

INTRUSION INC
Form DEF 14A
April 20, 2007
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

SCHEDULE 14A INFORMATION

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

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
 Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
 Definitive Proxy Statement
 Definitive Additional Materials
 Soliciting Material Pursuant to §240.14a-12

Intrusion Inc.

(Name of Registrant as Specified In Its Charter)

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

Payment of Filing Fee (Check the appropriate box):

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- (2) Form, Schedule or Registration Statement No.:
- (3) Filing Party:
- (4) Date Filed:

**1101 East Arapaho Road, Suite 200
Richardson, Texas 75081
(972) 234-6400**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
To Be Held May 30, 2007**

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*To the Stockholders of
Intrusion Inc.:*

NOTICE IS HEREBY GIVEN that the 2007 Annual Meeting of Stockholders (the Meeting) of Intrusion Inc. (the Company) will be held at the Radisson Hotel, Dallas North at Richardson, 1981 North Central Expressway, Richardson, Texas, at 10:00 A.M., Local Time, on Wednesday, May 30, 2007, for the following purposes:

- (1) To elect five (5) directors to serve until the next Annual Meeting of Stockholders or until their respective successors are duly elected and qualified;
- (2) To approve the amendment to the 2005 Stock Incentive Plan, as described in the accompanying proxy statement and set forth in Appendix A thereto;
- (3) To ratify the appointment of KBA Group LLP as independent auditors of the Company for the fiscal year ending December 31, 2007; and
- (4) To transact such other business as may properly come before the Meeting or any adjournments thereof.

The foregoing items of business are more fully described in the Proxy Statement accompanying this Notice. The record date for determining those stockholders who will be entitled to notice of, and to vote at, the Meeting and at any adjournment thereof is April 5, 2007. A list of stockholders entitled to vote at the Meeting will be available for inspection at the offices of the Company.

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

By Order of the Board of Directors

*G. WARD PAXTON
Chairman, President and Chief Executive Officer*

Richardson, Texas
April, 27, 2007

INTRUSION INC.
1101 East Arapaho Road, Suite 200
Richardson, Texas 75081

PROXY STATEMENT
for
ANNUAL MEETING OF STOCKHOLDERS
to be Held May 30, 2007

SOLICITATION AND REVOCABILITY OF PROXIES

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The enclosed proxy (the Proxy) is being solicited on behalf of the Board of Directors (the Board) of Intrusion Inc. (the Company) for use at the Annual Meeting of Stockholders (the Meeting) to be held at the Radisson Hotel, Dallas North at Richardson, 1981 North Central Expressway, Richardson, Texas, at 10:00 A.M., Local Time, on Wednesday, May 30, 2007, or at such other time and place to which the Meeting may be adjourned. Proxies, together with copies of this Proxy Statement, are being mailed to stockholders of record entitled to vote at the Meeting on or about April 27, 2007.

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

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

RECORD DATE AND VOTING SECURITIES

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Only stockholders of record at the close of business on April 5, 2007 are entitled to notice of and to vote at the Meeting. The stock transfer books of the Company will remain open between the record date and the date of the Meeting. A list of stockholders entitled to vote at the Meeting will be available for inspection at the executive offices of the Company. On the April 5, 2007 record date, the Company had 9,222,139 outstanding shares of Common Stock, \$0.01 par value (the Common Stock); 259,696 outstanding shares of 5% Convertible Preferred Stock, par value \$0.01 per share (the 5% Preferred Stock); 460,000 shares of Series 2 5% Convertible Preferred Stock, par value \$0.01 per share (the Series 2 5% Preferred Stock); and 468,735 shares of Series 3 5% Convertible Preferred Stock, par value \$0.01 per share (the Series 3 5% Preferred Stock). The holders of Series 2 and Series 3 5% Preferred Stock do not have voting rights other than as required by the Delaware General Corporation. Therefore, the holders of the Series 2 and Series 3 5% Preferred Stock are not entitled to vote with respect to the proposals set forth in this Proxy Statement.

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QUORUM AND VOTING

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The presence at the Meeting, in person or by Proxy, of the holders of a majority of the shares of Common Stock outstanding or issuable upon conversion of the 5% Preferred Stock is necessary to constitute a quorum. Holders of Common Stock are entitled to one vote for each share of Common Stock held on each matter to be voted on at the Meeting including the election of directors. Holders of 5% Preferred Stock are entitled to vote on an as-converted to Common Stock basis with any fractional votes being rounded to the nearest whole vote. As of the record date, each share of 5% Preferred Stock was convertible into 1.59 shares of Common Stock. As a result, each holder of Preferred Stock is entitled to 1.59 votes for each share of Preferred Stock held on each matter to be voted on at the Meeting, including the election of directors.

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

Assuming the presence of a quorum, the following paragraphs describe the vote required by the stockholders of record to approve each of the proposals set forth in this Proxy Statement.

- **Proposal One.** The five nominees receiving the greatest number of votes of the shares of Common Stock outstanding or issuable upon conversion of the 5% Preferred Stock present in person or represented by Proxy at the Meeting and entitled to vote shall be deemed elected even if they receive the affirmative vote of less than a majority of the shares of Common Stock outstanding or issuable upon conversion of the 5% Preferred Stock entitled to be voted at the Meeting. Cumulative voting is prohibited in the election of directors, and Proxies cannot be voted for more than five nominees.
- **Proposal Two.** The affirmative vote of the holders of a majority of the shares of Common Stock outstanding or issuable upon conversion of the 5% Preferred Stock entitled to vote at the Meeting, present in person or by Proxy, is required for the approval to the amendment of the 2005 Incentive Stock Plan.
- **Proposal Three.** The affirmative vote of the holders of a majority of the shares of Common Stock outstanding or issuable upon conversion of the 5% Preferred Stock entitled to vote at the Meeting, present in person or by Proxy, is required for the ratification of the appointment of KBA Group LLP as independent auditors.

The Board unanimously recommends a vote FOR each of the proposals set forth in this Proxy Statement.

PROPOSAL ONE ELECTION OF DIRECTORS

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

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

Name of Nominee	Age	Position(s)	Director Since
G. Ward Paxton	71	Chairman, President, Chief Executive Officer and Director	1983
T. Joe Head	50	Vice Chairman, Vice President and Director	1983
J. Fred Bucy, Jr. (1)(2)	78	Director	1993
James F. Gero (1)(2)	62	Director	2003
Donald M. Johnston (1)(2)	57	Director	1983

(1) Member of the Compensation Committee.

(2) Member of the Audit Committee.

G. Ward Paxton was named President and Chief Executive Officer of the Company on November 28, 2001. He is also co-founder of the Company and has served as Chairman of the Board since the Company's inception in September 1983. Mr. Paxton also served as President and Chief Executive Officer of the Company from 1983 until June 2000 and served as Chief Financial Officer from 1983 until 1994. Prior to founding the Company, Mr. Paxton was Vice President of Honeywell Optoelectronics, a division of Honeywell, Inc., from 1978 to 1983. From 1969 to 1978, Mr. Paxton was Chairman of the Board, President, Chief Executive Officer and founder of Spectronics, Inc., which was acquired by Honeywell, Inc. in 1978. Prior to founding Spectronics, Inc., Mr. Paxton held various managerial and technical positions at Texas Instruments Incorporated from 1959 to 1969. Mr. Paxton holds Ph.D., M.S. and B.S. degrees in Physics from the University of Oklahoma.

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

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

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

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

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

Stockholder Approval

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The affirmative vote of a plurality of the shares of Common Stock outstanding or issuable upon conversion of outstanding 5% Preferred Stock present in person or by proxy at the Annual Meeting is required for the election of each of the nominees for director.

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

CORPORATE GOVERNANCE

Board of Directors and Committees

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The business affairs of the Company are managed under the direction of the Board. The Board meets on a regularly scheduled basis during the fiscal year of the Company to review significant developments affecting the Company and to act on matters requiring Board approval. It also holds special meetings as required from time to time when important matters arise requiring Board action between scheduled meetings. The Board of Directors or its authorized committees met twenty-one times during the 2006 fiscal year. During fiscal year 2006, each director participated in at least 75% or more of the aggregate of (i) the total number of meetings of the Board of Directors (held during the period for which he was a director) and (ii) the total number of meetings of all committees of the Board on which he served (during the period that he served).

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

Audit Committee. The Audit Committee is composed of: Donald M. Johnston (Chairman), James F. Gero, and J. Fred Bucy, Jr. Each member of the Audit Committee is independent (as defined in Nasdaq Marketplace Rule 4200). The Audit Committee has at least one financial expert (as defined by Item 401(e) of Regulation S-B). Mr. Bucy is currently the Audit Committee financial expert. The functions performed by the Committee, its membership and the number of meetings held during the fiscal year, are set forth in the Report of the Audit Committee, included in this Proxy Statement. The Audit Committee is governed by a written charter, which was approved by the Audit Committee on March 18, 2004, and included under the investor relations section on the Company's website. The Audit Committee held six meetings during fiscal year 2006.

Compensation Committee. The Compensation Committee is empowered to advise management and make recommendations to the Board with respect to the compensation and other employment benefits of executive officers, key employees and directors of the Company. The Compensation Committee also administers the Company's incentive stock incentive plan for officers, key employees and directors, and the Company's incentive bonus programs for executive

officers and employees. The Compensation Committee is authorized, among other powers, to determine from time to time the individuals to whom options shall be granted, the number of shares to be covered by each option and the time or times at which options shall be granted pursuant to the stock incentive plan. The Compensation Committee is comprised of Mr. Bucy (Chairman), Mr. Gero and Mr. Johnston, each of whom is an independent director. The Compensation Committee met six times during the 2006 fiscal year.

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

Report of the Audit Committee

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

The Audit Committee reviewed with the Independent Registered Public Accounting Firm, who are responsible for expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles, their judgments as to the quality, not just the acceptability, of the Company's accounting principles, the matters required to be discussed by SAS 61 (Certification of Accounting Standards AU Section 280) and such other matters as are required to be discussed with the Audit Committee under generally accepted auditing standards. In addition, the Audit Committee has discussed with the Independent Registered Public Accounting Firm the auditors' independence from management and the Company including the matters in the written disclosures and the letter from the Independent Registered Public Accounting Firm required by the Independence Standards Board Standard No. 1 (Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees) and considered the compatibility of non-audit services with the auditors' independence.

The Audit Committee discussed with the Company's Independent Registered Public Accounting Firm the overall scope and plans for their audit. The Audit Committee meets with Independent Registered Public Accounting Firm, with and without management present, to discuss the results of their examinations, their evaluations of the Company's internal controls, and the overall quality of the Company's financial reporting. The Audit Committee held six meetings during fiscal year 2006.

In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors (and the Board has approved) that the audited financial statements be included in the Annual Report on Form 10-KSB for the year ended December 31, 2006 for filing with the Securities and Exchange Commission. The Audit Committee and the Board have also recommended, subject to stockholder ratification, the selection of the Company's Independent Registered Public Accounting Firm.

Respectfully submitted,

AUDIT COMMITTEE

of the Board of Directors

Donald M. Johnston, Audit Committee Chair

James F. Gero, Audit Committee Member

J. Fred Bucy, Jr., Audit Committee Member

REPORT OF COMPENSATION COMMITTEE

The Compensation Committee is responsible for administering the compensation programs of the executive officers. The Compensation Committee sets performance goals and objectives for the chief executive officer and the other executive officers, evaluates their performance with respect to those goals and sets their compensation based upon the evaluation of their performance. In evaluating executive officer pay, the Compensation Committee may consider recommendations from the chief executive officer with respect to goals and compensation of the other executive officers. The Compensation Committee also periodically reviews director compensation. All decisions with respect to executive and director compensation are approved by the Compensation Committee and recommended to the full board for ratification.

The Compensation Committee is responsible for administering all of the Company's equity-based plans. The Compensation Committee also periodically reviews compensation and equity-based plans and makes its recommendations to the board with respect to these areas.

On March 15, 2007, the Committee approved the Amended 2005 Stock Incentive Plan (the Amended 2005 Plan) as a replacement to the 2005 Stock Incentive Plan. If approved by the stockholders under Proposal Two, the Amended 2005 Plan will become effective on May 30, 2007. A full description of the Amended 2005 Plan can be found in the section *Proposal Two-Proposal to Approve Amendment to the 2005 Stock Incentive Plan*.

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

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis (the CD&A) for the year ended December 31, 2006 with management. In reliance on the reviews and discussions referred to above, the Compensation Committee recommended to the board, and the board has approved, that the CD&A be included in the proxy statement for the year ended December 31, 2006 for filing with the SEC.

Respectfully submitted,

*COMPENSATION COMMITTEE
of the Board of Directors*

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

Compensation Committee Interlocks and Insider Participation

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

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Nomination of Directors

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

- personal and professional character, integrity, ethics and values;
- general business experience and leadership profile, including experience in corporate management, such as serving as an officer or former officer of a publicly held company, or experience as a board member of another publicly held company;
- strategic planning abilities and experience;
- aptitude in accounting and finance;
- expertise in domestic and international markets;
- experience in the network security or telecommunications industry;
- understanding of relevant technologies;
- academic expertise in an area of the Company's operations;
- communications and interpersonal skills; and
- practical and mature business judgment.

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

These directors will also consider nominees proposed by stockholders. Although the Company has no formal policy regarding stockholder nominees, stockholder nominees are viewed in substantially the same manner as other nominees. The consideration of any candidate for director will be based on the assessment of the individual's background, skills and abilities, and if such characteristics qualify the individual to fulfill the needs of the Board at that time. To recommend a prospective nominee for consideration, stockholders should submit the candidate's name and qualifications to the Company's Secretary in writing at the address listed above. There have been no changes to the procedures by which stockholders may recommend nominees to the Board since the date of the Company's proxy statement for its 2006 annual meeting of stockholders. The Company did not receive any recommendations for Board nominees for election at the Meeting from its stockholders.

Communication with the Board

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

Policy Regarding Board Attendance at Stockholders Meetings

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Although it has no formal policy requiring attendance, the Company encourages all directors to attend all meetings of stockholders. Four out of five of the Company's directors attended its 2006 annual stockholders meeting.

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Code of Ethics

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

PROPOSAL TWO

PROPOSAL TO APPROVE AMENDMENT TO THE 2005 STOCK INCENTIVE PLAN

The Company has used stock options as a key element of its overall compensation program for employees of the Company. The Board of Directors and the Compensation Committee believe that it is important to have equity-based incentives available to attract and retain quality employees for the Company. On January 25, 2007, the Board of Directors approved, subject to stockholder approval, a proposal to amend the 2005 Stock Incentive Plan. The following descriptions present summaries of (i) the 2005 Stock Incentive Plan as it currently exists and (ii) the proposed amendment to the 2005 Stock Incentive Plan.

Description of the Existing 2005 Stock Incentive Plan

The 2005 Plan consists of three (3) separate equity incentive programs:

- the Discretionary Option Grant Program;
- the Stock Issuance Program; and
- the Automatic Option Grant Program for non-employee Board members.

The principal features of each program are described below. The Compensation Committee of the Board will have the exclusive authority to administer the Discretionary Option Grant and Stock Issuance Programs with respect to option grants and stock issuances made to the Company's executive officers and non-employee Board members and also will have the authority to make option grants and stock issuances under those programs to all other eligible individuals. However, the Board may at any time appoint a secondary committee of one or more Board members to have separate but concurrent authority with the Compensation Committee to make option grants and stock issuances under those two programs to eligible individuals other than the Company's executive officers and non-employee directors.

The term plan administrator, as used in this summary, will mean the Compensation Committee and any secondary committee, to the extent each committee is acting within the scope of its administrative discretion under the 2005 Plan. However, neither the Compensation Committee nor any secondary committee exercises any administrative discretion under the Automatic Option Grant Program. All grants under Automatic Option Grant Program are made in strict compliance with the express provisions of that program.

Issuable Shares

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Under the 2005 Stock Incentive Plan, 750,000 new shares of Common Stock have been reserved for issuance, 736,500 shares have been granted for issuance as of March 31, 2007.

No participant in the 2005 Plan may receive option grants for more than 100,000 shares of Common Stock in total per calendar year, subject to adjustment for subsequent stock splits, stock dividends and similar transactions. Stockholder approval of this proposal will also constitute approval of this share limitation for purposes of Internal Revenue Code

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Section 162(m). This limitation, together with the fact that option grants under the Discretionary Option Grant Program to its executive officers will be made by the Compensation Committee and will have an exercise price per share equal to the fair market value per share of Common Stock on the date of grant, should ensure that any deductions to which the Company would otherwise be entitled upon the exercise of stock options granted under the Discretionary Option Grant Program or the subsequent sale of the shares purchased under those options will not be subject to the \$1 million limitation on the income tax deductibility of compensation paid per executive officer imposed under Section 162(m) of the Internal Revenue Code.

If an option expires or is terminated for any reason before all its shares are exercised, the shares not exercised will be available for subsequent option grants or stock issuances under the 2005 Plan. In addition, unvested shares issued under the 2005 Plan and subsequently repurchased by the Company at a price not greater than the original exercise price or issue price paid per share will be added back to the number of shares of common stock reserved for issuance under the 2005 Plan. Accordingly, these repurchased shares will be available for reissuance through one or more subsequent option grants or direct stock issuance under the 2005 Plan.

Eligibility

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Officers and employees, non-employee Board members and independent contractors in the Company's service or in the service of its parent or subsidiary companies (whether now existing or subsequently established) will be eligible to participate in the Discretionary Option Grant and Stock Issuance Programs. Participation in the Automatic Option Grant Program is limited to non-employee members of the Board.

As of March 31, 2007, approximately 31 employees, including six executive officers and three non-employee Board members were eligible to participate in the Discretionary Option Grant and Stock Issuance Programs. The three non-employee Board members are also eligible to participate in the Automatic Option Grant Program.

Valuation

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The fair market value per share of Common Stock on any relevant date under the Plan will be deemed to be equal to the closing selling price per share on that date on the OTCBB Market. On March 30, 2007, the fair market value per share determined on this basis was \$0.52.

Discretionary Option Grant Program

Grants

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The plan administrator will have complete discretion under the Discretionary Option Grant Program to determine which eligible individuals are to receive option grants, the time or times when those grants are to be made, the number of shares subject to each grant, the status of any granted option as either an incentive stock option or a non-statutory option under federal tax laws, the vesting schedule, if any, to be in effect for the option grant and the maximum term for which any granted option is to remain outstanding.

Price and Exercisability

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Each granted option will have an exercise price per share not less than 100% of the fair market value of the shares unless otherwise determined by the plan administrator on the date of grant. No granted option will have a term in excess of ten (10) years. The shares subject to each option will generally vest in one or more installments over a specified period of service measured from the grant date subject to the optionee's continued service. However, one or more options may be structured so that they will be immediately exercisable for any or all of the option shares. The shares acquired under those options will be subject to repurchase by the Company, at the lower of the exercise price paid per share or the fair market value per share, if the optionee ceases service with the Company prior to vesting in those shares.

The exercise price may be paid in cash or in shares of common stock. Outstanding options may also be exercised through a same-day sale program pursuant to which a designated brokerage firm is to effect an immediate sale of the

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shares purchased under the option and pay to the Company, out of the sale proceeds available on the settlement date, sufficient funds to cover the exercise price for the purchased shares plus all applicable withholding taxes.

Termination of Service

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Upon cessation of service, the optionee will have a limited period of time in which to exercise any outstanding option to the extent exercisable for vested shares. The plan administrator will have complete discretion to extend the period following the optionee's cessation of service during which his or her outstanding options may be exercised and/or to accelerate the exercisability or vesting of such options in whole or in part. This discretion may be exercised at any time while the options remain outstanding, whether before or after the optionee's actual cessation of service.

Cancellation/Regrant Program

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The plan administrator will have the authority to effect, with the consent of the affected option holders, the cancellation of outstanding options under the Discretionary Option Grant Program in return for the grant of new options for the same or a different number of option shares with an exercise price per share based upon the fair market value of the common stock on the new grant date.

Stock Issuance Program

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Shares of the Company's Common Stock may be issued under the Stock Issuance Program at a price per share not less than 100% of their fair market value, payable in cash. In addition, shares may be issued as a bonus for past services without any cash outlay required of the recipient. Further, shares of common stock may be issued under the Stock Issuance Program pursuant to share right awards which entitle the recipients to receive those shares upon the attainment of designated performance goals or completion of a specified service period. The plan administrator will have complete discretion under this program to determine which eligible individuals are to receive these stock issuances or share right awards, the time or times when these issuances or awards are to be made, the number of shares subject to each issuance or award and the vesting schedule to be in effect for the stock issuance or share rights award (subject to the limitations of Section 162(m) of the Internal Revenue Code described above).

The shares issued may be fully and immediately vested upon issuance or may vest upon the recipient's completion of a designated service period or upon the attainment of pre-established performance goals. The plan administrator will, however, have the discretionary authority at any time to accelerate the vesting of any and all unvested shares outstanding under the Stock Issuance Program.

Any unvested shares for which the requisite service requirement or performance objective is not obtained must be surrendered to the Company for cancellation, and the participant will not have any further stockholder rights with respect to those shares. However, for shares issued for cash or cash equivalents, including a promissory note, the Company will repay the participant the cash amount paid for the surrendered shares without interest and/or shall cancel the unpaid principal balance of any promissory note delivered in payment of those shares.

Outstanding share right awards under the Stock Issuance Program will automatically terminate, and no shares of common stock will actually be issued in satisfaction of those awards, if the performance goals established for such awards are not attained. The plan administrator, however, will have the discretionary authority to issue shares of common stock in satisfaction of one or more outstanding share right awards as to which the designated performance goals are not attained.

However, in order to assure that the compensation attributable to one or more stock issuances under the program will qualify as performance-based compensation which will not be subject to the \$1 million limitation on the income tax deductibility of the compensation paid per executive officer which is imposed under Internal Revenue Code Section 162(m), the plan administrator shall, in its sole discretion, provide that those particular issuances will be contingent upon the actual attainment of certain pre-established performance goals based on one or more of the following criteria:

- return on total stockholder equity;
- earnings per share of common stock;
- net income (before or after taxes);
- earnings before interest, taxes, depreciation and amortization;
- sales or revenues;
- return on assets, capital or investment;
- market share;
- cost reduction goals;
- budget comparisons;
- implementation or completion of critical projects or processes;
- customer satisfaction;
- any combination of, or a specified increase in, any of the foregoing; and
- the formation of joint ventures, research or development collaborations, or the completion of other corporate transactions.

In addition, performance goals may be based upon the attainment of specified levels of the Company's performance under one or more of the measures described above relative to the performance of other entities and may also be based on the performance of any of its business units or divisions or subsidiaries. Performance goals may include a minimum threshold level of performance below which no award will be earned, levels of performance at which specified portions of an award will be earned and a maximum level of performance at which an award will be fully earned.

Automatic Option Grant Program

Grant

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Under the Automatic Option Grant Program of the 2005 Plan, eligible non-employee Board members receive a series of option grants over their period of Board service. Each non-employee Board member will, at the time of his or her initial election or appointment to the Board, receive an option grant for 10,000 shares of Common Stock, provided that individual has not previously been employed by the Company in the preceding six months. In addition, on the date of each annual stockholders meeting, each individual who is to continue to serve as a non-employee Board member will automatically be granted an option to purchase 5,000 shares of Common Stock, provided he or she has served as a non-employee Board member for at least six (6) months. There will be no limit on the number of such 5,000-share option grants any one eligible non-employee Board member may receive over his or her period of continued Board service, and non-employee board members who have previously been one of the Company's employees will be eligible to receive one or more such annual grants over their period of board service.

Option Terms

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Each automatic grant will have an exercise price per share equal to 100% of the fair market value per share of the Company's Common Stock on the grant date and will have a maximum term of 10 years, subject to earlier termination following the optionee's cessation of Board service. Each automatic option will vest in three (3) successive equal annual installments upon the optionee's completion of each year of Board service measured from the grant date. Following the optionee's cessation of Board service for any reason, each option will remain exercisable for a 12-month period and may be exercised during that time for any or all shares in which the optionee is vested at the time of the cessation of Board service.

General Provisions

Acceleration

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In the event that the Company is acquired by merger or asset sale or its stockholders sell more than 50% of the Company's outstanding voting stock pursuant to a successful tender offer, each outstanding option under the Discretionary Option Grant Program that is not to be assumed or replaced by the successor corporation or otherwise

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continued in effect will automatically accelerate in full, and all unvested shares outstanding under the Discretionary Option Grant and Stock Issuance Programs will immediately vest, except to the extent the Company's repurchase rights with respect to those shares are to be assigned to the successor corporation or otherwise continued in effect. The plan administrator will also have the authority to grant options which will immediately vest upon an acquisition of the Company, whether or not those options are assumed by the successor corporation.

The plan administrator is also authorized under the Discretionary Option Grant and Stock Issuance Programs to grant options and to structure repurchase rights so that the shares subject to those options or repurchase rights will immediately vest upon an acquisition of the Company by merger or asset sale, the successful completion of a tender offer for more than 50% of the Company's outstanding voting stock or a proxy contest for the election of Board members. This accelerated vesting may occur either at the time of the transaction or proxy contest or upon the subsequent involuntary termination of the individual's service within a designated period not to exceed 18 months following the transaction or proxy contest.

The shares subject to each option under the Automatic Option Grant will immediately vest upon an acquisition of the Company by merger or asset sale, the successful completion of a tender offer for more than 50% of the Company's outstanding voting stock or a proxy contest for the election of Board members.

The acceleration of vesting in the event of a change in the ownership or control of the Company may be seen as an anti-takeover provision and may have the effect of discouraging a merger proposal, a takeover attempt or other efforts to gain control of the Company.

Stockholder Rights and Option Transferability

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No optionee will have any stockholder rights with respect to the option shares until he or she has exercised the option and paid the exercise price for the purchased shares. Options will generally not be assignable or transferable other than by will or the laws of inheritance following the optionee's death, and during the optionee's lifetime, the option may only be exercised by the optionee. However, the plan administrator may structure one or more non-statutory options under the 2005 Plan so that those options will be transferable during the optionee's lifetime to one or more members of the optionee's family or to a trust established for one or more such family members or to the optionee's former spouse, to the extent such transfer is in connection with the optionee's estate or pursuant to a domestic relations order. The optionee may also designate one or more beneficiaries to automatically receive his or her options at death.

Changes in Capitalization

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Should any change be made to the Common Stock issuable under the 2005 Plan by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding common stock as a class without the Company's receipt of consideration, then appropriate adjustments will be made to:

- the maximum number and/or class of securities issuable under the 2005 Plan;
- the number and/or class of securities for which any one person may be granted options and direct stock issuances per calendar year under the 2005 Plan;
- the number and/or class of securities for which grants are to be made under the Automatic Option Grant Program to new or continuing non-employee Board members; and
- the number and/or class of securities and price per share in effect under each outstanding option.

These adjustments to the outstanding options will be effected in a manner which will preclude the enlargement or dilution of rights and benefits under those options.

Financial Assistance

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The plan administrator may institute a loan program to assist one or more participants in financing the exercise of outstanding options under the Discretionary Option Grant Program or the purchase of shares under the Stock Issuance

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Program through full-recourse interest-bearing promissory notes to the extent permitted by law. However, the maximum amount of financing provided any participant may not exceed the cash consideration payable for the issued shares plus all applicable taxes incurred in connection with the acquisition of those shares.

Special Tax Election

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The plan administrator may provide one or more holders of options or unvested share issuances under the 2005 Plan with the right to have the Company withhold a portion of the shares otherwise issuable to these individuals in satisfaction of the withholding taxes to which these individuals become subject in connection with the exercise of those options or the vesting of those shares. Alternatively, the plan administrator may allow these individuals to deliver previously acquired shares of common stock in payment of such withholding tax liability.

Amendment and Termination

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The Board may amend or modify the Plan at any time, subject to any required stockholder approval pursuant to applicable laws and regulations. Unless sooner terminated by the Board, the 2005 Plan will terminate on the earliest of (1) June 14, 2015, (2) the date on which all shares available for issuance under the 2005 Plan have been issued as fully-vested shares or (3) the termination of all outstanding options in connection with certain changes in control or ownership of the Company.

Federal Income Tax Consequences

Option Grants

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Options granted under the Discretionary Option Grant Program may be either incentive stock options which satisfy the requirements of Section 422 of the Internal Revenue Code or non-statutory options which are not intended to meet those requirements. All options granted under the Automatic Option Grant Programs will be non-statutory options. The federal income tax treatment for the two types of options differs as follows:

Incentive Options. The optionee recognizes no taxable income at the time of the option grant, and no taxable income is recognized for regular tax purpose at the time the option is exercised, although taxable income may arise at that time for alternative minimum tax purposes. The optionee will, however, recognize taxable income in the year in which the purchased shares are sold or otherwise made the subject of a taxable disposition. For Federal tax purposes, dispositions are divided into two categories: (1) qualifying and (2) disqualifying. A qualifying disposition occurs if the sale or other disposition is made after the optionee has held the shares for more than two (2) years after the option grant date and more than one (1) year after the exercise date. If either of these two holding periods is not satisfied, then a disqualifying disposition will result.

Upon a qualifying disposition, the optionee will recognize long-term capital gain in an amount equal to the excess of (1) the amount realized upon the sale or other disposition of the purchased shares over (2) the exercise price paid for the shares. If there is a disqualifying disposition of the shares, then the excess of (1) the fair market value of those shares on the exercise date over (2) the exercise price paid for the shares will be taxable as ordinary income to the optionee. Any additional gain or loss recognized upon the disposition will be recognized as a capital gain or loss by the optionee.

If the optionee makes a disqualifying disposition of the purchased shares, then the Company will be entitled to an income tax deduction, for the taxable year in which such disposition occurs, equal to the excess of (1) the fair market value of such shares on the option exercise date over (2) the exercise price paid for the shares. The Company will not be entitled to any income tax deduction if the optionee makes a qualifying disposition of the shares.

Non-Statutory Options. No taxable income is recognized by an optionee upon the grant of a non-statutory option. The optionee will in general recognize ordinary income, in the year in which the option is exercised, equal to the excess of

the fair market value of the purchased shares on the exercise date over the exercise price paid for the shares, and the optionee will be required to satisfy the tax withholding requirements applicable to such income.

If the shares acquired upon exercise of the non-statutory option are unvested and subject to repurchase by the Company in the event of the optionee's termination of service prior to vesting in those shares, then the optionee will not recognize any taxable income at the time of exercise but will have to report as ordinary income, as and when this repurchase right lapses, an amount equal to the excess of (1) the fair market value of the shares on the date the repurchase right lapses over (2) the exercise price paid for the shares. The optionee may, however, elect under Section 83(b) of the Internal Revenue Code to include as ordinary income in the year of exercise of the option an amount equal to the excess of (1) the fair market value of the purchased shares on the exercise date over (2) the exercise price paid for such shares. If the Section 83(b) election is made, the optionee will not recognize any additional income as and when the repurchase right lapses.

The Company will be entitled to an income tax deduction equal to the amount of ordinary income recognized by the optionee with respect to the exercised non-statutory option. The deduction will in general be allowed for the Company's taxable year in which the ordinary income is recognized by the optionee.

Direct Stock Issuances

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The tax principles applicable to direct stock issuances under the 2005 Plan will be substantially the same as those summarized above for the exercise of unvested non-statutory options, if the shares are not vested. If the shares are vested, the recipient of the shares will recognize taxable income upon receipt of the shares in the amount equal to the fair market value of the shares at the time of receipt, less any amount, if any, paid for the shares.

Deductibility of Executive Compensation

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The Company anticipates that any compensation deemed paid by it in connection with the disqualifying dispositions of incentive stock option shares or the exercise of non-statutory options with exercise prices equal to the fair market value of the option shares on the grant date will qualify as performance-based compensation for purposes of Internal Revenue Code Section 162(m) and will not have to be taken into account for purposes of the \$1 million limitation per covered individual on the deductibility of the compensation paid to certain of its executive officers. Accordingly, all compensation deemed paid with respect to those options will remain deductible by the Company without limitation under Internal Revenue Code Section 162(m).

Accounting Treatment

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In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123(R)), which replaces SFAS 123 and supersedes APB Opinion No. 25. SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition.

Prior to January 1, 2006, the Company accounted for employee stock-based compensation in accordance with APB 25 and followed the disclosure requirements in accordance with SFAS 148. No compensation cost was recorded for stock options, as historically all options granted under the Company's stock option plans have an exercise price equal (at minimum) to the market value of the underlying common stock on the date of grant.

The Company adopted SFAS 123(R) on January 1, 2006 using the modified prospective application method described in the statement. Results for prior periods have not been restated. Stock-based compensation expense recognized during each period is based on the value of the portion of stock-based payment awards that is ultimately expected to vest. Stock-based compensation expense recognized in the consolidated statement of operations during 2006 included compensation expense for stock-based payment awards granted prior to, but not yet vested, as of December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 148 and

compensation expense for the stock-based payment awards granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with SFAS 123(R). As stock-based compensation expense recognized in the statement of operations after December 31, 2005 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the pro forma information required under SFAS 148 for the periods prior to 2006, we accounted for forfeitures as they occurred.

By adopting SFAS 123(R) the Company anticipates recording substantial non-cash stock compensation expenses. The adoption of SFAS 123(R) is not expected to have a significant effect on the Company's financial condition or cash flows but is expected to have a significant, adverse effect on the Company's results of operations.

Interests of Officers and Directors

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The Company's executive officers, including the employee director nominees, Mr. Paxton and Mr. Head, and the Company's non-employee director nominees, Mr. Bucy, Mr. Gero and Mr. Johnston, are entitled to participate in the 2005 Plan and may receive option grants and stock issuances under the Discretionary Option Grant Program and the Stock Issuance Program. In addition, the non-employee director nominees will receive option grants under the Automatic Option Program as set forth above under *New Plan Benefits*.

Description of Proposed Amendment to the 2005 Stock Incentive Plan

Assuming approval by the stockholders of the Company of the proposed amendment to the 2005 Stock Incentive Plan, the Company intends to restate such plan, as amended (the Amended Stock Incentive Plan). Stock options under the Amended Stock Incentive Plan would continue to vest under conditions determined by the Committee. The material amendment to be effected pursuant to the Amended Stock Incentive Plan is as follows:

Increase in Number of Shares Available for Issuance. The Amended Stock Incentive Plan would increase the total number of shares available under the 2005 Stock Incentive Plan to be issued upon the exercise of stock options granted by 750,000 shares to 1,500,000 shares of Common Stock. This amendment would increase the shares available for issuance as of March 30, 2007 from 85,500 to 835,500 shares. As noted previously, the proceeds received by the Company upon exercise of stock options will increase the Company's cash and equity balances.

The Amended Stock Incentive Plan would continue to be administered by the Committee.

As of March 30, 2007, no stock options had been granted, and no shares of Common Stock had been issued, on the basis of the share increase which is the subject of this Proposal.

New Plan Benefits

Because awards granted under the Amended Stock Incentive Plan are at the discretion of the Compensation Committee, the awards that will be granted in the future are not currently determinable. The Company has not made or entered into any commitments, agreements or understandings related to any future awards excepts as described in the section titled Automatic Option Grant Program. For the year 2006, a total of 421,500 shares were awarded as incentive options. 220,000 or 52% were awarded to Named Executive Officer Group and 201,500 shares or 48% of the total awarded were awarded to Non-Executive Officer Named Employee Group. Plan awards for the previous year are set forth in the following table:

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Name and Principal Position	Year	Award Date	Exercise Price	Option Awarded	Vesting Schedule	Expiration Date
G. Ward Paxton, Chairman, President, and Director	2006	11/09/06	\$ 0.33	30,000	3 Years	11/09/11
Michael L. Paxton, Vice President, Chief Financial Officer, Treasurer and Secretary	2006	11/09/06	0.33	30,000	3 Years	11/09/11
T. Joe Head, Vice-Chairman, Vice President and Director	2006	11/09/06	0.30	100,000	3 Years	11/09/16
Aaron N. Bawcom, Vice President of Engineering	2006	11/09/06	0.30	30,000	3 Years	11/09/16
Garry L. Hemphill, Vice President of Sales	2006	11/09/06	0.30	30,000	3 Years	11/09/16
Eric H. Gore, (1) Former Vice President of Worldwide Sales	2006					
Named Executive Officers as a Group	2006	11/09/06	0.30-0.33	220,000	3 Years	11/09/11-11/09/16
Non Executive Officers Employee Group	2006	11/09/06	0.30	201,500	3 Years	11/09/16

(1) Eric H. Gore left the Company on July 28, 2006 to pursue other interests.

Stockholder Approval

The affirmative vote of at least a majority of the outstanding shares of Common Stock present in person or by proxy at the Annual Meeting and entitled to vote is required for approval of the amendment to the 2005 Stock Incentive Plan. Should such stockholder approval not be obtained, then the 750,000 share increase to the share reserve under the 2005 Stock Incentive Plan will not occur and no options or stock issuances will be made on the basis of such increases. The 2005 Stock Incentive Plan will, however, continue in effect, and option grants may continue to be made under the 2005 Stock Incentive Plan until all the shares available for issuance under the 2005 Stock Incentive Plan has been issued pursuant to such option grants.

The Board of Directors recommends a vote FOR this proposal.

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**PROPOSAL THREE
RATIFICATION OF THE APPOINTMENT
OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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The Board has appointed KBA Group LLP to serve as independent auditors of the Company and to audit its consolidated financial statements for fiscal year 2007, subject to ratification by the Company's stockholders at the Meeting. KBA Group LLP has served as the Company's Independent Registered Public Accounting Firm since March 2003. To the knowledge of management of the Company, neither such firm nor any of its members has any direct or material indirect financial interest in the Company, nor any connection with the Company in any capacity other than as independent auditors.

Although stockholder ratification and approval of this appointment is not required by the Company's bylaws or otherwise, in keeping with the Company's policy that its stockholders should be entitled to a voice in this regard and as a matter of good corporate practice, the Board is seeking ratification of this appointment. If the appointment is not ratified, the Board must then determine whether to appoint other auditors prior to the end of the current fiscal year. In such case, the opinions of stockholders will be taken into consideration.

Fees Paid to Independent Registered Public Accounting Firm

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The Audit Committee has reviewed the following audit and non-audit fees the Company has paid to the Independent Registered Public Accounting Firm for purposes of considering whether such fees are compatible with maintaining the auditor's independence. The policy of the Audit Committee is to pre-approve all audit and non-audit services performed by its Independent Registered Public Accounting Firm before the services are performed, including all of the services described below under *Audit-Related Fees*, *Tax Fees* and *All Other Fees* below.

Audited Fees. Estimated fees billed for service rendered by KBA Group LLP for the reviews of Forms 10-QSB and for the audit of the consolidated financial statements of the Company were \$117,850 for 2006 and \$107,725 for 2005.

Audited-Related Fees. Aggregate fees billed for all audit-related services rendered by KBA Group LLP consisted of \$8,400 for 2006 and \$7,000 for 2005. These amounts include employee benefit plan audits in 2004 and 2005.

Tax Fees. Aggregate fees billed for permissible tax services rendered by KBA Group LLP consisted of \$39,278 for 2006 and \$46,145 for 2005. These amounts include tax strategy services, preparation of sales tax returns, preparation of federal and state income tax returns, preparation of property tax and franchise tax returns and international tax issues.

All Other Fees. Aggregate fees billed for all other services rendered by KBA Group LLP consisted of \$5,000 for 2006 and \$16,850 for 2005. The services billed for 2006 were related to the S-3 filed in 2006. The services billed for 2005 were related to the Form S-3 filed in 2005. Representatives of KBA Group LLP are expected to be in attendance at the Meeting and will be afforded the opportunity to make a statement. The representatives will also be available to respond to appropriate questions.

The enclosed Proxy will be voted as specified, but if no specification is made, it will be voted for the adoption of the resolution of ratification.

The Board recommends a vote FOR this proposal.

**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL
OWNERS AND MANAGEMENT**

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The following table sets forth information regarding the beneficial ownership of the Common Stock as of March 30, 2007, unless otherwise indicated, by (i) each person known by the Company to be the beneficial owner of more than 5% of the outstanding shares of Common and Preferred Stock, (ii) each director of the Company, (iii) the Company's current executive officers including one terminated executive and (iv) all current directors and executive officers of the Company as a group. The persons and entities named in the table have sole voting and investment power with respect to all such shares owned by them, unless otherwise indicated.

Name of Beneficial Owner or Group (1)	Common Stock Amount and Nature of Beneficial Ownership (2)	Percent of Class (%)	5% Preferred Stock Amount and Nature of Beneficial Ownership (2)	Percent of Class (%)
G. Ward Paxton (1)(3)	2,953,034	29.80	% 140,000	53.91 %
T. Joe Head (1)(4)	544,115	5.86		
J. Fred Bucy, Jr. (5)	17,667		*	
James F. Gero (1)(6)	458,881	4.83	60,000	23.10
Donald M. Johnston (7)	20,524		*	
Aaron N. Bawcom (8)	111,201	1.19		
Garry L. Hemphill (9)	82,759	0.89		
Michael L. Paxton (1)(10)	744,468	7.99		
Enable Growth Partners L.P. (1) (11)	608,180	6.19	39,696	15.29
Marshall B. Payne (1)(12)	137,730	1.47	20,000	7.70
Eric H. Gore (13)	4,976		*	
All directors and executive officers as a group (9 persons) (14)	4,932,648	46.72	200,000	77.01

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* Represents beneficial ownership of less than 1% of the outstanding shares of Common Stock.

(1) The addresses of the persons or entities shown in the foregoing table who are beneficial owners of more than 5% of the Common Stock or Preferred Stock are as follows: G. Ward Paxton, T. Joe Head, James F. Gero and Michael L. Paxton, 1101 East Arapaho Road, Suite 200, Richardson, Texas 75081; Enable Growth Partners L.P., One Sansome Street, Suite 2900, San Francisco, CA 94104 and Marshall B. Payne, 500 Crescent Court, Suite 250, Dallas, TX 75201.

(2) Beneficial ownership is calculated in accordance with the rules of the Securities and Exchange Commission in accordance with Rule 13d-3(d)(1). Percentage of beneficial ownership is based on 8,296,213 shares of Common Stock outstanding as of March 30, 2007 and 259,696 shares of 5% Preferred Stock. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of Common Stock subject to options or warrants held by that person that are currently exercisable or will become exercisable within 60 days following March 30, 2007 are deemed outstanding. However, these shares are not deemed outstanding for the purpose of computing the percentage ownership of any other person. Unless otherwise indicated in the footnotes to this table, the persons and entities named in the table have sole voting and sole investment power with respect to all shares beneficially owned, subject to community property laws where applicable.

Certain shares of Common Stock shown as beneficially owned are issuable upon conversion of the 5% Preferred Stock or exercise of warrants the Company issued in a private placement on March 25, 2004. Under the terms of these shares preferred stock and warrants, the shares of 5% Preferred Stock are convertible and the warrants are exercisable only to the extent that the number of shares of common stock issuable pursuant to those securities, together with the number of shares of Common Stock owned by the relevant person and its affiliates (but not including shares of Common Stock underlying unconverted portions of the 5% Preferred Stock or unexercised portions of the warrants) would not exceed 9.9% of the then outstanding Common Stock as determined in

accordance with Section 13(d) of the Exchange Act. In addition, certain shares of Common Stock shown as beneficially owned are issuable upon the conversion of Series 2 5% Preferred Stock issued in a private placement on March 28, 2005. Under the terms of the Series 2 5% Preferred Stock, the shares are convertible only to the extent that the number of shares of Common Stock issuable upon conversion thereof and upon the exercise of the warrants issued in such private placement, together with the number of shares of Common Stock owned the relevant person and its affiliates (but not including shares of Common Stock underlying unconverted portions of the Series 2 preferred stock or unexercised portions of the warrants) would not exceed 4.99% of the then outstanding common stock as determined in accordance with Section 13(d) of the Exchange Act. However, this restriction does not apply to any holder of the Series 2 Preferred Stock who is one of the Company's directors or officers. Similar restrictions apply to the conversion of the Series 3 5% Preferred Stock and Private Placement Warrants.

- (3) Includes the equivalent of 5,133 shares held by Mr. Paxton in the Intrusion Stock Fund in the Intrusion 401(k) Savings Plan. Includes the equivalent of 55,046 shares that may be issued upon conversion of Series 3 5% Preferred Stock, 160,000 shares that may be issued upon conversion of Series 2 5% Preferred Stock, 222,646 shares that may be issued upon conversion of 5% Preferred Stock and 185,449 shares that Mr. Paxton may acquire upon the exercise of warrants that are currently exercisable or exercisable within 60 days of March 30, 2007. Also includes 65,000 shares that Mr. Paxton may acquire upon exercise of options that are currently exercisable or will become exercisable within 60 days of March 30, 2007.
- (4) Includes 65,000 shares that Mr. Head may acquire upon exercise of options that are currently exercisable or will become exercisable within 60 days of March 30, 2007.
- (5) Includes 14,167 shares that Mr. Bucy may acquire upon exercise of options that are currently exercisable or will become exercisable within 60 days of March 30, 2007.
- (6) Includes the equivalent of 27,523 shares that may be issued upon conversion of Series 3 5% Preferred Stock, the equivalent of 60,000 shares that may be issued upon conversion of Series 2 5% Preferred Stock, 95,419 shares that may issued upon conversion of 5% Preferred Stock and 77,159 shares that Mr. Gero may acquire upon exercise of warrants that are currently exercisable or exercisable within 60 days of March 30, 2007. Also includes 9,167 shares that Mr. Gero may acquire upon exercise of options that are currently exercisable or will become exercisable within 60 days of March 30, 2007.
- (7) Includes 14,167 shares that Mr. Johnston may acquire upon exercise of options that are currently exercisable or will become exercisable within 60 days of March 30, 2007.
- (8) Includes 111,201 shares that Mr. Bawcom may acquire upon exercise of options that are currently exercisable or will become exercisable within 60 days of March 30, 2007.
- (9) Includes 76,875 shares that Mr. Hemphill may acquire upon exercise of options that are currently exercisable or will become exercisable within 60 days of March 30, 2007.
- (10) Includes 654,468 shares held by Mr. Michael Paxton, of which includes 8,029 shares held by Mr. Paxton's wife and 68,221 held by trusts of Mr. Paxton's children. In addition it includes 90,000 shares that Mr. Paxton may acquire upon exercise of options that are currently exercisable or will become exercisable within 60 days of March 30, 2007.
- (11) Includes the equivalent of 137,615 shares that may be issued upon the conversion of Series 3 5% Preferred Stock, the equivalent of 200,000 shares that may be issued upon conversion of Series 2 5% Preferred Stock, 63,129 shares that may be issued upon conversion of 5% Preferred Stock and 207,436 shares that Enable Growth Partners L.P. may acquire upon exercise of warrants that are currently exercisable or exercisable within 60 days of March 30, 2007. Mitch Levine has voting and/or investment control over the shares held by Enable Growth Partners LP. Mr. Levine disclaims beneficial ownership of these shares.
- (12) Includes the equivalent of 23,194 shares that may be issued upon the conversion of Series 3 5% Preferred Stock, the equivalent of 40,000 shares that may be issued upon conversion of Series 2 5% Preferred Stock, 31,806 shares that may be issued upon conversion of 5% Preferred Stock and 42,730 shares that Mr. Payne may acquire upon exercise of warrants that are currently exercisable or exercisable within 60 days of March 30, 2007.
- (13) Represents the equivalent of 4,976 shares held by Mr. Gore in the Intrusion Stock Fund in the Intrusion 401(k) Savings Plan. Mr. Gore left the Company on July 28, 2006 to pursue other interests

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- (14) Includes an aggregate of 452,244 shares that may be acquired upon exercise of options of officers and directors that are currently exercisable or will become exercisable within 60 days of March 30, 2007. Includes the equivalent of 82,569 shares that may be issued upon conversion of Series 3 5% Preferred Stock, the equivalent of 220,000 shares that may be issued upon conversion of Series 2 5% Preferred Stock, 318,065 shares that may be issued upon conversion of 5% Preferred Stock and 262,608 shares that may be acquired upon exercise of warrants that are currently exercisable or exercisable within 60 days of March 30, 2007.

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Executive Officers

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The following table sets forth the names and ages of all executive officers of the Company, their respective positions with the Company, and the period during which each has served as an officer.

Name of Officer	Age	Position(s)	Served as Officer Since
G. Ward Paxton	71	Chairman, President, Chief Executive Officer and Director	2001
Jay W. Barbour	38	Vice President, Marketing	2006
Aaron N. Bawcom	34	Vice President, Engineering	2003
T. Joe Head	50	Vice Chairman and Vice President	2003
Garry L. Hemphill	58	Vice President, Operations	2003
Michael L. Paxton	46	Vice President, Chief Financial Officer, Treasurer and Corporate Secretary	2002

Jay W. Barbour joined the Company on January 11, 2006 as Vice President of Marketing. As Vice President of Marketing, he is responsible for the strategies to bring the Company's services to market. Prior to joining the Company, Mr. Barbour held various positions in the hi-tech industry including the Vice President of Product Management at ScanSafe in 2005 as well as a consultant to security and wireless start-ups in the United Kingdom and United States from 2003 until 2005. From 2002 to 2003, Mr. Barbour was a Senior Product Manager at Hewlett Packard. Mr. Barbour was Product Manager of Security at 3Com from 2000 to 2002 and was also the Product Marketing Manager at Teradyne from 1999 to 2000. Mr. Barbour holds a B.S. degree in Engineering Physics with honors from Queen's University, Canada. Mr. Barbour also holds an M.B.A from INSEAD, France, and is a Certified Information Systems Security Professional (CISSP).

Aaron N. Bawcom was named Vice President of Engineering on January 29, 2003. He joined the Company on April 10, 2000 as Director of Product Development of Security Software. As Vice President of Engineering, he is responsible for the technical direction and development of all products. From 1998 to 2000, Mr. Bawcom served as engineer, manager, and chief architect for Network Associates security products where he produced Enterprise Management, Intrusion Detection, and Firewall software. Prior to that time, Mr. Bawcom worked as an engineer producing a network based content scanning product for McAfee. Mr. Bawcom holds a B.S. degree in Computer Science from Texas A&M University.

Garry L. Hemphill joined the Company on February 14, 2003 as Vice President of Operations and was named as Vice President of Sales in 2006. Mr. Hemphill was previously employed with the Company from 1987 to 2000 as Vice President of Operations and 1984 to 1987 as Director of Operations. From 2002 to 2003, Mr. Hemphill acted as an independent consultant to contract manufacturers in the area of business development. From 2000 to 2001, Mr. Hemphill was President and Chief Executive Officer of VHB Technologies, Inc., a Richardson, Texas based start-up. Mr. Hemphill's background covers over 20 years in data networking, engineering and operation management. Mr. Hemphill holds an Associate Degree in Business Administration from the University of Texas at Dallas.

Michael L. Paxton joined the Company on August 13, 2002 as Vice President, Chief Financial Officer, Secretary and Treasurer. He was also employed by the Company from 1986 until May 1998. Mr. Paxton previously held positions with the Company as Vice President and Secretary from 1995 to 1998, Controller of Finance and Accounting from 1987 to 1995 and Accounting Manager from 1986 to 1987. From 1998 to August 2002, Mr. Paxton served as General Partner for Paxton Ventures, L.P. Mr. Paxton holds a B.B.A. degree from the University of Oklahoma.

The biographies of G. Ward Paxton and T. Joe Head are provided in *Proposal One - Election of Directors*.

All executive officers of the Company are elected annually by the Board and serve at the discretion of the Board. There are no family relationships between any director or executive officer and any other such person except for Michael L. Paxton, Vice President, Chief Financial Officer, Secretary and Treasurer, who is the son of G. Ward Paxton, Chairman, President and Chief Executive Officer.

COMPENSATION DISCUSSION AND ANALYSIS

Philosophy

The Company operates in the highly competitive and rapidly changing high technology industry. The Compensation Committee believes that the compensation programs for executive officers of the Company should be designed to attract, motivate and retain talented executives who contribute to the success of the Company and should be determined within a competitive framework based on the achievement of overall business objectives and financial performance and individual contributions. Within this framework, the Compensation Committee's objectives are to:

- provide a total compensation program competitive with the compensation practices of organizations in the high technology industry of comparable size to the Company;
- provide annual variable incentive awards based on the Company's overall financial performance relative to corporate objectives; and
- align the financial interests of executive officers with those of stockholders by providing equity-based incentives.

The Company believes that the compensation of the executives should reflect their success as a management team, rather than individuals, in attaining key operating objectives, such as growth of sales, and growth of operating earnings and earnings per share. In addition emphasis is placed on competitive analysis and industry data. The Company has developed long term and short term compensation components for the executive. The long-term performance of stock options reflected in executive compensation through stock options is considered an important part of overall compensation.

Overview of Compensation and Process

Compensation elements provided to the Company's executives include: salary, bonus, stock options, health, disability and life insurance, and 401(k) retirement plan matching. Base salaries are set for the executive officers at the regularly scheduled January meeting of the Compensation Committee. At this meeting, the Compensation Committee also approves and adopts the management incentive plan for the new fiscal year and typically grants stock awards to all of the executive officers and certain other eligible employees.

At the beginning of each fiscal year, the Compensation Committee reviews the history of all the elements of each executive officer's total compensation over the past year and compares the compensation of the executive officers with that of the executive officers in similar positions within the industry or located within the same geographical area. Typically, the Chief Executive Officer makes compensation recommendations to the Compensation Committee for the remaining executives in a private meeting. The Compensation Committee then approves the compensation for the Chief Executive Officer and the remaining executive officers in a closed door meeting.

The Company uses several factors when determining the amount of salary, equity and other benefits to pay each executive. Some of these factors include:

- performance against individual and corporate objectives outlined the previous year;
- value of their skills and experience that support the long-term vision of the Company;

- performance of the individual divisions for which the executives are responsible; and
- compensation paid to executives with similar responsibilities at companies of comparable size and sale volume.

The Company's policy for allocating between long-term and currently paid compensation is to ensure adequate base compensation to attract and retain personnel, while providing incentives to maximize long-term value for the Company and stockholders. The Company provides cash compensation in the form of base salary to meet competitive salary levels. In previous years, bonus compensation was also used to reward superior performance.

The following items of corporate performance are taken into account in setting compensation policies:

- The Company's overall financial results; and
- achievement of corporate objectives.

Section 162(m) of the Internal Revenue Code disallows a tax deduction to publicly held companies for compensation paid to certain of their executive officers to the extent that compensation exceeds \$1 million per covered officer in any fiscal year. The limitation applies only to compensation which is not considered to be performance-based. Non-performance based compensation paid to the Company's executive officers for the 2006 fiscal year did not exceed the \$1 million limit per officer, and the Compensation Committee does not anticipate that the non-performance based compensation to be paid to the Company's executive officers for fiscal 2007 will exceed that limit. The Company's 2005 Stock Incentive Plan have been structured so that any compensation deemed paid in connection with the exercise of option grants made under that plan with an exercise price equal to the fair market value of the option shares on the grant date will qualify as performance-based compensation which will not be subject to the \$1 million limitation. Because it is unlikely that the cash compensation payable to any of the Company's executive officers in the foreseeable future will approach the \$1 million limit, the Compensation Committee has decided at this time not to take any action to limit or restructure the elements of cash compensation payable to the Company's executive officers. The Compensation Committee will reconsider this decision should the individual cash compensation of any executive officer ever approach the \$1 million level.

Summary Compensation Information

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The following table sets forth certain summary information regarding all cash compensation earned by the Company's Chief Executive Officer, Chief Financial Officer and each of the Company's other three most highly compensated executive officers (the "Named Executive Officers") for the last three fiscal years in all capacities in which they served the Company and its subsidiaries for such period. An additional individual for whom disclosure would have been provided but for the fact that the individual was not serving as an executive officer of the registrant at the end of the 2006 was also included in the table. The individuals listed below shall be referred to as the ("Named Executive Officers").

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2006 SUMMARY COMPENSATION TABLE (6)

Name and Principal Position	Year	Salary (\$)	Bonus \$(1)	Option Awards \$(2)	Non-Equity Incentive Plan Compensation (\$)	All Other Compensation \$(3)	Total (\$)
G. Ward Paxton, Chairman, President, and Director	2006	\$ 122,500		\$ 47,565		\$ 1,225	\$ 171,290
	2005	122,500		107,121		1,225	230,846
	2004	122,500				1,225	123,725
Michael L. Paxton, Vice President, Chief Financial Officer, Treasurer and Secretary	2006	122,500		44,950		1,225	168,675
	2005	122,500		89,399		1,225	213,124
	2004	122,500		31,016		1,225	154,741
T. Joe Head, Vice-Chairman, Vice President and Director	2006	175,000		48,658		1,750	225,408
	2005	175,000		107,121		1,750	283,871
	2004	175,000				1,750	176,750
Aaron N. Bawcom, Vice President of Engineering	2006	175,000		43,915			218,915
	2005	175,000		81,345			256,345
	2004	175,000		36,142			211,142
Garry L. Hemphill, (4) Vice President of Sales	2006	110,000		43,948		1,100	155,048
Eric H. Gore, (5) Former Vice President of Worldwide Sales	2006	92,404	7,719	43,451		24,946	168,520
	2005	155,000	37,831	81,345		7,200	281,376
	2004	155,000	37,102	32,880		7,200	232,182

(2) Represents bonus compensation and/or commission earned during the fiscal year indicated, a portion of which may have been or will be paid during the subsequent fiscal year.

(3) For 2006, the number represents the annual compensation cost for stock options as expensed by the Company pursuant to FAS 123(R). The full compensation cost related to each option grant will continue to be reported as the option vests. For 2005 and 2004, the number represents the amount that was reported in pro-forma financial disclosure pursuant to FAS 123. No compensation cost was expensed for 2005 and 2004. A complete discussion of the assumptions used to calculate such values can be found in the Company's 2006 Annual Report on Form 10-KSB which accompanies this Proxy Statement.

(4) This amount includes the annual employer matching contributions under the Company's tax qualified Section 401(k) Savings Plan for Mr. G. Ward Paxton, Mr. Michael L. Paxton, T. Joe Head and Garry L. Hemphill, respectively.

(5) Garry L. Hemphill joined the Company on February 23, 2003 as Vice President of Operations. Detailed compensation information for Mr. Hemphill was not included for 2005 and 2004 as Mr. Hemphill was not a Named Executive Officer during such years.

(6) Eric H. Gore left the Company on July 28, 2006 to pursue other interests. Mr. Gore was paid \$21,137 in vacation hours that were earned, but not taken during his employment in 2006. It is the Company's general practice to pay all employees their accrued, yet unused vacation at termination. Also includes car allowance income of \$3,809 during 2006 and \$7,200 in 2005 and 2004.

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(7) No stock awards were paid, no non-equity incentive plan compensation was paid, and no pension or non-qualified deferred compensation earnings were changed to the Company's Chief Executive Officer, Chief Financial Officer and the Named Executive Officers for the last three fiscal years. These columns have been omitted from the table.

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Base Salary

The salaries of the executive officers, including the Chief Executive Officer, are determined annually by the Compensation Committee with reference to the following without specific weighting:

- salaries paid to executives with similar responsibilities at companies of a comparable size and sales volume, primarily in the high technology industry;
- each officer's performance; and
- the Company's overall financial results.

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

Bonus

To reinforce the attainment of corporate objectives, the Compensation Committee believes that a substantial portion of the potential annual compensation of each executive officer should be in the form of short-term variable incentive pay. The incentive cash bonus program for executives is established annually by the Compensation Committee based upon the Company's achievement of sales and/or net income targets established at the beginning of the fiscal year. The incentive plan for executives, other than certain executives in the Company's sales organization, requires a threshold level of Company financial performance before any incentives are awarded. Once the threshold objective for sales and/or net income of a fiscal year is reached, specific formulas are in place to calculate the actual incentive payment for each executive for such year.

At the beginning of fiscal 2006, the Compensation Committee adopted the 2006 management incentive plan. Under the terms of the 2006 management incentive plan, the bonus payable to each executive officer was based on sales targets.

Bonuses Awarded

In fiscal 2006, the Company did not achieve its threshold level of sales; thus, non-sales executives, including the Chief Executive Officer, Chief Financial Officer and the Named Executive Officers other than the Company's Vice President of Worldwide Sales, did not receive any incentive bonus awards. Certain employees in the sales organization, including Eric Gore, the Company's former Vice President of Worldwide Sales, received incentive sales commission in fiscal 2006 based upon the Company's sales.

Stock Option and Equity Incentive Programs

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

relationship between stock option value and the market price, it is believed that granting options is the best method to motivate executives to mirror the concerns of other stockholders.

Stock Options Granted

The Company grants stock option awards to the executive officers and key employees in order to retain their services and increase their performance potential to help attain long-term goals of the Company. However, there is no set formula for the granting of awards to individual executives or employees. In each of the past three fiscal years, 2006, 2005 and 2004 respectively, the Company has granted stock options to purchase 426,500, 578,750 and 162,500 shares of the Company's common stock. Of this amount, 220,000, 325,000 and 81,250 shares have been granted to the named executive officers, and the balance has been granted to other key employees and non-employee directors in 2006, 2005 and 2004 respectively. During fiscal year 2006, a total of 30 employees and 3 non-employee directors received stock options to purchase an aggregate of 5.14% of the outstanding shares of common stock, including five of the six named executive officers, who received stock options to acquire an aggregate of 220,000 shares or 57.65% of the total options granted in fiscal 2006.

Timing of Grants

Stock awards to executive officers and other key employees are typically granted annually in conjunction with the review of the individual performance. This review typically takes place in January. Because of discussions surrounding the stock option expensing pursuant to FAS 123(R), stock options were not granted to the executives until November 2006. It is the Compensation Committee's intention to return to the practice of granting annual stock options at the time of the Compensation Committee's January meeting. Stock option awards are granted to non-employee directors on the date of the annual meeting of stockholders, in accordance with the terms of the 2005 plan. Grants to newly hired employees are effective on the first Compensation Committee meeting following the employee's first day of employment, after approval by the committee. The exercise price of all stock options is set at the current day's closing price of common stock.

Stock Ownership Guidelines

The Company does not have any standard stock ownership guidelines. However, all executives are encouraged to retain stock options and other shares that they directly own.

Perquisites

The Company limits the perquisites that are made available to executive officers. The Company does not have a pension program for executives or employees.

The perquisites provided by the Company in fiscal 2006 are as follows. All employees who participated in the 401(k) plan received up to \$1,750 in matching funds. All of the named executive officers who participated in the 401(k) plan received matching funds. The health and life insurance plans are the same for all employees. In general, all employees health premiums are paid 100% and the employee pays approximately 24% of the health premiums for dependents. All employees are also provided life insurance up to \$10,000. This policy is the same for all employees, including executive officers.

Grants of Plan-Based Awards During Fiscal Year 2006

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The following table provides information related to options to acquire shares of Common Stock granted to the Named Executive Officers during fiscal year 2006. The Company did not grant any stock awards or Non-Equity Incentive Plan Units during fiscal year 2006.

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2006 GRANTS OF PLAN-BASED AWARDS TABLE

Name	Grant Date	Estimated future payouts under non-equity incentive plan awards			Estimated future payouts under equity incentive plan awards			All other stock awards: number of shares of stock or units (#)	All other option awards: number of securities underlying options (#) (1)	Exercise base price of awards (\$ / Sh) (2)	Grant date fair value of option stock and option awards (\$) (3)
		Threshold (#)	Target (#)	Maximum (#)	Threshold (#)	Target (#)	Maximum (#)				
G. Ward Paxton	11/09/06								30,000	\$ 0.33	\$ 6,871
Michael L. Paxton	11/09/06								30,000	0.33	6,871
T. Joe Head	11/09/06								100,000	0.30	23,657
Aaron N. Bawcom	11/09/06								30,000	0.30	7,097
Garry L. Hemphill	11/09/06								30,000	0.30	7,097
Eric H. Gore (4)											

(1) Refer to Note C, "Stock-Based Compensation", in the Notes to Consolidated Financial Statements included in the Annual Report on Form 10-K filed on March 29, 2007 for the relevant assumptions used to determine the valuation of the option awards.

(2) No options were granted to Mr. Gore during 2006.

(3) Represents the annual compensation cost for stock options as expensed by the Company pursuant to FAS 123(R). The full compensation cost related to each option grant will continue to be reported as the options vests. Refer to Note C, "Stock-Based Compensation", in the Notes to Consolidated Financial Statements included in the Annual Report on Form 10-K filed on March 29, 2007 for the relevant assumptions used to determine the valuation of the stock option awards.

Outstanding Equity Awards at the End of Fiscal Year 2006

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The following table sets forth information with respect to the options outstanding by the Named Executive Officers held at fiscal year end.

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2006 OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END TABLE

Name	Option Awards			Stock Awards			Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (\$)
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) (1) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options\ (#)	Option Exercise Price (\$)	Option Expiration Date (2)	Number of Shares or Units of Stock That Have Not Vested (#)		
G. Ward Paxton	25,000 40,000	30,000		\$ 3.20 3.08 0.33	01/31/15 06/14/15 11/09/11			
Michael L. Paxton	6,875 1,250 4,375 6,875 1,250 4,375 12,500 12,500 40,000	30,000		2.32 2.00 1.92 2.96 4.44 3.00 1.50 3.20 3.08 0.33	08/14/07 10/17/07 01/29/08 08/20/08 11/05/08 01/29/09 08/12/09 01/31/15 06/14/15 11/09/11			
T. Joe Head	25,000 40,000	100,000		3.20 3.08 0.30	01/31/15 06/14/15 11/09/16			
Aaron N. Bawcom	3,750 1,876 5,625 2,500 4,375 5,000 3,075 3,125 5,000 4,375 3,125 4,375 17,500 7,500 40,000	30,000		63.00 51.24 20.00 18.00 5.24 6.96 5.24 1.80 1.72 1.08 4.04 2.72 1.36 3.20 3.08 0.30	04/20/10 08/24/10 01/17/11 04/30/11 10/17/11 01/17/12 04/30/12 10/17/12 01/29/13 05/01/13 11/05/13 01/29/14 08/12/14 01/31/15 06/14/15 11/09/16			
Garry L. Hemphill	17,500 7,500 40,000	30,000		1.36 3.20 3.08 0.30	08/12/14 01/31/15 06/14/15 11/09/06			
Eric H. Gore (3)								

- (1) Options become exercisable in three equal annual installments beginning on the first anniversary date of grant.
- (2) The expiration date of each option occurs 10 years after the date of grant of each option except for the options granted to Mr. G. Ward Paxton and Mr. Michael Paxton on November 9, 2011 for 30,000 shares respectively. Such options expire 5 years after the date of grant due to the Incentive Stock Option requirements for 10% owners of the Company.
- (3) Mr. Gore did not have any outstanding options at the end of the fiscal year.

DIRECTOR COMPENSATION

Name	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)	Option Awards (\$)(2)(3)(4)	Non-Equity Incentive Plan Compensation (\$)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
G. Ward Paxton, (1) Chairman of the Board							
T. Joe Head, (1) Vice Chairman of the Board							
J. Fred Bucy, Jr., (2) Member	\$ 20,000		\$ 5,605				\$ 25,605
James F. Gero, (2) Member	21,000		6,838				27,838
Donald M. Johnston, (2) Member	20,500		5,605				26,105

- (1) Mr. G. Ward Paxton and Mr. T. Joe Head are employee directors of the Company. All compensation paid to them is paid for their services as employee executives of the Company which are detailed in the 2006 Summary Compensation Table. No additional fees were paid to Mr. Paxton or Mr. Head for their services as a Director of the Company as noted above.
- (2) Mr. Bucy, Mr. Gero and Mr. Johnston were each granted 5,000 stock options with an exercise price of \$0.60, the closing fair market value on such date. The FAS 123(R) full grant date fair value of \$9,000 will continue to be expensed and reported as the option vests for each non employee director.
- (3) Represents the annual compensation cost for stock options as expensed by the Company pursuant to FAS 123(R). The full compensation cost related to each option grant will continue to be reported as the options vests. Refer to Note C, "Stock-Based Compensation", in the Notes to Consolidated Financial Statements included in the Annual Report on Form 10-K filed on March 29, 2007 for the relevant assumptions used to determine the valuation of the stock option awards.
- (4) The following are the aggregate number of option awards outstanding that have been granted to each of the non-employee directors as of December 31, 2006: Mr. Bucy 22,500; Mr. Gero 17,500; and Mr. Johnston 22,500.

Overview of Compensation and Procedures

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The Compensation Committee reviews the level of compensation of non-employee directors on an annual basis. The Company has historically used data from a number of different sources to determine the compensation for non-employee directors. Some examples of the data used include:

- publicly available data describing director compensation in peer companies; and
- survey data collected by the Company.

We compensate non-employee members of the board through a mixture of cash and equity-based compensation. Each non-employee director receives a cash retainer fee of \$1,000 per month. Each non-employee director also receives a fee of \$1,000 for each meeting of the Board attended (excluding telephonic meetings) and for each meeting of a

committee of the Board attended (exclusive of committee meetings held on the same day as Board meetings). Each non-employee director also receives a fee of \$500 for each telephonic meeting attended. Each non-employee director is also reimbursed for all reasonable expenses incurred in attending such meetings. No director who is an employee of the Company receives any fees for service as a director of the Board. However, G. Ward Paxton and T. Joe Head each earned compensation for his services to the Company as an employee as set forth in the Summary Compensation Table. Mr. G. Ward Paxton received a stock option grant for 30,000 shares at a price of \$0.33 per share during 2006. Mr. T. Joe Head received a stock option grant for 100,000 shares at a price of \$0.30 per share during 2006. The options are detailed on the Stock Option Grants in Last Fiscal Year table in this proxy statement. Neither Mr. Paxton nor Mr. Head received any additional fees for his services as a director of the Board.

Under the Automatic Option Grant Program of the 2005 Plan, each non-employee director will automatically be granted an option to purchase 10,000 shares of Common Stock upon joining the Board and an option to purchase 5,000 shares of Common Stock on the date of each annual stockholder meeting as long as the director has served at least six months prior to the date of grant.

Employment Agreements

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Neither the Company nor its subsidiaries has any employment agreements with any of its Named Executive Officers.

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Stock Performance Information

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The following chart illustrates the percentage of change in the cumulative total stockholder return on the Company's Common Stock during the five year period ending December 29, 2006, compared with the cumulative total return on the Center for Research in Securities Prices (CRSP) Total Return Index for The US Nasdaq Stock Market, CRSP Total Return Index for Nasdaq Computer Manufacturing Stocks, and the CRSP Total Return Index for Nasdaq Computer and Data Processing Stocks, respectively, for the same periods.

STOCK PERFORMANCE*

	Dec 31 2001	Dec 31 2002	12/31/2003	Dec 31 2004	Dec 30 2005	Dec 29 2006
Intrusion Inc.	100	18.60	34.30	42.30	30.52	6.69
CRSP Total Rtn. Index for the NasdaqStock Market	100	69.13	103.36	112.49	114.88	126.22
CRSP Total Rtn. Index for Nasdaq Computer Mfg. Stocks	100					

