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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

or

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

Commission file number: 001-33852

VirnetX Holding Corporation

(Exact name of registrant as specified in its charter)

Delaware	**77-0390628**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
308 Dorla Court, Suite 206 **Zephyr Cove, Nevada**	**89448**
(Address of principal executive offices)	**(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:

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 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 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 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 number of shares outstanding of the Registrant's Common Stock as of November 4, 2016, was 56,689,167.

VIRNETX HOLDING CORPORATION

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PART I — FINANCIAL INFORMATION

ITEM 1. - FINANCIAL STATEMENTS.

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

	As of September 30, 2016 (unaudited)	As of December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 8,527	$ 8,726
Investments available for sale	9,243	9,954
Prepaid expenses and other current assets	706	685
Total current assets	18,476	19,365
Prepaid expenses, non-current	2,470	2,759
Property and equipment, net	40	48
Total assets	$ 20,986	$ 22,172
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 2,832	$ 2,283
Accrued payroll and related expenses	—	1,383
Royalty payable	884	—
Related-party payable	94	11
Income tax liability	400	400
Deferred revenue, current portion	1,500	1,500
Total current liabilities	5,710	5,577
Deferred revenue, non-current portion	2,875	1,500
Commitments and contingencies (Note 4)	—	—
Stockholders' equity:		
Preferred stock, par value $0.0001 per share Authorized: 10,000,000 shares at September 30, 2016 and December 31, 2015, Issued and outstanding: 0 shares at September 30, 2016 and December 31, 2015	—	—
Common stock, par value $0.0001 per share		
Authorized: 100,000,000 shares at September 30, 2016 and December 31, 2015, Issued and outstanding: 56,689,167 shares and 53,198,835 shares, at September 30, 2016 and December 31, 2015, respectively	6	5
Additional paid-in capital	163,402	144,778
Accumulated deficit	(151,004)	(129,669)
Accumulated other comprehensive loss	(3)	(19)
Total stockholders' equity	12,401	15,095
Total liabilities and stockholders' equity	$ 20,986	$ 22,172

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Revenue	$ 375	$ 375	$ 1,148	$ 1,150
Operating expense:				
Royalty expense	884	1,029	884	5,264
Research and development	460	463	1,391	1,272
Selling, general and administrative expenses	6,318	4,985	20,132	16,043
Total operating expense	7,662	6,477	22,407	22,579
Loss from operations	(7,287)	(6,102)	(21,259)	(21,429)
Loss on change in value of derivative liability	—	—	—	(117)
Interest and other income, net	19	12	50	57
Loss before taxes	(7,268)	(6,090)	(21,209)	(21,489)
Income tax expense	(119)	(7)	(126)	(9)
Net loss	**$ (7,387)**	**$ (6,097)**	**$ (21,335)**	**$ (21,498)**
Basic and diluted loss per share	$ (0.13)	$ (0.12)	$ (0.38)	$ (0.41)
Weighted average shares outstanding basic and diluted	56,651	52,339	55,503	52,174

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

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Net loss	$ (7,387)	$ (6,097)	$ (21,335)	$ (21,498)
Other comprehensive gain (loss), net of tax:				
Change in equity adjustment from foreign currency translation, net of tax	—	2	4	(1)
Change in unrealized gain (loss) on investments, net of tax	(1)	(1)	12	6
	(1)	1	16	5
Comprehensive loss	$ (7,388)	$ (6,096)	$ (21,319)	$ (21,493)

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Cash flows from operating activities:		
Net loss	$ (21,335)	$ (21,498)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	22	19
Amortization of warrant issuance costs	30	61
Stock-based compensation	3,979	5,326
Change in value of derivative liability	—	117
Changes in assets and liabilities:		
Prepaid expenses and other assets	238	182
Accounts payable and accrued liabilities	549	(2,176)
Accrued payroll and related expenses	(1,383)	—
Royalty payable	884	(5,071)
Related-party payable	83	(81)
Income tax liability	—	(8)
Deferred revenue	1,375	1,375
Net cash used in operating activities	**(15,558)**	**(21,754)**
Cash flows from investing activities:		
Purchase of property and equipment	(14)	(4)
Purchase of investments	(7,888)	(6,234)
Proceeds from sale or maturity of investments	8,615	18,009
Net cash provided by investing activities	**713**	**11,771**
Cash flows from financing activities:		
Proceeds from exercise of options	20	165
Proceeds from exercise of warrants	—	431
Proceeds from sale of common stock	14,626	719
Net cash provided by financing activities	**14,646**	**1,315**
Net decrease in cash and cash equivalents	(199)	(8,668)
Cash and cash equivalents, beginning of period	8,726	18,658
Cash and cash equivalents, end of period	$ 8,527	$ 9,990
Cash paid for income taxes	$ 126	$ 6
Non-cash transactions		
Fair value of warrants issued for services	$ —	$ 121

See accompanying notes to condensed consolidated financial statements.

VIRNETX HOLDING CORPORATION

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

Note 1 — Business Description and Basis of Presentation

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

Our portfolio of intellectual property is the foundation of our business model. We currently own approximately 49 U.S. and 69 foreign patents with approximately 50 pending patent applications worldwide. Our patent portfolio is primarily focused on securing real-time communications over the Internet, as well as related services such as the establishment and maintenance of a secure domain name registry. Our patented methods also have additional applications in the key areas of device operating systems and network security for Cloud services, M2M communications in areas of Smart City, Connected Car and Connected Home. All our U.S. and foreign patents and pending patent applications relate generally to securing communications over the internet and as such, cover all our technology and other products. Our issued U.S. and foreign patents expire at various times during the period from 2019 to 2024. Some of our issued patents and pending patent applications were acquired by our principal operating subsidiary, VirnetX, Inc., from Leidos, (f/k/a Science Applications International Corporation or SAIC) in 2006 and we are required to make payments to Leidos, in certain cases that result in 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.

Note 2 — Summary of Significant Accounting Policies

Unaudited Interim Financial Information

The accompanying Condensed Consolidated Balance Sheet as of September 30, 2016, the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2016 and 2015, the Condensed Consolidated Statements of Comprehensive Loss for the three and nine months ended September 30, 2016 and 2015, and the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2016 and 2015 are unaudited. These unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP"). In our opinion, the unaudited interim consolidated financial statements include all adjustments of a normal recurring nature necessary for the fair presentation of our financial position as of September 30, 2016, our results of operations for the three and nine months ended September 30, 2016 and 2015, and our cash flows for the nine months ended September 30, 2016 and 2015. The results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the year ending December 31, 2016.

These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015, filed with the SEC on March 15, 2016.

Use of Estimates

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

Basis of Consolidation

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

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 may be complex and 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 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 upon 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 do or expect to 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, because 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*: Ongoing royalty payments cover 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 Up-Front Fees and Minimum Fee Contracts*: For licenses that provide for non-refundable up-front or fixed minimum fees over their term, for which we have no future obligations or performance requirements, revenue is generally recognized over the license term. For licenses that provide for fees that are not fixed or determinable, including licenses that provide for extended payment terms and/or payment of a significant portion of the fee after expiration of the license or more than 12 months after delivery, the fees are generally presumed not to be fixed or determinable, and revenue is deferred and recognized as earned, but generally not in advance of collection.

• *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.

Deferred revenue

In August 2013 we began receiving annual payments on a contract that requires payment to us over 4 years totaling $10,000 ("August 2013 Contract Settlement"). As of September 30, 2016, we received cash totaling $10,000, all of which is non-refundable. We recognized $375 and $1,125 of revenue related to the August 2013 Contract Settlement during the three and nine months ended September 30, 2016 and 2015 respectively.

Activity under the August 2013 Contract Settlement was as follows:

Deferred Revenue, December 31, 2015	$	3,000
Payment received		2,500
Less: Amount amortized as revenue		(1,125)
Deferred Revenue, September 30, 2016	$	4,375

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 are computed by dividing net income by the weighted average number of shares outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the potentially dilutive securities had been issued.

Concentration of Credit Risk and Other Risks and Uncertainties

Our cash and cash equivalents are primarily maintained at two major financial institutions in the United States. A portion of those balances are insured by the Federal Deposit Insurance Corporation. During the nine months ended September 30, 2016 we had funds which were uninsured. We do not believe that we are subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships with major financial institutions. We have not experienced any losses on our deposits of cash and cash equivalents.

Derivative Instruments

Our Series I Warrants were required to be accounted for as derivative liabilities and carried at fair value on our Condensed Consolidated Balance Sheets because of an anti-dilution provision which precluded them from being considered indexed to our stock. The warrant liabilities were marked-to-market each period and the change in the fair value was recorded as gain or loss on derivative liability in the accompanying Condensed Consolidated Statements of Operations. All remaining unexercised Series I Warrants expired during the three months ended March 31, 2015.

Prepaid Expenses

Prepaid expenses at September 30, 2016 include the current portion of prepaid rent for a facility lease for corporate promotional and marketing purposes. From inception, the prepayment totaling $4,000 is being amortized over the 10-year term of the lease. The unamortized non-current portion of the prepayment is included in Prepaid expenses-non-current on the condensed consolidated balance sheet.

Impairment of Long-Lived Assets

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

Fair Value of Financial Instruments

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

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

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

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

The following tables show the adjusted cost, gross unrealized gains, gross unrealized losses and fair value of our securities by significant investment category as of September 30, 2016 and December 31, 2015.

	September 30, 2016					
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Investments Available for Sale
Cash	$ 5,335	$ —	$ —	$ 5,335	$ 5,335	$ —
Level 1:						
Mutual funds	3,192	—	—	3,192	3,192	—
U.S. government securities	1,803	2	—	1,805	—	1,805
U.S. agency securities	7,433	5	—	7,438	—	7,438
	12,428	7	—	12,435	3,192	9,243
Total	$ 17,763	$ 7	$ —	$ 17,770	$ 8,527	$ 9,243

	December 31, 2015					
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Investments Available for Sale
Cash	$ 3,296	$ —	$ —	$ 3,296	$ 3,296	$ —
Level 1:						
Mutual funds	5,005	—	—	5,005	5,005	—
U.S. government securities	1,806	—	(3)	1,803	—	1,803
U.S. agency securities	8,579	1	(4)	8,576	425	8,151
	15,390	1	(7)	15,384	5,430	9,954
Total	$ 18,686	$ 1	$ (7)	$ 18,680	$ 8,726	$ 9,954

New Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This update addresses a diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and other Topics. This ASU covers the following eight specific cash flow issues: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. We are currently evaluating the impact this guidance will have on our financial position and statement of operations.

In June 2016, the FASB issued ASU No. 2016-13. The purpose of this ASU is to require a financial asset measured at amortized cost basis to be presented at the net amount expected to be collected. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. This ASU is effective for interim and annual reporting periods beginning after December 15, 2019. We are currently evaluating the impact this guidance will have on our financial position and statement of operations.

In May 2016, the FASB issued ASU No. 2016-12 which amended the revenue recognition guidance regarding collectability, noncash consideration, presentation of sales tax and transition. This ASU is effective for reporting periods beginning after December 15, 2017. We are currently evaluating the impact this guidance will have on our financial position and statement of operations.

In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606), which amends certain aspects of the FASB's new revenue standard, ASU No. 2014-09, Revenue from Contracts with Customers. The standard should be adopted concurrently with adoption of ASU 2014-09 which is effective for annual and interim periods beginning after December 15, 2017. We have not yet selected a transition method nor have we determined the effect of the standard on our financial position and statement of operations.

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation (Topic 718) (“ASU 2016-09”), which simplified certain aspects of the accounting for share-based payment transactions, including income taxes, classification of awards and classification in the statement of cash flows. ASU 2016-09 will be effective for the Company beginning in its first quarter of 2018. We are currently evaluating the impact of adopting the new stock compensation standard on our consolidated financial statements.

In February 2016, FASB issued ASU 2016-02, Leases (Topic 842) (“ASU 2016-02”). ASU 2016-02 requires an entity to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. ASU 2016-02 offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. For public companies, ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period, and requires a modified retrospective adoption, with early adoption permitted. We are evaluating the impact this guidance will have on our financial position and statement of operations.

In November 2015, the FASB issued “*Accounting Standards Update No. 2015-17—Income Taxes (Topic 740)”.* Current GAAP requires an entity to separate deferred income tax liabilities and assets into current and noncurrent amounts in a classified statement of financial position. To simplify the presentation of deferred income taxes, this Update requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The amendments in this Update apply to all entities that present a classified statement of financial position. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected by the amendments in this Update. For public business entities, the amendments in this Update are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Earlier application is permitted for all entities as of the beginning of an interim or annual reporting period. We are evaluating the impact this guidance will have on our financial position and statement of operations.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, “ *Presentation of Financial Statements – Going Concern”*, Subtopic 205-40, “*Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern.”* The amendments in this ASU apply to all entities and require management to assess an entity’s ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. Specifically, the amendments (1) provide a definition of the term *substantial doubt,* (2) require an evaluation every reporting period including interim periods, (3) provide principles for considering the mitigating effect of management’s plans, (4) require certain disclosures when substantial doubt is alleviated as a result of consideration of management’s plans, (5) require an express statement and other disclosures when substantial doubt is not alleviated, and (6) require an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). The amendments in this update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. We are currently evaluating the impact this guidance will have on our financial position and results of operations.

In May 2014, the FASB issued ASU No. 2014-09 "*Revenue from Contracts with Customers*" (Topic 606). Topic 606 supersedes the revenue recognition requirements in Topic 605, *"Revenue Recognition"* including most industry-specific revenue recognition guidance throughout the Industry Topics of the Codification. In addition, the amendments create a new Subtopic 340-40, *"Other Assets and Deferred Costs—Contracts with Customers"*. In summary, the core principle of Topic 606 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. For a public entity, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. We are currently evaluating the impact this guidance will have on our financial position and statement of operations.

Note 3 - Income Taxes

We had $119 and $126 of income tax expense for the three and nine months ended September 30, 2016 as a result of minimum tax payments and a change related to 2010 state taxes. During the three and nine month periods ended September 30, 2016, we had net operating losses ("NOLs") which generated deferred tax assets for NOL carryforwards. We have provided valuation allowances against the net deferred tax assets including the deferred tax assets for NOL carryforwards. Valuation allowances provided for our net deferred tax assets increased by $2,707 and $7,942 for the three and nine months ended September 30, 2016, respectively.

We had $7 income tax expense for the three months ended September 30, 2015, because of an adjustment related to a prior year tax return. Our income tax expense was $9 for the nine months ended September 30, 2015, which included the $7 adjustment noted above and a $2 expense related to minimum tax payments. During the three and nine month periods ended September 30, 2015, we had NOLs which generated deferred tax assets for NOL carry-forwards. We provided valuation allowances against the net deferred tax assets including the deferred tax assets for NOL carry-forwards. Valuation allowances provided for our net deferred tax assets increased by approximately $1,951 and $7,520 for the three and nine months ended September 30, 2015, respectively.

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, including our history of operating losses and the uncertainty of generating future taxable income, management believes it is more likely than not that the net deferred tax assets at September 30, 2016 will not be fully realizable. Accordingly, management has maintained a valuation allowance against our net deferred tax assets at September 30, 2016. The valuation allowance provided against our net deferred tax assets was approximately $38,000 and $30,000 at September 30, 2016 and December 31, 2015, respectively.

At September 30, 2016, we have federal and state NOL carry-forwards of approximately $69,000 and $37,000, respectively, expiring beginning in 2027 and 2016, respectively.

We have adopted accounting guidance for income taxes, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement attribute for the financial statements recognition and measurement of a tax position taken or expected to be taken in a tax return. We are required to recognize in the financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position.

Our tax years for 2005 and forward are subject to examination by the U.S. tax authority and various state tax authorities. These years are open due to net operating losses and tax credits remaining unutilized from such years.

Our policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of September 30, 2016, we had accrued immaterial amounts of interest and penalties related to uncertain tax positions.

Note 4 — Commitments and Related Party Transactions

We lease our offices under an operating lease with a third party expiring in October 2017. We recognize rent expense on a straight-line basis over the term of the lease.

We lease the use of an aircraft from K2 Investment Fund LLC ("LLC") for business travel for employees of the Company. We incurred approximately $228 and $596 compared to $88 and $391 in rental fees and reimbursements to the LLC during the three and nine months ended September 30, 2016 and 2015, respectively. Our Chief Executive Officer and Chief Administrative Officer are the managing partners and control the equity interests of the LLC. The lease term ends January 2017, and provides for non-exclusive use of the plane at a rate of $8 per flight hour, and requires no minimum usage. The agreement contains other terms and conditions normal in such transactions and can be cancelled by either us or the LLC with 30 days' notice. The lease renews on an annual basis unless terminated by the Lessor or Lessee.

Note 5 — Stock-Based Compensation

We have a stock incentive plan for employees and others called the VirnetX Holding Corporation 2013 Equity Incentive Plan (the "Plan"), which has been approved by our stockholders. The Plan provides for grants of 14,124,469 shares of our common stock, including stock options and restricted stock units ("RSUs"), and will expire in 2023. As of September 30, 2016, 421,221 shares remained available for grant under the Plan.

During the three months ended September 30, 2016 and 2015, we granted no options.

During the nine months ended September 30, 2016, we granted options for a total of 429,000 shares. The weighted average fair values at the grant dates for options issued during the nine months ended September 30, 2016 was $3.25 per option. The fair values of options at the grant date were estimated utilizing the Black-Scholes valuation model with the following weighted average assumptions for the nine months ended September 30, 2016 (i) dividend yield on our common stock of 0 percent (ii) expected stock price volatility of 80 percent (iii) a risk-free interest rate of 1.84 percent and (iv) an expected option term of 6 years.

During the nine months ended September 30, 2015, we granted options for a total of 294,000 shares with a weighted average grant date fair value of $4.19. The fair values of options at the grant date were estimated utilizing the Black-Scholes valuation model with the following weighted average assumptions for the nine months ended September 30, 2015 (i) dividend yield on our common stock of 0 percent (ii) expected stock price volatility of 86 percent (iii) a risk-free interest rate of 2.21 percent and (iv) an expected option term of 6 years.

During the three months ended September 30, 2016 and 2015, we granted no RSUs.

During the nine months ended September 30, 2016 and 2015, we granted 219,331 and 162,665 RSUs, respectively. The weighted average fair values at the grant dates for RSUs issued during the nine months ended September 30, 2016 and 2015 were $4.75 and $5.57 per RSU, respectively. RSUs, which are subject to forfeiture if service terminates prior to the shares vesting, are expensed ratably over the vesting period.

Stock-based compensation expense included in general and administrative expense was $1,423 and $3,979 for the three and nine months ended September 30, 2016, respectively, and $1,889 and $5,326 for the three and nine months ended September 30, 2015, respectively.

As of September 30, 2016, the unrecognized stock-based compensation expense related to non-vested stock options and RSUs was $4,890 and $2,796, respectively, which will be amortized over an estimated weighted average period of approximately 2.86 and 2.70 years, respectively.

During the nine-month period ended September 30, 2016 we issued 135,102 new shares of common stock as a result of RSUs which vested and were paid out and issued 50,357 shares of common stock as a result of stock options that were exercised during the period.

Note 6 — Equity

In August 2015, we filed a universal shelf registration statement with the SEC enabling us to offer and sell from time to time up to $100 million of equity, debt or other types of securities. We also entered into an at-the-market (“ATM”) equity offering sales agreement with Cowen & Company, LLC in August 2015, under which we may offer and sell shares of our common stock having an aggregate value of up to $35 million. We have and expect to use proceeds from this offering for GABRIEL product development and marketing, and general corporate purposes, which may include working capital, capital expenditures, other corporate expenses and acquisitions of complementary products, technologies or businesses. From August 2015 through September 30, 2016, we sold 4,139,929 shares under the ATM. The average sales price per common share was $4.46 and the aggregate proceeds from the sales totaled $18,456 during the period. Sales commissions, fees and other costs associated with the ATM totaled $554.

During the three and nine months ended September 30, 2016, we sold 224,944 and 3,304,873 shares under the ATM, respectively. The average sales price per common share was $4.05 and $4.56 and the aggregate proceeds from the sales totaled $910 and $15,079 during the three and nine months ended September 30, 2016, respectively. Sales commissions, fees and other costs associated with the ATM totaled $27 and $452, respectively.

Warrants

During 2015 we issued warrants (“Advisor Warrants”) for the purchase of 25,000 shares of common stock for $7 per share, which expire in April 2020. The Advisor Warrants were issued for advisory services provided by a third party. Our Advisor Warrants were recorded at fair value on the issuance date and included in Additional Paid in Capital on our Condensed Consolidated Balance Sheet. The Advisor Warrants are exercisable by the holder, in whole or in part, until expiration, and may also be net-share-settled. Terms of the warrant agreement include no registration requirements for the underlying common stock and there are no anti-dilution provisions. The fair value at issuance of the warrants was recorded in Prepaid Expenses and Other Current Assets, and is being amortized over the twelve-month life of the service contract, with the expense included in Selling, General and Administrative Expense in our Condensed Consolidated Statements of Operations.

The fair value of the Advisor Warrants at the issuance date of $121 was estimated utilizing the Black-Scholes valuation model with the following assumptions: (i) dividend yield on our common stock of 0 percent, (ii) expected stock price volatility of 87.5 percent, (iii) a risk-free interest rate of 1.33 percent, and (iv) an expected warrant term of 5 years.

Information about warrants outstanding during the nine months ended September 30, 2016 follows:

Original Number of Warrants Issued	Exercise Price per Common Share	Exercisable at December 31, 2015	Became Exercisable	Exercised	Terminated / Cancelled / Expired	Exercisable at September 30, 2016	Expiration Date
25,000	$ 7.00	25,000	—	—	—	25,000	April 2020
		25,000	—	—	—	25,000	

Note 7 — Litigation

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

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

On March 30, 2015, the United States Court for the Eastern District of Texas, Tyler Division, issued an order finding substantial overlap between the remanded portions of the Civil Action Case 6:10-CV-00417-LED (VirnetX vs. Cisco et. al.), and the ongoing Civil Action Case 6:12-CV-00855-LED (VirnetX Inc. v. Apple, Inc.). The court consolidated the two civil actions under Civil Action Case 6:12-CV-00855-LED (VirnetX Inc. v. Apple, Inc.) and designated it as the lead case. The jury trial in this case was held on January 25, 2016. On February 4, 2016, a jury in the United States Court for the Eastern District of Texas, Tyler Division, awarded us $625.6 million in a verdict against Apple Inc. for infringing four of our US patents, marking it the second time a federal jury has found Apple liable for infringing VirnetX's patented technology. The verdict includes royalties awarded to us based on an earlier patent infringement finding **(Case 6:10-CV-00417-LED)** against Apple. The jury found that Apple's modified VPN On-Demand, iMessage and FaceTime services infringed VirnetX's patents and that Apple's infringement was willful. In addition to determining the royalty owed by Apple for its prior infringement, this verdict also includes an award based on the jury's finding that Apple's modified VPN On Demand, iMessage and FaceTime services have continued to infringe VirnetX's patents. The post-trial hearing was held on May 25, 2016 in the United States Court for the Eastern District of Texas, Texarkana Division. On July 29, 2016, the court issued a new order, vacating its previous orders consolidating the cases (Case No. 6:10-cv-417, Docket No. 878 ("Apple I case"); Case No. 6:12-cv-855, Docket No. 220 ("Apple II case")), ordering that the two cases be retried separately, and setting the retrial date for Apple I case with jury selection to begin on September 26, 2016. The court also ordered that the issue of willfulness in both cases is bifurcated and that the Apple II case will be retried after Apple I case. Events and developments subsequent to the order from the court are described to support Apple I and Apple II matters.

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

On August 11, 2010, we initiated a lawsuit by filing a complaint against Aastra USA. Inc. ("Aastra"), Apple, Cisco Systems, Inc. ("Cisco"), and NEC Corporation ("NEC") in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we alleged that these parties infringe on certain of our patents. We sought damages and injunctive relief. Aastra and NEC agreed to sign license agreements with us and we agreed to drop all the accusations of infringement against them. At the pre-trial hearing, the judge decided to conduct separate jury trial for each defendant, and try only the case against Apple on the scheduled trial date. The jury trial of our case against Cisco was held on March 4, 2013. The jury in our case against Cisco came back with a verdict of non-infringement also determined that all our patents-in-suit patents are not invalid. Our motions for a new trial and Cisco's infringement of certain VirnetX patents were denied and the case against Cisco was closed.

The jury trial of our case against Apple was held on October 31, 2012. 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 for infringing four of our patents. On February 26, 2013, the court issued its Memorandum Opinion and Order regarding post-trial motions resulting from the prior jury verdict denying 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 and granted our motions for pre-judgment interest, post-judgment interest, and post-verdict damages to date. 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 and severed the future infringement portion into its own separate proceedings under Case 6:13-CV-00211-LED.

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 USCAFC. On September 16, 2014, USCAFC issued their opinion, affirming the jury's finding that all 4 of our patents are valid, confirming the jury's finding of infringement of VPN on Demand under many of the asserted claims of our '135 and '151 patents, and confirming the district's court's decision to allow evidence concerning our licenses and royalty rates in connection with the determination of damages. In its opinion, the USCAFC also vacated the jury's damages award and the district court's claim construction with respect to parts of our '504 and '211 patents and remanded the damages award and determination of infringement with respect to FaceTime –for further proceedings consistent with its opinion. On October 16, 2014, we filed a petition with the USCAFC, requesting a rehearing and rehearing en banc of the Federal Circuit's September 14, 2014, decision concerning VirnetX's litigation against Apple Inc. On December 16, 2014, USCAFC denied our petition requesting a rehearing and rehearing en banc of the Federal Circuit's September 14, 2014, decision and remanded the case back to the Eastern District of Texas, Tyler Division, for further proceedings consistent with its opinion. On February 25, 2015, USCAFC granted Apple's motions to lift stay of proceedings and vacate Case 6:13-CV-00211-LED. On March 30, 2015, the court issued an order finding substantial overlap between the remanded portions of this case and the ongoing Civil Action Case 6:12-CV-00855-LED (VirnetX Inc. v. Apple, Inc.). The court consolidated the two civil actions under Civil Action Case 6:12-CV-00855-LED (VirnetX Inc. v. Apple, Inc.) and designated it as the lead case.

On July 29, 2016, the court issued a new order, vacating its previous orders consolidating the cases Apple I case and Apple II case, ordering that the two cases be retried separately, and setting the retrial date for Apple I case with jury selection to begin on September 26, 2016. The court also ordered that the issue of willfulness in both cases is bifurcated and that the Apple II will be retried after Apple I case.

The jury trial in this case was held on September 26, 2016. On September 30, 2016, a Jury in the United States Court for the Eastern District of Texas, Tyler Division, in the case VirnetX Inc., et al. v. Apple Inc., No. Apple I, has awarded VirnetX $302.4 million in a verdict against Apple Corporation for infringing four VirnetX patents, marking the third time a federal jury has found Apple liable for infringing VirnetX's patented technology.

The verdict includes royalties awarded to VirnetX, for unresolved issues in the Apple I case, remanded back from the USCAFC, related to (1) damages owed to VirnetX for infringement by Apple's original VPN-on-Demand (VOD) and (2) the alleged infringement by Apple's original FaceTime product, under the new claim construction of "secure communication link" pertaining to the '504 and '211 patents by the USCAFC, and the damages associated with that infringement. The court has scheduled a hearing on the issue of willfulness in this case on October 14, 2016. Both parties are in the process of briefing the court on their post-trial motions and pleading.

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

On November 6, 2012, we filed a new complaint against Apple 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 an unspecified amount of 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 was held on May 20, 2014 and on August 8, 2014, issued its Markman Order, denying Apple's motion for summary judgment of indefiniteness, in which Apple alleged that some of the disputed claims terms in the patents asserted by us were invalid for indefiniteness. In a separate order, the court granted in part and denied in part our motion for partial summary judgment on Apple's invalidity counterclaims, precluding Apple from asserting invalidity as a defense against infringement of the claims that were tried before a jury in our prior litigation against Apple (VirnetX vs. Cisco et. al., Case 6:10-CV-00417-LED). The jury trial in this case was scheduled for October 13, 2015. On March 30, 2015, the court issued an order finding substantial overlap between this case and the remanded portions of Case 6:10-CV-00417-LED (VirnetX vs. Cisco et. al.). The court consolidated the two civil actions under Civil Action Case 6:12-CV-00855-LED (VirnetX Inc. v. Apple, Inc.) and designated it as the lead case. On July 29, 2016, the court issued a new order, vacating its previous orders consolidating the cases Apple I case and Apple II case, ordering that the two cases be retried separately, and setting the retrial date for Apple I case with jury selection to begin on September 26, 2016. The court also ordered that the issue of willfulness in both cases is bifurcated and that the Apple II will be retried after Apple I case. We are awaiting court order setting the date for a new jury trial in Apple II case.

VirnetX Inc. v. Apple, Inc. (Case 15-1934)

On July 10, 2015, we filed appeals with the USCAFC, appealing the invalidity findings by the United States Patent and Trademark Office, Patent Trial and Appeal Board ("PTAB") in IPR2014-00237 and IPR2014-00238, related to U.S. Patent Nos. 8,504,697. The oral arguments in this case are scheduled for November 7, 2016.

VirnetX Inc. v. Apple, Inc. (Case 16-1211)

On September 28, 2015, we filed appeals with the USCAFC, appealing the invalidity findings by the PTAB in IPR2014-00403 and IPR2014-00404 and on October 22, 2015 for IPR2014-00481 and IPR2014-00482 involving our U.S. Patent Nos. 7,188,180, and 7,987,274. The oral arguments in this case are scheduled for November 7, 2016.

VirnetX Inc. v. Apple, Inc. (Case 16-1460)

On November 30, 2015, we filed appeals with the USCAFC, appealing the invalidity findings by the PTAB in *inter-partes* reexamination no. 95/001,949 related to U.S. Patent No. 8,051,181. The oral arguments in this case are scheduled for November 7, 2016.

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 8 — Subsequent Events

Subsequent to the period ended September 30, 2016, we sold 276,550 shares of common stock under the ATM. The average sales price per common share was $3.07 and the aggregate proceeds from the sales totaled $848 during the period. Sales commissions, fees and other costs associated with the ATM totaled $25.

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

Note About Forward-Looking Statements

Certain statements in this report, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives, and expected operating results, and the assumptions upon which those statements are based, are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may appear throughout this report, including without limitation, the following sections: “Management’s Discussion and Analysis,” and “Risk Factors.” These forward-looking statements generally are identified by the words “believe,” “project,” “expect,” “anticipate,” “estimate,” “intend,” “strategy,” “future,” “opportunity,” “plan,” “may,” “should,” “will,” “would,” “will be,” “will continue,” “will likely result,” and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. A detailed discussion of risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in the section titled “Risk Factors” (Part II, Item 1A of this Form 10-Q). We undertake no obligation to update or revise publicly any forward-looking statements, whether because of new information, future events, or otherwise.

Company Overview

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 our Secure Domain Name Registry and GABRIEL Connection Technology™, are designed to facilitate secure communications and provide the security platform required by next-generation Internet-based applications such as instant messaging, or IM, voice over Internet protocol, or VoIP, mobile services, streaming video, file transfer, remote desktop and Machine-to-Machine, or M2M communications. Our technology generates secure connections on a “zero-click” or “single-click” basis, significantly simplifying the deployment of secure real-time communication solutions by eliminating the need for end-users to enter any encryption information. Our portfolio of intellectual property is the foundation of our business model. We currently own approximately 49 U.S. and 69 foreign patents with approximately 50 pending patent applications worldwide. Our patent portfolio is primarily focused on securing real-time communications over the Internet, as well as related services such as the establishment and maintenance of a secure domain name registry. Our patented methods also have additional applications in the key areas of device operating systems and network security for Cloud services, M2M communications in the new initiatives like “Smart City”, “Connected Car” and “Connected Home” that would connect everything from social services and citizen engagement to public safety, transportation and economic development to the internet to enable more productivity, features and efficiency in our everyday lives. The subject matter of all our U.S. and foreign patents and pending applications relates generally to securing communication over the internet, and as such covers all our technology and other products. Our issued U.S. and foreign patents expire at various times during the period from 2019 to 2024. Some of our issued patents and pending patent applications were acquired by our principal operating subsidiary; VirnetX, Inc., from Leidos, Inc., (f/k/a Science Applications International Corporation, or SAIC) in 2006 and we are required to make payments to Leidos, in certain cases that result in cash or certain other values generated from those patents. The amount of such payments depends upon the type of value generated, and certain categories are subject to maximums and other limitations.

Our product GABRIEL Secure Communication Platform™, unlike other collaboration and communication products and services on the market today, does not require access to user’s confidential data and minimizes the threat of hacking and data mining. It enables individuals and organizations to maintain complete ownership and control over their personal and confidential data, secured within their own private network, while enabling authorized secure encrypted access from anywhere at any time. Our GABRIEL Collaboration Suite™ is a set of applications that run on top of our GABRIEL Secure Communication Platform™. It enables seamless and secure cross-platform communications between user’s devices that have our software installed. Our GABRIEL Collaboration Suite™ is available for download and free trial, for Android, iOS, Windows, Linux and Mac OS X platforms, at http://www.gabrielsecure.com/. We continue to enhance our products and add new functionality to our products. We will provide updates to new and existing customers as they are released to the general public. Over 80 small and medium businesses have installed our GABRIEL Secure Communication Platform™ and GABRIEL Collaboration Suite™ products in their corporate networks. We continue to rapidly expand our customer base with targeted promotions and direct sales initiatives.

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 3 Technology™ Software Development Kit (SDK) to assist with rapid integration of these techniques into existing software implementations with minimal code changes and include object libraries, sample code, testing and quality assurance tools and the supporting documentation necessary for a customer to implement our technology. Customers who want to develop their own implementation of the VirnetX patented techniques for supporting secure domain names, or other techniques that are covered by our patent portfolio for establishing secure communication links, can purchase a patent license. The number of patents licensed, and therefore the cost of the patent license to the customer, will depend upon which of the patents are used in a particular product or service. These licenses will typically include an initial license fee, as well as an ongoing royalty.

We have signed Patent License Agreements with Avaya Inc., Aastra USA, Inc., Microsoft, Mitel Networks Corporation, NEC Corporation and NEC Corporation of America, Siemens Enterprise Communications GmbH & Co. KG, and Siemens Enterprise Communications Inc. to license certain of our patents, for a one-time payment and/or an ongoing royalty for all future sales through the expiration of the licensed patents with respect to certain current and future IP-encrypted products. We have engaged IPVALUE Management Inc. to assist us in commercializing our portfolio of patents on securing real-time communications over the Internet. Under the multi-year agreement, IPVALUE is actively assisting us with negotiating transactions related to patent licensing worldwide with respect to certain third parties.

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 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 further 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. (“Leidos”) is a FORTUNE 500® scientific, engineering and technology applications company that uses its deep domain knowledge to solve problems of vital importance to the nation and the world, in national security, energy and the environment, critical infrastructure and health. The team has continued its research and development work started at Leidos, and expanded the set of patents we acquired in 2006 from Leidos, into a larger portfolio of over 110 U.S. and international patents and with over 75 pending applications. This portfolio now serves as the foundation of our licensing business and planned service offerings and is expected to generate the majority of our future revenue in license fees and royalties. We intend to continue our research and development efforts to further strengthen and expand our patent portfolio

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

New Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This update addresses a diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and other Topics. This ASU covers the following eight specific cash flow issues: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. We are currently evaluating the impact this guidance will have on our financial position and statement of operations.

In June 2016, the FASB issued ASU No. 2016-13. The purpose of this ASU is to require a financial asset measured at amortized cost basis to be presented at the net amount expected to be collected. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. This ASU is effective for interim and annual reporting periods beginning after December 15, 2019. We are currently evaluating the impact this guidance will have on our financial position and statement of operations.

In May 2016, the FASB issued ASU No. 2016-12 which amended the revenue recognition guidance regarding collectability, noncash consideration, presentation of sales tax and transition. This ASU is effective for accounting periods beginning after December 15, 2017. We are currently evaluating the impact this guidance will have on our financial position and statement of operations.

In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606), which amends certain aspects of the FASB's new revenue standard, ASU No. 2014-09, Revenue from Contracts with Customers. The standard should be adopted concurrently with adoption of ASU 2014-09 which is effective for annual and interim periods beginning after December 15, 2017. We have not yet selected a transition method nor have we determined the effect of the standard on our financial position and statement of operations.

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation (Topic 718) ("ASU 2016-09"), which simplified certain aspects of the accounting for share-based payment transactions, including income taxes, classification of awards and classification in the statement of cash flows. ASU 2016-09 will be effective for the Company beginning in its first quarter of 2018. We are currently evaluating the impact of adopting the new stock compensation standard on our consolidated financial statements.

In February of 2016, FASB issued ASU 2016-02, Leases (Topic 842) ("ASU 2016-02"). ASU 2016-02 requires an entity to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. ASU 2016-02 offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. For public companies, ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period, and requires a modified retrospective adoption, with early adoption permitted. We are evaluating the impact this guidance will have on our financial position and statement of operations.

In November 2015, the FASB issued "*Accounting Standards Update No. 2015-17—Income Taxes (Topic 740)".* Current GAAP requires an entity to separate deferred income tax liabilities and assets into current and noncurrent amounts in a classified statement of financial position. To simplify the presentation of deferred income taxes, this Update requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The amendments in this Update apply to all entities that present a classified statement of financial position. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected by the amendments in this Update. For public business entities, the amendments in this Update are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Earlier application is permitted for all entities as of the beginning of an interim or annual reporting period. We are evaluating the impact this guidance will have on our financial position and statement of operations.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, "*Presentation of Financial Statements – Going Concern"*, Subtopic 205-40, "*Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern."* The amendments in this ASU apply to all entities and require management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. Specifically, the amendments (1) provide a definition of the term *substantial doubt,* (2) require an evaluation every reporting period including interim periods, (3) provide principles for considering the mitigating effect of management's plans, (4) require certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans, (5) require an express statement and other disclosures when substantial doubt is not alleviated, and (6) require an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). The amendments in this update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. We are currently evaluating the impact this guidance will have on our financial position and results of operations.

In May 2014, the FASB issued ASU No. 2014-09 "*Revenue from Contracts with Customers*" (Topic 606). Topic 606 supersedes the revenue recognition requirements in Topic 605, *"Revenue Recognition"* including most industry-specific revenue recognition guidance throughout the Industry Topics of the Codification. In addition, the amendments create a new Subtopic 340-40, *"Other Assets and Deferred Costs—Contracts with Customers".* In summary, the core principle of Topic 606 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. For a public entity, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. We are currently evaluating the impact this guidance will have on our financial position and statement of operations.

Results of Operation

Three and Nine Months Ended September 30, 2016
Compared with Three and Nine Months Ended September 30, 2015
(in thousands, except per share amounts)

Revenue

We had revenues of $375 and $1,148 for the three and nine months ended September 30, 2016, respectively, and revenues of $375 and $1,150 for the three and nine months ended September 30, 2015, respectively.

For the three and nine months ended September 30, 2016 we recognized revenue of $375 and $1,125, respectively, from non-refundable up-front fees earned during the period ("August 2013 Contract Settlement"). In August 2013 we began receiving annual payments on this contract with a total value over 5 years of $10,000. From its inception through September 30, 2016 we received a total payment of $10,000 under this license. Revenues from these fees are deferred and recognized as revenue when earned over a 12-month period, but not in advance of collection.

For the three and nine months ended September 30, 2015 we recognized revenue of $375 and $1,125, respectively from the August 2013 Contract Settlement. From its inception through September 30, 2015 we received payments of $7,500 under this license.

Royalties Expense

Royalty expense for the three and nine months ended September 30, 2016 was $884, respectively, and was $1,029 and $5,264 for the three and nine months ended September 30, 2015, respectively. The 2016 and 2015 expense was primarily due to contractual revenue share and legal reimbursements to Leidos.

Research and Development Expenses

Research and development expenses were $460 and $463 for the three months ended September 30, 2016 and 2015, respectively. Research and development expenses were $1,391 and $1,272 for the nine months ended September 30, 2016 and 2015, respectively, representing an increase of $119 due primarily to an increase in staffing, partially offset by less utilization of independent contractors.

Selling, General and Administrative Expenses

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

Our selling, general and administrative expenses for the three months ended September 30, 2016 compared to September 30, 2015 increased by $1,333 to $6,318. The change is primarily due to an increase in legal fees associated with our patent infringement actions (see "Legal Proceedings"), offset by a decrease in stock-based compensation. For the nine months ended September 30, 2016 our selling, general and administrative expenses increased by $4,089 to $20,132 compared to the nine months ended September 30, 2015. The change was primarily due to a $4,424 increase in legal fees associated with our patent infringement actions. We expect to incur the same levels or increased levels of legal fees over the next two quarters and expect to report losses from operations as a result. (See "Legal Proceedings" for additional information regarding these infringement actions.)

Other Income and Expenses

For the three and nine months ended September 30, 2015, the non-cash loss related to the periodic revaluation of our Series I Warrants liability was zero and $117, respectively. The loss from the revaluation of the warrant liability in the nine months ended September 30, 2015 primarily resulted from an increase in our common share price during the period. There was no gain or loss related to these warrants for the three and nine months ended September 30, 2016, as the warrants were settled or expired during the three months ended March 31, 2015.

Interest and other income increased by $7 to $19 for the three months ended September 30, 2016, from $12 for the comparable 2015 period, and decreased by $7 to $50 for the nine months ended September 30, 2016, from $57 for the nine months ended September 30, 2015.

Income Taxes

We had $119 and $126 of income tax expense for the three and nine months ended September 30, 2016 as a result of minimum tax payments and a change related to 2010 state taxes. During the three and nine month periods ended September 30, 2016, we had net operating losses ("NOLs") which generated deferred tax assets for NOL carryforwards. We have provided valuation allowances against the net deferred tax assets including the deferred tax assets for NOL carryforwards. Valuation allowances provided for our net deferred tax assets increased by $2,707 and $7,942 for the three and nine months ended September 30, 2016, respectively.

We had $7 income tax expense for the three months ended September 30, 2015, because of an adjustment related to a prior year tax return. Our income tax expense was $9 for the nine months ended September 30, 2015, which included the $7 adjustment noted above and a $2 expense related to minimum tax payments. During the three and nine month periods ended September 30, 2015, we had NOLs which generated deferred tax assets for NOL carry-forwards. We provided valuation allowances against the net deferred tax assets including the deferred tax assets for NOL carry-forwards. Valuation allowances provided for our net deferred tax assets increased by approximately $1,951 and $7,520 for the three and nine months ended September 30, 2015, respectively.

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, including our history of operating losses and the uncertainty of generating future taxable income, management believes it is more likely than not that the net deferred tax assets at September 30, 2016 will not be fully realizable. Accordingly, management has maintained a valuation allowance against our net deferred tax assets at September 30, 2016. The valuation allowance provided against our net deferred tax assets was approximately $38,000 and $30,000 at September 30, 2016 and December 31, 2015, respectively.

At September 30, 2016, we have federal and state NOL carry-forwards of approximately $69,000 and $37,000, respectively, expiring beginning in 2027 and 2016, respectively.

We have adopted accounting guidance for income taxes, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement attribute for the financial statements recognition and measurement of a tax position taken or expected to be taken in a tax return. We are required to recognize in the financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position.

Our tax years for 2005 and forward are subject to examination by the U.S. tax authority and various state tax authorities. These years are open due to net operating losses and tax credits remaining unutilized from such years.

Our policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of September 30, 2016, we had accrued immaterial amounts of interest and penalties related to uncertain tax positions.

Liquidity and Capital Resources

As of September 30, 2016, our cash and cash equivalents totaled $8,527 and our short-term investments totaled $9,243 compared to cash equivalents of $8,726 and short-term investments of $9,954 at December 31, 2015. Working capital was $12,766 at September 30, 2016 and $13,788 at December 31, 2015. The $910 decrease in cash and cash equivalents and short-term investments during the periods reported are primarily attributed to costs incurred for legal expenses in defense of our patent infringement actions and losses incurred during the periods reported partially offset by proceeds from sales of common stock under the ATM program discussed below.

We expect that our cash and cash equivalents and short-term investments as of September 30, 2016, as well as cash received from sales of common shares under the ATM discussed below, will be sufficient to fund our current level of selling, general and administration costs, including legal expenses and provide related working capital for the foreseeable future. Over the longer term, we expect to derive the majority of our future revenue from license fees and royalties associated with our patent portfolio, technology, software and secure domain name registry in the United States and other markets around the world.

Universal Shelf Registration and ATM Offering

In August 2015 we filed a universal shelf registration statement with the U.S. Securities and Exchange Commission enabling us to offer and sell from time to time up to $100 million of equity, debt or other types of securities. We also entered into an at-the-market ("ATM") equity offering sales agreement with Cowen & Company, LLC in August 2015, under which we may offer and sell shares of our common stock having an aggregate value of up to $35 million. We expect to use proceeds from this offering for GABRIEL product development and marketing, and general corporate purposes, which may include working capital, capital expenditures, other corporate expenses and acquisitions of complementary products, technologies or businesses. From August 2015 through September 30, 2016, we sold 4,139,929 shares under the ATM. The average sales price per common share was $4.46 and the aggregate proceeds from the sale totaled $18,456 during the period. Sales commissions, fees and other costs associated with the ATM totaled $554.

During the three and nine months ended September 30, 2016, we sold 224,944 and 3,304,873 shares under the ATM, respectively. The average sales price per common share was $4.05 and $4.56 and the aggregate proceeds from the sales totaled $910 and $15,078 during the period respectively. Sales commissions, fees and other costs associated with the ATM totaled $27 and $452, respectively.

Warrants

During the quarter ended September 30, 2015 we issued warrants ("Advisor Warrants") for the purchase of 25,000 shares of common stock for $7 per share, which expire in April 2020. The warrants were issued for advisory services provided by a third party. Our Advisor Warrants were recorded at fair value on the issuance date and are included in Additional Paid in Capital on our Condensed Consolidated Balance Sheet. The Advisor Warrants are exercisable by the holder, in whole or in part, until expiration, and may also be net-share-settled. Terms of the warrant agreement include no registration requirements for the underlying common stock and there are no anti-dilution provisions. The fair value at issuance of the warrants was recorded in Prepaid Expenses and Other Current Assets, and is being amortized over the twelve-month life of the service contract, with the expense included in Selling, General and Administrative Expense in the Condensed Consolidated Statements of Operations.

Contractual Obligations

There have been no material changes to the contractual obligations disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

Off-Balance Sheet Arrangements

None.

ITEM 3 — QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Interest Rate Risk

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

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

We considered the historical volatility of short-term interest rates and determined that it was reasonably possible that an adverse change of 100 basis points could be experienced in the near term but would have an immaterial impact in the fair value of our marketable securities, which generally mature within one year of September 30, 2016.

Other Market Risks

We considered the historical volatility of our stock prices and determined that it was reasonably possible that the fair market value of our stock price could increase or decrease substantially in the near term and could have a material impact to our consolidated balance sheets and statement of operations.

ITEM 4 — CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of September 30, 2016.

The purpose of this evaluation was to determine whether as of September 30, 2016 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 September 30, 2016, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1 — LEGAL PROCEEDINGS

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

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

On March 30, 2015, the United States Court for the Eastern District of Texas, Tyler Division, issued an order finding substantial overlap between the remanded portions of the Civil Action Case 6:10-CV-00417-LED (VirnetX vs. Cisco et. al.), and the ongoing Civil Action Case 6:12-CV-00855-LED (VirnetX Inc. v. Apple, Inc.). The court consolidated the two civil actions under Civil Action Case 6:12-CV-00855-LED (VirnetX Inc. v. Apple, Inc.) and designated it as the lead case. The jury trial in this case was held on January 25, 2016. On February 4, 2016, a jury in the United States Court for the Eastern District of Texas, Tyler Division, awarded us $625.6 million in a verdict against Apple Inc. for infringing four of our US patents, marking it the second time a federal jury has found Apple liable for infringing VirnetX's patented technology. The verdict includes royalties awarded to us based on an earlier patent infringement finding **(Case 6:10-CV-00417-LED)** against Apple. The jury found that Apple's modified VPN On-Demand, iMessage and FaceTime services infringed VirnetX's patents and that Apple's infringement was willful. In addition to determining the royalty owed by Apple for its prior infringement, this verdict also includes an award based on the jury's finding that Apple's modified VPN On Demand, iMessage and FaceTime services have continued to infringe VirnetX's patents. The post-trial hearing was held on May 25, 2016 in the United States Court for the Eastern District of Texas, Texarkana Division. On July 29, 2016, the court issued a new order, vacating its previous orders consolidating the cases (Case No. 6:10-cv-417, Docket No. 878 ("Apple I case"); Case No. 6:12-cv-855, Docket No. 220 ("Apple II case")), ordering that the two cases be retried separately, and setting the retrial date for Apple I case with jury selection to begin on September 26, 2016. The court also ordered that the issue of willfulness in both cases is bifurcated and that the Apple II case will be retried after Apple I case. Events and developments subsequent to the order from the court are described to support Apple I and Apple II matters.

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

On August 11, 2010, we initiated a lawsuit by filing a complaint against Aastra USA. Inc. ("Aastra"), Apple, Cisco Systems, Inc. ("Cisco"), and NEC Corporation ("NEC") in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we alleged that these parties infringe on certain of our patents. We sought damages and injunctive relief. Aastra and NEC agreed to sign license agreements with us and we agreed to drop all the accusations of infringement against them. At the pre-trial hearing, the judge decided to conduct separate jury trial for each defendant, and try only the case against Apple on the scheduled trial date. The jury trial of our case against Cisco was held on March 4, 2013. The jury in our case against Cisco came back with a verdict of non-infringement also determined that all our patents-in-suit patents are not invalid. Our motions for a new trial and Cisco's infringement of certain VirnetX patents were denied and the case against Cisco was closed.

The jury trial of our case against Apple was held on October 31, 2012. 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 for infringing four of our patents. On February 26, 2013, the court issued its Memorandum Opinion and Order regarding post-trial motions resulting from the prior jury verdict denying 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 and granted our motions for pre-judgment interest, post-judgment interest, and post-verdict damages to date. 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 and severed the future infringement portion into its own separate proceedings under Case 6:13-CV-00211-LED.

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 USCAFC. On September 16, 2014, USCAFC issued their opinion, affirming the jury's finding that all 4 of our patents are valid, confirming the jury's finding of infringement of VPN on Demand under many of the asserted claims of our '135 and '151 patents, and confirming the district's court's decision to allow evidence concerning our licenses and royalty rates in connection with the determination of damages. In its opinion, the USCAFC also vacated the jury's damages award and the district court's claim construction with respect to parts of our '504 and '211 patents and remanded the damages award and determination of infringement with respect to FaceTime –for further proceedings consistent with its opinion. On October 16, 2014, we filed a petition with the USCAFC, requesting a rehearing and rehearing en banc of the Federal Circuit's September 14, 2014, decision concerning VirnetX's litigation against Apple Inc. On December 16, 2014, USCAFC denied our petition requesting a rehearing and rehearing en banc of the Federal Circuit's September 14, 2014, decision and remanded the case back to the Eastern District of Texas, Tyler Division, for further proceedings consistent with its opinion. On February 25, 2015, USCAFC granted Apple's motions to lift stay of proceedings and vacate Case 6:13-CV-00211-LED. On March 30, 2015, the court issued an order finding substantial overlap between the remanded portions of this case and the ongoing Civil Action Case 6:12-CV-00855-LED (VirnetX Inc. v. Apple, Inc.). The court consolidated the two civil actions under Civil Action Case 6:12-CV-00855-LED (VirnetX Inc. v. Apple, Inc.) and designated it as the lead case.

On July 29, 2016, the court issued a new order, vacating its previous orders consolidating the cases Apple I case and Apple II case, ordering that the two cases be retried separately, and setting the retrial date for Apple I case with jury selection to begin on September 26, 2016. The court also ordered that the issue of willfulness in both cases is bifurcated and that the Apple II will be retried after Apple I case.

The jury trial in this case was held on September 26, 2016. On September 30, 2016, a Jury in the United States Court for the Eastern District of Texas, Tyler Division, in the case VirnetX Inc., et al. v. Apple Inc., No. Apple I, has awarded VirnetX $302.4 million in a verdict against Apple Corporation for infringing four VirnetX patents, marking the third time a federal jury has found Apple liable for infringing VirnetX's patented technology.

The verdict includes royalties awarded to VirnetX, for unresolved issues in the Apple I case, remanded back from the USCAFC, related to (1) damages owed to VirnetX for infringement by Apple's original VPN-on-Demand (VOD) and (2) the alleged infringement by Apple's original FaceTime product, under the new claim construction of "secure communication link" pertaining to the '504 and '211 patents by the USCAFC, and the damages associated with that infringement. The court has scheduled a hearing on the issue of willfulness in this case on October 14, 2016. Both parties are in the process of briefing the court on their post-trial motions and pleading.

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

On November 6, 2012, we filed a new complaint against Apple 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 an unspecified amount of 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 was held on May 20, 2014 and on August 8, 2014, issued its Markman Order, denying Apple's motion for summary judgment of indefiniteness, in which Apple alleged that some of the disputed claims terms in the patents asserted by us were invalid for indefiniteness. In a separate order, the court granted in part and denied in part our motion for partial summary judgment on Apple's invalidity counterclaims, precluding Apple from asserting invalidity as a defense against infringement of the claims that were tried before a jury in our prior litigation against Apple (VirnetX vs. Cisco et. al., Case 6:10-CV-00417-LED). The jury trial in this case was scheduled for October 13, 2015. On March 30, 2015, the court issued an order finding substantial overlap between this case and the remanded portions of Case 6:10-CV-00417-LED (VirnetX vs. Cisco et. al.). The court consolidated the two civil actions under Civil Action Case 6:12-CV-00855-LED (VirnetX Inc. v. Apple, Inc.) and designated it as the lead case. On July 29, 2016, the court issued a new order, vacating its previous orders consolidating the cases Apple I case and Apple II case, ordering that the two cases be retried separately, and setting the retrial date for Apple I case with jury selection to begin on September 26, 2016. The court also ordered that the issue of willfulness in both cases is bifurcated and that the Apple II will be retried after Apple I case. We are awaiting court order setting the date for a new jury trial in Apple II case.

VirnetX Inc. v. Apple, Inc. (Case 15-1934)

On July 10, 2015, we filed appeals with the USCAFC, appealing the invalidity findings by the United States Patent and Trademark Office, Patent Trial and Appeal Board ("PTAB") in IPR2014-00237 and IPR2014-00238, related to U.S. Patent Nos. 8,504,697. The oral arguments in this case are scheduled for November 7, 2016.

VirnetX Inc. v. Apple, Inc. (Case 16-1211)

On September 28, 2015, we filed appeals with the USCAFC, appealing the invalidity findings by the PTAB in IPR2014-00403 and IPR2014-00404 and on October 22, 2015 for IPR2014-00481 and IPR2014-00482 involving our U.S. Patent Nos. 7,188,180, and 7,987,274. The oral arguments in this case are scheduled for November 7, 2016.

VirnetX Inc. v. Apple, Inc. (Case 16-1460)

On November 30, 2015, we filed appeals with the USCAFC, appealing the invalidity findings by the PTAB in *inter-partes* reexamination no. 95/001,949 related to U.S. Patent No. 8,051,181. The oral arguments in this case are scheduled for November 7, 2016.

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 1A — RISK FACTORS

You should carefully consider the following material risks in addition to the other information set forth in this Quarterly Report on Form 10-Q, as well as our Annual Form 10-K filed March 15, 2016 before making any investment in our common stock. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently believe to be immaterial may also adversely affect our business. If any of these risk factors occurs, you could lose substantial value or your entire investment in our shares.

Risks Related to Our Business and Our Financial Reporting

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

We spend a significant amount of our financial and management resources to pursue our current litigation. We believe that this litigation and others that we may in the future determine to pursue could continue for years and continue to consume significant financial and management resources. The counterpart to our litigation is a large, well-financed company 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, they may be inconsistent with the ultimate resolution of the dispute. Also, we cannot assure you that we will not be exposed to claims or sanctions which may be costly or impossible for us to defend. Unfavorable or adverse outcomes may result in losses, exhaustion of financial resources or other adverse effects, which could encumber our ability to develop and commercialize our products.

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

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

- 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, or if we are successful in entering into such relationships, the acquisition of them may be expensive, and they, as well as our existing settlement and license agreements may not generate the financial results we expect;
- Third parties may challenge the validity of our patents;
- The pendency of our various litigations may cause potential licensees not to do business with us;
- We face, and we expect to continue to face, intense competition from new and established competitors who may have superior products and services or better marketing, financial or other capacities than we do; and
- It is possible that one or more of our potential customers or licensees develops or otherwise sources products or technologies similar to, competitive with or superior to ours.

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

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

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

At the request of the European Telecommunications Standards Institute ("ETSI"), and the Alliance for Telecommunications Industry Solutions ("ATIS"), we agreed to update our licensing declaration to ETSI and ATIS under their respective Intellectual Property Rights ("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 us that are or become essential, to applicants desiring to implement the Technical Specifications identified by us, as set forth in the updated licensing declaration under the ATIS and ETSI IPR policies. 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 us on reasonable terms or at all, which could have an adverse effect on our business and harm our competitive position.

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

The current regulatory environment for our products and services remains unclear. We can give no assurance that our planned product offerings will be in compliance with laws and regulations of local, state, United States federal or foreign authorities. Further, we can give no assurance that we will not unintentionally violate such laws or regulations or that such laws or regulations will not be modified, or that new laws or regulations will be enacted in the future which would cause us to be in violation of such laws or regulations. For example, Voice-over-Internet Protocol ("VoIP") services are not currently subject to all 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 to us which could adversely affect the marketability of our products and planned products related to VoIP. For further example, the use of the Internet and private Internet Protocol ("IP") networks for communication is largely unregulated within the United States, but may become regulated in the future; 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. A decline in the use of these applications due to complexity or cost of these applications relative to alternate traditional or newly developed communications channels, or development of alternative technologies, could cause a material decline in the number of users in these areas.

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

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

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

- New legislation, regulations or rules related to obtaining patents or enforcing patents could significantly increase our operating costs and decrease our revenue. For instance, the United States Supreme Court has 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 United States 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.

- As patent enforcement becomes more prevalent, it may become more difficult for us to voluntarily license our patents.

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.

A security breach could require a substantial level of financial resources 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 factors, including but not limited to:

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

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

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

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

We recently launched our first commercial product, the GABRIEL Collaboration Suite. As such, we have a small technical team, which limits our ability to rapidly adapt our product to customer requirements or add new product features to maintain our competitive edge and drive adoption. Based on the scale of our technical resources, our limited historical financial data upon which to base our projected revenue or planned operating expenses related to our GABRIEL Collaboration Suite, we may not be able to effectively:

- generate revenues or profit from product sales;
- drive adoption of our products;
- attract and retain customers for our products;
- provide appropriate levels of customer training and support for our products;
- implement an effective marketing strategy to promote awareness of our products;
- focus our research and development efforts in areas that generate returns on our efforts;
- anticipate and adapt to changes in our market; or
- protect our products from any system failures or other breaches.

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

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

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

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

Our business will depend upon, among other things, the capacity, reliability 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 that the number of users of networks utilizing our current or future products suddenly increases, the technology platform and secure hosting services which will be required to accommodate a higher volume of traffic may result in slower response times or service interruptions. System interruptions or increases in response time could result in a loss of potential or existing users and, if sustained or repeated, could reduce the appeal of the networks to users. In addition, users depend on real-time communications; outages caused by increased traffic could result in delays and system failures. These types of occurrences could cause users to perceive that our solution does not function properly and could therefore adversely affect our ability to attract and retain licensees, strategic partners and customers.

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

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

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

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

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

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

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

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

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

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

Our success largely depends on the skills, experience and 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 engineering, operations, marketing, sales and executive personnel. Inability to attract and retain such personnel could adversely affect our business. Competition for engineering, operations, marketing, sales and executive personnel is intense, particularly in the technology and Internet sectors and in the regions where we conduct our business. We can provide no assurance that we will attract or retain such personnel.

We may identify future material weakness which may result in late filings, increased costs or declines in our share price.

Although we believe that we currently maintain effective control over our disclosures and procedures and internal control over financial reporting, we may in the future identify deficiencies regarding the design and effectiveness of our system of internal control over financial reporting. If we experience any material weaknesses in our internal control over financial reporting 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.

Risks Related to Our Stock

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.

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

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

The exercise of our outstanding vested stock options would dilute the ownership interests of our existing stockholders. As of September 30, 2016, we had outstanding options to purchase an aggregate of 5,378,571 shares of common stock representing 9.49% of our total shares outstanding of which 4,357,246 were vested and therefore exercisable. To the extent outstanding stock options are exercised, additional shares of common stock will be issued, existing stockholders' percentage voting interests will decline and the number of shares eligible for resale in the public market will increase. Such increase may have a negative effect on the value or market trading price of our common stock.

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. Over the past years the market price of our common stock has experienced significant fluctuations. Between July 1, 2015, and September 30, 2016, the reported last adjusted closing price on NYSE MKT for our common stock ranged between $2.29 and $4.36 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 derivative transactions related to our stock;
- actual or anticipated announcements of new products or services by us or competitors;
- general conditions in the markets in which we compete; and
- general social, political, economic and financial conditions

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

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 $26.9 million for the year ended December 31, 2012, a net loss of $27.6 million for the year ended December 31, 2013, a net loss of $9.9 million for the year ended December 31, 2014 and a net loss of $29.2 million for the year ended December 31, 2015 and a net loss $21.3 million for the period ended September 30, 2016, with an accumulated deficit of $151.0 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 September 30, 2016, our executive officers and directors beneficially owned approximately 19% of our outstanding common stock. In addition, a group of stockholders that, as of December 31, 2007, held 4,766,666 shares, or approximately 8.4% 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.

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 6 —EXHIBITS.

Exhibit Number	Description
31.1	Certification of the President and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of the President and Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Interactive Data Files

* This exhibit is furnished herewith, but not deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under that section. Such certifications will not be deemed to be incorporated by reference in any filing under the Securities Act or the Exchange Act, except to the extent that we explicitly incorporate them by reference.

SIGNATURES

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

VIRNETX HOLDING CORPORATION

By: /s/ Kendall Larsen

Name Kendall Larsen

Title Chief Executive Officer (Principal Executive Officer)

By: /s/ Richard H. Nance

Name Richard H. Nance

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

Date: November 09, 2016

EXHIBIT INDEX

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EXHIBIT 31.1

CERTIFICATIONS

I, Kendall Larsen, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of VirnetX Holding Corporation for the quarter ended September 30, 2016;

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: November 09, 2016

EXHIBIT 31.2

CERTIFICATIONS

I, Richard H. Nance, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of VirnetX Holding Corporation for the quarter ended September 30, 2016;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15 (e) and 15d-15 (e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15 (f) and 15d-15 (f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Richard H. Nance

Richard H. Nance
Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)

Date: November 09, 2016

EXHIBIT 32.1

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

In connection with the Quarterly Report of VirnetX Holding Corporation (the "Company") on Form 10-Q for the quarter ended September 30, 2016 as filed with the Securities and Exchange Commission on November 09, 2016 (the "Report"), I, Kendall Larsen, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Kendall Larsen

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

Date: November 09, 2016

EXHIBIT 32.2

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

In connection with the Quarterly Report of VirnetX Holding Corporation (the "Company") on Form 10-Q for the quarter ended September 30, 2016 as filed with the Securities and Exchange Commission on November 09, 2016 (the "Report"), I, Richard H. Nance, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Richard H. Nance

Richard H. Nance
Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)

Date: November 09, 2016