

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2011

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number: 001-33852

**VirnetX Holding Corporation**

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

77-0390628

(I.R.S. Employer Identification Number)

308 Dorla Court, Suite 206

Zephyr Cove, Nevada

(Address of principal executive offices)

89448

(Zip Code)

Registrant's telephone number, including area code: 775-548-1785

Former name, former address and former fiscal year, if changed since last report:

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

**Title of Class**

**Name of Exchange on Which Registered**

Common Stock, par value \$0.0001 per share

NYSE Amex Stock Exchange

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

None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2011, was \$1,173,043,513 based upon the closing price of the common shares of the Registrant on June 30, 2011. This calculation does not reflect a determination that certain persons are affiliates of the Registrant for any other purpose.

50,671,136 shares of Registrant's Common Stock were outstanding as of February 22, 2012.

**DOCUMENTS INCORPORATED BY REFERENCE**

Certain portions of this Annual Report on Form 10-K incorporate by reference information from the Registrant's Proxy Statement to be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2011 in connection with the solicitation of proxies for the Registrant's 2012 Annual Meeting of Stockholders.

VirnetX Holding Corporation

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## WARNING CONCERNING FORWARD LOOKING STATEMENTS

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

- THE DESCRIPTION OF OUR BUSINESS INCLUDES A STATEMENT THAT WE INTEND TO MARKET OUR GABRIEL CONNECTION TECHNOLOGY™. AN IMPLICATION OF THIS STATEMENT MAY BE THAT WE WILL BE ABLE TO SUCCESSFULLY MARKET THIS TECHNOLOGY AND THAT IT WILL GENERATE REVENUE IN THE FUTURE. IN FACT, THERE ARE MANY FACTORS WHICH WILL IMPACT THE SUCCESS OF THIS TECHNOLOGY FOR US, INCLUDING SEVERAL FACTORS WHICH ARE BEYOND OUR CONTROL, SUCH AS THE DEMAND FOR THIS TECHNOLOGY BY POTENTIAL CUSTOMERS AND THE LEVEL OF COMPETITION IN OUR BUSINESS.
- THE DESCRIPTION OF OUR BUSINESS INCLUDES STATEMENTS RELATING TO OUR INTENT TO ESTABLISH A SECURE DOMAIN NAME REGISTRY IN THE U.S. AND OTHER PARTS OF THE WORLD AND THAT WE ARE CONSIDERING MAKING APPLICATIONS TO BECOME ACCREDITED TO DO SO UNDER AUTHORITY OF THE U.S. GOVERNMENT. THE IMPLICATION OF THOSE STATEMENTS MAY BE THAT WE WILL BE ABLE TO ESTABLISH A REGISTRY THAT WILL HAVE MARKET ACCEPTANCE AND THAT IT WILL GENERATE REVENUE FOR US IN THE FUTURE. THERE ARE MANY FACTORS WHICH WILL IMPACT OUR ABILITY TO SUCCESSFULLY ESTABLISH A DOMAIN NAME REGISTRY, INCLUDING SEVERAL FACTORS WHICH ARE BEYOND OUR CONTROL, SUCH AS THE ACCREDITATION APPLICATION PROCESS OR THE ACCEPTANCE OF OUR REGISTRY OVER OTHERS IN THE MARKET, PARTICULARLY IF WE DETERMINE TO ESTABLISH A REGISTRY WITHOUT ACCREDITATION.
- THE STATEMENTS THAT WE HAVE SUBMITTED A LICENSING DECLARATION TO THE 3<sup>RD</sup> GENERATION PARTNERSHIP, OR 3GPP, UPDATED SUCH DECLARATIONS AT THE REQUEST OF THE EUROPEAN TELECOMMUNICATIONS STANDARDS INSTITUTE, OR ETSI, AND THE ALLIANCE FOR TELECOMMUNICATIONS INDUSTRY SOLUTIONS, OR ATIS, AND THAT WE BELIEVE WE ARE POSITIONED TO LICENSE OUR PATENTS TO 3GPP MEMBERS DESIRING TO IMPLEMENT THE TECHNICAL SPECIFICATIONS IDENTIFIED BY US, MAY IMPLY THAT THE PATENTS WE HAVE IDENTIFIED TO 3GPP WILL GENERATE LICENSING REVENUE FOR US IN THE FUTURE. WE CANNOT ASSURE YOU THAT WE WILL BE SUCCESSFUL IN LICENSING OUR PATENTS OR THAT THIRD PARTIES WILL BE WILLING TO ENTER INTO LICENSES WITH US ON REASONABLE TERMS OR AT ALL.
- OUR STATEMENT THAT WE BELIEVE WE HAVE THE FINANCIAL AND OTHER RESOURCES TO COMPLETE OUR BUSINESS PLAN MAY IMPLY THAT OUR RESOURCES WILL BE SUFFICIENT TO COMPLETE THAT PLAN SUCCESSFULLY. HOWEVER, WE MAY NOT BE ABLE TO SUCCESSFULLY IMPLEMENT OUR BUSINESS PLAN FOR MANY REASONS, INCLUDING MANY REASONS THAT ARE BEYOND OUR CONTROL, SUCH AS THE POSSIBILITY THAT OUR FINANCIAL RESOURCES BECOME EXHAUSTED DUE TO INCREASED COSTS ASSOCIATED WITH OUR ATTEMPTS TO COMPETE WITH OTHERS WHO MAY HAVE GREATER RESOURCES, OR DUE TO OUR OTHER ACTIVITIES, INCLUDING OUR LITIGATION ACTIVITIES.
- STATEMENTS DESCRIBING OUR CONTINUED LITIGATION EFFORTS MAY IMPLY THAT WE WILL PREVAIL IN SOME OR ALL OF OUR LITIGATION. HOWEVER, WE CANNOT ASSURE YOU WE WILL PREVAIL IN OUR PENDING LITIGATION MATTERS AND ANY ADVERSE RULING MAY HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS. ALSO, THE LEGAL AND OTHER COSTS WE MAY INCUR IN CONNECTION WITH LITIGATION MATTERS WILL DEPEND, IN PART, UPON ACTIONS TAKEN BY OTHER PARTIES, WHICH ACTIONS ARE NOT WITHIN OUR CONTROL AND THESE COSTS MAY HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS.
- OUR REFERENCES TO THE FACTS THAT OUR CORE DEVELOPMENT TEAM HAS SPENT OVER TEN YEARS WORKING TOGETHER, AND HAS HAD PRIOR SUCCESS AT SAIC MAY IMPLY THAT OUR TEAM WILL BE SUCCESSFUL IN THE FUTURE. HOWEVER, THIS TEAM MAY NOT BE SUCCESSFUL FOR MANY REASONS, INCLUDING MANY REASONS THAT ARE BEYOND OUR CONTROL, SUCH AS THE POSSIBILITY THAT ONE OR MORE KEY MEMBERS OF THE TEAM BECOMES INCAPACITATED, OR THAT COMPETITORS ARE SUCCESSFUL IN DEVELOPING SUPERIOR PRODUCTS.
- OUR STATEMENT WITH RESPECT TO OUR INTENT TO MARKET AND SELL LICENSE AND SERVICES TO OTHERS MAY IMPLY THAT OUR PLANS TO DO SO ARE IMMINENT OR WILL BE SUCCESSFUL. HOWEVER, MARKETING AND SELLING OUR PRODUCT AND SERVICES WHILE SIMULTANEOUSLY PURSUING OUR LITIGATION AND OUR FURTHER DEVELOPMENT ACTIVITIES CAN PRESENT SIGNIFICANT CHALLENGES. OUR MARKETING AND SALES PLANS MAY TAKE LONGER TO IMPLEMENT THAN WE NOW EXPECT, MAY NOT BE IMPLEMENTED, OR MAY FAIL.

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

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

[\*Index\*](#)

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

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

YOU SHOULD NOT PLACE UNDUE RELIANCE UPON FORWARD LOOKING STATEMENTS.

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

## PART I

### Item 1. *Business.*

#### The Company

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

Our portfolio of intellectual property is the foundation of our business model. We currently own 20 patents in the United States and 26 foreign patents, as well as several pending U.S. and foreign patent applications. Our patent portfolio is primarily focused on securing real-time communications over the Internet, as well as related services such as the establishment and maintenance of a secure domain name registry. Our patented methods also have additional applications in operating systems and network security. On December 1, 2009, we submitted a licensing declaration to the 3rd Generation Partnership Project, or 3GPP, identifying those of our U.S. and international patents which may be relevant to Long Term Evolution, or LTE. On March 14, 2011, we supplemented our licensing declaration to include five additional specifications. On April 28, 2011, at the request of the European Telecommunications Standards Institute, or ETSI, we agreed to update our licensing declaration to ETSI under ETSI's Intellectual Property Rights or IPR policy. We agreed with ETSI that we will 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, as set forth in the updated licensing declaration under ETSI's IPR policy. On June 17, 2011, in response to a request from the Alliance for Telecommunications Industry Solutions, or ATIS, the North American Organizational Partner for 3GPP, we also agreed to make available a non-exclusive patent license to 3GPP members desiring to implement the technical specifications identified by us, as set forth in the updated licensing declaration under ATIS' IPR policy. We believe that we are positioned to license our essential security patents to 3GPP members as they move into 4G.

We intend to license our patent portfolio, technology and software, including our secure domain name registry service, to domain infrastructure providers, communication service providers as well as to system integrators. We 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 wireless networks. We also believe that all 4G mobile devices will require unique secure domain names and become part of a secure domain name registry.

Our software and technology solutions provide the security platform required by next-generation Internet-based applications such as instant messaging, or IM, voice over Internet protocol, or VoIP, mobile services, streaming video, file transfer and remote desktop. 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.

Microsoft Corporation is our first licensee and has been granted a worldwide, irrevocable, nonexclusive, non-sublicenseable fully paid up license of our patents for Microsoft products. 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 Science Application International Corporation, or SAIC. SAIC is a FORTUNE 500® scientific, engineering and technology applications company that uses its deep domain knowledge to solve problems of vital importance to the nation and the world, in national security, energy and the environment, critical infrastructure and health. The team has continued its research and development work started at SAIC and expanded the set of patents we acquired in 2006 from SAIC into a larger portfolio with 46 issued U.S. and foreign patents and numerous pending U.S. and foreign patents applications. This portfolio now serves as the foundation of our licensing business and planned service offerings and is expected to generate the majority of our future revenue in license fees and royalties. We intend to continue our research and development efforts to further strengthen and expand our patent portfolio. Please see Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Operations – Research and Development Expenses for a description of our research and development expenses for the past three fiscal years.

We intend to continue using an outsourced and leveraged model to maintain efficiency and manage costs as we grow our licensing business by 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.

In 2011, we moved our corporate headquarters from California to Nevada.

#### Industry Overview

We believe that the Internet is an evolving, rich and complex medium used by individuals and businesses to conduct commerce, share information and engage in real-time communications including email, text messaging, IM, and voice and video calls. We believe that users have grown accustomed to having broadband access wherever they go, and not just at home or in the office. Users can browse the Internet or send e-mails using their mobile broadband enabled notebooks, replace their fixed DSL modems with mobile broadband modems or other devices, and send and receive video or music using 3G phones. We believe that Long Term Evolution, or LTE, will further advance a transition from the cellular 3G services to an all internet packet, or “IP”, based network that can provide mobile data access speeds closer to fixed DSL speeds and allow for more bandwidth intensive applications like interactive TV, mobile video blogging, advanced games or professional services. Session initiation protocol, or SIP, was developed to enable the convergence of voice and data networks and today is the predominant industry standard for establishing multimedia communications over the Internet such as voice, video, instant messaging, presence information and file transfer. SIP, XMPP and other real-time collaboration protocols use DNS lookup as the primary means of connecting Internet devices. However, because these protocols use “open architecture”, we believe that they are inherently insecure.

We also believe that many enterprises have concluded that security provided to communication by way of an optional add-on solution is less secure than

security that can be provided by upgrading core information technology, or "IT", infrastructure (systems, networks, and management) with integrated security. We believe that, because of the complexity of today's networks and the requirement to connect users from any location at any time on any device, enterprises are reevaluating numerous parts of their technology systems, including but not limited to software solutions for smartphones, routers and switches with integrated security, massive security appliances for data centers, cloud-based security services and security solutions for virtualized environments and public and private clouds. The portions of the IP-telephony, mobility, fixed-mobile convergence and unified communications markets that could benefit from our software and technology solutions are forecasted by Infonetics and our internal estimates to grow from approximately \$128 billion of worldwide revenues in 2010 to approximately \$226 billion by 2015, representing a compound annual growth rate, or CAGR, of approximately 12%. We believe that this growing trend represents a significant opportunity for us to license our technology and software, and establish our secure domain name registry.

We also believe that various enterprises have concluded that optional add-on solution, and enterprises everywhere are currently upgrading core IT infrastructure (systems, networks, and management) to integrate security into everything. Because of the complexity of today's networks, and the requirement to connect users from any location at any time on any device, enterprise IT is having to reevaluate everything from software solutions for smartphones to routers and switches with integrated security, massive security appliances for data centers, cloud-based security services, and security solutions for virtualized environments and public and private clouds. The portions of the IP-telephony, mobility, fixed-mobile convergence and unified communications markets that could benefit from our software and technology solutions are forecasted by Infonetics and our internal estimates to grow from approximately \$128 billion of worldwide revenues in 2010 to approximately \$226 billion by 2015, representing a compound annual growth rate, or CAGR, of approximately 12%. We believe that this growing trend represents a significant opportunity for VimetX to license its technology and software, and establish its secure domain name registry.

#### ***IP Telephony – VoIP, Telepresence and Video Conferencing***

IP telephony includes technologies that use Internet Protocol's packet-switched connections to exchange voice, fax, and other forms of information traditionally carried over the dedicated circuit-switched connections of the public switched telephone network, or PSTN. The adoption of IP telephony has helped businesses significantly lower network operating costs by using a common network for voice and data. As the workforce becomes increasingly dispersed, mobile features enabled by Internet protocol-based communications such as presence, unified messaging, peer-to-peer applications, find me/follow me, white-boarding and document sharing have become more commonplace. However, the development of the related security infrastructure has lagged behind, leaving next-generation networks vulnerable to a multitude of threats including man-in-middle, eavesdropping, domain hijacking, distributed denial of service, or DDoS, spam over Internet telephony, or SPIT, and spam over instant messaging, or SPIM. These threats continue to highlight the need for securing next-generation networks. As the use of IP telephony systems extends beyond the boundaries of an organization's private network, security is likely to become an even bigger concern. Worldwide revenue from IP telephony products like IP-PBX including IP phones, service provider VoIP and IMS equipment, VoIP gateways, Enterprise Telepresence and Video Conferencing for businesses is forecasted by Infonetics and our internal estimates to grow from approximately \$30 billion in 2010 to approximately \$59 billion in 2015, representing a CAGR of approximately 15%. We believe our unique and patented solution provides the robust security platform required for providing on-demand secure communication links between enterprises intending to communicate securely without manually configuring the connections. We believe a standard security solution such as ours will further accelerate the adoption of IP telephony products in the market and allow enterprises to take full advantage of these rich content applications and real-time communications over the Internet, thereby significantly increasing their return on investment.

#### ***Unified Communications***

We believe that the need to enhance productivity is rapidly increasing demand for the management of and instant access to real-time information. We believe that mobile collaboration, instant Internet access and the ability to conduct business whether inside or outside of the office, are high priorities. We also believe that the ability to establish multiple secure simultaneous network connections and provide IP sessions with security and encryption will be critical to widespread deployment of next-generation networks. However, one possible shortcoming of this new communications environment is that the various modes of communication operate independently from one another and do not integrate easily, if at all. We believe that the number of individual points of contact in these environments will grow and that as a result, communication will become more sophisticated and increasingly vulnerable.

An array of communication methodologies integrated into a single communications experience is often referred to as unified communications. We believe that unified communications have higher utility and can increase productivity for users. The basic components of unified communications include: a directory for storing addresses, various modes of communication with each user/contact (desk phone, mobile phone, IM, etc.), message storage for all messages regardless of communication method and secure presence of a user's status for each mode of communication (available, away, busy, etc.). Worldwide unified communications market generated approximately \$462 million in revenue in 2010 and is forecasted to grow rapidly over the next few years generating approximately \$1.04 billion in revenue in 2015, representing a CAGR of approximately 11%. We believe the growth in unified communication products may not reach its full potential due to the lack of transparent and seamless security as users hesitate to place their presence information online for all to see and as organizations block access due to the lack of credentials verified by a neutral third party. We believe that our solutions help address these concerns and should enable significant growth in the unified communications market.

#### ***IP Mobility-LTE, Fixed-Mobile Convergence***

We believe that telecommunication markets are rapidly changing and presenting new challenges to the equipment and service providers, including but not limited to increasing user demand for mobile, always-on connections with multiple devices. We also believe that traffic growth, video acceleration, cloud services and a rapidly growing number of subscribers challenge currently available network architectures and that, because of this, service providers and carriers will eventually use a single network for fixed and mobile communications, private/premium communications and Internet access, in spite of the difficulties involved challenging their business models and forcing the consideration of new network architectures. We believe that LTE technology will deliver users the benefits of faster data speeds and new services by creating a new radio access technology that's optimized for IP-based traffic and offers operators a simple upgrade path from 3G networks. Smartphones are multi-functional devices that handle a wide variety of business-critical applications and support increasingly complex functions including enhanced data processing, Internet access, e-mail access, calendars and scheduling, contact management and the ability to view electronic documents. Users have continual access to these applications while on the move making them an increasingly essential business tool for the mobile worker. These devices enable mobile workers to have similar functionality inside or outside the office thereby increasing employee efficiency. However, it is critical that this mobile environment have the same level of security as an enterprise's internal network. Fixed-mobile convergence is an environment where wired and wireless phones work together with Internet Protocol to deliver services (voice, video, data and combinations thereof) uniformly across multiple access networks, including, among others, WiMAX, WiFi cellular and fixed. Worldwide revenue from IP mobility products like smartphones and mobile data cards, femtocell equipment, rich communication devices and services is expected to grow from approximately \$98 billion in 2010 to approximately \$166 billion by 2015, representing a CAGR of approximately 11%. We believe in order to realize the full functionality of IP mobility, several challenges including security must be overcome. When users are mobile, connections and data need to cross multiple network boundaries, each of which poses a security threat. Wireless networks may be threatened or compromised by rogue users who enter through (insecure wireless access points. We believe that providing authenticated access to the wireless networks and enterprise applications through the wireless domain are important requirements and represent a significant market opportunity for our patented technology and secure domain names to provide users fully authenticated secure access on a "zero-click" or "single-click" basis.

## Our Solutions

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

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

## Competitive Strengths

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

- **Unique patented technology.** We are focused on developing innovative technology for securing real-time communications over the Internet, and establishing the exclusive secure domain name registry in the United States and other key markets around the world. Our unique solutions combine industry standard encryption methods and communication protocols with our patented techniques for automated DNS lookup mechanisms. Our technology and patented approach enables users to create a secure communication link by generating secure domain names. We have a portfolio comprised of twenty (20) patents in the United States and twenty-six (26) foreign patents, as well as several pending U.S. and foreign patent applications. Our portfolio includes patents and pending patent applications in the United States and other key markets that support our secure domain name registry service for the Internet.
- **Scalable licensing business model.** We are actively engaged in pursuing licensing agreements with OEMs, service providers and system integrators within the IP-telephony, mobility, fixed-mobile convergence and unified communications end-markets.
- **Highly experienced research and development team.** Our research and development team is comprised of nationally recognized network security and encryption technology scientists and experts that have worked together as a team for over ten years. During their careers, this team has developed several cutting-edge technologies for U.S. national defense, intelligence and civilian agencies, many of which remain critical to our national security today. Prior to joining VimetX, our team worked for SAIC during which time they invented the technology that is the foundation of our technology, and software. Based on the collective knowledge and experience of our development team, we believe that we have one of the most experienced and sophisticated groups of security experts researching vulnerability and threats to real-time communication over the Internet and developing solutions to mitigate these problems.

## Our Strategy

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

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

On December 2, 2009, we submitted a licensing declaration to the 3rd Generation Partnership Project, or 3GPP, identifying those of our U.S. and international patents which may be relevant to Long Term Evolution, or LTE. On March 14, 2011, we supplemented our licensing declaration to include five additional specifications. On April 28, 2011, at the request of the European Telecommunications Standards Institute, or ETSI, we agreed to update our licensing declaration to ETSI under ETSI's Intellectual Property Rights (IPR) policy. We agreed with ETSI that we will 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, as set forth in the updated licensing declaration under ETSI's IPR policy. On June 17, 2011, in response to a request from the Alliance for Telecommunications Industry Solutions, or ATIS, the North American Organizational Partner for 3GPP, we also agreed to make available a non-exclusive patent license to 3GPP members desiring to implement the Technical Specifications identified by us, as set forth in the updated licensing declaration under ATIS' IPR policy. We believe that we are positioned to license our essential security patents to 3GPP members as they move into 4G. We believe that we hold the patents relevant to compliance with the 3GPP Series 33 specifications that define security requirements for LTE/4G networks.



## License and Service Offerings

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

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

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

## Customers

Our primary source of income since inception has been from the Settlement and License Agreement we entered into with Microsoft Corporation, our first licensee, on May 14, 2010, or the Settlement and License Agreement. Pursuant to the Settlement and License Agreement, Microsoft paid us \$200,000,000 in June 2010, which has been classified as gain on settlement. As a consequence, we dismissed the two patent infringement lawsuits we initiated against Microsoft in February 2007 and March 2010 and granted Microsoft a worldwide, irrevocable, nonexclusive, non-sub licensable fully paid up license under our patents. The Settlement and License Agreement with Microsoft will not impact our plans to operate a secure domain name service.

We are currently focused on commercializing our technology and are actively offering our GABRIEL Connection Technology™ to original equipment manufacturers, or OEMs, within the IP-telephony, mobility, fixed-mobile convergence and unified communications markets.

We also intend to provide technology licenses and software offerings, including our secure domain name registry service, to communication service providers as well as to system integrators.

## Marketing and Sales

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

We plan to directly market our domain name registry services to our service provider and system integrator customers. We hope to leverage our relationship with SAIC to extend our offering to departments and agencies within the federal government. SAIC is a FORTUNE 500® scientific, engineering and technology applications company that uses its deep domain knowledge to solve problems of vital importance to the nation and the world, in national security, energy and the environment, critical infrastructure, and health. We intend to build a sales force that will be responsible for managing accounts and pursuing technology licensing and sales opportunities with new customers.

## Competition

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

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

## Intellectual Property and Patent Rights

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

We have a portfolio comprised of twenty (20) patents in the United States and twenty six (26) foreign patents, as well as several pending U.S. and foreign patent applications. Our portfolio includes a number of patents that describe unique systems and methods for securing real-time communications over the Internet, as well as related services such as the establishment and maintenance of a secure domain name registry. Our software and technology solutions also have additional applications relating to operating systems and network security.

We have included a list of our U.S. patents below. Each patent below is publicly accessible on the Internet website of the U.S. Patent and Trademark Office at [www.uspto.gov](http://www.uspto.gov). The term of each of our issued U.S. and foreign patents will expire during the period from 2019 to 2024.

U.S. Patent Number	Link to Patent	Title of Patent
6,502,135		Agile network protocol for secure communications with assured system availability
6,618,761		Agile network protocol for secure communications with assured system availability
6,826,616		Method for establishing secure communication link between computers of virtual private network
6,834,310		Preventing packet flooding of a computer on a computer network
6,839,759		Method for establishing secure communication link between computers of virtual private network without user entering any cryptographic information
6,907,473		Agile network protocol for secure communications with assured system availability
7,010,604		Agile network protocol for secure communications with assured system availability
7,133,930		Agile network protocol for secure communications with assured system availability
7,188,180		Method for establishing secure communication link between computers of virtual private network
7,209,479		Third party VPN certification
7,418,504		Agile network protocol for secure communications using secure domain names
7,490,151		Establishment of a secure communication link based on a domain name service (DNS) request
7,921,211		Agile network protocol for secure communications using secure domain names
7,933,990		Agile network protocol for secure communications with assured system availability
7,945,654		Agile network protocol for secure communications using secure domain names
7,944,915		Third party VPN certification
7,897,274		Method for establishing secure communication link between computers of virtual private network
7,986,688		Third party VPN certification
7,996,539		Agile network protocol for secure communications with assured system availability
8,051,181		Method for establishing secure communication link between computers of virtual private network



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

#### **Assignment of Patents**

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

Key terms of these agreements are as follows:

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

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

*Compensation Obligations.* As consideration for the assignment of the patents and for the rights we obtained from SAIC as amended, we are required to make payments to SAIC based on cash or certain other values generated from those patents. The amount of such payments depends upon the type of value generated, and certain categories are subject to maximums and other limitations. As of June 30, 2010, we met our maximum royalty payment requirement; however, SAIC is also entitled under certain circumstances to receive a portion of the proceeds paid to us for certain acquisitions of VimetX, from the settlement of certain patent infringement claims of ours.

#### **Government Regulation**

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

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

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

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

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

#### **Employees**

As of December 31, 2011, we had 13 full-time employees.

## **Corporate Overview and History**

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

## **Available Information**

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

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

## **Item 1A. Risk Factors.**

*You should carefully consider the following material risks in addition to the other information set forth in this Quarterly Report on Form 10-Q before making any investment in the offered securities. 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 Financial Reporting Obligations**

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

In early 2011, we restated our previously filed financial statements for the fiscal quarter ended September 30, 2010, each of the then previous five fiscal quarters and the fiscal year ended December 31, 2009, to adjust our accounting for our Series I Warrants. In connection with these restatements, we determined that we had not maintained effective control over our accounting for these Series I Warrants and, as a result, that a material weakness existed with respect to our reporting of complex, non-routine transactions as of the end of the periods covered by the Form 10-K and Form 10-Qs that included the financial statements referenced above. Although we believe that we currently maintain effective control over our disclosure controls and procedures and internal control over financial reporting as regards this issue, we may in the future identify deficiencies regarding the design and effectiveness of our system of internal control over financial reporting. In addition, we expect that we will continue to be required to provide a management report in our Form 10-K regarding our internal control over financial reporting and that our independent registered public accounting firm will continue to be required to attest to our internal control matters. 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.

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

We spend a significant amount of our financial and management resources to pursue our current litigation matters. We believe that these litigation matters and others that we may in the future determine to pursue could continue for years and continue to consume significant financial and management resources. The counterparties to our litigation are all large, well-financed companies with substantially greater resources than us. We cannot assure you that any of our current or future litigation matters will result in a favorable outcome for us. Also, we cannot assure you that we will not be exposed to claims or sanctions against us which may be costly or impossible for us to defend. Unfavorable or adverse outcomes may result in losses, exhaustion of financial resources or other adverse affect our ability to develop and commercialize products.

### **Risks Related to Our Business and Our Industry**

***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 on-going that may affect our ability to execute our current business strategy including, but are not limited to:

- Although we entered into a Settlement and License Agreement with Microsoft Corporation, we may not be successful in entering into further licensing relationships;
- Third parties may challenge the validity of certain of our patents;
- The pendency of our various litigations may cause potential licensees not to do business with us;
- We expect that we will face intense competition new and established competitors who may have superior products and services or better marketing, financial or other capacities than we do; and
- It is possible that one or more of our potential customers or licensees develops or otherwise sources products or technologies similar to, competitive with or superior to ours.

***If we are not able to adequately protect our patented 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, or otherwise materially and adversely affect our business. Similar challenges could also prevent us from obtaining additional patents in the future. Even if we are successful in enforcing our rights, our patents may not ultimately provide us with any competitive advantages and may be less valuable than we currently expect. These risks may be heightened in countries other than the U.S., and may be negatively affected by the fact that legal standards in the U.S. 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 U.S. 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 (IRP) 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 VimetX that are or become essential, to applicants desiring to implement the Technical Specifications identified by VimetX, as set forth in the updated licensing declaration under the ATIS and ETSI IPR policies. While we believe that our FRAND commitment positions us to license our essential security patents for the Technical Specifications identified by VimetX, 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 VimetX on reasonable terms or at all, which could have an adverse effect on our business and harm our competitive position.

***Because our business is conducted or expected to be conducted in an environment that is subject to rapid change, we may be subjected to various developments in regulation, law and consumer preferences that we may not be able to adapt to 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, U.S. 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, VoIP services are not currently subject to all of the same regulations that apply to traditional telephony, but it is possible that similar regulations may be applied to VoIP in the future and that these could result in substantial costs and adversely affect the marketability of our products and planned products related to VoIP. For further example, the use of the Internet and private 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 IM, VoIP, mobile services, streaming video, file transfer and remote desktop and other next-generation Internet-based applications which are relatively new. The Internet may ultimately prove not to be a viable commercial marketplace which could cease growth or cause material decline in the number of users in these areas due to complexity or cost of these applications relative to alternate traditional or newly developed communications channels.

More aggressive domestic or international regulation of the Internet in general, and Internet telephony providers and services specifically or a lack of growth in acceptance of the Internet as a long term viable marketplace for communications services may materially and adversely affect our business, financial condition, operating results and future prospects.

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

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

- New legislation, regulations or rules related to obtaining patents or enforcing patents could significantly increase our operating costs and decrease our revenue. . For instance, the U.S. Supreme Court has recently modified some tests used by the U.S. Patent and Trademark Office in granting patents during the past 20 years which may decrease the likelihood that we will be able to obtain patents and increase the likelihood of challenge of any patents we obtain or license. In addition, the U.S. recently enacted sweeping changes to the U.S. patent system under the Leahy-Smith America Invents Act (“AIA”), including changes that would transition the U.S. 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 amount of expense to rectify and could result in a product liability claim that causes us to incur substantial liability and related legal and other costs. A security breach may also harm our reputation and make it more difficult or impossible for us to successfully market to others. These matters could harm our operating results and financial condition.



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

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

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

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

We expect that in the future, a significant portion of our revenues will be generated from a limited number of customers. Substantially all of our income during 2010 was from the payments to us resulting from the Settlement and License Agreement we entered into with Microsoft. There can be no guarantee that we will be able to obtain additional customers, or if we do so, to sustain our revenue levels from these prospective customers. If we are not able to establish, maintain or replace the limited group of prospective customers that we anticipate may generate a substantial majority of our revenues in the future, or if they do not generate revenues at the levels or at the times that we anticipate, our ability to maintain or grow our revenues will be adversely affected.

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

Our products are highly technical and complex and, when deployed, 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 we cannot control.***

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

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

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

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

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

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

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

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

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

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

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

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

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

Our future success will depend in part on our ability to attract and retain qualified operations, marketing and sales personnel as well as engineers. Inability to attract and retain such personnel could adversely affect our business. Competition for engineering, sales, marketing and executive personnel is intense, particularly in the technology and Internet sectors and in the regions where our facilities are located. We can provide no assurance that we will attract or retain such personnel.

#### **Risks Related to Our Stock**

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

Although we paid a special cash dividend to holders of our common stock with a record date of July 1, 2010, we do not have any plans to pay regular dividends in the foreseeable future. Instead, we generally intend to retain future earnings to fund our business plan. Our future dividend policy is within the discretion of our Board of Directors and will depend upon various factors, including our business, financial condition, results of operations, capital requirements, and investment opportunities. Accordingly, stockholders must generally look to appreciation of our common stock to realize a gain on their investment. This appreciation may not occur.

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

The exercise of our outstanding vested stock options would dilute the ownership interests of our existing stockholders. As of December 31, 2011, we had outstanding options to purchase an aggregate of 4,906,998 shares of common stock (representing 9.7% of our total shares outstanding as of December 31, 2011) of which 3,965,140 are vested and therefore exercisable. To the extent outstanding stock options are exercised, additional shares of common stock will be issued, and such issuance would dilute non-exercising stockholders' percentage voting interests and increase the number of shares eligible for resale in the public market.

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

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

***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 Amex, but its daily trading volume has been limited, sporadic and volatile. Over the past years the market price of our common stock has experienced significant fluctuations. Between January 1, 2011, and December 31, 2011, the reported last sale price for our common stock ranged between \$11.53 and \$39.88 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;
- actual or anticipated announcements of new products or services by us or competitors;
- general conditions in the markets in which we compete; and
- economic and financial conditions.

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

Our reported net income has fluctuated in the past due to several factors. We expect that our future operating results may also fluctuate due to the same or similar factors. We had a net loss of \$12.5 million for the year ended December 31, 2009, a net income of \$41.4 million for the year ended December 31, 2010, and we have had a net loss of \$17.3 million for the year ended December 31, 2011. The following include some of the factors that may cause our operating results to fluctuate:

- the outcome of enforcement actions 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 outcome of actions we have taken and may take in the future to enforce our intellectual property rights;
- the rate of adoption of our patented technologies;
- the number of new license arrangements we may execute, or that may expire, within a particular period and the scope of those licenses, including the number of our patents which are licensed, the extent of prior infringement of our patent rights, royalty rates, timing of payment obligations, expiration date etc;
- the success of a licensee in selling products that use our patented technologies; and
- the amount and timing of expenses related to our patent filings and enforcement proceedings, including litigation, related to our intellectual property rights.

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

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

As of December 31, 2011, our executive officers and directors beneficially owned approximately 21% of our then outstanding common stock. In addition, a group of stockholders that, as of December 31, 2007, held 4,766,666 shares, or approximately 12%, of our then outstanding common stock, have entered into a voting agreement with us that requires them to vote all of their shares of our voting stock in favor of the director nominees approved by our Board of Directors at each director election going forward, and in a manner that is proportional to the votes cast by all other voting shares as to any other matters submitted to the stockholders for a vote. However, we cannot be certain how many shares of our common stock this group of stockholders currently owns. Because of their beneficial ownership interest, our officers and directors could significantly influence stockholder actions of which you disapprove or that are contrary to your interests. This ability to exercise significant influence could prevent or significantly delay another company from acquiring or merging with us.

***Our protective provisions could make it difficult for a third party to successfully acquire us even if you would like to sell your stock to them.***

We have a number of protective provisions that could delay, discourage or prevent a third party from acquiring control of us without the approval of our Board of Directors. Our protective provisions include:

- **A staggered Board of Directors:** This means that only one or two directors (since we have a five-person Board of Directors) will be up for election at any given annual meeting. This has the effect of delaying the ability of stockholders to effect a change in control of us because it would take two annual meetings to effectively replace a majority of the Board of Directors.
- **Blank check preferred stock:** Our Board of Directors has the authority to establish the rights, preferences and privileges of our 10,000,000 authorized, but unissued, shares of preferred stock. Therefore, this stock may be issued at the discretion of our Board of Directors with preferences over your shares of our common stock in a manner that is materially dilutive to you. In addition, blank check preferred stock can be used to create a "poison pill" which is designed to deter a hostile bidder from buying a controlling interest in our stock without the approval of our Board of Directors. We have not adopted such a "poison pill;" but our Board of Directors has the ability to do so in the future, very rapidly and without stockholder approval.
- **Advance notice requirements for director nominations and for new business to be brought up at stockholder meetings:** Stockholders wishing to submit director nominations or raise matters to a vote of the stockholders must provide notice to us within very specific date windows and in very specific form in order to have the matter voted on at a stockholder meeting. This has the effect of giving our Board of Directors and management more time to react to stockholder proposals generally and could also have the effect of disregarding a stockholder proposal or deferring it to a subsequent meeting to the extent such proposal is not raised properly.



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- **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 1B. Unresolved Staff Comments.**

Not applicable

**Item 2. Properties.**

Our principal executive offices are located at 308 Dorla Court, Suite 206, Zephyr Cove, Nevada 89448. We lease this property, which comprises approximately 2,090 square feet of office space, from a third party for a term that ends in 2013. We have no other properties and believe that our office facility is suitable and appropriately supports our current business needs. Until October 2011, our principal executive offices were located at 5615 Scotts Valley Drive, Suite 110, Scotts Valley, California 95066, which we leased for a term that was scheduled to end in 2012. In connection with the move of our corporate offices to Nevada, we terminated the Scotts Valley lease effective October 2011.

**Item 3. Legal Proceedings.**

On August 11, 2010, we initiated a lawsuit by filing a complaint against Aastra, Apple, Cisco, and NEC in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we allege that these parties infringe on certain of our patents. We seek damages and injunctive relief. On February 4, 2011, we amended our original complaint, filed on August 11, 2010, against Aastra, Apple, Cisco and NEC in the United States District Court for the Eastern District of Texas, Tyler Division, to assert U.S. Patent No. 7,418,504 against Apple and Aastra. On April 5, 2011, we again amended our complaint against Aastra, Apple, Cisco and NEC in the United States District Court for the Eastern District of Texas, Tyler Division, to include Apple's iPad 2 in the list of Apple products that are accused of infringing our patents. We also asserted our newly-issued patent, U.S. Patent No. 7,921,211 against all of the defendants in that lawsuit. A claim construction hearing was held on January 5, 2012 and a ruling is awaited. A jury trial is scheduled for November 13, 2012, in that lawsuit.

On January 12, 2011, we initiated a lawsuit by filing a complaint against Siemens and Mitel in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we allege that these companies infringe three of our patents. We seek damages and injunctive relief. On April 12, 2011 we again amended our complaint against Siemens and Mitel in the United States District Court for the Eastern District of Texas, Tyler Division, to add Avaya Inc. as a defendant.

A claim construction hearing date has been scheduled for July 12, 2011, and trial dates has been set for November 13, 2011, in that lawsuit.

On November 1, 2011, we initiated a new lawsuit against Apple in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we allege that Apple products infringe one or more claims of our U.S. Patent No. 8,051,181. We seek damages and injunctive relief. No hearing or trial dates have been set. On December 15, 2011, the court entered a stay of this matter pending the completion of ITC investigation.

On November 4, 2011, we filed a complaint with the United States International Trade Commission (ITC) alleging that Apple Inc has engaged in unfair trade practices by the importation, sale for importation, and sale after importation of certain devices with secure communication capabilities that infringe one or more claims of our U.S. Patent No. 8,051,181. The accused products include the latest iPhones, iPads, iPods and Macintosh computers. We have requested that the ITC institute an investigation into Apple's allegedly infringing imports and ultimately bar Apple from importing those Apple products or further selling the infringing Apple products that have already been imported. A 16 month target date of April 6, 2013, has been set in this Case A 5 day hearing in front of the Administrative Law Judge (AJL) is scheduled for September 5 through September 11, 2012.

One or more potential intellectual property infringement claims may also be available to us against certain other companies who have the resources to defend against any such claims. Although we believe these potential claims are worth pursuing, commencing a lawsuit can be expensive and time-consuming, and there is no assurance that we will prevail on such potential claims. In addition, bringing a lawsuit may lead to potential counterclaims which may preclude our ability to commercialize our initial products, which are currently in development.

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

**Item 4. Mine Safety Disclosure.**

Not applicable

**PART II**

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

**Market Information**

Our common stock currently trades under the symbol "VHC" on the NYSE Amex Stock Exchange. Common stock warrants that we issued in our January 2009 public offering that remain outstanding trade under the symbols "VHCOZ" and "VHCOL" on the OTC Bulletin Board.

The following table shows the price range of our common stock, as reported on the NYSE Amex Stock Exchange, for each quarter ended during the last three fiscal years.

<b>Quarter Ended</b>	<b>High</b>	<b>Low</b>
3/31/10	\$ 7.99	\$ 3.00
6/30/10	\$ 7.09	\$ 4.03
9/30/10	\$ 14.88	\$ 5.42
12/31/10	\$ 20.00	\$ 11.61
3/31/11	\$ 21.75	\$ 11.43
6/30/11	\$ 30.50	\$ 19.66
9/30/11	\$ 41.77	\$ 14.81
12/31/11	\$ 29.45	\$ 11.61

The closing price of our common stock on the NYSE Amex Stock Exchange on February 22, 2012 was \$23.61 per share.

**Holdings**

As of February 22, 2012, we had 49 stockholders of record. Because many of our shares of common stock are held of record by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of beneficial stockholders represented by such record holders.

**Dividends**

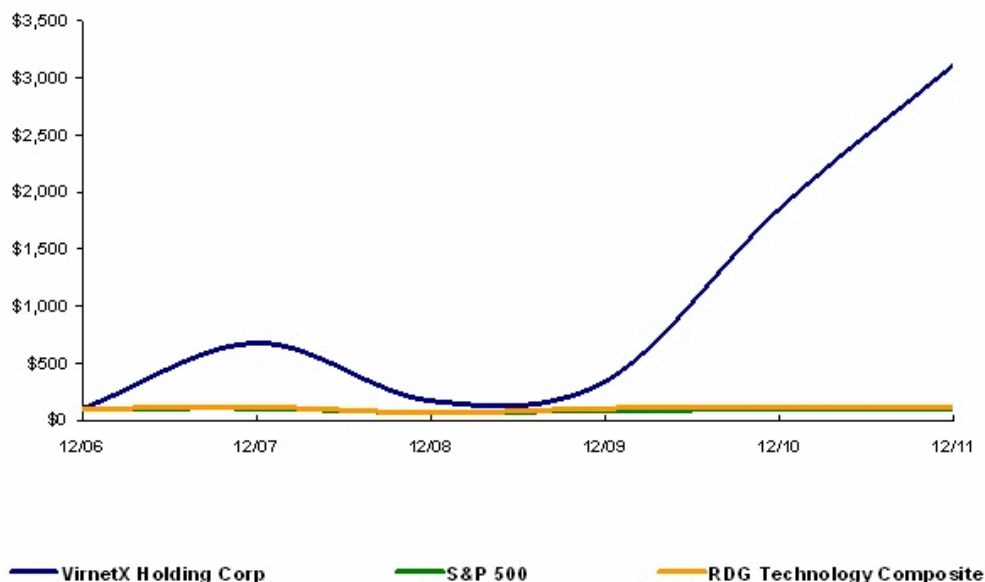
On June 15, 2010, the Company's Board of Directors declared a special cash dividend of \$0.50 per share of the Company's common stock to holders of record on July 1, 2010. We currently intend to retain all available funds and any future earnings to support the operation of and to finance the growth and development of our business. We do not anticipate paying any cash dividends in the foreseeable future. Any future determination to declare cash dividends will be made at the discretion of our board of directors and will depend on our financial condition, operating results, capital requirements, general business conditions and other factors that our board of directors may deem relevant.

**Performance Graph**

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

The following graph compares the cumulative 5-year total return attained by shareholders on VirnetX Holding Corp's common stock relative to the cumulative total returns of the S&P 500 index and the RDG Technology Composite index. An investment of \$100 (with reinvestment of all dividends) is assumed to have been made in our common stock and in each of the indexes on 12/31/2006 and its relative performance is tracked through 12/31/2011.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\***  
Among VirnetX Holding Corp, the S&P 500 Index, and the RDG Technology Composite Index



\*\$100 invested on 12/31/06 in stock or index, including reinvestment of dividends.  
Fiscal year ending December 31.

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

	12/06	12/07	12/08	12/09	12/10	12/11
<b>VirnetX Holding Corp</b>	<b>100.00</b>	<b>675.86</b>	<b>170.11</b>	<b>337.93</b>	<b>1850.33</b>	<b>3111.30</b>
<b>S&amp;P 500</b>	<b>100.00</b>	<b>105.49</b>	<b>66.46</b>	<b>84.05</b>	<b>96.71</b>	<b>98.75</b>
<b>RDG Technology Composite</b>	<b>100.00</b>	<b>115.01</b>	<b>65.30</b>	<b>105.06</b>	<b>118.52</b>	<b>118.29</b>

**Recent Sales of Unregistered Securities**

During the year ended December 31, 2011, the Company had no sales of unregistered securities and no repurchases of stock.



**Item 6. Selected Financial Data.**

The statement of operations data for the three years ended December 31, 2011, 2010 and 2009 and the balance sheet data at December 31, 2011 and 2010, respectively, are derived from, and qualified by reference to, our audited financial statements included elsewhere in this Annual Report on Form 10-K. The statements of operations data for the for the two years ended December 31, 2008 and 2007 and the balance sheet data at December 31, 2009, 2008 and 2007, respectively, are derived from our audited financial statements not included in this Annual Report on Form 10-K.

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

	For the year ended December 31,				
	2011	2010	2009	2008	2007
Consolidated Statement of Operations Data:					
Revenue	\$ 20	\$ 68	\$ 26	\$ 134	\$ 75
Gain on settlement		(200,000)	—	—	—
Other operating expenses	17,396	95,383	13,114	12,355	8,725
Net operating expenses	(17,376)	(104,617)	13,114	12,355	8,725
Income tax expense (benefit)	(5,480)	34,062	—	—	—
Net (loss) income	(17,263)	41,417	(12,524)	(12,072)	(8,692)
Earnings (loss) per share	\$ (0.35)	\$ 0.91	\$ (0.33)	\$ (0.35)	\$ (0.36)
Dividends declared per common share	\$ 0.00	\$ 0.50	\$ 0.00	\$ 0.00	\$ 0.00
Consolidated Balance Sheet Data:					
Cash and cash equivalents	\$ 49,482	\$ 34,635	\$ 2,011	\$ 457	8,589
Investments available for sale	14,438	43,457	—	—	—
Total assets	\$ 74,633	\$ 81,694	\$ 2,242	\$ 979	9,279
Long-term obligation	—	—	120	160	204
Stockholders' equity (deficit)	\$ 68,277	\$ 59,453	\$ (8,708)	\$ (894)	\$ 8,495

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

**Company Overview**

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

Our portfolio of intellectual property is the foundation of our business model. We currently own 20 patents in the United States and 26 foreign patents, as well as several pending U.S. and foreign patent applications. Our patent portfolio is primarily focused on securing real-time communications over the Internet, as well as related services such as the establishment and maintenance of a secure domain name registry. Our patented methods also have additional applications in operating systems and network security. On December 2, 2009, we submitted a licensing declaration to the 3rd Generation Partnership Project, or 3GPP; identifying those of our U.S. and international patents which may be relevant to Long Term Evolution, or LTE. On March 14, 2011, we supplemented our licensing declaration to include five additional specifications. On April 28, 2011, at the request of the European Telecommunications Standards Institute, or ETSI, we agreed to update our licensing declaration to ETSI under ETSI's Intellectual Property Rights or IPR policy. We agreed with ETSI that we will 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, as set forth in the updated licensing declaration under ETSI's IPR policy. On June 17, 2011, in response to a request from the Alliance for Telecommunications Industry Solutions, or ATIS, the North American Organizational Partner for 3GPP, we also agreed to make available a non-exclusive patent license to 3GPP members desiring to implement the technical specifications identified by us, as set forth in the updated licensing declaration under ATIS' IPR policy. We believe that we are positioned to license our essential security patents to 3GPP members as they move into 4G.

We intend to license our patent portfolio, technology and software, including our secure domain name registry service, to domain infrastructure providers, communication service providers as well as to system integrators. We 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 wireless networks. We also believe that all 4G mobile devices will require unique secure domain names and become part of a secure domain name registry.

Our software and technology solutions provide the security platform required by next-generation Internet-based applications such as instant messaging, or IM, voice over Internet protocol, or VoIP, mobile services, streaming video, file transfer and remote desktop. Our technology generates secure connections on a "zero-click" or "single-click" basis, significantly simplifying the deployment of secure real-time communication solutions by eliminating the need for end-users to enter any encryption information.

In connection with the settlement of our lawsuit against Microsoft Corporation in 2010, Microsoft became our first licensee. Pursuant to the Settlement and License Agreement between us and Microsoft, Microsoft paid us \$200 million, which has been recognized as gain on settlement and Microsoft was granted a worldwide, irrevocable, nonexclusive, non-sublicenseable fully paid up license for our patents for Microsoft products. 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 Science Application International Corporation, or SAIC. SAIC is a FORTUNE 500® scientific, engineering and technology applications company that uses its deep domain knowledge to solve problems of vital importance to the nation and the world, in national security, energy and the environment, critical infrastructure and health. The team has continued its research and development work started at SAIC and expanded the set of patents we acquired in 2006 from SAIC into a larger portfolio with 46 issued U.S. and foreign patents and numerous pending U.S. and foreign patent applications. This portfolio now serves as the foundation of our licensing business and planned service offerings and is expected to generate the majority of our future revenue in license fees and royalties. We intend to continue our research and development efforts to further strengthen and expand our patent portfolio. Please see Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Operations – Research and Development Expenses for a description of our research and development expenses for the past three fiscal years.

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

## **Developments in the Year Ended December 31, 2011**

### ***Litigation***

On January 12, 2011, we initiated a lawsuit by filing a complaint against Siemens and Mitel in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we allege that these companies infringe two of our patents.

On February 4, 2011, we amended our original complaint, filed on August 11, 2010, against Aastra, Apple, Cisco and NEC in the United States District Court for the Eastern District of Texas, Tyler Division, to assert U.S. Patent No. 7,418,504 against Apple and Aastra.

On April 5, 2011, we again amended our complaint against Aastra, Apple, Cisco and NEC in the United States District Court for the Eastern District of Texas, Tyler Division, to include Apple's iPad 2 in the list of Apple products that are accused of infringing our patents. We also asserted our newly-issued patent, U.S. Patent No. 7,921,211 against all of the defendants in that lawsuit.

Also on April 5, 2011, we amended our original complaint, filed on January 12, 2011, against Siemens and Mitel in the United States District Court for the Eastern District of Texas, Tyler Division, to assert our newly-issued patent, U.S. Patent No. 7,921,211 against all of the defendants in that lawsuit.

On April 12, 2011, we again amended our complaint against Siemens and Mitel in the United States District Court for the Eastern District of Texas, Tyler Division, to add Avaya Inc. as a defendant. On November 1, 2011, we filed a new complaint against Apple Inc. in the United States District Court for the Eastern District of Texas, Tyler Division. The complaint includes allegations of patent infringement regarding our '181 patent. In our complaint, we seek both damages and injunctive relief.

On November 4, 2011, we filed a complaint with the United States International Trade Commission (ITC) alleging that Apple Inc. has engaged in unfair trade practices by the importation, sale for importation, and sale after importation of certain devices with secure communication capabilities that infringe one or more claims of our U.S. Patent No. 8,051,181. The accused products include the latest iPhones, iPads, iPods, and Macintosh computers. We have requested that the ITC institute an investigation into Apple's allegedly infringing imports and ultimately bar Apple from importing those Apple products or further selling the infringing Apple products that have already been imported.

### ***Patents***

On March 15, 2011, we updated our original patent declaration from December 2, 2009 to ETSI and ATIS, to include five additional specifications in the (3rd Generation Partnership Project) or 3GPP Long-Term Evolution or (LTE) project and we indicated that we are willing, upon request, to make available a non-exclusive license under what is commonly referred to as RAND (reasonable terms and conditions that are free of any unfair discrimination) with respect to necessary claims that may issue from our identified patents and patent applications for the specifications indicated in our Statement of Patent Holder, as updated, to the extent adopted as a final standard, and subject to the conditions set forth in the Statement of Patent Holder.

On April 5, 2011, we were granted a new patent by the USPTO: U.S. Patent # 7,921,211, Agile Network Protocol for Secure Communications Using Secure Domain Names.

On April 26, 2011, we were granted a new patent by the USPTO: U.S. Patent # 7,933,990, Agile Network Protocol for Secure Communications with Assured System Availability.

On April 28, 2011, at the request of the European Telecommunications Standards Institute (ETSI), we agreed to update our licensing declaration and make available a non-exclusive patent license under FRAND (fair, reasonable and non-discriminatory terms and conditions, with compensation), to 3GPP members desiring to implement the Technical Specifications identified by VimetX, as set forth in the updated licensing declaration under ETSI's IPR policy.

On May 17, 2011, we were granted two patents by the United States Patent and Trademark Office, or USPTO: U.S. Patent No.# 7,944,915, Third Party VPN Certification and U.S. Patent # 7,945,654, Agile Network Protocol for Secure Communications Using Secure Domain Names.

On July 08, 2011, Cisco filed with the USPTO a request for a reexamination of our US Patent# 6,502,135. The USPTO accepted this request and issued an order granting the reexamination on October 03, 2011. This was followed by the first non-final office action on February 15, 2012. Our response is due on April 15, 2012.

On July 11, 2011, Apple filed with the USPTO a request for a reexamination of our US Patent# 6,502,135. The USPTO accepted this request and issued an order granting the reexamination on October 03, 2011. This was followed by the first non-final office action on February 15, 2012. Our response is due on April 15, 2012.

On July 25, 2011, Apple filed with the USPTO a request for a reexamination of our US Patent# 7,490,151. The USPTO accepted this request and issued an order granting the reexamination on October 21, 2011. The USPTO has not issued the first non-final office action for this reexamination.

On July 26, 2011, we were granted two patents by the United States Patent and Trademark Office, or USPTO: U.S. Patent # 7,987,274 Method for Establishing Secure Communication Link Between Computers of Virtual Private Network and U.S. Patent # 7,986,688, Third Party Virtual Private Network Certification.

On August 2, 2011, we were granted a new patent by the USPTO: U.S. Patent # 7,996,539, Agile Network Protocol for Secure Communications with Assured System Availability.

On August 16, 2011, Cisco filed with the USPTO a request for a reexamination of our US Patent# 7,490,151. The USPTO accepted this request and issued an order granting the reexamination on October 31, 2011. The USPTO has not issued the first non-final office action for this reexamination.

On September 07, 2011, Cisco filed with the USPTO a request for a reexamination of our US Patent# 6,839,759. The USPTO accepted this request and issued an order granting the reexamination along with the first non-final office action on October 14, 2011. We responded to the first non-final office action on January 17, 2012. Cisco submitted its comments on our response to the USPTO on February 15, 2012. We are currently awaiting a response back from the USPTO.

On October 18, 2011, Apple filed with the USPTO a request for a reexamination of our US Patent# 7,418,504. The USPTO accepted this request and issued an order granting the reexamination along with the first non-final office action on December 29, 2011. Our response is due on March 29, 2012.

On October 18, 2011, Apple filed with the USPTO a request for a reexamination of our US Patent# 7,921,211. The USPTO accepted this request and issued an order granting the reexamination along with the first non-final office action on January 18, 2012. Our response is due on April 18, 2012.

On October 25, 2011, Cisco filed with the USPTO a request for a reexamination of our US Patent# 7,188,180. The USPTO denied this request on December 17, 2011. On January 17, Cisco filled a petition seeking a review of the order denying the reexamination request. No decision has been issued by the USPTO on this petition.

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On November 1, 2011, we were granted a new patent by the USPTO: U.S. Patent # 8,051,181, ("the '181 patent"), Method for Establishing Secure Communication Link Between Computers of Virtual Private Network.

On December 13, 2011, Cisco filed with the USPTO a request for a reexamination of our US Patent # 7,418,504. The USPTO has not issued its decision on the request.

On December 16, 2011, Cisco filed with the USPTO a request for a reexamination of our US Patent # 7,921,211. The USPTO has not issued its decision on the request.

**Commitments**

On October 30, 2011, we entered into a new lease agreement with Sierra Tahoe Professional Center, LLC., for our corporate headquarters located at 308 Dorla Court, Suite 206, Zephyr Cove, Nevada 89448. The lease commencement date was October 30, 2011 and the lease term expires in 2013.

**Audit**

On January 25, 2011, our audit committee determined that the previously filed financial statements for: (i) the fiscal quarter ended September 30, 2009 included in the Form 10-Q filed with the SEC on November 9, 2009, (ii) the fiscal year ended December 31, 2009 included in the Form 10-K filed with the SEC on March 31, 2010, (iii) the fiscal quarter ended March 31, 2010 included in the Form 10-Q filed with the SEC on May 7, 2010, (iv) the fiscal quarter ended June 30, 2010 included in the Form 10-Q filed with the SEC on August 9, 2010 and (v) the fiscal quarter ended September 30, 2010 included in the Form 10-Q filed with the SEC on November 8, 2010 (collectively, the "Periodic Reports") should no longer be relied upon. We determined that the financial statements contained in the Periodic Reports needed to be restated to correct our accounting for certain derivative instruments (the Series I Warrants we issued in 2009) in such financial statements, which were previously recorded as equity instruments. On January 31, 2011, amendments to the Periodic Reports were filed with the SEC with the restated financial statements.

**Recent Developments**

On January 5, 2012, a claims construction hearing was held in our case against Aastra, Apple, Cisco and NEC in the United States District Court for the Eastern District of Texas, Tyler Division. As of February 22, 2012 the judge had not issued his Markman order.

**Critical Accounting Policies**

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

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

**Reclassification of Gain on Settlement**

In June 2010, we received \$200,000 from Microsoft Corporation related to a licensing agreement and originally classified it as revenue. Upon further analysis, we determined that we could not practically and objectively separate any settlement portion from the revenue element as discussed under the guidance of U.S. GAAP Accounting Standards Codification Topic 605: Revenue Recognition, or ASC Topic 605. As a result, we reclassified this amount in our 2010 financial statements to present it as a gain on settlement. This reclassification had no impact on our net income, financial position or cash flows for any period.

**Revenue Recognition**

We defer recognition of revenue in accordance with ASC Topic 605 until such time as all of the criteria below have been met:

- persuasive evidence of sales arrangements;
- delivery has occurred or services have been rendered;
- the buyer's price is fixed or determinable; and
- collection is reasonably assured.

We expect that some or all of our future licensing agreements will provide for payments to us over an extended period of time. For a licensing agreement with fixed royalty payments, we expect to recognize revenue as amounts become due. For a licensing agreement with variable royalty payments we expect to recognize royalty revenue at the time that the licensees' sales occur; however, because we expect that a licensee may report sales information to us on a delayed basis, we expect our revenue recognition criterion may also be met on a delayed basis.

Complex revenue arrangements may require us to make significant judgments, assumptions and estimates about when substantial delivery of contract

elements will occur, whether any significant ongoing obligations exist subsequent to contract execution, whether amounts due are collectible and the appropriate period in which the completion of the earning process occurs. If new information subsequently becomes known to us which causes us to make different judgments, assumptions or estimates regarding material contracts, our financial results may be materially affected.

### ***Earnings Per Share***

Basic earnings per share are computed by dividing earnings available to common stockholders by the weighted average number of outstanding common shares during the period. Diluted earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the potentially dilutive securities had been issued. During 2011 and 2009, the Company has incurred losses; therefore, the effect of any Common Stock equivalent would be anti-dilutive during that period.

### ***Concentration of Credit Risk and Other Risks and Uncertainties***

Our cash and cash equivalents are primarily maintained at two financial institutions in the United States. Deposits held with these financial institutions may exceed the amount of insurance provided on such deposits. The balances are insured by the Federal Deposit Insurance Corporation, or FDIC. During the year ended December 31, 2011, 2010 and 2009, we had, at times, funds that were uninsured. The uninsured balance at December 31, 2011, was approximately \$29,185 compared to \$9,900 for 2010 and \$1,310 for 2009. We do not believe that we are subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships. We have not experienced any losses on our deposits of cash and cash equivalents.

### ***Derivative Instruments***

Our Series I Warrants contain an anti-dilutive provision which causes it to not be considered indexed to our stock. As a result, the warrants are required to be accounted for as derivative instruments.

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

### ***Impairment of Long-Lived Assets***

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

### ***Income Taxes***

Because of our history of operating losses, we do not currently recognize the benefit of all of our deferred tax assets, including tax loss carry forwards, that may be used to offset future taxable income. We will, however, continue to assess our ability to generate sufficient taxable income during future periods in which our deferred tax assets may be realized. If and when we believe it is more likely than not that we will recover our deferred tax assets, we will reverse the valuation allowance as an income tax benefit in our statements of operations.

### ***Stock-based Compensation***

We account for share-based compensation in accordance with the fair value method, which requires the measurement and recognition of compensation expense in the statement of operations for all share-based payment awards made to employees and directors including employee stock options based on estimated fair values. Using the modified retrospective transition method of adopting this standard, the financial statements presented herein reflect compensation expense for stock-based awards as if the provisions of this standard had been applied from the date of our inception.

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

### ***Fair Value 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 observable inputs in markets other than active markets.

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

## **New Accounting Pronouncements**

In May 2011, the FASB issued a new accounting standard update, which amends the fair value measurement guidance and includes some enhanced disclosure requirements. The most significant change in disclosures is an expansion of the information required for Level 3 measurements based on unobservable inputs. The standard is effective for fiscal years beginning after December 15, 2011. The adoption will not have a material impact on our consolidated financial statements and disclosures.

In June 2011, the FASB issued an amendment to an existing accounting standard which requires companies to present net income and other comprehensive income in one continuous statement or in two separate, but consecutive, statements. In addition, in December 2011, the FASB issued an amendment to an existing accounting standard which defers the requirement to present components of reclassifications of other comprehensive income on the face of the income statement. We will adopt this standard in the first quarter of 2012.

In September 2011, the FASB issued an amendment to an existing accounting standard, which provides entities an option to perform a qualitative assessment to determine whether further impairment testing on goodwill is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. This standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption will not have a material impact on our consolidated financial statements.



## **Operations**

### ***Revenue - Royalties***

Revenue generated for the twelve months ended December 31, 2011 was approximately \$20 compared to \$68 for the twelve months ended December 31, 2010 and \$26 for the twelve months ended December 31, 2009. Our revenue in 2011, 2010 and 2009, was solely limited to the royalties earned under our single license agreement through our Japanese subsidiary. We expect the revenue from this license will continue to be insignificant in the future. We do not intend to seek additional licenses or other revenue through our Japanese subsidiary.

### ***Gain on Settlement***

In June 2010, we received \$200,000 from Microsoft Corporation related to a licensing agreement and originally classified it as revenue. Upon further analysis, we determined that we could not practically and objectively separate any settlement portion from the revenue element as discussed under the guidance of U.S. GAAP Accounting Standards Codification Topic 605: Revenue Recognition, or ASC Topic 605. As a result, we reclassified this amount in our 2010 financial statements to present it as a gain on settlement. This reclassification had no impact on our net income, financial position or cash flows for any period. We did not receive a gain on settlement for the twelve months ended December 31, 2011 or 2009, respectively.

### ***Royalty Expense***

There was no royalty expense for the year ended December 31, 2011, compared to \$59,207 for the year ended December 31, 2010, and zero for the year ended December 31, 2009. Under our agreements with SAIC, we were obligated to pay SAIC 35% of the proceeds from the settlement of litigation with Microsoft after reduction for costs, including legal fees and expenses, incurred by us and SAIC in connection with the Microsoft litigation.

### ***Research and Development Expenses***

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

Our research and development expenses for the year ended December 31, 2011 was \$1,464 compared to \$2,412 for the year ended December 31, 2010 and \$864 for the year ended December 31, 2009. The decrease in 2011 was primarily due to the decrease in bonuses paid in 2011 compared to 2010. The increase in 2010 as compared to 2009, was primarily due to the increase in wages and medical costs and bonuses paid to our research and development staff.

### ***Selling, General and Administrative Expenses***

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

Our selling, general and administrative expenses for the year ended December 31, 2011 was \$15,932 compared to \$33,764 for the year ended December 31, 2010 and \$12,250 for the year ended December 31, 2009. The decrease in 2011 and increase in 2010 was primarily due to the increase in legal fees associated with the settlement of the Microsoft litigation in 2010. Legal fees represent approximately 40% of general and administrative expenses for 2011 as compared to 75% for 2010 and 57% for 2009.

Within selling, general and administrative expenses, legal fees for the year ended December 31, 2011 was \$6,342 compared to \$25,353 for the year ended December 31, 2010 and \$6,942 for the year ended December 31, 2009. The increase in 2010 was primarily due to the increase in legal fees associated with the settlement of the Microsoft litigation.

### ***Other Income and Expenses***

Our non-cash loss related to the periodic revaluation of our Series I Warrants liability for the year ended December 31, 2011 was \$5,595 compared to \$30,516 for the year ended December 31, 2010 and \$559 for the year ended December 31, 2009. Our non-cash loss related to the periodic revaluation of our Series I Warrants liability decreased by \$9,665 in the year ended December 31, 2011, as compared to the comparable period in 2010 as a result of a higher common share price and warrant exercises during the year ended 2011. Our Series I Warrants liability increased by \$7,495 in the year ended December 31, 2010 as compared to the comparable period in 2009 mainly as a result of a higher common share price in 2010 as compared to 2009.

Interest income for the year ended December 31, 2011 was \$228 compared to \$1,310 for the year ended December 31, 2010, and \$5 for the year ended December 31, 2009. These changes are due to timing on the maturity of the investments as well as the amount of cash available for investments.

### **Liquidity and Capital Resources**

For the year ended December 31, 2011, our cash and cash equivalents totaled \$49,482 and our short-term investments totaled \$14,438 compared to \$34,635 and \$43,457, respectively, for the year ended December 31, 2010 and \$2,011 and zero, respectively, as of December 31, 2009.

We recognized an unrealized loss on our investments of \$4 for the year ended December 31, 2011 compared to \$984 for the year ended December 31, 2010 and no gain or loss for the twelve months ended December 31, 2009, as we did not have any investments available for sale as of December 31, 2009. We have determined that this loss in 2011 and 2010 is temporary because the fair value of our investment securities is below the carrying value due to the changes in interest rates and we anticipate that this loss will be reversed over the securities remaining lives.

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Before entering into the Microsoft Settlement, we allocated a large amount of cash to legal fees and other expenses associated with the Microsoft litigation. We expect that our cash and cash equivalents as of December 31, 2011, will be sufficient to fund our operations and provide working capital for general corporate purposes and legal expenses including the expenses for our ongoing complaints against Aastra, Apple, Cisco, NEC, Siemens, Mitel and Avaya in the United States District Court of the Eastern District of Texas, Tyler Division, as well as the complaint with the U.S. International Trade Commission, for at least the next 36 months. While we do not expect to generate net income in the near term similar to in the net income generated during the year ended December 31, 2010, generally attributable to the Microsoft Settlement, we do expect to derive the majority of our future revenue from license fees and royalties associated with our patent portfolio, technology, software and secure domain name registry in the United States and other markets around the world over the long term. However, we will not receive any proceeds from these claims unless and until they may be resolved in our favor, and we expect to continue to incur substantial legal and other costs associated with pursuit of our claims.

**Contractual Commitments**

The following table summarizes our contractual obligations, including interest expense, and commitments as of December 31, 2011

<b>Operating Obligations</b>	<b>Total</b>	<b>Less than 1 year</b>	<b>1 - 3 Years</b>	<b>3 - 5 Years</b>	<b>More than 5 Years</b>
Operating Lease Obligations	102	56	46	---	---
<b>Total</b>	<b>102</b>	<b>56</b>	<b>46</b>	<b>---</b>	<b>---</b>

**Off-Balance Sheet Arrangements**

As of December 31, 2011, we had no off-balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K.

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

**Interest Rate Risk**

We invest our excess cash primarily in highly liquid debt instruments of the time deposits, money market, and corporate debt securities. By policy, we limit the amount of credit exposure to any one issuer.

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

We considered the historical volatility of short-term interest rates and determined that it was reasonably possible that an adverse change of 100 basis points could be experienced in the near term but would have an immaterial impact in the fair value of our marketable securities as they will be maturing in six months or less.

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

We considered the historical volatility of our stock prices and determined that it was reasonably possible that the fair market value of our stock price could drastically increase in the near term but would have an immaterial impact to our consolidated balance sheets and statement of operations as there are only approximately 205,000 warrants outstanding.

**Item 8. Financial Statements and Supplementary Data.**

**FINANCIAL STATEMENTS**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders  
VirnetX Holding Corporation

We have audited the accompanying consolidated balance sheets of VirnetX Holding Corporation (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2011. VirnetX Holding Corporation's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of VirnetX Holding Corporation, Inc. as of December 31, 2011 and 2010, and the consolidated results of their operations, and cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), VirnetX Holding Corporation's internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 29, 2012 expressed an unqualified opinion as to the effectiveness of the Company's control over financial reporting.

*/s/ Farber Hass Hurley LLP*

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Granada Hills, California  
February 29, 2012

## VirnetX Holding Corporation

**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and per share amounts)

	<u>As of December 31,</u> <u>2011</u>	<u>As of December 31,</u> <u>2010</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 49,482	\$ 34,635
Investments available for sale	14,438	43,457
Accounts receivable, net	—	3
Prepaid taxes	10,459	—
Deferred tax benefit	—	1,735
Prepaid expenses and other current assets	91	86
<b>Total current assets</b>	<u>74,470</u>	<u>79,916</u>
Property and equipment, net	56	25
Intangible and other assets	60	108
Deferred tax benefit	47	1,645
<b>Total assets</b>	<u>\$ 74,633</u>	<u>\$ 81,694</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,227	\$ 519
Income tax liability	430	7,358
Derivative liability	4,699	14,364
<b>Total current liabilities</b>	<u>6,356</u>	<u>22,241</u>
Stockholders' equity:		
Preferred stock, par value \$0.0001 per share		
Authorized: 10,000,000 shares at December 31, 2011 and 2010, respectively		
Issued and outstanding: 0 shares at December 31, 2011 and 2010, respectively	—	—
Common stock, par value \$0.0001 per share		
Authorized: 100,000,000 shares at December 31, 2011 and 2010, respectively Issued and outstanding:		
50,619,136 shares and 49,341,028 shares, at December 31, 2011 and 2010, respectively	5	5
Additional paid-in capital	104,277	78,187
Accumulated deficit	(36,001)	(17,755)
Accumulated other comprehensive loss	(4)	(984)
<b>Total stockholders' equity</b>	<u>68,277</u>	<u>59,453</u>
<b>Total liabilities and stockholders' equity</b>	<u>\$ 74,633</u>	<u>\$ 81,694</u>

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

## VirnetX Holding Corporation

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

	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
Revenue - Royalties	\$ 20	\$ 68	\$ 26
Operating expenses:			
Royalty expense	—	59,207	—
Research and development	1,464	2,412	864
General, selling and administrative	15,932	33,764	12,250
Gain on settlement	—	(200,000)	—
Total operating expenses	17,396	(104,617)	13,114
Income (loss) from operations	(17,376)	104,685	(13,088)
Gain (loss) on change in value of embedded derivative and warrants	(5,595)	(30,516)	559
Interest income, net	228	1,310	5
Income (loss) before taxes	(22,743)	75,479	(12,524)
Income tax expense (benefit)	(5,480)	34,062	—
Net Income (loss)	\$ (17,263)	\$ 41,417	\$ (12,524)
Basic earnings (loss) per share:	\$ (0.35)	\$ 0.91	\$ (0.33)
Diluted earnings (loss) per share:	\$ (0.35)	\$ 0.84	\$ (0.33)
Weighted average shares outstanding basic	50,028,413	45,452,550	37,911,340
Weighted average shares outstanding dilutive	50,028,413	49,066,704	37,911,340
Dividends declared per common share	\$ —	\$ 0.50	\$ —

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

## VirnetX Holding Corporation

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
AND COMPREHENSIVE INCOME (LOSS)**  
(in thousands, except share and per share amounts)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Other Comprehensive Income (Expense)	Total Stockholders' Equity (Deficit)
	Shares	Amount				
<b>Balance at December 31, 2008</b>	<b>34,899,985</b>	<b>\$ 3.50</b>	<b>\$ 22,150</b>	<b>\$ (23,048)</b>	<b>\$ -</b>	<b>\$ (895)</b>
Stock issued for cash at \$1.50 per share, net	2,470,000	.30	3,273			3,274
Stock issued for cash at \$2.52 per share, net	2,380,942	.20	5,400			5,400
Deferred offering costs			(125)			(125)
Stock-based compensation			3,032			3,032
Derivative liability			(6,869)			(6,869)
Net loss				(12,524)		(12,524)
<b>Balance at December 31, 2009</b>	<b>39,750,927</b>	<b>4.00</b>	<b>26,861</b>	<b>(35,572)</b>	<b>-</b>	<b>(8,707)</b>
Stock issued for cash exercise of warrants at \$2.52 per share, net	2,380,943	.24	5,395			5,395
Stock issued for cash exercise of warrants at \$2.00 per share, net	1,233,741	.12	2,354			2,354
Stock issued for cash exercise of warrants at \$3.00 per share, net	1,235,000	.12	3,750			3,750
Stock issued for cash exercise of warrants at \$4.00 per share, net	1,235,000	.12	4,945			4,945
Stock issued for cash exercise of warrants at \$1.80 per share, net	220,000	.02	396			396
Stock issued for cash exercise of warrants at \$4.80 per share, net	228,648	.02	1,098			1,098
Stock issued for cash exercise of warrants at \$3.93-3.59 per share, net	1,787,620	.17	6,593			6,593
Stock issued for cash exercise of options, net	1,269,149	.12	1,404			1,404
Stock-based compensation			3,381			3,381
Deferred tax benefit related to stock based compensation			528			528
Fees and commissions			(980)			(980)
Derivative liability			22,462			22,462
Dividend				(23,600)		(23,600)
Components of comprehensive income:						
Net Income				41,417		41,417
Change in unrealized loss on investment					(984)	(984)
Comprehensive income						40,433
<b>Balance at December 31, 2010</b>	<b>49,341,028</b>	<b>4.93</b>	<b>78,187</b>	<b>(17,755)</b>	<b>(984)</b>	<b>59,453</b>
Stock issued for cash exercise of warrants at \$3.93-3.59 per share, net	855,536	.09	3,063			3,063
Stock-based compensation			4,368			4,368
Deferred tax benefit related to stock based compensation			2,331			2,331
Derivative liability			15,260			15,260
Cashless exercise of \$4.80 underwriter warrants	24,178					--
Exercise of options	398,394	.04	1,068			1,068
Components of comprehensive income:						
Reclassification adjustment for net loss included in net income				(983)	983	--
Net loss				(17,263)		(17,263)
Change in unrealized loss on investment					(3)	(3)
Comprehensive loss						(17,266)
<b>Balance at December 31, 2011</b>	<b>50,619,136</b>	<b>\$ 5.06</b>	<b>\$ 104,277</b>	<b>\$ (36,001)</b>	<b>\$ (4)</b>	<b>\$ 68,277</b>

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

VirnetX Holding Corporation

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

	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
Cash flows from operating activities:			
Net income (loss)	\$ (17,263)	\$ 41,417	\$ (12,524)
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Depreciation and amortization	68	59	63
Stock-based compensation	4,367	3,381	3,032
Net change in deferred taxes (benefit)	5,663	(2,851)	—
Change in value of derivative liability	5,595	30,516	(559)
Changes in assets and liabilities:			
Receivables and other current assets	(3)	(39)	140
Prepaid taxes	(10,459)	—	94
Accounts payable and accrued liabilities	708	(3,960)	2,809
Income tax liability	(6,928)	7,358	—
Net cash provided by (used in) operating activities	<u>(18,252)</u>	<u>75,881</u>	<u>(6,945)</u>
Cash flows from investing activities:			
Purchase of property and equipment	(51)	(13)	(6)
Purchase of investments	(34,082)	(44,441)	—
Proceeds from sale, maturity of investments	63,101	—	—
Net cash provided by (used in) investing activities	<u>28,968</u>	<u>(44,454)</u>	<u>(6)</u>
Cash flows from financing activities:			
Payment of royalty obligation less imputed interest	—	(160)	(44)
Payment of dividend	—	(23,599)	—
Proceeds from exercise of options	1,068	1,341	—
Proceeds from exercise of warrants	3,063	23,615	—
Proceeds from sales of common stock	—	—	8,549
Net cash provided by financing activities	<u>4,131</u>	<u>1,197</u>	<u>8,505</u>
Net increase in cash and cash equivalents	14,847	32,623	1,554
Cash and cash equivalents, beginning of year	34,635	2,011	457
Cash and cash equivalents, end of year	<u>\$ 49,482</u>	<u>\$ 34,635</u>	<u>\$ 2,011</u>
Supplemental disclosure of cash flow information:			
Cash paid during the year for taxes	<u>\$ 9,600</u>	<u>\$ 29,556</u>	<u>\$ 2</u>
Cash paid during the year for interest	<u>\$ —</u>	<u>\$ 10</u>	<u>\$ 6</u>

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



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

**Note 1 - Formation and Business of the Company**

VirnetX Holding Corporation, which we refer to as we, us, our, the Company or VirnetX, is engaged in the business of commercializing a portfolio of patents. We seek to license our technology, including GABRIEL Connection Technology™, to various original equipment manufacturers, or OEMs, that use our technologies in the development and manufacturing of their own products within the IP-telephony, mobility, fixed-mobile convergence and unified communications markets. To date our revenue has been limited to an insignificant amount of software royalties pursuant to the terms of a single license agreement.

**Note 2 - Summary of Significant Accounting Policies**

***Basis of Presentation***

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

***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

***Revenue Recognition***

We defer recognition of revenue in accordance with ASC Topic 605 until such time as all of the criteria below have been met:

- persuasive evidence of sales arrangements;
- delivery has occurred or services have been rendered;
- the buyer's price is fixed or determinable; and
- collection is reasonably assured.

We expect that some or all of our future licensing agreements will provide for payments to us over an extended period of time. For a licensing agreement with fixed royalty payments, we expect to recognize revenue as amounts become due. For a licensing agreement with variable royalty payments we expect to recognize royalty revenue at the time that the licensees' sales occur; however, because we expect that a licensee may report sales information to us on a delayed basis, we expect our revenue recognition criterion may also be met on a delayed basis.

Complex revenue arrangements may require us to make significant judgments, assumptions and estimates about when substantial delivery of contract elements will occur, whether any significant ongoing obligations exist subsequent to contract execution, whether amounts due are collectible and the appropriate period in which the completion of the earning process occurs. If new information subsequently becomes known to us which causes us to make different judgments, assumptions or estimates regarding material contracts, our financial results may be materially affected.

***Cash and Cash Equivalents***

We consider all highly liquid investments purchased with original maturities of three months or less at the date of purchase to be cash equivalents.

***Investments***

Investments are classified as available-for-sale and are recorded at fair market value. Unrealized gain and losses are reported as other comprehensive income. Realized gains and losses are included in income in the period they are realized. The Company's investments consist of debt securities with maturity dates primarily less than nine months.

***Property and Equipment***

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

***Concentration of Credit Risk and Other Risks and Uncertainties***

Our cash and cash equivalents are primarily maintained at two financial institutions in the United States. Deposits held with these financial institutions may exceed the amount of insurance provided on such deposits. The balances are insured by the Federal Deposit Insurance Corporation or (FDIC). During the year ended December 31, 2011, we had, at times, funds that were uninsured. The uninsured balance at December 31, 2011 was \$29,185. We do not believe that we are subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships. We have not experienced any losses on our deposits of cash and cash equivalents.

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### ***Fair Value of Financial Instruments***

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

### ***Intangible Assets***

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

### ***Impairment of Long-Lived Assets***

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

### ***Research and Development***

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

### ***Income Taxes***

The provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon settlement. See Note 12, "Income Taxes" of this Form 10-K for additional information.

### ***Derivative Instruments***

Our Series I Warrants contain an anti-dilutive provision which causes it to not be considered indexed to our stock. As a result, the warrants are required to be accounted for as derivative instruments.

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

### ***Stock-Based Compensation***

Our accounting for share-based compensation is in accordance with the fair value method which requires the measurement and recognition of compensation expense in the statement of operations for all share-based payment awards made to employees and directors including employee stock-options based on estimated fair values. Using the modified retrospective transition method of adopting this standard, the financial statements presented herein reflect compensation expense for stock-based awards as if the provisions of this standard had been applied from the date of inception.

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

### ***Earnings Per Share***

Basic earnings per share are computed by dividing earnings available to common stockholders by the weighted average number of outstanding common shares during the period. Diluted earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the potentially dilutive securities had been issued. During 2011 and 2009, the Company has incurred losses; therefore the effect of any Common Stock equivalent would be anti-dilutive during that period.

### ***New Accounting Pronouncements***

In May 2011, the FASB issued a new accounting standard update, which amends the fair value measurement guidance and includes some enhanced disclosure requirements. The most significant change in disclosures is an expansion of the information required for Level 3 measurements based on unobservable inputs. The standard is effective for fiscal years beginning after December 15, 2011. We do not expect the adoption to have a material impact on our consolidated financial statements and disclosures.

In June 2011, the FASB issued an amendment to an existing accounting standard which requires companies to present net income and other comprehensive income in one continuous statement or in two separate, but consecutive, statements. In addition, in December 2011, the FASB issued an amendment to an existing accounting standard which defers the requirement to present components of reclassifications of other comprehensive income on the face of the income statement. We will adopt this standard in the first quarter of 2012.

In September 2011, the FASB issued an amendment to an existing accounting standard, which provides entities an option to perform a qualitative assessment to determine whether further impairment testing on goodwill is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. This standard is effective for annual and interim goodwill impairment test performed for fiscal years beginning after December 15, 2011. We do not expect the adoption to have a material impact on our consolidated financial statements.

**Note 3 - Property**

Our major classes of property and equipment were as follows:

	<b>December 31</b>		
	<b>2011</b>	<b>2010</b>	<b>2009</b>
Office furniture	\$ 57	\$ 22	\$ 22
Computer equipment	91	75	62
Total	148	97	84
Less accumulated depreciation	(92)	(72)	(61)
	<u>\$ 56</u>	<u>\$ 25</u>	<u>\$ 23</u>

Depreciation expense for the years ended December 31, 2011, 2010 and 2009 was \$20, \$11 and \$15 respectively.

**Note 4 - Commitments**

We lease our offices under an operating lease with a third party that requires minimum payments monthly until it ends in June 2013. We recognize rent expense on a straight-line basis over the term of the lease.

<b>For the Year</b>	<b>Minimum Required Lease Payments in Period</b>
2012	\$ 56
2013	46
Total	<u>\$ 102</u>

**Note 5 - Stock Plan**

In 2005, VirmetX, Inc. adopted the 2005 Stock Plan (the "Plan"), which was assumed by us upon the closing of the transaction between VirmetX Holding Corporation and VirmetX, Inc. on July 5, 2007. Our Board of Directors renamed this Plan the VirmetX Holding Corporation 2007 Stock Plan and our stockholders approved the Plan at our 2008 annual stockholders' meeting. The Plan provides for the issuance of up to 11,624,469 shares of our common stock. To the extent that any award should expire, become unexercisable or is otherwise forfeited, the shares subject to such award will again become available for issuance under the Plan. The Plan provides for the granting of stock options and stock purchase rights to our employees and consultants. Stock options granted under the Plan may be incentive stock options or nonqualified stock options. Incentive stock options ("ISO") may only be granted to our employees (including officers and directors). Nonqualified stock options ("NSO") and stock purchase rights may be granted to our employees and consultants.

The Plan will expire 10 years after it was approved by our Board of Directors. Options may be granted under the Plan with an exercise price determined by our Board of Directors, or a duly appointed committee thereof, provided, however, that the exercise price of an option granted to any employee shall be not less than 100% of the fair market value at the date of grant in the case of ISO or 85% of the case of an NSO, the exercise price of an ISO or NSO granted to one of our Named Executive Officers shall not be less than 100% fair market value of the shares at the date of grant and the exercise price of an ISO granted to a 10% shareholder shall not be less than 110% of the fair market value of the shares on the date of grant.

Activity under the Plan is as follows:

	<b>Options Outstanding</b>		
	<b>Shares Available for Grant</b>	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>
<b>Balance at December 31, 2008</b>	2,651,392	4,468,595	\$ 2.98
Restricted stock granted	—	—	—
Options granted	(1,317,195)	1,317,195	1.18
Options exercised	—	—	—
Options cancelled	83,031	—	—
<b>Balance at December 31, 2009</b>	1,417,228	5,785,790	2.57
Restricted stock granted	—	—	—
Options granted	(345,250)	345,250	5.53
Options exercised	—	(1,269,149)	1.11
Options cancelled	31,500	(31,500)	5.48
<b>Balance at December 31, 2010</b>	1,103,478	4,830,391	\$ 3.14
Restricted stock granted	—	—	—
Options granted	(475,000)	475,000	23.80
Options exercised	—	(398,393)	2.68
Options cancelled	—	—	—
<b>Balance at December 31, 2011</b>	<u>628,478</u>	<u>4,906,998</u>	<u>\$ 5.12</u>

**Note 6 - Stock-Based Compensation**

We account for equity instruments issued to employees in accordance with the fair value method which requires that such issuances be recorded at their fair value on the grant date. The recognition of the expense is subject to periodic adjustment as the underlying equity instrument vests.

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

<b>Stock-Based Compensation by Type of Award</b>	<b>Year Ended</b>	<b>Year Ended</b>	<b>Year Ended</b>
	<b>December 31, 2011</b>	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Employee stock options	\$ 4,367	\$ 3,381	\$ 3,032
Total stock-based compensation	\$ 4,367	\$ 3,381	\$ 3,032

As of December 31, 2011, the unrecorded deferred stock-based compensation balance related to stock options was \$9,697, which will be amortized as expense over an estimated weighted average vesting amortization period of approximately 0.7 years, as compared to \$4,027 and 1.2 years for 2010 and \$5,741 and 1.6 years for 2009.

The fair value of each option grant was estimated on the date of grant using the following weighted average assumptions:

	<b>Year Ended</b>	<b>Year Ended</b>	<b>Year Ended</b>
	<b>December 31, 2011</b>	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Expected stock price volatility	123%	110%	120%
Risk-free interest rate	3.05%	3.66%	2.93%
Expected life term (in years)	6.6 years	7.0 years	6.6 years
Expected dividends	0%	0%	0%

Based on the Black-Scholes option pricing model, the weighted average estimated fair value of employee stock options granted was \$21.13, \$4.83 and \$1.06 during the years ended December 31, 2011, 2010 and 2009 respectively.

The expected life was determined using the simplified method outlined in FASB Codification Topic 718, taking the average of the vesting term and the contractual term of the option. Expected volatility of the stock options was based upon historical data and other relevant factors, such as the volatility of comparable publicly-traded companies at a similar stage of life cycle. We have not provided an estimate for forfeitures because we have no history of forfeited options and believe that all outstanding options at December 31, 2011, will vest. In the future, the Company may change this estimate based on actual and expected future forfeiture rates.

The following table summarizes activity under the Plan for the indicated periods:

	<b>Number of</b>	<b>Weighted</b>	<b>Weighted</b>	<b>Aggregate</b>
	<b>Shares</b>	<b>Average</b>	<b>Average</b>	<b>Intrinsic</b>
		<b>Exercise</b>	<b>Remaining</b>	<b>Value</b>
		<b>Price</b>	<b>Contractual</b>	
			<b>Life (Years)</b>	
Outstanding at December 31, 2008	4,468,595	\$ 2.98	—	—
Options granted	1,317,195	1.18	—	—
Options exercised	—	—	—	—
Options cancelled	—	—	—	—
Outstanding at December 31, 2009	5,785,790	2.57	—	—
Options granted	345,250	5.53	—	—
Options exercised	(1,269,149)	1.11	—	—
Options cancelled	(31,500)	5.48	—	—
Outstanding at December 31, 2010	4,830,391	3.14	—	—
Options granted	475,000	23.30	—	—
Options exercised	(398,393)	2.68	—	—
Options cancelled	—	—	—	—
Outstanding at December 31, 2011	4,906,998	\$ 5.12	6.43	\$ 97,385

Intrinsic value is calculated at the difference between the per share market price of our common stock on the last trading day of 2011 was \$24.97 and the exercise price of the options. For options exercised, the intrinsic value is the difference between market price and the exercise price on the date of exercise.

The following table summarizes information about stock options outstanding at December 31, 2011:

Date of Option Issue	Range of Exercise Prices	Options Outstanding			Options Vested and Exercisable		
		Number Outstanding	Weighted Average Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Contractual Life (Years)	Weighted Average Exercise Price
2006	\$ 0.24	690,612	4.22	\$ 0.24	690,612	4.22	\$ 0.24
2007	4.20	1,312,899	5.56	4.20	1,312,899	5.56	4.20
2007	5.88-6.47	697,026	6.00	6.06	697,026	6.00	6.06
2008	1.74-6.20	250,016	6.46	4.39	221,294	6.45	4.52
2009	1.15- 1.58	1,167,695	7.26	1.16	799,297	7.27	1.17
2010	5.48-6.03	313,750	8.18	5.47	160,055	8.21	5.41
2011	19.85-23.62	475,000	9.42	23.30	83,957	9.38	23.58
		<u>4,906,998</u>	<u>6.43</u>	<u>\$ 5.12</u>	<u>3,965,140</u>	<u>5.99</u>	<u>\$ 3.70</u>

**Note 7 - Earnings Per Share**

Basic earnings per share are based on the weighted average number of shares outstanding for a period. Diluted earnings per share are based upon the weighted average number of shares and potentially dilutive common shares outstanding. Potential common shares outstanding principally include stock options, warrants, under our stock plan. During 2011 and 2009, the Company has incurred losses; therefore the effect of any common stock equivalent would be anti-dilutive during that period.

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

	Period Ended December 31,		
	2011	2010	2009
Net income (loss)	\$ (17,263)	\$ 41,417	\$ (12,524)
Weighted average number of shares outstanding	50,547	45,453	37,911
Diluted weighted average number of shares outstanding	50,547	49,067	37,911
Basic earnings (loss) per share	\$ (0.35)	\$ 0.91	\$ (0.33)
Diluted earnings (loss) per share	\$ (0.35)	\$ 0.84	\$ (0.33)

For the years ended December 31, 2011, 2010 and 2009, there were the following stock equivalents:

	2011	2010	2009
Options	4,906,998	4,830,391	5,785,790
Warrants	204,908	1,090,444	12,271,946

**Note 8 - Preferred Stock**

Our Amended and Restated Certificate of Incorporation, as amended in October 2007, authorizes us to issue 10,000,000 shares of \$0.0001 par value per share preferred stock having rights, preferences and privileges to be designated by our Board of Directors. There were no shares of preferred stock outstanding at December 31, 2011.

**Note 9 - Common Stock**

Each share of common stock has the right to one vote. The holders of common stock are entitled to receive dividends whenever funds are legally available and when declared by our Board of Directors, subject to the prior rights of holders of all classes of stock outstanding having priority rights as to dividends. On June 15, 2010, the Company's Board of Directors declared a special cash dividend of \$0.50 per share of the Company's common stock to holders of record on July 1, 2010. Our restated articles of incorporation authorize us to issue up to 100,000,000 shares of \$0.0001 par value common stock.

**Note 10 - Warrants**

Information about warrants outstanding during the twelve months ended December 31, 2011 follows:

<u>Original Number of Warrants Issued</u>	<u>Exercise Price per Common Share</u>	<u>Exercisable at December 31, 2010</u>	<u>Became Exercisable</u>	<u>Exercised</u>	<u>Terminated / Cancelled / Expired</u>	<u>Exercisable at December 31, 2011</u>	<u>Expiration Date</u>
300,000	\$ 4.80	30,000	—	(30,000)	—	—	December 2012
2,619,036(1)	\$ 3.59	1,060,444	—	(855,536)	—	204,908	March 2015
<b>Total</b>		<b>1,090,444</b>		<b>(885,536)</b>	<b>—</b>	<b>204,908</b>	

(1) Referred to as our Series I Warrants.

**Note 11 - Employee Benefit Plan**

We sponsor a defined contribution, 401k plan, covering substantially all our employees. The Company's matching contribution to the plan was approximately, \$36 in 2011, \$36 in 2010 and \$36 in 2009 respectively.

**Note 12 - Income Taxes**

The components of the income tax expense for the years ended December 31, 2011, 2010 and 2009 are as follows:

	<u>Year Ended December 31, 2011</u>	<u>Year Ended December 31, 2010</u>	<u>Year Ended December 31, 2009</u>
Current:			
Federal	\$ (8,036)	\$ 27,822	-
State	(767)	9,609	-
Foreign	(9)	11	-
	<u>(8,812)</u>	<u>37,442</u>	<u>-</u>
Deferred:			
Federal	3,331	(3,380)	-
State	1	-	-
Foreign	-	-	-
	<u>3,332</u>	<u>(3,380)</u>	<u>-</u>
Total provision for income taxes	<u>\$ (5,480)</u>	<u>\$ 34,062</u>	<u>-</u>

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

	<u>Year Ended December 31, 2011</u>	<u>Year Ended December 31, 2010</u>	<u>Year Ended December 31, 2009</u>
United States federal statutory rate	35.00%	35.00%	35.00%
State taxes, net of federal benefit	2.19%	8.28%	0.00%
Valuation allowance	(4.39%)	(9.69%)	(33.96%)
Stock options	(1.92%)	0.00%	0.00%
Warrants	(8.60%)	14.15%	(2.07%)
Other	1.79%	(3.64%)	1.03%
Balance at the end of the year	<u>24.07%</u>	<u>44.10%</u>	<u>0.00%</u>

As allowed by ASC 740, Income Taxes, we used the actual effective tax rate for the year ended December 31, 2011 because our 2011 annual profit before tax is not estimable at this time. To the extent our expected profitability changes during the year, the effective tax rate would be revised to reflect the change.



Deferred tax assets (liabilities) consist of the following:

	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
Deferred tax assets:			
Reserves and accruals	\$ 46	\$ 53	\$ -
State tax	1	3,326	-
Research and development credits and other credits	-	225	500
Net operating loss carry forward	2,822	372	10,500
Stock based compensation	3,155	3,109	-
Other	211	-	-
Total deferred tax assets	<u>6,235</u>	<u>7,085</u>	<u>11,000</u>
Valuation allowance	<u>(6,168)</u>	<u>(3,687)</u>	<u>(11,000)</u>
Deferred tax assets after valuation allowance	67	3,398	-
Deferred tax liability			
Depreciation and amortization	(20)	(18)	-
Total deferred tax liability	<u>(20)</u>	<u>(18)</u>	<u>-</u>
Net deferred tax assets	<u>\$ 47</u>	<u>\$ 3,380</u>	<u>\$ -</u>

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

Based on the available objective evidence, we believe it is more likely than not that the net deferred tax assets as of December 31, 2011 will not be fully realizable. Accordingly, management has maintained partial valuation allowance against its net deferred tax assets at December 31, 2011. The net change in the total valuation allowance for the year ended December 31, 2011 was an increase of \$1,000 and \$2,488 for state and federal deferred tax assets, respectively. At December 31, 2011, the Company has federal and state net operating loss carryforwards of approximately \$913 and \$43,565, respectively expiring in 2027 and 2012, respectively. At December 31, 2011, the Company has federal research and development credits carryforwards of approximately zero expiring beginning in 2031.

Internal Revenue Code Section 382 places a limitation (the "Section 382 Limitation") on the amount of taxable income can be offset by net operating carryforwards after a change in control (generally greater than 50% change in ownership) of a loss corporation. California has similar rules. Our capitalization described herein may have resulted in such a change. Generally, after a control change, a loss corporation cannot deduct net operating loss carryforward in excess of the Section 382 Limitation. Management has analyzed analysis on the utilization of its net operating loss carryforward against taxable income in future periods and determined on a more likely than not basis it will be able to use all its recognized net operating losses before they expire.

We are required to recognize the financial statement effects of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. As a result, we have reduced our gross deferred tax assets by zero and \$128 at December 31, 2011 and December 31, 2010, respectively, for certain tax benefits which may not be sustained upon examination, and we have provided an offset through equal reductions in our deferred tax asset, which offsets by an equal reduction in the valuation allowance. Our tax returns are subject to review by various tax authorities. The returns are subject to review those from 2008 forward.

Our policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. We did not have associated accrued interest or penalties nor was any interest expense or penalties recognized during the year ended December 31, 2011.

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

	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
Balance at the beginning of the year	\$ 128	\$ -	\$ -
Additions based on tax positions related to the current year	-	-	-
Additions for tax positions of prior years	-	128	-
Settlements	-	-	-
Lapse of applicable statute of limitations	-	-	-
Balance at the end of the year	<u>\$ 128</u>	<u>\$ 128</u>	<u>\$ -</u>

**Note 13 - Fair Value Measurement**

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 observable inputs in markets other than active markets.

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

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

*Corporate bonds:* Fair value measured at the closing price reported on the active market on which the individual securities are traded.

*Series I Warrants:* Fair value measured by using a Binomial valuation model. As of December 31, 2011, the assumptions used to measure fair value of the liability embedded in our outstanding Series I Warrants included a warrant exercise price of \$3.59 per share, a common share price of \$24.97, a discount rate of 0.83%, and a volatility of 123%.

The following table sets forth by level, within the fair value hierarchy, our financial instrument assets as of December 31, 2011:

	Level 1	Level 2	Level 3	Total
Certificates of deposit	\$ 2,584	—	—	\$ 2,584
Corporate Bonds:				
AA	2,011	—	—	2,011
A	9,843	—	—	9,843
Total Corporate Bonds	11,854	—	—	11,854
Total Investments at Fair Value	\$ 14,438	—	—	\$ 14,438

The following table sets forth, by level within the fair value hierarchy, our financial instrument liabilities as of December 31, 2011 (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Series I Warrants	\$ —	\$ —	\$ 4,699	\$ 4,699
Total	\$ —	\$ —	\$ 4,699	\$ 4,699

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

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
Balance December 31, 2010	\$ 14,364
Net loss included in earnings	5,595
Settlements	(15,260)
Balance December 31, 2011	\$ 4,699

**Note 14 - Patent Portfolio**

As of September 30, 2011, we own 20 issued U.S. and 26 issued foreign patents, in addition to several pending U.S. and foreign patent applications. Our issued U.S. and foreign patents expire at various times during the period from 2019 to 2024. Some of our issued patents and pending patent applications were acquired by our principal operating subsidiary, VimetX, Inc., from Science Applications International Corporation, or SAIC, in 2006 and we are required to make payments to SAIC based on cash or certain other values generated from those patents. The amount of such payments depends upon the type of value generated, and certain categories are subject to maximums and other limitations. As of June 30, 2010, we met our maximum royalty payment requirement; however, SAIC is also entitled under certain circumstances to receive a portion of the proceeds paid to us for certain acquisitions of VimetX or from the settlement of certain patent infringement claims of ours.

As of December 31, 2011, the expected future amortization of the intangible assets is as follows:

2012	\$	48
2013		12
Total	\$	<u>60</u>

**Note 15 - Litigation**

We have three intellectual property infringement lawsuits pending against multiple parties in the United States District Court for the Eastern District of Texas, Tyler Division, pursuant to which we allege that these parties infringe on certain of our patents. We seek damages and injunctive relief in all the complaints. We have one complaint with the United States International Trade Commission (ITC) alleging that Apple Inc has engaged in unfair trade practices by the importation, sale for importation, and sale after importation of certain devices with secure communication capabilities that infringe one or more claims of our U.S. Patent No. 8,051,181.

On August 11, 2010, we initiated a lawsuit by filing a complaint against Aastra Technologies, Inc., Apple, Inc., Cisco Systems, Inc., and NEC Corporation.

On January 12, 2011, we initiated a new lawsuit by filing a complaint against Siemens Enterprise Communications and Mitel Networks Corp. On April 12, 2011, we amended this complaint to add Avaya, Inc., as a defendant.

We believe that Aastra, Apple, Cisco, NEC, Siemens, Mitel and Avaya infringe on certain of our patents, but obtaining and collecting a judgment against these parties may be difficult or impossible. Patent litigation is inherently risky and the outcome is uncertain. Aastra, Apple, Cisco, NEC, Siemens, Mitel and Avaya are all large, well-financed companies with substantially greater resources than us. We believe that these parties will devote a substantial amount of resources in an attempt to prove that either their products do not infringe our patents or that our patents are invalid and unenforceable. At this time, we cannot predict the final outcome of these litigation matters.

On November 1, 2011, we initiated a lawsuit against Apple in the United States District Court, Tyler Division, pursuant to which we allege that Apple infringes an additional patent of ours. We seek damages and injunctive relief. No hearing or trial dates have been set.

On November 4, 2011, We filed a complaint with the United States International Trade Commission (ITC) alleging that Apple Inc has engaged in unfair trade practices by the importation, sale for importation, and sale after importation of certain devices with secure communication capabilities that infringe one or more claims of our U.S. Patent No. 8,051,181. The accused products include the latest iPhones, iPads, iPods and Macintosh computers. We have requested that the ITC institute an investigation into Apple's allegedly infringing imports and ultimately bar Apple from importing those Apple products or further selling the infringing Apple products that have already been imported

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.

**Note 16 - Quarterly Financial Information (unaudited)**

	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>
	(in thousands except per share)			
<b>2011</b>				
Revenue	\$ 16	\$ 1	\$ 3	\$ -
Income (loss) from operations	(2,752)	(3,754)	(4,180)	(6,690)
Net (loss) income	(7,122)	(9,805)	5,879	(6,215)
Basic earnings (loss) per common share	\$ (0.14)	\$ (0.20)	\$ 0.12	\$ (0.12)
Diluted earnings (loss) per common share	\$ (0.14)	\$ (0.20)	\$ 0.11	\$ (0.12)

	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>
	(in thousands except per share)			
<b>2010</b>				
Revenue	\$ 21	\$ 23	\$ 16	\$ 8
Income (loss) from operations	(4,457)	115,101	(2,434)	(3,525)
Net (loss) income	(8,900)	78,576	(25,420)	(2,839)
Basic earnings (loss) per common share	\$ (0.23)	\$ 1.77	\$ (0.54)	\$ (0.06)
Diluted earnings (loss) per common share	\$ (0.23)	\$ 1.67	\$ (0.54)	\$ (0.06)

	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>
	(in thousands except per share)			
<b>2009</b>				
Revenue	\$ 3	\$ 7	\$ 3	\$ 13

Income (loss) from operations	(3,405)	(3,928)	(2,624)	(3,131)
Net (loss) income	(3,403)	(3,927)	(2,623)	(2,571)
Basic earnings (loss) per common share	\$ (0.09)	\$ (0.11)	\$ (0.07)	\$ (0.07)
Diluted earnings (loss) per common share	\$ (0.09)	\$ (0.11)	\$ (0.07)	\$ (0.07)

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and  
Stockholders of VimetX Holding Corporation

We have audited the internal control over financial reporting of VimetX Holding Corporation (the “Company” as of December 31, 2011, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2011, of the Company and our report dated February 29, 2012, expressed an unqualified opinion on those financial statements.

/s/ Farber Hass Hurley LLP

Granada Hills, California  
February 29, 2012

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

None.

**Item 9A. Controls and Procedures.**

**Evaluation of Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, December 31, 2011.

The purpose of this evaluation was to determine whether as of December 31, 2011 our disclosure controls and procedures were effective to provide reasonable assurance that the information we are required to disclose in our filings with the SEC, (i) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Based on their evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of December 31, 2011, our disclosure controls and procedures were effective.

**Management's Report on Internal Control Over Financial Reporting**

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

Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2011. There were no changes in our internal control over financial reporting during the quarter ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Farber Hass Hurley LLP has audited our internal control over financial reporting as of December 31, 2011; their report is included elsewhere herein.

**Item 9B. Other Information.**

As previously reported on the Current Report on Form 8-K filed with the Securities and Exchange Commission on November 29, 2011 by the Company, the Compensation Committee of the Board of Directors (the "Compensation Committee") exercised its discretion in determining to pay Messrs. Larsen and Sliney 100% of their 2011 target bonuses in light of the Company's overall strong performance for the year and their contributions in achieving this performance (collectively, the "2011 Annual Incentive Bonuses"). As a result, the Compensation Committee determined to award Mr. Larsen a cash bonus for 2011 equal to \$210,000 and Mr. Sliney a cash bonus for 2011 equal to \$30,000.

On February 27, 2012, the Compensation Committee confirmed that the cash bonus amounts awarded to Mr. Larsen and Mr. Sliney, include, in addition to the foregoing amounts, an additional payment equal to the estimated amount of payroll withholding taxes (as calculated by the Company's payroll processing agent) to be incurred by Mr. Larsen and Mr. Sliney (but that the executives would be responsible for any incremental taxes associated with such additional payment). The resulting aggregate 2011 Annual Incentive Bonus payments, including these additional amounts, paid to Mr. Larsen and Mr. Sliney were \$287,671 and \$43,717, respectively.

**PART III**

Certain information required by Part III is omitted from this report and is incorporated by reference to our definitive proxy statement pursuant to Regulation 14A for our 2012 annual meeting of stockholders (the “Definitive Proxy Statement”) which will be filed within 120 days of our fiscal year end.

**Item 10. Directors, Executive Officers and Corporate Governance.**

The information required by this item is incorporated by reference to the information set forth in the Definitive Proxy Statement under the sections “Board of Directors,” “Nominee and Continuing Directors,” “Executive Officers,” “Composition of the Board of Directors,” “Board Meetings and Committees and Annual Meeting Attendance,” “Audit Committee Matters” and “Section 16(a) Beneficial Ownership Reporting Compliance.” Information regarding delinquent filers pursuant to Item 405 of Regulation S-K is included under the caption “Section 16(a) Beneficial Ownership Reporting Compliance” in our Proxy Statement for the 2012 Annual Meeting of Stockholders and is incorporated herein by reference.

**Code of Ethics**

We have adopted a Code of Ethics for all employees and directors to prohibit conflicts of interest between them and the Company. A copy of our Code of Ethics is available on our website at <http://www.vimtx.com> in the “Highlights” link in the “Corporate Governance” subcategory under the “Investors” tab, or by writing to us at VimetX Holding Corporation, PO Box 439, Zephyr Cove, NV 89448, Attention: Investor Relations.

We intend to post on our website any amendment to, or waiver from, a provision of our Code of Ethics within four business days following the date of such amendment or waiver. We do not anticipate any such amendments or waivers.

**Item 11. Executive Compensation.**

The information required by this item is incorporated by reference to the information set forth in the Definitive Proxy Statement under the sections “Compensation Committee Matters,” “Director Compensation,” “Executive Compensation,” “Compensation Committee Report,” “Summary Compensation Table,” “Outstanding Equity Awards at 2011 Fiscal Year-End,” and “Option Exercises in Fiscal Year 2011.”

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

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

**Securities Authorized for Issuance Under Equity Compensation Plans**

We have a stock incentive plan for employees and others called the “VimetX Holding Corporation 2007 Stock Plan”, or the Plan, which has been approved by our stockholders. The Plan provides for the granting of up to 11,624,469 shares of our common stock, including stock options and stock purchase rights, and will expire in 2018. As of December 31, 2011, there were 628,478 shares available to be granted under the Plan. We had 4,906,998 and 4,830,391 options outstanding at December 31, 2011, and December 31, 2010, respectively, with an average exercise price of \$5.12 and \$3.14, respectively.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans Excluding Securities Reflected in Column (a) (c)
Equity compensation plans approved by security holders	5,111,906	5.07	628,478
Equity compensation plans not approved by security holders	—		—
Total	5,111,906	5.07	628,478

On May 13, 2011 the Compensation Committee granted an additional 435,000 options to the employees of VimetX Inc. Then on November 22, 2011 the Compensation Committee granted an additional 40,000 options to the employees of VimetX, Inc.

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

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

**Item 14. Principal Accountant Fees and Services.**

The information required by this item is incorporated by reference to the information set forth in the Definitive Proxy Statement for the 2012 Annual Meeting of Stockholders under “Principal Accountant Fees & Services.”

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules.**

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



**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

**VirnetX Holding Corporation**

By: /s/ Kendall Larsen  
 Name: Kendall Larsen  
 Title: Chief Executive Officer and President

Dated: February 29, 2012

**POWER OF ATTORNEY**

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

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

<u>Name</u>	<u>Capacity</u>	<u>Date</u>
<u>/s/ Kendall Larsen</u> Kendall Larsen	Director, Chief Executive Officer and President <i>(Principal Executive Officer)</i>	February 29, 2012
<u>/s/ William E. Sliney</u> William E. Sliney	Chief Financial Officer <i>(Principal Financial Officer and Principal Accounting Officer)</i>	February 29, 2012
<u>/s/ Robert D. Short III</u> Robert D. Short III	Director	February 29, 2012
<u>/s/ Scott C. Taylor</u> Scott C. Taylor	Director	February 29, 2012
<u>/s/ Michael F. Angelo</u> Michael F. Angelo	Director	February 29, 2012
<u>/s/ Thomas M. O'Brien</u> Thomas M. O'Brien	Director	February 29, 2012

**EXHIBIT INDEX**

<u>Exhibit Number</u>	<u>Description</u>
3.1	Certificate of Incorporation of the Company. (1)
3.2	By-Laws of the Company. (1)
4.1	Form of Warrant Issued to Gilford Securities Incorporated. (2)
4.2	Form of Warrant Agency Agreement by and between the Company and Corporate Stock Transfer, Inc. as Warrant Agent. (2)
4.3	Form of Underwriter's Warrant. (2)
4.4	Form of Series I Warrant. (3)
4.5	Amended Form of Stock Option Agreement - 2007 Stock Plan. (12)
10.1	Form of Indemnification Agreement by and between the Company and each of Kendall Larsen, Robert D. Short III, Scott C. Taylor, Michael F. Angelo, Thomas M. O'Brien and William E. Sliney. (1)
10.2	Voting Agreement among the Company and certain of its stockholders, dated as of December 12, 2007. (5)
10.3	2007 Stock Plan. (4)
10.4	Securities Purchase Agreement, dated as of September 2, 2009, by and between the Company and the Purchasers. (3)
10.5	Form of Registration Rights Agreement by and between the Company and the Purchasers. (3)
10.6	Form of Underwriting Agreement between VimetX Holding Corporation and Gilford Securities Incorporated. (2)
10.7	Patent License and Assignment Agreement by and between the Company and Science Applications International Corporation, dated as of August 12, 2005. (6)
10.8	Security Agreement by and between the Company and Science Applications International Corporation, dated as of August 12, 2005. (6)
10.9	Amendment No. 1 to Patent License and Assignment Agreement by and between the Company and Science Applications International Corporation, dated as of November 2, 2006. (6)
10.10	Assignment Agreement between the Company and Science Applications International Corporation, dated as of December 21, 2006. (6)
10.11	Professional Services Agreement by and between the Company and Science Applications International Corporation, dated as of August 12, 2005. (6)



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10.12	Amendment No. 2 to Patent License and Assignment Agreement by and between VimetX, Inc. and Science Applications International Corporation, dated as of March 12, 2008. (7)
10.13	IP Brokerage Agreement by and between ipCapital Group, Inc. and VimetX, Inc., effective as of March 13, 2008. (7)
10.14	Engagement Letter by and between VimetX Holding Corporation and ipCapital Group, Inc. dated March 12, 2008. (7)
10.15	Lease Agreement by and between the Company and Granite Creek Business Center, dated as of March 15, 2006, as amended in April 2007 and April 2008. (8)
10.16*	Engagement Letter dated June 9, 2009, by and between McKool Smith, a professional corporation, and the Company. (9)
10.17	Engagement Letter dated April 15, 2010, by and between McKool Smith, a professional corporation, and the Company. (10)
10.18*	Settlement and License Agreement, by and between Microsoft Corporation, a Washington corporation, and VimetX, Inc., a Delaware corporation. (11)
10.19	Fiscal Year 2011 Director Compensation (13)
<a href="#">21.1</a>	Subsidiaries of VimetX Holding Corporation.
<a href="#">23.1</a>	Consent of Farber Hass Hurley LLP, Independent Registered Public Accounting Firm.
<a href="#">31.1</a>	Chief Executive Officer Certification pursuant to Rule 13a-14(a) of the Securities Exchange Act.
<a href="#">31.2</a>	Chief Financial Officer Certification pursuant to Rule 13a-14(a) of the Securities Exchange Act.
<a href="#">32.1</a> †	Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
<a href="#">32.2</a> †	Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS††	XBRL Instance Document
101.SCH††	XBRL Taxonomy Extension Schema Document
101.CAL††	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF††	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB††	XBRL Taxonomy Extension Label Linkbase Document
101.PRE††	XBRL Taxonomy Extension Presentation Linkbase Document

- (1) Incorporated herein by reference to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 1, 2007.
- (2) Incorporated herein by reference to the Company's Registration Statement on Form S-1/A filed with the Securities and Exchange Commission on January 16, 2009.
- (3) Incorporated herein by reference to the Company's Form 8-K filed with the Securities and Exchange Commission on September 3, 2009.
- (4) Incorporated herein by reference to the Company's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on March 25, 2008.
- (5) Incorporated herein by reference to the Company's Form 10-K filed with the Securities and Exchange Commission on March 31, 2008.
- (6) Incorporated by reference to the Company's Form 8-K (Commission File No. 001-33852) filed with the Securities and Exchange Commission on July 12, 2007.
- (7) Incorporated by reference to the Company's Form 8-K (Commission File No. 001-33852) filed with the Securities and Exchange Commission on March 18, 2008.
- (8) Incorporated by reference to the Company's Form 10-K (Commission File No. 001-33852) filed with the Securities and Exchange Commission on March 31, 2009.
- (9) Incorporated by reference to the Company's Form 10-Q (Commission File No. 001-33852) filed with the Securities and Exchange Commission on August 10, 2009.
- (10) Incorporated by reference to the Company's Form 10-Q (Commission File No. 001-33852) filed with the Securities and Exchange Commission on May 7, 2010.
- (11) Incorporated by reference to the Company's Form 10-Q/A (Commission File No. 001-33852) for the period ended June 30, 2010, filed with the Securities and Exchange Commission on January 31, 2011.
- (12) Incorporated by reference to the Company's Form 10-Q (Commission File No. 001-33852) filed with the Securities and Exchange Commission on May 10, 2011.
- (13) Incorporated by reference to the Company's Form 10-Q (Commission File No. 001-33852) filed with the Securities and Exchange Commission on August 9, 2011.

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

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

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

**Subsidiaries of Registrant**

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

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 333-149884, 333-153645 and 333-162145) and Form S-8 (No. 333-149883) of our reports dated February 29, 2012, relating to the consolidated financial statements of VirnetX Holding Corporation (the "Company"), and the effectiveness of the Company's internal control over financial reporting, appearing in this Annual Report on Form 10-K of the Company for the year ended December 31, 2011.

/s/ Farber Hass Hurley LLP

Granada Hills, CA

February 29, 2012

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## CERTIFICATIONS

I, Kendall Larsen, certify that:

1. I have reviewed this Annual Report on Form 10-K of VimetX Holding Corporation for the fiscal year ended December 31, 2011;
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: February 29, 2012

CERTIFICATIONS

I, William E. Sliney, certify that:

1. I have reviewed this Annual Report on Form 10-K of VimetX Holding Corporation for the fiscal year ended December 31, 2011;
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/ William E. Sliney  
William E. Sliney  
Chief Financial Officer  
(Principal Accounting and Financial Officer)

Date: February 29, 2012

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

In connection with the Annual Report of VimetX Holding Corporation (the "Company") on Form 10-K for the fiscal year ended December 31, 2011 as filed with the Securities and Exchange Commission on February 29, 2012 (the "Report"), I, Kendall Larsen, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

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

/s/ Kendall Larsen  
Kendall Larsen  
*President and Chief Executive Officer*  
*(Principal Executive Officer)*

Date: February 29, 2012

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

In connection with the Annual Report of VimetX Holding Corporation (the "Company") on Form 10-K for the fiscal year ended December 31, 2011 as filed with the Securities and Exchange Commission on February 29, 2012 (the "Report"), I, William E. Sliney, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

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

/s/ William E. Sliney  
William E. Sliney  
Chief Financial Officer  
(Principal Accounting and Financial Officer)

Date: February 29, 2012

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