholders for the period by the weighted average number of common shares outstanding for the period. Diluted net loss per share is computed by dividing the net loss attributable to common stockholders by the weighted average number of common shares and dilutive common stock equivalents outstanding for the period. Our common stock equivalents include all common stock issuable upon conversion of preferred stock and the exercise of outstanding options and warrants. The aggregate number of common stock equivalents excluded from the diluted loss per share calculation for the three-month periods ending September 30, 2021, and 2020 are 917,472 and 1,071,952, respectively. The aggregate number of common stock equivalents excluded from the diluted loss per share calculation for the nine-month periods ended September 30, 2021, and 2020 are 978,977 and 960,933, respectively. Since the Company is in a net loss position for the three- and nine-month periods ended September 30, 2021, and 2020, basic and dilutive net loss per share are the same.

6. Concentrations

The Company's operations are concentrated in one area—security software/entity identification. Sales to the U.S. Government through direct and indirect channels totaled 69.14% of total revenues attributable to five government customers and 92.3% of total revenues attributable to four government customers for the nine-month periods ended September 30, 2021, and 2020, respectively. One individual commercial customer during the nine months ended September 30, 2021, individually accounted for over 10.0% of total revenues and during the three months ended September 30, 2021, two individual commercial customers accounted for revenues that were individually over 10.0% of total revenues. During the three and nine months ended September 30, 2020, no individual commercial customer accounted for revenues that were over 10.0% of total revenues. The Company's similar product and service offerings are not viewed as individual segments, as its management analyzes the business as a whole and expenses are not allocated to each product offering.

7. Commitments and Contingencies

The Company is periodically involved in claims asserted in the normal course of its business. We believe these actions are routine and incidental to the business. While the outcome of these actions cannot be predicted with certainty, we do not believe that any will have a material adverse impact on our business.

Class Action Litigation

On April 16, 2021, a purported class action lawsuit was filed in the United States District Court, Eastern District of Texas, Sherman Division, captioned Celeste v. Intrusion Inc. et al., Case No. 4:21-cv-00307 (E.D. Tex) against the Company, the Company's chief financial officer, and former chief executive officer alleging, among other things, that the defendants made false and/or misleading statements or omissions about the Company's business, operations, and prospects in violation of Section 10(b) of The Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Rule 10b-5 promulgated thereunder, as well as Section 20(a) of the Exchange Act. The Celeste lawsuit claims compensatory damages and legal fees.

On May 14, 2021, a related purported class action lawsuit was filed in the United States District Court, Eastern District of Texas, Sherman Division, captioned Neely v. Intrusion Inc., et al., Case No. 4:12-cv-00374 (E.D. Tex.) against the Company, the Company's chief financial officer, and former chief executive officer. The Neely lawsuit alleges the same violations under the federal securities laws as those alleged in the Celeste lawsuit. The Neely lawsuit also seeks compensatory damages and legal fees. A motion to consolidate the two lawsuits and appoint a lead plaintiff is pending before the court. The Company believes the claims in the lawsuits are without merit and intends to defend itself vigorously.

The Company is unable to predict the ultimate outcome and is unable to make a meaningful estimate of the amount or range of loss, if any, that could result from any unfavorable outcome of the Class Action Litigation.

Securities Investigation

On August 8, 2021, the Company received a notification from the Securities and Exchange Commission, Division of Enforcement, that it was conducting an investigation captioned In the Matter of Intrusion Inc. and requesting the Company produce certain documents and information. On November 9, 2021, the Securities and Exchange Commission served a subpoena on the Company in connection with this investigation which formally requested substantially similar information as in the prior request. The Company is continuing to comply with the requests and is cooperating in the investigation. The Company can offer no assurances as to the outcome of this investigation or its potential effect on the Company or its results of operations.

8. Right-of-use Asset and Leasing Liabilities

The Company has operating and finance leases where it records the right-of-use assets and a related lease liability as required under ASC 842. The lease liabilities are determined by the net present value of total lease payments and amortized over the life of the lease. All obligations under the Company's lease agreements are designed to terminate with the last scheduled payment. The Company's leases are for the following types of assets:

- Computer hardware and copy machines- The Company's finance lease right-of-use assets consist of computer hardware and copy machines. These leases have a three-year life and are in various stages of completion.
- Office space - The Company's operating lease right-of-use assets include its rental agreements for its offices in Plano, TX, and San Marcos, CA, and a data service center in Allen, TX. The Plano offices operating lease liability was modified during the three months ended September 30, 2021, to add an additional floor of office space and terminate the prior lease. The modified lease has a life of two years and one month as of September 30, 2021. The San Marcos operating lease liability terminated on March 31, 2021. The data service center operating lease liability has a life of four years and one month as of September 30, 2021. The Company also has an operating lease liability for its former corporate office in Richardson. The Richardson operating lease liability has a life of three years and two months as of September 30, 2021; however, the related right-of-use asset was fully impaired due to the Company's abandonment of the lease as of December 31, 2020.

Additional qualitative and quantitative disclosures regarding the Company's leasing arrangements are also required. The Company adopted ASC 842 prospectively and elected the package of transition practical expedients that does not require reassessment of: (1) whether any existing or expired contracts are or contain leases, (2) lease classification and (3) initial direct costs. In addition, the Company has elected other available practical expedients to not separate lease and non-lease components, which consist principally of common area maintenance charges, for all classes of underlying assets and to exclude leases with an initial term of 12 months or less.

As the implicit rate is not readily determinable for the Company's lease agreement, the Company uses an estimated incremental borrowing rate to determine the initial present value of lease payments. This discount rate for the lease approximates Silicon Valley Bank's prime rate.

Supplemental cash flow information includes operating cash flows related to operating leases. For the three months ended September 30, 2021, and 2020, the Company had \$79,000 and \$92,000, respectively, in lease payments related to operating leases. For the nine months ended September 30, 2021, and 2020, the Company had \$200,000 and \$271,000, respectively, in lease payments related to operating leases.

Schedule of Items Appearing on the Statement of Operations (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2021	September 30, 2020	September 30, 2021	September 30, 2020
Operating expense:				

Amortization expense – Finance ROU	\$	111	\$	11	\$	144	\$	32
Lease expense – Operating ROU	\$	66	\$	82	\$	252	\$	248
Other expense:								
Interest expense – Finance ROU	\$	8	\$	–	\$	9	\$	2

Future minimum lease obligations consisted of the following as of September 30, 2021 (in thousands):

	Operating ROU Leases	Finance ROU Leases	Total
Remaining 2021	\$ 410	\$ 8	\$ 418
2022	704	618	1,322
2023	705	618	1,323
2024	486	9	495
2025	115	1	116
Thereafter	—	—	—
	\$ 2,420	\$ 1,254	\$ 3,674
Less Interest*	(148)	(52)	
	\$ 2,272	\$ 1,202	

* Interest is imputed for operating ROU leases and classified as lease expense and is included in operating expenses in the accompanying condensed consolidated statement of operations.

10. Coronavirus Outbreak in the United States

Our customers were forced to allocate scarce and competing resources and balance budgetary demands placed upon them as a result of the effects of the coronavirus, mandatory quarantines, decreased travel, interruptions in workforce populations, scarcity of commodities, and similar economic and operational effects of the virus upon their own constituencies. These adverse effects resulted in decreased demand by many of our customers for our product offerings and cybersecurity solutions, negatively affecting revenue levels for the Company. We anticipate that our customers will continue to budget conservatively in the coming months, particularly as uncertainty remains about new strains and variants of the COVID-19 virus and potential future restrictions, slow-downs, or lock-downs.

11. SBA Paycheck Protection Program Loan

On March 27, 2020, the U.S. federal government enacted the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), which included provision for a Paycheck Protection Program (“PPP”) administered by the U.S. Small Business Administration (“SBA”). The PPP allowed qualifying businesses to borrow up to \$10 million calculated based on qualifying payroll costs. The loan was guaranteed by the federal government and did not require collateral. On April 30, 2020, the Company entered a PPP Loan with Silicon Valley Bank, pursuant to the PPP under CARES Act for a principal amount of \$629,000. The PPP Loan was to mature on April 30, 2022, and bear interest at a rate of 1.0% per annum. The Company received the PPP Loan funds on April 30, 2020. The PPP Loan contained events of default and other provisions customary for a loan of this type. The PPP provided that (1) the use of PPP Loan amount shall be limited to certain qualifying expenses, (2) 100% of the principal amount of the loan is guaranteed by the SBA and (3) an amount up to the full principal amount plus accrued interest may qualify for loan forgiveness in accordance with the terms of CARES Act.

The Company utilized the full proceeds of the PPP loan in accordance with the provisions of CARES Act and submitted the PPP Loan Forgiveness Application. On April 7, 2021, the Company received notice from the SBA that the PPP loan and accrued interest was forgiven in full. As a result, the Company recorded gain in the extinguishment of debt of \$635,000 on its condensed statement of operations during the nine months ended September 30, 2021.

12. Subsequent Events.

On November 9, 2021, the Securities and Exchange Commission served a subpoena on the Company in connection with its August 8, 2021, investigation notification, formally requesting substantially similar information as in its prior request on August 8, 2021.

On November 11, 2021, the Company announced the appointment of Mr. Tony Scott as the Company’s President and Chief Executive Officer, effective November 15, 2021. The Company will be providing additional details regarding this appointment in a current report on Form 8-K on or before November 17, 2021.

Management has evaluated subsequent events through November 12, 2021, the date these condensed consolidated financial statements are issued. No events or transactions other than those already described in these condensed consolidated financial statements have occurred subsequent to the balance sheet date that might require recognition or disclosure in the condensed consolidated financial statements.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward Looking Statements

This Quarterly Report on Form 10-Q, including, without limitation, the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations," contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such forward-looking statements are generally accompanied by words such as "estimate," "expect," "believe," "should," "would," "could," "anticipate," "may" or other words that convey uncertainty of future events or outcomes. 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. Factors that may cause actual results to differ materially from current expectations, which we describe in more detail elsewhere in this Quarterly Report on Form 10-Q, as well as in our 2020 Annual Report on Form 10-K, filed March 9, 2021, in Item 1A "Risk Factors" include, but are not limited to:

- We had a net loss of \$ 6.1 million and \$15.0 million for the three- and nine-month periods ended September 30, 2021, respectively, and at September 30, 2021, we had an accumulated deficit of \$76.3 million. To continue to operate our business as a going concern, we must increase our revenue levels.
- We anticipate that we will not have sufficient cash resources to implement the Company's current business plan and may not be able to raise additional funds through public or private financings, which raises the possibility that the Company may not be able to continue as a going concern.
- We have experienced slower than anticipated results from the marketing, promotion, evaluation, and sales of our new commercial solution, **INTRUSION Shield**, as we continue to develop sales channels to market and sell this new product to not only our existing but also to a new set of prospective customers.
- A large percentage of our current revenues are received from U.S. government entities, and the loss of these customers or our failure to widen the scope of our customer base to include general commercial enterprises could negatively affect our revenues.
- We have experienced recent volatility in the market for our common stock, particularly with respect to significant swings in the market price as well as significant volume in the trading of our common stock.
- We expect to expend considerable time and resources in a search for a new chief executive officer as well as integrating such a successor CEO into our business operations.
- We may experience volatility in our workforce and be unable to attract employees in the future as a result of our recent reduction in force.
- We could experience damage to our reputation in the cybersecurity industry in the event that our **INTRUSION Shield** solution fails to perform as expected, to meet our customers' needs, or to achieve market acceptance.
- A breach of network security could harm public perception of our cybersecurity solutions, which could cause us to lose revenues.
- If we fail to respond to rapid technological changes in the network security industry, we may lose customers, or our solutions may become obsolete.
- Our solutions 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 solutions and services.
- We must adequately protect our intellectual property in order to prevent loss of valuable proprietary information.
- We face intense competition from both start-up and established companies that may have significant advantages over us and our solutions.
- We are currently a plaintiff in class action lawsuits alleging violations of the federal securities laws, which will potentially divert the attention of the Company's management and board or directors, result in significant legal expenditures in the defense of such suit, as well as potential financial liability should the Company be unsuccessful in its defense of these claims.

If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, our actual results may vary significantly from what we projected. These forward-looking statements and other statements made elsewhere in this report are made in reliance on the Private Securities Litigation Reform Act of 1995. Any forward-looking statement you read in this Quarterly Report on Form 10-Q, or our Annual Report on Form 10-K, 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.

Results of Operations

The following table sets forth, for the condensed consolidated statements of operations in dollar amounts and as a percentage of our total revenue for the periods indicated. The period-to-period comparison of results is not necessarily indicative of results for future periods.

(in thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2021	September 30, 2020	September 30, 2021	September 30, 2020
Revenue	\$ 1,819	\$ 1,588	\$ 5,632	\$ 5,039
Cost of revenue	690	652	2,048	2,050
Gross profit	1,129	936	3,584	2,989
Operating expenses:				
Sales and marketing	3,782	885	10,123	1,880
Research and development	1,863	1,081	4,862	2,741
General and administrative	1,592	377	4,261	962
Operating loss	(6,108)	(1,407)	(15,662)	(2,594)
Interest and other income	19	—	87	8
Interest expense	(8)	(2)	(11)	(4)
Gain on the extinguishment of debt	—	—	635	—
Net loss	<u>\$ (6,097)</u>	<u>\$ (1,409)</u>	<u>\$ (14,951)</u>	<u>\$ (2,590)</u>
Preferred stock dividends accrued	—	(13)	—	(79)
Net loss attributable to common stockholders	<u>\$ (6,097)</u>	<u>\$ (1,422)</u>	<u>\$ (14,951)</u>	<u>\$ (2,669)</u>
Net loss per share attributable to common stockholders:				
Basic	<u>\$ (0.34)</u>	<u>\$ (0.10)</u>	<u>\$ (0.85)</u>	<u>\$ (0.19)</u>
Diluted	<u>\$ (0.34)</u>	<u>\$ (0.10)</u>	<u>\$ (0.85)</u>	<u>\$ (0.19)</u>

	Three Months Ended		Nine Months Ended	
	September 30, 2021	September 30, 2020	September 30, 2021	September 30, 2020
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of revenue	37.9%	41.1%	36.4%	40.7%
Gross profit	62.1%	58.9%	63.6%	59.3%
Operating expenses:				
Sales and marketing	207.9%	55.7%	179.7%	37.3%
Research and development	102.4%	68.1%	86.3%	54.4%
General and administrative	87.5%	23.7%	75.7%	19.1%
Operating loss	-335.8%	-88.6%	-278.1%	-51.5%
Interest and other income	1.0%	—	1.5%	0.4%
Interest expense	-0.4%	-0.1%	-0.2%	-0.2%
Gain on the extinguishment of debt	0.0%	—	11.3%	—
Net loss	-335.2%	-88.7%	-265.5%	-51.3%
Preferred stock dividends accrued	0.00%	-0.8%	0.00%	-1.6%
Net loss attributable to common stockholders	-335.2%	-89.5%	-265.5%	-52.9%

	Three Months Ended		Nine Months Ended	
	September 30, 2021	September 30, 2020	September 30, 2021	September 30, 2020
Domestic revenues	100.0%	100.0%	100.0%	100.0%
Export revenues	—	—	—	—
Revenues	100.0%	100.0%	100.0%	100.0%

Revenues. Revenues for the three and nine months ended September 30, 2021, were \$1.8 million and \$5.6 million, respectively, compared to \$1.6 million and \$5.0 million, respectively, for the same periods in 2020. Product revenues increased \$0.2 and \$0.6 million for the three- and nine-month periods ended September 30, 2021, compared to the same periods in 2020. The increases in product revenues were primarily due to revenues from our *Shield* product line which was introduced to the market in the first quarter of 2021 and an increase in *TraceCop* revenues between the periods. *TraceCop* revenues were \$1.5 million and \$4.9 million for the three- and nine-month periods ended September 30, 2021, respectively, compared to \$1.5 million and \$4.7 million for the three- and nine-month periods ended September 30, 2020, respectively. *Shield* revenues were \$0.2 million and \$0.3 million for the three- and nine-month periods ended September 30, 2021. No revenue related to *Shield* was recognized during the same periods in 2020, as *Shield* was introduced in 2021. The increases in revenues during these periods were offset by a de minimis decrease in revenues related to *Savant*.

Concentration of Revenues. Revenues from sales to various U.S. government entities totaled \$1.3 million, or 69.4% of revenues, for the quarter ended September 30, 2021, compared to \$1.5 million, or 92.3% of revenues, for the same period in 2020. Revenues from sales to various U.S. government entities totaled \$3.9 million, or 69.1% of revenues, for the nine months ended September 30, 2021, compared to \$4.3 million, or 84.4% of revenues, for the same period in 2020. Sales to commercial customers totaled \$0.6 million or 30.6% of total revenue for the third quarter of 2021 compared to \$0.1 million or 7.7% of total revenue for the third quarter of 2020. Sales to commercial customers totaled \$1.7 million or 30.9% of total revenue for the nine months ended September 30, 2021, compared to \$0.8 million or 15.6% of total revenue for the nine months period ended September 30, 2020. Although we expect our concentration of revenues to vary among customers in future periods depending upon the timing of certain sales, we anticipate that sales to government customers will continue to account for a significant portion of our revenues in future periods. Sales to the government present risks in addition to those involved in sales to commercial customers which could adversely affect our revenues, including, without limitation, potential disruption to appropriation and spending patterns and the government's reservation of the right to cancel contracts and purchase orders for its convenience. Although we do not anticipate that any of our revenues with government customers will be renegotiated, any cancelled or renegotiated government orders 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 and, historically, cancellations or renegotiated orders by government entities have not resulted in a material adverse effect on our business. One individual commercial customer during the nine months ended September 30, 2021, individually accounted for over 10.0% of total revenues and during the three months ended September 30, 2021, two individual commercial customers accounted for revenues that were individually over 10.0% of total revenues. During the three and nine months ended September 30, 2020, no individual commercial customer accounted for revenues that were over 10.0% of total revenues. The Company's similar product and service offerings are not viewed as individual segments, as its management analyzes the business as a whole and expenses are not allocated to each product offering.

Gross Profit. Gross profit was \$1.1 million or 62.1% of revenues for the quarter ended September 30, 2021, compared to \$0.9 million or 58.9% of revenues for the quarter ended September 30, 2020. Gross profit was \$3.6 million, or 63.6% of revenues for the nine months ended September 30, 2021, compared to \$3.0 million or 59.3% of revenues for the nine months ended September 30, 2020, with the changes mainly due to changes in the *TraceCop/Savant* product mix. Gross profit as a percentage of revenues is impacted by several factors, including shifts in product mix, changes in channel of distributions, revenue volume, pricing strategies, and fluctuations in revenues of integrated third-party products.

Sales and Marketing. Sales and marketing expenses increased to \$3.8 million or 207.9% of revenues for the quarter ended September 30, 2021, compared to \$0.9 million or 55.7% of revenues for the quarter ended September 30, 2020. Sales and marketing expense also increased to \$10.2 million or 179.7% of revenues for the nine months ended September 30, 2021, compared to \$1.9 million or 37.3% of revenues for the nine months ended September 30, 2020. The increase is primarily related to an aggressive ramp up in labor cost, web marketing and other forms of business development advertising costs including \$0.6 million related to a trade show event in anticipation of increased revenues from the sales of our new commercial product. The anticipated revenues from our *INTRUSION Shield* product have been slow to materialize and as a result we determined that these sales costs should be reduced. During the third quarter of 2021, we started implementing certain cost saving measures such as a reduction in force as well as negotiations with certain contractors and vendors to appropriately align our expenses with our revenue trends.

Research and Development. Research and development expenses increased to \$1.9 million or 102.4% of revenues for the quarter ended September 30, 2021, compared to \$1.1 million or 68.1% of revenues for the quarter ended September 30, 2020. Research and development expenses also increased to \$4.9 million or 86.3% of revenues for the nine months ended September 30, 2021, compared to \$2.7 million or 54.4% of revenues for the nine months ended September 30, 2020. The increase in research and development expense was due to increases in direct labor expenses and increases in costs associated with the development and testing of our legacy and *Shield* products. As discussed above, during the third quarter of 2021, we started implementing certain cost saving measures such as a reduction in force as well as negotiations with certain contractors and vendors to appropriately align our expenses with our revenue trends. Research and development costs are expensed in the period in which they are incurred. Research and development expenses may vary in the future; mainly dependent on levels of research and development labor expense charged to direct labor.

General and Administrative. General and administrative expenses increased to \$1.6 million or 87.5% of revenues for the quarter ended September 30, 2021, compared to \$0.4 million or 23.7% of revenues for the quarter ended September 30, 2020. General and administrative expenses also increased to \$4.3 million or 75.7% of revenues for the nine months ended September 30, 2021, compared to \$1.0 million or 19.1% of revenues for the nine months ended September 30, 2020. The increase in general and administrative costs was also related to an aggressive ramp up in general and administrative costs in anticipation of increased revenues from sales of our new *Shield* commercial product which have been slow to materialize. Some of the more significant increases include: Employee related expenses such as direct labor, benefits, recruitment agency fees, officer liability insurance and contract labor costs increased by \$1.1 million and \$3.0 million during the three and nine months ended September 30, 2021, when compared to the same periods in 2020. Legal costs increased by \$0.6 million and \$0.9 million specifically related to non-recurring projects during the three and nine months ended September 30, 2021, when compared to the same periods in 2020. Stock compensation expense decreased by \$60,000 and increased by \$0.5 million during the three and nine months ended September 30, 2021, when compared to the same periods in 2020. The increase during the nine months ended September 30, 2021, was related to options granted to new employees as well as compensation expense recognized during this period, related to the accelerated vesting of stock options granted to certain members of our Board upon retirement during the nine months ended September 30, 2021, when compared to the same period in 2020. The decrease during the three months ended September 30, 2021, was due to increases in new awards granted during the nine month period ended September 30, 2021 that did not exist during the same period in 2020 leading to no expense recognized on these 2021 grants during the three and nine months ended September 30, 2020, offset by a reduction in expense related to the forfeiture of compensation expense as a result of recent employee resignations, terminations and departures that occurred during the third quarter of 2021. The results of the recent employee resignations, terminations and departures during the three months ended September 30, 2021, was a decrease in stock compensation expense of \$0.6 million. For the three and nine months ended September 30, 2021, costs allocated to other departments within the research and development group and the sales and marketing group increased by \$1.1 million and \$2.0 million during the three and nine months ended September 30, 2021, when compared with the same periods in 2020. On July 29, 2021, the Company executed a planned reduction in force resulting in the termination of approximately 20% of its employees across the organization. The reduction in force was part of a larger effort on the Company's part to reduce expenses and overhead as a result of the challenges the Company anticipates in meeting its liquidity and cash-flow needs in the near term, as a result of lower-than-expected 2021 revenues from its newly introduced *INTRUSION Shield* service offering.

Interest Expense. Interest expense increased to \$8,000 or 0.4% of revenues for the quarter ended September 30, 2021, compared to \$2,000 or 0.1% of revenues for the same period in 2020. Interest expense increased to \$10,000 or 0.2% of revenues for the nine months ended September 30, 2021, compared to \$4,000 or 0.1% of revenues for the same period in 2020. Our interest expense consists primarily of interest related to finance leases and in 2020 interest specifically related to the SBA PPP Loan entered in April of 2020. During 2021, we entered multiple finance lease arrangement in the amount of \$1.8 million. \$1.5 million of which related to new server systems replacing our old and outdated sever systems and \$0.3 million related to equipment necessarily for our *Shield* commercial product. The PPP Loan along with accrued interest amounts was forgiven in April 2021 and a gain in the extinguishment of debt was recognized on the condensed consolidated statement of operations. The primarily increase in Interest Expense for the periods mentioned above is related to the increase in finance leases between the periods and the extinguishment of the PPP Loan. Interest expense will vary in the future based on our cash flow and borrowing needs.

Interest and other Income. Interest and other income were \$19,000 and \$87,000 for the three and nine months ended September 30, 2021, respectively, compared to \$0 and \$8,000 for the three and nine months ended September 30, 2020, respectively.

Gain on the extinguishment of debt. Gain and extinguishment of debt increased \$0.6 million for the nine months ended September 30, 2021, compared to no gains or losses on the extinguishment of debt incurred for the nine months ended September 30, 2021. This increase was primarily related to the forgiveness of our SBA PPP Loan principal and accrued interest balance of \$0.6 million entered in April 2020 and forgiven in April 2021. There were no gains or losses on the extinguishment of debt incurred for the three months ended September 30, 2021 and 2020.

Liquidity and Capital Resources

Sources of Liquidity

As of September 30, 2021, we had cash and cash equivalents of \$7.2 million, down from approximately \$16.7 million as of December 31, 2020, and working capital of \$4.9 million compared to \$16.2 million as of December 31, 2020. Our primary source of cash for funding operations and growth had been through cash flows generated from operating activities together with the approximately \$18.0 million in net proceeds received from our secondary public offering in 2020 and approximately \$4.8 million in net proceeds received from our at-the-market program in 2021.

Our current cash position combined with increased expenses primarily related with management's accelerated increase in staffing our sales and administrative resources together with decreased revenue expectations related to our **INTRUSION Shield** offering has created significant concerns about our ability to meet our current and short-term cash-flow and liquidity needs, over the next 12 months. In recognition of this determination, we have been actively considering strategic alternatives for the funding and implementation of our long-term business plan. For example, we have engaged B. Riley Securities, Inc. to act as sales agent under our at-the-market program, which allows us to potentially sell up to \$50.0 million of our common stock on a delayed or continuous basis through the use of a shelf-registration statement on Form S-3, which we initially filed on August 5, 2021. The shelf registration became effective on August 16, 2021. As of September 30, 2021, we received proceeds of approximately \$4.8 million net of fees from the sale of our common stock related to this program.

In order to finance our operations and to continue as a going concern, we believe it will be necessary for us to raise additional funds through public or private financings, including through the utilization of our at-the-market program. While we can provide no assurances that we will be able to raise additional funds through any future equity or debt financings, the terms of those financings, if available at all, may be on terms, which are not favorable to us and, in the case of equity financings, will result in dilution to our stockholders.

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.

Condensed Consolidated Statements of Cash Flows

Our cash flows for the nine months ended September 30, 2021 and 2020 were:

	Nine Months Ended	
	September 30, 2021	September 30, 2020
Net cash used in operating activities	\$ (12,775)	\$ (2,367)
Net cash used in investing activities	(1,132)	(153)
Net cash provided by financing activities	4,356	691
Change in cash and cash equivalents	<u>\$ (9,551)</u>	<u>\$ (1,829)</u>

Operating Activities

For the nine months ended September 30, 2021, net cash used in operating activities was \$12.8 million, as a result of net loss of \$15.0 million, adjusted for non-cash charges of \$1.1 million and net cash inflow of \$1.1 million from changes in operating assets and liabilities. Non-cash charges primarily consisted of \$0.5 million in depreciation and amortization, \$1.1 million in stock-based compensation, and \$0.1 million in other operating activities, partially offset by \$0.6 million in gain on the extinguishment of debt. The net cash inflow from changes in operating assets and liabilities was primarily due to (i) a \$0.1 million decrease in accounts receivable which is primarily caused by timing in receipt of receivables from our customers, (ii) a \$0.2 million increase in prepaid expenses and other assets specifically related to the renewal of our D&O insurance policy, partially offset by (iii) a \$0.6 million increase in deferred revenue primarily due to increases in deferred revenue balances resulting from certain customers shifting to making upfront payment for our services for their contract term of one year and an increased customer based related to our **INTRUSION Shield** product, and (iv) a \$0.6 million increase in other liabilities primarily due to an aggressive ramp up in expenses in anticipation of revenues from our **INTRUSION Shield** product.

For the nine months ended September 30, 2020, net cash used in operating activities was \$2.4 million, as a result of net loss of \$2.6 million, adjusted for non-cash charges of \$0.5 million, and net cash outflow of \$0.3 million from changes in operating assets and liabilities. Non-cash charges primarily consisted of \$0.2 million in depreciation and amortization, \$0.2 million in stock-based compensation and \$0.1 million in other operating activities. The net cash outflow from changes in operating assets and liabilities was primarily due to (i) a \$0.5 million decrease in accounts receivable which was primarily due to the timing in receipt of receivables from our customers, partially offset by (ii) \$0.4 million decrease in deferred revenue primarily due to shorter term upfront fee payments received from our customers, (iii) \$0.5 million increase in prepaids and other assets primarily driven by increases in prepaid software and insurance costs and in the right of use assets recorded primarily due to leases and (iv) a \$0.1 million increase in other liabilities due to the beginning of the ramp up in expenses in anticipation of the launch of our **INTRUSION Shield** product.

Investing Activities

For the nine months ended September 30, 2021, net cash used in investing activities was \$1.1 million, which was primarily the result of additions to property and equipment specifically related to \$0.4 million related to hardware utilized to administer our **INTRUSION Shield** product, \$0.3 million of hardware and software equipment utilized in our data center, \$0.1 million of in-house software and computer systems for employees, \$0.2 million of AI related computer systems and \$0.1 million related to website design and intangible assets – domain name (“www.Cyberwarfare.com”).

For the nine months ended September 30, 2020, net cash used in investing activities was \$0.2 million, which was primarily the result of additions to property and equipment.

Financing Activities

For the nine months ended September 30, 2021, net cash provided by financing activities was \$4.4 million, which was primarily the result of net proceeds from our at-the-market program public offering of \$4.8 million, exercise of stock options of \$0.2 million offset by payment on principal of finance right-of-use leases of \$0.6 million.

For the nine months ended September 30, 2020, net cash provided by financing activities was \$0.7 million, which was primarily the result of proceeds of \$0.6 million from an SBA PPP loan, proceeds from exercise of stock options of \$0.2 million, partially offset by the payments for preferred stock dividends of \$0.1 million and payment on principal of finance right-of-use leases of \$32,000.

Contractual Obligations and Commitments

As of September 30, 2021, we have future contractual obligations under our leases. The following table sets forth certain information concerning these obligations:

Future minimum lease obligations consisted of the following as of September 30, 2021 (in thousands):

	Operating ROU Leases	Finance ROU Leases	Total
Remaining 2021	\$ 410	\$ 8	\$ 418
2022	704	618	1,322
2023	705	618	1,323
2024	486	9	495
2025	115	1	116
Thereafter	—	—	—
	<u>\$ 2,420</u>	<u>\$ 1,254</u>	<u>\$ 3,674</u>
Less Interest*	(148)	(52)	
	<u>\$ 2,272</u>	<u>\$ 1,202</u>	

*Interest is imputed for operating ROU leases and classified as lease expense and is included in operating expenses in the accompanying condensed consolidated statement of operations.

Off-Balance Sheet Arrangements

As of September 30, 2021, we did not have any significant off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K.

Critical Accounting Policies and Use of Estimates

Our condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. We evaluate our estimates and assumptions on an ongoing basis. Actual results may differ from these estimates. To the extent that there are material differences between these estimates and our actual results, our future financial statements will be affected.

We believe the critical accounting policies and estimates discussed under “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in our Annual Report of Form 10-K for the year ended December 31, 2020, filed with the SEC on March 9, 2021, pursuant to Rule 424(b) under the Securities Act, reflect our more significant judgments and estimates used in the preparation of the condensed consolidated financial statements. There have been no significant changes to our critical accounting policies and estimates as filed in such report.

Item 4. CONTROLS AND PROCEDURES

We maintain “disclosure controls and procedures,” as defined in Rule 13a-15(e) under the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable assurance of achieving the desired control objectives, and we must apply our reasonable judgment in evaluating the cost-benefit relationship of potential disclosure controls and procedures. We implemented certain changes to our disclosure controls during the quarter ended September 30, 2021, in response to our management’s determination at June 30, 2021, that our disclosure controls were not effective. These changes included the formation of a disclosure committee and a newly adopted disclosure control policy.

As of September 30, 2021, our management, including our principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures and concluded that the disclosure controls and procedures were effective.

There have not been any changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2021, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

On February 16, 2021, Intrusion Inc. instituted legal proceedings in the District Court of Dallas County, Texas, 14th Judicial District against Purple Plaza LLC, the landlord for the facilities we previously occupied in Richardson, Texas. This lawsuit claims damages for breach of contract for, among other things, failure to maintain and repair the leased facilities and to provide adequate heating, air conditioning and ventilation on the premises, resulting in a constructive eviction. Intrusion is seeking damages in excess of \$1,000,000 together with a declaratory judgment that any of Intrusion's remaining obligations under the lease have terminated. Purple Plaza, LLC has answered by filing a general denial, and recently added a counterclaim seeking alleged past due rent in the amount of approximately \$229,000 and future rent allegedly exceeding \$2.0 million without offsetting its duty to mitigate its damages. Discovery is underway in the matter. The case is set for jury trial on February 15, 2022.

On April 16, 2021, a purported class action lawsuit was filed in the United States District Court, Eastern District of Texas, Sherman Division, captioned Celeste v. Intrusion Inc. et al., Case No. 4:21-cv-00307 (E.D.Tex) against the Company, the Company's chief financial officer, and former chief executive officer alleging, among other things, that the defendants made false and/or misleading statements or omissions about the Company's business, operations, and prospects in violation of Section 10(b) of The Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Rule 10b-5 promulgated thereunder, as well as Section 20(a) of the Exchange Act. The Celeste lawsuit claims compensatory damages and legal fees.

On May 14, 2021, a related purported class action lawsuit was filed in the United States District Court, Eastern District of Texas, Sherman Division, captioned Neely v. Intrusion Inc., et al., Case No. 4:12-cv-00374 (E.D. Tex.) against the Company, the Company's chief financial officer, and former chief executive officer. The Neely lawsuit alleges the same violations under the federal securities laws as those alleged in the Celeste lawsuit. The Neely lawsuit also seeks compensatory damages and legal fees. A motion to consolidate the two lawsuits and appoint a lead plaintiff is pending before the court. The Company believes the claims in the lawsuits are without merit and intends to defend itself vigorously.

On August 8, 2021, the Company received a notification from the Securities and Exchange Commission, Division of Enforcement, that it was conducting an investigation captioned In the Matter of Intrusion Inc. and requesting the Company produce certain documents and information. On November 9, 2021, the Securities and Exchange Commission served a subpoena on the Company in connection with this investigation which formally requested substantially similar information as in the prior request. The Company is continuing to comply with the requests and is cooperating in the investigation. The Company can offer no assurances as to the outcome of this investigation or its potential effect on the Company or its results of operations.

In addition to this pending litigation, we are subject to various other legal proceedings and claims that may 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 our future results.

Item 1A. RISK FACTORS

Factors That May Affect Future Results of Operations

We are providing the following information regarding changes that have occurred to previously disclosed risk factors from our Annual Report on Form 10-K for the year ended December 31, 2020. In addition to the other information set forth below and elsewhere in this report, you should consider the factors discussed under the heading "Risk Factors" in our Form 10-K for the year ended December 31, 2020, filed on March 9, 2021. The risks described in our Annual Report on Form 10-K and our Quarterly Reports on Form 10-Q are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

We may not have sufficient cash resources to implement the Company's current business plan and may not be able to raise additional funds through public or private financings, which raises the possibility that the Company may not be able to continue as a going concern.

Our current cash position combined with increased expenses primarily related with management's accelerated increase in staffing our sales and administrative resources together and the decreased revenue expectations related to our **INTRUSION Shield** offering has created significant concerns about our ability to meet our current and short-term cash-flow and liquidity needs, over the next 12 months. In recognition of this determination, we have been actively considering strategic alternatives for the funding and implementation of our long-term business plan. For example, we have engaged B. Riley Securities, Inc. to act as sales agent under our at-the-market program, which allows us to potentially sell up to \$50.0 million of our common stock on a delayed or continuous basis through the use of a shelf-registration statement on Form S-3, which we initially filed on August 5, 2021. The shelf registration became effective on August 16, 2021. As of September 30, 2021, we received proceeds of approximately \$4.8 million net of fees from the sale of our common stock related to this program.

In order to finance our operations and to continue as a going concern, we believe it will be necessary for us to raise additional funds through public or private financings, including through the utilization of our at-the-market program. While we can provide no assurances that we will be able to raise additional funds through any future equity or debt financings, the terms of those financings, if available at all, may be on terms, which are not favorable to us and, in the case of equity financings, will result in dilution to our stockholders.

We had a net loss of \$6.1 million and \$15.0 million for the three- and nine-month periods ended September 30, 2021, respectively, and we had an accumulated deficit of \$76.3 million as of September 30, 2021. To improve our financial performance, we must increase our revenue levels.

For the three- and nine-month periods ended September 30, 2021, we had a net loss of \$6.1 million and \$15.0 million, respectively, and had an accumulated deficit of approximately \$76.3 million as of September 30, 2021, compared to net losses of \$1.4 million and \$2.6 million for the three- and nine-month periods ended September 30, 2020, respectively, and an accumulated deficit of approximately \$61.3 million as of December 31, 2020. We need to increase current revenue levels from the sales of our solutions if we are to regain profitability. If we are unable to increase our revenue levels, losses could continue for the near term and possibly longer, and we may not achieve profitability or generate positive cash flow from operations in the future.

Most of our current revenues are generated from one family of solutions with a limited number of customers, and the decrease of revenue from sales of this family of solutions could materially harm our business and prospects. Timeliness of orders from customers may cause volatility in growth.

Approximately 88% of our existing revenues result from sales of **TraceCop** a cybersecurity solution. **TraceCop** revenues were \$1.5 million and \$4.9 million for the three- and nine-month periods ended September 30, 2021, respectively, compared to \$1.5 million and \$4.7 million for the same periods in 2020. While we anticipate the continued introduction of our new **INTRUSION Shield** solution will reduce our dependence on this single solution, we can offer no assurances as such, and in the absence of a shift in solution mix, we may continue to face risks in the event that sales of this key solution to these limited customers were to decrease.

Item 6. EXHIBITS

The following Exhibits are filed with this report form 10-Q:

- 3.1 [Restated Certificate of Incorporation](#) (incorporated by reference to Exhibit 3.1 of the Registrant's Form 8-K filed on June 15, 2010)
- 3.2 [Corporate Bylaws](#) (incorporated by reference to Exhibit 3.2 of the Registrant's Form 10-K filed on March 21, 2001)
- 10.1 [Intrusion Inc. 2021 Omnibus Incentive Plan](#) (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on May 24, 2021)
- 10.2 [Form of Incentive Stock Option Award Agreement to the Intrusion Inc. 2021 Omnibus Incentive Plan](#)
- 31.1 [Certification of Chief Executive Officer Pursuant to Rule 13a-14\(a\) of the Exchange Act.](#)
- 31.2 [Certification of Chief Financial Officer Pursuant to Rule 13a-14\(a\) of the Exchange Act.](#)
- 32.1 [Certification 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 Inline XBRL Instance Document (the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document)
- 101.SCH Inline XBRL Taxonomy Extension Schema Document
- 101.CAL Inline XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF Inline XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB Inline XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE Inline XBRL Taxonomy Extension Presentation Linkbase Document
- 104 Cover Page Interactive Data File (formatted in IXBRL, and included in exhibit 101).

SIGNATURES

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

INTRUSION INC.

Date: November 12, 2021

/s/ Anthony J. LeVecchio

Anthony J LeVecchio

Executive Chairman of the Board
(Principal Executive Officer)

Date: November 12, 2021

/s/ B. Franklin Byrd

Franklin Byrd

Chief Financial Officer,
(Principal Financial & Accounting Officer)

INTRUSION, INC.
2021 OMNIBUS INCENTIVE PLAN INCENTIVE STOCK OPTION NOTICE

Participant has been granted an Incentive Stock Option in accordance with the terms set forth in this Option Notice, and subject to the terms and conditions of the Plan and the Incentive Stock Option Agreement to which this Option Notice is attached. Capitalized terms used and not defined in this Option Notice will have the meanings set forth in the Incentive Stock Option Agreement and the Plan.

Participant Name	Number of Shares Subject to Option	Exercise Price per Share	Vesting Schedule % vest on each of the first () anniversary of the Date of Grant	Date of Grant

Vesting of the Option as specified in the chart above is subject to Participant’s continued employment or service through the applicable vesting date. If the number of Shares is not evenly divisible by [], then no fractional Share will vest, and the installments will be as equal as possible with the smaller installment(s) vesting first. Each such right of purchase will be cumulative and will continue, unless sooner exercised or terminated during the remaining period of the Option Period.

INTRUSION, INC.
2021 OMNIBUS INCENTIVE PLAN

INCENTIVE STOCK OPTION AGREEMENT

THIS INCENTIVE STOCK OPTION AGREEMENT ("Agreement"), effective as of the Date of Grant (as defined in the Award Notice), is between INTRUSION INC., a Delaware corporation (together with its successors and assigns, the "Company"), and the individual listed in the Award Notice as the Participant. Capitalized terms have the meaning set forth in Section 1, or, if not otherwise defined herein, in the INTRUSION INC. 2021 OMNIBUS INCENTIVE PLAN (as it may be amended, the "Plan").

WHEREAS, the Company has adopted the Plan to provide incentive to certain employees; and

WHEREAS, the Committee has determined to grant to the Participant an Incentive Stock Option to encourage the Participant's efforts toward the continuing success of the Company.

NOW, THEREFORE, the parties agree as follows:

1. Definitions. The following terms have the following meanings for purposes of this Agreement:

- (a) "Award Notice" means the notice pursuant to which Participant was granted the Option.
- (b) "Exercise Price" means the Exercise Price listed in the Award Notice.
- (c) "Officer" means "officer" as defined under Rule 16a-1(f) of the Exchange Act.
- (d) "Participant" means the Participant listed in the Award Notice.
- (e) "Shares" means the number of shares of Common Stock listed in the Award Notice as "Number of Shares Subject to Option", as adjusted in accordance with the Plan.

2. Grant of Option.

(a) Effective as of the Date of Grant, the Company irrevocably grants to Participant the right and option (the "Option") to purchase all or any part of the Shares, subject to and in accordance with the terms, conditions and restrictions set forth in the Plan, the Award Notice, and this Agreement. The Option will vest in accordance with the schedule set forth on the Award Notice.

(b) The Option referred qualifies as an Incentive Stock Option within the meaning of Section 422 of the Code. To the extent that the Option or any portion thereof is designated as an Incentive Stock Option and such Option does not qualify as an Incentive Stock Option, the Option or portion thereof shall be treated as a nonqualified stock option.

(c) To the extent that this Option is designated as an Incentive Stock Option, if Shares acquired upon exercise of the Option are disposed of within two years following the date of grant or one year following the transfer of such Shares to the Participant upon exercise, the Participant shall, promptly following such disposition, notify the Company in writing of the date and terms of such disposition and provide such other information regarding the disposition as the Administrator may reasonably require.

(d) In no event shall there first become exercisable by the Participant in any one calendar year Incentive Stock Options granted by the Company or any Parent or Subsidiary with respect to Shares having an aggregate Fair Market Value (determined at the time an Incentive Stock Option is granted) greater than \$100,000. To the extent that any Incentive Stock Options are first exercisable by the Participant in excess of such limitation, the excess shall be considered a nonqualified stock option.

(e) This Agreement will be construed in accordance and consistent with, and subject to, the terms of the Plan (the provisions of which are incorporated by reference). In the event of any conflict between one or more of this Agreement, the Award Notice and the Plan, the Plan will govern this Agreement and the Award Notice, and this Agreement (to the extent not in conflict with the Plan) will govern the Award Notice.

3. Exercise Price. The price at which Participant will be entitled to purchase the Shares upon the exercise of the Option will be the Exercise Price per Share, subject to adjustment as provided in Section 4 and Section 11 of the Plan.

4. Exercisability of Option. The Option will become vested and exercisable in accordance with the schedule set forth on the Award Notice.

5. Duration of Option. The Option will be exercisable to the extent and in the manner provided in this Agreement for a period of ten (10) years from the Date of Grant (the “Option Period”); provided, that the Option may be earlier terminated as provided in Section 7.

6. Manner of Exercise and Payment.

(a) Subject to the terms and conditions of this Agreement and the Plan, the Option may be exercised by delivery of written or electronic notice to the Company in the manner prescribed in Section 6(d) of the Plan and as otherwise set forth by the Committee from time to time, including the payment provisions set forth in Section 6(d)(iv) of the Plan. Such notice will set forth the number of Shares in respect of which the Option is being exercised and will be signed by the person or persons exercising the Option. In the event the Company has designated an Award Administrator (as defined below), the Option may also be exercised by giving notice (including through electronic means) in accordance with the procedures established from time to time by the Award Administrator. Any exercisable portion of the Option or the entire Option, if then wholly exercisable, may be exercised in whole or in part, provided that partial exercise will be for whole Shares only.

(b) Upon exercise of the Option pursuant to Section 6(a), unless otherwise determined by the Committee, the Company will withhold a number of Shares otherwise deliverable to Participant to pay (i) the full purchase price for the Shares in respect of which the Option is being exercised and (ii) an amount necessary to satisfy applicable U.S. and non-U.S. Federal, state or local tax or other withholding requirements, if any (“Withholding Taxes”) in accordance with Section 14(d) of the Plan (or, if Participant is subject to Section 16 of the Exchange Act at such time, such amount which would not result in adverse consequences under GAAP), unless otherwise agreed to in writing by Participant and the Company. The number of Shares to be withheld or otherwise used for payment will be calculated using the closing price per Share on the principal exchange on which the Shares then trade) on the date of determination, and will be rounded up to the nearest whole Share.

(c) Upon receipt of the notice of exercise and any payment or other documentation as may be necessary pursuant to Sections 6(a) and 6(b) relating to the Shares in respect of which the Option is being exercised, the Company will, subject to the Plan and this Agreement, take such action as may be necessary to effect the transfer to Participant of the number of Shares as to which such exercise was effective.

(d) Participant will not be deemed to be the holder of, or to have any of the rights and privileges of a stockholder of the Company (including the right to vote or receive dividends) in respect of, Shares purchased upon exercise of the Option until (i) the Option has been exercised pursuant to the terms of this Agreement and Participant has paid the full purchase price for the number of Shares in respect of which the Option was exercised and any applicable Withholding Taxes and (ii) the Company has issued the Shares in connection with such exercise. Notwithstanding the foregoing, unless otherwise determined by the Committee, Participant may otherwise elect to make all or a portion of such payments in cash, check, cash equivalent, and/or Shares, or as provided in Section 14(d) of the Plan.

7. Termination of Employment or Service.

(a) Except as provided below in this section, if a Participant incurs a Termination for any reason, any unvested portion of the Option will be forfeited and all of Participant’s rights under this Agreement will terminate as of the effective date of Termination (the “Termination Date”) (unless otherwise provided for by the Committee in accordance with the Plan).

(b) If a Participant's Termination is voluntary (other than a voluntary termination described in Section 7(d) below, all Stock Options that are held by such Participant that are vested and exercisable at the time of the Participant's Termination may be exercised by the Participant at any time within a period of 90 days from the date of such Termination, but in no event beyond the expiration of the stated term of such Stock Options.

(c) If a Participant's Termination is by reason of death or Disability, all Stock Options that are held by such Participant that are vested and exercisable at the time of the Participant's Termination may be exercised by the Participant (or in the case of the Participant's death, by the legal representative of the Participant's estate) at any time within a period of one year from the date of such Termination, but in no event beyond the expiration of the stated term of such Stock Options; provided, however, that, in the event of a Participant's Termination by reason of Disability, if the Participant dies within such exercise period, all unexercised Stock Options held by such Participant shall be exercisable, to the extent to which they were exercisable at the time of death, for a period of one year from the date of such death, but in no event beyond the expiration of the stated term of such Stock Options.

(d) If a Participant's Termination is for Cause or is a voluntary termination after the occurrence of an event that would be grounds for a Termination for Cause, the vested and unvested portions of the Option will terminate as of the Termination Date.

(e) A Participant's rights with respect to the Option will not be affected by any change in the nature of Participant's employment or service so long as Participant continues to be an employee or service provider of the Company or its Affiliates. Whether (and the circumstances under which) employment or service has terminated and the determination of the Termination Date for the purposes of this Agreement will be determined by the Committee (or, with respect to any Participant who is not a director or Officer, its designee, whose good faith determination will be final, binding and conclusive; provided, that such designee may not make any such determination with respect to the designee's own employment or service for purposes of the Option).

8. Restrictions on Transfer. To the extent that this Option is designated as an Incentive Stock Option, the Option shall not be transferable (including by sale, assignment, pledge or hypothecation) other than transfers by will or the laws or intestate succession, or, in the Administrator's discretion, such transfers as may otherwise be permitted in accordance with Treasury Regulation Section 1.421-1(b)(2) or Treasury Regulation Section 1.421-2(c) or any successor provisions thereto. To the extent that this Option is treated as a nonqualified stock option, Participant may not assign, alienate, pledge, attach, sell or otherwise transfer or encumber the Option or Participant's right under the Option to receive Shares, other than to Permitted Transferees as may be permitted by the Committee from time to time in accordance with applicable laws and Section 14(e) of the Plan. Except as otherwise provided herein, no assignment or transfer of the Option, or of the rights represented thereby, whether voluntary or involuntary, by operation of law or otherwise, shall vest in the assignee or transferee any interest or right herein whatsoever, but immediately upon such assignment or transfer the Option shall terminate and become of no further effect.

9. Repayment of Proceeds; Clawback Policy. The award granted in this Agreement and all proceeds related to the award are subject to the clawback and repayment terms set forth in Section 14(t) of the Plan and the Company's clawback policy, as in effect from time to time, to the extent Participant is a director or Officer.

10. No Right to Continued Employment or Engagement. Neither the Plan nor this Agreement nor Participant's receipt of the award hereunder will impose any obligation on the Company to continue the employment or engagement of Participant. Further, the Company may at any time terminate the employment or engagement of Participant, free from any liability or claim under the Plan or this Agreement, except as otherwise expressly provided herein.

11. Award Subject to Plan. The award granted under this Agreement is subject to the Plan and the terms of the Plan are incorporated into this Agreement. By accepting the award, Participant acknowledges that Participant has received and read the Plan and agrees to be bound by the terms, conditions, and restrictions set forth in the Plan, this Agreement, and the Company's policies, as in effect from time to time, relating to the Plan. In the event of a conflict between any term or provision contained herein and a term or provision of the Plan, the applicable terms and provisions of the Plan will govern and prevail.

12. Severability. Should any provision of this Agreement be held by a court of competent jurisdiction to be unenforceable or invalid for any reason, the remaining provisions of this Agreement will not be affected by such holding and will continue in full force in accordance with their terms.

13. Governing Law; Venue; Language. This Agreement will be governed by and construed in accordance with the internal laws of the State of Delaware applicable to contracts made and performed wholly within the State of Delaware, without giving effect to the conflict of laws provisions thereof. Any suit, action or proceeding with respect to this Agreement (or any provision incorporated by reference), or any judgment entered by any court in respect of any thereof, will be brought in any court of competent jurisdiction in the State of Delaware or the State of Texas, and each of Participant, the Company, and any Permitted Transferees who hold a portion of the award pursuant to a valid assignment, hereby submits to the exclusive jurisdiction of such courts for the purpose of any such suit, action, proceeding, or judgment. Each of Participant, the Company, and any Permitted Transferees who hold a portion of the award pursuant to a valid assignment hereby irrevocably waives (a) any objections which it may now or hereafter have to the laying of the venue of any suit, action, or proceeding arising out of or relating to this Agreement brought in any court of competent jurisdiction in the State of Delaware or the State of Texas, (b) any claim that any such suit, action, or proceeding brought in any such court has been brought in any inconvenient forum and (c) any right to a jury trial. If Participant has received a copy of this Agreement (or the Plan or any other document related hereto or thereto) translated into a language other than English, such translated copy is qualified in its entirety by reference to the English version thereof, and in the event of any conflict the English version will govern. Participant acknowledges that Participant is sufficiently proficient in English to understand the terms and conditions of this Agreement.

14. Successors in Interest. This Agreement shall inure to the benefit of and be binding upon any successor to the Company. This Agreement shall inure to the benefit of the Participant's legal representatives. All obligations imposed upon the Participant and all rights granted to the Company under this Agreement shall be binding upon the Participant's heirs, executors, administrators and successors.

15. Data Privacy Acknowledgement.

(a) General. Participant acknowledges and agrees to the collection, use and transfer, in electronic or other form, of Participant's personal data as described in this Agreement and any other award materials by and among, as applicable, Participant's employer or contracting party (the "Employer") and the Company for the exclusive purpose of implementing, administering and managing Participant's participation in the Plan. Participant understands that the Company may hold certain personal information about Participant, including, but not limited to, Participant's name, home address, email address and telephone number, work location and phone number, date of birth, social insurance number, passport or other identification number, salary, nationality, job title, hire date, any shares of stock or directorships held in the Company, details of all awards or any other entitlement to shares awarded, cancelled, exercised, vested, unvested or outstanding in Participant's favor, for the purpose of implementing, administering and managing Participant's participation in the Plan ("Personal Data").

(b) Use of Personal Data; Retention. Participant understands that Personal Data may be transferred to any third parties assisting in the implementation, administration and management of the Plan, now or in the future, that these recipients may be located in Participant's country or elsewhere, and that a recipient's country may have different data privacy laws and protections than Participant's country. Participant understands that Participant may request a list with the names and addresses of any potential recipients of the Personal Data by contacting Participant's local human resources representative. Participant authorizes the recipients to receive, possess, use, retain and transfer the Personal Data, in electronic or other form, for the purposes of implementing, administering and managing Participant's participation in the Plan. Participant understands that Personal Data will be held only as long as is necessary to implement, administer and manage Participant's participation in the Plan. Participant understands that Participant may, at any time, view Personal Data, request additional information about the storage and processing of Personal Data, require any necessary amendments to Personal Data or refuse or withdraw the consents herein, in any case without cost, by contacting in writing Participant's local human resources representative.

(c) Withdrawal of Consent. Participant understands that Participant is providing the consents herein on a purely voluntary basis. If Participant does not consent, or if Participant later seeks to revoke Participant's consent, Participant's employment status or service with the Employer will not be affected; the only consequence of Participant's refusing or withdrawing Participant's consent is that the Company would not be able to grant options or other equity awards to Participant or administer or maintain such awards. Therefore, Participant understands that refusing or withdrawing Participant's consent may affect Participant's ability to participate in the Plan. For more information on the consequences of Participant's refusal to consent or withdrawal of consent, Participant understands that Participant may contact Participant's local human resources representative.

16. Limitation on Rights; No Right to Future Grants; Extraordinary Item of Compensation. By accepting this Agreement and the grant of the award evidenced hereby, Participant expressly acknowledges that (a) the Plan is established voluntarily by the Company, it is discretionary in nature and may be suspended or terminated by the Company at any time to the extent permitted by the Plan; (b) the grant of the award is exceptional, voluntary and occasional and it does not create any contractual or other right to receive future grants of awards, or benefits; (c) all determinations with respect to future award grants, if any, will be at the sole discretion of the Company; (d) Participant's participation in the Plan is voluntary and not a condition of employment or service, and Participant may decline to accept the award without adverse consequences to Participant's continued employment or service relationship with the Company or its Affiliates; (e) the value of the award is an extraordinary item that is outside the scope of Participant's employment or service contract, if any, and nothing can or must automatically be inferred from such employment or service contract or its consequences; (f) awards and any shares acquired under the Plan, and the income from and value of same, are not part of normal or expected compensation for any purpose and are not to be used for calculating any severance, resignation, redundancy, end of service payments, bonuses, long-service awards, pension or retirement benefits or similar payments, Participant waives any claim on such basis and, for the avoidance of doubt, the award will not constitute an "acquired right" under the applicable law of any jurisdiction; (g) the future value of the underlying shares is unknown and cannot be predicted with certainty. In addition, Participant understands, acknowledges and agrees that Participant will have no rights to compensation or damages related to award proceeds in consequence of Participant's Termination for any reason whatsoever and whether or not in breach of contract.

17. Award Administrator. The Company may from time to time designate a third party (an "Award Administrator") to assist the Company in the implementation, administration and management of the Plan and any awards granted thereunder, including by sending award notices on behalf of the Company to Participants, and by facilitating through electronic means acceptance of Agreement by Participants and Option exercises by Participants.

18. Book Entry Delivery of Shares. Whenever reference in this Agreement is made to the issuance or delivery of certificates representing one or more shares, the Company may elect to issue or deliver such shares in book entry form in lieu of certificates.

19. Electronic Delivery and Acceptance. This Agreement may be executed electronically and in counterparts. The Company may, in its sole discretion, decide to deliver any documents related to the Plan by electronic means. Participant consents to receive such documents by electronic delivery and agrees to participate in the Plan through an on-line or electronic system established and maintained by the Company or a third party designated by the Company.

20. Acceptance and Agreement by Participant; Forfeiture upon Failure to Accept. Participant's rights under the award will lapse ninety (90) days from the Date of Grant, and the award will be forfeited on such date if Participant will not have accepted this Agreement by such date. For the avoidance of doubt, Participant's failure to accept this Agreement will not affect Participant's continuing obligations under any other agreement between the Company and Participant.

21. Modification of Agreement. This Agreement may be modified, amended, suspended or terminated, and any terms or conditions may be waived, but only by a written instrument executed by the parties to this Agreement.

22. No Advice Regarding Grant. Notwithstanding anything herein to the contrary, Participant acknowledges and agrees that the Company is not providing any tax, legal or financial advice, nor is the Company making any recommendations regarding Participant's participation in the Plan, or Participant's acquisition or sale of the underlying shares. Participant is advised to consult with Participant's own personal tax, legal and financial advisors regarding Participant's participation in the Plan before taking any action related to the Plan.

23. Imposition of Other Requirements. The Company reserves the right to impose other requirements on Participant's participation in the Plan, on the award and on any shares acquired under the Plan, to the extent the Company determines it is necessary or advisable for legal or administrative reasons, and to require Participant to sign any additional agreements or undertakings that may be necessary to accomplish the foregoing.

24. Waiver. Participant acknowledges that a waiver by the Company of breach of any provision of this Agreement will not operate or be construed as a waiver of any other provision of this Agreement, or of any subsequent breach by Participant or any other participant in the Plan.

25. Notices. Any notice necessary under this Agreement shall be addressed to the Company in care of its Corporate Secretary at the principal executive office of the Company and to Participant at the address appearing in the personnel records of the Company for such Participant or to either party at such other address as either party hereto may hereafter designate in writing to the other. Any such notice shall be deemed effective upon receipt thereof by the addressee.

26. Resolution of Disputes. Any dispute or disagreement which may arise under, or as a result of, or in any way relate to, the interpretation, construction or application of this Agreement shall be determined by the Committee. Any determination made under this Agreement shall be final, binding and conclusive on the Participant, the Participant's heirs, executors, administrators and successors, and the Company and its Affiliates for all purposes.

27. Entire Agreement. This Agreement and the terms and conditions of the Plan constitute the entire understanding between the Participant and the Company and its Affiliates, and supersede all other agreements, whether written or oral, with respect to the Award.

28. Headings. The headings of this Agreement are inserted for convenience only and do not constitute a part of this Agreement.

29. Counterparts. This Agreement may be executed simultaneously in two or more counterparts, each of which shall constitute an original, but all of which taken together shall constitute one and the same agreement.

30. Stockholder Approval. The effectiveness of this Agreement and of the grant of the Award pursuant the Agreement is subject to the approval of the Plan by the stockholders of the Company in accordance with the terms of the Plan.

[Signature Page Follows]

Acknowledged and Agreed to as of the date first written above:

INTRUSION, INC.

Name: _____

Title: _____

PARTICIPANT

Name: _____

APPENDIX A

[Spreadsheet setting forth Participant's Performance Criteria]

I, Anthony J. LeVecchio, Principal Executive Officer of Intrusion Inc., certify that:

- (1) I have reviewed this quarterly report on Form 10-Q of Intrusion Inc.;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- (4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- (5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2021

/s/ Anthony J. LeVecchio

Anthony J LeVecchio

Executive Chairman of the Board

(Principal Executive Officer)

I, B. Franklin Byrd, Chief Financial Officer of Intrusion Inc., certify that:

- (1) I have reviewed this quarterly report on Form 10-Q of Intrusion Inc.;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- (4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- (5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2021

/s/ B. Franklin Byrd
B. Franklin Byrd
Chief Financial Officer

CERTIFICATION PURSUANT TO RULE 13a-14(b) OF THE EXCHANGE ACT AND 18 U.S.C. SECTION 1350, AS ENACTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Intrusion Inc. (the “Company”) on Form 10-Q, for the quarter ended September 30, 2021 (the “Report”) as filed with the Securities and Exchange Commission on the date hereof, each of the undersigned Officers of the Company does hereby certify, pursuant to 18 U.S.C. Section 1350, as enacted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

November 12, 2021

/s/ Anthony J. LeVecchio

Anthony J. LeVecchio
Executive Chairman of the Board
(Principal Executive Officer)

November 12, 2021

/s/ B. Franklin Byrd

B. Franklin Byrd
Chief Financial Officer

The foregoing certification is being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and is not being filed as part of the Report or as a separate disclosure document.