

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2013

or

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

For the transition period from _____ to _____

Commission File Number: 001-33852

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 Number)

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

Title of Class	Name of Exchange on Which Registered
Common Stock, par value \$0.0001 per share	NYSE MKT LLC

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

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

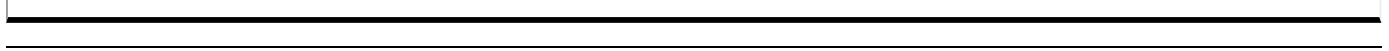
The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant as of June 28, 2013, was \$1,023,550,789 based upon the closing price of the common shares of the Registrant on June 28, 2013. This calculation does not reflect a determination that

certain persons are affiliates of the Registrant for any other purpose.

51,236,141 shares of Registrant's Common Stock were outstanding as of February 21, 2014.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of this Annual Report on Form 10-K incorporate by reference information from the Registrant's Proxy Statement to be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2013 in connection with the solicitation of proxies for the Registrant's 2014 Annual Meeting of Stockholders.



INDEX

Page

PART I

Item 1.	Business	5
Item 1A.	Risk Factors	15
Item 1B.	Unresolved Staff Comments	22
Item 2.	Properties	22
Item 3.	Legal Proceedings	22
Item 4.	Mine Safety Disclosure	23

PART II

Item 5.	Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	24
Item 6.	Selected Financial Data	26
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	27
Item 7A.	Quantitative and Qualitative Disclosures about Market Risk	35
Item 8.	Financial Statements and Supplementary Data	36
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	58
Item 9A.	Controls and Procedures	58
Item 9B.	Other Information	58

PART III

Item 10.	Directors, Executive Officers and Corporate Governance	59
Item 11.	Executive Compensation	59
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matter	59
Item 13.	Certain Relationships and Related Transactions, and Director Independence	59
Item 14.	Principal Accountant Fees and Services	59

PART IV

Item 15.	Exhibits and Financial Statement Schedules	60
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WARNING CONCERNING FORWARD LOOKING STATEMENTS

THIS ANNUAL REPORT ON FORM 10-K CONTAINS STATEMENTS THAT CONSTITUTE FORWARD LOOKING STATEMENTS WITHIN THE MEANING OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 AND OTHER FEDERAL SECURITIES LAWS. ALSO, WHENEVER WE USE WORDS SUCH AS "BELIEVE", "EXPECT", "ANTICIPATE", "INTEND", "PLAN", "ESTIMATE" OR SIMILAR EXPRESSIONS, WE ARE MAKING FORWARD LOOKING STATEMENTS. THESE FORWARD LOOKING STATEMENTS ARE BASED UPON OUR PRESENT INTENT, BELIEFS OR EXPECTATIONS, BUT FORWARD LOOKING STATEMENTS ARE NOT GUARANTEED TO OCCUR AND MAY NOT OCCUR. ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE CONTAINED IN OR IMPLIED BY OUR FORWARD LOOKING STATEMENTS AS A RESULT OF VARIOUS FACTORS. AMONG OTHERS, THE FORWARD LOOKING STATEMENTS WHICH APPEAR IN THIS REPORT THAT MAY NOT OCCUR INCLUDE:

- THE DESCRIPTION OF OUR BUSINESS INCLUDES A STATEMENT THAT WE INTEND TO MARKET OUR GABRIEL CONNECTION TECHNOLOGY™. AN IMPLICATION OF THIS STATEMENT MAY BE THAT WE WILL BE ABLE TO SUCCESSFULLY MARKET THIS TECHNOLOGY AND THAT IT WILL GENERATE REVENUE IN THE FUTURE. IN FACT, THERE ARE MANY FACTORS WHICH WILL IMPACT THE SUCCESS OF THIS TECHNOLOGY FOR US, INCLUDING SEVERAL FACTORS WHICH ARE BEYOND OUR CONTROL, SUCH AS THE DEMAND FOR THIS TECHNOLOGY BY POTENTIAL CUSTOMERS AND THE LEVEL OF COMPETITION IN OUR BUSINESS.
- THE DESCRIPTION OF OUR BUSINESS INCLUDES STATEMENTS RELATING TO OUR INTENT TO ESTABLISH A SECURE DOMAIN NAME REGISTRY IN THE U.S. AND OTHER PARTS OF THE WORLD AND THAT WE ARE CONSIDERING MAKING APPLICATIONS TO BECOME ACCREDITED TO DO SO UNDER AUTHORITY OF THE U.S. GOVERNMENT. THE IMPLICATION OF THOSE STATEMENTS MAY BE THAT WE WILL BE ABLE TO ESTABLISH A REGISTRY THAT WILL HAVE MARKET ACCEPTANCE AND THAT IT WILL GENERATE REVENUE FOR US IN THE FUTURE. THERE ARE MANY FACTORS WHICH WILL IMPACT OUR ABILITY TO SUCCESSFULLY ESTABLISH A DOMAIN NAME REGISTRY, INCLUDING SEVERAL FACTORS WHICH ARE BEYOND OUR CONTROL, SUCH AS THE ACCREDITATION APPLICATION PROCESS OR THE ACCEPTANCE OF OUR REGISTRY OVER OTHERS IN THE MARKET, PARTICULARLY IF WE DETERMINE TO ESTABLISH A REGISTRY WITHOUT ACCREDITATION.
- THE STATEMENTS THAT WE HAVE SUBMITTED A LICENSING DECLARATION TO THE 3RD GENERATION PARTNERSHIP, OR 3GPP, UPDATED SUCH DECLARATIONS AT THE REQUEST OF THE EUROPEAN TELECOMMUNICATIONS STANDARDS INSTITUTE, OR ETSI, AND THE ALLIANCE FOR TELECOMMUNICATIONS INDUSTRY SOLUTIONS, OR ATIS, AND THAT WE BELIEVE WE ARE POSITIONED TO LICENSE OUR PATENTS TO 3GPP MEMBERS DESIRING TO IMPLEMENT THE TECHNICAL SPECIFICATIONS IDENTIFIED BY US, MAY IMPLY THAT THE PATENTS WE HAVE IDENTIFIED TO 3GPP WILL GENERATE LICENSING REVENUE FOR US IN THE FUTURE. WE CANNOT ASSURE YOU THAT WE WILL BE SUCCESSFUL IN LICENSING OUR PATENTS OR THAT THIRD PARTIES WILL BE WILLING TO ENTER INTO LICENSES WITH US ON REASONABLE TERMS OR AT ALL.
- OUR STATEMENT THAT WE BELIEVE WE HAVE THE FINANCIAL AND OTHER RESOURCES TO COMPLETE OUR BUSINESS PLAN MAY IMPLY THAT OUR RESOURCES WILL BE SUFFICIENT TO COMPLETE THAT PLAN SUCCESSFULLY. HOWEVER, WE MAY NOT BE ABLE TO SUCCESSFULLY IMPLEMENT OUR BUSINESS PLAN FOR MANY REASONS, INCLUDING MANY REASONS THAT ARE BEYOND OUR CONTROL, SUCH AS THE POSSIBILITY THAT OUR FINANCIAL RESOURCES BECOME EXHAUSTED DUE TO INCREASED COSTS ASSOCIATED WITH OUR ATTEMPTS TO COMPETE WITH OTHERS WHO MAY HAVE GREATER RESOURCES, OR DUE TO OUR OTHER ACTIVITIES, INCLUDING OUR LITIGATION ACTIVITIES.

[Index](#)

- STATEMENTS DESCRIBING OUR CONTINUED LITIGATION EFFORTS MAY IMPLY THAT WE WILL PREVAIL IN SOME OR ALL OF OUR LITIGATION. HOWEVER, WE CANNOT ASSURE YOU WE WILL PREVAIL IN OUR PENDING LITIGATION MATTERS AND ANY ADVERSE RULING MAY HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS. ALSO, THE LEGAL AND OTHER COSTS WE MAY INCUR IN CONNECTION WITH LITIGATION MATTERS WILL DEPEND, IN PART, UPON ACTIONS TAKEN BY OTHER PARTIES, WHICH ACTIONS ARE NOT WITHIN OUR CONTROL AND THESE COSTS MAY HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS.
- OUR REFERENCES TO THE FACTS THAT OUR CORE DEVELOPMENT TEAM HAS SPENT OVER TEN YEARS WORKING TOGETHER, AND HAS HAD PRIOR SUCCESS AT LEIDOS, INC. MAY IMPLY THAT OUR TEAM WILL BE SUCCESSFUL IN THE FUTURE. HOWEVER, THIS TEAM MAY NOT BE SUCCESSFUL FOR MANY REASONS, INCLUDING MANY REASONS THAT ARE BEYOND OUR CONTROL, SUCH AS THE POSSIBILITY THAT ONE OR MORE KEY MEMBERS OF THE TEAM BECOMES INCAPACITATED, OR THAT COMPETITORS ARE SUCCESSFUL IN DEVELOPING SUPERIOR PRODUCTS.
- OUR STATEMENT WITH RESPECT TO OUR INTENT TO MARKET AND SELL LICENSE AND SERVICES TO OTHERS MAY IMPLY THAT OUR PLANS TO DO SO ARE IMMINENT OR WILL BE SUCCESSFUL. HOWEVER, MARKETING AND SELLING OUR PRODUCT AND SERVICES WHILE SIMULTANEOUSLY PURSUING OUR LITIGATION AND OUR FURTHER DEVELOPMENT ACTIVITIES CAN PRESENT SIGNIFICANT CHALLENGES. OUR MARKETING AND SALES PLANS MAY TAKE LONGER TO IMPLEMENT THAN WE NOW EXPECT, MAY NOT BE IMPLEMENTED, OR MAY FAIL.

THESE AND OTHER UNEXPECTED RESULTS MAY BE CAUSED BY VARIOUS FACTORS, SOME OF WHICH ARE BEYOND OUR CONTROL, INCLUDING:

- THE IMPACT OF CHANGES IN THE U.S. AND GLOBAL ECONOMIES IN GENERAL AND THE CAPITAL MARKETS ON US AND OUR INTENDED CUSTOMERS;
- COMPLIANCE WITH, AND CHANGES TO, U.S. FEDERAL, STATE AND LOCAL LAWS AND REGULATIONS, FOREIGN LAWS AND REGULATIONS, ACCOUNTING RULES, TAX RATES AND SIMILAR MATTERS; AND
- COMPETITION WITHIN OUR INDUSTRY.

WE HAVE GENERATED NET INCOME IN ONLY ONE ANNUAL REPORTING PERIOD SINCE WE BECAME PUBLICLY OWNED. ALTHOUGH OUR PLANS ARE INTENDED TO GENERATE NET INCOME, THERE CAN BE NO ASSURANCE THAT THESE PLANS WILL SUCCEED.

RESULTS THAT DIFFER FROM THOSE STATED OR IMPLIED BY OUR FORWARD LOOKING STATEMENTS MAY ALSO BE CAUSED BY VARIOUS CHANGES IN OUR BUSINESS OR MARKET CONDITIONS AS DESCRIBED MORE FULLY UNDER "PART I. ITEM 1A. RISK FACTORS" AND ELSEWHERE IN THIS REPORT.

YOU SHOULD NOT PLACE UNDUE RELIANCE UPON FORWARD LOOKING STATEMENTS.

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.

PART I

Item 1. Business.

The Company

We are an Internet security software and technology company with patented technology for secure communications including 4G LTE security. Our software and technology solutions, including its secure domain name registry and GABRIEL Connection Technology™, are designed to facilitate secure communications and to create a secure environment for real-time communication applications such as instant messaging, VoIP, smart phones, eReaders and video conferencing. Our portfolio of intellectual property is the foundation of our business model. Our patent portfolio of over 80 U.S. and international patents with over 100 pending applications, has applicability in a number of areas; however, it 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 the new initiatives like "Smart Cities", "Connected Cars" and "Connected Homes" 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."

Our software and technology solutions 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 (M2M) communications in areas including Smart City, Connected Car and Connected Home. 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.

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 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, 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 4G/LTE Advanced devices and solutions.

We have an ongoing Gabriel Licensing Program under which we offer licenses to 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.

In connection with the settlement of our lawsuit against Microsoft Corporation in 2010, Microsoft became our first licensee. Pursuant to the Settlement and License Agreement between ourselves and Microsoft, Microsoft paid us \$200 million, and Microsoft was granted a worldwide, irrevocable, nonexclusive, non-sub licensable fully paid up license for our patents for certain Microsoft products. We have also signed Patent License Agreements with Avaya Inc., Aastra USA, Inc. 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 U.S. patents, for a one-time payment and 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 4G/LTE Advanced wireless networks and Machine-to-Machine (M2M) communications in areas including Smart City, Connected Car and Connected Home. We also believe that all 4G/LTE Advanced mobile devices will require unique secure domain names and become part of a secure domain name registry.

[Index](#)

We intend 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 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. (formerly known as SAIC) 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, Inc. and expanded the set of patents we acquired in 2006 from Leidos, Inc. into a larger portfolio over 80 U.S. and international patents and with over 100 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. Please see Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Operations – Research and Development Expenses for a description of our research and development expenses for the past three fiscal years.

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 4G/LTE companies (domain infrastructure providers, chipset manufacturers, service providers and others) and build our secure domain name registry.

Industry Overview

We believe that the rapid growth of mobile devices (smartphones/tablets/ultra-mobile PCs), with always-on network access, and need to socially interact with friends and family while maintaining a constant online presence has transformed the “Internet of Web 2.0” in to the “The Internet of the People”. It has become, an evolving, rich and complex medium used by individuals and businesses to conduct commerce, share information and engage in real-time communications including email, text messaging, IM, and voice and video calls. We believe the user demand for high speed broadband access along with the quality of experience wherever they are and whatever BYOD (bring your own device) they may be using; Mobility, IP video delivery, and the move to cloud have dramatically changed the way service providers deliver services. While wireline networks remain the primary mechanism for delivering premium and high bandwidth services, its growth has held steady compared to the growth of the mobile communications. The cost barrier to obtaining a mobile device with data access has disappeared allowing billions of people to have online access on fixed and mobile networks, and those users accessing social networking websites, using peer-to-peer, or P2P applications, and uploading live content over the internet, which in turn is downloaded by millions, has led to staggering growth in packet traffic. Not only is traffic growing and changing in nature, it’s location of origin and timing has become completely unpredictable. There is a significant impact on the mobile signaling network, brought on by smartphone penetration and consumer use of “chatty” applications that do frequent network queries.

We believe that as the users become more comfortable with using their smartphones/tablets and other connected devices, they will increasingly treat their mobile and fixed/WiFi networks as a single network and demand seamless transition from one network type to another without any disruption of service. The 4G/LTE standard was developed with the goal of creating a single IP network that is efficient, flexible, open up new business models and services revenues and eventually lead to true “virtual networks” or software-defined networks (SDN). The service providers were forced to perform complete overhaul of their telecom network infrastructure in order to move from TDM paradigm to next generation IP networks based on 4G/LTE for dealing with this rapidly growing demand. Before these network overhauls could be completed, some service providers decided to mislabel their hybrid 3.5G/HSPA+/partial LTE implementations as 4G networks in order to stem the loss of revenue and protect themselves against the threat of being forever relegated to the role of pipe provider. This marketing ploy has led to significant confusion and misunderstanding among users.

Adding further fuel to the demand for mobile and fixed broadband services is the fast adoption of connected machines or devices, or embedded systems capable of Machine-to-Machine (M2M) communication. These M2M communications are made possible by a device (non-phone/tablet/pc such as a sensor) that is attached to a machine to capture an event that is relayed over a network via 3G/4G routers or fixed broadband lines, delivering data or events (such as temperature, location, consumption, heart rate, stress levels, light, movement, altitude and speed) to applications creating an “Internet of Things” or IoT. As the service providers start deploying true 4G (Long Term Evolution-Advanced, or LTE-Advanced) and this pace picks up, we believe that almost every device will get its own unique identity and a high-speed connection to the internet over a high speed IP (Internet Protocol) based telecommunication network making it an “Internet of Everything”.

We believe that growing security concerns and vulnerabilities in a large number of use-case scenarios due to the inherent “open” nature of this architecture can throttle the successful adoption of these technologies. Security can no longer exist as a point solution, and enterprises everywhere are currently upgrading core IT infrastructure (systems, networks, and management) to integrate security into everything. Because of the complexity of today’s networks and the requirement to connect users from any location at any time on any device, enterprise buyers looking to improve security posture have to evaluate everything from software solutions for smartphones to routers and switches with integrated security, massive security appliances for data centers, cloud-based security services, and security solutions for virtualized environments and public and private clouds.

The portions of the IP-telephony, mobility, fixed-mobile convergence and unified communications markets that could benefit from our software and technology solutions, as forecasted by Infonetics and by our internal estimates, are expected to grow from approximately \$96 billion of worldwide revenues in 2012 to approximately \$342 billion by 2017, representing a compound annual growth rate, or CAGR, of approximately 29%. We believe that this growing trend represents a significant opportunity for us to license our technology and software, and establish our secure domain name registry.

Enterprise Telephony – Unified Communications, VoIP, Telepresence and Video Conferencing

Enterprise Telephony includes technologies that use Internet Protocol's packet-switched connections to exchange voice, fax, and other forms of information traditionally carried over the dedicated circuit-switched connections of the public switched telephone network, or PSTN. The adoption of Enterprise Telephony has helped businesses significantly lower network operating costs by using a common network for voice and data. As the workforce becomes increasingly dispersed, mobile features enabled by Internet protocol-based communications such as presence, unified messaging, peer-to-peer applications, find me/follow me, white-boarding and document sharing have become more commonplace. However, the development of the related security infrastructure has lagged behind, leaving next-generation networks vulnerable to a multitude of threats including man-in-middle, eavesdropping, domain hijacking, distributed denial of service, or DDoS, spam over Internet telephony, or SPIT, and spam over instant messaging, or SPIM. These threats continue to highlight the need for securing next-generation networks. As the use of Enterprise Telephony systems extends beyond the boundaries of an organization's private network, security is likely to become an even bigger concern. Enterprises are increasingly deploying an array of communication methodologies integrated into a single communications experience is often referred to as unified communications. We believe that unified communications have higher utility and can increase productivity for users. The basic components of unified communications include: a directory for storing addresses, various modes of communication with each user/contact (desk phone, mobile phone, IM, etc.), message storage for all messages regardless of communication method and secure presence of a user's status for each mode of communication (available, away, busy, etc.).

Based on our estimates using Infonetics and other market data, we believe that worldwide revenue from IP telephony products like IP-PBX including IP phones, service provider VoIP and IMS equipment, VoIP gateways, Enterprise Telepresence and Video Conferencing for businesses and Unified Communication clients, is expected to grow from approximately \$38 billion in 2012 to approximately \$60 billion in 2017, representing a CAGR of approximately 9%. We believe our unique and patented solution provides the robust security platform required for providing on-demand secure communication links between enterprises intending to communicate securely without manually configuring the connections. We believe a standard security solution such as ours will further accelerate the adoption of Enterprise telephony products in the market and allow enterprises to take full advantage of these rich content applications and real-time communications over the Internet, thereby significantly increasing their return on investment.

IP Mobility- Smartphones, Embedded Devices, Machine-to-Machine (M2M) Devices (LTE)

We believe that telecommunication markets are rapidly changing and presenting new challenges to the equipment and service providers, including but not limited to increasing user demand for mobile, always-on connections with multiple devices. We also believe that traffic growth, video acceleration, cloud services and a rapidly growing number of subscribers challenge currently available network architectures and that, because of this, service providers and carriers will eventually use a single network for fixed and mobile communications, private/premium communications and Internet access, in spite of the difficulties involved challenging their business models and forcing the consideration of new network architectures. We believe that LTE technology will deliver users the benefits of faster data speeds and new services by creating a new radio access technology that's optimized for IP-based traffic and offers operators a simple upgrade path from 3G networks.

Smartphones are multi-functional devices that handle a wide variety of business-critical applications and support increasingly complex functions including enhanced data processing, Internet access, e-mail access, calendars and scheduling, contact management and the ability to view electronic documents. Users have continual access to these applications while on the move making them an increasingly essential business tool for the mobile worker. These devices enable mobile workers to have similar functionality inside or outside the office thereby increasing employee efficiency. However, it is critical that this mobile environment have the same level of security as an enterprise's internal network.

Embedded mobile broadband computing devices include PCs, netbooks, tablets, and mobile Internet devices (MIDs) with embedded mobile broadband modems to enable Internet access via a mobile broadband network. A growing number of these devices are now shipping enabled with LTE/4G. Mobile Internet devices (MIDs) include handheld mobile Internet devices; e.g. eReader, gaming console, digital picture frame, digital camera, with embedded mobile broadband modems. Mobile broadband routers have mobile broadband modems or antenna as the broadband connection; have multiple Ethernet ports and integrated wireless access points for local area connectivity and bandwidth sharing; can have integrated hub or switch; may have an integrated stateful firewall or IPSec VPN and are also known as mobile hotspot routers.

Machine-to-Machine (M2M), connected devices, or embedded systems, connected machines are fast becoming the eyes and ears of the enterprise. By adding sensors and networking technologies to the products they sell and the equipment they employ, companies are finding new ways to gather powerful insights and use new forms of data, thus creating a vast “internet of things”. This communication is made possible by a device (such as an intelligent sensor) that is attached to a machine to capture an event, such as temperature, location, consumption, heart rate, stress levels, light, movement, altitude and speed, that is relayed over a network delivering data to applications. The potential application for this technology is limitless. There are smart meters in energy and utilities (the “smart grid”), connected vehicles in automotive and logistics, heart monitors in healthcare, RFID tagged inventory in retail and manufacturing, and digital signage in media and communications to name a few. Another fast growing application is in the wearable technology products namely, fitness and wellness, infotainment, healthcare and medical, and industrial and military. The fitness and wellness segment comprises products like smart clothing and smart sensors, activity monitors, sleep sensors and others, whereas the Infotainment sector consists of products like smart watches, heads-up displays, smart glasses and others. The products like continuous glucose monitor, drug delivery, monitors, wearable patches and others have been covered under healthcare and medical segment and products like hand worn terminals, augmented reality headsets and others have been mentioned under industrial and military segment. We believe that the large revenue potential for M2M services that has attracted the attention of carriers globally risks being thwarted by the growing security concerns in M2M applications. Porous security is exposing vulnerabilities in a large number of use-case scenarios, including cars, energy management systems, telemedicine, and telemetry. While built-in security is a high priority in all other information and communication technologies, it is yet to be considered, even at a basic level, in most M2M applications. The rapid and successful adoption of M2M in automobiles, healthcare, industrial installations, and consumer homes may be jeopardized if communication security is not designed in to all M2M devices and applications. All these new devices will require a unique identity addressable by a secure domain name and all their communications, with application servers and other devices, completely secured automatically and on-demand.

IP mobility services require an environment where wired and wireless phones work together with Internet Protocol to deliver services (voice, video, data and combinations thereof) uniformly across multiple access networks, including, among others, LTE, WiMAX, WiFi cellular and fixed. Based on our estimates using Infonetics and other market data, we believe that worldwide revenue from IP mobility products like smartphones, embedded devices, hotspots and mobile data cards, femtocell equipment, M2M communication devices and services is expected to grow from approximately \$57 billion in 2012 to approximately \$282 billion by 2017, representing a CAGR of approximately 37%. We believe in order to realize the full functionality of IP mobility, several challenges including security must be overcome. When users are mobile, connections and data need to cross multiple network boundaries, each of which poses a security threat. Wireless networks may be threatened or compromised by rogue users who enter through (insecure wireless access points. We believe that providing authenticated access to the M2M networks and enterprise applications are important requirements and represent a significant market opportunity for our patented technology and secure domain names to provide users or machines fully authenticated secure access on a "zero-click" or "single-click" basis.

Our Solutions

Our software and technology solutions, including our secure domain name registry, our patents and our GABRIEL Connection Technology™ are designed to secure all types of real-time communications over the Internet. Our technology uses industry standard encryption methods with our patented DNS lookup mechanisms to create a secure communication link between users intending to communicate in real time over the Internet. Our technology can be built into network infrastructure, operating systems or silicon chips developed for a communication or computing device to secure real-time communications over the Internet between numerous devices. Our technology automatically encrypts data allowing organizations and individuals to establish communities of secure, registered users and transmit information between multiple devices, networks and operating systems. These secure network communities, which we call secure private domains, or SPDs, are designed to be fully-customizable and support rich content applications such as IM, VoIP, mobile services, streaming video, file transfer and remote desktop in a completely secure environment. Our approach is a unique and patented solution that we believe provides the robust security platform required by these rich content applications and real-time communications over the Internet. We believe the key benefits and features of our technology include the following:

- **Automatic and seamless to the user.** After a one-time registration, users connect securely on a “zero-click” or “single-click” basis.
- **Secure data communications.** Users create secure networks with people they trust and communicate over a secure channel.
- **Control of data at all times.** Users can secure and customize their unified communication and collaboration applications such as file sharing and remote desktop with policy-based access and secure presence information.
- **Authenticated users.** Users know they are communicating with authenticated users with secure domain names.
- **Application-agnostic technology.** Our solution provides security at the IP layer of the network by using patented DNS lookup mechanisms to make connections between secure domain names, thereby obviating the need to provide application specific security.

Competitive Strengths

We believe the following competitive strengths will enable our success in the marketplace:

- **Unique patented technology.** We are focused on developing innovative technology for securing real-time communications over the Internet, and establishing the exclusive secure domain name registry in the United States and other key markets around the world. Our unique solutions combine industry standard encryption methods and communication protocols with our patented techniques for automated DNS lookup mechanisms. Our technology and patented approach enables users to create a secure communication link by generating secure domain names. We have a portfolio comprised of over 80 U.S. and international patents with over 100 pending applications. Our portfolio includes patents and pending patent applications in the United States and other key markets that support our secure domain name registry service for the Internet.
- **Scalable licensing business model.** We are actively engaged in pursuing additional licensing agreements with OEMs, service providers and system integrators within the IP-telephony, mobility, mobile-to-mobile communications, fixed-mobile convergence and unified communications end-markets.
- **Highly experienced research and development team.** Our research and development team is comprised of nationally recognized network security and encryption technology scientists and experts that have worked together as a team for over ten years. During their careers, this team has developed several cutting-edge technologies for U.S. national defense, intelligence and civilian agencies, many of which remain critical to our national security today. Prior to joining VirnetX, our team worked for Leidos, Inc. during which time they invented the technology that is the foundation of our technology, and software. Based on the collective knowledge and experience of our development team, we believe that we have one of the most experienced and sophisticated groups of security experts researching vulnerability and threats to real-time communication over the Internet and developing solutions to mitigate these problems.

Our Strategy

Our strategy is to become the market leader in securing real-time communications over the Internet and to establish our GABRIEL Communications Technology™ as the industry standard security platform. Key elements of our strategy are to:

[Index](#)

- Implement a technology licensing program to commercialize our intellectual property, including our GABRIEL Connection Technology™.
- Establish VirnetX as the exclusive universal registry of secure domain names and to enable our customers to act as registrars for their users and broker secure communication between users on different registries.
- Leverage our existing technology to develop a suite of products that can be sold directly to end-user enterprises.

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, 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 have also submitted a number of updates to our original declaration, identifying additional technical specifications that would also require a license to our US and International patents.

License and Service Offerings

We offer a diversified portfolio of license and service offerings focused on securing real-time communications over the Internet, including:

- **VirnetX technology licensing:** Customers who want to develop their own implementation of the VirnetX code module for supporting secure domain names, or who want to use their own techniques that are covered by our patent portfolio for establishing secure communication links, will purchase a technology license. We anticipate that these licenses would typically include an initial license fee, as well as an ongoing royalty. We expect that these licenses will include a one-time delivery of GABRIEL software development kit including object libraries, sample code, testing and quality assurance tools and the supporting documentation necessary for a customer to implement of the techniques we have developed.
- **GABRIEL Connection Technology™ Software Development Kit or SDK:** OEM customers who want to adopt the GABRIEL Connection Technology™ as their solution for establishing secure connections using secure domain names within their products will purchase an SDK license. The software development kit consists of object libraries, sample code, testing and quality assurance tools and the supporting documentation necessary for a customer to implement our technology. These tools are comprised of software for a secure domain name connection test server, a relay test server and a registration test server. We expect that customers would pay an up-front license fee to purchase an SDK license and a royalty fee for every product shipped with the embedded VirnetX code module.
- **Secure domain name registrar service:** Customers, including service providers, telecommunication companies, ISPs, system integrators and OEMs could purchase a license to our secure domain name registrar service. We would provide the software suite and technology support to enable such customers to provision devices with secure domain names and facilitate secure connections between registered devices. This suite includes the following server software modules:
- **Registrar server software:** We anticipate that our registrar server software would enable customers to operate as a secure domain name registrar that provisions devices with secure domain names. The registrar server software is designed to provide an interface for our customers to register new virtual private domains and sub-domain names. This server module must be enrolled with the VirnetX secure domain name master registry to obtain its credentials before functioning as an authorized registrar.
- **Connection server software:** We anticipate that our connection server software would allow customers to provide connection services to enrolled devices. The connection services include registration of presence information for authenticated users and devices, presence information query request services, enforcement of policies and support for communication with peers behind firewalls.
- **Relay server software:** We anticipate that our relay server software would allow customers to dynamically maintain connections and relay data to private IP addresses for network devices that reside behind firewalls. Secure domain name registrar service customers will enter into a technology licensing and revenue sharing agreement with VirnetX whereby we will typically receive an up-front licensing fee for the secure domain name registrar technology, as well as ongoing annual royalties for each secure domain name issued by the customer.

[Index](#)

- **Secure domain name master registry and connection service**: As part of enabling the secure domain name registrar service, we expect that we will maintain and manage the secure domain name master registry. This service is expected to enroll all secure domain name registrar customers and generate the credentials required to function as an authorized registrar. It also is expected to provide connection services and universal name resolution, presence information and secure connections between authorized devices with secure domain names.
- **Technical support services**: We intend to provide high-quality technical support services to licensees and customers for the rapid customization and deployment of GABRIEL Connection Technology™ in an individual customer's products and services.

Our research and development team was the team responsible for inventing the claimed subject matter of the patents that form the foundation of our technology. This team has worked together for over ten years. We intend to leverage this experience and continue investing in research and development and, over time, expect to strengthen and expand our patent portfolio, technology, and software. While we are currently focused on securing real-time communications over the Internet and establishing the first and only secure domain name registry, we believe our existing and future intellectual property portfolio will extend to additional areas including, among others, network security and operating systems for fixed and mobile devices.

Customers

In connection with the settlement of our lawsuit against Microsoft Corporation in 2010, Microsoft became our first licensee. Pursuant to the Settlement and License Agreement between us and Microsoft, Microsoft paid us \$200 million, and Microsoft was granted a worldwide, irrevocable, nonexclusive, non-sub licensable fully paid up license for our patents for certain Microsoft products. We have also signed Patent License Agreements with Aastra USA, Inc. Avaya, Inc., 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 U.S. patents, for a one-time payment and 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 intend to seek further license of our technology, including our GABRIEL Connection Technology™ to 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 4G/LTE. We have published our royalty rates and guidelines on our website. All forward moving licenses have adhered to these guidelines and have met or exceeded these rates and we will use these rates and guidelines in all future license negotiations.

Marketing and Sales

We plan to employ a leveraged, partner-oriented, marketing strategy for our technology licenses and software offerings. We expect the marketing strategy will primarily be focused on OEMs.

We plan to directly market our domain name registry services to our service provider and system integrator customers. We hope to leverage our relationship with Leidos, Inc. to extend our offering to departments and agencies within the federal government. Leidos, Inc. 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. We intend to build a sales force that will be responsible for managing accounts and pursuing technology licensing and sales opportunities with new customers.

Competition

We believe our technology and solutions will compete primarily against various proprietary security solutions. We group these solutions into three main categories:

- Proprietary or home-grown application specific security solutions have been developed by vendors and integrated directly into their products for our target markets including IP-telephony, mobility, fixed-mobile convergence, and unified communications. These proprietary solutions have been developed due to the lack of standardized approaches to securing real-time communications. This approach has led to corporate networks that are isolated and, as a result, restrict enterprises to using these next-generation networks within the boundaries of their private network. These solutions generally do not provide security for communications over the Internet or require network administrators to manually exchange keys and other security parameters with each destination network outside their corporate network boundary. The cost-savings and other benefits of IP-based real-time communications are significantly limited by this approach to securing real-time communications.
- A session border controller, or SBC, is a device used in networks to exert control over the signaling and media streams involved in establishing, conducting and terminating VoIP calls. A traditional firewall or network address translation, or NAT, device typically block information like endpoint IP addresses and port numbers required by signaling protocols, such as SIP and XMPP, to reach and communicate with their intended destination. SBCs are used in physical networks to address these limitations and enable real-time session traffic to cross the boundaries created by firewalls and other NAT devices and enable VoIP calls to be established successfully. However, SBCs must decrypt and analyze every single data packet for the information to be transmitted successfully, thereby preventing end-to-end encryption. This network design results in SBCs becoming a single point of congestion on the network, as well as a single point of failure. SBCs are also limited to the physical network they secure.
- SIP firewalls, or SIP-aware firewalls, and application layer gateways, manage and protect the traffic, flow and quality of VoIP and other SIP-related communications. They perform real-time network address translation, dynamic firewall functions; support multiple signaling protocols, and media functionality, allowing secure interconnection and the flow of IP media streams across multiple networks. While SIP firewalls assist in analyzing SIP traffic transmitted over the corporate network to filter out various threats, they do not necessarily encrypt the traffic. As a result, this traffic is not entirely secure from end-to-end nor is it protected against threats like man-in-middle and eavesdropping.

Intellectual Property and Patent Rights

Our intellectual property is primarily comprised of trade secrets, patented know-how, issued and pending patents, copyrights and technological innovation.

We have a portfolio comprised of over 80 U.S. and international patents with over 100 pending applications. Our portfolio includes a number of patents that describe unique systems and methods for 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 software and technology solutions also have additional applications relating to operating systems and network security. A complete list of our US patents is available on our website located at www.vimtx.com. Each patent is publicly accessible on the Internet website of the U.S. Patent and Trademark Office at www.uspto.gov. The term of each of our issued U.S. and foreign patents will expire during the period from 2019 to 2024.

Notwithstanding anything to the contrary set forth in any of our filings under the Securities Act of 1933 or the Securities Exchange Act of 1934 that might incorporate future filings, the information set forth on the United States Patent and Trademark Office, or the USPTO Website, shall not be deemed to be a part of or incorporated by reference into any such filings. The Company does not warrant the accuracy, or completeness or adequacy of the USPTO Website, and expressly disclaims liability for errors or omissions on such website.

Assignment of Patents

Some of our issued patents and pending patent applications were acquired by our principal operating subsidiary, VirnetX, Inc., from Leidos, Inc. pursuant to an Assignment Agreement dated December 21, 2006, and a Patent License and Assignment Agreement dated August 12, 2005, as amended on November 2, 2006, including documents prepared pursuant to the November amendment, and as further amended on March 12, 2008. We recorded the assignment from Leidos, Inc. with the U.S. Patent Office on December 21, 2006.

Key terms of these agreements are as follows:

Patent Assignment. Leidos, Inc. unconditionally and irrevocably conveyed, transferred, assigned and quitclaimed all its right, title and interest in and to the patents and patent applications, as specifically set forth on Exhibit A to the assignment document recorded with the U.S. Patent Office, including, without limitation, the right to sue for past infringement.

License to Leidos, Inc. Outside the Field of Use. On November 2, 2006, we granted to Leidos, Inc. an exclusive, royalty free, fully paid, perpetual, worldwide, irrevocable, sub licensable and transferable right and license permitting Leidos, Inc. and its assignees to make, have made, import, use, offer for sale, and sell products and services covered by, and to make improvements to, the patents and patent applications we acquired from Leidos, Inc., solely outside our field of use. We have, and retain, all right, title and interest to all our patents within our field of use. On March 12, 2008, Leidos, Inc. relinquished the November 2, 2006, exclusive right and license outside our field of use referred to above, as well as any right to obtain such exclusive license in the future. Effective March 12, 2008, we granted to Leidos, Inc. a non-exclusive, royalty free, fully paid, perpetual, worldwide, irrevocable, sub licensable and transferable right and license permitting Leidos, Inc. and its assignees to make, have made, import, use, offer for sale, and sell products and services covered by, and to make improvements to, the patents and patent applications we acquired from Leidos, Inc., solely outside our field of use.

Compensation Obligations. As consideration for the assignment of the patents and for the rights we obtained from Leidos, Inc. as amended, we are required to make payments to Leidos, Inc. 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. As of June 30, 2010, we met our maximum royalty payment requirement; however, Leidos, Inc. is also entitled under certain circumstances to receive a portion of the proceeds paid to us for certain acquisitions of VirnetX, from the settlement of certain patent infringement claims of ours.

Government Regulation

The laws governing online secure communications remain largely unsettled, even in areas where there has been legislative action. It may take years to determine whether and how existing laws governing intellectual property, privacy and libel apply to online communications and media. Such legislation may interfere with the growth in use of online secure communications and decrease the acceptance of online secure communications as a viable solution, which could adversely affect our business.

Due to the Internet's popularity and increasing use, new laws regulating secure communications may be adopted. These laws and regulations may cover, among other things, issues relating to privacy, pricing, taxation, telecommunications over the Internet, content, copyrights, distribution and quality of products and services. We intend to comply with all new laws and regulations as they are adopted.

The U.S. government has controlled the authoritative domain name system, or DNS, root server since the inception of the Internet. On July 1, 1997, the President of the United States directed the U.S. Secretary of Commerce to privatize the management of the domain name system in a manner that increases competition and facilitates international participation in its management.

On September 29, 2006, the U.S. Department of Commerce extended its delegation of authority by entering into a new agreement with the Internet Corporation for Assigned Names and Numbers, or ICANN, a California non-profit corporation headquartered in Marina Del Rey, California. ICANN is responsible for managing the accreditation of registry providers and registrars that manage the assignment of top level domain names associated with the authoritative DNS root directory. Although it is possible to create and manage other DNS root directories privately without accreditation from ICANN, the possibility of conflicting name and number assignments makes it less likely that users would widely adopt a top level domain name associated with an alternative DNS root directory provided by a non-ICANN-accredited registry service.

We are aware of the recent announcements made by ICANN related to the anticipated launch of new domain name extensions and an ICANN-supervised Trademark Clearinghouse to assist brand owners with protecting their trademarks during the initial launch of the new domain name extensions. We are currently evaluating whether we will apply to become an ICANN-accredited registry provider with respect to one or more customized generic top-level domain (gTLD), or create our own alternative DNS root directory to manage the assignment of non-standard secure domain names. We have not yet begun discussions with ICANN and we cannot assure you that we will be successful in obtaining ICANN accreditation for our registry service on terms acceptable to us or at all. Whether or not we obtain accreditation from ICANN, we will be subject to the ongoing risks arising out of the delegation of the U.S. government's responsibilities for the domain name system to the U.S. Department of Commerce and ICANN and the evolving government regulatory environment with respect to domain name registry services.

[Index](#)

Employees

As of December 31, 2013, we had 15 full-time employees.

Corporate Overview and History

VirnetX, Inc., was incorporated in the State of Delaware in August 2005. In November 2006, VirnetX acquired certain patents from Leidos, Inc. In July 2007, we effected a reverse merger between PASW, Inc. and VirnetX, which became our principal operating subsidiary. As a result of this merger, the former security holders of VirnetX came to own a majority of our outstanding common stock. On October 29, 2007, we changed our name from PASW, Inc. to VirnetX Holding Corporation.

Available Information

We file or furnish various reports, such as registration statements, periodic and current reports, proxy statements and other materials with the SEC. Our Internet website address is www.virnetx.com. You may obtain, free of charge on our Internet website, copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information we post is intended for reference purposes only; none of the information posted on our website is part of this report or incorporated by reference herein.

In addition to the materials that are posted on our website, you may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and other information statements, and other information regarding issuers, including us, that file electronically with the SEC. The Internet address of the SEC's Internet site is <http://www.sec.gov>.

Item 1A. Risk Factors

We face a variety of risks that may affect our business, financial condition, operating results, the trading price of our common stock, or any combination thereof. You should carefully consider the following information and the other information in this Form 10-K in evaluating our business and prospects and before making an investment decision with respect to our common stock. If any of these risks were to occur, our business, financial condition, results of operations or prospects could be materially and adversely affected. In such an event, the market price of our common stock could decline, and you could lose all or part of your investment. The risks and uncertainties we describe below are not the only ones facing us. Additional risks not presently known to us or that we currently deem immaterial may also affect our business .

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 nominal revenue from licensing activities 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 including, but are not limited to:

- Although we have to date entered into a limited number of settlement and license agreements, we may not be successful in entering into further licensing relationships and existing settlement and 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 expect that we will face intense competition 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 non-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, or otherwise materially and adversely affect our business. Similar challenges could also prevent us from obtaining additional patents in the future. Even if we are successful in enforcing our 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, 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.

Our litigation can be time-consuming, costly and we cannot anticipate the results.

We spend a significant amount of our financial and management resources to pursue our current litigation matters. We believe that these litigation matters and others that we may in the future determine to pursue could continue for years and continue to consume significant financial and management resources. The counterparties to our litigation are all large, well-financed companies with substantially greater resources than us. 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 in particular litigation matters, they may not be predictive of 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 products.

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 (IPR) 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 (3GPP) Long Term Evolution (LTE), Systems Architecture Evolution (SAE) 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 VirnetX that are or become essential, to applicants desiring to implement the Technical Specifications identified by VirnetX, as set forth in the updated licensing declaration under the ATIS and ETSI IPR policies. While we believe that our FRAND commitment positions us to license our essential security patents for the Technical Specifications identified by VirnetX, our licensing declarations under the ATIS and ETSI IPR 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 VirnetX 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 subjected 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 (or VoIP) services are not currently subject to all of 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 and 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; also 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 which are relatively new. 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, or a lack of growth in acceptance of the Internet as a long term viable marketplace for communications services, 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, court and agency decisions, or rules related to obtaining patents or enforcing patents could significantly increase our operating costs and decrease our revenue. For instance, the U.S. Supreme Court has recently modified some tests used by the United States Patent and Trademark Office (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, the U.S. recently enacted sweeping changes to the United States patent system under the Leahy-Smith America Invents Act (“AIA”), 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.

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

We expect to retain certain confidential customer information in our secure data centers and secure domain name registry. 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 facilities and infrastructure. Security technologies are constantly being tested by computer professionals, academics and “hackers.” Advances in the techniques for attacking security solutions could make some or all of 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 our security measures, our infrastructure may be vulnerable to physical break-ins, computer viruses, attacks by hackers or similar disruptive problems. It is possible that we may have to expend additional financial and other resources to address such problems. 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 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 customers could be reluctant to use our services. Such an occurrence could also result in adverse publicity 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.

[Index](#)

A security breach could require a substantial amount of expense to rectify and could result in a product liability claim that causes us to incur substantial liability and related legal and other costs. A security breach may also harm our reputation and make it more difficult or impossible for us to successfully market to others. These matters could harm our operating results and financial condition.

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

We expect that our sales cycles will be long and unpredictable due to a number of uncertainties such as:

- The need to educate potential customers about our patent rights and our product and service capabilities;
- Customers' willingness to invest potentially substantial resources and modify their network infrastructures to take advantage of our products;
- Customers' budgetary constraints;
- The timing of customers' budget cycles; and
- Delays caused by customers' internal review processes.

Long sales cycles may increase the risk that our financial resources are exhausted before we are able to generate significant revenue.

We expect that we will be substantially dependent on a concentrated number of customers. If we are unable to establish, maintain or replace our relationships with customers and develop a diversified customer base, our revenues may fluctuate and our growth may be limited.

We expect that in the future, a significant portion of our revenues will be generated from a limited number of customers. Substantially all of our income during 2010 was from the payments to us resulting from the Settlement and License Agreement we entered into with Microsoft. Nominal revenues from 2010 and 2011 were derived from a single licensing agreement and 2012 and 2013 revenues were derived from settlement and license agreements entered into as we settled lawsuits we initiated against customers for patent infringements. There can be no guarantee that we will be able to obtain additional customers, or if we do so, to sustain our revenue levels from these prospective customers. If we are not able to establish, maintain or replace the limited group of prospective customers that we anticipate may generate a substantial majority of our revenues in the future, or if they do not generate revenues at the levels or at the times that we anticipate, our ability to maintain or grow our revenues will be adversely affected.

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, could 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 we cannot control.

[Index](#)

Our business will also depend upon the capacity, reliability and security 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 or not 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 the number of users of networks utilizing our 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:

- 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 to achieve to the foregoing, our ability to sell our products would be adversely affected, and our reputation with 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 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 efforts of our key personnel, including 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, 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 operations, marketing and sales personnel as well as engineers. Inability to attract and retain such personnel could adversely affect our business. Competition for engineering, sales, marketing and executive personnel is intense, particularly in the technology and Internet sectors and in the region in which our facility is located. We can provide no assurance that we will attract or retain such personnel.

Our consolidated financial statements were restated in 2011 in connection with our identification of a material weakness in our internal control over financial reporting; we may identify future material weakness which may result in late filings, increased costs or declines in our share price.

In early 2011, we restated our previously filed financial statements for the fiscal quarter ended September 30, 2010, each of the then previous five fiscal quarters and the fiscal year ended December 31, 2009, to adjust our accounting for our Series I Warrants. In connection with these restatements, we determined that we had not maintained effective control over our accounting for these Series I Warrants and, as a result, that a material weakness existed with respect to our reporting of complex, non-routine transactions as of the end of the periods covered by the Form 10-K and Form 10-Qs that included the financial statements referenced above. Although we believe that we currently maintain effective control over our disclosure controls and procedures and internal control over financial reporting as regards this issue, 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 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.

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

Although we paid a special cash dividend to holders of our common stock in 2010, we do not currently pay regular dividends on our common stock and instead intend to retain our cash and future earnings, if any to fund our business plan. Our future 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 can't assure you 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 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 December 31, 2013, we had outstanding options and restricted stock units to purchase an aggregate of 5,225,764 shares of common stock (representing 10.19% of our total shares outstanding as of December 31, 2013) of which 4,410,411 are vested and therefore exercisable. To the extent outstanding stock options are exercised, additional shares of common stock will be issued, and such issuance would dilute non-exercising stockholders' percentage voting interests and increase the number of shares eligible for resale in the public market.

The fair value of accounting for our Series I Warrants as derivative liabilities may materially impact our results of our operations in future periods.

We record the Series I Warrants as a derivative liability in accordance with ASC 815-40, "Derivatives and Hedging – Contracts in Entity's Own Equity." These derivative liabilities are reported at fair value each reporting period with changes in the fair value recognized as gain or loss during each reporting period. An increase in our share price or measure of our share price volatility, for example, will generally result in an increase in the fair value of our warrant liability and a non-cash charge during the period of such increase, which could materially and negatively impact our results of operations in future periods.

[Index](#)

Trading in our common shares is limited and the price of our common shares may be subject to substantial volatility, particularly in light of the instability in the financial and capital markets.

Our common stock is listed on NYSE MKT LLC, but its daily trading volume has been limited, sporadic and volatile. Over the past years the market price of our common stock has experienced significant fluctuations. Between January 1, 2013, and December 31, 2013, the reported last sale price for our common stock ranged between \$16.45 and \$35.74 per share. The price of our common stock may continue to be volatile as a result of a number of factors, some of which are beyond our control. These factors include, but not limited to, the following:

- developments in any then-outstanding litigation;
- quarterly variations in our operating results;
- large purchases or sales of common stock or derivatives 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
- economic and financial conditions

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. We had a net loss of \$17.3 million for the year ended December 31, 2011, a net loss \$26.9 million for the year ended December 31, 2012 and a net loss of \$27.6 million for the year ended December 31, 2013 with an accumulated deficit of \$90.5 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 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, 2013, our executive officers and directors beneficially owned approximately 20% of our then outstanding common stock. In addition, a group of stockholders that, as of December 31, 2007, held 4,766,666 shares, or approximately 12%, of our then 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 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 that could delay, discourage or prevent a third party from acquiring control of us without the approval of our Board of Directors. Our 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 effect 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 By-laws**: Stockholder proposals to alter or amend our By-laws or to adopt new By-laws 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.

[Index](#)

In addition, the provisions of Section 203 of the Delaware General Corporate Law govern us. These provisions may prohibit large stockholders, in particular 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 By-laws 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.

Item 1B. Unresolved Staff Comments.

None

Item 2. Properties.

Our principal executive offices are located at 308 Dorla Court, Suite 206, Zephyr Cove, Nevada, 89448. We lease this property, which comprises approximately 2,090 square feet of office space, from a third party for a term that ends in 2015. We have no other properties and believe that our office facility is suitable and appropriately supports our current business needs.

Item 3. Legal Proceedings.

We have four intellectual property infringement lawsuits pending against multiple parties in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we allege that these parties infringe on certain of our patents. We seek damages and injunctive relief in all the complaints.

VirnetX Inc. et al., v. Microsoft Corporation

On April 22, 2013, we initiated a lawsuit by filing a complaint against Microsoft Corporation in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we allege that Microsoft has infringed U.S. Patent Nos. 6,502,135, 7,188,180, 7,418,504, 7,490,151, 7,921,211, and 7,987,274. We seek damages and injunctive relief. The Markman hearing in this case is scheduled for September 4, 2014 and the jury trial is scheduled for July 13, 2015.

VirnetX Inc. v. Cisco Systems, Inc. et al and VirnetX Inc. v. Apple Inc. (Severed Case)

On August 11, 2010, we initiated a lawsuit by filing a complaint against Aastra, Apple, Cisco, and NEC in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we allege that these parties infringe on certain of our patents. We seek damages and injunctive relief. On February 4, 2011, we amended our original complaint, filed on August 11, 2010, against Aastra, Apple, Cisco and NEC in the United States District Court for the Eastern District of Texas, Tyler Division, to assert U.S. Patent No. 7,418,504 against Apple and Aastra. On April 5, 2011, we again amended our complaint against Aastra, Apple, Cisco and NEC in the United States District Court for the Eastern District of Texas, Tyler Division, to include Apple's iPad 2 in the list of Apple products that are accused of infringing our patents. We also asserted our newly-issued patent, U.S. Patent No. 7,921,211 against all of the defendants in that lawsuit. A claim construction hearing was held on January 5, 2012 and the court issued a Markman ruling on April 25, 2012. Aastra and NEC have signed license agreements with us and we have agreed to drop all the accusations of infringement against them. At the pre-trial hearing, the judge decided to postpone the trial against Cisco to March 4, 2013 and just try the case against Apple. On November 6, 2012, a Jury in the United States Court for the Eastern District of Texas, Tyler Division, awarded us over \$368 million in a verdict against Apple Corporation for infringing four of our patents. A post-trial hearing in the case against Apple was held on December 20, 2012. On February 26, 2013, the United States District Court for the Eastern District of Texas, Tyler Division issued its Memorandum Opinion and Order regarding post-trial motions resulting from the prior jury verdict. The Court denied Apple's motion to reduce the damages awarded by the jury for past infringement. The Court further denied Apple's request for a new trial on the liability and damages portions of the verdict. Additionally, the Court granted our motions for pre-judgment interest, post-judgment interest, and post-verdict damages to date. Specifically, the Court ordered that Apple pay \$34 in daily interest up to final judgment and \$330 in daily damages for infringement up to final judgment for certain Apple devices included in the verdict. The Court denied our request for a permanent injunction. In doing so, the Court ordered the parties to mediate over a license in the following 45 days for Apple's future infringing use not covered by the Court's Order, and ordered us to file an appropriate motion with the court if the parties fail to agree to a license. On March 28, 2013, Apple filed a motion to alter or amend the judgment entered by the Court. The mediation was held on April 9, 2013 and the parties did not come to an agreement on an ongoing royalty rate for infringing Apple products. We filed our opposition to this motion on April 10, 2013. As ordered by the Court, we filed a sealed motion with the Court on April 16, 2013, requesting the Court's assistance in deciding an appropriate royalty rate for all infringing products shipped by Apple that are "not more than colorably different" with regards to the accused functionality. However, the judgment may be appealed and no assurances can be given as to when or if we will receive any proceeds in connection with these matters, and accordingly there has been no recognition of the jury awards or royalties in our accompanying financial statements. Under our agreements with Leidos, Inc. we would pay to Leidos, Inc. 25% of the proceeds obtained by us in this lawsuit against Apple after reduction for attorneys' fees and costs incurred in litigating those claims. We are awaiting the Court's decision in this matter. On July 1, 2013, the Court entered an Order setting a hearing on our motion for an ongoing royalty for August 15, 2013. On July 3, 2013, Apple filed an appeal of the judgment dated February 27, 2013 and order dated June 4, 2013 denying Apple's motion to alter or amend the judgment to the United States Court of Appeals for the Federal Circuit. On October 16, 2013 Apple filed its opening appeal brief to the United States Court of Appeals for the Federal Circuit. Our response to the opening brief was filed on December 02, 2013, and on December 19, 2013, Apple filed its final response to complete the briefing of the court. The case is scheduled for hearing on March 03, 2014 at 10:00 a.m. at the United States Court of Appeals for the Federal Circuit (Howard T. Markey National Courts Building, 717 Madison Place, N.W. Washington, DC 20439), Courtroom 402.

[Index](#)

The jury trial against Cisco was held on March 4, 2013. At the end of the trial, the jury came back with a verdict of non-infringement in the trial. The same jury determined that all our patents-in-suit patents are not invalid. On April 3, 2013, we filed a request for a new trial regarding Cisco's infringement of four of our patents based primarily on our allegations of Cisco's inappropriate conduct and arguments during the jury trial that concluded on March 14, 2013. In addition to the request for a new trial, we filed a motion for a judgment as a matter of law on Cisco's infringement of the '759 patent. On April 11, 2013, in response to our motion, Cisco filed its renewed motion to dismiss as moot its invalidity counterclaims against the claims in our patents that were not asserted in the lawsuit as well as a conditional motion for a new trial on certain limited claims and defenses. We are awaiting the Court's decision in this matter. A hearing on our motion for new trial and Cisco's renewed motion to dismiss as moot its invalidity counterclaims and conditional motion for a new trial was held on June 17, 2013. We are awaiting the Court's ruling on these motions.

VirnetX Inc. v. Apple, Inc.

On November 1, 2011, we initiated a lawsuit against Apple in the United States District Court, Tyler Division, pursuant to which we allege that Apple infringes one or more claims of our U.S. Patent No. 8,051,181. We seek damages and injunctive relief. On June 17, 2013 the Court granted our unopposed motion to lift the stay ordered by the Court on December 15, 2011. On June 18, 2013 the Court granted the parties unopposed motion to consolidate this case with Civil Action No. 6:12-cv-00855-LED.

VirnetX Inc. v. Apple, Inc.

On November 6, 2012, we filed a new complaint against Apple Inc., in the United States District Court for the Eastern District of Texas, Tyler Division for willfully infringing four of our patents, U.S. Patent Nos. 6,502,135, 7,418,504, 7,921,211 and 7,490,151, and seeking both 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. Due to their release dates, these products were not included in the previous lawsuit that concluded with a Jury verdict on November 6, 2012 that was subsequently upheld by the United States District Court for the Eastern District of Texas, Tyler Division, on February 26, 2013. On July 1, 2013, we filed a consolidated and amended complaint to include U.S. Patent No. 8,051,181 and consolidate Civil Action No. 6:11-cv-00563-LED. On August 27, 2013, we filed an amended complaint including allegations of willful infringement related to U.S. Patent No. 8,504,697 seeking both damages and injunctive relief. The Markman hearing in this case is scheduled for May 8, 2014 and the jury trial is scheduled for October 13, 2015.

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 worth pursuing, commencing a lawsuit can be expensive and time-consuming, and there is no assurance that we will prevail on such potential claims. In addition, bringing a lawsuit may lead to potential counterclaims which may preclude our ability to commercialize our initial products, which are currently in development. Currently, we are not a party to any other pending legal proceedings, and are not aware of any proceeding threatened or contemplated against us by any governmental authority or other party.

Item 4. Mine Safety Disclosure.

Not applicable

PART II

Item 5. Market for the Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

Our common stock currently trades under the symbol “VHC” on the NYSE MKT LLC.

The following table shows the price range of our common stock, as reported on the NYSE MKT LLC, for each quarter ended during the last two fiscal years.

Quarter Ended	High	Low
3/31/12	\$ 27.97	\$ 19.13
6/30/12	\$ 36.25	\$ 21.71
9/30/12	\$ 41.93	\$ 21.25
12/31/12	\$ 37.65	\$ 23.41
3/31/13	\$ 36.84	\$ 17.98
6/30/13	\$ 26.25	\$ 16.10
9/30/13	\$ 22.41	\$ 16.70
12/31/13	\$ 23.20	\$ 17.16

The closing price of our common stock on the NYSE MKT LLC on February 21, 2014 was \$19.36 per share.

Holders

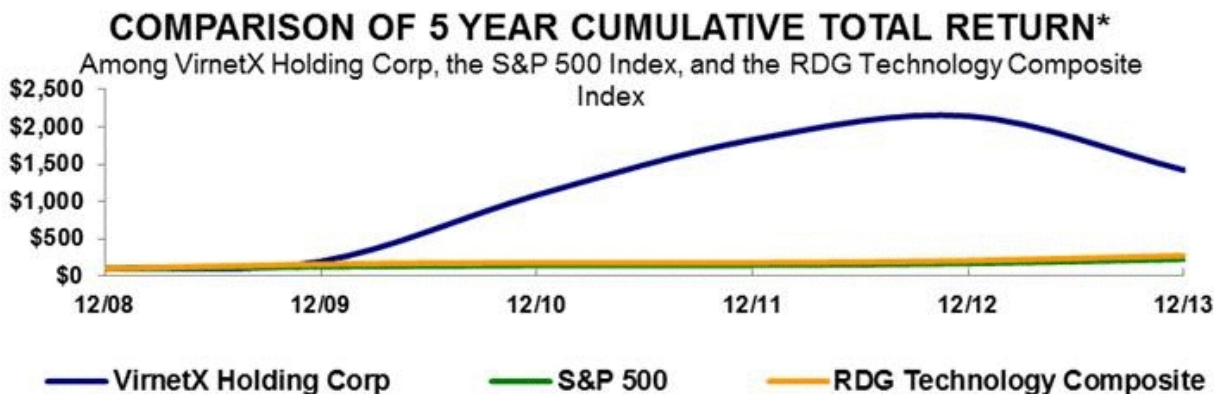
As of February 21, 2014, we had 37 stockholders of record. Because many of our shares of common stock are held of record by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of beneficial stockholders represented by such record holders.

Dividends

On June 15, 2010, our Board of Directors declared a special cash dividend of \$0.50 per share of our common stock to holders of record on July 1, 2010. We do not currently intend to begin paying a regular dividend in the foreseeable future. Any future determination to declare cash dividends will be made at the discretion of our board of directors and will depend on our financial condition, operating results, capital requirements, general business conditions and other factors that our board of directors may deem relevant.

Performance Graph

This performance graph shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act), or incorporated by reference into any filing of VirnetX under the Securities Act of 1933, as amended, or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.



*\$100 invested on 12/31/08 in stock or index, including reinvestment of dividends. Fiscal year ending December 31.

[Index](#)

The stock price performance reflected on this graph is not necessarily indicative of future stock price performance. See the disclosure in part I, Item 1A. "Risk Factors"

	12/08	12/09	12/10	12/11	12/12	12/13
VirnetX Holding Corp	100.00	198.65	1087.70	1828.94	2144.63	1421.70
S&P 500	100.00	126.46	145.51	148.59	172.37	228.19
RDG Technology Composite	100.00	160.94	181.64	181.83	208.18	274.77

Recent Sales of Unregistered Securities

During the year ended December 31, 2013, we had no sales of unregistered securities and no repurchases of stock.

Item 6. Selected Financial Data.

The consolidated statement of operations data for the three years ended December 31, 2013, 2012 and 2011 and the balance sheet data at December 31, 2013 and 2012, are derived from our audited financial statements included elsewhere in this Annual Report on Form 10-K. The consolidated statements of operations data for the for the two years ended December 31, 2010 and 2009 and the balance sheet data at December 31, 2011, 2010 and 2009, are derived from our audited financial statements not included in this Annual Report on Form 10-K.

The selected consolidated financial data below are not necessarily indicative of future performance and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes thereto included in Item 8 of this Annual Report on Form 10-K.

	For the year ended December 31,				
	2013	2012	2011	2010	2009
Consolidated Statement of Operations Data:					
Revenue	\$ 2,197	\$ 412	\$ 20	\$ 68	\$ 26
Gain on settlement	—	—	—	\$ 200,000	—
Other operating expenses	\$ (30,784)	\$ (39,273)	\$ (17,396)	\$ (95,383)	\$ (13,114)
Income tax benefit (expense)	\$ (751)	\$ 12,535	\$ 5,480	\$ (34,062)	—
Net (loss) income	\$ (27,608)	\$ (26,924)	\$ (17,263)	\$ 41,417	\$ (12,524)
Earnings (loss) per share	\$ (0.54)	\$ (0.53)	\$ (0.35)	\$ 0.91	\$ (0.33)
Dividends declared per common share	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.50	\$ 0.00
Consolidated Balance Sheet Data:					
Cash and cash equivalents	\$ 19,173	\$ 19,661	\$ 49,482	\$ 34,635	\$ 2,011
Investments available for sale	\$ 19,815	\$ 26,493	\$ 14,438	\$ 43,457	—
Total assets	\$ 39,398	\$ 61,313	\$ 74,633	\$ 81,694	\$ 2,242
Long-term obligation	—	—	—	—	\$ 120
Stockholders' equity (deficit)	\$ 34,024	\$ 53,944	\$ 68,277	\$ 59,453	\$ (8,708)

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

Company Overview

We develop software and technology solutions for securing real-time communications over the Internet. Our patented GABRIEL Connection Technology™ combines industry standard encryption protocols with our patented techniques for automated domain name system, or DNS, lookup mechanisms, and enables users to create a secure communication link using secure domain names over wired or wireless (4G/LTE) networks. We are currently beta testing our GABRIEL Connection Technology™ as part of our Secure Domain Name Initiative, or (SDNI), on various platforms including PCs, smart phones and tablets. We also intend to establish the exclusive secure domain name registry in the United States and other key markets around the world.

Our portfolio of intellectual property is the foundation of our business model. We currently own over 80 U.S. and international patents with over 100 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, Mobile-to-Mobile (M2M) communications in areas of Smart City, Connected Car and Connected Home.

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, 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 4G.

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 4G/LTE Advanced wireless networks and Mobile-to-Mobile (M2M) communications in areas including Smart City, Connected Car and Connected Home. We also believe that all 4G/LTE Advanced mobile devices will require unique secure domain names and become part of a secure domain name registry.

We intend 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 4G/LTE. We have published our royalty rates and guidelines on our website. All forward moving licenses have adhered to these guidelines and have met or exceeded these rates and we will use these rates and guidelines in all future license negotiations.

Our software and technology solutions 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 Mobile-to-Mobile (M2M) communications in areas including Smart City, Connected Car and Connected Home. 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.

In connection with the settlement of our lawsuit against Microsoft Corporation in 2010, Microsoft became our first licensee. Pursuant to the Settlement and License Agreement between us and Microsoft, Microsoft paid us \$200 million, and Microsoft was granted a worldwide, irrevocable, nonexclusive, non-sub licensable fully paid up license for our patents for certain Microsoft products. We have also signed Patent License Agreements with Avaya Inc., Aastra USA, Inc. 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 U.S. patents, for a one-time payment and an ongoing royalty for all future sales through the expiration of the licensed patents with respect to certain current and future IP-encrypted products.

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, Inc. 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, Inc. and expanded the set of patents we acquired in 2006 from Leidos, Inc. into a larger portfolio with over 80 U.S. and international patents with over 100 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. See – Operations – Research and Development Expenses for a description of our research and development expenses for the past three fiscal years discussed below.

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 4G/LTE companies (domain infrastructure providers, chipset manufacturers, service providers, and others) and build our secure domain name registry.

Developments in the Year Ended December 31, 2013

Litigation

We have four intellectual property infringement lawsuits pending against multiple parties in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we allege that these parties infringe on certain of our patents. We seek damages and injunctive relief in all the complaints.

VirnetX Inc. et al., v. Microsoft Corporation

On April 22, 2013, we initiated a lawsuit by filing a complaint against Microsoft Corporation in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we allege that Microsoft has infringed U.S. Patent Nos. 6,502,135, 7,188,180, 7,418,504, 7,490,151, 7,921,211, and 7,987,274. We seek damages and injunctive relief. The Markman hearing in this case is scheduled for September 4, 2014 and the jury trial is scheduled for July 13, 2015.

VirnetX Inc. v. Cisco Systems, Inc. et al and VirnetX Inc. v. Apple Inc. (Severed Case)

On August 11, 2010, we initiated a lawsuit by filing a complaint against Aastra, Apple, Cisco, and NEC in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we allege that these parties infringe on certain of our patents. We seek damages and injunctive relief. On February 4, 2011, we amended our original complaint, filed on August 11, 2010, against Aastra, Apple, Cisco and NEC in the United States District Court for the Eastern District of Texas, Tyler Division, to assert U.S. Patent No. 7,418,504 against Apple and Aastra. On April 5, 2011, we again amended our complaint against Aastra, Apple, Cisco and NEC in the United States District Court for the Eastern District of Texas, Tyler Division, to include Apple's iPad 2 in the list of Apple products that are accused of infringing our patents. We also asserted our newly-issued patent, U.S. Patent No. 7,921,211 against all of the defendants in that lawsuit. A claim construction hearing was held on January 5, 2012 and the court issued a Markman ruling on April 25, 2012. Aastra and NEC have signed license agreements with us and we have agreed to drop all the accusations of infringement against them. At the pre-trial hearing, the judge decided to postpone the trial against Cisco to March 4, 2013 and just try the case against Apple. On November 6, 2012, a Jury in the United States Court for the Eastern District of Texas, Tyler Division, awarded us over \$368 million in a verdict against Apple Corporation for infringing four of our patents. A post-trial hearing in the case against Apple was held on December 20, 2012. On February 26, 2013, the United States District Court for the Eastern District of Texas, Tyler Division issued its Memorandum Opinion and Order regarding post-trial motions resulting from the prior jury verdict. The Court denied Apple's motion to reduce the damages awarded by the jury for past infringement. The Court further denied Apple's request for a new trial on the liability and damages portions of the verdict. Additionally, the Court granted our motions for pre-judgment interest, post-judgment interest, and post-verdict damages to date. Specifically, the Court ordered that Apple pay \$34 in daily interest up to final judgment and \$330 in daily damages for infringement up to final judgment for certain Apple devices included in the verdict. The Court denied our request for a permanent injunction. In doing so, the Court ordered the parties to mediate over a license in the following 45 days for Apple's future infringing use not covered by the Court's Order, and ordered us to file an appropriate motion with the court if the parties fail to agree to a license. On March 28, 2013, Apple filed a motion to alter or amend the judgment entered by the Court. The mediation was held on April 9, 2013 and the parties did not come to an agreement on an ongoing royalty rate for infringing Apple products. We filed our opposition to this motion on April 10, 2013. As ordered by the Court, we filed a sealed motion with the Court on April 16, 2013, requesting the Court's assistance in deciding an appropriate royalty rate for all infringing products shipped by Apple that are "not more than colorably different" with regards to the accused functionality. However, the judgment may be appealed and no assurances can be given as to when or if we will receive any proceeds in connection with these matters, and accordingly there has been no recognition of the jury awards or royalties in our accompanying financial statements. Under our agreements with Leidos, Inc. we would pay to Leidos, Inc. 25% of the proceeds obtained by us in this lawsuit against Apple after reduction for attorneys' fees and costs incurred in litigating those claims. We are awaiting the Court's decision in this matter. On July 1, 2013, the Court entered an Order setting a hearing on our motion for an ongoing royalty for August 15, 2013. On July 3, 2013, Apple filed an appeal of the judgment dated February 27, 2013 and order dated June 4, 2013 denying Apple's motion to alter or amend the judgment to the United States Court of Appeals for the Federal Circuit. On October 16, 2013 Apple filed its opening appeal brief to the United States Court of Appeals for the Federal Circuit. Our response to the opening brief was filed on December 02, 2013, and on December 19, 2013, Apple filed its final response to complete the briefing of the court. The case is scheduled for hearing on March 03, 2014 at 10:00 a.m. at the United States Court of Appeals for the Federal Circuit (Howard T. Markey National Courts Building, 717 Madison Place, N.W. Washington, DC 20439), Courtroom 402.

The jury trial against Cisco was held on March 4, 2013. At the end of the trial, the jury came back with a verdict of non-infringement in the trial. The same jury determined that all our patents-in-suit patents are not invalid. On April 3, 2013, we filed a request for a new trial regarding Cisco's infringement of four of our patents based primarily on our allegations of Cisco's inappropriate conduct and arguments during the jury trial that concluded on March 14, 2013. In addition to the request for a new trial, we filed a motion for a judgment as a matter of law on Cisco's infringement of the '759 patent. On April 11, 2013, in response to our motion, Cisco filed its renewed motion to dismiss as moot its invalidity counterclaims against the claims in our patents that were not asserted in the lawsuit as well as a conditional motion for a new trial on certain limited claims and defenses. We are awaiting the Court's decision in this matter. A hearing on our motion for new trial and Cisco's renewed motion to dismiss as moot its invalidity counterclaims and conditional motion for a new trial was held on June 17, 2013. We are awaiting the Court's ruling on these motions.

[Index](#)

VirnetX Inc. v. Apple, Inc.

On November 1, 2011, we initiated a lawsuit against Apple in the United States District Court, Tyler Division, pursuant to which we allege that Apple infringes one or more claims of our U.S. Patent No. 8,051,181. We seek damages and injunctive relief. On June 17, 2013 the Court granted our unopposed motion to lift the stay ordered by the Court on December 15, 2011. On June 18, 2013 the Court granted the parties unopposed motion to consolidate this case with Civil Action No. 6:12-cv-00855-LED.

VirnetX Inc. v. Apple, Inc.

On November 6, 2012, we filed a new complaint against Apple Inc., in the United States District Court for the Eastern District of Texas, Tyler Division for willfully infringing four of our patents, U.S. Patent Nos. 6,502,135, 7,418,504, 7,921,211 and 7,490,151, and seeking both 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. Due to their release dates, these products were not included in the previous lawsuit that concluded with a Jury verdict on November 6, 2012 that was subsequently upheld by the United States District Court for the Eastern District of Texas, Tyler Division, on February 26, 2013. On July 1, 2013, we filed a consolidated and amended complaint to include U.S. Patent No. 8,051,181 and consolidate Civil Action No. 6:11-cv-00563-LED. On August 27, 2013, we filed an amended complaint including allegations of willful infringement related to U.S. Patent No. 8,504,697 seeking both damages and injunctive relief. The Markman hearing in this case is scheduled for May 8, 2014 and the jury trial is scheduled for October 13, 2015.

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 worth pursuing, commencing a lawsuit can be expensive and time-consuming, and there is no assurance that we will prevail on such potential claims. In addition, bringing a lawsuit may lead to potential counterclaims which may preclude our ability to commercialize our initial products, which are currently in development. Currently, we are not a party to any other pending legal proceedings, and are not aware of any proceeding threatened or contemplated against us by any governmental authority or other party.

Patents

On August 10, 2012, we submitted updates to our licensing declaration to European Telecommunications Standards Institute (ETSI) and the Alliance for Telecommunications Industry Solutions (ATIS) where we identified three (3) additional developing specifications in the 3GPP LTE, SAE project to which our patents and patent applications are or may become essential.

On September 18, 2012, we submitted additional updates to our licensing declaration to European Telecommunications Standards Institute (ETSI) and the Alliance for Telecommunications Industry Solutions (ATIS) where we identified seven (7) additional developing specifications in the 3GPP LTE, SAE project to which our patents and patent applications are or may become essential.

On February 28, 2012, we announced that the United States Patent and Trademark Office (“USPTO”) issued an Action Closing Prosecution for our U.S. Patent No. 7,188,180 in the inter-partes reexamination filed by Cisco Systems, Inc. on October 25, 2011, confirming all of our claims as valid and patentable. The USPTO rejected all of Cisco’s proposed validity challenges to U.S. Patent No. 7,188,180, and withdrew all of its grounds for rejection.

Commitments

Our lease agreement for our corporate headquarters commenced in October 2011 and includes monthly payments of \$5 until the lease term expired in October 2013. In August 2013, we extended the terms of the lease agreement for two years to expire in October 2015.

We entered into a non-cancelable agreement for corporate promotional and marketing purposes for a period of ten years at a cost of \$4,000. Initial payments of \$250 have been prepaid and are included in prepaid expenses and other current assets on our Consolidated Balance Sheet. The remaining balance is due on March 1 of the year the facility will become available for use, which the lessor anticipates will be in 2014, at which time we will begin amortizing the agreement over the contract period. The lease terms include certain refunds and deductions in the event construction is delayed or not completed within specified time-frames.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. The critical accounting policies we employ in the preparation of our consolidated financial statements are those which involve impairment of long-lived assets, income taxes, fair value of financial instruments and stock-based compensation.

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the U.S. ("U.S. GAAP"). In doing so, we have to 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 the accounting estimates are reasonably likely to occur from period to period. 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 past experience and other assumptions that we believe are reasonable under the circumstances, 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. We have reviewed our critical accounting policies and estimates with the audit committee of our board of directors.

Revenue Recognition

We derive our revenue from patent licensing. The timing and amount of revenue recognized from each licensee depends upon a variety of factors, including the specific terms of each agreement and the nature of the deliverables and obligations. Such agreements can be complex and may or may not include multiple elements. These agreements may include, without limitation, elements related to the settlement of past patent infringement liabilities, up-front and non-refundable license fees for the use of patents, patent licensing royalties on covered products sold by licensees, and the compensation structure and ownership of intellectual property rights associated with contractual technology development arrangements. Licensing agreements are accounted for under the Financial Accounting Standards Board ("FASB") revenue recognition guidance, "Revenue Arrangements with Multiple Deliverables." This guidance requires consideration to be allocated to each element of an agreement that has stand-alone value using the relative fair value method. In other circumstances, such as those agreements involving consideration for past and expected future patent royalty obligations, after consideration of the particular facts and circumstances, the appropriate recording of revenue between periods may require the use of judgment. In all cases, revenue is only recognized after all of the following criteria are met: (1) written agreements have been executed; (2) delivery of technology or intellectual property rights has occurred or services have been rendered; (3) fees are fixed or determinable; and (4) collectability of fees is reasonably assured.

- *Patent License Agreements:* Upon signing a patent license agreement, including licenses entered into settlement of litigation, we provide the licensee permission to use our patented technology in specific applications. We account for patent license agreements in accordance with the guidance for revenue recognition for arrangements with multiple deliverables, with amounts allocated to each element based on their fair values. We have elected to utilize the leased-based model for revenue recognition with revenue being recognized over the expected period of benefit to the licensee. Under our patent license agreements, we typically receive one or a combination of the following forms of payment as consideration for permitting our licensees to use our patented inventions in specific applications and products:
- *Consideration for Past Sales:* Consideration related to a licensee's product sales from prior periods may result from a negotiated agreement with a licensee that utilized our patented technology prior to signing a patent license agreement with us or from the resolution of a litigation, disagreement or arbitration with a licensee over the specific terms of an existing license agreement. We may also receive royalty for past sales in connection with the settlement of patent litigation where there was no prior patent license agreement. These amounts are negotiated, typically based upon application of a royalty rate to historical sales prior to the execution of the license agreement. In each of these cases, since delivery has occurred, we record the consideration as revenue when we have obtained a signed agreement, identified a fixed or determinable price, and determined that collectability is reasonably assured.
- *Current Royalty Payments:* We may also receive ongoing royalty payments covering a licensee's obligations to us related to its sales of covered products in the current contractual reporting period. Licensees that owe these current royalty payments are obligated to provide us with quarterly or semi-annual royalty reports that summarize their sales of covered products and their related royalty obligations to us. We expect to receive these royalty reports subsequent to the period in which our licensees' underlying sales occurred. As a result, it is impractical for us to recognize revenue in the period in which the underlying sales occur, and, in most cases, we will recognize revenue in the period in which the royalty report is received and other revenue recognition criteria are met due to the fact that without royalty reports from our licensees, our visibility into our licensees' sales is limited.
- *Non-Refundable Prepaid Fees and Minimum Fee Contracts:* For contracts which contain non-refundable prepayment or fixed minimum payments over the remaining term of the license, where we have no future obligations or performance requirements, revenue will generally be deferred and recognized over the license term, depending on how and when the revenue recognition process is complete. Revenue for contracts longer than one year may not be recognized in advance of collections as the fee may be considered to be not fixed and determinable.
- *Non-Royalty Elements:* Elements that are not related to royalty revenue in nature, such as settlement fees, expense reimbursement, and damages, if any, are recorded as gain from settlement which is reflected as a separate line item within the operating expenses section in the consolidated statements of operations.

Earnings Per Share

Basic earnings per share are computed by dividing earnings available to common stockholders by the weighted average number of outstanding common shares during the period. Diluted earnings per share is 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. During 2013, 2012 and 2011 we incurred losses; therefore, the effect of any Common Stock equivalent is anti-dilutive during those periods.

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 year ended December 31, 2013, and 2012 we had, at times, 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.

Derivative Instruments

Our Series I Warrants contain an anti-dilution provision which prevents them from being considered indexed to our stock. As a result, the warrants are required to be accounted for as derivative instruments.

We recognize derivative instruments as either assets or liabilities on the accompanying Consolidated Balance Sheets at fair value. We record changes in the fair value (i.e., gains or losses) of the derivatives in the accompanying Consolidated Statements of Operations.

Impairment of Long-Lived Assets

We identify and record impairment losses on long-lived assets used in operations when events and changes in circumstances indicate that the carrying amount of an asset might not be recoverable, but not less than annually. Recoverability is measured by comparison of the anticipated future net undiscounted cash flows to the related assets' carrying value. If such assets are considered to be 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.

Income Taxes

We account for income taxes using the asset and liability method. The asset and liability method requires the recognition of deferred tax assets and liabilities for expected future tax consequences of temporary differences that currently exist between the tax basis and financial reporting basis of our assets and liabilities. We calculate current and deferred tax provisions based on estimates and assumptions that could differ from actual results reflected on the income tax returns filed during the following years. Adjustments based on filed returns are recorded when identified in the subsequent years. The effect on deferred taxes for a change in tax rates is recognized in income in the period that the tax rate change is enacted. In assessing if we will realize our deferred tax assets, we consider whether it is more likely than not that some portion of the deferred tax assets will not be realized.

A valuation allowance is provided for deferred income 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 a valuation allowance to reduce 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. Consistent with our policy, and because of our history of operating losses, we do not currently recognize the benefit of all of our deferred tax assets, including tax loss carry forwards, that may be 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. If and when we believe it is more likely than not that we will recover our deferred tax assets, we will reverse the valuation allowance as an income tax benefit in our statements of operations.

We account for our uncertain tax positions in accordance with U.S. GAAP. The purpose of this method is to clarify accounting for uncertain tax positions recognized. The U.S. GAAP method of accounting for uncertain tax positions utilizes a two-step approach to evaluate tax positions. Step one, recognition, requires evaluation of the tax position to determine if based solely on technical merits it is more likely than not to be sustained upon examination. Step two, measurement, is addressed only if a position is more likely than not to be sustained. In step two, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis, which is more likely than not to be realized upon ultimate settlement with tax authorities. If a position does not meet the more likely than not threshold for recognition in step one, no benefit is recorded until the first subsequent period in which the more likely than not standard is met, the issue is resolved with the taxing authority, or the statute of limitations expires. Positions previously recognized are derecognized when we subsequently determine the position no longer is more likely than not to be sustained. Evaluation of tax positions, their technical merits, and measurements using cumulative probability are highly subjective management estimates. Actual results could differ materially from these estimates.

Stock-based Compensation

We account for stock-based compensation using the fair value recognition method. We recognize these compensation costs net of the applicable forfeiture rate and recognize the compensation costs for only those shares expected to vest on a straight-line basis over the requisite service period of the award, which is generally the option vesting term of 4 years. We estimate the forfeiture rate based on our historical experience.

In addition, we record stock and options granted to non-employees at fair value of the consideration received or the fair value of the equity investments issued as they vest over the performance period.

Fair Value

We apply fair value accounting to all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Inputs that are generally unobservable and typically reflect management's estimate of assumptions that market participants would use in pricing the asset or liability.

Our financial instruments are stated at amounts that equal, or are intended to approximate, fair value. When we approximate 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 quoted valuation techniques, primarily the income and market approach that maximize the use of observable inputs and minimize the use of unobservable inputs for recurring fair value measurements.

New Accounting Pronouncements

In February 2013, the FASB issued final guidance on the presentation of reclassifications out of other comprehensive income. This guidance requires an entity to provide information about the amounts reclassified out of other comprehensive income by component. In addition, an entity is required to present, either on the face of the income statement or in a footnote, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, only if the amount reclassified is required by GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide detail about those amounts. This guidance was effective for interim and fiscal years beginning after December 15, 2012. The guidance did not impact our financial position or results of operations.

In July 2013, the FASB issued Accounting Standards Update ("ASU") No. 2013-11 "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carry forward, a Similar Tax Loss, or a Tax Credit Carry forward Exists." The guidance is a new accounting standard on the financial statement presentation of unrecognized tax benefits. The standard provides that a liability related to an unrecognized tax benefit would be presented as a reduction of a deferred tax asset for a net operating loss carry forward, a similar tax loss or a tax credit carry forward if such settlement is required or expected in the event the uncertain tax position is disallowed. The standard became effective for us on January 1, 2014 and had no material effect on our financial position or statement of operations.

[Index](#)

Operations (all amounts in this section are expressed in thousands)

Revenue

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Revenue	\$ 2,197	\$ 412	\$ 20

Revenue generated for the year ended December 31, 2013 was \$2,197, compared to the December 31, 2012 revenue of approximately \$412 and \$20 for the year ended December 31, 2011. Revenue for the year ended December 31, 2013 of \$2,197, was largely a result of a settlement agreement with one of our patent infringement lawsuits in 2013. Under the terms of the agreement we are to be paid minimum annual payments of \$2,500 over the contract period for a total of \$10,000, with a portion allocated to the use of our patented technology prior the execution of the license agreement ("historical royalties"). During the year ended December 31, 2013 we recognized \$1,500 of revenue for historical royalties and \$697 of revenue for royalties earned subsequent to the settlement, and other licensees. Revenues for historical royalties were estimated based on estimated past and future usage of our IP on our customer's products. No amounts were allocable to settlement fees, expense reimbursement, damages or any other amounts other than historical and future sales as no such amounts were requested or received.

In addition to the settlement discussed above, during 2013 and 2012 we recognized royalty revenue as part of license agreements entered into with customers during the patent infringement actions (see "Litigation"). These revenues relate to both payment for use of our patented technology prior to the signing of a license agreement, and royalty payments after the execution of the license agreements. No amounts were allocable to settlement fees, expense reimbursement, damages or any other amounts other than historical and future sales as no such amounts were requested or received. In 2011, revenue was from our Japanese subsidiary.

Research and Development Expenses

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Research and Development	\$ 1,782	\$ 1,555	\$ 1,464

Research and development costs include expenses paid to outside development consultants and compensation-related expenses for our engineering staff. Research and development costs are expensed as incurred.

Our research and development expenses for the year ended December 31, 2013 was \$1,782 compared to \$1,555 for 2012, and compared to \$1,464 for the year ended December 31, 2011. The increase in 2013 was primarily due to the increase in wages and bonuses paid in 2013 compared to 2012. The increase in 2012 as compared to 2011, was primarily due to the increase in wages.

Selling, General and Administrative Expenses

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Selling, General and Administration	\$ 29,002	\$ 37,718	\$ 15,932

Selling, general and administrative expenses include compensation expense for management and administrative personnel, as well as expenses for outside legal, accounting, and consulting services.

Our selling, general and administrative expenses for the year ended December 31, 2013 was \$29,002 compared to December 31, 2012 of \$37,718 and \$15,932 for the year ended December 31, 2011. The decrease in 2013 was primarily due to the decrease in legal fees. The increase in 2012 was associated with the settlement of the Aastra, Mitel and NEC cases as well as the ongoing Apples, Cisco and Avaya cases in 2012. Legal fees represent approximately 57% of general and administrative expenses for 2013 as compared to 71% for 2012 and 40% for 2011.

Within selling, general and administrative expenses, legal fees for the year ended December 31, 2013 were \$16,363 compared to December 31, 2012 of \$26,537 and \$6,342 for the year ended December 31, 2011. The increase in 2012 was associated with the settlement of the Aastra, Mitel and NEC cases as well as the ongoing Apple, Cisco and Avaya cases in 2012.

Other Income and Expenses

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Other Income and Expense	\$ 1,608	\$ (927)	\$ (5,595)

Our non-cash gain (loss) related to the periodic revaluation of our Series I Warrants liability for the year ended December 31, 2013 was \$1,608 compared to (\$927) for the year ended December 31, 2012 and (\$5,595) for the year ended December 31, 2011. Our non-cash gain (loss) related to the periodic revaluation of our Series I Warrants liability decreased by \$2,535 in the year ended December 31, 2013, as compared to the comparable period in 2012 as a result of a lower common share price during the year ended December 31, 2013.

Interest income for the year ended December 31, 2013 was \$122 compared to \$329 for the year ended December 31, 2012, and \$228 for the year ended December 31, 2011. These changes are due to timing on the maturity of the investments as well as the amount of cash available for investments.

Liquidity and Capital Resources

For the year ended December 31, 2013, our cash and cash equivalents totaled \$19,173 and our short-term investments totaled \$19,815 compared to \$19,661 and \$26,493, respectively, for the year ended December 31, 2012 and \$49,482 and \$14,438, respectively, as of December 31, 2011.

We expect that our cash and cash equivalents as of December 31, 2013, will be sufficient to meet our short-term capital needs. While we do not expect to generate net income in the near term similar to in the net income generated during the year ended December 31, 2010, generally attributable to the Microsoft Settlement, we do 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 over the long term. However, we will not receive any proceeds from these claims unless and until they may be resolved in our favor, and we expect to continue to incur substantial legal and other costs associated with pursuit of our claims.

Contractual Commitments

	<u>Total</u>	<u>2014</u>	<u>2015</u>	<u>There after</u>
Contractual obligations	\$ 3,750	\$ 3,750	\$ —	—
Leases	102	56	46	—
Total	<u>\$ 3,852</u>	<u>\$ 3,806</u>	<u>\$ 46</u>	<u>—</u>

Off-Balance Sheet Arrangements

As of December 31, 2013, we had no off-balance sheet arrangements.

Item 7A. *Quantitative and Qualitative Disclosures about Market Risk*

We invest our excess cash primarily in highly liquid debt instruments including municipal and federal agency securities. By policy, we limit the amount of credit exposure to any one issuer.

Investments in fixed rate earning securities 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 as they will be maturing in six months or less.

Although we have no obligation to settle our Series I Warrant obligations in cash or an unknown number of shares, the embedded liability in the Series I Warrant obligations is recorded at estimated fair value. That estimated fair value is determined in large part by reference to our assumptions and estimates of various factors. Notably, our liability will increase and we may incur significant non-cash expenses, all other factors being constant, if the market price of our common shares increases. Conversely, our liability will decrease and we may recognize significant non-cash gains, all other factors being constant, if the market price of our common shares decreases.

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 drastically increase in the near term but would have an immaterial impact to our consolidated balance sheets and statement of operations as there are only approximately 160,000 warrants outstanding as of December 31, 2013.

[Index](#)

Item 8. Financial Statements and Supplementary Data.

FINANCIAL STATEMENTS

Financial Statements Index

	Page
Report of Farber Hass Hurley LLP, Independent Registered Public Accounting Firm	37
Consolidated Balance Sheets of VirnetX Holding Corporation as of December 31, 2013 and December 31, 2012	38
Consolidated Statements of Operations of VirnetX Holding Corporation for the years ended December 31, 2013, December 31, 2012 and December 31, 2011	39
Consolidated Statements of Comprehensive Loss of VirnetX Holding Corporation for the years ended December 31, 2013, December 31, 2012 and December 31, 2011	39
Consolidated Statements of Stockholders' Equity of VirnetX Holding Corporation for the years ended December 31, 2013, December 31, 2012 and December 31, 2011	40
Consolidated Statements of Cash Flows of VirnetX Holding Corporation for the years ended December 31, 2013, December 31, 2012 and December 31, 2011	41
Notes to Financial Statements of VirnetX Holding Corporation	42

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
VirnetX Holding Corporation

We have audited the accompanying consolidated balance sheets of VirnetX Holding Corporation (the “Company”) as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive loss, stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2013. VirnetX Holding Corporation’s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of VirnetX Holding Corporation, Inc. as of December 31, 2013, and the consolidated results of their operations, and cash flows for each of the three years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), VirnetX Holding Corporation’s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 3, 2014 expressed an unqualified opinion as to the effectiveness of the Company’s control over financial reporting.

/s/ Farber Hass Hurley LLP

Chatsworth, California
March 3, 2014

VirnetX Holding Corporation

CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	As of December 31, 2013	As of December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 19,173	\$ 19,661
Investments available for sale	19,815	26,493
Prepaid taxes	—	14,963
Prepaid expenses and other current assets	357	114
Total current assets	<u>39,345</u>	<u>61,231</u>
Property and equipment, net	53	70
Intangible and other assets	—	12
Total assets	<u>\$ 39,398</u>	<u>\$ 61,313</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,748	\$ 3,197
Income tax liability	395	—
Deferred revenue	667	—
Derivative liability	2,564	4,172
Total current liabilities	<u>5,374</u>	<u>7,369</u>
Commitments and contingencies	—	—
Stockholders' equity:		
Preferred stock, par value \$0.0001 per share		
Authorized: 10,000,000 shares at December 31, 2013 and 2012,		
Issued and outstanding: 0 shares at December 31, 2013 and 2012	—	—
Common stock, par value \$0.0001 per share		
Authorized: 100,000,000 shares at December 31, 2013 and 2012, Issued and outstanding: 51,236,141 shares and 51,150,242 shares, at December 31, 2013 and 2012, respectively	5	5
Additional paid-in capital	124,589	116,856
Accumulated deficit	(90,533)	(62,925)
Accumulated other comprehensive income (loss)	(37)	8
Total stockholders' equity	<u>34,024</u>	<u>53,944</u>
Total liabilities and stockholders' equity	<u>\$ 39,398</u>	<u>\$ 61,313</u>

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

VirnetX Holding Corporation

CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share amounts)

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Revenue	\$ 2,197	\$ 412	\$ 20
Operating expenses:			
Research and development	1,782	1,555	1,464
General, selling and administrative	29,002	37,718	15,932
Total operating expenses	30,784	39,273	17,396
Loss from operations	(28,587)	(38,861)	(17,376)
Gain (loss) on change in value of embedded derivative and warrants	1,608	(927)	(5,595)
Interest income, net	122	329	228
Loss before taxes	(26,857)	(39,459)	(22,743)
Income tax (expense) benefit	(751)	12,535	5,480
Net loss	\$ (27,608)	\$ (26,924)	\$ (17,263)
Basic and diluted loss per share:	\$ (0.54)	\$ (0.53)	\$ (0.35)
Weighted average shares outstanding basic and diluted	51,188,006	50,934,266	50,028,413

VirnetX Holding Corporation
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(in thousands)

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Net loss	\$ (27,608)	\$ (26,924)	\$ (17,263)
Other comprehensive income (loss), net of tax:			
Change in equity adjustment from foreign currency translation, net of tax	(12)	—	—
Change in unrealized gain (loss) on investments, net of tax	(33)	12	(3)
Total other comprehensive income (loss), net of tax	(45)	12	(3)
Comprehensive loss	\$ (27,653)	\$ (26,912)	\$ (17,266)

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

VirnetX Holding Corporation
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except share and per share amounts)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Other Comprehensive Income (Expense)	Total Stockholders' Equity (Deficit)
	Shares	Amount				
Balance at December 31, 2010	<u>49,341,028</u>	<u>\$ 5</u>	<u>\$ 78,187</u>	<u>\$ (17,755)</u>	<u>\$ (984)</u>	<u>\$ 59,453</u>
Stock issued for cash exercise of warrants at \$3.93-3.59 per share, net	855,536		3,063			3,063
Stock-based compensation			4,368			4,368
Deferred tax benefit related to stock based compensation			2,331			2,331
Derivative liability			15,260			15,260
Cashless exercise of \$4.80 underwriter warrants	24,178					--
Exercise of options	398,394		1,068			1,068
Comprehensive income:						
Reclassification adjustment for net loss included in net income				(983)	983	--
Net loss				(17,263)		(17,263)
Other comprehensive income net of tax					(3)	(3)
Comprehensive loss						(17,266)
Balance at December 31, 2011	<u>50,619,136</u>	<u>5</u>	<u>104,277</u>	<u>(36,001)</u>	<u>(4)</u>	<u>68,277</u>
Stock issued for cash exercise of warrants at \$3.93-3.59 per share, net	44,941		161			161
Stock-based compensation			6,162			6,162
Deferred tax benefit related to stock based compensation			3,111			3,111
Derivative liability			1,454			1,454
Exercise of options	486,165		1,691			1,691
Comprehensive income:						
Net loss				(26,924)		(26,924)
Other comprehensive income net of tax					12	12
Comprehensive loss						(26,912)
Balance at December 31, 2012	<u>51,150,242</u>	<u>5</u>	<u>116,856</u>	<u>(62,925)</u>	<u>8</u>	<u>53,944</u>
Stock-based compensation			7,563			7,563
Exercise of options	39,833		170			170
Vested RSU's	46,066					
Comprehensive income:						
Net loss				(27,608)		(27,608)
Other comprehensive income net of tax					(45)	(45)
Comprehensive loss						(27,653)
Balance at December 31, 2013	<u>51,236,141</u>	<u>\$ 5</u>	<u>\$ 124,589</u>	<u>\$ (90,533)</u>	<u>\$ (37)</u>	<u>\$ 34,024</u>

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

VirnetX Holding Corporation

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Cash flows from operating activities:			
Net (loss)	\$ (27,608)	\$ (26,924)	\$ (17,263)
Adjustments to reconcile net (loss) to net cash used in operating activities:			
Depreciation and amortization	36	71	68
Stock-based compensation	7,563	6,162	4,367
Net change in deferred taxes	—	3,158	5,663
Change in value of derivative liability	(1,608)	927	5,595
Changes in assets and liabilities:			
Prepaid expenses and other current assets	(243)	(23)	(3)
Prepaid taxes	14,963	(4,934)	(10,459)
Deferred revenue	667	—	—
Accounts payable and accrued liabilities	(1,449)	1,970	708
Income tax liability	395	—	(6,928)
Net cash used in operating activities	<u>(7,284)</u>	<u>(19,593)</u>	<u>(18,252)</u>
Cash flows from investing activities:			
Purchase of property and equipment	(7)	(37)	(51)
Purchase of investments	(92,729)	(59,342)	(34,082)
Proceeds from sale, maturity of investments	99,362	47,299	63,101
Net cash provided by (used in) investing activities	<u>6,626</u>	<u>(12,080)</u>	<u>28,968</u>
Cash flows from financing activities:			
Proceeds from exercise of options	170	1,691	1,068
Proceeds from exercise of warrants	—	161	3,063
Net cash provided by financing activities	<u>170</u>	<u>1,852</u>	<u>4,131</u>
Net increase (decrease) in cash and cash equivalents	(488)	(29,821)	14,847
Cash and cash equivalents, beginning of year	19,661	49,482	34,635
Cash and cash equivalents, end of year	<u>\$ 19,173</u>	<u>\$ 19,661</u>	<u>\$ 49,482</u>
Supplemental disclosure of cash flow information:			
Cash paid during the year for taxes	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 9,600</u>
Cash paid during the year for interest	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

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

VirnetX Holding Corporation
NOTES TO FINANCIAL STATEMENTS
(in thousands except share and per share amounts)

Note 1 - Formation and Business of the Company

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. Prior to 2012 our revenue was limited to an insignificant amount of software royalties pursuant to the terms of a single license agreement. During 2013 and 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 (see "Revenue Recognition").

Note 2 - Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of VirnetX Holding Corporation and all wholly-owned subsidiaries. All material intercompany accounts and transactions have been eliminated. Certain prior year amounts have been reclassified to conform to current year presentations.

Use of Estimates

We have made a number of estimates and assumptions related to the reporting of assets, liabilities, revenues and expenses to prepare these financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) as delineated by the Financial Accounting Standards Board (FASB) in its Accounting Standards Codification (ASC). Generally, assets and liabilities that are subject to estimation and judgment include the fair value of stock-based compensation, the fair value of our warrant liability and deferred income taxes. While actual results could differ, we believe such estimates to be reasonable.

Revenue Recognition

We derive our revenue from patent licensing. The timing and amount of revenue recognized from each licensee depends upon a variety of factors, including the specific terms of each agreement and the nature of the deliverables and obligations. Such agreements can be complex and may or may not include multiple elements. These agreements may include, without limitation, elements related to the settlement of past patent infringement liabilities, up-front and non-refundable license fees for the use of patents, patent licensing royalties on covered products sold by licensees, and the compensation structure and ownership of intellectual property rights associated with contractual technology development arrangements. Licensing agreements are accounted for under the FASB revenue recognition guidance, "Revenue Arrangements with Multiple Deliverables." This guidance requires consideration to be allocated to each element of an agreement that has stand-alone value using the relative fair value method. In other circumstances, such as those agreements involving consideration for past and expected future patent royalty obligations, after consideration of the particular facts and circumstances, the appropriate recording of revenue between periods may require the use of judgment. In all cases, revenue is only recognized after all of the following criteria are met: (1) written agreements have been executed; (2) delivery of technology or intellectual property rights has occurred or services have been rendered; (3) fees are fixed or determinable; and (4) collectability of fees is reasonably assured.

Patent License Agreements: Upon signing a patent license agreement, including licenses entered into settlement of litigation, we provide the licensee permission to use our patented technology in specific applications. We account for patent license agreements in accordance with the guidance for revenue recognition for arrangements with multiple deliverables, with amounts allocated to each element based on their fair values. We have elected to utilize the leased-based model for revenue recognition with revenue being recognized over the expected period of benefit to the licensee. Under our patent license agreements, we typically receive one or a combination of the following forms of payment as consideration for permitting our licensees to use our patented inventions in specific applications and products:

- *Consideration for Past Sales:* Consideration related to a licensee's product sales from prior periods may result from a negotiated agreement with a licensee that utilized our patented technology prior to signing a patent license agreement with us or from the resolution of a litigation, disagreement or arbitration with a licensee over the specific terms of an existing license agreement. We may also receive royalty for past sales in connection with the settlement of patent litigation where there was no prior patent license agreement. These amounts are negotiated, typically based upon application of a royalty rate to historical sales prior to the execution of the license agreement. In each of these cases, since delivery has occurred, we record the consideration as revenue when we have obtained a signed agreement, identified a fixed or determinable price, and determined that collectability is reasonably assured.

[Index](#)

- *Current Royalty Payments*: We may also receive ongoing royalty payments covering a licensee's obligations to us related to its sales of covered products in the current contractual reporting period. Licensees that owe these current royalty payments are obligated to provide us with quarterly or semi-annual royalty reports that summarize their sales of covered products and their related royalty obligations to us. We expect to receive these royalty reports subsequent to the period in which our licensees' underlying sales occurred. As a result, it is impractical for us to recognize revenue in the period in which the underlying sales occur, and, in most cases, we will recognize revenue in the period in which the royalty report is received and other revenue recognition criteria are met due to the fact that without royalty reports from our licensees, our visibility into our licensees' sales is limited.
- *Non-Refundable Prepaid Fees and Minimum Fee Contracts* : For contracts which contain non-refundable prepayment or fixed minimum payments over the remaining term of the license, where we have no future obligations or performance requirements, revenue will generally be deferred and recognized over the license term, depending on how and when the revenue recognition process is complete. Revenue for contracts longer than one year may not be recognized in advance of collections as the fee may be considered to be not fixed and determinable.
- *Non-Royalty Elements*: Elements that are not related to royalty revenue in nature, such as settlement fees, expense reimbursement, and damages, if any, are recorded as gain from settlement which is reflected as a separate line item within the operating expenses section in the consolidated statements of operations.

[Index](#)

Cash and Cash Equivalents

We consider all highly liquid investments purchased with original maturities of three months or less at the date of purchase to be cash equivalents. Our cash and cash equivalents are not subject to significant interest rate risk due to the short maturities of these investments.

Investments

Investments are classified as available-for-sale and are recorded at fair market value. Unrealized gain and losses are reported as other comprehensive income. Realized gains and losses are recorded in income in the period they are realized. We invest our excess cash primarily in highly liquid debt instruments including municipal and federal agency securities. By policy, we limit the amount of credit exposure to any one issuer.

Property and Equipment

Property and equipment are stated at historical cost, less accumulated depreciation and amortization. Depreciation and amortization are computed using the accelerated and straight line methods over the estimated useful lives of the assets, which range from five to seven years. Repair and maintenance costs are charged to expense as incurred.

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. Deposits held with these financial institutions may exceed the amount of insurance provided on such deposits. A portion of those balances are insured by the Federal Deposit Insurance Corporation, or FDIC. During the year ended December 31, 2013 and 2012, we had, at times, funds that were uninsured. We do not believe that we are subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships. We have not experienced any losses on our deposits of cash and cash equivalents.

Fair Value

The carrying amounts of our financial instruments, including cash equivalents, accounts payable, and accrued liabilities, approximate fair value because of their generally short maturities.

Intangible Assets

We record intangible assets at cost, less accumulated amortization. Amortization of intangible assets is provided over their estimated useful lives, which can range from 3 to 15 years, on either a straight-line basis or as revenue is generated by the assets.

Impairment of Long-Lived Assets

We identify and record impairment losses on long-lived assets used in operations when events and changes in circumstances indicate that the carrying amount of an asset might not be recoverable, but not less than annually. Recoverability is measured by comparison of the anticipated future net undiscounted cash flows to the related assets' carrying value. If such assets are considered to be 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.

Research and Development

Research and development costs include expenses paid to outside development consultants and compensation related expenses for our engineering staff. Research and development costs are expensed as incurred.

Income Taxes

We account for income taxes using the asset and liability method. The asset and liability method requires the recognition of deferred tax assets and liabilities for expected future tax consequences of temporary differences that currently exist between the tax basis and financial reporting basis of our assets and liabilities. We calculate current and deferred tax provisions based on estimates and assumptions that could differ from actual results reflected on the income tax returns filed during the following years. Adjustments based on filed returns are recorded when identified in the subsequent years. The effect on deferred taxes for a change in tax rates is recognized in income in the period that the tax rate change is enacted. In assessing if we will realize our deferred tax assets, we consider whether it is more likely than not that some portion of the deferred tax assets will not be realized.

[Index](#)

A valuation allowance is provided for deferred income 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 a valuation allowance to reduce 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. Consistent with our policy, and because of our history of operating losses, we do not currently recognize the benefit of all of our deferred tax assets, including tax loss carry forwards, that may be 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. If and when we believe it is more likely than not that we will recover our deferred tax assets, we will reverse the valuation allowance as an income tax benefit in our statements of operations.

We account for our uncertain tax positions in accordance with U.S. GAAP. The purpose of this method is to clarify accounting for uncertain tax positions recognized. The U.S. GAAP method of accounting for uncertain tax positions utilizes a two-step approach to evaluate tax positions. Step one, recognition, requires evaluation of the tax position to determine if based solely on technical merits it is more likely than not to be sustained upon examination. Step two, measurement, is addressed only if a position is more likely than not to be sustained. In step two, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis, which is more likely than not to be realized upon ultimate settlement with tax authorities. If a position does not meet the more likely than not threshold for recognition in step one, no benefit is recorded until the first subsequent period in which the more likely than not standard is met, the issue is resolved with the taxing authority, or the statute of limitations expires. Positions previously recognized are derecognized when we subsequently determine the position no longer is more likely than not to be sustained. Evaluation of tax positions, their technical merits, and measurements using cumulative probability are highly subjective management estimates. Actual results could differ materially from these estimates.

Derivative Instruments

Our Series I Warrants are accounted for as derivative instruments as a result of an anti-dilution provision which, in accordance with U.S. GAAP, prevents them from being considered indexed to our stock and qualified for an exception to derivative accounting.

We recognize derivative instruments as either assets or liabilities on the accompanying Consolidated Balance Sheets at fair value. We record changes in the fair value (i.e., gains or losses) of the derivatives in the accompanying Consolidated Statements of Operations.

Stock-Based Compensation

We account for stock-based compensation using the fair value recognition method in accordance with U.S. GAAP. We recognize these compensation costs net of the applicable forfeiture rate and recognize the compensation costs for only those shares expected to vest on a straight-line basis over the requisite service period of the award, which is generally the vesting term of 4 years. We estimate the forfeiture rate based on our historical experience if any. See Note 6 - Stock-Based Compensation for additional information concerning our share-based compensation awards.

In addition, as required we record stock and options granted to non-employees at fair value of the consideration received or the fair value of the equity instruments issued as they vest over the performance period.

Earnings per Share

Basic earnings per share are computed by dividing earnings available to common stockholders by the weighted average number of outstanding common shares during the period. Diluted earnings per share is 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. During 2013, 2012 and 2011 we incurred losses; therefore the effect of any common stock equivalent would be anti-dilutive during these periods.

New Accounting Pronouncements

In February 2013, the FASB issued final guidance on the presentation of reclassifications out of other comprehensive income. The guidance requires an entity to provide information about the amounts reclassified out of other comprehensive income by component. In addition, an entity is required to present, either on the face of the income statement or in a footnote, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, only if the amount reclassified is required by GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide detail about those amounts. This guidance was effective for interim and fiscal years beginning after December 15, 2012. The guidance did not impact our financial position or results of operations.

In July 2013, the FASB issued Accounting Standards Update ("ASU") No. 2013-11 "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carry forward, a Similar Tax Loss, or a Tax Credit Carry forward Exists." The guidance is a new accounting standard on the financial statement presentation of unrecognized tax benefits. The standard provides that a liability related to an unrecognized tax benefit would be presented as a reduction of a deferred tax asset for a net operating loss carry forward, a similar tax loss or a tax credit carry forward if such settlement is required or expected in the event the uncertain tax position is disallowed. The standard became effective for us on January 1, 2014 and had no material effect on our financial position or statement of operations.

Note 3 - Property and Equipment

Our major classes of property and equipment were as follows:

	December 31		
	2013	2012	2011
Office furniture	\$ 70	\$ 70	\$ 57
Computer equipment	121	115	91
Total	191	185	148
Less accumulated depreciation	(138)	(115)	(92)
	<u>\$ 53</u>	<u>\$ 70</u>	<u>\$ 56</u>

Depreciation expense for the years ended December 31, 2013, 2012 and 2011 was \$24, \$23 and \$20 respectively.

Note 4 - Commitments

We lease our offices under an operating lease with a third party expiring in October 2015. We recognize rent expense on a straight-line basis over the term of the lease. Rent expense was \$56, \$56 and \$59 for the years ended December 31, 2013, 2012 and 2011, respectively.

We entered into a non-cancelable agreement for corporate promotional and marketing purposes for a period of ten years at a cost of \$4,000. Initial payments of \$250 have been prepaid and are included in prepaid expenses and other current assets on our Consolidated Balance Sheet. The remaining balance is due on March 1 of the year the facility will become available for use, which the lessor anticipates will be in 2014, at which time we will begin amortizing the agreement over the contract period. The lease terms include certain refunds and deductions in the event construction is delayed or not completed within specified time-frames.

The following table summarizes our contractual obligations, including interest expense, and commitments as of December 31, 2013:

	Total	2014	2015	Thereafter
Contractual obligations	\$ 3,750	\$ 3,750	\$ —	—
Leases	102	56	46	—
Total	<u>\$ 3,852</u>	<u>\$ 3,806</u>	<u>\$ 46</u>	<u>—</u>

Note 5 - Stock Plan

In 2005, VirnetX, Inc. adopted the 2005 Stock Plan (the "2005 Plan"), which was assumed by us upon the closing of the transaction between VirnetX Holding Corporation and VirnetX, Inc. on July 5, 2007. Our Board of Directors renamed the 2005 Plan the VirnetX Holding Corporation 2007 Stock Plan and our stockholders approved the 2007 Plan at our 2008 annual stockholders' meeting. The 2007 Plan provided for the issuance of up to 11,624,469 shares of our common stock. The 2007 Plan provided for the granting of stock options and restricted stock purchase rights (RSU) to our employees and consultants.

On May 22, 2013, our stockholders approved the VirnetX Holding Corporation 2013 Equity Incentive Plan (the "2013 Plan") at our 2013 annual stockholders' meeting. The 2013 Plan provides for the issuance of up to 2,500,000 shares of our common stock. To the extent that any award should expire, become unexercisable or is otherwise forfeited, the shares subject to such award will again become available for issuance under the 2013 Plan. The 2013 Plan provides for the granting of stock options and restricted stock purchase rights ("RSU") to our employees and consultants. Stock options granted under the 2013 Plan may be incentive stock options or nonqualified stock options. Incentive stock options ("ISO") may only be granted to our employees (including officers and directors). Nonqualified stock options ("NSO") and stock purchase rights may be granted to our employees and consultants.

The 2013 Plan will expire in 2023. Options may be granted under the 2013 Plan with an exercise price determined by our Board of Directors, or a duly appointed committee thereof, provided, however, that the exercise price of an option granted to any employee shall be not less than 100% of the fair market value at the date of grant in the case of ISO or 85% of the fair market value at the date of grant in the case of an NSO. The exercise price of an ISO or NSO granted to one of our Named Executive Officers shall not be less than 100% fair market value of the shares at the date of grant and the exercise price of an ISO granted to a 10% shareholder shall not be less than 110% of the fair market value of the shares on the date of grant. Stock options granted under the 2013 Plan typically vest over four years and have a 10 year term. All RSUs are considered to be granted at the fair value of our stock on the date of grant because they have no exercise price. RSUs typically vest over four years. At December 31, 2013 there were 2,227,882 shares available for grant under the 2013 Plan.

Note 6 - Stock-Based Compensation

The following tables summarize information about stock-options and RSU's outstanding at December 31, 2013:

Date of Option Issue	Options Outstanding		Weighted Average Remaining Contractual Life (Years)		Options Vested and Exercisable		Weighted Average Remaining Contractual Life (Years)		Weighted Average Exercise Price	
	Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	
2006	\$ 0.24	690,612	2.22	\$ 0.24	690,612	2.22	\$ 0.24			
2007	\$ 4.20	1,277,574	3.56	4.20	1,277,574	3.56	4.20			
2007	\$ 5.88-6.47	563,931	3.99	5.88	563,931	3.99	5.88			
2008	\$ 1.74-6.20	169,500	4.37	5.13	169,500	4.37	5.13			
2009	\$ 1.15- 1.58	933,211	5.26	1.16	933,211	5.26	1.16			
2010	\$ 5.48-6.03	279,896	6.17	5.49	268,440	6.17	5.49			
2011	\$ 19.85-23.62	425,000	7.37	23.62	290,416	7.37	23.62			
	23.84 –									
2012	\$ 35.25	362,500	8.39	27.00	164,166	8.35	27.16			
	23.72 –									
2013	\$ 35.05	274,625	9.37	25.37	52,561	9.36	25.70			
		<u>4,976,849</u>	<u>4.91</u>	<u>\$ 7.86</u>	<u>4,410,411</u>	<u>4.45</u>	<u>\$ 5.66</u>			

Grant Date	RSU's Outstanding		
	Range of Grant Prices	Number Outstanding	Weighted Average Grant Price
2012	\$ 24.75 – 29.90	92,500	\$ 24.75
2013	\$ 23.72	156,415	23.72
		<u>248,915</u>	<u>\$ 24.10</u>

[Index](#)

The following tables summarize activity under the Plan for the indicated periods:

	Options			
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2010	4,830,391	\$ 3.14	—	—
Options granted	475,000	23.80	—	—
Options exercised	(398,393)	2.68	—	—
Options cancelled	—	—	—	—
Outstanding at December 31, 2011	4,906,998	5.12	—	—
Options granted	367,500	26.97	—	—
Options exercised	(486,165)	3.48	—	—
Options cancelled	(12,109)	17.34	—	—
Outstanding at December 31, 2012	4,776,224	6.94	—	—
Options granted	274,625	25.37	—	—
Options exercised	(39,833)	4.27	—	—
Options cancelled	(34,167)	20.57	—	—
Outstanding at December 31, 2013	<u>4,976,849</u>	<u>\$ 7.86</u>	<u>4.91</u>	<u>\$ 63,649</u>

	RSU's		
	Number of RSU's	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Outstanding at December 31, 2011	—	—	—
RSU's granted	151,665	25.60	—
Outstanding at December 31, 2012	<u>151,665</u>	<u>\$ 25.60</u>	<u>\$ —</u>
RSU's granted	156,415	23.72	—
RSU's vested	(55,832)	27.06	—
RSU's cancelled	(3,333)	24.75	—
Outstanding at December 31, 2013	<u>248,915</u>	<u>\$ 24.10</u>	<u>\$ —</u>

Intrinsic value is calculated as the difference between, the per share market price of our common stock on the last trading day of 2013, which was \$19.41, and the exercise price of the options. For options exercised, the intrinsic value is the difference between market price and the exercise price on the date of exercise. We received cash proceeds of \$170, \$1,691 and \$1,068 from stock options exercised in 2013, 2012 and 2011 respectively. The total intrinsic value of options exercised was \$676, \$11,509 and \$8,050 during the years ended December 31, 2013, 2012 and 2011, respectively. The aggregate intrinsic value of options exercisable at December 31, 2013 was \$63,490. For RSU's vested, the intrinsic value is the difference between market price and the vested price on the date of vest. The total intrinsic value of the RSU's vested was zero during the year ended December 31, 2013.

Stock-based compensation expense is included in general and administrative expense for each period as follows:

Stock-Based Compensation by Type of Award	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Employee stock options	\$ 6,488	\$ 5,171	\$ 4,367
RSU's	1,075	991	—
Total stock-based compensation expense	<u>\$ 7,563</u>	<u>\$ 6,162</u>	<u>\$ 4,367</u>

[Index](#)

As of December 31, 2013, there was \$11,752 of unrecognized stock-based compensation expense expected to be recognized related to unvested employee stock options and 4,773 of unrecognized stock-based compensation expense to be recognized related to unvested RSU's. These costs are expected to be recognized over a weighted-average period of 2.39 and 2.70 years, respectively.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model using the following weighted average assumptions:

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Expected stock price volatility	93%	111%	123%
Risk-free interest rate	2.04%	1.90%	3.05%
Expected life term (in years)	6.10 years	6.8 years	6.6 years
Expected dividends	0%	0%	0%

Based on the Black-Scholes option pricing model, the weighted average estimated fair value of employee stock options granted was \$19.24, \$23.17 and \$21.43 per share during the years ended December 31, 2013, 2012 and 2011, respectively.

The expected life was determined using the simplified method outlined in ASC 718, taking the average of the vesting term and the contractual term of the option. Expected volatility of the stock options was based upon historical data and other relevant factors, such as the volatility of comparable publicly-traded companies at a similar stage of life cycle. We have not provided an estimate for forfeitures because we have had nominal forfeited options and believe that all outstanding options at December 31, 2013, will vest. In the future, we may change this estimate based on actual and expected future forfeiture rates.

Note 7 - Earnings Per Share

Basic earnings per share are based on the weighted average number of shares outstanding for a period. Diluted earnings per share are based upon the weighted average number of shares and potentially dilutive common shares outstanding. Potential common shares outstanding principally include stock options, under our stock plan and warrants. During 2013, 2012 and 2011 we incurred losses; therefore the effect of any common stock equivalent would be anti-dilutive during those periods.

The table below sets forth the basic loss per share calculations:

	Period Ended December 31,		
	2013	2012	2011
Net loss	\$ (27,608)	\$ (26,924)	\$ (17,263)
Basic weighted average number of shares outstanding	51,188	50,934	50,028
Diluted weighted average number of shares outstanding	51,188	50,934	50,028
Basic and diluted loss per share	\$ (0.54)	\$ (0.53)	\$ (0.35)

Note 8 - Common Stock

Each share of common stock has the right to one vote. The holders of common stock are entitled to receive dividends whenever funds are legally available and when declared by our Board of Directors, subject to the prior rights of holders of all classes of stock outstanding having priority rights as to dividends. Our restated articles of incorporation authorize us to issue up to 100,000,000 shares of \$.0001 par value common stock.

Note 9 - Warrants

Information about warrants outstanding during the twelve months ended December 31, 2013 follows:

Original Number of Warrants Issued	Exercise Price per Common Share	Exercisable at December 31, 2012	Became Exercisable	Exercised	Terminated / Cancelled / Expired	Exercisable at December 31, 2013	Expiration Date
2,619,036(1)	\$ 3.59	159,967	—	—	—	159,967	March 2015
Total		159,967	—	—	—	159,967	

(1) Referred to as our Series I Warrants.

Note 10 - Employee Benefit Plan

We sponsor a defined contribution, 401k plan, covering substantially all our employees. Our matching contribution to the plan was approximately, \$47 in 2013, \$41 in 2012 and \$36 in 2011.

Note 11 - Income Taxes

The benefit (provision) for income taxes is comprised of the following:

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Current:			
Federal	\$ (354)	\$ 12,154	\$ 8,036
State	(397)	428	767
Foreign	-	-	9
	(751)	12,582	8,812
Deferred:			
Federal	-	(40)	(3,331)
State	-	(7)	(1)
	-	(47)	(3,332)
Total benefit (provision) for income taxes	\$ (751)	\$ 12,535	\$ 5,480

A reconciliation of the United States federal statutory income tax rate to our effective income tax rate is as follows:

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
United States federal statutory rate	35.00%	35.00%	35.00%
State taxes, net of federal benefit	(1.48)%	1.07%	2.19%
Valuation allowance	(37.11)%	(4.41)%	(4.39)%
Stock options	(0.17)%	0.14%	(1.92)%
Prior year true-up	(1.32)%	1.03%	-
Warrants	2.10%	(0.82)%	(8.60)%
Other	0.18%	(0.32)%	1.79%
Balance at the end of the year	(2.80)%	31.69%	24.07%

[Index](#)

Deferred tax assets (liabilities) consist of the following:

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Deferred tax assets:			
Reserves and accruals	\$ 58	\$ 50	\$ 46
State tax	1	1	1
Research and development credits and other credits	907	-	-
Net operating loss carry forward	8,249	2,254	2,822
Stock based compensation	6,600	4,506	3,155
Other	154	177	211
Total deferred tax assets	<u>15,969</u>	<u>6,988</u>	<u>6,235</u>
Valuation allowance	(15,955)	(6,969)	(6,168)
Deferred tax assets after valuation allowance	14	19	67
Deferred tax liability:			
Depreciation and amortization	(14)	(19)	(20)
Total deferred tax liability	<u>(14)</u>	<u>(19)</u>	<u>(20)</u>
Net deferred tax assets	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 47</u>

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all of deferred assets will not be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible.

Based on the available objective evidence, management believes it is more likely than not that the net deferred tax assets at December 31, 2013 will not be fully realizable. Accordingly, management has maintained a full valuation allowance against its net deferred tax assets at December 31, 2013. The net change in the total valuation allowance for the 12 months ended December 31, 2013 was an increase of \$8,986. At December 31, 2013, we had federal and state net operating loss carry-forwards of approximately \$23,468 and \$37,993, respectively, expiring beginning in 2027 and 2016, respectively. At December 31, 2013, we had federal research and development credit carry-forwards of approximately \$907 expiring beginning in 2031.

Internal Revenue Code Section 382 places a limitation (the "Section 382 Limitation") on the amount of taxable income can be offset by net operating loss carry forwards after a change in control (generally greater than 50% change in ownership) of a loss corporation. California has similar rules. Our capitalization described herein may have resulted in such a change. Generally, after a control change, a loss corporation cannot deduct net operating loss carry forwards generated in years prior to the deemed change of control under IRC Section 382 in excess of the Section 382 Limitation.

We are required to recognize the financial statement effects of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. As a result, we have provided contingent reserve under ASC 740-10 of \$316, \$128 and \$128 at December 31, 2013, December 31, 2012 and December 31, 2011, respectively. Our tax returns are subject to review by various tax authorities. The returns are subject to review those from 2008 forward.

Our policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. We have accrued interest or penalties during the 12 month period ended December 31, 2013 in the amount of \$79.

A reconciliation of beginning and ending amounts of unrecognized tax benefits follows:

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Balance at the beginning of the year	\$ 128	\$ 128	\$ 128
Additions based on tax positions related to the current year	-	-	-
Additions for tax positions of prior years	188	-	-
Settlements	-	-	-
Lapse of applicable statute of limitations	-	-	-
Balance at the end of the year	<u>\$ 316</u>	<u>\$ 128</u>	<u>\$ 128</u>

Note 12 - Fair Value Measurement

We apply fair value accounting for all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Inputs that are generally unobservable and typically reflect management’s estimate of assumptions that market participants would use in pricing the asset or liability.

The carrying amounts for cash and cash equivalents, investments in certificates of deposit, accounts payable and accrued expenses approximate their fair values due to the short period of time until maturity.

Certificate of deposits: Fair value measured at face value plus accrued interest.

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

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

Series I Warrants: Fair value measured by using a Binomial valuation model. As of December 31, 2013, the assumptions used to measure fair value of the liability embedded in our outstanding Series I Warrants included a warrant exercise price of \$3.59 per share, a common share price of \$19.41, a discount rate of 1.75%, and a volatility of 91.55%. As of December 31, 2012, the assumptions used to measure fair value of the liability embedded in our outstanding Series I Warrants included a warrant exercise price of \$3.59 per share, a common share price of \$29.28, a discount rate of 0.72%, and a volatility of 94.15%.

The following table shows our cash and available-for-sale securities adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category recorded as cash and cash equivalents of investments available for sale as of December 31, 2013 and 2012 respectively (in thousands):

	December 31, 2013					
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Investments Available for Sale
Cash	\$ 11,699	\$ -	\$ -	\$ 11,699	\$ 11,699	\$ -
Level 1:						
Mutual funds	73	-	-	73	73	-
Corporate securities	10,782	-	-	10,782	2,325	8,457
Municipal securities	2,173	-	-	2,173	665	1,508
U.S agency securities	14,287	-	(25)	14,262	4,411	9,851
	27,315	-	(25)	27,289	7,474	19,815
Total	\$ 39,014	\$ -	\$ (25)	\$ 38,988	\$ 19,173	\$ 19,815
	December 31, 2012					
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Investments Available for Sale
Cash	\$ 19,661	\$ -	\$ -	\$ 19,661	\$ 19,661	\$ -
Level 1:						
Certificates of deposit	17,836	-	-	17,836	-	17,836
Corporate securities	8,649	8	-	8,657	-	8,657
	26,485	8	-	26,493	-	26,493
Total	\$ 46,146	\$ 8	\$ -	\$ 46,154	\$ 19,661	\$ 26,493

The maturities of the Company's marketable securities generally range from within one to two years. Actual maturities could differ from contractual maturities due to call or prepayment provisions.

[Index](#)

The following table sets forth, by level within the fair value hierarchy, our financial instrument liabilities as of December 31, 2013 (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Series I Warrants	\$ —	\$ —	\$ 2,564	\$ 2,564
Total	\$ —	\$ —	\$ 2,564	\$ 2,564

The following table sets forth, by level within the fair value hierarchy, our financial instrument liabilities as of December 31, 2012 (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Series I Warrants	\$ —	\$ —	\$ 4,172	\$ 4,172
Total	\$ —	\$ —	\$ 4,172	\$ 4,172

The following table sets forth a summary of changes in the fair value of our Level 3 financial instrument liability for the year ended December 31, 2013, 2012 and 2011 (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
	Year ended December 31, 2013	Year ended December 31, 2012	Year ended December 31, 2011
Beginning Balance	\$ 4,172	\$ 4,699	\$ 14,364
(Gain) losses included in losses	(1,608)	927	5,595
Settlements	—	(1,454)	(15,260)
Ending Balance	\$ 2,564	\$ 4,172	\$ 4,699

Note 13 - Patent Portfolio

As of December 31, 2013, we have over 80 U.S. and international patents with over 100 pending applications. Our issued U.S. and foreign patents expire at various times during the period from 2019 to 2024. Some of our issued patents and pending patent applications were acquired by our principal operating subsidiary, VirnetX, Inc., from Leidos, Inc. in 2006 and we are required to make payments to Leidos, Inc. 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. As of June 30, 2010, we met our maximum royalty payment requirement; however, Leidos, Inc. is also entitled under certain circumstances to receive a portion of the proceeds paid to us for certain acquisitions of VirnetX or from the settlement of certain patent infringement claims of ours.

Note 14 - Litigation

We have four intellectual property infringement lawsuits pending against multiple parties in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we allege that these parties infringe on certain of our patents. We seek damages and injunctive relief in all the complaints.

VirnetX Inc. et al, v. Microsoft Corporation

On April 22, 2013, we initiated a lawsuit by filing a complaint against Microsoft Corporation in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we allege that Microsoft has infringed U.S. Patent Nos. 6,502,135, 7,188,180, 7,418,504, 7,490,151, 7,921,211, and 7,987,274. We seek damages and injunctive relief. The Markman hearing in this case is scheduled for September 4, 2014 and the jury trial is scheduled for July 13, 2015.

VirnetX Inc. v. Cisco Systems, Inc. et al and VirnetX Inc. v. Apple Inc. (Severed Case)

On August 11, 2010, we initiated a lawsuit by filing a complaint against Aastra, Apple, Cisco, and NEC in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we allege that these parties infringe on certain of our patents. We seek damages and injunctive relief. On February 4, 2011, we amended our original complaint, filed on August 11, 2010, against Aastra, Apple, Cisco and NEC in the United States District Court for the Eastern District of Texas, Tyler Division, to assert U.S. Patent No. 7,418,504 against Apple and Aastra. On April 5, 2011, we again amended our complaint against Aastra, Apple, Cisco and NEC in the United States District Court for the Eastern District of Texas, Tyler Division, to include Apple's iPad 2 in the list of Apple products that are accused of infringing our patents. We also asserted our newly-issued patent, U.S. Patent No. 7,921,211 against all of the defendants in that lawsuit. A claim construction hearing was held on January 5, 2012 and the court issued a Markman ruling on April 25, 2012. Aastra and NEC have signed license agreements with us and we have agreed to drop all the accusations of infringement against them. At the pre-trial hearing, the judge decided to postpone the trial against Cisco to March 4, 2013 and just try the case against Apple. On November 6, 2012, a Jury in the United States Court for the Eastern District of Texas, Tyler Division, awarded us over \$368 million in a verdict against Apple Corporation for infringing four of our patents. A post-trial hearing in the case against Apple was held on December 20, 2012. On February 26, 2013, the United States District Court for the Eastern District of Texas, Tyler Division issued its Memorandum Opinion and Order regarding post-trial motions resulting from the prior jury verdict. The Court denied Apple's motion to reduce the damages awarded by the jury for past infringement. The Court further denied Apple's request for a new trial on the liability and damages portions of the verdict. Additionally, the Court granted our motions for pre-judgment interest, post-judgment interest, and post-verdict damages to date. Specifically, the Court ordered that Apple pay \$34 in daily interest up to final judgment and \$330 in daily damages for infringement up to final judgment for certain Apple devices included in the verdict. The Court denied our request for a permanent injunction. In doing so, the Court ordered the parties to mediate over a license in the following 45 days for Apple's future infringing use not covered by the Court's Order, and ordered us to file an appropriate motion with the court if the parties fail to agree to a license. On March 28, 2013, Apple filed a motion to alter or amend the judgment entered by the Court. The mediation was held on April 9, 2013 and the parties did not come to an agreement on an ongoing royalty rate for infringing Apple products. We filed our opposition to this motion on April 10, 2013. As ordered by the Court, we filed a sealed motion with the Court on April 16, 2013, requesting the Court's assistance in deciding an appropriate royalty rate for all infringing products shipped by Apple that are "not more than colorably different" with regards to the accused functionality. However, the judgment may be appealed and no assurances can be given as to when or if we will receive any proceeds in connection with these matters, and accordingly there has been no recognition of the jury awards or royalties in our accompanying financial statements. Under our agreements with Leidos, Inc. we would pay to Leidos, Inc. 25% of the proceeds obtained by us in this lawsuit against Apple after reduction for attorneys' fees and costs incurred in litigating those claims. We are awaiting the Court's decision in this matter. On July 1, 2013, the Court entered an Order setting a hearing on our motion for an ongoing royalty for August 15, 2013. On July 3, 2013, Apple filed an appeal of the judgment dated February 27, 2013 and order dated June 4, 2013 denying Apple's motion to alter or amend the judgment to the United States Court of Appeals for the Federal Circuit. On October 16, 2013 Apple filed its opening appeal brief to the United States Court of Appeals for the Federal Circuit. Our response to the opening brief was filed on December 02, 2013, and on December 19, 2013, Apple filed its final response to complete the briefing of the court. The case is scheduled for hearing on March 03, 2014 at 10:00 a.m. at the United States Court of Appeals for the Federal Circuit (Howard T. Markey National Courts Building, 717 Madison Place, N.W. Washington, DC 20439), Courtroom 402.

The jury trial against Cisco was held on March 4, 2013. At the end of the trial, the jury came back with a verdict of non-infringement in the trial. The same jury determined that all our patents-in-suit patents are not invalid. On April 3, 2013, we filed a request for a new trial regarding Cisco's infringement of four of our patents based primarily on our allegations of Cisco's inappropriate conduct and arguments during the jury trial that concluded on March 14, 2013. In addition to the request for a new trial, we filed a motion for a judgment as a matter of law on Cisco's infringement of the '759 patent. On April 11, 2013, in response to our motion, Cisco filed its renewed motion to dismiss as moot its invalidity counterclaims against the claims in our patents that were not asserted in the lawsuit as well as a conditional motion for a new trial on certain limited claims and defenses. We are awaiting the Court's decision in this matter. A hearing on our motion for new trial and Cisco's renewed motion to dismiss as moot its invalidity counterclaims and conditional motion for a new trial was held on June 17, 2013. We are awaiting the Court's ruling on these motions.

VirnetX Inc. v. Apple, Inc.

On November 1, 2011, we initiated a lawsuit against Apple in the United States District Court, Tyler Division, pursuant to which we allege that Apple infringes one or more claims of our U.S. Patent No. 8,051,181. We seek damages and injunctive relief. On June 17, 2013 the Court granted our unopposed motion to lift the stay ordered by the Court on December 15, 2011. On June 18, 2013 the Court granted the parties unopposed motion to consolidate this case with Civil Action No. 6:12-cv-00855-LED.

VirnetX Inc. v. Apple, Inc.

On November 6, 2012, we filed a new complaint against Apple Inc., in the United States District Court for the Eastern District of Texas, Tyler Division for willfully infringing four of our patents, U.S. Patent Nos. 6,502,135, 7,418,504, 7,921,211 and 7,490,151, and seeking both 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. Due to their release dates, these products were not included in the previous lawsuit that concluded with a Jury verdict on November 6, 2012 that was subsequently upheld by the United States District Court for the Eastern District of Texas, Tyler Division, on February 26, 2013. On July 1, 2013, we filed a consolidated and amended complaint to include U.S. Patent No. 8,051,181 and consolidate Civil Action No. 6:11-cv-00563-LED. On August 27, 2013, we filed an amended complaint including allegations of willful infringement related to U.S. Patent No. 8,504,697 seeking both damages and injunctive relief. The Markman hearing in this case is scheduled for May 8, 2014 and the jury trial is scheduled for October 13, 2015.

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 worth pursuing, commencing a lawsuit can be expensive and time-consuming, and there is no assurance that we will prevail on such potential claims. In addition, bringing a lawsuit may lead to potential counterclaims which may preclude our ability to commercialize our initial products, which are currently in development. Currently, we are not a party to any other pending legal proceedings, and are not aware of any proceeding threatened or contemplated against us by any governmental authority or other party.

Note 15 - Quarterly Financial Information (unaudited)

	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>
	(in thousands except per share)			
2013				
Revenue	\$ 293	\$ 6	\$ 1,612	\$ 286
Loss from operations	(9,529)	(6,578)	(5,133)	(7,347)
Net loss	(7,891)	(7,029)	(5,134)	(7,554)
Basic and diluted loss per common share	\$ (0.15)	\$ (0.14)	\$ (0.10)	\$ (0.15)
	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>
	(in thousands except per share)			
2012				
Revenue	\$ -	\$ 36	\$ 368	\$ 8
Loss from operations	(7,223)	(11,734)	(9,371)	(10,533)
Net loss	(4,707)	(10,264)	(4,719)	(7,234)
Basic and diluted loss per common share	\$ (0.09)	\$ (0.20)	\$ (0.09)	\$ (0.14)

Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Stockholders of VirnetX Holding Corporation

We have audited the internal control over financial reporting of VirnetX Holding Corporation (the “Company”) as of December 31, 2013, based on criteria established in *Internal Control—Integrated Framework* (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the criteria established in *Internal Control – Integrated Framework* (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2013, of the Company and our report dated March 3, 2014, expressed an unqualified opinion on those financial statements.

/s/ Farber Hass Hurley LLP

Chatsworth, California
March 3, 2014

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Evaluation of Disclosure 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, December 31, 2013.

The purpose of this evaluation was to determine whether as of December 31, 2013 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 December 31, 2013, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal controls over financial reporting (as such term is defined in rules 13a-15 (f) under the Securities Exchange Act of 1934, as amended) during the fiscal year ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the company. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes maintaining records that in reasonable detail accurately and fairly reflect our transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of our financial statements; providing reasonable assurance that receipts and expenditures of company assets are made in accordance with management authorization; and providing reasonable assurance that unauthorized acquisition, use or disposition of company assets that could have a material effect on our financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2013. There were no changes in our internal control over financial reporting during the period ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Farber Hass Hurley LLP has audited our internal control over financial reporting as of December 31, 2013; their report is included elsewhere herein.

Item 9B. Other Information.

None.

PART III

Certain information required by Part III is omitted from this report and is incorporated by reference to our definitive proxy statement pursuant to Regulation 14A for our 2014 Annual Meeting of Stockholders (the “Definitive Proxy Statement”) which will be filed within 120 days of our fiscal year end.

Item 10. Directors, Executive Officers and Corporate Governance.

The information required by this item is incorporated by reference to the information set forth in the Definitive Proxy Statement under the sections “Board of Directors,” “Nominee and Continuing Directors,” “Executive Officers,” “Composition of the Board of Directors,” “Board Meetings and Committees and Annual Meeting Attendance,” “Audit Committee Matters” and “Section 16(a) Beneficial Ownership Reporting Compliance.” Information regarding delinquent filers pursuant to Item 405 of Regulation S-K will be included under the caption “Section 16(a) Beneficial Ownership Reporting Compliance” in our Proxy Statement for the 2013 Annual Meeting of Stockholders and is incorporated herein by reference.

Item 11. Executive Compensation.

The information required by this item is incorporated by reference to the information set forth in the Definitive Proxy Statement under the sections “Compensation Committee Matters,” “Director Compensation,” “Executive Compensation,” “Compensation Committee Report,” “Summary Compensation Table,” “Outstanding Equity Awards at 2013 Fiscal Year-End,” and “Option Exercises in Fiscal Year 2013.”

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

The information required by this item is incorporated by reference to the information set forth in the Definitive Proxy Statement under the section “Voting Securities and Principal Holders.”

Securities Authorized for Issuance Under Equity Compensation Plans

We have a stock incentive plan for employees and others called the “VirnetX Holding Corporation 2013 Stock Plan”, or the Plan, which has been approved by our stockholders. The Plan provides for the granting of up to 14,124,469 shares of our common stock, including stock options and stock purchase rights, and will expire in 2023. As of December 31, 2013, there were 2,227,882 shares available to be granted under the Plan. We had 4,976,849 and 4,776,224 options outstanding at December 31, 2013, and December 31, 2012, respectively, with an average exercise price of \$7.86 and \$6.94, respectively. We had 248,915 and 151,665 restricted stock units outstanding at December 31, 2013 and December 31, 2012 respectively with a weighted average grant price of \$24.10 and \$25.60 respectively.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by security holders	5,385,731	\$ 8.48	2,227,882
Equity compensation plans not approved by security holders	—	—	—
Total	5,385,731	\$ 8.48	2,227,882

On January 25, 2013 the Compensation Committee granted 40,000 options to the employees of VirnetX Inc. On June 6, 2013 the Compensation Committee granted an additional 197,125 options and 131,416 RSU’s to the employees of VirnetX, Inc. On June 6, 2013 the Compensation Committee granted an additional 37,500 options and 24,999 RSU’s to the Board of Directors of VirnetX, Inc.

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

The information required by this item is incorporated by reference to the information set forth in the Definitive Proxy Statement under the sections “Transactions with Related Persons” and “Composition of Board of Directors.”

Item 14. Principal Accountant Fees and Services.

The information required by this item is incorporated by reference to the information set forth in the Definitive Proxy Statement for the 2013 Annual Meeting of Stockholders under “Principal Accountant Fees & Services.”

PART IV

Item 15. Exhibits and Financial Statement Schedules.

- (a) The following documents are filed as part of this Annual Report on Form
 - (1) *Financial Statements*: See the Index to Consolidated Financial Statements under Item 8 of this Annual Report on Form 10-K.
 - (2) *Financial Statement Schedule*: Financial statement schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto. All other schedules are omitted because of the absence of conditions under which they are required or because the required information is given in the financial statements or the notes thereto.
 - (3) *Exhibits*: See Exhibit Index immediately following the signature page of this Form 10-K.

[Index](#)

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Annual Report on Form 10-K 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 and President

Dated: March 3, 2014

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Kendall Larsen his or her attorney-in-fact, with full power of substitution, for him or her in any and all capacities, to sign any amendments to this Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, hereby ratifying and confirming all that said attorney-in-fact, or his or her substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed below by the following persons on behalf of the registrant and in the capacities indicated.

Name	Capacity	Date
<u>/s/ Kendall Larsen</u> Kendall Larsen	Director, Chief Executive Officer and President <i>(Principal Executive Officer)</i>	March 3, 2014
<u>/s/ Richard H. Nance</u> Richard H. Nance	Chief Financial Officer <i>(Principal Financial Officer and Principal Accounting Officer)</i>	March 3, 2014
<u>/s/ Robert D. Short III</u> Robert D. Short III	Director	March 3, 2014
<u>/s/ Scott C. Taylor</u> Scott C. Taylor	Director	March 3, 2014
<u>/s/ Michael F. Angelo</u> Michael F. Angelo	Director	March 3, 2014
<u>/s/ Thomas M. O'Brien</u> Thomas M. O'Brien	Director	March 3, 2014

EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Description</u>
3.1	Certificate of Incorporation of the Company. (1)
3.2	By-Laws of the Company. (1)
4.1	Form of Warrant Agency Agreement by and between the Company and Corporate Stock Transfer, Inc. as Warrant Agent. (2)
4.2	Form of Series I Warrant. (3)
10.1	Form of Indemnification Agreement by and between the Company and each of Kendall Larsen, Robert D. Short III, Scott C. Taylor, Michael F. Angelo, Thomas M. O'Brien and Richard Nance. (1)
10.2	Voting Agreement among the Company and certain of its stockholders, dated as of December 12, 2007. (5)
10.3**	2007 Stock Plan, as amended on April 13, 2012.
10.4	Securities Purchase Agreement, dated as of September 2, 2009, by and between the Company and the Purchasers. (3)
10.5	Form of Registration Rights Agreement by and between the Company and the Purchasers. (3)
10.6	Form of Underwriting Agreement between VirnetX Holding Corporation and Gilford Securities Incorporated. (2)
10.7	Patent License and Assignment Agreement by and between the Company and Leidos, Inc. dated as of August 12, 2005. (6)
10.8	Security Agreement by and between the Company and Leidos, Inc. dated as of August 12, 2005. (6)
10.9	Amendment No. 1 to Patent License and Assignment Agreement by and between the Company and Leidos, Inc. dated as of November 2, 2006. (6)
10.10	Assignment Agreement between the Company and Leidos, Inc. dated as of December 21, 2006. (6)
10.11	Professional Services Agreement by and between the Company and Leidos, Inc. dated as of August 12, 2005. (6)
10.12	Amendment No. 2 to Patent License and Assignment Agreement by and between VirnetX, Inc. and Leidos, Inc. dated as of March 12, 2008. (7)
10.13	IP Brokerage Agreement by and between ipCapital Group, Inc. and VirnetX, Inc., effective as of March 13, 2008. (7)
10.14	Engagement Letter by and between VirnetX Holding Corporation and ipCapital Group, Inc. dated March 12, 2008. (7)
10.15*	Engagement Letter dated June 9, 2009, by and between McKool Smith, a professional corporation, and the Company. (8)
10.16	Engagement Letter dated April 15, 2010, by and between McKool Smith, a professional corporation, and the Company. (9)
10.17*	Settlement and License Agreement, by and between Microsoft Corporation, a Washington corporation, and VirnetX, Inc., a Delaware corporation. (10)
10.18**	Amended Form of Stock Option Agreement - 2007 Stock Plan. (10)
10.19**	Form of Restricted Stock Unit Award Agreement - 2007 Stock Plan. (4)
10.20**	Employment Offer Letter from VirnetX, Inc. to Richard H. Nance. (4)
10.21**	2013 Equity Incentive Plan. (11)
21.1	Subsidiaries of VirnetX Holding Corporation.
23.1	Consent of Farber Hass Hurley LLP, Independent Registered Public Accounting Firm.
31.1	Chief Executive Officer Certification pursuant to Rule 13a-14(a) of the Securities Exchange Act.
31.2	Chief Financial Officer Certification pursuant to Rule 13a-14(a) of the Securities Exchange Act.
32.1†	Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2†	Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS††	XBRL Instance Document
101.SCH††	XBRL Taxonomy Extension Schema Document
101.CAL††	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF††	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB††	XBRL Taxonomy Extension Label Linkbase Document
101.PRE††	XBRL Taxonomy Extension Presentation Linkbase Document

[Index](#)

- (1) Incorporated herein by reference to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 1, 2007.
- (2) Incorporated herein by reference to the Company's Registration Statement on Form S-1/A filed with the Securities and Exchange Commission on January 16, 2009.
- (3) Incorporated herein by reference to the Company's Form 8-K filed with the Securities and Exchange Commission on September 3, 2009.
- (4) Incorporated herein by reference to the Company's Form 10-Q (Commission File No. 001-33852) filed with the Securities and Exchange Commission on May 10, 2012.
- (5) Incorporated herein by reference to the Company's Form 10-K filed with the Securities and Exchange Commission on March 31, 2008.
- (6) Incorporated by reference to the Company's Form 8-K (Commission File No. 001-33852) filed with the Securities and Exchange Commission on July 12, 2007.
- (7) Incorporated by reference to the Company's Form 8-K (Commission File No. 001-33852) filed with the Securities and Exchange Commission on March 18, 2008.
- (8) Incorporated by reference to the Company's Form 10-Q (Commission File No. 001-33852) filed with the Securities and Exchange Commission on May 7, 2010.
- (9) Incorporated by reference to the Company's Form 10-Q/A (Commission File No. 001-33852) for the period ended June 30, 2010, filed with the Securities and Exchange Commission on January 31, 2011.
- (10) Incorporated by reference to the Company's Form 10-Q (Commission File No. 001-33852) filed with the Securities and Exchange Commission on May 10, 2011.
- (11) Incorporated by reference to Annex A of the Company's Proxy Statement (Commission File No. 001-33852) filed with the Securities and Exchange Commission on April 12, 2013.

*Confidential treatment has been granted by the U.S. Securities and Exchange Commission as to certain portions of this Exhibit.

** Indicates management contract or compensatory plan.

† The certifications attached as Exhibit 32.1 and 32.2 that accompany this Annual Report on Form 10-K are not deemed 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 Act of 1934, as amended, whether before or after the date of this Form 10-K, irrespective of any general incorporation language contained in such filing.

†† XBRL (eXtensible Business Reporting Language) information is furnished and not filed herewith, is not a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

Subsidiaries of Registrant

Name of Entity	Jurisdiction of Incorporation or Organization
Network Research Corporation Japan Ltd. (known as Network Research Corporation Japan Kabushiki Kaisha in Japan)	Japan
VirnetX Inc.	Delaware

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 333-149884, 333-153645 and 333-162145) and Form S-8 (No. 333-149883) of our reports dated March 3, 2014, relating to the consolidated financial statements of VirnetX Holding Corporation (the "Company"), and the effectiveness of the Company's internal control over financial reporting, appearing in this Annual Report on Form 10-K of the Company for the year ended December 31, 2013.

/s/ Farber Hass Hurley LLP

Chatsworth, CA

March 3, 2014

CERTIFICATIONS

I, Kendall Larsen, certify that:

1. I have reviewed this Annual Report on Form 10-K of VirnetX Holding Corporation for the fiscal year ended December 31, 2013;
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: March 3, 2014

CERTIFICATIONS

I, Richard H. Nance, certify that:

1. I have reviewed this Annual Report on Form 10-K of VirnetX Holding Corporation for the fiscal year ended December 31, 2013;
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 Accounting and Financial Officer)

Date: March 3, 2014

**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 Annual Report of VirnetX Holding Corporation (the "Company") on Form 10-K for the fiscal year ended December 31, 2013 as filed with the Securities and Exchange Commission on March 3, 2014 (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; 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: March 3, 2014

**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 Annual Report of VirnetX Holding Corporation (the "Company") on Form 10-K for the fiscal year ended December 31, 2013 as filed with the Securities and Exchange Commission on March 3, 2014 (the "Report"), I, Richard 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; 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 Accounting and Financial Officer)

Date: March 3, 2014
