

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2020

or

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

Commission File Number: 001-33852



VirnetX Holding Corporation

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

77-0390628
(I.R.S. Employer Identification No.)

308 Dorla Court, Suite 206 Zephyr Cove, Nevada
(Address of principal executive offices)

89448
(Zip Code)

Registrant's telephone number, including area code: (775) 548-1785
Former name, former address and former fiscal year, if changed since last report: N/A

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

Title of class	Trading Symbol	Name of exchange on which registered
Common Stock, par value \$0.0001 per share	VHC	New York Stock Exchange

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, a 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 Accelerated filer Smaller reporting company Non-accelerated filer
Emerging growth company

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

71,058,570 shares of Registrant's Common Stock were outstanding as of August 5, 2020.

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

We have included or incorporated by reference in this Quarterly Report on Form 10-Q (including in the section entitled Management's Discussion and Analysis of Financial Condition and Results of Operations), and from time to time we may make statements that may constitute "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. These forward-looking statements are based upon our current expectations, estimates, assumptions and beliefs concerning future events and conditions and may discuss, among other things, anticipated future performance (including sales and earnings), expected growth, future business plans and costs and the impact of potential and ongoing litigation. Any statement that is not historical in nature is a forward-looking statement and may be identified by the use of words and phrases such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "predicts," "projects," "will be," "will continue," "will likely result in," and similar expressions. These statements include our beliefs and statements regarding general industry and market conditions and growth rates, as well as general domestic and international economic conditions. Readers are cautioned not to place undue reliance on forward-looking statements. Forward-looking statements are necessarily subject to risks, uncertainties and other factors, many of which are outside our control, which could cause actual results to differ materially from such statements and from our historical results and experience. These risks, uncertainties and other factors include, but are not limited to those described in Item 1A - Risk Factors of this Quarterly Report and elsewhere in this Report and those described from time to time in our future reports filed with the Securities and Exchange Commission. Readers are cautioned that it is not possible to predict or identify all the risks, uncertainties and other factors that may affect future results and that the risks described herein should not be considered a complete list. Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

Among others, the forward-looking statements appearing in this Quarterly Report that may not occur include statements that:

- In the *VirnetX Inc. v. Cisco Systems, Inc. et al.* (Case 6:10-CV-00417-LED) ("Apple I") litigation, we have been awarded total damages in the amount of \$439.7 million. On February 24, 2020, the United States Supreme Court denied Apple's petition for certiorari with respect to the final judgment awarded in that case. Under a stipulation filed in the case, Apple agreed to pay any payments then due under the judgment within 20 days of completion of any appeal from the judgment in this matter. Accordingly, on March 13, 2020, we received final payment of \$454,033,859.87 from Apple, representing the previously announced final judgment with interest in the case. Apple has filed a motion in the district court seeking to vacate the district court's final judgment and has indicated that it will seek restitution of the payment if relief is awarded. Although the Company believes Apple's motion is without merit, the district court has not yet ruled on this motion. We cannot assure that Apple will not continue to challenge and seek reimbursement of the payment.
- In the *VirnetX Inc. v. Apple, Inc.* (Case Nos. 6:11-cv-00563-RWS, 6:12-cv-00855-RWS) ("Apple II") litigation, in November 2019, the United States Court of Appeals for the Federal Circuit (the "Federal Circuit") affirmed-in-part and reversed-in-part the judgment issued by the United States District Court for the Eastern District of Texas (the "district court") in the case awarding VirnetX damages of \$595.9 million. The Federal Circuit affirmed the district court's ruling that Apple Inc. ("Apple") was precluded from challenging the validity of the asserted patents, and also affirmed the jury's finding of infringement with respect to Apple's VPN on Demand feature. The Federal Circuit reversed, however, the finding of infringement with respect to Apple's FaceTime feature. The Federal Circuit remanded to the district court for an assessment of whether, given that only VPN on Demand infringed. In its order, unsealed on May 1, 2020, the district court denied VirnetX's motion for entry of a new judgment based on the prior jury verdict and ordered a new jury trial on damages. The jury selection and trial has been scheduled on August 17, 2020. In addition, the patents in issue are being challenged in the United States Patent and Trademark Office. If those challenges are successful, they could also impact the award in the case. The continuation of this litigation, as well as the Apple I litigation discussed above, is distracting to our management and expensive, and these distraction and expense may continue.
- We have undertaken activities to commercialize our products and patent portfolio in and outside the United States. These statements may imply that the worldwide market for our commercialized products is large and will result in significant future revenues for us. However, commercialization of products such as ours are subject to significant obstacles and risks, including but not limited to a perception by some potential partners and customers that they should await the outcome of the Apple II litigations before entering or considering to enter any agreement with us, and that or other factors may lead us to be unsuccessful in obtaining further licensing agreements or making arrangements or entering contracts which create significant future revenues for us.

EXCEPT AS REQUIRED BY LAW, WE UNDERTAKE NO OBLIGATION TO UPDATE OR REVISE ANY FORWARD-LOOKING STATEMENT AS A RESULT OF NEW INFORMATION, FUTURE EVENTS OR OTHERWISE.

VIRNETX HOLDING CORPORATION

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PART I — FINANCIAL INFORMATION
ITEM 1-FINANCIAL STATEMENTS.

VIRNETX HOLDING CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	<u>As of</u> <u>June 30, 2020</u>	<u>As of</u> <u>December 31, 2019</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 270,183	\$ 3,135
Investments available for sale	2,622	2,394
Accounts receivable	5	5
Prepaid expenses and other current assets	572	237
Total current assets	<u>273,382</u>	<u>5,771</u>
Prepaid expenses and other assets	1,491	1,711
Property and equipment, net	14	16
Deferred tax asset	8,536	—
Total assets	<u>\$ 283,423</u>	<u>\$ 7,498</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,059	\$ 1,346
Accrued licensing costs	9,438	—
Accrued payroll and related expenses	286	287
Other liabilities, current	53	193
Income taxes payable	38,863	—
Total current liabilities	<u>49,699</u>	<u>1,826</u>
Other liabilities	17	44
Total liabilities	<u>49,716</u>	<u>1,870</u>
Commitments and contingencies (Note 4)		
Stockholders' equity:		
Preferred stock, par value \$0.0001 per share Authorized: 10,000,000 shares at June 30, 2020 and December 31, 2019, Issued and outstanding: 0 shares at June 30, 2020 and December 31, 2019	—	—
Common stock, par value \$0.0001 per share Authorized: 100,000,000 shares at June 30, 2020 and December 31, 2019, Issued and outstanding: 71,058,570 shares and 69,586,764 shares, at June 30, 2020 and December 31, 2019, respectively	7	7
Additional paid-in capital	230,250	223,237
Retained earnings (Accumulated deficit)	3,462	(217,602)
Accumulated other comprehensive loss	(12)	(14)
Total stockholders' equity	<u>233,707</u>	<u>5,628</u>
Total liabilities and stockholders' equity	<u>\$ 283,423</u>	<u>\$ 7,498</u>

See accompanying notes to condensed consolidated financial statements.

VIRNETX HOLDING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(in thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Revenue	\$ 18	\$ 38	\$ 302,594	\$ 46
Operating expense:				
Licensing costs	—	—	90,101	—
Research and development	3,803	986	5,708	1,921
Selling, general and administrative	6,701	3,604	34,077	8,310
Total operating expense	10,504	4,590	129,886	10,231
Income (loss) from operations	(10,486)	(4,552)	172,708	(10,185)
Gain	—	—	41,271	—
Realized gain	—	—	1	—
Interest and other income, net	16	27	108,254	54
Income (loss) before taxes	(10,470)	(4,525)	322,234	(10,131)
Income tax (expense) benefit	2,430	395	(30,329)	393
Net income (loss)	\$ (8,040)	\$ (4,130)	\$ 291,905	\$ (9,738)
Basic income (loss) per share	\$ (0.11)	\$ (0.06)	\$ 4.13	\$ (0.14)
Diluted income (loss) per share	\$ (0.11)	\$ (0.06)	\$ 4.05	\$ (0.14)
Weighted average shares outstanding - basic	70,915	68,258	70,640	67,929
Weighted average shares outstanding - diluted	70,915	68,258	72,098	67,929

See accompanying notes to condensed consolidated financial statements.

VIRNETX HOLDING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)
(in thousands)

	Three Months Ended		Six Months Ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Net income (loss)	\$ (8,040)	\$ (4,130)	\$ 291,905	\$ (9,738)
Other comprehensive income (loss):				
Change in unrealized gain (loss) on investments, net of tax	(1)	—	1	1
Change in foreign currency translation, net of tax	—	—	1	—
Total other comprehensive income (loss)	(1)	—	2	1
Comprehensive income (loss)	\$ (8,041)	\$ (4,130)	\$ 291,907	\$ (9,737)

See accompanying notes to condensed consolidated financial statements.

VIRNETX HOLDING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (Unaudited)
(in thousands, except per share amounts)

	Common Stock		Additional	Retained Earnings	Accumulated	Total
	Shares	Amount	Paid-in	(Accumulated	Other	Stockholders'
			Capital	Deficit)	Comprehensive	Equity
					Loss	(Deficit)
Balance, December 31, 2018	66,879,847	\$ 7	\$ 208,317	\$ (198,422)	\$ (14)	\$ 9,888
Stock issued for cash at \$5.05 -\$5.42 per share, net	560,338		2,848			2,848
Stock-based compensation			785			785
Stock issued for options and RSUs, net	663,816		816			816
Comprehensive loss:						
Net loss				(5,608)		(5,608)
Unrealized gain, net					1	1
Comprehensive loss						(5,607)
Balance, March 31, 2019	68,104,001	\$ 7	\$ 212,766	\$ (204,030)	\$ (13)	\$ 8,730
Stock issued for cash at \$6.02 - \$6.49 per share, net	467,928		2,849			2,849
Stock-based compensation			928			928
Stock issued for options and RSUs, net	182,618					
Comprehensive loss:						
Net loss				(4,130)		(4,130)
Comprehensive loss						(4,130)
Balance, June 30, 2019	68,754,547	\$ 7	\$ 216,543	\$ (208,160)	\$ (13)	\$ 8,377
Balance, December 31, 2019	69,586,764	\$ 7	\$ 223,237	\$ (217,602)	\$ (14)	\$ 5,628
Stock issued for cash at \$4.00 -\$4.96 per share, net	1,049,382		4,488			4,488
Stock-based compensation			778			778
Stock issued for options and RSUs, net	202,031		768			768
Comprehensive income:						
Net income				299,945		299,945
Unrealized gain, net					2	2
Foreign currency translation, net					1	1
Comprehensive income						299,948
Balance, March 31, 2020	70,838,177	\$ 7	\$ 229,271	\$ 82,343	\$ (11)	\$ 311,610
Stock-based compensation			953			953
Warrants for services			104			104
Stock issued for options and RSUs, net	220,393		(78)			(78)
Dividends paid				(70,841)		(70,841)
Comprehensive loss:						
Net loss				(8,040)		(8,040)
Unrealized loss, net					(1)	(1)
Comprehensive loss						(8,041)
Balance, June 30, 2020	71,058,570	\$ 7	\$ 230,250	\$ 3,462	\$ (12)	\$ 233,707

One-time cash dividend of \$1 per share declared and paid as of the three and six months ended June 30, 2020.

See accompanying notes to condensed consolidated financial statements.

VIRNETX HOLDING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(in thousands)

	Six Months Ended	
	June 30, 2020	June 30, 2019
Cash flows from operating activities:		
Net income (loss)	\$ 291,905	\$ (9,738)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation	2	4
Amortization of warrant costs	17	—
Stock-based compensation	1,731	1,713
Deferred tax asset	(8,536)	-
Changes in assets and liabilities:		
Prepaid expenses and other assets	(28)	36
Accounts payable and accrued liabilities	(287)	(602)
Other liabilities	(167)	—
Accrued payroll and related expenses	(1)	31
Accrued licensing costs	9,438	—
Accounts receivable	—	(2)
Income taxes payable	38,863	(396)
Net cash provided by (used in) operating activities	<u>332,937</u>	<u>(8,954)</u>
Cash flows from investing activities:		
Purchase of investments	(2,292)	(3,391)
Proceeds from sale or maturity of investments	2,066	2,423
Net cash (used in) investing activities	<u>(226)</u>	<u>(968)</u>
Cash flows from financing activities:		
Proceeds from exercise of options	1,046	816
Proceeds from sale of common stock	4,488	5,697
Dividends paid	(70,841)	—
Payment of payroll taxes on vested restricted stock units	(356)	(47)
Net cash provided by (used in) financing activities	<u>(65,663)</u>	<u>6,466</u>
Net change in cash and cash equivalents	267,048	(3,456)
Cash and cash equivalents, beginning of period	3,135	7,611
Cash and cash equivalents, end of period	<u>\$ 270,183</u>	<u>\$ 4,155</u>

See accompanying notes to condensed consolidated financial statements.

VIRNETX HOLDING CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share and per share amounts)

(Unaudited)

Note 1 — Business Description and Basis of Presentation

VirnetX Holding Corporation, which we refer to as “we”, “us”, “our”, “the Company” or “VirnetX”, is engaged in the business of commercializing a portfolio of patents. We seek to license our technology, including GABRIEL Connection Technology™, to various original equipment manufacturers, or OEMs, that use our technologies in the development and manufacturing of their own products within the IP-telephony, mobility, fixed-mobile convergence and unified communications markets. Since 2012 we had revenues from settlements of patent infringement disputes whereby, we received consideration for past sales of licensees that utilized our technology, where there was no prior patent license agreement, as well as license agreement revenues from settlements providing licensing for the continued use of our technology (see “Revenue Recognition”).

Our portfolio of intellectual property is the foundation of our business model. We currently own approximately 194 total patents and pending applications, including 70 U.S. patents/patent applications and 124 foreign patents/validations/pending applications. Our patent portfolio is primarily focused on securing real-time communications over the Internet, as well as related services such as the establishment and maintenance of a secure domain name registry. Our patented methods also have additional applications in the key areas of device operating systems and network security for Cloud services, Machine-to-Machine (“M2M”), communications in areas including “Smart City,” “Connected Car” and “Connected Home.” All our U.S. and foreign patents and pending patent applications relate generally to securing communications over the internet and as such, cover all our technology and other products. Our issued U.S. and foreign patents expire at various times during the period from 2020 to 2024. Some of our issued patents and pending patent applications were acquired by our principal operating subsidiary, VirnetX, Inc., from Leidos, Inc. (“Leidos”) (f/k/a Science Applications International Corporation, or SAIC) in 2006 and we are required to make payments to Leidos based on cash or certain other values generated from those patents in certain circumstances. The amount of such payments depends upon the type of value generated and certain categories are subject to maximums and other limitations. During the six months ended June 30, 2020, the Company accrued \$90,101, in conjunction with proceeds received from Apple Inc., pursuant to a favorable court decision relating to a patent infringement case (see “Note 7— Litigation”).

Note 2 — Summary of Significant Accounting Policies

Unaudited Interim Financial Information

The accompanying Condensed Consolidated Balance Sheet as of June 30, 2020, the Condensed Consolidated Statements of Operations, the Condensed Consolidated Statements of Comprehensive Income (Loss), the Condensed Consolidated Statements of Shareholders’ Equity (Deficit) for the three and six months ended June 30, 2020 and 2019, and the Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2020 and 2019 are unaudited. These unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“U.S. GAAP”). In our opinion, the unaudited interim consolidated financial statements include all adjustments of a normal recurring nature necessary for the fair presentation of our financial position as of June 30, 2020, our results of operations for the three and six months ended June 30, 2020 and 2019, and our cash flows for the six months ended June 30, 2020 and 2019. The results of operations for interim periods are not necessarily indicative of the results to be expected for a full year.

These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019, filed with the SEC on March 16, 2020.

Use of Estimates

We prepare our consolidated financial statements in accordance with U.S. GAAP. In doing so, we must make estimates and assumptions that affect our reported amounts of assets, liabilities, revenues, and expenses, as well as related disclosure of contingent assets and liabilities. In some cases, we could reasonably have used different accounting policies and estimates. In some cases, changes in our accounting estimates are reasonably likely to occur. Accordingly, actual results could differ materially from our estimates. To the extent that there are material differences between these estimates and actual results, our financial condition or results of operations will be affected. We base our estimates on experience and other assumptions that we believe are reasonable under the circumstances, at the time they are made, and we evaluate these estimates on an ongoing basis. We refer to accounting estimates of this type as critical accounting policies and estimates, which we discuss further below.

Reclassifications

Certain prior period amounts were reclassified to conform to the current year’s presentation. None of these reclassifications had an impact on reported operating expenses, operating income or net income for any of the periods presented.

Basis of Consolidation

The consolidated financial statements include the accounts of VirnetX Holding Corporation and our wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

Leases

The Company determines if an arrangement, giving the Company a right-of-use (“ROU”) asset, is a lease at inception. Operating lease ROU assets are included in other assets on the Condensed Consolidated Balance Sheet. ROU assets represent the Company’s right to use an underlying asset for the lease term and lease liabilities represent the Company’s obligation to make lease payments arising from the lease. ROU assets and lease liabilities are recognized at the commencement date of the arrangement based on the present value of lease payments over the lease term. Other assets at June 30, 2020, includes a ROU asset related to a facility lease for corporate promotional and marketing purposes. The facility lease was paid in full at inception and the ROU is being amortized over the 10-year term of the lease. Other assets also include a ROU related to our office operating lease which expires in October 2021 (See Note 8 - Leases).

Revenue Recognition

The Company derives revenue from licensing and royalty fees from contracts with customers which often span several years. We account for this revenue in accordance with Accounting Standards Codification (“ASC”) Topic 606, Revenue from Contracts with Customers. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer. A contract’s transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. Our revenue arrangements may consist of multiple-element arrangements, with revenue for each unit of accounting recognized as the product or service is delivered to the customer.

With the licensing of our patents, performance obligations are generally satisfied at a point in time as work is complete when our patent rights are transferred to our customers. We generally have no further obligation to our customers regarding our technology.

Certain contracts may require our customers to enter into a hosting arrangement with us and for these arrangements, revenue is recognized over time, generally over the life of the servicing contract.

The Company actively monitors and enforces its intellectual property (“IP”) rights, including seeking appropriate compensation from third parties that utilize the Company’s IP without a license. As a result, the Company may, from time to time, receive payments as part of a settlement or compensation for a patent infringement dispute. Proceeds received are allocated to each element identified in the settlement or compensation, based on the fair value of each element. Generally, settlements and compensation may include the following elements: the value of a license or royalty agreement, cost reimbursement, damages and interest. Elements identified related to licensing and royalty are recognized as revenue. Elements identified as reimbursed costs are generally recorded as a reduction to the reported expenses. Elements identified as damages or interest are generally recorded in other income in the condensed consolidated statement of operations. During the six months ended June 30, 2020, the Company collected a lump sum payment of \$454,034 from Apple, Inc., because of a favorable court decision relating to a patent infringement case. The court decision identified the following as the basis of the award: \$302,428 for past royalties, \$41,271 in damages for willful infringement, \$108,221 for interest, and \$2,114 in reimbursement for court costs and attorney’s fees (see Note 7 - Litigation). Elements of the payment were recognized in the Company’s condensed consolidated statement of operations as follows:

**Classification in the Company’s Condensed Consolidated Statement of Operations
Six Months Ended**

	June 30, 2020
Revenue (royalties)	\$ 302,428
Operating expenses: selling, general and administrative (reimbursed litigation costs)	2,114
Other income: gain (willful infringement)	41,271
Other income: interest income (pre and post judgment interest)	108,221
Total cash received	<u>\$ 454,034</u>

Contingent Gains

ASC Topic 450-30-25, Contingent Gains, prohibits recognition of contingent gains until realized. Accordingly, we do not record contingent gains ahead of such realization. Management generally considers any such gains as realized only upon the collection of cash.

Earnings (Loss) Per Share

Basic earnings (loss) per share are computed by dividing earnings (loss) available to common stockholders by the weighted average number of outstanding common shares during the period. Diluted earnings per share are computed by dividing net income by the weighted average number of shares outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the potentially dilutive securities had been issued.

Concentration of Credit Risk and Other Risks and Uncertainties

Our cash and cash equivalents are primarily maintained at two major financial institutions in the United States. A portion of those balances are insured by the Federal Deposit Insurance Corporation. During the six months ended June 30, 2020, we had funds which were uninsured. We do not believe that we are subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships with major financial institutions. We have not experienced any losses on our deposits of cash and cash equivalents.

Other Assets

Other assets at June 30, 2020 includes a right-of-use asset totaling \$1,412 related to a facility lease for corporate promotional and marketing purposes. The facility lease was paid in full at inception and the ROU is being amortized over the 10-year term of the lease. Other assets also include a ROU asset totaling \$71 related to our office operating lease which expires in October 2021 (See Note 8).

Impairment of Long-Lived Assets

On an annual basis, we identify and record impairment losses on long-lived assets when events and changes in circumstances indicate that the carrying amount of an asset might not be recoverable. Recoverability is measured by comparison of the anticipated future net undiscounted cash flows to the related assets' carrying value. If such assets are impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the projected discounted future net cash flows arising from the asset.

Fair Value of Financial Instruments

Fair value is the price that would result from an orderly transaction between market participants at the measurement date. A fair value hierarchy prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). Level 2 measurements utilize either directly or indirectly observable inputs in markets other than quoted prices in active markets.

Our financial instruments are stated at amounts that equal, or approximate, fair value. When we estimate fair value, we utilize market data or assumptions that we believe market participants would use in pricing the financial instrument, including assumptions about risk and inputs to the valuation technique. We use valuation techniques, primarily the income and market approach, which maximizes the use of observable inputs and minimize the use of unobservable inputs for recurring fair value measurements.

Mutual Funds: Valued at the quoted net asset value of shares held.

U.S. Agency Securities: Fair value measured at the closing price reported on the active market on which the individual securities are traded.

The following tables show the adjusted cost, gross unrealized gains, gross unrealized losses and fair value of our securities by significant investment category as of June 30, 2020 and December 31, 2019.

	June 30, 2020					
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Investments Available for Sale
Cash	\$ 269,330	\$ —	\$ —	\$ 269,330	\$ 269,330	\$ —
Level 1:						
Mutual funds	853	—	—	853	853	—
U.S. agency securities	2,619	3	—	2,622	—	2,622
	<u>3,472</u>	<u>3</u>	<u>—</u>	<u>3,475</u>	<u>853</u>	<u>2,622</u>
Total	<u>\$ 272,802</u>	<u>\$ 3</u>	<u>\$ —</u>	<u>\$ 272,805</u>	<u>\$ 270,183</u>	<u>\$ 2,622</u>
	December 31, 2019					
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Investments Available for Sale
Cash	\$ 2,076	\$ —	\$ —	\$ 2,076	\$ 2,076	\$ —
Level 1:						
Mutual funds	613	—	—	613	613	—
U.S. agency securities	2,837	3	—	2,840	446	2,394
	<u>3,450</u>	<u>3</u>	<u>—</u>	<u>3,453</u>	<u>1,059</u>	<u>2,394</u>
Total	<u>\$ 5,526</u>	<u>\$ 3</u>	<u>\$ —</u>	<u>\$ 5,529</u>	<u>\$ 3,135</u>	<u>\$ 2,394</u>

New Accounting Pronouncements

In December 2019, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2019-12 Income Taxes (Topic 740). The amendments in this ASU simplify the accounting for income taxes by removing certain exceptions to the general principles in Topic 740. The amendments also improve consistent application of and simplify GAAP for other areas of Topic 740 by clarifying and amending existing guidance. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. We are currently evaluating the impact, if any this ASU will have on our consolidated financial statements and related disclosures.

In August 2018, the FASB issued ASU 2018-13 - Fair Value Measurement (Topic 820). The FASB is issuing the amendments in this ASU as part of its disclosure framework project. On March 4, 2014, the Board issued a proposed FASB Concepts Statement, Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements, which the Board finalized on August 28, 2018. The disclosure framework project’s objective and primary focus are to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by GAAP that is most important to users of each entity’s financial statements. The amendments in this ASU are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. We adopted this guidance on January 1, 2020 with no material impact on our financial position and statement of operations.

In June 2016, the FASB issued ASU 2016-13 Financial Instruments—Credit Losses (Topic 326). The amendments in this Update require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. We adopted this guidance on January 1, 2020 and there was no material impact on our financial position or statement of operations.

Note 3 — Income Taxes

For the three months ended June 30, 2020, we recognized an income tax benefit of \$2,430 on a loss before income taxes of \$10,470, which is an effective tax rate of a 23.2%. For the six months ended June 30, 2020, we recognized income tax expense of \$30,329 on income before income taxes of \$322,234 which is an effective tax rate of 9.4%. For the three and six months ended June 30, 2019, we had an income tax benefit of \$395 and \$393, respectively, due to a release of a state reserve as the statute of limitation for the tax return expired in the quarter. The effective tax rate for the 2020 six-month period was favorably impacted by the reversal of valuation allowance reserves totaling \$37,694, which were established in prior years on our deferred tax assets primarily associated with net operating loss (“NOL”) carryforwards. For the three and six months ended June 30, 2019, we had NOLs which generated deferred tax assets for NOL carryforwards. During 2019, we provided valuation allowances against the net deferred tax assets including the deferred tax assets for NOL carryforwards. At June 30, 2020, we had deferred tax assets of \$8,536.

A valuation allowance is provided for deferred tax assets when, in our judgment, based upon currently available information and other factors, it is more likely than not that all or a portion of such deferred income tax assets will not be realized. The determination of the need for a valuation allowance is based on an on-going evaluation of current information including, among other things, historical operating results, estimates of future earnings in different taxing jurisdictions and the expected timing of the reversals of temporary differences. We believe the determination to record, or reduce, a valuation allowance associated with a deferred income tax asset is a significant accounting estimate because it is based, among other things, on an estimate of future taxable income in the United States and certain other jurisdictions, which is susceptible to change and may or may not occur, and because the impact of adjusting a valuation allowance may be material. In determining when to release the valuation allowance established against our net deferred income tax assets, we consider all available evidence, both positive and negative.

As a result of the significant taxable income recognized in the six months ended June 30, 2020, we determined that it was more likely than not that we will recover our deferred tax assets and accordingly the valuation allowances were reduced during the period. During 2019, consistent with our policy, and because of our history of operating losses, we did not recognize the benefit of our deferred tax assets, including NOL carryforwards, that may have been used to offset future taxable income. We continually assess our ability to generate sufficient taxable income during future periods in which our deferred tax assets may be realized.

Internal Revenue Code Section 382 places a limitation (the “IRC Section 382 Limitation”) on the amount of net operating loss carryforwards that can be used to offset taxable income after a change in control (generally greater than 50% change in ownership) of a loss corporation. California, the state in which our headquarters was once located, has similar rules. Generally, after a control change, a loss corporation cannot deduct net operating loss carryforwards generated in years prior to the deemed change of control under IRC Section 382 in excess of the Section 382 Limitation. Because we have concluded that the Company has not experienced a change in control under Section 382, all NOL carryforwards were utilized to offset taxable income generated in the period.

Our tax years for 2005 and forward are subject to examination by the U.S. tax authority and various state tax authorities. These years are open due to NOLs and tax credits to be utilized from such years.

Our policy is to recognize interest and penalties accrued on uncertain tax positions as a component of income tax expense. As of June 30, 2020, we had accrued immaterial amounts of interest and penalties related to the uncertain tax positions.

Note 4 — Commitments and Related Party Transactions

We lease our offices under an operating lease with a third party which expires in October 2021 (see Note 8 - Leases).

We entered into a service agreement for the use of an aircraft from K2 Investment Fund LLC (“LLC”) for business travel for employees of the Company. We incurred approximately \$13, and \$89 compared to \$326, and \$885 in rental fees and reimbursements to the LLC during the three and six months ended June 30, 2020 and 2019, respectively. We pay for the Company’s usage of the aircraft and have no rights to purchase. Our Chief Executive Officer and Chief Administrative Officer are the managing partners of the LLC and control the equity interests of the LLC. We entered into a 12-month non-exclusive agreement with the LLC for use of the plane at a rate of \$8 per flight hour, with no minimum usage requirement. The agreement contains other terms and conditions and can be cancelled by either us or the LLC with 30 days’ notice. The agreement renews on an annual basis unless terminated by either party. Neither party has exercised their termination rights.

Note 5 — Stock Based Compensation

We have a stock incentive plan for employees and others called the VirnetX Holding Corporation 2013 Equity Incentive Plan (the “Plan”), which has been approved by our stockholders. In April 2017, the Board approved an amendment and restatement of the Plan to, among other things, increase the shares reserved under the Plan by 2,500,000 shares (the “Plan Amendment”). Our stockholders approved of the Plan Amendment at the 2017 Annual Meeting of Stockholders held on June 1, 2017. The Plan provides for grants of 16,624,469 shares of our common stock, including stock options and restricted stock units (“RSUs”), and will expire in 2023. As of June 30, 2020, 675,210 shares remained available for grant under the Plan.

During the three months ended June 30, 2020, we granted options for a total of 377,500 shares with a weighted average grant date fair value of \$5.07 per option. During the three months ended June 30, 2019, we granted options totaling 345,000 shares with a weighted average grant date fair value of \$4.63.

During the six months ended June 30, 2020, we granted options for a total of 617,500 shares. The weighted average fair value at the grant dates was \$4.77 per option. The fair values of options at the grant date were estimated utilizing the Black-Scholes valuation model with the following weighted average assumptions for the six months ended June 30, 2020 (i) dividend yield on our common stock of 0 percent (ii) expected stock price volatility of 94 percent (iii) a risk-free interest rate of 0.65 percent and (iv) and expected option term of 6 years.

During the six months ended June 30, 2019, we granted options for a total of 345,000 shares. The weighted average fair value at the grant dates for options issued during the six months ended June 30, 2019 was \$4.63 per option. The fair values of options at the grant date were estimated utilizing the Black-Scholes valuation model with the following weighted average assumptions for the six months ended June 30, 2019 (i) dividend yield on our common stock of 0 percent (ii) expected stock price volatility of 92 percent (iii) a risk-free interest rate of 2.09 percent and (iv) and expected option term of 6 years.

During the three months ended June 30, 2020 and 2019, we granted 218,329 and 229,996 RSUs, respectively. The weighted average fair values at the grant dates for RSUs issued during the three months ended June 30, 2020 and 2019 were \$6.89 and \$6.06 per RSU, respectively. RSUs, which are subject to forfeiture if service terminates prior to the shares vesting, are expensed ratably over the vesting period. During the three months ended June 30, 2020 and 2019, we paid \$356 and \$47 in withholding taxes on shares issued upon conversion of RSUs. The underlying shares were canceled. These amounts are reflected as financing costs in the accompanying statement of cash flows. No RSUs were issued during the first three months of 2020 or 2019.

As of June 30, 2020, the unrecognized stock-based compensation expense related to non-vested stock options and RSUs was \$6,353 and \$2,812, respectively, which will be amortized over an estimated weighted average period of approximately 2.40 and 2.83 years, respectively.

During the three months ended June 30, 2020, we issued 60,000 shares of common stock as a result of the exercise of options and 160,393 shares of common stock as a result of vesting RSUs. During the three months ended June 30, 2019, no options were exercised, but we issued 182,618 shares of common stock as a result of vesting RSUs.

During the six months ended June 30, 2020 we issued 262,031 shares of common stock as a result of the exercise of options and 160,393 shares of common stock as a result of vesting RSUs. During the six months ended June 30, 2019, we issued 663,816 shares of common stock as a result of the exercise of options and 182,618 shares of common stock as a result of vesting RSUs.

Note 6 — Equity

Common Stock

On July 30, 2018 we filed a \$100,000 universal shelf registration statement on SEC Form S-3 which was declared effective by the SEC on August 16, 2018. We also entered an at-the-market equity offering sales agreement (“ATM”) with Cowen & Company, LLC on August 31, 2018, under which we can offer and sell shares of our common stock having an aggregate value of up to \$50,000.

We use the ATM proceeds for GABRIEL product development, marketing and general corporate purposes, which may include working capital, capital expenditures, other corporate expenses and acquisitions of complementary products, technologies or businesses. As of June 30, 2020, common stock with an aggregate value of up to \$21,964 remained available for offer and sale under the ATM agreement.

We did not sell any shares under the ATM during the three months ended June 30, 2020. During six months ended June 30, 2020, we sold 1,049,382 shares under the ATM. The average price per common share was \$4.41 and the aggregate proceeds from the sales totaled \$4,627. Sales commissions, fees and other costs associated with the ATM totaled \$139.

During the three months ended June 30, 2019, we sold 467,928 shares under the ATM. The average price per common share was \$6.28 and the aggregate proceeds from the sales totaled \$2,937. Sales commissions, fees and other costs associated with the ATM totaled \$88. During the six months ended June 30, 2019, we sold 1,028,266 shares under the ATM. The average price per common share was \$5.71 and the aggregate proceeds from the sales totaled \$5,873. Sales commissions, fees and other costs associated with the ATM totaled \$176.

Dividends

On May 8, 2020, we declared a one-time cash dividend of \$1 per share of common stock, payable on May 26, 2020 to shareholders of record as of the close of business on May 18, 2020. The timing and amount of future dividends, if any, will depend on market conditions, corporate business and financial considerations and regulatory requirements.

Warrants

In 2020, we issued warrants for the purchase of 25,000 shares of common stock at an exercise price of \$5.75 per share, which will expire in April 2025. The weighted average fair value at the grant date was \$4.16 per warrant. The fair value at the grant date was estimated utilizing the Black-Scholes valuation model with the following weighted average assumptions (i) dividend yield on our common stock of 0 percent (ii) expected stock price volatility of 97 percent (iii) a risk-free interest rate of 0.27 percent and (iv) and expected option term of 5 years.

Warrants Issued	Exercise Price	Exercisable at December 31, 2019	Newly Exercisable	Exercised	Terminated / Cancelled	Exercisable at June 30, 2020	Expiration Date
25,000	\$ 7.00	25,000	—	—	25,000	—	April 30, 2020
	\$ 5.75	—	25,000	—	—	25,000	April 30, 2025
		25,000	25,000	—	25,000	25,000	

Note 7 — Litigation

We have several intellectual property infringement lawsuits pending in the United States District Court for the Eastern District of Texas, Tyler Division (“USDC”), and United States Court of Appeals for the Federal Circuit (“USCAFC”).

VirnetX Inc. v. Cisco Systems, Inc. et al. (Case 6:10-CV-00417-LED) (“Apple I”)

On August 11, 2010, we filed a complaint against Aastra USA, Inc. (“Aastra”), Apple Inc. (“Apple”), Cisco Systems, Inc. (“Cisco”), and NEC Corporation (“NEC”) the USDC in which we alleged that these parties infringe on certain of our patents (U.S. Patent Nos. 6,502,135, 7,418,504, 7,921,211 and 7,490,151). We sought damages and injunctive relief. The cases against each defendant were separated by the judge. Aastra and NEC agreed to sign license agreements with us, and we dropped all accusations of infringement against them. A jury in USDC decided that our patents were not invalid and rendered a verdict of non-infringement by Cisco on March 4, 2013. Our motion for a new Cisco trial was denied and the case against Cisco was closed.

On November 6, 2012, a jury in the USDC awarded us over \$368,000 for Apple’s infringement of four of our patents, plus daily interest up to the final judgment.

Apple filed an appeal of the judgment to the USCAFC. On September 16, 2014, USCAFC affirmed the USDC jury’s finding that all four of our patents at issue are valid and confirmed the USDC jury’s finding of infringement of VPN on Demand under many of the asserted claims of our ‘135 and ‘151 patents, and the USDC’s decision to allow evidence about our license and royalty rates regarding the determination of damages. However, the USCAFC vacated the USDC jury’s damages award and some of the USDC’s claim construction with respect to parts of our ‘504 and ‘211 patents and remanded the damages award and determination of infringement with respect to FaceTime back to the USDC for further proceedings.

On September 30, 2016, pursuant to the 2014 remand from the USCAFC, a jury in the USDC awarded us \$302,400 for Apple’s infringement of four of our patents. On September 29, 2017, the USDC entered its final judgment, denied all of Apple’s post-trial motions, granted all our post-trial motions, including our motion for willful infringement and enhanced the royalty rate during the willfulness period from \$1.20 to \$1.80 per device, and awarded us costs, certain attorneys’ fees, and prejudgment interest. The total amount in the final judgment was \$439,700, including \$302,400 (jury verdict), \$41,300 (enhanced damages) and \$96,000 (costs, fees and interest).

On October 27, 2017 Apple appealed the final judgment entered on September 29, 2017 to the USCAFC. Oral arguments in this case were held on January 8, 2019. On January 15, 2019 the Court issued a Rule 36 order affirming the district court's final judgment. Apple filed a petition for panel rehearing and rehearing en-banc in this matter on February 21, 2019. On October 1, 2019, USCAFC issued an order denying Apple's petition. Apple filed a petition for a writ of certiorari with the U.S. Supreme Court, which was denied on February 24, 2020. Prior to the Supreme Court decision denying Apple's petition for a writ of certiorari, on February 20, 2020, Apple filed a Rule 60(b) motion for relief from judgment with the USDC, seeking relief from the district court's September 29, 2017 final judgment. VirnetX filed a responsive brief in opposition on March 5, 2020.

On March 13, 2020, the Company received payment of \$454,034 from Apple, representing the previously announced final judgment with interest in this case. Apple has indicated that it will seek restitution of the payment if relief sought in its Rule 60(b) motion is awarded. On April 16, 2020, the USDC ordered Apple to file a supplemental brief with respect to its Rule 60(b) motion within 7 days. The USDC has not ruled in this matter.

VirnetX Inc. v. Apple, Inc. (Case 6:12-CV-00855-LED) ("Apple II")

This case began on November 6, 2012, when we had filed a complaint against Apple in USDC in which we alleged that Apple infringed on certain of our patents, (U.S. Patent Nos. 6,502,135, 7,418,504, 7,921,211 and 7,490,151). We sought damages and injunctive relief. The accused products include the iPhone 5, iPod Touch 5th Generation, iPad 4th Generation, iPad mini, and the latest Macintosh computers; these products were not included in the Apple I case because they were released after the Apple I case was initiated. Post-trial motions hearing was held on July 18, 2018. On August 31, 2018, the USDC entered a Final Judgment and issued its Memorandum Opinion and Order regarding post-trial motions, affirming the jury's verdict of \$502,600 and granting VirnetX motions for supplemental damages, a sunset royalty and the royalty rate of \$1.20 per infringing iPhone, iPad and Mac products, pre-judgment and post-judgment interest and costs. On September 20, 2018, pursuant to a Court's order, attorneys from VirnetX and Apple conferred and agreed, without dispute, to add an amount totaling \$93,300 for Bill of Costs and Prejudgment Interest to the \$502,600 jury verdict. The total amount in the final judgment in the Apple II case is now \$595,900. Apple has filed a notice of appeal with the USCAFC in the Apple II case.

On October 9, 2018, USCAFC docketed the appeal as Case No. 19-1050 - VirnetX Inc. v. Apple Inc. . On January 24, 2019 Apple filed its opening brief. We filed our response brief on March 1, 2019. Apple filed its reply brief on April 5, 2019. The oral arguments were heard on October 4, 2019. On November 22, 2019, the USCAFC issued an opinion affirming the district court's findings that Apple is precluded from making certain invalidity arguments and that Apple infringed the '135 and '151 patents; reversing the district court's finding that Apple infringed the '504 and '211 patents; and remanding the case for proceedings on damages. Apple sought panel and en banc rehearing, which the USCAFC denied on February 10, 2020.

On February 22, 2020, the USDC issued a scheduling order for the parties to brief the court about the need for a new trial for recalculating the damages. We filed our motion for entry of judgment on February 28, 2020. The arguments on this matter were heard on April 14, 2020. In its order, unsealed on May 1, 2020, the district court denied VirnetX's motion for entry of a new judgment based on the prior jury verdict and ordered a new jury trial on damages. The jury selection and trial has been scheduled on August 17, 2020.

VirnetX Inc. v. Cisco Systems, Inc. (USCAFC Case 19-1671)

On March 18, 2018, we filed with the USCAFC an appeal of the invalidity findings by the PTAB in inter-partes reexamination no. 95/001,679 involving our U.S. Patent No. 6,502,135. We filed a motion to remand on August 23, 2019, which the USCAFC denied on October 1, 2019, directing the parties to address the issues in the merits briefs. On November 7, 2019, we filed another motion to vacate and remand in light of *Arthrex*. The USPTO intervened and opposed the remand. The USCAFC granted our motion on January 24, 2020. On March 9, 2020, Cisco and the USPTO both filed petitions for panel and en banc rehearing, which were denied on May 13, 2020. The mandate vacating the case and remanding it to PTAB was issued on May 20, 2020.

McKool Smith P.C. v. VirnetX, Inc., AAA Case No. 01-20-0003-7975

On March 23, 2020, the law firm of McKool Smith, P.C. ("McKool") filed a Demand for Arbitration against VirnetX, Inc. with the American Arbitration Association ("AAA"). In its demand, McKool claims that a retention agreement it entered into in 2010 with VirnetX entitles it to a contingency fee arising from the recent 2020 payment made by Apple. McKool claims it is owed \$36.3 million (or 8% of the payment). We have filed a general response with AAA denying McKool's claim and intend to vigorously contest the matter.

Neal Hurwitz v. Kendall Larsen et al. (Case 2020-0425-JRS)

On June 2, 2020, stockholder Neal Hurwitz filed a verified derivative complaint in the Delaware Court of Chancery against Kendall Larsen, Robert D. Short III, Gary Feiner, Michael F. Angelo, and Thomas M. O'Brien and naming the Company as nominal defendant. The lawsuit alleges breaches of fiduciary duty, corporate waste, and unjust enrichment arising out of a series of previously-disclosed transactions and compensation awards and seeks an award of monetary damages and equitable relief. On July 1, 2020, the defendants filed a motion to dismiss the complaint based on a failure to plead demand futility and a failure to state a claim on which relief can be granted. The parties are currently briefing the motion, which briefing is expected to be complete by October 2020, with the court to hold a hearing and render a decision on the motion thereafter.

One or more potential intellectual property infringement claims may also be available to us against certain other companies who have the resources to defend against any such claims. Although we believe these potential claims are likely valid, commencing a lawsuit can be expensive and time-consuming, and there is no assurance that we could prevail on such potential claims if we made them. In addition, bringing a lawsuit may lead to potential counterclaims which may distract our management and our other resources, including capital resources, from efforts to successfully commercialize our products.

Currently, we are not a party to any other pending legal proceedings and are not aware of any proceeding threatened or contemplated against us.

Note 8 — Leases

We lease office space under an operating lease which expires in October 2021; at June 30, 2020, the underlying ROU asset and lease liability totaled \$71. For the three and six months ended June 30, 2020, we recorded lease expense of \$13 and \$26. For the three and six months ended June 30, 2019, we recorded lease expense of \$14 and \$28.

We also entered into an operating lease for a facility used for corporate promotional and marketing purposes which was prepaid in full in a prior year and expires in 2024; at June 30, 2020, the ROU totaled \$1,412. For the three and six months ended June 30, 2020, we recorded promotional and marketing lease expense of \$96 and \$193. For the three and six months ended June 30, 2019, we recorded lease expense of \$96 and \$193.

Note 9 — Earnings Per Share

Basic earnings per are share based on the weighted average number of common shares outstanding for the period. Diluted earnings per share are based on the weighted average number of common shares and potentially dilutive common shares outstanding. Potential common shares outstanding principally include stock options, RSUs and warrants, excluding any potentially dilutive shares convertible at a price higher than the closing price of our stock at the end of each reporting period.

The following table shows the computation of basic and diluted earnings per share for the three and six months ended June 30, 2020 and 2019 (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Weighted-average basic shares outstanding	70,915	68,258	70,640	67,929
Effect of dilutive securities	—	—	1,458	—
Weighted-average diluted shares outstanding	70,915	68,258	72,098	67,929
Basic earnings per share	\$ (0.11)	\$ (0.06)	\$ 4.13	\$ (0.14)
Diluted earnings per share	\$ (0.11)	\$ (0.06)	\$ 4.05	\$ (0.14)

Potentially dilutive securities representing 1,824,454 shares of common stock were excluded from the computation of diluted earnings per share for the six months ended June 30, 2020, because their effect would have been antidilutive. We incurred a net loss for the three months ended June 30, 2020, and the three and six months ended June 30, 2019; therefore, all potentially dilutive securities representing shares of common stock were excluded from the computation of diluted earnings per share for the quarter, because their effect would have been antidilutive.

ITEM 2 — MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Company Overview

We are an Internet security software and technology company with patented technology for secure communications including 5G and 4G LTE security. Our software and technology solutions, including our Secure Domain Name Registry and GABRIEL Connection Technology™, are designed to facilitate secure communications and provide the security platform required by next-generation Internet-based applications such as instant messaging, or IM, voice over Internet protocol, or VoIP, mobile services, streaming video, file transfer, remote desktop and Machine-to-Machine, or M2M communications. Our technology generates secure connections on a “zero-click” or “single-click” basis, significantly simplifying the deployment of secure real-time communication solutions by eliminating the need for end-users to enter any encryption information. Our portfolio of intellectual property is the foundation of our business model. We currently own approximately 194 total patents and pending applications, including 70 U.S. patents/patent applications and 124 foreign patents/validations/pending applications. Our patent portfolio is primarily focused on securing real-time communications over the Internet, as well as related services such as the establishment and maintenance of a secure domain name registry. Our patented methods also have additional applications in the key areas of device operating systems and network security for Cloud services, M2M communications in the new initiatives like “Smart City”, “Connected Car” and “Connected Home” that would connect everything from social services and citizen engagement to public safety, transportation and economic development to the internet to enable more productivity, features and efficiency in our everyday lives. The subject matter of all our U.S. and foreign patents and pending applications relates generally to securing communication over the internet, and as such covers all our technology and other products. Our issued U.S. and foreign patents expire at various times during the period from 2020 to 2024. Some of our issued patents and pending patent applications were acquired by our principal operating subsidiary; VirnetX, Inc., from Leidos, Inc., or Leidos, (f/k/a Science Applications International Corporation, or SAIC) in 2006 and we are required to make payments to Leidos, based on cash or certain other values generated from those patents. The amount of such payments depends upon the type of value generated, and certain categories are subject to maximums and other limitations.

Our product GABRIEL Secure Communication Platform™ includes a set of sophisticated software libraries with application interfaces available for securing third-party applications seamlessly across multiple operating system platforms. Unlike other collaboration and communication products and services on the market today, this product does not require access to user’s confidential data and reduces the threat of hacking and data mining. It enables individuals and organizations to maintain complete ownership and control over their personal and confidential data, secured within their own private network, while enabling authorized secure encrypted access from anywhere at any time.

Our GABRIEL Gateway product extends our Secure Communication Platform™ by allowing existing Networked Devices and Services to seamlessly join the “GABRIEL SECURED” network without requiring any modifications. All these devices or services, including cloud-based services, can now be assigned a VirnetX Secure Domain Name and use a fully authenticated secure communication channels for its communications.

Our GABRIEL Collaboration Suite™ is a set of communication tools that use our GABRIEL Secure Communication Platform™. It enables seamless and secure cross-platform communications between devices that are enrolled in our security fabric and have our software installed. Our GABRIEL Collaboration Suite™ is available for download and free trial, for Android, iOS, Windows, Linux and Mac OS X platforms, at <http://www.gabrielsecure.com/>. We continue to enhance our products and add new functionality to our products. We will provide updates to new and existing customers as they are released to the general public. A large number of small and medium businesses have installed our GABRIEL Secure Communication Platform™ and GABRIEL Collaboration Suite™ products in their corporate networks. We intend to continue to expand our customer base with targeted promotions and direct sales initiatives.

We are actively recruiting partners in various vertical markets including, healthcare, finance, government, etc., to help us rapidly expand our enterprise customer base. A number of International Association of Certified ISAO (IACI) including ISAO’s for Maritime & Ports ISAO, Credit Union ISAO, City of Chicago ISAO, Human Trafficking ISAO, have chosen to deploy our software as private and secure e-technology to protect their communications. Several other ISAOs are completing their evaluations before deploying our products within their networks.

We have executed a number of patent and technology licenses and intend to seek further licensees for our technology, including our GABRIEL Connection Technology™ to original equipment manufacturers, or OEMs, of chips, servers, smart phones, tablets, e-Readers, laptops, net books and other devices, within the IP-telephony, mobility, fixed-mobile convergence and unified communications markets including 5G and 4G/LTE Advanced.

We have submitted a declaration with the 3rd Generation Partnership Project, or 3GPP, identifying a group of our patents and patent applications that we believe are or may become essential to certain developing specifications in the 3GPP LTE, Systems Architecture Evolution, or SAE project. We have agreed to make available a non-exclusive patent license under fair, reasonable and non-discriminatory terms and conditions, with compensation, or FRAND, to 3GPP members desiring to implement the technical specifications identified by us. We believe that we are positioned to license our essential security patents to 3GPP members as they move into deploying 5G and 4G/LTE Advanced devices and solutions.

We have an ongoing GABRIEL Licensing Program under which we offer licenses to a portion of our patent portfolio, technology and software, including our secure domain name registry service, to domain infrastructure providers, communication service providers as well as to system integrators. Our GABRIEL Connection Technology™ License is offered to OEM customers who want to adopt the GABRIEL Connection Technology™ as their solution for establishing secure connections using secure domain names within their products. We have developed GABRIEL Connection Technology™ Software Development Kit (SDK) to assist with rapid integration of these techniques into existing software implementations with minimal code changes and include object libraries, sample code, testing and quality assurance tools and the supporting documentation necessary for a customer to implement our technology. Customers who want to develop their own implementation of the VirnetX patented techniques for supporting secure domain names, or other techniques that are covered by our patent portfolio for establishing secure communication links, can purchase a patent license. The number of patents licensed, and therefore the cost of the patent license to the customer, will depend upon which of the patents are used in a particular product or service. These licenses will typically include an initial license fee, as well as an ongoing royalty.

We have signed Patent License Agreements with Avaya Inc., Aastra USA, Inc., Microsoft Corporation, Mitel Networks Corporation, NEC Corporation and NEC Corporation of America, Siemens Enterprise Communications GmbH & Co. KG, and Siemens Enterprise Communications Inc. to license certain of our patents, for a one-time payment and/or an ongoing royalty for all future sales through the expiration of the licensed patents with respect to certain current and future IP-encrypted products.

We believe that the market opportunity for our software and technology solutions is large and expanding as secure domain names are now an integral part of securing the next generation 5G and 4G/LTE Advanced wireless networks and M2M communications in areas including Smart City, Connected Car and Connected Home. We also believe that all 5G and 4G/LTE Advanced mobile devices will require unique secure domain names and become part of a secure domain name registry.

We intend to continue to license our patent portfolio, technology and software, including our secure domain name registry service, to domain infrastructure providers, communication service providers as well as to system integrators. We intend to seek further license of our technology, including our GABRIEL Connection Technology™ to enterprise customers, developers and original equipment manufacturers, or OEMs, of chips, servers, smart phones, tablets, e-Readers, laptops, net books and other devices, within the IP-telephony, mobility, fixed-mobile convergence and unified communications markets including 5G and 4G/LTE.

Our employees include the core development team behind our patent portfolio, technology and software. This team has worked together for over ten years and is the same team that invented and developed this technology while working at Leidos, Inc. (“Leidos”). Leidos is a FORTUNE 500® scientific, engineering and technology applications company that uses its deep domain knowledge to solve problems of vital importance to the nation and the world, in national security, energy and the environment, critical infrastructure and health. The team has continued its research and development work started at Leidos and expanded the set of patents we acquired in 2006 from Leidos, into a larger portfolio of approximately 194 U.S. and foreign patents, patent validations and pending applications. This portfolio now serves as the foundation of our licensing business and planned service offerings and is expected to generate the majority of our future revenue in license fees and royalties. We intend to continue our research and development efforts to further strengthen and expand our patent portfolio.

We intend to continue using an outsourced and leveraged model to maintain efficiency and manage costs as we grow our licensing business by, for example, offering incentives to early licensing targets or asserting our rights for use of our patents. We also intend to expand our design pilot in participation with leading 5G and 4G/LTE companies (domain infrastructure providers, chipset manufacturers, service providers and others) and build our secure domain name registry.

New Accounting Pronouncements

In December 2019 the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2019-12 Income Taxes (Topic 740). The amendments in this ASU simplify the accounting for income taxes by removing certain exceptions to the general principles in Topic 740. The amendments also improve consistent application of and simplify GAAP for other areas of Topic 740 by clarifying and amending existing guidance. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. We are currently evaluating the impact, if any this ASU will have on our consolidated financial statements and related disclosures.

In August 2018 the FASB issued ASU 2018-13 - Fair Value Measurement (Topic 820). The FASB is issuing the amendments in this ASU as part of the disclosure framework project. On March 4, 2014, the Board issued a proposed FASB Concepts Statement, Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements, which the Board finalized on August 28, 2018. The disclosure framework project’s objective and primary focus are to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by GAAP that is most important to users of each entity’s financial statements. The amendments in this ASU are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. We adopted this guidance on January 1, 2020 which had no material impact on our financial position and statement of operations.

In June 2016 the FASB issued ASU 2016-13 Financial Instruments—Credit Losses (Topic 326). The amendments in this Update require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. We adopted this guidance on January 1, 2020 and there was no material impact on our financial position or statement of operations.

Results of Operations

Three and Six Months Ended June 30, 2020 Compared with Three and Six Months Ended June 30, 2019 (in thousands, except per share amounts)

Revenue

For the three and six months ended June 30, 2020 we recognized revenue of \$18 and \$302,594, respectively compared to the three and six months ended June 30, 2019 of \$38 and \$46, respectively. During the six months ended June 30, 2020, the Company collected a lump sum payment of \$454,034 from Apple, Inc. (see “Legal Proceedings”), as a result of a favorable court decision relating to a patent infringement case. The one-time payment includes past royalties, damages for willful infringement, interest, court costs and attorneys’ fees. The elements of the payment were recognized in the Company’s condensed consolidated statement of operations as follow (see Note 2):

Classification in the Company’s Condensed Consolidated Statement of Operations for the Six Months Ended June 30, 2020

Revenue (royalties)	\$ 302,428
Operating expenses: selling, general and administrative (reimbursed litigation costs)	2,114
Other income: gain (willful infringement)	41,271
Other income: interest income (pre and post judgment interest)	108,221
Total cash received	<u>\$ 454,034</u>

Licensing Costs

Included in operating expenses for the six months ended June 30, 2020, is \$90,101 in licensing costs we have incurred in conjunction with the proceeds received from Apple, Inc., pursuant to a favorable court decision relating to a patent infringement case.

Research and Development Expenses

Research and development expenses were \$3,803 and \$986 for the three months ended June 30, 2020 and 2019, respectively, representing an increase of \$2,817 due primarily to an increase in staff expense. Research and development expenses were \$5,708 and \$1,921 for the six months ended June 30, 2020 and 2019, respectively, representing an increase of \$3,787 due primarily to an increase in staff expense.

Selling, General and Administrative Expenses

Selling, general and administrative expenses includes wages and benefits of management and administrative personnel, as well as outside legal, accounting, and consulting services.

Our selling, general and administrative expenses for the three months ended June 30, 2020 compared to June 30, 2019 increased by \$3,097 to \$6,701. The change is primarily due to an increase in staff expenses. For the six months ended June 30, 2020 our selling, general and administrative expenses increased by \$25,767 to \$34,077 compared to the six months ended June 30, 2019. The change was primarily due to a \$21,820 increase in legal fees associated with our patent infringement actions, after reflecting reimbursement of \$2,114, pursuant to a judgment collected from Apple. We expect to incur the same levels or decreased levels of legal fees over the next two quarters and expect to report losses from operations as a result. (See “Legal Proceedings” for additional information regarding these infringement actions.)

Other Income and Expenses

For the six months ended June 30, 2020, we recognized a gain of \$41,271 and interest income of \$108,254 which included interest received of \$108,221 pursuant to a judgment collected from Apple.

Net income (loss)

Net income (loss) for the three and six months ended June 30, 2020 was (\$8,040) and \$291,905, respectively. Net loss for the three and six months ended June 30, 2019 (\$4,130) and (\$9,738), respectively. The change is primarily due to the judgment collected from Apple associated with our patent infringement action.

Income Taxes

For the three months ended June 30, 2020, we recognized an income tax benefit of \$2,430 on loss before income taxes of \$10,470, which is an effective tax rate of a 23.2%. For the six months ended June 30, 2020, we recognized income tax expense of \$30,329 on income before income taxes of \$322,234 which is an effective tax rate of 9.4%. For the three and six months ended June 30, 2019, we had an income tax benefit of \$395 and \$393, respectively, due to a release of a state reserve as the statute of limitation for the tax return expired in the quarter. The effective tax rate for the 2020 six-month period was favorably impacted by the reversal of valuation allowance reserves totaling \$37,694, which were established in prior years on our deferred tax assets primarily associated with net operating loss (“NOL”) carryforwards. For the three and six months ended June 30, 2019, we had NOLs which generated deferred tax assets for NOL carryforwards. During 2019, we provided valuation allowances against the net deferred tax assets including the deferred tax assets for NOL carryforwards. At June 30, 2020, we had deferred tax assets of \$8,536.

A valuation allowance is provided for deferred tax assets when, in our judgment, based upon currently available information and other factors, it is more likely than not that all or a portion of such deferred income tax assets will not be realized. The determination of the need for a valuation allowance is based on an on-going evaluation of current information including, among other things, historical operating results, estimates of future earnings in different taxing jurisdictions and the expected timing of the reversals of temporary differences. We believe the determination to record, or reduce, a valuation allowance associated with a deferred income tax asset is a significant accounting estimate because it is based, among other things, on an estimate of future taxable

income in the United States and certain other jurisdictions, which is susceptible to change and may or may not occur, and because the impact of adjusting a valuation allowance may be material. In determining when to release the valuation allowance established against our net deferred income tax assets, we consider all available evidence, both positive and negative.

As a result of the significant taxable income recognized in the six months ended June 30, 2020, we determined that it was more likely than not that we will recover our deferred tax assets and accordingly the valuation allowances were reduced during the period. During 2019, consistent with our policy, and because of our history of operating losses, we did not recognize the benefit of our deferred tax assets, including NOL carryforwards, that may have been used to offset future taxable income. We continually assess our ability to generate sufficient taxable income during future periods in which our deferred tax assets may be realized.

Internal Revenue Code Section 382 places a limitation (the “IRC Section 382 Limitation”) on the amount of net operating loss carryforwards that can be used to offset taxable income after a change in control (generally greater than 50% change in ownership) of a loss corporation. California, the state in which our headquarters was once located, has similar rules. Generally, after a control change, a loss corporation cannot deduct net operating loss carryforwards generated in years prior to the deemed change of control under IRC Section 382 in excess of the Section 382 Limitation. Because we have concluded that the Company has not experienced a change in control under Section 382, all NOL carryforwards were utilized to offset taxable income generated in the period.

Our tax years for 2005 and forward are subject to examination by the U.S. tax authority and various state tax authorities. These years are open due to NOLs and tax credits to be utilized from such years.

Our policy is to recognize interest and penalties accrued on uncertain tax positions as a component of income tax expense. As of June 30, 2020, we had accrued immaterial amounts of interest and penalties related to the uncertain tax positions.

Liquidity and Capital Resources

As of June 30, 2020, our cash and cash equivalents totaled approximately \$270,183 and our short-term investments totaled approximately \$2,622, compared to cash and cash equivalents of approximately \$3,135 and short-term investments of approximately \$2,394 at December 31, 2019, respectively. Working capital was \$223,683 at June 30, 2020, and \$3,945 at December 31, 2019. The increase in cash and investments during the three months June 30, 2020, will be sufficient to fund our current level of selling, general and administration costs, including legal expenses and provide related working capital for the foreseeable future. Over the longer term, we expect to derive the majority of our future revenue from license fees and royalties associated with our patent portfolio, technology, software and secure domain name registry in the United States and other markets around the world.

Dividends

On May 8, 2020, we declared a one-time cash dividend of \$1 per share of common stock, payable on May 26, 2020 to shareholders of record as of the close of business on May 18, 2020. The timing and amount of future dividends, if any, will depend on market conditions, corporate business and financial considerations and regulatory requirements.

Universal Shelf Registration Statement and ATM Offering

On July 30, 2018 we filed a \$100,000 universal shelf registration statement on SEC Form S-3 which was declared effective by the SEC on August 16, 2018. We also entered an at-the-market equity offering sales agreement (“ATM”) with Cowen & Company, LLC on August 31, 2018, under which we can offer and sell shares of our common stock having an aggregate value of up to \$50,000.

We use the ATM proceeds for GABRIEL product development, marketing and general corporate purposes, which may include working capital, capital expenditures, other corporate expenses and acquisitions of complementary products, technologies or businesses. As of June 30, 2020, common stock with an aggregate value of up to \$21,964 remained available for offer and sale under the ATM agreement.

During the six months ended June 30, 2020, we sold 1,049,382 shares under the ATM. The average sales price per common share was \$4.41 and the aggregate proceeds from the sales totaled \$4,627 during the period. Sales commissions, fees and other costs associated with the ATM totaled \$139. No sales were made under the ATM during the three months ended June 30, 2020.

Contractual Obligations

There have been no material changes to the contractual obligations disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019.

Off-Balance Sheet Arrangements

None.

ITEM 3 — QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Interest Rate Risk

We invest our excess cash primarily in highly liquid instruments including time deposits, money market, and U.S. agency securities. We seek to limit the amount of our credit exposure to any one issuer.

Investments in fixed rate instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates. Due in part to these factors, our income from investments may decrease in the future.

We considered the historical volatility of short-term interest rates and determined that it was reasonably possible that an adverse change of 100 basis points could be experienced in the near term but would have an immaterial impact in the fair value of our marketable securities, which generally mature within one year of June 30, 2020.

Other Market Risks

We considered the historical volatility of our stock prices and determined that it was reasonably possible that the fair market value of our stock price could increase or decrease substantially in the near term and could have a material impact to our consolidated balance sheets and statement of operations with respect to future stock-based compensation costs and other equity transactions.

ITEM 4 — CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of June 30, 2020.

The purpose of this evaluation was to determine whether as of June 30, 2020 our disclosure controls and procedures were effective to provide reasonable assurance that the information we are required to disclose in our filings with the SEC, (i) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Based on their evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of June 30, 2020, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting.

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2020 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We have not experienced any material impact to our internal controls over financial reporting even though most of our employees are working remotely due to the COVID-19 pandemic. We are continually monitoring and assessing the impact of the COVID-19 outbreak on our internal controls to minimize the impact on their design and operating effectiveness.

PART II — OTHER INFORMATION

ITEM 1 — LEGAL PROCEEDINGS

We have several intellectual property infringement lawsuits pending in the United States District Court for the Eastern District of Texas, Tyler Division (“USDC”), and United States Court of Appeals for the Federal Circuit (“USCAFC”).

VirnetX Inc. v. Cisco Systems, Inc. et al. (Case 6:10-CV-00417-LED) (“Apple I”)

On August 11, 2010, we filed a complaint against Aastra USA, Inc. (“Aastra”), Apple Inc. (“Apple”), Cisco Systems, Inc. (“Cisco”), and NEC Corporation (“NEC”) the USDC in which we alleged that these parties infringe on certain of our patents (U.S. Patent Nos. 6,502,135, 7,418,504, 7,921,211 and 7,490,151). We sought damages and injunctive relief. The cases against each defendant were separated by the judge. Aastra and NEC agreed to sign license agreements with us, and we dropped all accusations of infringement against them. A jury in USDC decided that our patents were not invalid and rendered a verdict of non-infringement by Cisco on March 4, 2013. Our motion for a new Cisco trial was denied and the case against Cisco was closed.

On November 6, 2012, a jury in the USDC awarded us over \$368,000 for Apple’s infringement of four of our patents, plus daily interest up to the final judgment.

Apple filed an appeal of the judgment to the USCAFC. On September 16, 2014, USCAFC affirmed the USDC jury’s finding that all four of our patents at issue are valid and confirmed the USDC jury’s finding of infringement of VPN on Demand under many of the asserted claims of our ‘135 and ‘151 patents, and the USDC’s decision to allow evidence about our license and royalty rates regarding the determination of damages. However, the USCAFC vacated the USDC jury’s damages award and some of the USDC’s claim construction with respect to parts of our ‘504 and ‘211 patents and remanded the damages award and determination of infringement with respect to FaceTime back to the USDC for further proceedings.

On September 30, 2016, pursuant to the 2014 remand from the USCAFC, a jury in the USDC awarded us \$302,400 for Apple’s infringement of four of our patents. On September 29, 2017, the USDC entered its final judgment, denied all of Apple’s post-trial motions, granted all our post-trial motions, including our motion for willful infringement and enhanced the royalty rate during the willfulness period from \$1.20 to \$1.80 per device, and awarded us costs, certain attorneys’ fees, and prejudgment interest. The total amount in the final judgment was \$439,700, including \$302,400 (jury verdict), \$41,300 (enhanced damages) and \$96,000 (costs, fees and interest).

On October 27, 2017 Apple appealed the final judgment entered on September 29, 2017 to the USCAFC. Oral arguments in this case were held on January 8, 2019. On January 15, 2019 the Court issued a Rule 36 order affirming the district court’s final judgment. Apple filed a petition for panel rehearing and rehearing en-banc in this matter on February 21, 2019. On October 1, 2019, USCAFC issued an order denying Apple’s petition. Apple filed a petition for a writ of certiorari with the U.S. Supreme Court, which was denied on February 24, 2020. Prior to the Supreme Court decision denying Apple’s petition for a writ of certiorari, on February 20, 2020, Apple filed a Rule 60(b) motion for relief from judgment with the USDC, seeking relief from the district court’s September 29, 2017 final judgment. VirnetX filed a responsive brief in opposition on March 5, 2020.

On March 13, 2020, the Company received payment of \$454,034 from Apple, representing the previously announced final judgment with interest in this case. Apple has indicated that it will seek restitution of the payment if relief sought in its Rule 60(b) motion is awarded. As ordered by the USDC, Apple filed its supplemental brief with respect to its Rule 60(b) motion on April 23, 2020. The USDC has not ruled in this matter.

VirnetX Inc. v. Apple, Inc. (Case 6:12-CV-00855-LED) (“Apple II”)

This case began on November 6, 2012, when we had filed a complaint against Apple in USDC in which we alleged that Apple infringed on certain of our patents, (U.S. Patent Nos. 6,502,135, 7,418,504, 7,921,211 and 7,490,151). We sought damages and injunctive relief. The accused products include the iPhone 5, iPod Touch 5th Generation, iPad 4th Generation, iPad mini, and the latest Macintosh computers; these products were not included in the Apple I case because they were released after the Apple I case was initiated. Post-trial motions hearing was held on July 18, 2018. On August 31, 2018, the USDC entered a Final Judgment and issued its Memorandum Opinion and Order regarding post-trial motions, affirming the jury’s verdict of \$502,600 and granting VirnetX motions for supplemental damages, a sunset royalty and the royalty rate of \$1.20 per infringing iPhone, iPad and Mac products, pre-judgment and post-judgment interest and costs. On September 20, 2018, pursuant to a Court’s order, attorneys from VirnetX and Apple conferred and agreed, without dispute, to add an amount totaling \$93,300 for Bill of Costs and Prejudgment Interest to the \$502,600 jury verdict. The total amount in the final judgment in the Apple II case is now \$595,900. Apple has filed a notice of appeal with the USCAFC in the Apple II case.

On October 9, 2018, USCAFC docketed the appeal as Case No. 19-1050 - VirnetX Inc. v. Apple Inc. On January 24, 2019 Apple filed its opening brief. We filed our response brief on March 1, 2019. Apple filed its reply brief on April 5, 2019. The oral arguments were heard on October 4, 2019. On November 22, 2019, the USCAFC issued an opinion affirming the district court’s findings that Apple is precluded from making certain invalidity arguments and that Apple infringed the ‘135 and ‘151 patents; reversing the district court’s finding that Apple infringed the ‘504 and ‘211 patents; and remanding the case for proceedings on damages. Apple sought panel and en banc rehearing, which the USCAFC denied on February 10, 2020.

On February 22, 2020, the USDC issued a scheduling order for the parties to brief the court about the need for a new trial for recalculating the damages. We filed our motion for entry of judgment on February 28, 2020. The arguments on this matter were heard on April 14, 2020. In its order, unsealed on May 1, 2020, the district court denied VirnetX's motion for entry of a new judgment based on the prior jury verdict and ordered a new jury trial on damages. The jury selection and trial has been scheduled on August 17, 2020.

VirnetX Inc. v. Cisco Systems, Inc. (USCAFC Case 19-1671)

On March 18, 2018, we filed with the USCAFC an appeal of the invalidity findings by the PTAB in inter-partes reexamination no. 95/001,679 involving our U.S. Patent No. 6,502,135. We filed a motion to remand on August 23, 2019, which the USCAFC denied on October 1, 2019, directing the parties to address the issues in the merits briefs. On November 7, 2019, we filed another motion to vacate and remand in light of Arthrex. The USPTO intervened and opposed the remand. The USCAFC granted our motion on January 24, 2020. On March 9, 2020, Cisco and the USPTO both filed petitions for panel and en banc rehearing, which were denied on May 13, 2020. The mandate vacating the case and remanding it to PTAB was issued on May 20, 2020

McKool Smith P.C. v. VirnetX, Inc., AAA Case No. 01-20-0003-7975

On March 23, 2020, the law firm of McKool Smith, P.C. ("McKool") filed a Demand for Arbitration against VirnetX, Inc. with the American Arbitration Association ("AAA"). In its demand, McKool claims that a retention agreement it entered into in 2010 with VirnetX entitles it to a contingency fee arising from the recent 2020 payment made by Apple. McKool claims it is owed \$36.3 million (or 8% of the payment). We have filed a general response with AAA denying McKool's claim and intend to vigorously contest the matter.

Neal Hurwitz v. Kendall Larsen et al. (Case 2020-0425-JRS)

On June 2, 2020, stockholder Neal Hurwitz filed a verified derivative complaint in the Delaware Court of Chancery against Kendall Larsen, Robert D. Short III, Gary Feiner, Michael F. Angelo, and Thomas M. O'Brien and naming the Company as nominal defendant. The lawsuit alleges breaches of fiduciary duty, corporate waste, and unjust enrichment arising out of a series of previously-disclosed transactions and compensation awards and seeks an award of monetary damages and equitable relief. On July 1, 2020, the defendants filed a motion to dismiss the complaint based on a failure to plead demand futility and a failure to state a claim on which relief can be granted. The parties are currently briefing the motion, which briefing is expected to be complete by October 2020, with the court to hold a hearing and render a decision on the motion thereafter.

One or more potential intellectual property infringement claims may also be available to us against certain other companies who have the resources to defend against any such claims. Although we believe these potential claims are likely valid, commencing a lawsuit can be expensive and time-consuming, and there is no assurance that we could prevail on such potential claims if we made them. In addition, bringing a lawsuit may lead to potential counterclaims which may distract our management and our other resources, including capital resources, from efforts to successfully commercialize our products.

Currently, we are not a party to any other pending legal proceedings and are not aware of any proceeding threatened or contemplated against us.

ITEM 1A — RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties, including those described below, which could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our common and capital stock. You should carefully consider the risks and uncertainties described below in addition to the other information set forth in this Quarterly Report on Form 10-Q, including the section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and related notes, before making any investment in our common stock. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently believe to be immaterial may also adversely affect our business. If any of these risk factors occur, you could lose substantial value or your entire investment in our shares.

Risks Related to Our Business and Our Financial Reporting

We are involved and will continue to be involved in litigation defending our patent portfolio, which can be time-consuming and costly, and we cannot anticipate the results.

We spend a significant amount of our financial and management resources to pursue our current litigation. We believe that this litigation and others that we may pursue in the future could continue for years and consume significant financial and management resources. The counterparties to our litigation include large, well-financed companies with substantially greater resources than us. Patent litigation is risky, and the outcome is uncertain, and we cannot assure you that any of our current or future litigation matters will result in a favorable outcome for us. In addition, even if we obtain favorable interim rulings or verdicts, they may be inconsistent with the ultimate resolution of the dispute. Also, we cannot assure you that we will not be exposed to claims or sanctions against us which may be costly or impossible for us to defend. Unfavorable or adverse outcomes may result in losses, exhaustion of financial resources or other adverse effects, which could encumber our ability to develop and commercialize our products.

We may not be able to capitalize on market opportunities related to our licensing strategy or our patent portfolio.

Our business strategy includes licensing our patents and technology to other companies in order to reach a larger end-user base than we could reach through direct sales and marketing efforts; as such, our business strategy and revenues will depend on intellectual property licensing fees and royalties for the majority of our revenues. We currently derive minimal revenue from licensing activities, and royalties, and we cannot assure you that we will successfully capitalize on our market opportunities or that our current business strategy will succeed. Factors that may affect our ability to execute our current business strategy include, but are not limited to, the following:

Although to date we have entered into a limited number of settlement and license agreements, we may not be successful in entering into further licensing relationships, or if we are successful in entering into such relationships, the acquisition of them may be expensive, and they, as well as our existing settlement and our existing and pending license agreements may not generate the financial results we expect;

- Third parties may challenge the validity of our patents.
- The pendency of our various litigations may cause potential licensees not to do business with us;
- We face, and we expect to continue to face, intense competition from new and established competitors who may have superior products and services or better marketing, financial or other capacities than we do; and
- It is possible that one or more of our potential customers or licensees develops or otherwise sources products or technologies similar to, competitive with or superior to ours.

If we are not able to adequately protect our patent rights, our business would be negatively impacted.

We believe our patents are valid, enforceable and valuable. Notwithstanding this belief, third parties may make claims of infringement or invalidity claims with respect to our patents and such claims could give rise to material cost for defense or settlement or both, jeopardize or substantially delay a successful outcome of litigation we are or may become involved in, divert resources away from our other activities, limit or cease our revenues related to such patents, or otherwise materially and adversely affect our business. Similar challenges could also prevent us from obtaining additional patents in the future. Additionally, several of our patents are currently, and other patents may in the future be, subject to United States Patent and Trademark Office (“USPTO”) post-grant inter partes review proceedings (“IPR”) which may result in all or part of these patents being invalidated, or the claims of our patents being limited. Unfavorable or adverse outcomes in our litigation or IPRs may result in losses, exhaustion of financial resources, reduction in our ability to enforce our intellectual property rights, or other adverse effects, which could encumber our ability to develop and commercialize our products. Even if we are successful in enforcing our intellectual property rights, our patents may not ultimately provide us with any competitive advantages and may be less valuable than we currently expect. These risks may be heightened in countries other than the United States where laws regarding patent protection are less developed and may be negatively affected by the fact that legal standards in the United States and elsewhere for protection of intellectual property rights in Internet-related businesses are uncertain and still evolving. In addition, there are a significant number of United States and foreign patents and patent applications in our areas of interest, and we expect that significant litigation in these areas will continue and will add uncertainty to the value of certain patents and other intellectual property rights in our areas of interest. If we are unable to protect our intellectual property rights or otherwise realize value from them, our business would be negatively affected.

We can provide no assurances that the licensing of our essential security patents under FRAND will be successful.

At the request of the European Telecommunications Standards Institute (“ETSI”), and the Alliance for Telecommunications Industry Solutions (“ATIS”), we agreed to update our licensing declaration to ETSI and ATIS under their respective Intellectual Property Rights policies. This was in response to our Statement of Patent Holder identifying a group of our patents and patent applications that we believe are or may become essential to certain developing specifications in the 3rd Generation Partnership Project Long Term Evolution (“LTE”), Systems Architecture Evolution project. We will make available a non-exclusive patent license under FRAND (fair, reasonable and non-discriminatory terms and conditions, with compensation) for the patents identified by us that are or become essential to applicants desiring to implement the Technical Specifications identified by us, as set forth in the updated licensing declaration under the ATIS and ETSI Intellectual Property Rights policies. Our licensing declarations under the ATIS and ETSI Intellectual Property Rights policies may limit our flexibility in determining royalties and license terms for certain of our patents. Consequently, we cannot assure you that the licensing of the essential security patents will be successful or that third parties will be willing to enter into licenses with us on reasonable terms or at all, which could have an adverse effect on our business and harm our competitive position.

Because our business is conducted or expected to be conducted in an environment that is subject to rapid change, we may be subject to various developments in regulation, law and consumer preferences to which we may not be able to adapt successfully.

The current regulatory environment for our products and services remains unclear. We can give no assurance that our planned product offerings will be in compliance with laws and regulations of local, state, United States federal or foreign authorities. Further, we can give no assurance that we will not unintentionally violate such laws or regulations or that such laws or regulations will not be modified, or that new laws or regulations will be enacted in the future which would cause us to be in violation of such laws or regulations. For example, Voice-Over-Internet Protocol (“VoIP”) services are not currently subject to all the same regulations that apply to traditional telephony, but it is possible that similar regulations may be applied to VoIP in the future and that these could result in substantial costs to us which could adversely affect the marketability of our products and planned products related to VoIP. For further example, the use of the Internet and private Internet Protocol (“IP”) networks for communication is largely unregulated within the United States, but may become regulated in the future; additionally, several foreign governments have enacted measures that could restrict or prohibit voice communications services over the Internet or private IP networks.

Our business depends on the growth of instant messaging, VoIP, mobile services, streaming video, file transfer and remote desktop and other next-generation Internet-based applications. A decline in the use of these applications due to complexity or cost of these applications relative to alternate traditional or newly developed communications channels, or development of alternative technologies, could cause a material decline in the number of users in these areas.

More aggressive domestic or international regulation of the Internet in general, and Internet telephony providers and services specifically may materially and adversely affect our business, financial condition, operating results and future prospects.

Our exposure to outside influences beyond our control, including new legislation, court rulings or actions by the United States Patent and Trademark Office, could adversely affect our licensing and enforcement activities and results of operations.

Our licensing and enforcement activities are subject to numerous risks from outside influences, including the following:

- New legislation, regulations or rules related to obtaining patents or enforcing patents could significantly increase our operating costs and decrease our revenue. For instance, the United States Supreme Court has modified some tests used by the USPTO in granting patents during the past 20 years which may decrease the likelihood that we will be able to obtain patents and increase the likelihood of challenge of any patents we obtain or license. In addition, in 2012 the United States enacted sweeping changes to the United States patent system under the Leahy-Smith America Invents Act, including changes that transition the United States from a “first-to-invent” system to a “first to file” system and alter the processes for challenging issued patents;
- More patent applications are filed each year resulting in longer delays in getting patents issued by the USPTO;
- Federal courts are becoming more crowded, and as a result, patent enforcement litigation is taking longer; and
- As patent enforcement becomes more prevalent, it may become more difficult for us to voluntarily license our patents.

New legislation, regulations or court rulings related to enforcing patents could harm our business and operating results.

Intellectual property is the subject of intense scrutiny by the courts, legislatures and executive branches of governments around the world. Various patent offices, governments or intergovernmental bodies may implement new legislation, regulations or rulings that impact the patent enforcement process, or the rights of patent holders and such changes could negatively affect licensing efforts and/or litigations. For example, limitations on the ability to bring patent enforcement claims, limitations on potential liability for patent infringement, lower evidentiary standards for invalidating patents, increases in the cost to resolve patent disputes and other similar developments could negatively affect our ability to assert our patent or other intellectual property rights.

It is impossible to determine the extent of the impact of any new laws, regulations or initiatives that may be proposed, or whether any of the proposals will become enacted as laws. Compliance with any new or existing laws or regulations could be difficult and expensive, affect the manner in which we conduct our business and negatively impact our business, prospects, financial condition and results of operations. We may need to raise additional capital to support our business growth, and this capital will be dilutive, may cause our stock price to drop or may not be available on acceptable terms, if at all.

We may need to raise additional capital, which may not be available to us when needed or may not be available on terms acceptable to us, to support our business growth or to respond to business opportunities, challenges or unforeseen circumstances, including sales under our ATM or our universal shelf registration statement. Our ability to obtain additional capital, if and when required, will depend on our business plans, investor demand, our operating performance, the condition of the capital markets, the terms of our current contractual obligations and other factors. If we raise additional funds through the issuance of equity, equity-linked or debt securities, including those under our ATM or our Universal Shelf Registration Statement, those securities may have rights, preferences, or privileges senior to the rights of our common stock, and our existing stockholders may experience dilution. Additionally, we are unable to predict the future success of our ATM offering or any other offering. Sales of a substantial number of shares of our common stock in the public market, or the perception that these sales or other financings might occur, could depress the market price of our common stock and could also impair our ability to raise capital through the sale of additional equity securities. If we issue debt securities or incur indebtedness, we could experience increased future payment obligations and a need to comply with restrictive covenants, such as limitations on our ability to incur additional debt, limitations on our ability to acquire, sell or license intellectual property rights and other operating restrictions that could adversely impact our ability to conduct our business. If we are unable to obtain additional capital or are unable to obtain additional capital on satisfactory terms, our ability to continue to support our business growth or to respond to business opportunities, challenges, or other circumstances could be adversely affected, and our business may be harmed.

If we experience security breaches, we could be exposed to liability and our reputation and business could suffer.

We expect to retain certain confidential and proprietary customer information in our secure data centers and secure domain name registry, as well as personal data and other confidential and proprietary information relating to our business. It will be critical to our business strategy that our facilities and infrastructure remain secure and are perceived by the marketplace to be secure. Our secure domain name registry operations will also depend on our ability to maintain our computer and telecommunications equipment in effective working order and to reasonably protect our systems against interruption, and potentially depend on protection by other registrars in the shared registration system. The secure domain name servers that we will operate will be critical hardware to our registry services operations. Therefore, we expect to have to expend significant time and money to maintain or increase the security of our products, facilities and infrastructure. Security technologies are constantly being tested by computer professionals, academics and “hackers.” Advances in computer capabilities and the techniques for attacking security solutions, new discoveries in the field of cryptography or other events or developments could result in compromises or breaches of our security measures and could make some or all our products obsolete or unmarketable. Likewise, if any of our products are found to have significant security vulnerabilities, then we may need to dedicate engineering and other resources to eliminate the vulnerabilities and to repair or replace products already sold or licensed to our customers. Despite the security measures that we and our service providers utilize, our infrastructure and that of our service providers may be vulnerable to physical break-ins, computer viruses, attacks by hackers, phishing attacks, social engineering, or similar disruptive problems. It is possible that we may have to expend additional financial and other resources to address such problems. The COVID-19 pandemic is increasing vulnerability to cyber-attacks, as more individuals and companies work online, which increases these risks. As a provider of Internet security software and technology, we may be the target of dedicated efforts by hackers and other third parties to overcome or defeat our security measures. Any physical or electronic break-in or other security breach or compromise of the information stored at our secure data centers and domain name registration systems, including any compromise due to human error or employee or contractor malfeasance, may jeopardize the security of information stored on our premises or in the computer systems and networks of our customers. In such an event, we could face significant liability and current or potential customers could be reluctant to use our services. Additionally, any such data security incident, or the perception that one has occurred could also result in adverse publicity, harm to our reputation and competitive position, and therefore adversely affect the market’s perception of the security of electronic commerce and communications over IP networks as well as the security or reliability of our services.

A security breach or other security incident could require a substantial level of financial resources to rectify and otherwise respond to, may be difficult to identify or address in a timely manner, and could result in claims, investigations, and inquires by private parties or governmental entities that may divert management’s attention and require the expenditure of significant time and resources, and which may cause us to incur substantial fines, penalties, or other liability and related legal and other costs. Any actual or perceived security breach or other security incident may also harm our reputation and make it more difficult or impossible for us to successfully market to others. Any of the foregoing matters could harm our operating results and financial condition.

Privacy and data security concerns, and data collection and transfer restrictions and related domestic or foreign regulations may limit the use and adoption of our solutions and adversely affect our business.

Personal privacy, information security, and data protection are significant issues in the United States, Europe and many other jurisdictions where we have operations or offer our products. The regulatory framework governing the collection, processing, storage and use of confidential and proprietary business information and personal data is rapidly evolving. The United States federal and various state and foreign governments have adopted or proposed requirements regarding the collection, distribution, use, security and storage of personally identifiable information and other data relating to individuals, and federal and state consumer protection laws are being applied to enforce regulations related to the online collection, use and dissemination of data.

Further, many foreign countries and governmental bodies, including the European Union (“EU”), where we conduct business, have laws and regulations concerning the collection and use of personal data obtained from their residents or by businesses operating within their jurisdiction. These laws and regulations often are more restrictive than those in the United States. Laws and regulations in these jurisdictions apply broadly to the collection, use, storage, disclosure and security of data that identifies or may be used to identify or locate an individual, such as names, email addresses and, in some jurisdictions, IP addresses.

We also expect that there will continue to be new proposed laws, regulations and industry standards concerning privacy, data protection and information security in the United States, the EU, and other jurisdictions. For example, the European Commission adopted a General Data Protection Regulation (the “GDPR”) that became fully effective on May 25, 2018, superseding prior EU data protection legislation, imposing more stringent EU data protection requirements, and providing for greater penalties for noncompliance. The United Kingdom enacted a Data Protection Act that substantially implements the GDPR. We are evaluating obligations imposed on us by the GDPR and we may be required to incur substantial expense in order to make significant changes to our product and business operations in connection with obtaining and maintaining compliance with the GDPR and similar legislation, such as the UK Data Protection Act, all of which may adversely affect our revenue and product sales. Additionally, California recently enacted legislation, the California Consumer Privacy Act (the “CCPA”) that, among other things, requires covered companies to provide new disclosures to California consumers, and afford such consumers new abilities to opt-out of certain sales of personal information. We cannot fully predict the impact of the CCPA on our business or operations, but it may require us to modify our data processing practices and policies and to incur substantial costs and expenses in an effort to comply. Additionally, a new privacy law, the California Privacy Rights Act (“CPRA”), recently was certified by the California Secretary of State to appear on the ballot for the November 3, 2020 election. If this initiative is approved by California voters, the CPRA would significantly modify the CCPA, potentially resulting in further uncertainty and requiring us to incur additional costs. More generally, we cannot yet fully determine the impact these or future laws, regulations and standards may have on our business. Privacy, data protection and information security laws and regulations are often subject to differing interpretations, may be inconsistent among jurisdictions, and may be alleged to be inconsistent with our current or future practices. Additionally, we may be bound by contractual requirements applicable to our collection, use, processing, and disclosure of various types of data, including personal data, and may be bound by, or voluntarily comply with, self-regulatory or other industry standards relating to these matters. These and other requirements could reduce demand for our products, increase our costs, impair our ability to grow our business, or restrict our ability to store and process data or, in some cases, impact our ability to offer our service in some locations and may subject us to liability. Any failure or perceived failure to comply with applicable laws, regulations, industry standards, and contractual obligations may adversely affect our business. Further, in view of new or modified federal, state or foreign laws and regulations, industry standards, contractual obligations and other legal obligations, or any changes in their interpretation, we may find it necessary or desirable to fundamentally change our business activities and practices or to expend significant resources to modify our product and otherwise adapt to these changes. We may be unable to make such changes and modifications in a commercially reasonable manner or at all, and our ability to develop new products and features could be limited.

The costs of compliance with and other burdens imposed by laws, regulations and standards may limit the use and adoption of our service and reduce overall demand for it, or lead to significant fines, penalties or liabilities for any noncompliance. Privacy, information security, and data protection concerns, whether valid or not valid, may inhibit market adoption of our platform, particularly in certain industries and foreign countries.

We expect that we will experience long and unpredictable sales cycles, which may impact our operating results.

The sales cycle between initial customer contact and execution of a contract or license agreement with a customer or purchaser of our products can vary widely. We expect that our sales cycles will be long and unpredictable due to several factors, including but not limited to:

- The need to educate potential customers about our patent rights and our product and service capabilities;
- The impact of the COVID-19 pandemic on our potential customers and their business operations, including their budgetary constraints and resources devoted to adopting new products.
- Our customers’ willingness to invest potentially substantial resources and modify their network infrastructures to take advantage of our products;
- Our customers’ budgetary constraints;
- The timing of our customers’ budget cycles;
- Delays caused by customers’ internal review processes; and
- Long sales cycles that may increase the risk that our financial resources are exhausted before we are able to generate significant revenue.

In addition, potential customers of our products include local, state, federal and foreign government authorities. Sales to government authorities can be extended and unpredictable. Government authorities generally have complex budgeting, purchasing, and regulatory processes that govern their capital spending, and their spending is likely to be adversely impacted by economic conditions, including impacts from the COVID-19 pandemic. In addition, in many instances, sales to government authorities may require field trials and may be delayed by the time it takes for government officials to evaluate multiple competing bids, negotiate terms, and award contracts.

For these reasons the sales cycle associated with our products is subject to a number of significant risks that are beyond our control. Consequently, if our forecasted customer orders are not realized or delayed, our revenues and results of operations could be materially and adversely affected.

If we are unable to expand our revenue sources or establish, sustain, grow or replace relationships with a diversified customer base, our revenues may be limited.

We currently generate revenue from a limited number of customers that have entered Settlement and License Agreements. Our GABRIEL Collaboration Suite™ is currently generating limited revenue, it will take time for us to grow our installed user base and generate new customers. Additionally, there is no guarantee that we will be able to derive revenue from new customers, sustain or increase revenue from existing customers or replace customers from whom we currently generate revenue. As a result, our revenue may be limited or static.

We have limited technical resources and are at an early stage in commercialization of our GABRIEL Collaboration Suite™.

Part of our business includes the internal development of commercial products we seek to monetize. This aspect of our business may require significant capital, time and resources and we cannot guarantee that it will be successful or meet our expectations. We currently have only one commercial product, the GABRIEL Collaboration Suite™. As such, we have a small technical team, which may limit our ability to rapidly adapt our product to customer requirements or add new product features to maintain our competitive edge and drive adoption. Based on the scale of our technical resources, our limited historical financial data upon which to base our projected revenue or planned operating expenses related to our GABRIEL Collaboration Suite™, we may not be able to effectively:

- Generate revenues or profit from product sales;
- Drive adoption of our products;
- Attract and retain customers for our products;
- Provide appropriate levels of customer training and support for our products;
- Implement an effective marketing strategy to promote awareness of our products;
- Focus our research and development efforts in areas that generate returns on our efforts;
- Anticipate and adapt to changes in our market; or
- Protect our products from any system failures or other breaches.

In addition, a high percentage of our expenses are and will continue to be fixed. Accordingly, if we do not generate revenue as and when anticipated, our losses may be greater than expected and our operating results will suffer.

Our products are highly technical and may contain undetected errors, which could cause harm to our reputation and adversely affect our business.

Our products are highly technical and complex and, when deployed, may contain errors or defects. Despite testing, some errors in our products may only be discovered after a product has been installed and used by customers. Any errors or defects discovered in our products after commercial release could result in failure to achieve market acceptance, loss of revenue or delay in revenue recognition, loss of customers and increased service and warranty cost, any of which could adversely affect our business, operating results and financial condition. In addition, we could face claims for product liability, tort or breach of warranty, including claims relating to changes to our products made by our channel partners. The performance of our products could have unforeseen or unknown adverse effects on the networks over which they are delivered as well as on third-party applications and services that utilize our services, which could result in legal claims against us, harming our business. Furthermore, we expect to provide implementation, consulting and other technical services in connection with the implementation and ongoing maintenance of our products, which typically involves working with sophisticated software, computing and communications systems. We expect that our contracts with customers will contain provisions relating to warranty disclaimers and liability limitations, which may not be upheld. Defending a lawsuit, regardless of its merit, is costly and may divert management's attention and adversely affect the market's perception of us and our products. In addition, if our business liability insurance coverage proves inadequate or future coverage is unavailable on acceptable terms or at all, our business, operating results and financial condition could be adversely impacted.

Malfunctions of third-party communications infrastructure, hardware and software expose us to a variety of risks that we cannot control.

Our business will depend upon, among other things, the capacity, reliability, security and unimpeded access of the infrastructure owned by third parties that we will use to deploy our offerings. We have no control over the operation, quality or maintenance of a significant portion of that infrastructure or whether those third parties will upgrade or improve their equipment. We depend on these companies to maintain the operational integrity of our connections. If one or more of these companies is unable or unwilling to supply or expand its levels of service to us in the future, our operations could be severely interrupted. Also, to the extent that the number of users of networks utilizing our current or future products suddenly increases, the technology platform and secure hosting services which will be required to accommodate a higher volume of traffic may result in slower response times or service interruptions. System interruptions or increases in response time could result in a loss of potential or existing users and, if sustained or repeated, could reduce the appeal of the networks to users. In addition, users depend on real-time communications; outages caused by increased traffic could result in delays and system failures. These types of occurrences could cause users to perceive that our solution does not function properly and could therefore adversely affect our ability to attract and retain licensees, strategic partners and customers.

System failure or interruption or our failure to meet increasing demands on our systems could harm our business.

The success of our license and service offerings will depend on the uninterrupted operation of various systems, secure data centers and other computer and communication networks that we establish. To the extent, the number of users of networks utilizing our future products suddenly increases, the technology platform and hosting services which will be required to accommodate a higher volume of traffic may result in slower response times, service interruptions or delays or system failures. Our systems and operations will also be vulnerable to damage or interruption from, among other things:

- Power loss, transmission cable cuts and other telecommunications failures;
- Damage or interruption caused by fire, earthquake, and other natural disasters;
- Computer viruses or software defects; and
- Physical or electronic break-ins, sabotage, intentional acts of vandalism, terrorist attacks and other events beyond our control.

System interruptions or failures and increases or delays in response time could result in a loss of potential or existing users and, if sustained or repeated, could reduce the appeal of the networks to users. These types of occurrences could cause users to perceive that our solution does not function properly and could therefore adversely affect our ability to attract and retain licensees, strategic partners and customers.

Any significant problem with our systems or operations could result in lost revenue, customer dissatisfaction or lawsuits against us. A failure in the operation of our secure domain name registration system could result in the inability of one or more registrars to register and maintain secure domain names for a period of time. A failure in the operation or update of the master directory that we plan to maintain could result in deletion or discontinuation of assigned secure domain names for a period of time. The inability of the registrar systems we establish, including our back-office billing and collections infrastructure, and telecommunications systems to meet the demands of an increasing number of secure domain name requests could result in substantial degradation in our customer support service and our ability to process registration requests in a timely manner.

Our ability to sell our solutions will be dependent on the quality of our technical support, and our failure to deliver high- quality technical support services could have a material adverse effect on our sales and results of operations.

If we do not effectively assist our customers in deploying our products, succeed in helping our customers quickly resolve post- deployment issues and provide effective ongoing support, or if potential customers perceive that we may not be able achieve to the foregoing, our ability to sell our products would be adversely affected, and our reputation with current and potential customers could be harmed. In addition, as we expand our operations internationally, our technical support team will face additional challenges, including those associated with delivering support, training and documentation in languages other than English. Our failure to deliver and maintain high-quality technical support services to our customers could result in customers choosing to use our competitors' products and support services instead of ours in the future.

Telephone carriers have petitioned governmental agencies to enforce regulatory tariffs, which, if granted, would increase the cost of online communication, and such increase in cost may impede the growth of online communication and adversely affect our business.

Use of the Internet has over-burdened existing telecommunications infrastructures, and many high traffic areas have begun to experience interruptions in service. As a result, certain local telephone carriers have petitioned governmental agencies to enforce regulatory tariffs on IP telephony traffic that crosses over their traditional telephone networks. If the relief sought in these petitions is granted, the costs of communicating via online could increase substantially, potentially adversely affecting the growth in the use of online secure communications. Any of these developments could have an adverse effect on our business.

The departure of Kendall Larsen, our Chief Executive Officer and President, and/or other key personnel could compromise our ability to execute our strategic plan and may result in additional severance costs to us.

Our success largely depends on the skills, experience and performance of our key personnel. Due to the specialized nature of our business and limited staff, we are particularly dependent on Kendall Larsen, our Chief Executive Officer and President. We have no employment agreements with any of our key executives that prevent them from leaving us at any time. In addition, we do not maintain key person life insurance for any of our officers or key employees. The loss of Mr. Larsen, or our failure to retain other key personnel or failure to adequately plan for the succession of key personnel, would jeopardize our ability to execute our strategic plan and materially harm our business.

We will need to recruit and retain additional qualified personnel to successfully grow our business.

Our future success will depend, in part, on our ability to attract and retain qualified engineering, operations, marketing, sales and executive personnel. Inability to attract and retain such personnel could adversely affect our business. Competition for engineering, operations, marketing, sales and executive personnel is intense, particularly in the technology and Internet sectors and in the regions where we conduct our business. We may need to invest significant amounts of cash and equity to attract and retain employees and expend significant time and resources to identify, recruit, train and integrate such employees, and we may never realize returns on these investments. Additionally, we can provide no assurance that we will attract or retain such personnel.

Our international expansion will subject us to additional costs and risks, and our plans may not be successful.

We expect to expand our presence internationally in Japan and elsewhere through, third party arrangements such as international partnerships, joint ventures and potentially establishing international subsidiaries and offices. Our international expansion may present challenges and risks, including those inherent in international operations, to us and may require significant attention from management. For example, the COVID-19 pandemic could disrupt and slow our international expansion and partnership efforts, as our international partners' businesses could be disrupted. We may not be successful in our international partnerships, expansion efforts, and we may incur significant operating expenses in our efforts to expand internationally.

We have incurred and will continue to incur significant increased costs as a result of operating as a public company, and our management will be required to continue to devote substantial time to various compliance initiatives.

The Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, as well as other rules implemented by the SEC and the New York Stock Exchange ("NYSE"), impose various requirements on public companies, including requiring changes in corporate governance practices. These and proposed corporate governance laws and regulations under consideration may further increase our compliance costs. If compliance with these various legal and regulatory requirements diverts our management's attention from other business concerns, it could have a material adverse effect on our business, financial condition and operating results. The Sarbanes-Oxley Act requires, among other things, that we assess the effectiveness of our internal control over financial reporting annually and disclosure controls and procedures quarterly. If we are unable to assert in any future reporting periods that our internal control over financial reporting is effective (or if our independent registered public accounting firm is unable to express an opinion on the effectiveness of our internal controls), we could lose investor confidence in the accuracy and completeness of our financial reports, which would have an adverse effect on our share price.

Although we believe that we currently maintain effective control over our disclosures and procedures and internal control over financial reporting, we may in the future identify deficiencies regarding the design and effectiveness of our system of internal control over financial reporting. If we experience any material weaknesses in our internal control over financial reporting in the future or are unable to provide unqualified management or attestation reports about our internal controls, we may be unable to meet financial and other reporting deadlines and may incur costs associated with remediation, and any of which could cause our share price to decline. Moreover, if we identify deficiencies in our internal control over financial reporting that are deemed to be material weaknesses in future periods, the market price of our ordinary shares could decline, and we could be subject to potential delisting by the NYSE and review by the NYSE, the SEC, or other regulatory authorities, which would require the expenditure by us of additional financial and management resources. As a result, our shareholders could lose confidence in our financial reporting, which would harm our business and the market price of our ordinary shares.

There are inherent uncertainties involved in estimates, judgments and assumptions used in the preparation of financial statements in accordance with U.S. GAAP. Any changes in estimates, judgments and assumptions could have a material adverse effect on our business, financial condition and operating results.

The preparation of financial statements in accordance with U.S. GAAP involves making estimates, judgments and assumptions that affect reported amounts of assets (including intangible assets), liabilities and related reserves, revenues, expenses and income. Estimates, judgments and assumptions are inherently subject to change in the future, and any such changes could result in corresponding changes to the amounts of assets, liabilities, revenues, expenses and income. Any such changes could have a material adverse effect on our business, financial condition and operating results.

Our results of operations and financial condition could be materially affected by the enactment of legislation implementing changes in the U.S. or foreign taxation of international business activities or the adoption of other tax reform policies.

As we expand the scale of our international business activities, any changes in the U.S. or foreign taxation of such activities may increase our worldwide effective tax rate and harm our business, results of operations, and financial condition. For example, in December 2017, the legislation commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”) was enacted, which contained significant changes to U.S. tax law, including, but not limited to, a reduction in the corporate tax rate and a transition to a new territorial system of taxation. The impact of future changes to U.S. and foreign tax law on our business is uncertain and could be adverse, and we will continue to monitor and assess the impact of any such changes.

War, terrorism, other acts of violence, or natural or manmade disasters may affect the markets in which the Company operates, the Company’s clients and the Company’s service delivery.

The Company’s business may be adversely affected by instability, disruption or destruction in a geographic region in which it operates, regardless of cause, including war, terrorism, riot, civil insurrection or social unrest, and natural or manmade disasters, including famine, flood, fire, earthquake, storm or pandemic events and spread of disease, such as the COVID-19 pandemic. Such events may cause our customers to delay their decisions on spending for the services provided by the Company and give rise to sudden significant changes in regional and global economic conditions and cycles. These events may also pose risks to the Company’s personnel and to physical facilities and operations, which could adversely affect the Company’s financial results.

The global COVID-19 pandemic may harm our business, financial condition, and results of operations.

In December 2019, a novel coronavirus, COVID-19 was reported in China and in March 2020, the World Health Organization declared it a pandemic. This contagious disease outbreak has continued to spread across the globe and is impacting worldwide economic activity and financial markets. In light of the uncertain and rapidly evolving situation relating to the spread of COVID-19, we have taken precautionary measures intended to minimize the risk of the virus to our employees, our customers, and other third parties with whom we interact. We are requiring all employees to work remotely and have also suspended all non-essential travel worldwide for our employees. While we have a distributed workforce and our employees are accustomed to working remotely or working with other remote employees, our workforce is not fully remote. Our employees and consultants travel frequently to establish and maintain relationships with one another, our customers and prospective customers, partners, and investors. Although we continue to monitor the situation and may adjust our current policies as more information and public health guidance becomes available, temporarily suspending travel and restricting the ability to do business in person could negatively affect our customer success efforts, sales and marketing efforts, challenge our ability to enter into customer contracts in a timely manner, slow down our recruiting efforts, or create operational or other challenges, any of which could harm our business, financial condition and results of operations. Furthermore, if a natural disaster, power outage, connectivity issue, or other event occurred that impacted our employees’ ability to work remotely, it may be difficult or, in certain cases, not possible, for us to continue our business for a substantial period of time. The increase in remote working may also result in consumer privacy, IT security and fraud concerns as well as increase our exposure to potential wage and hour issues. In addition, the COVID-19 pandemic may disrupt the operations of our customers, partners, suppliers and other third-party providers for an indefinite period of time, including as a result of travel restrictions, adverse effects on budget planning processes, and/or business shutdowns, all of which could negatively impact our business, financial condition and results of operations. More generally, the COVID-19 pandemic could adversely affect economies and financial markets globally, potentially leading to an economic downturn, which could decrease technology spending and adversely affect our business. It is not possible at this time to estimate the impact that the COVID-19 pandemic could have on our business, as the impact will depend on future developments, which are highly uncertain and cannot be predicted.

Risks Related to Our Common Stock

Trading in our common stock is limited and the price of our common shares may be subject to substantial volatility.

Our common stock is currently listed on the New York Stock Exchange and was previously listed on the NYSE American LLC (formerly the NYSE MKT LLC). Over the past years, the market price of our common stock has experienced significant fluctuations. Between April 1, 2019, and June 30, 2020, the reported last adjusted closing price on NYSE American LLC for our common stock ranged between \$2.91 and \$7.54 per share. The price of our common stock may continue to be volatile as a result of several factors, some of which are beyond our control. These factors include, but not limited to, the following:

- Developments or lack thereof in any then-outstanding litigation;
- Quarterly variations in our operating results;
- Large purchases or sales of common stock or derivative transactions related to our stock;
- Actual or anticipated announcements of new products or services by us or competitors;
- General conditions in the markets in which we compete; and
- General social, political, economic and financial conditions, including the significant volatility in the global financial markets, and impacts from the COVID-19 pandemic.

In addition, we believe there has been and may continue to be substantial trading in derivatives of our stock, including short selling activity or related similar activities, which are beyond our control and which may be beyond the full control of the SEC and Financial Institutions Regulatory Authority or “FINRA”. While the SEC and FINRA rules prohibit some forms of short selling and other activities that may result in stock price manipulation, such activity may nonetheless occur without detection or enforcement. We have held conversations with regulators concerning trading activity in our stock; however, there can be no assurance that should there be any illegal manipulation in the trading of our stock, it will be detected, prosecuted or successfully eradicated. Significant short selling market manipulation could cause our stock trading price to decline, to become more volatile, or both.

The market price of our common stock has been and may continue to be volatile, and you could lose all or part of your investment.

The trading price of our common stock has been volatile since our initial public offering and is likely to continue to be volatile. Factors that could cause fluctuations in the market price of our common stock include, but are not limited to the following:

- Price and volume fluctuations in the overall stock market from time to time, including fluctuations due to general economic uncertainty or negative market sentiment, in particular related to the COVID-19 pandemic;
- Volatility in the market prices and trading volumes of companies in our industry or companies that investors consider comparable;
- Changes in operating performance and stock market valuations of other companies generally, or those in our industry;
- Sales of shares of our common stock by us or our stockholders;
- Failure of securities analysts to maintain coverage of us, changes in financial estimates by securities analysts who follow us, or our failure to meet these estimates or the expectations of investors;
- The financial projections we may provide to the public, any changes in those projections or our failure to meet those projections;
- Announcements by us or our competitors of new products or services;
- The public’s reaction to our press releases, other public announcements and filings with the SEC;
- Rumors and market speculation involving us or other companies in our industry;
- Actual or anticipated changes in our results of operations;
- Actual or anticipated developments in our business, our competitors’ businesses or the competitive landscape generally;
- Litigation involving us, our industry or both, or investigations by regulators into our operations or those of our competitors;
- Announced or completed acquisitions of businesses or technologies by us or our competitors;
- New laws or regulations or new interpretations of existing laws or regulations applicable to our business;
- Changes in accounting standards, policies, guidelines, interpretations or principles;
- Any significant change in our management; and
- General economic conditions and slow or negative growth of our markets, including any economic downturn from the COVID-19 pandemic;

Further, in recent years the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. In addition, the stock prices of many technology companies have experienced wide fluctuations that have often been unrelated to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions such as recessions, government shutdowns, global pandemics (such as the COVID-19 pandemic), interest rate changes the stability of the EU and the exit of the United Kingdom or international currency fluctuations, may cause the market price of our common stock to decline. In the past, following periods of volatility in the overall market and the market price of a particular company’s securities, securities class action litigation has often been instituted against these companies.

We have broad discretion in how we apply our funds, and we may not use these funds effectively, which could affect our results of operations and cause our stock price to decline.

Our management will have broad discretion in the application of our existing cash, cash equivalents and marketable securities and could spend these funds in ways that do not improve our results of operations or enhance the value of our common stock. Pending their use, we may invest our available funds in a manner that does not produce income or that loses value. The failure by our management to apply our available funds effectively could result in financial losses that could cause the price of our common stock to decline and delay the development of our products.

In addition, an entity that, among other things, is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, owning, trading, or holding certain types of securities would be deemed an Investment Company under the Investment Company Act of 1940 (the "1940 Act"). If we do not manage our investments and business in a manner that meets the requirements for an exemption under the 1940 Act, we may be deemed to be an investment company under the 1940 Act and subject to additional limitations on operating our business including limitations on the issuance of securities, which may make it difficult for us to raise capital.

We do not regularly pay dividends on our common stock and thus stockholders must look to appreciation of our common stock to realize a gain on their investments.

Our dividend policy is within the discretion of our Board of Directors and will depend upon various factors, including our business, financial condition, results of operations, capital requirements, and investment opportunities. We therefore cannot make assurances that our Board of Directors will determine to pay regular or special dividends in the future. Accordingly, unless our Board of Directors determines to pay dividends, stockholders will be required to look to appreciation of our common stock to realize a gain on their investment. This appreciation may not occur.

The exercise of our outstanding stock options, restricted stock units and issuance of new shares would result in a dilution of our current stockholders' voting power and an increase in the number of shares eligible for future resale in the public market which may negatively impact the market price of our stock.

The exercise of our outstanding vested stock options would dilute the ownership interests of our existing stockholders. As of June 30, 2020, we had outstanding options to purchase an aggregate of 5,682,521 shares of common stock representing approximately 8% of our total shares outstanding of which 3,996,750 were vested and therefore exercisable. To the extent outstanding stock options are exercised, additional shares of common stock will be issued, existing stockholders' percentage voting interests will decline and the number of shares eligible for resale in the public market will increase. Such increase may have a negative effect on the value or market trading price of our common stock.

The market price of our common stock may decline because our operating results may not be consistent and may be difficult to predict.

Our reported net income has fluctuated in the past due to several factors. We expect that our future operating results may also fluctuate due to the same or similar factors. While we had net income of \$291.9 million for the six months ended June 30, 2020, we had net losses of \$19.2 million for 2019 and \$25.4 million for 2018, and through the six month ended June 30, 2020, we had retained earnings of \$3.5 million. The following include some of the factors that may cause our operating results to fluctuate:

- The outcome of actions to enforce our intellectual property rights currently in progress or that we may undertake in the future, and the timing thereof;
- The impact of the COVID-19 pandemic on our sales cycle and results;
- The amount and timing of receipt of license fees from potential infringers, licensees or customers;
- The rate of adoption of our patented technologies;
- The number of new license arrangements we may execute, or that may expire, within a particular period and the scope of those licenses, including the number of our patents which are licensed, the extent of prior infringement of our patent rights, royalty rates, timing of payment obligations, expiration date etc.;
- The success of a licensee in selling products that use our patented technologies; and
- The amount and timing of expenses related to our patent filings and enforcement proceedings, including litigation, related to our intellectual property rights.

These fluctuations may make our business particularly difficult to manage, adversely affect our business and operating results, make our operating results difficult for investors to predict and, further, cause our results to fall below investor's expectations and adversely affect the market price of our common stock.

Because ownership of our common stock is concentrated, investors may have limited influence on stockholder decisions.

As of December 31, 2019, our executive officers and directors beneficially owned approximately 13.2% of our outstanding common stock. In addition, a group of stockholders that, as of December 31, 2007, held 4,766,666 shares, or approximately 7% of our outstanding common stock, have entered into a voting agreement with us that requires them to vote all of their shares of our voting stock in favor of the director nominees approved by our Board of Directors at each director election going forward, and in a manner that is proportional to the votes cast by all other voting shares as to any other matters submitted to the stockholders for a vote. However, we cannot be certain how many shares of our common stock this group of stockholders currently owns. Because of their beneficial ownership interest, our officers and directors could significantly influence stockholder actions of which you disapprove or that are contrary to your interests. This ability to exercise significant influence could prevent or significantly delay another company from acquiring or merging with us.

Our protective provisions in our amended and restated certificate of incorporation and bylaws could make it difficult for a third party to successfully acquire us even if you would like to sell your stock to them.

We have a number of protective provisions in our amended and restated certificate of incorporation and bylaws that could delay, discourage or prevent a third party from acquiring control of us without the approval of our Board of Directors. These protective provisions include:

- **A staggered Board of Directors:** This means that only one or two directors (since we have a five-person Board of Directors) will be up for election at any given annual meeting. This has the effect of delaying the ability of stockholders to affect a change in control of us because it would take two annual meetings to effectively replace a majority of the Board of Directors.
- **Blank check preferred stock:** Our Board of Directors has the authority to establish the rights, preferences and privileges of our 10,000,000 authorized, but unissued, shares of preferred stock. Therefore, this stock may be issued at the discretion of our Board of Directors with preferences over your shares of our common stock in a manner that is materially dilutive to you. In addition, blank check preferred stock can be used to create a "poison pill" which is designed to deter a hostile bidder from buying a controlling interest in our stock without the approval of our Board of Directors. We have not adopted such a "poison pill;" but our Board of Directors has the ability to do so in the future, very rapidly and without stockholder approval.
- **Advance notice requirements for director nominations and for new business to be brought up at stockholder meetings:** Stockholders wishing to submit director nominations or raise matters to a vote of the stockholders must provide notice to us within very specific date windows and in very specific form in order to have the matter voted on at a stockholder meeting. This has the effect of giving our Board of Directors and management more time to react to stockholder proposals generally and could also have the effect of disregarding a stockholder proposal or deferring it to a subsequent meeting to the extent such proposal is not raised properly.
- **No stockholder actions by written consent:** No stockholder or group of stockholders may take actions rapidly and without prior notice to our Board of Directors and management or to the minority stockholders. Along with the advance notice requirements described above, this provision also gives our Board of Directors and management more time to react to proposed stockholder actions.
- **Super majority requirement for stockholder amendments to the bylaws:** Stockholder proposals to alter or amend our bylaws or to adopt new bylaws can only be approved by the affirmative vote of at least 66 2/3% of the outstanding shares of our common stock.
- **No ability of stockholders to call a special meeting of the stockholders:** Only the Board of Directors or management can call special meetings of the stockholders. This could mean that stockholders, even those who represent a significant percentage of our shares of common stock, may need to wait for the annual meeting before nominating directors or raising other business proposals to be voted on by the stockholders.

In addition, the provisions of Section 203 of the Delaware General Corporation Law govern us. These provisions may prohibit large stockholders, particularly those owning 15% or more of our outstanding voting stock, from merging or combining with us for a certain period of time.

These and other provisions in our amended and restated certificate of incorporation, our bylaws and under Delaware law could discourage potential takeover attempts, reduce the price that investors might be willing to pay for shares of our common stock in the future and result in the market price being lower than it would be without these provisions

Our amended and restated bylaws designate a state or federal court located within the State of Delaware as the exclusive forum for substantially all disputes between us and our stockholders, which could limit our stockholders' ability to choose the judicial forum for disputes with us or our directors, officers, or employees.

Our amended and restated bylaws provide that, unless we consent in writing to the selection of an alternative forum, the sole and exclusive forum for (1) any derivative action or proceeding brought on our behalf, (2) any action asserting a claim of breach of a fiduciary duty owed by any of our directors, stockholders, officers, or other employees to us or our stockholders, (3) any action arising pursuant to any provision of the Delaware General Corporation Law, or our amended and restated certificate of incorporation or amended and restated bylaws or (4) any other action asserting a claim that is governed by the internal affairs doctrine shall be the Court of Chancery of the State of Delaware (or, if the Court of Chancery does not have jurisdiction, another State court in Delaware or the federal district court for the District of Delaware), in all cases subject to the court having jurisdiction over indispensable parties named as defendants.

However, notwithstanding the exclusive forum provisions, our amended and restated bylaws explicitly state that they would not preclude the filing of claims brought to enforce any liability or duty created under federal securities laws, including the Securities Act of 1933 or the Securities Exchange Act of 1934.

Any person or entity purchasing or otherwise acquiring any interest in any of our securities shall be deemed to have notice of and consented to this provision. This exclusive-forum provision may limit a stockholder's ability to bring a claim in a judicial forum of its choosing for disputes with us or our directors, officers, or other employees, which may discourage lawsuits against us and our directors, officers, and other employees. If a court were to find this exclusive-forum provision in our amended and restated bylaws to be inapplicable or unenforceable in an action, we may incur additional costs associated with resolving the dispute in other jurisdictions, which could harm our results of operations.

ITEM 5 — OTHER INFORMATION

None.

ITEM 6 — EXHIBITS.

The documents listed in the Exhibit Index of the Quarterly Report on Form 10-Q are incorporated by reference or are filed with this Quarterly Report on Form 10-Q, in each case as indicated therein (numbered in accordance with Item 601 of Regulation S-K).

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.

VIRNETX HOLDING CORPORATION

By: /s/ Kendall Larsen

Name Kendall Larsen

Title Chief Executive Officer (Principal Executive Officer) By:

/s/ Richard H. Nance

Name Richard H. Nance

Title Chief Financial Officer (Principal Financial Officer and
Principal Accounting Officer)

Date: August 10, 2020

EXHIBIT INDEX

Exhibit Number	Description
31.1	Certification of the President and Chief Executive Officer pursuant to Exchange Act Rules 13a – 14(a) and 15d – 14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Exchange Act Rules 13a – 14(a) and 15d – 14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	* Certification of the President and Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	* Certification of the Chief Financial Officer pursuant to 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 as inline XBRL and contained in Exhibit 101).

* The certifications attached as Exhibit 32.1 and Exhibit 32.2 that accompany this Quarterly Report on Form 10-Q are deemed furnished and not filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of VirnetX Holding Corporation under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Quarterly Report on Form 10-Q, irrespective of any general incorporation language contained in such filing.

CERTIFICATIONS

I, Kendall Larsen, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of VirnetX Holding Corporation for the quarter ended June 30, 2020;
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 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.

/s/ Kendall Larsen

Kendall Larsen
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 10, 2020

CERTIFICATIONS

I, Richard H. Nance, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of VirnetX Holding Corporation for the quarter ended June 30, 2020;
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 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.

/s/ Richard H. Nance

Richard H. Nance

Chief Financial Officer

(Principal Financial Officer and Principal Accounting Officer)

Date: August 10, 2020

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of VirnetX Holding Corporation (the "Company") on Form 10-Q for the quarter ended June 30, 2020 as filed with the Securities and Exchange Commission on August 10, 2020 (the "Report"), I, Kendall Larsen, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Kendall Larsen

Kendall Larsen
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 10, 2020

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of VirnetX Holding Corporation (the "Company") on Form 10-Q for the quarter ended June 30, 2020 as filed with the Securities and Exchange Commission on August 10, 2020 (the "Report"), I, Richard H. Nance, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Richard H. Nance

Richard H. Nance

Chief Financial Officer

(Principal Financial Officer and Principal Accounting Officer)

Date: August 10, 2020
