

INTRUSION INC
Form PRE 14A
March 18, 2005

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

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant

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Check the appropriate box:

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Intrusion Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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**1101 East Arapaho Road
Richardson, Texas 75081
(972) 234-6400**

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To Be Held May 12, 2005

*To the Stockholders of
Intrusion Inc.:*

NOTICE IS HEREBY GIVEN that the 2005 Annual Meeting of Stockholders (the Meeting) of Intrusion Inc. (the Company) will be held at the Radisson Hotel, Dallas North at Richardson, 1981 North Central Expressway, Richardson, Texas, at 10:00 A.M., Local Time, on Thursday, May 12, 2005, for the following purposes:

- (1) To elect five (5) directors to serve until the next Annual Meeting of Stockholders or until their respective successors are duly elected and qualified;
- (2) To approve the Intrusion Inc. 2005 Stock Incentive Plan, as described in the accompanying Proxy Statement and set forth in Appendix A thereto;
- (3) To ratify the appointment of KBA Group LLP as independent auditors of the Company for the fiscal year ending December 31, 2005; and
- (4) To transact such other business as may properly come before the Meeting or any adjournments thereof.

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The foregoing items of business are more fully described in the Proxy Statement accompanying this Notice. The record date for determining those stockholders who will be entitled to notice of, and to vote at, the Meeting and at any adjournment thereof is March 24, 2005. A list of stockholders entitled to vote at the Meeting will be available for inspection at the offices of the Company.

All stockholders are cordially invited to attend the Meeting in person. Stockholders are urged, whether or not they plan to attend the Meeting, to complete, date and sign the enclosed Proxy and return it promptly in the enclosed postage prepaid envelope. Your Proxy may be revoked at any time prior to the Meeting. If you decide to attend the Meeting and wish to change your Proxy vote, you may do so by voting in person at the Meeting.

By Order of the Board of Directors

G. WARD PAXTON
Chairman, President and Chief Executive Officer

Richardson, Texas
April 7, 2005

INTRUSION INC.

1101 East Arapaho Road

Richardson, Texas 75081

PROXY STATEMENT

for

ANNUAL MEETING OF STOCKHOLDERS

To be Held May 12, 2005

SOLICITATION AND REVOCABILITY OF PROXIES

The enclosed proxy (the **Proxy**) is being solicited on behalf of the Board of Directors (the **Board**) of Intrusion Inc. (the **Company**) for use at the Annual Meeting of Stockholders (the **Meeting**) to be held at the Radisson Hotel, Dallas North at Richardson, 1981 North Central Expressway, Richardson, Texas, at 10:00 A.M., Local Time, on Thursday, May 12, 2005, or at such other time and place to which the Meeting may be adjourned. Proxies, together with copies of this Proxy Statement, are being mailed to stockholders of record on or about April 7, 2005.

Execution and return of the enclosed Proxy will not affect a stockholder's right to attend the Meeting and to vote in person. Any stockholder executing a Proxy retains the right to revoke it at any time prior to exercise at the Meeting. A Proxy may be revoked by delivery of written notice of revocation to the Secretary of the Company, by execution and delivery of a later Proxy or by voting the shares in person at the Meeting. If you attend the Meeting and vote in person by ballot, your proxy will be revoked automatically and only your vote at the Meeting will be counted. A Proxy, when executed and not revoked, will be voted in accordance with the instructions thereon. In the absence of specific instructions, Proxies will be voted by those named in the Proxy **FOR** the election as directors of those nominees named in the Proxy Statement, **FOR** the approval of the Intrusion Inc. 2005 Stock Incentive Plan, **FOR** the proposal to ratify the appointment of KBA Group LLP as independent auditors for the Company, and in accordance with their best judgment on all other matters that may properly come before the Meeting.

The enclosed form of Proxy provides a method for stockholders to withhold authority to vote for any one or more of the nominees for director while granting authority to vote for the remaining nominees. The names of all nominees are listed on the Proxy. If you wish to grant authority to vote for all nominees, check the box marked **FOR**. If you wish to withhold authority to vote for all nominees, check the box marked **WITHHOLD**. If you wish your shares to be voted for some nominees and not for one or more of the others, check the box marked **FOR** and indicate the name(s) of the nominee(s) for whom you are withholding the authority to vote by writing the name(s) of such nominee(s) on the Proxy in the space provided.

RECORD DATE AND VOTING SECURITIES

Only stockholders of record at the close of business on March 24, 2005 are entitled to notice of and to vote at the Meeting. The stock transfer books of the Company will remain open between the record date and the date of the Meeting. A list of stockholders entitled to vote at the Meeting will be available for inspection at the executive offices of the Company. On the March 24, 2005 record date, the Company had [6,058,030] outstanding shares of Common Stock, \$0.01 par value (the Common Stock), and [439,392] outstanding shares of 5% Convertible Preferred Stock, par value \$0.01 per share (the Preferred Stock). In addition, under the rules of the Nasdaq Stock Market, brokers who hold stock in street name have the authority to vote on certain routine matters when they have not received instructions from beneficial owners.

QUORUM AND VOTING

The presence at the Meeting, in person or by Proxy, of the holders of a majority of the shares of Common Stock outstanding or issuable upon conversion of the Preferred Stock is necessary to constitute a quorum. Holders of Common Stock are entitled to one vote for each share of Common Stock held on each matter to be voted on at the Meeting including

the election of directors. Holders of Preferred Stock are entitled to vote on an as-converted to Common Stock basis with any fractional votes being rounded to the nearest whole vote. Each share of Preferred Stock was convertible into 1.59 shares of Common Stock. As a result, each holder of Preferred Stock is entitled to 1.59 votes for each share of Preferred Stock held on each matter to be voted on at the Meeting, including the election of directors. Assuming the presence of a quorum, the affirmative vote of the holders of a majority of the shares of Common Stock outstanding or issuable upon conversion of the Preferred Stock entitled to vote at the Meeting, present in person or by Proxy, is required for the approval of each matter submitted to the Meeting except the election of directors. For the election of directors, the five nominees receiving the greatest number of votes of the shares of Common Stock outstanding or issuable upon conversion of the Preferred Stock present in person or represented by Proxy at this Meeting and entitled to vote shall be deemed elected even if they receive the affirmative vote of less than a majority of the shares of Common Stock outstanding or issuable upon conversion of the Preferred Stock entitled to be voted at the Meeting. Additionally, in the election of directors, cumulative voting is prohibited and Proxies cannot be voted for more than five nominees.

All votes will be tabulated by the inspector of election appointed for the Meeting, who will separately tabulate affirmative and negative votes, abstentions and broker non-votes. Abstentions and broker non-votes are counted as present for purposes of determining the presence or absence of a quorum for the transaction of business. Abstentions will be counted towards the tabulations of votes cast on matters presented at the Meeting and will have the same effect as negative votes (other than the election of directors) whereas broker non-votes will not be counted for purposes of determining whether a matter has been approved.

**PROPOSAL ONE
ELECTION OF DIRECTORS**

The Board for the ensuing year will consist of five directors who are each to be elected at the Meeting for a term of office expiring at the next Annual Meeting of Stockholders or until their respective successors have been elected and qualified. It is intended that the persons named in the following table will be nominated as directors of the Company and that the persons named in the accompanying Proxy, unless otherwise directed, will vote for the election of such nominees at the Meeting. Each of the nominees has indicated his willingness to serve as a member of the Board of Directors, if elected. However, in the event any nominee shall become unavailable for election to the Board for any reason not presently known or contemplated, the Proxy holders will be vested with discretionary authority in such instance to vote the enclosed Proxy for such substitute as the Board of Directors shall designate.

The following slate of five nominees has been nominated by the Board of Directors:

Name of Nominee	Age	Position(s)	Director Since
G. Ward Paxton	69	Chairman, President, Chief Executive Officer and Director	1983
T. Joe Head	48	Vice Chairman, Vice President and Director	1983
J. Fred Bucy, Jr., (1)(2)	76	Director	1993
James F. Gero (1)(2)	60	Director	2003
Donald M. Johnston (1)(2)	55	Director	1983

(1) Member of the Compensation Committee.

(2) Member of the Audit Committee.

G. Ward Paxton was named President and Chief Executive Officer of the Company on November 28, 2001. He is also co-founder of the Company and has served as Chairman of the Board since the Company's inception in September 1983. Mr. Paxton also served as President and Chief Executive Officer of the Company from 1983 until June 2000 and served as Chief Financial Officer from 1983 until 1994. Prior to founding the Company, Mr. Paxton was Vice President of Honeywell Optoelectronics, a division of Honeywell, Inc., from 1978 to 1983. From 1969 to 1978, Mr. Paxton was Chairman of the Board, President, Chief Executive Officer and founder of Spectronics, Inc., which was acquired by Honeywell, Inc. in 1978. Prior to founding Spectronics, Inc., Mr. Paxton held various managerial and technical positions at Texas Instruments

Incorporated from 1959 to 1969. Mr. Paxton holds Ph.D., M.S. and B.S. degrees in Physics from the University of Oklahoma.

T. Joe Head is co-founder of the Company and has served as a director since the Company's inception in September 1983. Mr. Head was named Vice Chairman of the Board of Directors in June 2000 and was named Vice Chairman and Vice President on February 14, 2003. He also served as Senior Vice President from 1983 until 1998 and Executive Vice President from 1998 until June 2000. Prior to co-founding the Company, Mr. Head held the positions of Product Marketing Manager and Marketing Engineer of Honeywell Optoelectronics from 1980 to 1983. Mr. Head holds a B.S. degree in Electrical Engineering from Texas A & M University.

J. Fred Bucy, Jr. has served as a director of the Company since 1993. Mr. Bucy was employed in various technical and managerial capacities by Texas Instruments Incorporated from 1953 through his retirement in 1985. At the time of his retirement, Mr. Bucy was President, Chief Executive Officer and a director of Texas Instruments. Mr. Bucy was a Trustee of Southwest Research Institute. He was Chairman of the Texas National Research Laboratory Commission (re-appointed by George W. Bush in 1995) until 2001. Mr. Bucy was also a member of the Coordinating Board Advisory Committee on Research of the Texas College and University System and a former member of the Board of Regents of Texas Tech University and Texas Tech University Health Sciences Center from 1973 to 1991, including four years as its Chairman. Mr. Bucy has been accorded Distinguished Alumnus and Distinguished Engineer Awards by Texas Tech University, is a fellow of the Institute of Electrical and Electronics Engineers, a member of National Academy of Engineers, and is a life member of the Navy League. Mr. Bucy was awarded an honorary Doctor of Science degree from Texas Tech University in 1994. Mr. Bucy was recognized as an Eminent Member of Eta Kappa Nu in 2002.

James F. Gero was named a director of the Company on October 27, 2003. Mr. Gero is Chairman of the Board and a principal stockholder of Sierra Technologies, Inc., which was formed in September 1991, and is a private investor. Mr. Gero serves on the Boards of several other companies, including Drew Industries, a public company which supplies a broad array of components for recreational vehicles and manufactured homes, and Orthofix, N.V., a publicly traded medical equipment manufacturer. Mr. Gero is a former Chairman and Chief Executive Officer of Varo Inc., a manufacturer of high technology systems. Prior to becoming Chairman and CEO of Varo Inc., Mr. Gero served as Vice President and General Manager at Allied Signal Corporation. Mr. Gero holds a B.S. degree from State University of New York and an M.B.A. degree from University of New Haven.

Donald M. Johnston has served as a director of the Company since November 1983. Mr. Johnston is President of Massey Burch Capital Corp., a venture capital firm. He served as President of Massey Burch Investment Group, Inc., a venture capital firm (Massey Burch), from 1990 until December 1993 where he had been a principal since 1982. Prior to joining Massey Burch, Mr. Johnston was the President of InterFirst Venture Corporation, a venture capital subsidiary of Interfirst Bancshares, Inc., and the Executive Director of First Dallas, Ltd., a corporate finance group in London, England. Mr. Johnston holds a B.A. degree from Vanderbilt University and an M.B.A. degree from Southern Methodist University.

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All directors of the Company hold office until the next ensuing annual meeting of stockholders or until their respective successors are duly elected and qualified. All officers of the Company are elected annually by the Board of Directors and serve at the discretion of the Board. There are no family relationships between any director or officer of the Company and any other such person except that Michael L. Paxton, Vice President, Chief Financial Officer, Secretary and Treasurer, is the son of G. Ward Paxton, Chairman, President and Chief Executive Officer.

Stockholder Approval

The affirmative vote of a plurality of the shares of Common Stock outstanding or issuable upon conversion of outstanding Preferred Stock present in person or by proxy at the Annual Meeting is required for the election of each of the nominees for director.

The Board recommends a vote FOR the election of such nominees.

CORPORATE GOVERNANCE

Board of Directors and Committees

The business affairs of the Company are managed under the direction of the Board. The Board meets on a regularly scheduled basis during the fiscal year of the Company to review significant developments affecting the Company and to act on matters requiring Board approval. It also holds special meetings as required from time to time when important matters arise requiring Board action between scheduled meetings. The Board of Directors or its authorized committees met twenty-five times during the 2004 fiscal year. During fiscal year 2004, each director participated in at least 75% or more of the aggregate of (i) the total number of meetings of the Board of Directors (held during the period for which he was a director) and (ii) the total number of meetings of all committees of the Board on which he served (during the period that he served.)

The Board has established Audit and Compensation Committees to devote attention to specific subjects and to assist it in the discharge of its responsibilities. The functions of the Audit Committee and the Compensation Committee are described below.

Audit Committee. The Audit Committee is composed of: Donald M. Johnston (Chairman), James F. Gero, and J. Fred Bucy. Each member of the Audit Committee is independent (as defined in Nasdaq Marketplace Rule 4200). The Audit Committee has at least one financial expert (as defined by Item 401(e) of Regulation S-B). Fred Bucy is currently the Audit Committee financial expert. The functions performed by the Committee, its membership and the number of meetings held during the fiscal year, is set forth in the Report of the Audit Committee, included in this Proxy Statement. The Audit Committee is governed by a written charter, which was approved by the Audit Committee on March 18, 2004, and attached as Exhibit A to the Company's proxy statement for its 2004 annual meeting of stockholders.

Compensation Committee. The Compensation Committee is empowered to advise management and make recommendations to the Board with respect to the compensation and other employment benefits of executive officers and key employees of the Company. The Compensation Committee also administers the Company's incentive stock option plans (the Stock Option Plans) for officers and key employees and the Company's incentive bonus programs for executive officers and employees. The Compensation Committee is authorized, among other powers, to determine from time to time the individuals to whom options shall be granted, the number of shares to be covered by each option and the time or times at which options shall be granted pursuant to the Stock Option Plans. The Compensation Committee is comprised of J. Fred Bucy, Jr. (Chairman), James F. Gero, and Donald M. Johnston, each of whom is an independent director. The Compensation Committee met six times during the 2004 fiscal year.

Notwithstanding anything to the contrary set forth in any of the Company's previous or future filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, that might incorporate this Proxy or future filings made by the Company under those statutes, the Compensation Committee Report, the Audit Committee Report, the Audit Committee Charter, references to the independence of Audit Committee members and the Stock Performance Graph are not deemed filed with the Securities and Exchange Commission. They also shall not be deemed incorporated by reference into any of those prior filings or into any future filings made by the Company under those statutes, except the extent the Company specifically incorporates such information by reference in such filings.

Report of the Audit Committee

The Audit Committee oversees the Company's financial reporting process on behalf of the Board of Directors. Management has the primary responsibility for the financial statements and the reporting process including the systems of internal controls. In fulfilling its oversight responsibilities, the Committee reviewed the audited financial statements in the Annual Report with management including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the financial statements.

The Committee reviewed with the independent auditors, who are responsible for expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles, their judgments as to the quality, not just the acceptability, of the Company's accounting principles, the matters required to be discussed by SAS 61 (Certification of Accounting Standards AU Section 280) and such other matters as are required to be discussed with the Committee under generally accepted auditing standards. In addition, the Committee has discussed with the independent

auditors the auditors' independence from management and the Company including the matters in the written disclosures and the letter from the independent accountants required by the Independence Standards Board Standard No. 1 (Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees) and considered the compatibility of nonaudit services with the auditors' independence.

The Committee discussed with the Company's independent auditors the overall scope and plans for their audit. The Committee meets with independent auditors, with and without management present, to discuss the results of their examinations, their evaluations of the Company's internal controls, and the overall quality of the Company's financial reporting. The Committee held nine meetings during fiscal year 2004.

In reliance on the reviews and discussions referred to above, the Committee recommended to the Board of Directors (and the Board has approved) that the audited financial statements be included in the Annual Report on Form 10-KSB for the year ended December 31, 2004 for filing with the Securities and Exchange Commission. The Committee and the Board have also recommended, subject to stockholder ratification, the selection of the Company's independent auditors.

Respectfully submitted,

AUDIT COMMITTEE
of the Board of Directors

Donald M. Johnston, Audit Committee Chair
James F. Gero, Audit Committee Member
J. Fred Bucy, Jr., Audit Committee Member

Compensation Committee Report on Executive Compensation

General. The Compensation Committee of the Board sets the compensation for the Chief Executive Officer, reviews the design, administration and effectiveness of the compensation programs for other key executives, and approves stock option grants for all executive officers and key employees. The Compensation Committee is currently composed of three non-employee directors who have no interlocking relationships. The data and information included in the various compensation tables appearing elsewhere in this Proxy Statement should be read in conjunction with and deemed to be a part of this report.

Named Executive Officers. This report includes disclosure of the required compensation information for any one acting as the Company's Chief Executive Officer at any time during the year and its four most highly compensated executive officers.

Compensation Objectives. The Company operates in the highly competitive and rapidly changing high technology industry. The Compensation Committee believes that the compensation programs for executive officers of the Company should be designed to attract, motivate and retain talented executives who contribute to the success of the Company and should be determined within a competitive framework based on the achievement of overall business

objectives and financial performance and individual contributions. Within this framework, the Compensation Committee's objectives are to: (i) provide a total compensation program competitive with the compensation practices of organizations in the high technology industry of comparable size to the Company; (ii) provide annual variable incentive awards based on the Company's overall financial performance relative to corporate objectives; and (iii) align the financial interests of executive officers with those of stockholders by providing equity-based incentives.

Base Salary. The salaries of the executive officers, including the Chief Executive Officer, are determined annually by the Compensation Committee with reference to (i) salaries paid to executives with similar responsibilities at companies of a comparable size and sales volume, primarily in the high technology industry, (ii) each officer's performance and (iii) the Company's overall financial results, without specific weighting being attributed to any of these factors. In setting base salaries, the Company reviews available published executive compensation data for the high technology industry generally as well as the network security industry. This group of companies is a larger and more diverse group of companies than just the companies comprising the peer group identified in the Stock Performance Graph, but may include such companies if they

participated in one or more of the compensation surveys. The Compensation Committee believes that these companies likely compete with the Company for executive talent and that the Company must offer salaries within a competitive market range to attract and retain talented executives. However, the Compensation Committee manages salaries for the executive group as a whole in a conservative fashion in order to place more emphasis on incentive compensation. As a result, the Company believes the base salary of its executive officers is lower than the median compensation in effect for comparable positions in the surveyed data. The Company does not consider the performance of comparison group in determining compensation of its executive officers.

Incentive Bonus Plan. To reinforce the attainment of corporate objectives, the Compensation Committee believes that a substantial portion of the potential annual compensation of each executive officer should be in the form of variable incentive pay. The incentive cash bonus program for executives is established annually by the Compensation Committee based upon the Company's achievement of sales and/or net income targets established at the beginning of the fiscal year. The incentive plan for executives, other than certain executives in the Company's sales organization, requires a threshold level of Company financial performance before any incentives are awarded. Once the threshold objective for sales and/or net income of a fiscal year is reached, specific formulas are in place to calculate the actual incentive payment for each executive for such year. In fiscal 2004, the Company did not achieve its threshold level of profitability; thus, non-sales executives, including the Chief Executive Officer and the Named Executive Officers other than the Company's Vice President of Worldwide Sales, did not receive any incentive bonus awards. Certain employees in the sales organization, including Eric Gore, the Company's Vice President of Worldwide Sales, received incentive sales commission in fiscal 2004 based upon the Company's sales.

Equity-based Incentives. The goal of the Company's equity-based incentive awards is to align the interests of executive officers with stockholders. The Compensation Committee determines the value allocated to equity-based incentives according to each executive's position within the Company, individual performance, contributions to achievement of corporate objectives and related factors, and grants stock options to create a meaningful opportunity for stock ownership.

The Company has previously adopted three Stock Option Plans (collectively, the Plans), including the 1983 Incentive Stock Option Plan, the 1987 Incentive Stock Option Plan and the 1995 Stock Option Plan (as amended, the 1995 Option Plan), to provide long-term incentive compensation for eligible participants. Generally, executive officers and other key employees of the Company and its subsidiaries are eligible to participate in the Plans; however, non-employee directors of the Company are not eligible to participate in these Plans. These directors participate in the 1995 Director Stock Option Plan (as amended, the 1995 Director Plan, and together with the 1995 Option Plan, the 1995 Plans). Stock option grants under the Plans provide the right to purchase shares of Common Stock at fair market value on the date of grant, or in the case of an optionee who at the time of the grant holds more than 10% of the total combined voting securities of the Company, 110% of the fair market value on the date of grant. Stock options generally vest in a one, three or five-year period and provide terms of five or ten years, as applicable. In 2004, the Compensation Committee approved the grant of stock options pursuant to the Plans to the Named Executive Officers indicated in the tables accompanying this report.

On March 21, 2005, the 1995 Plans expired. The Board approved the 2005 Stock Incentive Plan (the 2005 Plan) on March 17, 2005, as a replacement for these plans. If approved by the stockholders under Proposal Two, the 2005 Plan will become effective on May 12, 2005. A full description of the 2005 Plan can be found in the section Proposal Two Approval of the 2005 Stock Incentive Plan of this proxy statement.

CEO Compensation. G. Ward Paxton was named President and Chief Executive Officer of the Company on November 28, 2001. He also served as President and Chief Executive Officer of the Company from 1983 until June 2000. Mr. Paxton's base salary was set at \$175,000 for fiscal year 2002, but was decreased to \$122,500 in April 2002 by the Compensation Committee. The salary of Mr. Paxton was decreased in an effort to reduce cost. The base salary for Mr. Paxton was based on personal performance of CEO duties and on salary levels paid to chief executive officers of comparable companies. Mr. Paxton did not receive an incentive bonus award for 2004 because the Company did not achieve its threshold level of profitability established at the beginning of the year.

Compliance with Internal Revenue Code Section 162(m). Section 162(m) of the Internal Revenue Code disallows a tax deduction to publicly held companies for compensation paid to certain of their executive officers, to the extent that compensation exceeds \$1 million per covered officer in any fiscal year. The limitation applies only to compensation which is not considered to be performance-based. Non-performance based compensation paid to the Company's executive officers for

the 2004 fiscal year did not exceed the \$1 million limit per officer, and the Compensation Committee does not anticipate that the non-performance based compensation to be paid to the Company's executive officers for fiscal 2005 will exceed that limit. The Company's 1995 Option Plan and the new 2005 Plan, if approved, have been structured so that any compensation deemed paid in connection with the exercise of option grants made under that plan with an exercise price equal to the fair market value of the option shares on the grant date will qualify as performance-based compensation which will not be subject to the \$1 million limitation. Because it is unlikely that the cash compensation payable to any of the Company's executive officers in the foreseeable future will approach the \$1 million limit, the Compensation Committee has decided at this time not to take any action to limit or restructure the elements of cash compensation payable to the Company's executive officers. The Compensation Committee will reconsider this decision should the individual cash compensation of any executive officer ever approach the \$1 million level.

It is the opinion of the Compensation Committee that the executive compensation policies and plans provide the necessary total remuneration program to properly align the Company's performance and the interests of the Company's stockholders through the use of competitive and equitable executive compensation in a balanced and reasonable manner, for both the short and long-term.

Respectfully submitted,

COMPENSATION COMMITTEE
of the Board of Directors

J. Fred Bucy, Jr. Compensation Committee Chair
James F. Gero, Compensation Committee Member
Donald M. Johnston, Compensation Committee Member

Compensation Committee Interlocks and Insider Participation

No member or nominee for election as a member of the Board or any committees of the Board has an interlocking relationship with the board (or member of such board) or any committee (or member of such committee) of a board of any other company.

Nomination of Directors

The Company does not have a formal nominating committee. Instead, the independent members of the Board, Mr. Bucy, Mr. Gero and Mr. Johnston, consider nominees and appointees to the Board in accordance with Nasdaq Marketplace Rule 4350. In evaluating candidates to determine if they are qualified to become Board members, these directors consider a number of attributes, including:

personal and professional character, integrity, ethics and values;

general business experience and leadership profile, including experience in corporate management, such as serving as an officer or former officer of a publicly held company, or experience as a board member of another publicly held company;

strategic planning abilities and experience; aptitude in accounting and finance;

expertise in domestic and international markets;

experience in the network security or telecommunications industry;

understanding of relevant technologies;

academics expertise in an area of the Company's operations;

communications and interpersonal skills;

and practical and mature business judgment.

These directors also evaluate board members and nominees service on the board of other public companies. Although these directors use these and other criteria to evaluate potential nominees, there are no stated minimum criteria for nominees. These directors also evaluate candidates identified by their personal contacts and other Board members.

These directors will also consider nominees proposed by stockholders. Although the Company has no formal policy regarding stockholder nominees, stockholder nominees are viewed in substantially the same manner as other nominees. The consideration of any candidate for director will be based on the assessment of the individual's background, skills and abilities, and if such characteristics qualify the individual to fulfill the needs of the Board at that time. To recommend a prospective nominee for consideration, stockholders should submit the candidate's name and qualifications to the Company's Secretary in writing at the address listed above. There have been no changes to the procedures by which stockholders may recommend nominees to the Board since the date of the Company's proxy statement for its 2004 annual meeting of stockholders. The Company did not receive any recommendations for Board nominees for election at the Meeting from its stockholders.

Communication with the Board

The Company does not have formal procedures for stockholder communication with the Board. Any matter intended for the Board, or for any individual member or members of the Board, should be directed to the Company's Secretary at the address of the Company indicated above, with a request to forward the same to the intended recipient. In general, all stockholder communication delivered to the Company's Secretary for forwarding to the Board or specified Board members will be forwarded in accordance with the stockholders instructions, unless the Secretary believes the question or issue may be addressed adequately by the Company's investor relations department. However, the Secretary reserves the right to not forward to Board members any abusive, threatening or otherwise inappropriate materials.

Policy Regarding Board Attendance at Stockholders Meetings

Although it has no formal policy requiring attendance, the Company encourages all directors to attend all meetings of stockholders. All of the Company's directors attended its 2004 annual stockholders meeting.

Code of Ethics

All of the Company's directors and employees are required to abide by the Company's Code of Business Conduct and Ethics, and the Company's Chief Executive Officer, Chief Financial Officer, and other senior financial employees are also required to abide by the Company's Code of Ethics for Senior Financial Employees, which the Company adopted on March 18, 2004 to comply with the new requirements of Nasdaq and the SEC to insure that the Company's business is conducted in a consistently legal and ethical manner. Both Codes cover all areas of professional conduct, including conflicts of interest, fair dealing and the strict adherence to all laws and regulations applicable to the conduct of the Company's business. The full text of the Codes is published on the Company's website at www.intrusion.com; click on the investor relations tab, and then Code of Ethics. The Company intends to disclose future amendments to, or waivers from, certain provisions of the Codes of Ethics on the Company's website within five business days following the date of such amendment or waiver. Upon the written request of any stockholder, the Company will furnish, without charge, a copy of each of the Code of Ethics. This request should be directed to the Company's Secretary at the address indicated above.

PROPOSAL TWO
APPROVAL OF THE 2005 STOCK INCENTIVE PLAN

Stockholders are being asked to approve the new 2005 Plan and to authorize 750,000 shares of Common Stock for issuance under the 2005 Plan. The Board approved the 2005 Plan on March 17, 2005, and if approved by the stockholders will become effective on May 12, 2005.

The 2005 Plan will serve as a replacement for the 1995 Director Plan and the 1995 Option Plan which expire by their terms on March 21, 2005. The approval of the 2005 Plan will have no effect on the 1995 Plans or any options granted pursuant to either the 1995 Director Plan or the 1995 Option Plan. All options will continue with their existing terms and will be subject to the 1995 Director Plan or the 1995 Plan, as applicable. No additional options will be granted under either the 1995 Director Plan or the 1995 Option Plan after the plans expire on March 21, 2005. Further, the Company will not be able to re-issue any option which is cancelled or terminated under the 1995 Director Plan or the 1995 Option Plan. As of March 24, 2005, there were [42,500] options outstanding under the 1995 Director Plan and [633,520] options outstanding under the 1995 Option Plan. There were no shares available for future issuance as of March 24, 2005 under the 1995 Director Plan or 1995 Option Plan due to their expiration on March 21, 2005.

The adoption of the 2005 Plan will allow the Company to continue to provide a comprehensive equity incentive program for the Company's officers, employees and non-employee Board members to encourage these individuals to remain in the Company's service and to more closely align their interests with those of the stockholders. The Company relies significantly on equity incentives in the form of stock option grants in order to attract and retain key employees, and it believes that equity incentives are necessary for it to remain competitive in the marketplace for executive talent and other key employees. Option grants made to newly-hired or continuing employees will be based on both competitive market conditions and individual performance.

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