3D SYSTEMS CORP
Form DEF 14A
July 24, 2003

SCHEDULE 14A

(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

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

Filed by the Registrant [x]   Filed by a Party other than the Registrant [_]

Check the appropriate box:

[_] Preliminary Proxy Statement
[x] Definitive Proxy Statement
[_] Definitive Additional Materials
[_] Soliciting Material Under Rule 14a-12

[_] Confidential, For Use of the Commission Only (as permitted by Rule 14A-6(e)(2))

3D SYSTEMS CORPORATION

(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):

[x] No fee required.
[_] Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

1) Title of each class of securities to which transaction applies:

---

2) Aggregate number of securities to which transaction applies:

---

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

---

4) Proposed maximum aggregate value of transaction:

---

5) Total fee paid:

[_] Fee paid previously with preliminary materials:

[_] Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

1) Amount previously paid:

---

2) Form, Schedule or Registration Statement No.:

---

3) Filing Party:

---

4) Date Filed:

3D SYSTEMS CORPORATION

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

TIME.........................	9:00 a.m. Pacific Time on August 26, 2003
PLACE........................	Hyatt Valencia Hotel 24500 Town Center Drive Santa Clarita, CA 91355
ITEMS OF BUSINESS............	(1) To elect three Class I members of the Board of Directors for three-year terms. (2) To ratify the appointment of BDO Seidman LLP as our independent auditors for the year ending December 31, 2003. (3) To transact such other business as may properly come before the Meeting and any adjournment or postponement.
RECORD DATE..................	You can vote if at the close of business on July 7, 2003, you were a stockholder of the Company.
PROXY VOTING.................	All stockholders are cordially invited to attend the Annual Meeting in person. However, to ensure your representation at the Annual Meeting, you are urged to vote promptly by signing and

returning the enclosed Proxy card. If you hold your shares in street name, you also may be eligible to vote via the Internet by accessing the World Wide Web.

/s/ Keith Kosco

July 24, 2003

Keith Kosco
GENERAL COUNSEL AND CORPORATE SECRETARY

3D SYSTEMS CORPORATION
26081 AVENUE HALL
VALENCIA, CALIFORNIA 91355

PROXY STATEMENT

These Proxy materials are delivered in connection with the solicitation by the Board of Directors of 3D Systems Corporation, a Delaware corporation, of Proxies to be voted at our 2003 Annual Meeting of Stockholders and at any adjournments or postponements. We refer to 3D Systems Corporation as 3D Systems, the Company, we, or us throughout this Proxy Statement.

You are invited to attend our Annual Meeting of Stockholders on Tuesday, August 26, 2003, beginning at 9:00 a.m. Pacific Time. The meeting will be held at the Hyatt Valencia Hotel, 24500 Town Center Drive, Santa Clarita, California 91355.

STOCKHOLDERS ENTITLED TO VOTE. Holders of 3D Systems Common Stock and Series B Convertible Preferred Stock at the close of business on July 7, 2003, are entitled to receive this notice and to vote their shares at the Annual Meeting. Common Stock and Series B Convertible Preferred Stock are the only outstanding classes of securities of the Company entitled to vote at the Annual Meeting. As of July 7, 2003, there were 12,734,301 shares of Common Stock and 2,634,016 shares of Series B Convertible Preferred Stock outstanding.

PROXIES. Your vote is important. If your shares are registered in your name, you are a stockholder of record. If your shares are in the name of your broker or bank, your shares are held in street name. We encourage you to vote by Proxy so that your shares will be represented and voted at the Annual Meeting even if you cannot attend. All stockholders can vote by written Proxy card. Street name stockholders also may be eligible to vote by Proxy via the Internet, pursuant to the instructions set forth on their Proxy card. Your submitting the enclosed Proxy will not limit your right to vote at the Annual Meeting if you later decide to attend in person. IF YOUR SHARES ARE HELD IN STREET NAME, YOU MUST OBTAIN A PROXY, EXECUTED IN YOUR FAVOR, FROM THE STOCKHOLDER OF RECORD IN ORDER TO BE ABLE TO VOTE AT THE MEETING. If you are a stockholder of record, you may revoke your Proxy at any time before the meeting either by filing with the Secretary of the Company, at its principal executive offices, a written notice of revocation or a duly executed Proxy bearing a later date, or by attending the Annual Meeting and expressing a desire to vote your shares in person. All shares entitled to vote and represented by properly executed Proxies received prior to the Annual Meeting, and not revoked, will be voted at the Annual Meeting in accordance with the instructions indicated on those Proxies. If no instructions are indicated on a properly executed Proxy, the shares represented by that Proxy will be voted as recommended by the Board of Directors.

INTERNET VOTING BY SHARES HELD IN STREET NAME. A number of brokerage firms and banks offer Internet voting options. The Internet voting procedures are designed to authenticate stockholders' identities, to allow stockholders to give their voting instructions and to confirm that stockholders' instructions have been recorded properly. Specific instructions to be followed by owners of shares of Common Stock held in street name are set forth on your Proxy card. Stockholders voting via the Internet should understand that there may be costs associated with electronic access, such as usage charges from telephone companies and Internet access providers, which must be borne by the stockholder.

QUORUM. The presence, in person or by Proxy, of a majority of the votes entitled to be cast by the stockholders entitled to vote at the Annual Meeting is necessary to constitute a quorum. Abstentions and broker non-votes will be included in the number of shares present at the Annual Meeting for determining the presence of a quorum.

VOTING. Each share of 3D Systems Common Stock and Series B Convertible Preferred Stock is entitled to one vote on each matter properly brought before the meeting. Abstentions will be counted toward the tabulation of votes cast on proposals submitted to stockholders and will have the same effect as negative

votes, while broker non-votes will not be counted as votes cast for or against these matters. A broker "non-vote" occurs when a broker holding shares for a beneficial owner does not vote on a particular proposal because the broker does not have discretionary voting power for that particular item and has not received instructions from the beneficial owner. If you are a beneficial owner and your broker holds your shares in its name, the broker may be permitted to vote your shares on the election of directors and the ratification of BDO Seidman, LLP as our independent auditors even if the broker does not receive voting instructions from you.

ELECTION OF DIRECTORS. The three nominees for Class I director receiving the highest number of votes at the Annual Meeting will be elected. If any nominee is unable or unwilling to serve as a director at the time of the Annual Meeting, the Proxies will be voted for such other nominee(s) as shall be designated by the current Board of Directors to fill any vacancy. The Company has no reason to believe that any nominee will be unable or unwilling to serve if elected as a director.

RATIFICATION OF INDEPENDENT PUBLIC ACCOUNTANTS. The ratification of the appointment of BDO Seidman, LLP as our independent public accountants for the year ending December 31, 2003, will require the affirmative vote of a majority of the shares of Common Stock and Series B Convertible Preferred Stock, voting together as a single class, present or represented and entitled to vote at the Annual Meeting.

OTHER MATTERS. At the date this Proxy Statement went to press, we do not know of any other matter to be raised at the Annual Meeting.

ITEM 1: ELECTION OF DIRECTORS

Item 1 is the election of three members of the Board of Directors. The Board of Directors is grouped into three classes, as nearly equal in number as possible. Directors hold office for staggered terms of three years. One of the three classes is elected each year to succeed the directors whose terms are expiring.

The Class I directors whose terms expire at the 2003 Annual Meeting are Jim Kever, G. Walter Loewenbaum II , and Richard Spalding. The Board of Directors has nominated Jim Kever, G. Walter Loewenbaum II, and Richard Spalding to serve as Class I directors for terms expiring in 2006. The Class II directors are serving terms that expire in 2004, and the Class III directors are serving terms that expire in 2005.

Unless otherwise instructed, the Proxy holders will vote the Proxies received by them for the nominees named below. If any nominee is unwilling to serve as a director at the time of the Annual Meeting, the Proxies will be voted for such other nominee(s) as shall be designated by the then current Board of Directors to fill any vacancy. The Company has no reason to believe that any nominee will be unable or unwilling to serve if elected as a director.

The Board of Directors proposes the election of the following nominees as Class I directors:

Jim Kever
G. Walter Loewenbaum II
Richard Spalding

The principal occupation and certain other information about the nominees, other directors whose terms of office continue after the Annual Meeting, and certain executive officers and significant employees are set forth on the following pages.

The election of the nominees listed above will require the affirmative vote of a plurality of the shares of Common Stock and Series B Convertible Preferred Stock, voting together as a single class, present or

3

represented and entitled to vote at the Annual Meeting. All Proxies will be voted to approve the election of the nominees listed above unless a contrary vote is indicated on the enclosed Proxy card.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE "FOR" THE ELECTION OF THE NOMINEES LISTED ABOVE.

MANAGEMENT

DIRECTORS AND EXECUTIVE OFFICERS

The following persons serve as our directors:

DIRECTORS	AGE	PRESENT POSITION
Miriam V. Gold (1) (2)...............	54	Director
Charles W. Hull......................	64	Director
Jim D. Kever (2) (3).................	50	Director
G. Walter Loewenbaum II (1)..........	59	Director and Chairman of the Board
Kevin S. Moore (1) (2) (3)...........	48	Director
Brian K. Service.....................	56	Director
Richard C. Spalding (3)..............	52	Director

(1) Member of the Compensation Committee.
(2) Member of the Corporate Governance Committee.

(3) Member of the Audit Committee.

The following persons serve as our executive officers:

EXECUTIVE OFFICERS	AGE	PRESENT POSITION
Brian K. Service....................	56	Chief Executive Officer, Chief Operating Officer and President
Charles W. Hull.....................	64	Executive Vice President, Chief Technology Officer
G. Peter V. White...................	63	Vice President, Finance
Kevin McAlea, Ph.D..................	44	Senior Vice President, Worldwide Revenue Generation
Ray Saunders........................	54	Senior Vice President Operations and Development

The following person is a significant employee:

SIGNIFICANT EMPLOYEES	AGE	PRESENT POSITION
Keith Kosco.........................	51	General Counsel and Corporate Secretary

Our executive officers are appointed by and serve at the discretion of the Board of Directors. There are no family relationships between any director and/or any executive officer.

MIRIAM V. GOLD. Ms. Gold has been our director since 1994. Since July 2002, Ms. Gold has been Deputy General Counsel of Ciba Specialty Chemical Corporation. Prior to that, since 1992, Ms. Gold served as Assistant General Counsel of Ciba Specialty Chemicals Corporation, and its predecessors, Novartis Inc. and Ciba-Geigy Corporation. Her legal practice involves a broad range of matters, including counseling on compliance, antitrust and general business issues. In addition, she was Vice President of Legal & Regulatory

Affairs for the Additives Division of Ciba from 1995 to 2001. In 2002, Ms. Gold was an adjunct professor at Pace University School of Law, where she taught a course in In-House Practice, focusing on the unique role of in-house counsel in ensuring that companies are positioned to operate legally and responsibly. Ms. Gold received her J.D. from New York University School of Law, and her B.A. in American History from Barnard College.

CHARLES W. HULL. Mr. Hull has been our director since 1993. Since April 1997, Mr. Hull has served as our Chief Technology Officer and, effective May 3, 2000, as Executive Vice President and a member of the Office of the Chief Executive Officer. Mr. Hull also has served as Vice Chairman of our Board of Directors and as our President and Chief Operating Officer. From March 1986 until April 1997, Mr. Hull served as President of 3D Systems, Inc., a subsidiary of ours through which substantially all of our business and operations is conducted. From February to June 1999, Mr. Hull acted as a consultant to us and served as a Vice Chairman of our Board of Directors. From January 1980 to March 1986, Mr. Hull was Vice President of UVP, Inc., a systems manufacturing company, where he developed our stereolithography technology.

JIM D. KEVER. Mr. Kever has been our director since 1996. He is Principal in

Voyent Partners, LLC, a venture capital partnership. From August 1995 until May 2001, Mr. Kever was associated with WebMD Corporation, Transaction Services Division (formerly Envoy Corporation) as the President and Co-Chief Executive Officer. Prior to August 1995, he served as Envoy Corporation's Executive Vice President, Secretary and General Counsel. Mr. Kever also is a director of Transaction Systems Architects, Inc., a supplier of electronic payment software products and network integration solutions, as well as Luminex Corporation, a value-added manufacturer of laboratory testing equipment. He also is on the Board of Directors of Tyson Foods, Inc., an integrated processor of poultry-based food products.

G. WALTER LOEWENBAUM II. Mr. Loewenbaum has been our director since March 1999, serving as a Vice Chairman of the Board until September 1999 when he was elected Chairman of the Board. Mr. Loewenbaum is Managing Director of LeCorgne Loewenbaum LLC. Prior to that, since 1990, he served as Chairman and Chief Executive Officer of Loewenbaum & Company (formerly Southcoast Capital Corp.), an investment banking and investment management firm that he founded. Mr. Loewenbaum also serves as the Chairman of the Board of Luminex Corporation, a value-added manufacturer of laboratory testing equipment.

KEVIN S. MOORE. Mr. Moore has been our director since October 1999. Since 1991, Mr. Moore has been with The Clark Estates, Inc., a private investment firm, where he currently is President and a director. Mr. Moore also is a director of Ducommun, Incorporated, as well as Aspect Resources LLC, The Clark Foundation and the National Baseball Hall of Fame & Museum, Inc.

BRIAN K. SERVICE. Mr. Service has served as our President and Chief Executive Officer since September 1999 and, since October 1999, also has served as President and Chief Executive Officer of 3D Systems, Inc. Mr. Service was elected to 3D Systems' Board of Directors in January 2001. From September 1999 to September 2002, Mr. Service provided his services to us pursuant to an agreement between us and Regent Pacific Management Corporation, where he was a Managing Director. Prior to Regent Pacific, Mr. Service served as Chief Executive Officer of Salmond Smith Biolab, Ltd. Prior to Salmond, he was Chief Executive Officer of Milk Products, Inc. Mr. Service holds a Bachelor's degree in Chemical Engineering from Canterbury University of New Zealand and has completed the Stanford Executive Program from Stanford University Business School. Mr. Service also was a director of Visual Data Corporation until April 2003.

RICHARD C. SPALDING. Mr. Spalding has been our director since 2001. Since April 2003, Mr. Spalding has served as a Partner of Thomas Weisel Healthcare Venture Partners, a venture capital group which Mr. Spalding co-founded. Since January 2000, Mr. Spalding also has served as a General Partner of ABS Ventures, a venture capital group. From February 1997 to March 1999, Mr. Spalding served as Vice President and Chief Financial Officer of Portal Software, an Internet billing company. From March 1996 to February 1997, he served as Vice President Finance and Corporate Development for Fusion Medical Technology. From November 1991 to February 1996, he served as Managing Director of Alex Brown &

Sons, heading up the Investment Banking for the West Coast. From June 1977 to November 1991, Mr. Spalding practiced law with Brobeck, Phleger and Harrison, serving as outside counsel for numerous public and private companies.

G. PETER V. WHITE. Mr. White has served as our Vice President, Finance since March 2003. Prior thereto, from June 2002 to March 2003, he served as Managing Director of WHI-Tec & Associates. From January 1998 to June 2002, Mr. White served as the Chief Financial Officer and Chief Operating Officer of MATRIX-Systems, Inc., and prior to that, he served as Managing Director of Phoenix Equity Partners since January 1996.

KEVIN MCALEA, PH.D. Dr. McAlea has served as our Senior Vice President, Worldwide Revenue Generation since May 2003. Prior thereto, from September 2001 to May 2003, he served as our Vice President & General Manager, Europe. From 1997 to August 2001, he served as Vice President, Marketing and Business Development of DTM Corporation, a Texas corporation which we acquired in August 2001. From 1993 to 1997, Dr. McAlea served as Director of Process and Materials Development of DTM. Prior to DTM, Dr. McAlea spent more than eight years in materials research and development for General Electric Company. His last position was managing the Polymer Physics Program at GE's Corporate Research and Development Center.

RAY SAUNDERS. Mr. Saunders has served as our Senior Vice President Operations and Development since May 2003. From July 2002 to May 2003, Mr. Saunders served as our Vice President of Operations and Development and, prior to that, as our Vice President of Manufacturing since September 2000. From January 1994 until September 2000, Mr. Saunders served as Director of Operations for Axiohm Transaction Solutions, Inc. where he was responsible for the manufacturing operations of its San Diego Division. Prior to Axiohm, he was the Vice President and General Manager of Brumko Magnetics, Inc., a division of Applied Magnetics Corporation.

KEITH KOSCO. Mr. Kosco has served as our General Counsel since April 2002 and as our Corporate Secretary since May 2002. From September 2001 until April 2002, he was an independent consultant. From May 1998 until September 2001, Mr. Kosco served as the Assistant General Counsel of Litton Industries. From November 1996 until April 1998, he was Of Counsel to the law firm of Squire, Sanders & Dempsey LLP, and from July 1981 until April 1996 he was an Associate and then a Partner with the law firm of Morgan, Lewis & Bockius, LLP.

FURTHER INFORMATION CONCERNING THE BOARD OF DIRECTORS

MEETINGS AND COMMITTEES. The Board of Directors held eleven meetings during fiscal 2002 and acted by written consent on one occasion. The Board of Directors currently has an Audit Committee, Compensation Committee, and Corporate Governance Committee. During fiscal 2002, the Board of Directors also had a Nominating Committee and the Oversight Committee.

The Audit Committee currently consists of Jim D. Kever, Kevin S. Moore, and Richard C. Spalding. The Board has determined that each member of the Audit Committee is independent as that term is defined in Rule 4200(a)(14) of the National Association of Securities Dealers' listing standards.

Under the terms of its charter, the Audit Committee meets periodically, including meetings held separately with management and the independent auditors. The Audit Committee represents and assists the Board with the oversight of the integrity of the Company's financial statements and internal controls, and the Company's compliance with legal and regulatory requirements. In addition, the Committee is responsible for: appointing, retaining, and terminating when appropriate, the independent auditors; setting the independent auditor's compensation, and pre-approving all audit services to be provided by the independent auditors; and establishing policies and procedures to pre-approve the performance of audit services and permitted non-audit services.

The role and responsibilities of the Audit Committee are more fully set forth in a written charter adopted by the Board and attached to this Proxy Statement as APPENDIX A. The Audit Committee held seven meetings during fiscal 2002 and acted by unanimous written consent on one occasion.

The Compensation Committee currently consists of Miriam V. Gold, G. Walter Lowenbaum II, and Kevin S. Moore. Mr. Lowenbaum replaced Gary J. Sbona, a former director who served on the Compensation Committee through September 9, 2002. The Compensation Committee is responsible for considering and making recommendations to the Board of Directors regarding executive compensation and is responsible for administering the Company's stock option and executive incentive compensation plans. The Compensation Committee held five meetings during fiscal 2002 and acted by unanimous written consent on two occasions.

During fiscal 2002, the Nominating Committee consisted of G. Walter Loewenbaum II and Charles W. Hull. The Nominating Committee was responsible for considering and recommending qualified candidates for election to the Board of Directors. The Nominating Committee held one meeting during fiscal 2002. The Nominating Committee was dissolved on November 18, 2002.

During fiscal 2002, the Oversight Committee consisted of Jim D. Kever, Kevin S. Moore, and Richard C. Spalding. The Oversight Committee was responsible for reviewing, from time to time, and serving as final authority for all matters related to our dealings, negotiations, contracts, agreements or other relations between the members of the Board of Directors and the Company, including the Company's relationship with Regent Pacific Management Corporation. The Oversight Committee held two meetings during fiscal 2002 and acted by unanimous written consent on two occasions. In 2003, the Oversight Committee was subsumed by the Corporate Governance Committee which currently is comprised of Miriam V. Gold, Jim D. Kever, and Kevin S. Moore. The Corporate Governance Committee's primary functions are to: advise the Board with respect to Board composition, procedures, and committees; develop and recommend to the Board, and annually review, a set of corporate governance principles applicable to the Company; and review and approve all matters relating to dealings, negotiations, contracts, agreements or other relations between any affiliate and the Company.

All directors attended 75% or more of all the meetings of the Board of Directors and those committees on which he or she served in fiscal 2002, except Mr. Kever.

DIRECTORS' COMPENSATION. During fiscal 2002, the Company paid its non-employee directors an annual retainer of $15,000 plus $1,500 for each Board meeting attended either in person or telephonically, and $1,500 for attendance at each committee meeting not held on a day that a Board meeting was held. In addition, non-employee directors each received an annual automatic grant of ten-year options to purchase, at the fair market value of the Common Stock on the date of grant, 10,000 shares of Common Stock. For fiscal 2003, in addition to the foregoing compensation, the Chairperson of Audit Committee will receive an annual retainer of $15,000, and the Chairpersons of the Corporate Governance and Compensation Committees and the members of the Audit Committee, each will receive an annual retainer of $5,000.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION. The Company has no interlocking relationships involving any of its Compensation Committee members that would be required by the Securities and Exchange Commission, which we refer to throughout this Proxy Statement as the SEC, to be reported in this Proxy Statement, and no officer or full-time employee of the Company serves on its Compensation Committee. Mr. Sbona, a member of the Compensation Committee during fiscal 2002, provided services to the Company as a part-time employee during fiscal 2002.

ITEM 2: RATIFICATION OF APPOINTMENT OF INDEPENDENT PUBLIC ACCOUNTANTS

The Audit Committee of the Board of Directors has engaged the firm of BDO Seidman, LLP, which we refer to throughout this Proxy Statement as BDO, to serve as our independent public accountants for the current fiscal year ending December 31, 2003. Deloitte and Touche, LLP, which we refer to throughout this Proxy Statement as Deloitte, was selected by the Board of Directors to serve as independent public accountants of the Company for fiscal 2002. We anticipate that a representative of Deloitte will attend the Annual Meeting for the purpose of responding to appropriate questions. At the Annual Meeting, a representative of Deloitte will be afforded an opportunity to make a statement if he or she so desires.

In connection with its audit of the Company's financial statements for fiscal year 2002, Deloitte identified sales transactions for which revenue had been recognized in the fourth quarter of 2002, which Deloitte believed should have been recognized in other periods. The Audit Committee commenced an investigation into the Company's revenue recognition policies generally and specifically with regard to the sales transactions identified by Deloitte, and other related or similar transactions. To assist it in this investigation, the Audit Committee retained Morgan Lewis & Bockius, LLP, as independent counsel, and Morgan Lewis retained the accounting firm of BDO to provide forensic accounting services in support of its work. During the conduct of the investigation and the audit of the Company's financial statements for 2002, deficiencies in the Company's internal controls were identified. At the direction of the Audit Committee, the Company is implementing changes to its financial organization and enhancing its internal controls. As of the date of this Proxy Statement, the Company has retained a Director of Internal Audit, expanded the number of employees in its finance department, terminated or reassigned senior officers and key employees, established an anonymous hotline for employees to report potential violations of policies and procedures and, through the Company's Disclosure Committee, engaged in detailed reviews of its public disclosures and reporting. The Company is continuing to implement all of the recommendations resulting from the investigation.

The ratification of BDO as the Company's independent public accountants for the fiscal year ending December 31, 2003, will require the affirmative vote of a majority of the shares of Common Stock and the Series B Convertible Preferred Stock, voting together as a single class, present or represented and entitled to vote at the Annual Meeting. All Proxies will be voted to approve the appointment unless a contrary vote is indicated on the enclosed Proxy card.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE "FOR" THE RATIFICATION OF THE APPOINTMENT OF BDO SEIDMAN LLP AS THE COMPANY'S INDEPENDENT PUBLIC ACCOUNTANTS.

CHANGE OF INDEPENDENT PUBLIC ACCOUNTANTS

As discussed in the Company's Current Report on Form 8-K filed on April 23, 2003, Deloitte informed the Company on April 16, 2003, that it did not intend to stand for reelection as the Company's principal independent accountant. On July 16, 2003, Deloitte advised the Company that the client-auditor relationship between the Company and Deloitte had ceased.

The reports of Deloitte on the Company's financial statements for the fiscal years ended December 31, 2002 and 2001 have not included an adverse opinion or a disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope, or accounting principles, except for the 2002 report which contained an explanatory paragraph relating to a going concern uncertainty.

During the fiscal years ended December 31, 2002 and 2001 and the period from January 1, 2003 to July 16, 2003: (a) there were no disagreements with Deloitte on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Deloitte, would have caused Deloitte to make reference to the subject matter of the disagreements in connection with its report, and (b) there were no "reportable events" as the term is defined in Item 304(a)(1)(v) of Regulation S-K, except as follows:

Deloitte informed the Company that material weaknesses in the Company's internal control existed. Specifically, Deloitte advised the Company that:

- The Company's accounting and finance staff are inadequate to meet the needs of a complex, multinational SEC registrant. The Company needs to strengthen its capability to implement existing generally accepted accounting principles as well as understand and implement new accounting standards. In addition, the Company needs to strengthen its capabilities in performing routine accounting processes involved in closing its books such as account reconciliations and analyses.

- The Company needs to strengthen its controls and processes related to revenue recognition. During 2002, 2001 and 2000 revenue was recognized for transactions that did not meet the requirements for revenue recognition under the Company's policies or generally accepted accounting principles.

The Company has furnished Deloitte with a copy of the foregoing disclosures and has requested Deloitte to furnish the Company with a letter addressed to the SEC stating whether it agrees with the above statements and, if not, stating the respects in which it does not agree. A copy of the letter, dated July 22, 2003 from Deloitte to the SEC has been filed as an exhibit to the Company's Current Report on Form 8-K filed on July 23, 2003.

On April 23, 2003, our Audit Committee engaged BDO to serve as our independent public accountants to audit our consolidated financial statements for the fiscal year ending December 31, 2003. Our Audit Committee carefully considered BDO's qualifications as independent accountants before appointing BDO as our independent public accountants. This consideration included a review of the qualifications of the engagement team and BDO's reputation for integrity, quality, and competence in the fields of accounting and auditing. The Audit Committee also analyzed matters required to be considered under the Audit Committee's charter and under the SEC's Rules on Auditor Independence in effect at the time of engagement, including the nature and extent of non-audit services, to ensure that the independence of the independent public accountants would not be impaired. Stockholders will be asked at the Annual Meeting to ratify the selection of BDO.

On March 27, 2003, the law firm of Morgan, Lewis & Bockius, LLP, as counsel to the Audit Committee of the Company, engaged BDO to assist the Audit Committee with its investigation related to certain sales transactions. As a result of the work preformed, BDO has orally communicated to the Company that it believes certain sales transactions were not recorded in the proper period. The Company has consulted with Deloitte with regard to the these transactions.

There were no other written or oral consultations between the Company and BDO regarding either the specific application of accounting principles or the type of audit opinion that might be rendered on the Company's financial statements that was considered an important factor by the Company in reaching a decision as to an accounting, auditing or financial reporting issue, or any other matter that was the subject of a disagreement or a reportable event, that would have required disclosure under Item 304 (a)(2) of Regulation S-K.

The Company requested that Deloitte furnish it with a letter addressed to the SEC stating whether it agrees with the above statements relating to the engagement of BDO as the Company's new independent auditors and, if not, stating the respects in which it does not agree. A copy of the letter dated April 29, 2003, from Deloitte to the SEC has been filed as an exhibit to the Company's 8-K filed on April 30, 2003.

SUMMARY COMPENSATION TABLE

The following table sets forth, as to the Chief Executive Officer and as to each of the other four most highly compensated officers whose compensation exceeded $100,000 during the last fiscal year, information concerning all compensation paid for services to the Company in all capacities for each of the three years ended December 31 indicated below. We refer to these officers as the Named Executive Officers.

		ANNUAL COMPENSATION		LONG TERM COMPENSATION	
Name PRINCIPAL POSITION(1)	Fiscal Year Ended DECEMBER 31	SALARY	BONUS	Number of Securities Underlying OPTIONS	All Other COMPENSATION
Brian K. Service.........	2002	$ (2)	--	350,000	$ 151,434 (3)
Chief Executive Officer,	2001	(2)	--	--	--
Chief Operating Officer and President	2000	(2)	--	--	--
Charles W. Hull..........	2002	$ 275,000	--	--	$ 2,040 (4)
Executive Vice President	2001	$ 275,000	--	10,000	$ 26,679 (5)
Chief Technology Officer	2000	$ 275,000	$ 66,000	--	$ 3,518 (4)
Grant R. Flaharty (6)....	2002	314,000	--	25,000	$ 1,823 (4)
Executive Vice President	2001	$ 263,077	--	10,000	$ 9,941 (7)
of Global Business Operations	2000	$ 213,462	$ 70,442	40,000	$ 36,357 (8)
E. James Selzer (9)	2002	$ 240,769	--	--	$ 1,705 (4)
Sr. VP, Global Finance &	2001	$ 200,000	$ 40,000	10,000	$ 1,662 (4)
Administration and Chief Financial Officer	2000	$ 108,870	--	75,000	$ 1,578 (4)
Ray Saunders............	2002	$ 173,046	--	10,000	$ 1,839 (4)

Senior Vice President	2001	$ 149,988	$8,727	11,500	$ 1,753 (4)
Operations and Development	2000	$ 45,378	--	30,000	$ 67 (4)

OPTION GRANTS IN FISCAL 2002

The following table sets forth certain information regarding the grant of stock options made during fiscal 2002 to the Named Executive Officers.

NAME	Number of Securities Underlying Options Granted	Percent of Total Options Granted To Employees in Fiscal Year	Exercise or Base Price (1)	Expiration Date	Potential Realizable Value at Assumed Rates of Stock Price Appreciation fo Option Term (5% ($)	10% (
Brian K. Service.....	350,000	47%	$5.78	10/14/07	558,918	1,235,
Charles W. Hull......	--	--	--	--	--	
Grant R. Flaharty....	25,000	3.3%	$11.98	2/5/12	188,354	477,
E. James Selzer......	--	--	--	--	--	
Ray Saunders.........	10,000	1.3%	$11.98	2/5/12	75,342	190,

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR
AND FISCAL YEAR-END OPTION VALUES

The following table sets forth, for each of the Named Executive Officers, certain information regarding the exercise of stock options during fiscal 2002, the number of shares of Common Stock underlying stock options held at fiscal year-end and the value of options held at fiscal year-end based upon the last reported sales price of the Common Stock on The Nasdaq National Market on December 31, 2002 ($7.80 per share).

	Shares Acquired on Exercise (#)	Value Realized ($)	Number of Securities Underlying Unexercised Options at December 31, 2002 (#)		Value of Unexercise In-the-Money Options December 31, 2002 ($)	
Name			EXERCISABLE	UNEXERCISABLE	EXERCISABLE	UNEXERCI

Brian K. Service...	--	--	350,000	--	1,986,250	
Charles W. Hull....	--	--	77,500	7,500	--	
Grant R. Flaharty..	--	--	142,500	52,500	450,937	28,4
E. James Selzer....	--	--	60,000	25,000	--	
Ray Saunders.......	--	--	19,000	32,500	--	

EMPLOYMENT AGREEMENTS

The Company has entered into employment agreements with the following Named Executive Officers.

Brian K. Service has been retained as Chief Executive Officer. Mr. Service's services previously were provided under an arrangement with Regent Pacific Management Corporation. From September 10, 2002 (the date of termination of the Regent Agreement), through October 15, 2002, Mr. Service was engaged on an interim consulting basis for which he was paid $79,999. Effective October 15, 2002, the Company employed Mr. Service pursuant to an employment agreement under which he has agreed to serve as Chief Executive Officer until at least December 2003. Mr. Service is being paid $17,809 on a bi-weekly basis under this agreement, and has been awarded fully vested options, with a term of five years, to purchase 350,000 shares of our Common Stock at a price of $5.78 (the closing price on October 15, 2002).

On November 18, 2002, the Company entered into a consulting agreement with Brian K. Service, Inc., a corporation in which Mr. Service is a stockholder, officer and director. Pursuant to this agreement, the Company pays to Brian K. Service, Inc. an amount up to $310,000 for an 11-month period for the provision of the services of qualified consultants to us. Under this agreement, the Company paid Brian K. Service, Inc. $71,000 through December 31, 2002.

The Company entered into an employment agreement with Mr. Hull in April 1994, pursuant to which Mr. Hull served as President and Chief Operating Officer of both us and 3D Systems, Inc. until April 1997, at which time Mr. Hull was appointed our Vice Chairman and Chief Technology Officer. Pursuant to the agreement, Mr. Hull's initial base salary was $200,000 per year, subject to increase at the discretion of the Board of Directors. In addition to standard benefits, Mr. Hull is eligible to participate in the Executive Incentive Compensation Plan. Mr. Hull's employment agreement also permits Mr. Hull, at any time during his employment term, to terminate his duties under the agreement and elect to become a consultant to the Company. Effective February 28, 1999, Mr. Hull terminated his duties under the agreement and Mr. Hull, the Company, and 3D Systems, Inc. entered into a four-year consulting agreement. In June 1999, Mr. Hull rejoined the Company as our Chief Technology Officer at a base salary of $275,000. Effective May 3, 2000, Mr. Hull was promoted to Executive Vice President and a member of the Office of the Chief Executive Officer; he continues his duties as Chief Technology Officer. All of the stock options granted to Mr. Hull

and unexercised as of the date of the consulting agreement continued in force during the consulting term and are continued under his subsequent employment arrangement.

REPORT OF COMPENSATION COMMITTEE

THE INFORMATION IN THIS COMPENSATION REPORT SHALL NOT BE DEEMED TO BE "SOLICITING MATERIAL," OR TO BE "FILED" WITH THE SECURITIES AND EXCHANGE COMMISSION OR TO BE SUBJECT TO REGULATION 14A OR 14C AS PROMULGATED BY THE SECURITIES AND EXCHANGE COMMISSION, OR TO THE LIABILITIES OF SECTION 18 OF THE SECURITIES AND EXCHANGE ACT OF 1934.

The Compensation Committee is charged with the responsibility of administering all aspects of the Company's executive compensation programs. The committee, which currently is comprised of three independent, non-employee directors, also grants all stock options and otherwise administers the Company's 1989 Employee and Director Plan, which we refer to as the 1989 Plan, the 1996 Stock Incentive Plan, which we refer to as the 1996 Plan, the 1996 Non-Employee Directors' Stock Option Plan, which we refer to as the Director Plan, the 2001 Stock Option Plan, which we refer to as the 2001 Plan, and the 1998 Employee Stock Purchase Plan. No further options will be granted under the 1989 Plan as it expired on May 9, 1999. Following review and approval by the committee, determinations pertaining to executive compensation are submitted to the full Board for approval. In connection with its deliberations, the committee seeks, and is significantly influenced by, the views of the Chief Executive Officer with respect to appropriate compensation levels of the other officers.

TOTAL COMPENSATION. It is the philosophy of the committee that executive compensation should be structured to provide an appropriate relationship between executive compensation and performance of the Company and the share price of the Common Stock, as well as to attract, motivate and retain executives of outstanding abilities and experience. The principal elements of total compensation paid to executives of the Company are as follows:

BASE SALARY. Base salaries are negotiated at the commencement of an executive's employment with the Company or upon renewal of his or her employment agreement, and are designed to reflect the position, duties and responsibilities of each executive officer, the cost of living in the area in which the officer is located, the market for base salaries of similarly situated executives at other companies engaged in businesses similar to that of the Company, and qualitative factors reflecting the individual performance of the particular executive officer. Base salaries may be annually adjusted in the sole discretion of the committee to reflect changes in any of the foregoing factors.

STOCK INCENTIVE PLAN OPTIONS AND AWARDS. Under the 1996 Plan, the committee is authorized to grant any type of award which might involve the issuance of shares of Common Stock, options, warrants, convertible securities, stock appreciation rights or similar rights or any other securities or benefits with a value derived from the value of the Common Stock. The number of options granted to an individual is based upon a number of factors, including his or her position, salary and performance, and the overall performance and stock price of the Company.

Under the 2001 Plan, the committee and the Chief Executive Officer are authorized to grant non-qualified stock options (options that are not intended to satisfy Section 422 of the Internal Revenue Code of 1986, as amended) to purchase shares of Common Stock of the Company. The number of options granted to an individual is based upon a number of factors, including his or her position, salary and performance, and the overall performance and stock price of the Company. Officers of the Company, including members of the Board of Directors who are officers, are not eligible for stock option grants under the 2001 Plan.

ANNUAL INCENTIVES. The committee believes that executive compensation should be determined with specific reference to the Company's overall performance and goals, as well as the performance and goals of the division or function over which each individual executive has primary responsibility. In this regard, the committee considers both quantitative and qualitative factors. Quantitative items used by the committee in

analyzing the Company's performance include sales and sales growth, results of operations and an analysis of actual levels of operating results and sales to budgeted amounts. Qualitative factors include the committee's assessment of such matters as the enhancement of the Company's image and reputation, expansion into new markets, and the development and success of new products and new marketing programs. No cash bonuses were paid to executives for the year 2002.

The committee has approved the 3D Systems Corporation Executive Incentive Compensation Plan, which we refer to as the 2002 Incentive Plan. Under the 2002 Incentive Plan, executive officers are eligible to receive an annual cash incentive award based, in part, upon the attainment of specified levels of earnings and revenue by the Company as determined by the committee at the beginning of the fiscal year, and individual non-financial objectives which are designed to measure each executive's overall contribution to the Company and the particular division over which he or she is assigned supervisory responsibility. The Chief Executive Officer establishes the non-financial objectives each other executive must attain based upon the overall performance goals of the Company.

Under the 2002 Incentive Plan, the committee has established the maximum bonus, as a percentage of base salary, attainable by each participating executive on the basis of the financial performance of the Company and the attainment of non-financial objectives by the officer. No bonuses will be paid unless the Company achieves a threshold earnings level established by the committee.

The committee attributes various weights to the qualitative factors discussed above based upon their perceived relative importance to the Company at the time compensation determinations are made. Each executive's performance is evaluated with respect to each of these factors, and compensation levels are determined based on each executive's overall performance.

Each participant is eligible for a range of awards based upon attaining or exceeding the earnings and revenue objectives and attainment of non-financial objectives. The 2002 Incentive Plan permits the committee to adjust targets or performance results to reflect unusual items that it determines to be extraordinary or non-recurring.

1998 EMPLOYEE STOCK PURCHASE PLAN. The Company also provides, under the 1998 Employee Stock Purchase Plan, an opportunity for substantially all of its employees to purchase Common Stock at a modest discount to the market price. Pursuant to this plan, employees may allocate annually up to the lesser of $25,000 or 10% of their regular compensation for the purchase of shares of Common Stock.

DETERMINATION OF CHIEF EXECUTIVE OFFICER'S COMPENSATION. On September 9, 1999, the Company and Regent Pacific executed an agreement, which we refer to as the Regent Agreement, pursuant to which Regent Pacific agreed to provide a team of executives, including Brian K. Service, to the Company for a term of 12 months. On September 16, 1999, the Board of Directors appointed Mr. Service as Chief Executive Officer. Pursuant to the Regent Agreement, the Company paid Regent Pacific $45,000 per week for the services of Mr. Service and certain other executives; it had a one-year term and, on August 8, 2000, and October 30, 2001, was extended for additional one-year terms. Mr. Service was compensated for his services by Regent Pacific and the Company made no payments, other than reimbursement for expenses, directly to Mr. Service, during this period. From September 10, 2002 (the date of termination of the Regent Agreement), through October 15, 2002, Mr. Service was engaged on an interim consulting basis for which he was paid $79,999. Effective October 15, 2002, Mr. Service is employed by the Company pursuant to an employment agreement under

which he has agreed to serve as Chief Executive Officer until at least December 2003. Mr. Service is being paid $17,809 on a bi-weekly basis under this agreement, and has been awarded fully vested options, with a term of five years, to purchase 350,000 shares of our Common Stock at a price of $5.78 (the closing price on October 15, 2002). The committee believes the aggregate stock ownership position is effective in aligning the interests of the Chief Executive Officer with the long term interests of the stockholders. The base salary was established based upon a comparative analysis of other chief executive officers taking into account one or more of the following factors: industry, size, and/or location. In addition, on November 18, 2002, the Company entered into a consulting agreement with Brian K. Service, Inc., a corporation in which Mr. Service is a stockholder, officer and director. Pursuant to this agreement, the Company pays to Brian K. Service, Inc. an amount up to $310,000 for an 11-month period for the provision of the services of qualified consultants to the Company. Under this agreement, the Company paid Brian K. Service, Inc. $71,000 through December 31, 2002.

The committee intends to continue its policy of linking executive compensation with maximizing stockholder returns and corporate performance to the extent possible through the programs described above.

OMNIBUS BUDGET RECONCILIATION ACT IMPLICATIONS FOR EXECUTIVE COMPENSATION. Effective January 1, 1994, under Section 162(m) of the Internal Revenue Code of 1986, as amended, a public company generally will not be entitled to a deduction for non-performance-based compensation paid to certain executive officers to the extent any individual's compensation exceeds $1.0 million. Special rules apply for "performance-based" compensation, including the approval of the performance goals by the stockholders of the Company.

All compensation paid to the Company's employees in fiscal 2002 will be fully deductible. With respect to compensation to be paid to executives in 2003 and future years, in certain instances their compensation may exceed $1.0 million. However, in order to maintain flexibility in compensating executive officers in a manner designed to promote varying corporate goals, the committee has not adopted a policy that all compensation must be deductible.

Compensation Committee

Miriam V. Gold
G. Walter Lowenbaum II
Kevin S. Moore

REPORT OF AUDIT COMMITTEE

THE INFORMATION IN THIS AUDIT COMMITTEE REPORT SHALL NOT BE DEEMED TO BE "SOLICITING MATERIAL," OR TO BE "FILED" WITH THE SECURITIES AND EXCHANGE COMMISSION OR TO BE SUBJECT TO REGULATION 14A OR 14C AS PROMULGATED BY THE

SECURITIES AND EXCHANGE COMMISSION, OR TO THE LIABILITIES OF SECTION 18 OF THE SECURITIES AND EXCHANGE ACT OF 1934.

The Audit Committee reviews the Company's financial reporting process on behalf of the Board of Directors. Management has the primary responsibility for the financial statements and the reporting process, including the system of internal controls.

In this context, the Committee has met and held discussions with management and Deloitte, the Company's the independent auditors for fiscal 2002, regarding the fair and complete presentation of the Company's results. The Committee has discussed significant accounting policies applied by the Company in its financial statements, as well as alternative treatments. Management represented to the Committee that the Company's consolidated financial statements were prepared in accordance with generally accepted accounting principles, and the Committee has reviewed and discussed the consolidated financial statements with management and Deloitte. The Committee discussed with Deloitte matters

required to be discussed by Statement on Auditing Standards No. 61 (Communication With Audit Committees).

In addition, the Committee has discussed with Deloitte, the auditors' independence from the Company and its management, including the matters in the written disclosures required by the Independence Standards Board Standard No. 1 (Independence Discussions With Audit Committees). The Committee also has considered whether Deloitte's provision of non-audit services to the Company is compatible with the auditors' independence. The Committee has concluded that the independent auditors are independent from the Company and its management.

The Committee discussed with Deloitte the overall scope and plans for their respective audit.

Based on the reviews and discussions referred to above, the Committee recommended to the Board of Directors, and the Board of Directors has approved, that the audited financial statements be included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002, for filing with the Securities and Exchange Commission.

Audit Committee

Jim D. Kever
Kevin S. Moore
Richard C. Spalding

AUDIT AND NON-AUDIT FEES

The following table presents fees for professional audit services rendered by Deloitte for the audit of our annual financial statements for the years ended December 31, 2002 and December 31, 2001, and fees billed for other services rendered by Deloitte during those periods:

	2002	2001
	(amounts in thousands)	

Audit Fees (1)	$ 660	$ 289
Audit Related Fees (2)	35	28
Tax Fees (3)	458	210
All Other Fees (4)	-	33
	$ 1,153	$ 560

POLICY ON AUDIT COMMITTEE PRE-APPROVAL OF AUDIT AND PERMISSIBLE NON-AUDIT SERVICES OF INDEPENDENT AUDITORS

16

Consistent with SEC policies regarding auditor independence, the Audit Committee has responsibility for appointing, setting compensation and overseeing the work of the independent auditor. In recognition of this responsibility, the Audit Committee has established a policy to pre-approve all audit and permissible non-audit services provided by the independent auditor.

PERFORMANCE GRAPH

The following graph sets forth the percentage change in cumulative total stockholder return of the Common Stock during the five-year period from December 31, 1997 to December 31, 2002, compared with the cumulative returns of the NASDAQ Stock Market (U.S. Companies) Index and the Index for S & P Technology Sector. The Comparison assumes $100 was invested on December 31, 1997, in the Company's Common Stock and in each of the foregoing indices. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

GRAPHICS OMITTED

	Cumulative Total Return					
	12/97	12/98	12/99	12/00	12/01	12/02
3D SYSTEMS CORPORATION	100.00	121.21	137.37	195.96	230.30	126.06
NASDAQ STOCK MARKET (U.S.)	100.00	140.99	261.48	157.40	124.87	86.38
S & P INFORMATION TECHNOLOGY	100.00	178.14	318.42	188.18	139.50	87.31

CERTAIN TRANSACTIONS WITH DIRECTORS AND EXECUTIVE OFFICERS AND 5% STOCKHOLDERS

Except as disclosed in this Proxy Statement, neither our directors or executive officers nor any stockholder owning more than five percent of our issued shares, nor any of their respective associates or affiliates, had any material interest, direct or indirect, in any material transaction to which the Company was a party during fiscal 2002, or which is presently proposed.

See "Employment Agreements" for a summary of employment agreements with certain of our executive officers.

On September 9, 1999, the Company and Regent Pacific Management Corporation executed an agreement pursuant to which Regent Pacific agreed to provide certain key management employees' services to us at a fee of $45,000 per week, including the services of Mr. Service, as President and Chief Executive Officer, and up to two other Regent Pacific personnel as part of our management team. The Regent Agreement also provided that Gary J. Sbona, Chairman and Chief Executive Officer of Regent Pacific, join our Board of Directors. The Agreement had a one-year term and, on August 8, 2000 was extended for an additional one-year term, and provided for the availability of up to two additional executives to provide management services on an as needed basis, beginning as of February 12, 2000. The Agreement was again extended on October 30, 2001 for an additional one-year term under the same terms as the previous extension. The Agreement also required that we provide Director & Officer insurance for Messrs. Sbona and Service.

Simultaneously with the execution of the Regent Agreement, we entered into an employment agreement with Gary J. Sbona. As an inducement to Mr. Sbona to provide services as a part-time employee of the Company, the Board of Directors granted to him an option to purchase 350,000 shares of our Common Stock at an exercise price of $6.00 per share. The shares subject to this option generally vest over a three year period, or sooner subject to certain conditions. On August 8, 2000, the Oversight Committee (later subsumed into the Corporate Governance Committee) extended Mr. Sbona's Employment Agreement for an additional year and authorized the grant of an additional 350,000 shares to Mr. Sbona at an exercise price of $17.3875 per share. The shares subject to this option vest on the same basis as the shares granted in 1999. On October 30, 2001, the Oversight Committee extended Mr. Sbona's Employment Agreement for an additional year and authorized the grant of an additional 350,000 shares to Mr. Sbona at an exercise price of $12.4280.

On May 1, 1999, we entered into an employment agreement with G. Walter Loewenbaum II, Chairman of the Board, whereby Mr. Loewenbaum agreed to provide part-time services to us in the area of strategic direction in exchange for $10,000 per month and an option to purchase 150,000 shares of our Common Stock at a price of $6.6125 per share. The options vested on January 1, 2000. The original term of the agreement was for six months. On December 20, 1999, the Board of Directors voted, with Mr. Loewenbaum abstaining, to change Mr. Loewenbaum's status to "at-will" employee pursuant to the terms and conditions of his employment agreement. On August 8, 2000 the Oversight Committee of the Board of Directors voted to increase Mr. Loewenbaum's monthly compensation to $15,000. On February 12, 2002, the Oversight Committee awarded Mr. Loewenbaum an option to purchase an additional 75,000 shares of our Common Stock at a price of $11.75 per share. These options vest in equal annual installments over a three-year period. Effective November 17, 2002, Mr. Loewenbaum resigned as an employee.

In June 2000, we entered into a distribution agreement for ThermoJet printers with 3D Solid Solutions, which we refer to as 3DSS, a partnership in which Mr. Loewenbaum, the Chairman of our Board of Directors, is a limited partner. As of December 31, 2002, Solid Imaging Technologies, LLC, of which Mr. Loewenbaum is the sole member, was the general partner of 3DSS. In 2002, 3DSS paid us approximately $84,000 for the purchase of products and services.

In 1998, we adopted under the 1996 Stock Incentive Plan, the Executive Long-Term Stock Incentive Plan pursuant to which we offered loans to our executive officers of up to $60,000 to purchase shares of the Common Stock reserved for issuance under the 1996 Plan. Charles W. Hull, our Executive Vice President, Chief Technology Officer, executed a promissory note for the principal amount of $60,000 that bears interest at the rate of 6% per annum. The note is secured by the shares of Common Stock purchased. At March 28, 2003, the Company had a remaining note receivable totaling $45,232, including accrued interest. This note was retired in July 2003 in exchange for 6,031 shares of Common Stock.

Pursuant to a July 1990 Distribution Agreement with Vantico, Inc., successor to Ciba Specialty Chemicals, Inc., and subject to conditions set forth in the agreement, we have been Vantico's exclusive distributor (except in Japan) of all photopolymers manufactured by Vantico for use in stereolithography. We purchased from Vantico resins valued at approximately $183,815 net of product returns and applicable credits during fiscal 2002. Pursuant to a Settlement Agreement and Mutual General Releases dated March 19, 2002, the

Distribution Agreement with Vantico terminated on April 22, 2002. In connection with the Settlement Agreement, Vantico paid us $22,000,000 by transferring to us 1,550,000 shares of our stock. A related Research and Development Agreement terminated at the same time.

In 1990, 3D Systems, Inc. acquired the patents for stereolithography technology from UVP, Inc. in exchange for $9,075,000, $500,000 of which was paid in cash and $350,000 by certain offsets. The balance of the purchase price ($8,225,000) is payable based upon sales of stereolithography systems and licensing of the patents and subject to certain conditions. Pursuant to a 1987 contract between UVP and Charles W. Hull, our Executive Vice President, Chief Technology Officer and a director of ours, Mr. Hull is entitled to receive from UVP, with respect to his prior relationship with UVP, an amount equal to 10% of all royalties or other amounts received by UVP with respect to the patents, but only after recoupment of certain expenses by UVP. To date, Mr. Hull has received $698,626 from UVP under that contract.

On May 5, 2003, we sold 2,634,016 shares of our Series B Convertible Preferred Stock, at a price of $6.00 per share, for aggregate consideration of $15.8 million. The preferred stock accrues dividends at 8% per share and is convertible at any time into approximately 2,634,016 shares of Common Stock. The stock is redeemable at our option after the third anniversary date. We must redeem any shares of preferred stock outstanding on the tenth anniversary date. The redemption price is $6.00 per share plus accrued and unpaid dividends. Messrs. Loewenbaum, Service and Hull, our Chairman of the Board, Chief Executive Officer and Chief Technology Officer, respectively, purchased an aggregate of $1,450,000 of the preferred shares. Additionally, Clark Partners I, L.P., a New York limited partnership, purchased $5.0 million of the preferred shares. Kevin Moore, a member of our Board of Directors, is the president of the general partner of Clark Partners I, L.P. In connection with the offering, Houlihan Lokey Howard & Zukin rendered its opinion that the terms of the offering were fair to the Company from a financial point of view. A special committee of the Board of Directors, composed entirely of disinterested independent directors, approved the offer and sale of the preferred shares and recommended the transaction to the Board of Directors. The Board also approved the transaction, with interested Board members not participating in the vote.

Our Board of Directors believes, based on its reasonable judgment, but without further investigation, that the terms of each of the foregoing transactions or arrangements between us on the one hand and our affiliates, officers, directors or stockholders which were parties to the transactions on the other hand, were, on an overall basis, at least as favorable to us as could then have been obtained from unrelated parties.

PRINCIPAL STOCKHOLDERS

The following table sets forth as of June 13, 2003, unless otherwise indicated, certain information relating to the ownership of Common Stock by (i) each person known by the Company to be the beneficial owner of more than five percent of the outstanding shares of Common Stock (636,716 shares) or Series B Convertible Preferred Stock (131,701 shares), (ii) each of the Company's directors, (iii) each of the Named Executive Officers, and (iv) all of the Company's executive officers and directors as a group. Except as may be indicated in the footnotes to the table and subject to applicable community property laws, each person has the sole voting and investment power with respect to the shares owned. The address of each person listed is in care of the Company, 26081 Avenue Hall, Valencia, California 91355, unless otherwise set forth below that person's name.

NAME AND ADDRESS OF BENEFICIAL OWNER	AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP (1)	PERCENT OF CLASS (1)	NUMBER OF SHARES OF SERIES B CONVERTIBLE PREFERRED STOCK BENEFICIALLY OWNED (1)	PERCENT OF CLASS (1)
Directors:				
Miriam V. Gold	54,166 (2)	*	--	*
Charles W. Hull	584,463 (3)	4.5%	8,333	*
Jim D. Kever	89,166 (4)	*	--	*
G. Walter Loewenbaum II	1,305,013 (5)	9.9%	208,334	7.9%
Kevin S. Moore	1,788,254 (6)	13.1%	833,333 (7)	31.6%
Brian K. Service	376,300 (8)	2.9%	25,000	*
Richard C. Spalding	9,298 (9)	*	--	*
Non-Director Named Executive Officers:				
Grant R. Flaharty (10)	192,867 (11)	1.5%	--	*
Kevin McAlea, Ph.D.	22,083 (12)	*	3,333	*
Ray Saunders	31,833 (13)	*	2,833	*
E. James Selzer (14)	74,429 (15)	*	--	*
G. Peter V. White	--	*	--	*
5% Holders:				
The Clark Estates, Inc. One Rockefeller Plaza,	1,766,605 (16)	13.0%	833,333 (7)	31.6%

New York, New York 10020				
St. Denis J. Villere & Company 210 Baronne Street, Suite 808, New Orleans, Louisiana 70112	1,230,114 (17)	9.7%	--	*
Daruma Asset Management, Inc. 60 East 42nd Street, Suite 1111, New York, New York 10165	1,423,200 (18)	11.2%	--	*
T. Rowe Price Associates, Inc. 100 East Pratt Street, Baltimore, Maryland 21202	1,295,482 (19)	8.1%	263,482	10.0%
3D Systems 2003 Grat Lisa P. Selz Trustee c/o Bernard Setz ING Furman Selz 230 Park Ave. New York, NY 10169	--	*	665,000	25.2%
Directors and officers as a group (10 persons)	4,527,872 (20)	30.2%	1,081,116	41.0%

* Less than one percent.

The information as to shares beneficially owned has been individually furnished by the respective directors, Named Executive Officers, and other stockholders of the Company, or taken from documents filed with the SEC.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's executive officers, directors, and persons who own more than ten percent of a registered class of the Company's equity securities to file reports of ownership and changes in ownership with the SEC. Executive officers, directors and greater-than-ten percent stockholders are required by SEC regulations to furnish the Company with all Section 16(a) forms they file. Based solely on its review of the copies of the forms received by it and written representations from certain reporting persons that they have complied with the relevant filing requirements, the Company believes that, during the year ended December 31, 2002, all of the Company's executive officers, directors and greater-than-ten percent stockholders complied with all Section 16(a) filing requirements, except, Brian K. Service filed a Form 5, which reported one transaction on an untimely basis.

STOCKHOLDER PROPOSALS

Any stockholder who intends to present a proposal at the 2004 Annual Meeting of Stockholders for inclusion in the Company's Proxy Statement and Proxy form relating to the 2004 Annual Meeting must submit the proposal to the Company at its principal executive offices by December 14, 2004.

If a stockholder, rather than including a proposal in the proxy statement as discussed above, commences a proxy solicitation for the 2004 Annual Meeting of Stockholders, the Company must receive notice of the proposal that is the subject of the solicitation on or before February 26, 2004. If the notice is not received on or before February 26, 2004, it will be considered untimely and the Company will have discretionary voting authority under proxies solicited for the 2004 Annual Meeting of Stockholders with respect to the proposal, if presented at the meeting.

SOLICITATION OF PROXIES

It is expected that the solicitation of Proxies will be by mail. The cost of solicitation by management will be borne by the Company. The Company will reimburse brokerage firms and other persons representing beneficial owners of shares for their reasonable disbursements in forwarding solicitation material to the beneficial owners. Proxies may also be solicited by certain of the Company's directors and officers, without additional compensation, personally or by mail, telephone, telegram or otherwise.

ANNUAL REPORT ON FORM 10-K

THE COMPANY'S ANNUAL REPORT ON FORM 10-K, WHICH HAS BEEN FILED WITH THE SECURITIES AND EXCHANGE COMMISSION FOR THE YEAR ENDED DECEMBER 31, 2002, WILL BE MADE AVAILABLE TO STOCKHOLDERS WITHOUT CHARGE UPON WRITTEN REQUEST TO INVESTOR RELATIONS, 3D SYSTEMS, 26081 AVENUE HALL, VALENCIA, CALIFORNIA 91355.

ON BEHALF OF THE BOARD OF DIRECTORS

/s/ Keith Kosco

Keith Kosco
GENERAL COUNSEL AND CORPORATE SECRETARY

26081 Avenue Hall
Valencia, California 91355
July 24, 2003

APPENDIX A

3D SYSTEMS CORPORATION

AUDIT COMMITTEE CHARTER

The Audit Committee is a committee of the Board of Directors of 3D Systems Corporation established pursuant to Article 3, Section (xiii) of the Company's

Bylaws. The Audit Committee's primary function is to assist the Board of Directors in fulfilling its oversight responsibilities by reviewing (i) the financial information which will be provided to the Company's shareholders and others, (ii) in consultation with the independent auditors, the integrity of the Company's systems of internal controls, and (iii) the audit process, and to have other powers and perform other duties as the Board of Directors may from time to time delegate to it in accordance with Article 3, Section (xiii) of the Bylaws of the Company.

In meeting its responsibilities, the Audit Committee is expected to:

1. Provide an open avenue of communication between the independent auditors and the Board of Directors.

2. Be solely responsible for the appointment, compensation, retention (and termination), and oversight of the work of the independent auditors (including resolving disagreements between management and the independent auditors). The independent auditors shall report directly to the Audit Committee.

3. Confirm the independence of the independent auditors, including:

   (a) Approval in advance of all audit and permitted non-audit services which may be provided by the independent auditors, together with any related fees, in order to ensure that the independent auditors do not perform for the Company any services that are prohibited by law or regulation;

   (b) Receipt from the independent auditors of a formal written statement delineating all relationships between the independent auditors and the Company;

   (c) Ensuring the rotation of independent auditors or independent audit personnel, to the extent required by law or regulation;

   (d) Reviewing the performance of services by an independent audit firm when a former employee of that firm currently serves as chief executive officer, chief financial officer, chief accounting officer, or equivalent officer of the Company; and

   (e) Establishment and review of hiring policies for employees and former employees of independent auditors.

4. Inquire of management, the chief financial officer, and the independent auditors about significant risks or exposures and assess the steps management has taken to minimize those risks to the Company.

5. Establish systems of reporting by each of management and the independent auditors regarding any significant judgments made in management's preparation of the financial statements and the view of each as to the appropriateness of those judgments.

6. Inquire as to the independent auditors' views about management's choices of accounting principles from the perspective of income, asset, and liability recognition, and whether those principles are common practices or are minority practices.

7. Determine, with regard to significant new transactions or events, the independent auditors' reasoning for the appropriateness of the accounting principles and disclosure practices adopted by management.

8. Consider and review with the independent auditors and the chief financial officer, and obtain at least annually, a written statement from the independent auditors regarding:

   (a) The adequacy of the Company's internal financial and disclosure controls, including computerized information system controls and security;

   (b) Any related significant findings and recommendations of the independent auditors, including the status of previous audit recommendations, together with management's responses to those recommendations; and

   (c) Major changes to the Company's accounting principles and practices as suggested by the independent auditors or management.

9. Consider, in consultation with the independent auditors, the audit scope, plan, and coordination, including completeness of coverage, reduction of redundant efforts, and effective use of audit resources.

10. Review with management, the chief financial officer, and the independent auditors at the completion of the annual examination:

   (a) The Company's annual financial statements and related footnotes, and any reports or other financial information submitted to any governmental body or the public;

   (b) The independent auditors' audit of the financial statements and their report regarding those financial statements;

   (c) Any significant changes required in the independent auditors' audit plan;

   (d) Any difficulties encountered in the course of the audit, including any serious difficulties or disputes with management, restrictions on the scope of activities, or access to required information; and

   (e) Other matters related to the conduct of the audit that are to be communicated to the Audit Committee under generally accepted auditing standards.

11. Review with management and the independent auditors (i) the quarterly financial results prior to the release of earnings and (ii) the quarterly financial statements prior to their filing.

12. Review with the general counsel at least annually any legal matters that could have a potential impact on the Company's financial statements.

13. Review with the general counsel or appropriate officer regulatory matters that may have a material impact on the financial statements.

14. Meet with the independent auditors and management in separate executive sessions to discuss any matters that the Audit Committee or these groups believe should be discussed privately with the Audit Committee.

15. Resolve any disputes existing between the Company's management and the independent auditors.

16. Establish, and annually review compliance with, the Company's Ethics Policy (including a procedure for the receipt, retention, and treatment of complaints regarding accounting, internal accounting controls, or auditing matters, which will incorporate procedures for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters). To the extent required by applicable laws or regulations:

    (a) The Ethics Policy will be applicable to senior financial officers of the Company, including its principal financial officer, its controller or principal accounting officer, and to persons performing similar functions;

    (b) The Company will immediately disclose, by means of the filing of an applicable reporting form, or dissemination by the Internet pursuant to applicable rules and regulations, any waiver of or change in the Ethics Policy for those senior officers; and

    (c) The Company's Ethics Policy will include standards as are reasonably necessary to promote: (1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships; (2) full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the Company; and (3) compliance with applicable governmental laws and regulations.

In addition, the Audit Committee will:

17. Meet as often and at such times and places (or telephonically) as determined by the Audit Committee. Any member of the Audit Committee may call a meeting. The Audit Committee may ask members of management or others to attend the meeting and provide pertinent information as necessary. If practicable, a written agenda will be prepared for each meeting and distributed to Audit Committee members prior to the meeting, together with any appropriate background materials. After each meeting, minutes will be prepared recording the deliberations of the Audit Committee.

18. Report Audit Committee actions to the Board of Directors with recommendations as the Audit Committee may deem appropriate.

19. Prepare letters and reports as may be necessary or desirable for inclusion in the annual report, proxy statement, and other reports and filings by the Company, which describe the Audit Committee's composition and responsibilities, and how they were discharged. In the Audit Committee report for inclusion in the Company's proxy statement, the Audit Committee will state whether it has: (i) reviewed and discussed the audited financial statements with management; (ii) discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61, as that statement may be modified or supplemented from time to time; (iii) received from the independent auditors the written disclosures and the letter required by Independence Standard Board Standard No. 1, as that standard may be modified or supplemented from time to time, and has discussed with the independent auditors their independence; and (iv) based on the review and discussions referred to in clauses (i), (ii), and (iii) above, recommended to the Board of Directors that the audited financial statements be included in the Company's Annual Report on Form 10-K for the last fiscal year for filing with the Securities and Exchange Commission.

20. Annually conduct an evaluation of its own performance and, in light of this evaluation, consider changes in its membership, charter, or procedures. The Audit Committee shall report to the Board of Directors the results of its evaluation, including recommended charter, membership, and other changes.

21. Review and update this Charter periodically as conditions dictate, but no less frequently than annually.

22. Have the power to (i) conduct or authorize investigations into any matters within the Audit Committee's scope of responsibilities and (ii) retain independent counsel, accountants, or other advisors to assist it in the conduct of any investigation. The Board of Directors will ensure that the Audit Committee receives all funding necessary to undertake any investigations and perform all of its other duties and obligations under this Charter.

23. Perform other functions as assigned by law, the Company's Certificate of Incorporation or Bylaws, or the Board of Directors.

The membership of the Audit Committee will consist of at least three members of the Board of Directors (including a Chairperson), who must meet the standards for independence and financial and/or accounting expertise established under the rules and regulations of the Securities and Exchange Commission, The Nasdaq Stock Market, and other legal and regulatory requirements as may be applicable. At least one member must fulfill the qualifications of a "financial expert," as defined by the rules and regulations of the Securities and Exchange Commission or The Nasdaq Stock Market. The members will serve at the pleasure of the Board of Directors. The full Board of Directors will designate the Audit Committee members and determine which member will serve as Chairperson on an annual basis. An Audit Committee member (including the Chairperson) may be removed at any time, with or without cause, by the Board of Directors. The Board of Directors may designate one or more independent directors as alternate members of the Audit Committee, who may replace any absent or disqualified member or members at any meetings of the Committee. No person may be made a member of the Committee if his or her service on the Audit Committee would violate any restriction on service imposed by any rule or regulation of the Securities and Exchange Commission or The Nasdaq Stock Market. The duties and responsibilities of the members of the Audit Committee are in addition to those duties set forth for the members of the Board of Directors. This Charter will be made available on the Company's website.

PROXY FOR ANNUAL MEETING OF STOCKHOLDERS

The undersigned, a stockholder of 3D SYSTEMS CORPORATION, a Delaware corporation (the "COMPANY"), hereby appoints Brian K. Service and Keith Kosco, and each of them, as the proxies of the undersigned, with full power of substitution, to attend, vote and act for the undersigned at the Annual Meeting of Stockholders of the Company, to be held on August 26, 2003, and any postponements or adjournments thereof, and in connection herewith, to vote and represent all of the shares of the Company which the undersigned would be entitled to vote, as follows:

The Board of Directors recommends a WITH vote on Proposal 1 and a FOR vote on Proposal 2.

1. ELECTION OF CLASS I DIRECTORS, as provided in the Company's Proxy Statement:

___ WITH ___ WITHOUT Authority to vote for the nominees listed below.

(INSTRUCTIONS: TO WITHHOLD AUTHORITY FOR THE NOMINEES, LINE THROUGH OR OTHERWISE STRIKE OUT NAMES BELOW)

Richard C. Spalding Jim D. Kever G. Walter Loewenbaum II

2. To consider and vote upon a proposal to ratify the appointment of BDO Seidman, LLP as our independent auditors for the fiscal year ending December 31, 2003.

FOR ______ AGAINST _______ ABSTAIN ________

The undersigned hereby revokes any other proxy to vote at such Meeting, and hereby ratifies and confirms all that said proxy may lawfully do by virtue hereof. WITH RESPECT TO SUCH OTHER BUSINESS THAT MAY PROPERLY COME BEFORE THE MEETING AND ANY POSTPONEMENTS OR ADJOURNMENTS THEREOF, SAID PROXY IS AUTHORIZED TO VOTE IN ACCORDANCE WITH ITS BEST JUDGMENT.

This Proxy will be voted in accordance with the instructions set forth above. THIS PROXY WILL BE TREATED AS A GRANT OF AUTHORITY TO VOTE FOR THE ELECTION OF THE CLASS I DIRECTORS NAMED, RATIFICATION OF THE APPOINTMENT OF BDO SEIDMAN, LLP AS OUR INDEPENDENT AUDITORS FOR THE FISCAL YEAR ENDING DECEMBER 31, 2003, AND AS SAID PROXY SHALL DEEM ADVISABLE ON SUCH OTHER BUSINESS AS MAY COME BEFORE THE MEETING, UNLESS OTHERWISE DIRECTED.

The undersigned acknowledges receipt of a copy of the Notice of Annual Meeting and accompanying Proxy Statement dated July 24, 2003 relating to the Meeting.

____ No. Shares _____________

____ Date: __________________, 2003

Signature(s) of Stockholder(s)
(See Instructions Below)

The signature(s) hereon should correspond exactly with the name(s) of the stockholder(s) appearing on the Stock Certificate. If stock is jointly held, all joint owners should sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title as such. If signer is a corporation, please sign the full corporation name, and give title of signing officer.

THIS PROXY IS SOLICITED BY
THE BOARD OF DIRECTORS OF 3D SYSTEMS CORPORATION

tyle="background:#CCEEFF;border:none;padding:0in 0in 0in 0in;width:12.0%;">

Gross profit	
	526
	392
	1,157
	864
Operating expenses:	

Sales and marketing	
	1,013
	1,923
	1,973
	3,786
Research and development	
	732
	901
	1,334
	1,824
General and administrative	

	315
	446
	579
	848
Severance costs	
	34
	118
	130
	244

Operating loss	(1,568)	(2,996)	(2,859)	(5,838)
Other income	40	10	40	

	10
Interest income, net	
	7
	53
	26
	114
Loss before income tax provision	
	(1,521
)	
	(2,933
)	

(2,793

)

(5,714

)

Income tax provision

Net loss	$ (1,521)	$ (2,933)	$ (2,793)	$ (5,714)

Preferred stock dividends accrued

(62

)

(62

)

Beneficial conversion feature on preferred stock

(938

)

Net loss attributable to common stockholders

$

(1,583

)

$

(2,933

)

$

(3,793

)

$

(5,714

)

Net loss per share attributable to common stockholders (basic and diluted)

$

(0.31

)

$

(0.57

)

$

(0.73

)

$

(1.11

)

Weighted average common shares outstanding, basic and diluted

5,166

5,162

5,165

5,162

See accompanying notes.

4

INTRUSION INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
Operating Activities:		
Net loss	$ (2,793)	$ (5,714)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	144	850
Provision for doubtful accounts		(290)
Changes in operating assets and liabilities:		
Accounts receivable	384	1,692
Inventories	(96)	(145)
Other assets	196	423
Accounts payable and accrued expenses	(558)	(872)
Deferred revenue	131	(502)
Net cash used in operating activities	(2,592)	(4,558)
Investing Activities:		
Purchases of short-term investments	(3,100)	(2,150)
Maturities of short-term investments	1,705	4,925
Net purchases of property and equipment	(82)	(85)
Net cash provided by investing activities	(1,477)	2,690
Financing Activities:		
Proceeds from the exercise of employee stock options	6	
Proceeds from the issuance of preferred stock and warrants, net	4,725	
Net cash provided by financing activities	4,731	
Net increase (decrease) in cash and cash equivalents	662	(1,868)
Cash and cash equivalents at beginning of period	974	2,898
Cash and cash equivalents at end of period	$ 1,636	$ 1,030
SUPPLEMENTAL DISCLOSURE OF NON CASH FINANCING ACTIVITIES:		
Fair value of warrants issued in connection with sale of preferred stock	$ 1,191	$
Amortization of preferred stock beneficial conversion feature	$ 938	$
Preferred stock dividend accrued	$ 62	$

See accompanying notes.

INTRUSION INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Description of Business

We develop, market and support a family of network intrusion prevention and detection systems and regulated information compliance systems that address vital security issues facing organizations with mission critical business applications or housing classified, confidential, or customer information assets. We currently provide network security and regulated information compliance solutions under our SecureNet family of hardware and software solutions.

We market and distribute our products through a direct sales force to end-users and distributors and by numerous domestic and international system integrators, managed service providers and value-added resellers. Our end-user customers include high technology, manufacturing, telecommunications, retail, transportation, health care, insurance, entertainment, utilities and energy companies, government entities, financial institutions, and academic institutions.

We were organized in Texas in September 1983 and reincorporated in Delaware in October 1995. For more than 15 years, we provided local area networking equipment and were known as Optical Data Systems or ODS Networks. On April 17, 2000, we announced plans to sell, or otherwise dispose of, our networking divisions, which included our Essential Communications division and our local area networking assets. In accordance with these plans, we have accounted for these businesses as discontinued operations. On June 1, 2000, we changed our name from ODS Networks, Inc. to Intrusion.com, Inc., and our NASDAQ ticker symbol from ODSI to INTZ to reflect our focus on intrusion detection solutions. On November 1, 2001, we changed our name from Intrusion.com, Inc. to Intrusion Inc.

Our principal executive offices are located at 1101 East Arapaho Road, Richardson, Texas 75081, and our telephone number is (972) 234-6400. Our website URL is www.intrusion.com. Information contained in or linked to our website are not a part of this report. References to we, us and our in this report refer to Intrusion Inc. and its subsidiaries.

As of June 30, 2004, we had cash, cash equivalents and short-term investments in the amount of approximately $4.7 million, up from approximately $2.7 million as of December 31, 2003. Although we believe we have sufficient cash resources to finance our operations and expected capital expenditures for the next twelve months, based on our internal estimates and our operating plan, the sufficiency of our cash resources may depend to a certain extent on general economic, financial, competitive or other factors beyond our control. Moreover, despite actions to reduce our costs and improve our profitability, we expect our operating losses and net operating cash outflows to continue through 2004. As a result, we may not be able to achieve the revenue and gross margin objectives necessary to achieve positive cash flow or profitability without obtaining additional financing. We do not currently have any arrangements for financing and we may not be able to secure additional debt or equity financing on terms acceptable to us, or at all, at the time when we need such funding. If our business does not generate sufficient cash flow from operations and sufficient future financings are not available, we may not be able to operate or grow our business, pay our expenses when due or fund our other liquidity needs.

2. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The December 31, 2003 balance sheet was derived from audited financial statements, but does not include all the disclosures required by accounting principles generally accepted in the United States. However, we believe that the disclosures are adequate to make the information presented not misleading. In our opinion, all the adjustments (consisting of normal recurring adjustments) considered necessary for fair presentation have been included. The results of operations for the three months ending June 30, 2004 are not necessarily indicative of the results that may be achieved for the full fiscal year or for any future period. The condensed consolidated financial statements included herein should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s annual report on Form 10-K for the year ended December 31, 2003.

3. Inventories (In thousands)

		June 30, 2004		December 31, 2003
Inventories consist of:				
Finished goods	$	1,008	$	851
Work in progress		146		261
Demonstration systems		228		174
Net inventory	$	1,382	$	1,286

4. Accounting for Stock-Based Compensation

We account for employee stock-based compensation under APB 25. The following table summarizes relevant information as to the reported results under our intrinsic value method of accounting for stock awards, with supplemental information as if the fair value recognition provision of SFAS 123 as amended by SFAS 148 had been applied for the quarters ended June 30, 2004 and June 30, 2003 (in thousands, except per share data). All stock information in this report reflects a four-for-one (4:1) reverse stock split completed on March 29, 2004:

	Quarter Ended June 30, 2004	Quarter Ended June 30, 2003	Six Months June 30, 2004	Six Months June 30, 2003
Net loss attributable to common stockholders	$ (1,583)	$ (2,933)	$ (3,793)	$ (5,714)
Add (Deduct): Total stock-based compensation determined under fair value-based method for all awards	(46)	4	(119)	336
Pro forma net loss attributable to common stockholders	$ (1,629)	$ (2,929)	$ (3,912)	$ (5,378)
Net loss per share attributable to common stockholders:				
as reported (basic and diluted)	$ (0.31)	$ (0.57)	$ (0.73)	$ (1.11)
pro forma (basic and diluted)	$ (0.32)	$ (0.57)	$ (0.76)	$ (1.04)
Weighted-average shares used in computation:				
Basic and diluted	5,166	5,162	5,165	5,162

As required, the pro forma disclosures above include options granted since January 1, 1995. Consequently, the effects of applying SFAS 123 and SFAS 148 for providing pro forma disclosures may not be representative of the effects on reported operating results for future years until all options outstanding are included in the pro forma disclosures. For purposes of pro forma disclosures, the estimated fair value of stock-based compensation plans and other options are amortized to expense primarily over the vesting period.

5. Net Loss Per Share

We report two separate earnings per share (EPS) numbers, basic EPS and diluted EPS. Basic net loss per share is computed by dividing net loss attributable to common stockholders for the period by the weighted average number of common shares outstanding for the period. Diluted net loss per share is computed by dividing the net loss attributable to common stockholders by the weighted average number of common shares and common stock equivalents outstanding for the period. Our common stock equivalents include all common stock issuable upon conversion of convertible preferred stock and the exercise of outstanding options and warrants. The aggregate number of common stock equivalents excluded from the loss per share calculation for the three and six-month periods ended June 30, 2004 and 2003 are 2,594,849 and 377,095, respectively. Our common stock equivalents are not included in the diluted loss per share for the three and six-month periods ended June 30, 2004 and 2003, as they are antidilutive.

6. Commitments and Contingencies

We are subject to legal proceedings and claims that arise in the ordinary course of business. We do not believe that the outcome of those matters, if any, will have a material adverse affect on our consolidated financial position, operating results or cash flows. However, there can be no assurance such legal proceedings will not have a material impact.

Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This report contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, that involve risks and uncertainties, such as statements concerning: the difficulties in forecasting future sales caused by current economic and market conditions, the effect of military actions on government and corporate spending on information security products, spending patterns of, and appropriations to, U.S. government departments, the impact of our cost reduction programs and our refocused product line, the difficulties and uncertainties in successfully developing and introducing new products, our ability to continue to meet operating expenses through current cash flow or additional financings, the highly competitive market for our products, difficulties in accurately estimating market growth, the consolidation of the information security industry, the impact of changing economic conditions, business conditions in the information security industry, our ability to manage acquisitions effectively, our ability to manage discontinued operations effectively, the impact of market peers and their products as well as risks concerning future technology and others identified in our Annual Report on Form 10-K, as amended, and other Securities and Exchange Commission filings. Such forward-looking statements are generally accompanied by words such as plan, estimate, expect, believe, should, would, could, anticipate, may or other words that convey future events or outcomes. These forward-looking statements and other statements made elsewhere in this report are made in reliance on the Private Securities Litigation Reform Act of 1995. The section below entitled Factors That May Affect Future Results of Operations sets forth and incorporates by reference certain factors that could cause actual future results of the company to differ materially from these statements.

Critical Accounting Policies and Estimates

Management s discussion and analysis of financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to product returns, bad debts, inventories, income taxes, warranty obligations, restructuring, maintenance contracts and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements.

Revenue Recognition

We generally recognize product revenue upon shipment of product. We accrue for estimated warranty costs and sales returns at the time of shipment based on our experience. Revenue from maintenance contracts is deferred and recognized over the contractual period the services are performed, generally one year. There is a risk that technical issues on new products could result in unexpected warranty costs and returns. However, as we migrate to more of a software-based business model, our warranty costs should continue to decline. To the extent that they do decline, our warranty reserve from current sales will decrease. If our warranty costs exceed our expectations, we will increase our warranty reserve to compensate for the additional expense expected to be incurred. We review these estimates periodically and determine the appropriate reserve percentage. However, to date, warranty costs and sales returns have not been material. Historically, our estimates for these items have not differed materially from actual results. We believe that our revenue recognition policy does not include significant or subjective estimates.

We recognize software revenue from the licensing of our software products in accordance with Statement of Position (SOP) No. 97-2 Software Revenue Recognition , SOP 98-9 Modification of 97-2, Software Revenue Recognition, with respect to certain transactions and Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition whereby revenue from the licensing of our products is not recognized until all four of the following have been met: i) execution of a written agreement; ii) delivery of the product has occurred; iii) the fee is fixed and determinable; and iv) collectibility is probable. Bundled hardware and perpetual software product sales are recognized at time of delivery, as our licenses are not sold on a subscription basis. In the case of multiple product and service sales, we perform a Vendor Specific Objective Evidence analysis to appropriately determine the amount of revenue derived from each deliverable. If our license strategy changes and we begin to offer licenses on a subscription basis, we would perform this analysis in a similar manner. Under these circumstances, the revenue related to the license would be recognized ratably over the subscription period. Market values are easily obtained for all of our product offerings, as we have historical sales information on our product offerings. We defer and recognize maintenance and support revenue over the term of the contract period, which is generally one year.

We have signed distribution agreements with distributors in the United States, Europe and Asia. In general, these relationships are non-exclusive. Distributors typically maintain an inventory of our products. Under these agreements, we provide certain protection to the distributors for their inventory of our products for price reductions as well as products that are slow moving or have been discontinued by us. Historically, returns from our distributors and charges related to price reductions on inventory held by distributors have not been material. Recognition of sales to distributors and related gross profits are deferred until the distributors resell the merchandise. However, since we have legally sold the inventory to the distributor and we no longer have care, custody or control over the inventory, we recognize the trade accounts receivable and reduce inventory related to the sale at the time of shipment to the distributor. Revenue, offset by deferred cost of sales, is included in deferred revenue in the accompanying financial statements. Since the net balance in Deferred Revenue represents the sales price less the cost of the product maintained by the distributors, the deferred costs of these products are included in our obsolescence and slow-moving analysis and are written down according to their current value. This transaction, effectively recognizes expense for the write-down, if any, and increases the net liability in the deferred revenue account.

We generally recognize service revenue upon delivery of the contracted service. Service revenue, primarily including maintenance, training and installation are recognized upon delivery of the service and typically are unrelated to product sales. These services are not essential to the functionality of the delivered product. To date, training and installation revenue has not been material.

Allowance for Doubtful Accounts and Returns

Trade accounts receivable are stated at the amount we expect to collect. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. Management considers the following factors when determining the collectibility of specific customer accounts: customer credit-worthiness, past transaction history with the customer, current economic industry trends, and changes in customer payment terms. If the financial condition of our customers were to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Based on management s assessment, we provide for estimated uncollectible amounts through a charge to earnings and a credit to a valuation allowance. Balances that remain outstanding after we have used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. Historically, our estimates for sales returns and doubtful accounts have not materially differed from actual results.

Inventory

We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Historically, our estimates for inventory obsolescence have not differed materially from actual results.

Results of Operations

The following table sets forth, for the periods indicated, certain financial data as a percentage of net revenues. The period-to-period comparison of financial results is not necessarily indicative of future results.

	Three Months Ended		Six Months Ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Net product revenue	58.4%	51.8%	51.3%	56.1%
Net customer support and maintenance revenue	41.6	48.2	48.7	43.9
Total revenue	100.0	100.0	100.0	100.0
Cost of product revenue	41.1	48.0	30.7	52.9
Cost of customer support and maintenance revenue	11.2	25.6	20.5	17.9
Total cost of revenue	52.3	73.6	51.2	70.8
Gross profit	47.7	26.4	48.8	29.2
Operating expenses:				
Sales and marketing	91.8	129.7	83.2	127.9
Research and development	66.4	60.8	56.3	61.6
General and administrative	28.6	30.1	24.4	28.7
Severance costs	3.1	8.0	5.5	8.2
Operating loss	(142.2)	(202.2)	(120.6)	(197.2)
Other income	3.6	0.7	1.7	0.3
Interest income, net	0.6	3.6	1.1	3.9
Loss before income tax provision	(137.9)	(197.9)	(117.8)	(193.0)
Income tax provision				
Net loss	(137.9)%	(197.9)%	(117.8)%	(193.0)%
Preferred stock dividends accrued	(5.6)		(2.6)	
Beneficial conversion feature on preferred stock			(39.6)	
Net loss attributable to common stockholders	(143.5)%	(197.9)%	(160.0)%	(193.0)%

	Three Months Ended		Six Months Ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Domestic revenues	84.6%	66.6%	73.7%	57.6%
Export revenues to:				
Europe	5.7	24.6	16.6	30.9
Canada	7.5	1.9	5.5	0.6
Asia	1.9	6.6	3.9	10.8
Latin America	0.3	0.3	0.3	0.1
Net revenues	100.0%	100.0%	100.0%	100.0%

Net Revenues. Net revenues for the quarter and six months ended June 30, 2004 were $1.1 million and $2.4 million, respectively, compared to $1.5 million and $3.0 million for the same periods in 2003. Product revenues decreased $0.1 million and $0.4 million for the quarter and six months ended June 30, 2004 compared to the same periods in 2003. Customer support and maintenance revenue decreased $0.3 million and $0.1 million for the quarter and six months ended June 30, 2004 compared to the same periods in 2003. Total revenues (including maintenance and support) for the quarter and six months ended June 30, 2004 from our SecureNet product line increased to $1.0 million and $2.1 million from $0.9 million and $1.9 million for the same periods in 2003, but were not sufficient to counteract a continued decline in sales of our hardware-based products in connection with our shift in business focus. Our first generation product sales, including PDS and SecureCom decreased for the quarter and six months ended June 30, 2004 to $0.1 million and $0.2 million from $0.7 million and $1.3 million from the same periods in 2003. In addition, continued sluggish economic conditions and delayed customer orders contributed to the decline in revenues.

Export Revenues. Export revenues for the quarter and six months ended June 30, 2004 decreased to $0.2 million and $0.6 million from $0.5 million and $1.3 million compared to the same periods in 2003 as revenues from our PDS security appliance family decreased and we focused more of our resources domestically.

Concentration of Revenues. Revenues from sales to various U.S. government entities totaled $0.4 million, or 37.6% of revenues, for the quarter ended June 30, 2004 compared to $0.2 million, or 13.6% of revenues, for the same period in 2003. Revenues from sales to Computer Science Corporation totaled $0.1 million or 10.3% of revenue for the quarter ended June 30, 2004 compared to $44 thousand or 3.0% of revenue for the same period in 2003. We expect our concentration of revenues to vary among customers in future quarters depending upon the timing of certain sales.

Gross Profit. Gross profit was $0.5 million or 47.7% of net revenues for the quarter ended June 30, 2004, compared to $0.4 million or 26.4% of net revenues for the quarter ended June 30, 2003. Gross profit was $1.2 million or 48.8% of net revenues for the six months ended June 30, 2004, compared to $0.9 million or 29.2% of net revenues for the six months ended June 30, 2003. Gross profit margins as a percentage of net revenues increased from the same period in the prior year due to a continued shift in product mix, which resulted in an increase as a percentage of revenues of our more profitable SecureNet product line. Gross profit on product revenues for the quarter ended June 30, increased from 7.3% in 2003 to 29.7% in 2004 due to the transition to our more profitable software-based products. Gross profit on customer support and maintenance revenues for the quarter ended June 30,

increased from 47.0% in 2003 to 73.0% in 2004, as less repair costs were incurred during the quarter in conjunction with our transition to software-based products.

Gross profit as a percentage of net revenues is impacted by several factors, including shifts in product mix, changes in channels of distribution, revenue volume, fluctuations in third-party assembly costs, pricing strategies, and fluctuations in revenues of integrated third-party products.

Sales and Marketing. Sales and marketing expenses decreased to $1.0 million for the quarter ended June 30, 2004, compared to $1.9 million for the quarter ended June 30, 2003. Sales and marketing expenses decreased to $2.0 million for the six months ended June 30, 2004, compared to $3.8 million for the six months ended June 30, 2003. This cost reduction was primarily due to the reorganization of our sales and marketing departments, including a reduction in headcount, and other cost reduction initiatives. We expect to continue to realize the impact of our cost reduction initiatives throughout 2004. Sales and marketing expenses may vary as a percentage of net sales in the future. However, we believe that these costs will remain relatively constant through the end of the year.

Research and Development. Research and development expenses decreased to $0.7 million for the quarter ended June 30, 2004, compared to $0.9 million for the quarter ended June 30, 2003. Research and development expenses decreased to $1.3 million for the six months ended June 30, 2004, compared to $1.8 million for the six months ended June 30, 2003. Research and development costs are expensed in the period incurred. Research and development expenses decreased in the quarter and six months ended June 30, 2004, compared to the same periods in 2003 as we focused more of our development efforts on our core SecureNet software-based security products and our regulated information compliance products, while reducing efforts on our PDS, SecureCom and other hardware-based security products. Research and development expenses may vary as a percentage of net sales in the future.

General and Administrative. General and administrative expenses decreased to $0.3 million for the quarter ended June 30, 2004, compared to $0.4 million for the quarter ended June 30, 2003. General and administrative expenses decreased to $0.6 million for the six months ended June 30, 2004, compared to $0.8 million for the six months ended June 30, 2003. This decrease was primarily due to the restructuring done in 2003, including a reduction in headcount, and other cost reduction initiatives. It is expected that general and administrative expenses will remain relatively constant throughout the remainder of the year, as no further headcount reductions are anticipated. General and administrative expense may vary as a percentage of net sales in the future.

Severance Costs. Severance costs decreased to $34 and $130 thousand for the three and six-month periods ended June 30, 2004, compared to $118 and $244 thousand for the quarter and six months ended June 30, 2003. Severance costs during the three- and six-month periods ended June 30, 2004 consisted primarily of severance payments made during the periods as a result of reductions in force. All severance obligations were paid prior to June 30, 2004, and we were not receiving further benefit from these individuals after June 30, 2004. Severance costs for the three and six-month periods ended June 30, 2003 consisted of reductions in force made during those periods.

Interest. Net interest income decreased to $7 thousand for the quarter ended June 30, 2004 compared to $53 thousand for the same period in 2003. Net interest income decreased to $26 thousand for the six months ended June 30, 2004 compared to $114 thousand for the same period in 2003. The decrease in interest income was primarily due to the decrease in overall cash balances over the prior year. Net interest income may vary in the future based on our cash flow and rate of return on investments.

Liquidity and Capital Resources

Our principal source of liquidity at June 30, 2004 is approximately $1.6 million of cash and cash equivalents and $3.1 million of short-term investments. As of June 30, 2004 working capital was $4.3 million compared to $5.8 million as of June 30, 2003.

Cash used in operations for the six months ended June 30, 2004 was $2.6 million, primarily due to an operating loss of $2.8 million, an increase in inventories of $0.1 million and a decrease in accounts payable and accrued expenses of $0.6 million. This cash usage was partially offset by depreciation expense of $0.1 million, a decrease in accounts receivable of $0.4 million, an increase in deferred revenue of $0.1 million and a decrease in other assets of $0.2 million. Cash used in operations of $4.6 million for the six months ended June 30, 2003, was primarily due to an operating loss from continuing operations of $5.7 million. This cash usage was offset by depreciation expense of $0.9 million, recovery of accounts previously written off of $0.3 million and decreases in accounts receivable of $1.7 million and other assets of $0.4 million, offset by an increase in inventories of $0.1 million, a decrease in accounts payable and accrued liabilities of $0.9 million and a decrease in deferred revenue of $0.5 million. Future fluctuations in inventory balances, accounts receivable and accounts payable will be dependent upon several factors, including, but not limited to, quarterly sales, our strategy in building inventory in advance of receiving orders from customers, and the accuracy of our forecasts of product demand and component requirements.

Cash used in investing activities in the six months ended June 30, 2004 was $1.5 million, which consisted primarily of the net purchase of short-term investments of $1.4 million, compared to cash provided by investing activities of $2.7 million for the six months ended June 30, 2003, which consisted primarily of the maturity of short-term investments.

Cash provided by financing activities in the six months ended June 30, 2004 was $4.7 million, consisting of net financing proceeds from a private placement of $4.7 million and the exercise of employee stock options of $6 thousand.

At June 30, 2004, the Company did not have any material commitments for capital expenditures.

During the six months ended June 30, 2004, the Company funded its operations through the use of cash and cash equivalents.

Based on our financial projections, we expect that our cash on hand, along with our short-term investments, and cash from our operations will be sufficient to fund our operations for the next 12 months. However, our projections are dependent upon our ability to meet our revenue and gross profit targets. We funded our operations and met our cash requirements during the quarter by selling a portion of our short-term investments. Although we believe we have sufficient cash resources to finance our operations and expected capital expenditures for the next twelve months, based on our internal estimates and our operating plan, the sufficiency of our cash resources may depend to a certain extent on general economic, financial, competitive or other factors beyond our control. Moreover, despite actions to reduce our costs and improve our profitability, we expect our operating losses and net operating cash outflows to continue through 2004. As a

result, we may not be able to achieve the revenue and gross margin objectives necessary to achieve positive cash flow or profitability without obtaining additional financing. We do not currently have any arrangements for financing, and we may not be able to secure additional debt or equity financing on terms acceptable to us, or at all, at the time when we need such funding. If our business does not generate sufficient cash flow from operations and sufficient future financings are not available, we may not be able to operate or grow our business, pay our expenses when due or fund our other liquidity needs.

We intend to explore the possible acquisitions of businesses, products and technologies that are complementary to our existing business. We are continuing to identify and prioritize additional security technologies which we may wish to develop, either internally or through the licensing or acquisition of products from third parties. While we engage from time to time in discussions with respect to potential acquisitions, there can be no assurances that any such acquisitions will be made or that we will be able to successfully integrate any acquired business. In order to finance such acquisitions and working capital it may be necessary for us to raise additional funds through public or private financings. Any equity or debt financings, if available at all, may be on terms, which are not favorable to us and, in the case of equity financings, may result in dilution to our stockholders.

Factors That May Affect Future Results of Operations

Numerous factors may affect our business and future results of operations. These factors include, but are not limited to, current economic and market conditions, the effect of military actions on government and corporate spending on information security products, spending patterns of, and appropriations to, U.S. government departments, technological changes, competition and market acceptance, acquisitions, product transitions, timing of orders, manufacturing and suppliers, reliance on outsourcing vendors and other partners, intellectual property and licenses, third-party products, dependence on government customers, international operations, intellectual property issues, liquidity and cash resources and effects of restructuring plans and cost reductions. The discussion below addresses some of these and other factors. For a more thorough discussion of these and other factors that may affect our business and future results, see the discussion under the caption Factors That May Affect Future Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2003.

If we fail to respond to rapid technological changes in the network security industry, we may lose customers or our products may become obsolete.

The network security industry is characterized by frequent product introductions, rapidly changing technology and continued evolution of new industry standards. We must also introduce upgrades to our products rapidly in response to customer needs such as new computer viruses or other novel external attacks on computer networks. In addition, the nature of the network security industry requires our products to be compatible and interoperable with numerous security products, networking products, workstation and personal computer architectures and computer and network operating systems offered by various vendors, including our competitors. As a result, our success depends upon our ability to develop and introduce in a timely manner new products and enhancements to our existing products that meet changing customer requirements and evolving industry standards. The development of technologically advanced network security products is a complex and uncertain process requiring high levels of innovation, rapid response and accurate anticipation of technological and market trends. We cannot assure you that we will be able to identify, develop, manufacture, market or support new or enhanced products successfully in a timely manner. Further, we or our competitors may introduce new products or product enhancements that shorten the life cycle of our existing products or cause our existing products to become obsolete.

Our revenues have declined from $16.7 million in 2001 to $6.5 million in 2003 and to $2.4 million for the six months ended June 30, 2004 from $3.0 in the same period in 2003 in connection with a shift to sales of our newer product lines. If our network intrusion detection and regulated information compliance system products do not achieve market acceptance, our revenues will suffer.

Over the past three years, we have transitioned our sales strategy from our lower margin SecureCom and PDS security appliance products to the development and sales of our higher margin SecureNet network intrusion detection products. During this transition, sales of our new products were not enough to counteract the loss in sales associated with our older products. As a result, our net revenues have declined from approximately $16.7 million in 2001, to approximately $7.8 million in 2002 and approximately $6.5 million in 2003. In addition, our revenues for the first half of 2004 are $2.4 million as compared to $3.0 million for the same period in 2003.

Our new network security products and regulated information compliance systems have only been in the market place for a limited period of time and may have longer sales cycles than our previous products. Although response to our products has been positive, we have not yet received broad market acceptance. We cannot assure you that our present or future products will achieve market acceptance on a sustained basis.

In order to achieve market acceptance and achieve future revenue growth, we must introduce complementary security products, incorporate new technologies into our existing product lines and design, develop and successfully commercialize higher performance products in a timely manner. We cannot assure you that we will be able to offer new or complementary products that gain market acceptance quickly enough to avoid decreased revenues during current or future product introductions or transitions.

We resemble a developmental stage company and our business strategy may not be successful.

From our founding in 1983 until 2000, we derived substantially all of our revenue from the design, manufacture and sale of local area networking equipment. In order to permit us to focus our resources solely on developing and marketing our network security products, on April 17, 2000, we announced our plans to sell our local area networking assets and related networking divisions.

As a result of these sales, we now depend exclusively on revenues generated from the sale of our networks security products, which have received limited market acceptance. Moreover, we have only recently introduced our regulated information compliance systems, and the market for these products has only begun to emerge. Consequently, we resemble a developmental stage company and will face the following inherent risks and uncertainties:

the need for our network security products and regulated information compliance systems to achieve market acceptance and produce a sustainable revenue stream;

our ability to manage costs and expenses;

our dependence on key personnel;

our ability to obtain financing on acceptable terms; and

our ability to offer greater value than our competitors.

Our business strategy may not successfully address these risks. If we fail to recognize significant revenues from the sales of our network security products and regulated information compliance systems, our business, financial condition and operating results would be materially adversely affected.

We had a net loss of $2.8 million and an accumulated deficit of $47.0 million as of the six months ending June 30, 2004. As a result, we must generate substantially greater revenues from sales in order to achieve profitability.

We have incurred significant operating losses and are uncertain about our future operating results. For the six months ended June 30, 2004, we incurred a net loss of $2.8 million and had an accumulated deficit of approximately $47.0 million at June 30, 2004. In addition, our revenues have declined from $16.7 million in 2001, to $7.8 million in 2002, and $6.5 million in 2003. We need to generate and sustain substantially greater revenues from the sales of our products if we are to achieve profitability. If we are unable to achieve these greater revenues, our losses will continue indefinitely, and we may never achieve or sustain profitability or generate positive cash flow.

We face intense competition from both start-up and established companies that may have significant advantages over us and our products.

The market for network security solutions is intensely competitive. There are numerous companies competing with us in various segments of the data security markets, and their products may have advantages over our products in areas such as conformity to existing and emerging industry standards, interoperability with networking and other security products, management and security capabilities, performance, price, ease of use, scalability, reliability, flexibility, product features and technical support.

Our principle competitors in the network intrusion and detection market include Internet Security Systems, Inc., Cisco Systems, Inc., Symantec, Inc., Netscreen Technologies, Inc., Tipping Point Technologies Inc. and NFR Security, Inc. The market for regulated information compliance systems is relatively new. Our competitors in this market include a number of start up companies that have entered the market in the last two years. However, as this market develops, we expect increased competition from both start up and established companies. Our current and potential competitors may have one or more of the following significant advantages over us:

greater financial, technical and marketing resources;

better name recognition;

more comprehensive security solutions;

better or more extensive cooperative relationships; and

larger customer base.

Although we believe that our focus on network perimeters with market leading VPN/firewall control technology and network intrusion detection visibility technology that reduce the total cost of ownership provides us with an advantage with large organizations with complex security requirements, we cannot assure you that our products will achieve market acceptance or that we will be able to compete successfully with our existing or new competitors.

Military actions may disrupt our business by reducing spending our products, increasing our costs and affecting our international operations.

United States military actions or other events occurring in response to or in connection with them, including future terrorist attacks, actual conflicts involving the United States or its allies or military or trade disruptions could impact our operations by:

- reducing or delaying government or corporate spending on network security products;
- increasing the cost and difficulty in obtaining materials or shipping products; and
- affecting our ability to conduct business internationally.

Should these events occur, our business, operating results and financial condition could be materially and adversely affected.

Our products can have long sales and implementation cycles, which may result in us incurring substantial expenses before realizing any associated revenues.

The sale and implementation of our products to large companies and government agencies typically involves a lengthy education process and a significant technical evaluation and commitment of capital and other resources. This process is also subject to the risk of delays associated with customers internal budgeting and other procedures for approving capital expenditures, deploying new technologies within their networks and testing and accepting new technologies that affect key operations. As a result, sales and implementation cycles for our products can be lengthy, and we may expend significant time and resources before we receive any revenues from a customer or potential customer. Our quarterly and annual operating results could be materially harmed if orders forecasted for a specific customer for a particular period are not realized.

Our cash, cash equivalents, and investments have increased approximately $2.1 million in the last six months but have generally declined since 2003. As a result of our expected continuing net cash outflows, we may not have sufficient cash to operate our business.

During the six months ended June 30, 2004, our cash, cash equivalents and short-term investments increased to approximately $4.7 million from approximately $2.7 million as of December 31, 2003, primarily as a result of a private placement of our preferred stock and warrants we completed on March 25, 2004. As of December 31, 2003, we had cash, cash equivalents and investments in the amount of approximately $2.7 million, down from approximately $10.7 million as of December 31, 2002. Although we believe the proceeds we received in connection with the private placement will provide us with sufficient cash resources to finance our operations for the next twelve months, based on our internal estimates and our operating plan, the sufficiency of our cash resources may depend to a certain extent on general economic, financial, competitive or other factors beyond our control. Moreover, despite our actions to reduce costs and improve profitability, we expect our net operating losses and net operating cash outflows to continue through 2004. We do not currently have any further arrangements for financing, and we may not be able to secure additional debt or equity financing on terms that are acceptable to us, or at all, at the time when we need this financing. If our business does not generate sufficient cash flow from operations and sufficient financing resources are not available, we may not be able to operate or grow our business, pay our expenses when due or fund our other liquidity needs.

Our failure to realize the expected benefits of our recent restructuring efforts could adversely affect our operating results.

During the first half of 2004, we continued a restructuring plan and cost reduction efforts, which resulted in $0.1 million in severance costs. Since we began restructuring in 2002, we have incurred approximately $0.8 million in restructuring charges, severance, and related expenses. The objective of our restructuring plan was to reduce our cost structure to a sustainable level that is consistent with our current cash resources and the general economic climate. We have also implemented other strategic initiatives to strengthen our operations, such as reductions in our work force and facilities and aligning our organization around our business objectives. Any further work force reductions could result in temporary reduced productivity of our remaining employees. Additionally, our customers and prospects may delay or forgo purchasing our products due to a perceived uncertainty caused by our restructuring and other changes. Failure to achieve the desired results of our initiatives could seriously harm our business, results of operations and financial condition.

Consolidation in the network security industry may limit market acceptance of our products.

Several of our competitors have acquired security companies with complementary technologies in the past, and we expect consolidation in the network security industry to continue in the future. These acquisitions may permit our competitors to accelerate the development and commercialization of broader product lines and more comprehensive solutions than we currently offer. Acquisitions of vendors or other companies with which we have a strategic relationship by our competitors may limit our access to commercially significant technologies. Further, business combinations in the network security industry are creating companies with larger market share, customer bases, sales forces, product offerings and technology and marketing expertise, which may make it more difficult for us to compete.

Sales to government agencies accounted for 38.5% of our revenues the six months ended June 30, 2004 and 17% of our revenues for the year ended December 31, 2003. Sales to government customers involve unique risks, which could adversely impact our revenues.

We derived 38.5% of our revenues from sales to various U.S. government entities for the six months ended June 30, 2004, and 17.0% of our revenues from these sales for the year ended December 31, 2003. We expect to continue to derive a substantial portion of our revenues from U.S. government customers in the future. Sales to the government present risks in addition to those involved in sales to commercial customers, including potential disruption due to appropriation and spending patterns and he government s right to cancel contracts and purchase orders for its convenience. General political and economic conditions, which we cannot accurately predict, directly and indirectly may affect the quantity and allocation of expenditures by federal departments. In addition, obtaining government contracts may involve long purchase and payment cycles, competitive bidding, qualification requirements, delays or changes in funding, budgetary constraints, political agendas, extensive specification development and price negotiations and milestone requirements. Each government entity also maintains its own rules and regulations with which we must comply and which can vary significantly among departments. As a result, cutbacks or re-allocations in the federal budget or losses of government sales due to other factors could have a material adverse effect on our revenues and operating results.

We derived 26.3% of our revenues from international sales in the six months ended June 30, 2004, and 31.4% of our revenues from these sales for the year ended December 31, 2003. Our ability to sell our products internationally are subject to certain risks which could harm our business.

Sales to foreign customers accounted for approximately 31.4% of our revenues for the year ended December 31, 2003, and 26.3% of our revenues for the six months ended June 30, 2004. Although export sales decreased for the three and six month periods ended June 30, 2004 when compared to the same periods in 2003, we expect sales to foreign customers to continue to represent a significant portion of our revenues in the future. Our international operations are subject to many inherent risks that may adversely affect our business, financial condition and operating results, including:

political, social and economic instability;

trade restrictions;

increases in duty rates and other potentially adverse tax consequences;

exposure to different legal standards, particularly with respect to the protection of intellectual property;

burdens of complying with a variety of foreign laws;

unexpected changes in regulatory requirements;

import and export license requirements and restrictions of the United States and each other country where we operate;

fluctuations in currency exchange rates; and

changes in local purchasing practices, including seasonal fluctuations in demand.

Sales through indirect channels accounted for 30.4% of our revenues for the six months ended June 30, 2004 and 57% of our revenue for the year ended December 31, 2003. Our revenues will suffer if we do not expand our sales through, or receive the anticipated benefits from our sales through, indirect sales channels.

We derived 30.4% of our revenues for the six months ended June 30, 2004, and 57% of our revenue for the year ended December 31, 2003 from sales through indirect sales channels, such as distributors, value added resellers, system integrators, original equipment manufacturers and managed service providers. We believe we must expand our sales through these indirect channels in order to increase our revenues. Although we are actively pursuing a strategy to increase the percentage of our revenues generated through these indirect sales channels, we cannot assure you that our products will gain market acceptance in these indirect sales channels or that sales through these indirect sales channels will increase our revenues as expected. Further, many of our competitors are also trying to sell their products through these indirect sales channels, which could result in lower prices and reduced profit margins for sales of our products.

We must adequately protect our intellectual property in order to prevent loss of valuable proprietary information.

We rely on a combination of patent, copyright, trademark and trade secret laws, confidentiality procedures and non-disclosure agreements to protect our proprietary technology. However, unauthorized parties may attempt to copy or reverse engineer aspects of our products or to obtain and use information that we regard as proprietary. Policing unauthorized use of our products is difficult, and we cannot be certain that the steps we have taken will prevent misappropriation of our intellectual property. This is particularly true in foreign countries where the laws may not protect proprietary rights to the same extent as the laws of the United States and may not provide us with an effective remedy against unauthorized use. If our protection of our intellectual property proves to be inadequate or unenforceable, others may be able to use our proprietary developments without compensation to us, resulting in potential cost advantages to our competitors.

We may incur substantial expenses defending ourselves against claims of infringement.

There are numerous patents held by many companies relating to the design and manufacture of network security systems. Although we are not aware of any instances in which our products violate the intellectual property rights of others or inappropriately use their technology, it is possible that third parties in the future may claim that our products infringe on their intellectual property rights. Any claim, with or without merit, could consume our management s time, result in costly litigation, cause delays in sales or implementations of our products or require us to enter into royalty or licensing agreements. Royalty and licensing agreements, if required and available, may be on terms unacceptable to us or detrimental to our business. Moreover, a successful claim of product infringement against us or our failure or inability to license the infringed or similar technology on commercially reasonable terms could seriously harm our business.

Fluctuations in our quarterly revenues may cause the price of our common stock to decline.

Our operating results have varied significantly from quarter to quarter in the past, and we expect our operating results to vary from quarter to quarter in the future due to a variety of factors, many of which are outside of our control. Although our revenues are subject to fluctuation, significant portions of our expenses are not variable in the short term, and we cannot reduce them quickly to respond to decreases in revenues. Therefore, if revenues are below our expectations, this shortfall is likely to adversely and disproportionately affect our operating results. Accordingly we may not attain positive operating margins in future quarters. Any of these factors could cause our operating results to be below the expectations of securities analysts and investors, which likely would negatively affect the price of our common stock.

The price of our common stock has been volatile in the past and may continue to be volatile in the future due factors outside of our control.

The market price of our common stock has been highly volatile in the past and may continue to be volatile in the future. For example, since August 1, 2003, the market price of our common stock on The Nasdaq SmallCap Market has fluctuated between $0.91 and $5.52 per share. The market price of our common stock may fluctuate significantly in response to a number of factors, many of which are outside our control, including:

variations in our quarterly operating results;

changes in estimates of our financial performance by securities analysts;

changes in market valuations of our competitors;

announcements by us or our competitors of new products, significant contracts, acquisitions, strategic relationships, joint ventures or capital commitments;

product or design flaws, product recalls or similar occurrences;

additions or departures of key personnel;

sales of common stock in the future; and

fluctuations in stock market prices and volume, which can be particularly common among network security and other high technology companies.

Our recent reductions in our work force may make it more difficult for us to attract and retain the personnel necessary to successfully operate our business.

We rely upon the continued service of a relatively small number of key technical, sales and senior management personnel. Our future success depends on retaining our key employees and our continuing ability to attract, train and retain other highly qualified technical, sales and managerial personnel. We have employment agreements with relatively few of our key technical, sales and senior management personnel. As a result, our employees could resign with little or no prior notice. We may not be able to attract, assimilate or retain other highly qualified technical, sales and managerial personnel in the future, especially given our recent reductions in force. The loss of any of our key technical, sales and senior management personnel or our inability to attract, train and retain additional qualified personnel could seriously harm our business.

Certain rights of the holders of 5% convertible preferred stock may hinder our ability to raise additional financing.

We cannot issue shares of capital stock with rights senior to those of our existing preferred or incur certain indebtedness without the approval of at least a majority of the holders of our 5% convertible preferred stock. In addition, holders of the preferred stock who are not executive officers or directors have the right to purchase a pro rata portion of certain future issuances of securities by us. The combination of these provisions could hinder or delay our ability to raise additional debt or equity financing.

You will experience substantial dilution upon the conversion of the shares of preferred stock and exercise of warrants that we issued in a private placement.

On March 25, 2004, we completed a $5,000,000 private placement in connection with which we issued 1,000,000 shares of our 5% Convertible Preferred Stock and warrants to acquire 556,619 shares of our common stock. The conversion price for the preferred stock and the exercise price of the warrants is $3.144 per share. We also issued our placement agent a warrant for 64,408 shares of our common stock at an exercise price of $3.144 per share. As a result, we expect the private placement to result in dilution to holders of our common stock upon conversion of the preferred stock and exercise of the warrants of 2,221,358 shares of common stock, or an approximately 43% increase in the number of shares of our common stock outstanding.

The conversion of preferred stock or exercise of warrants we issued in the private placement may cause the price of our common stock to decline.

Upon the effectiveness of the registration statement related to this prospectus, the holders of preferred stock and warrants we issued in the private placement will be able to freely convert their shares of preferred stock and exercise their warrants and sell their underlying shares of common stock. For the four weeks ended on July 30, 2004, the average daily trading volume of our common stock on The Nasdaq SmallCap Market was 7,505 shares. Consequently, if holders of preferred stock or warrants elect to convert their shares or exercise their warrants and sell a material amount of their underlying shares of common stock on the open market, the increase in selling activity could cause a decline in the market price of our common stock. Furthermore, these sales, or the potential for these sales, could encourage short sales, causing additional downward pressure on the market price of our common stock.

The percentage of our revenues attributable to sales of PDS products integrated with software of Check Point Software Technologies decreased from 29.1% in 2002 to 16.7% in 2003 and from 24.7% for the first half of 2003 to 9.5% for the first half of 2004. Because sales of our newer products may not offset the reduced sales of our PDS products, a change in our relationship with Check Point could have a negative effect on our operating results.

Our PDS family of security appliances, which are integrated with Check Point Software Technologies market-leading VPN-1®/FireWall-1® software, represented % of our revenues for the six months ended June 30, 2004, and 16.7% of our revenues for the year ended December 31, 2003. These percentages are down from % of our revenues for the six months ended June 30, 2003, and 29.1% of our revenues for the year ended December 31, 2002. We expect the percentage of our sales attributable to our PDS products to decline in the future; however, our reliance on newer product sales may not replace the anticipated decline in revenue from sales of our PDS products. Although we are a certified appliance partner of Check Point and our PDS products have received Check Point certification, we have no long-term agreement or exclusive relationship with Check Point. As a result, the loss or significant change in our relationship with Check Point, the failure of our PDS products to maintain or receive Check Point certification, the business failure of Check Point or its acquisition by or of one of our competitors and the loss of market share of Check Point or market acceptance of its products could each have a material adverse effect on our business, financial condition and results of operations.

Our acquisition of complementary products or businesses may adversely affect our financial condition.

We have made acquisitions in the past, and, in the future, we may acquire or invest in additional companies, business units, product lines or technologies to accelerate the development of products and sales channels complementary to our existing products and sales channels. Negotiation of potential acquisitions and integration of acquired products, technologies or businesses could divert our management s time and resources. Future acquisitions could cause us to issue equity securities that would dilute your ownership of us, incur debt or contingent liabilities, amortize intangible assets or write off in-process research and development, goodwill and other acquisition-related expenses that could seriously harm our financial condition and operating results. Further, if we are not able to properly integrate acquired products, technologies or businesses with our existing products and operations, train, retain and motivate personnel from the acquired business or combine potentially different corporate cultures, we may not receive the intended benefits of our acquisitions, which could adversely affect our business, operating results and financial condition.

The payment of accrued dividends on our 5% convertible preferred stock may strain our cash resources.

Shares of our 5% convertible preferred stock accrue cash dividends equal to $0.25 per share per annum. These dividends are payable in arrears on March 31 and September 30 of each year, commencing on September 30, 2004. Delaware law provides that we may only pay dividends out of our capital surplus or, if no surplus is available, out of our net profits for the fiscal year the dividend is declared and/or the preceding fiscal year. We have not had net profits for the last two fiscal years, and as of June 30, 2004 our capital surplus, defined as the amount by which our net assets exceed our stated capital, was approximately $3.7 million. Therefore, we have only limited resources to pay these dividends. In addition, the payment of these dividends could strain our available cash resources, which could adversely affect our ability to operate or grow our business.

Compliance with export regulations may hinder our sales to foreign customers.

Certain of our data security products incorporate encryption and other technology that may require clearance and export licenses from the U.S. Department of Commerce under United States export regulations. Any inability to obtain these clearances or licenses or any foreign regulatory approvals, if required, on a timely basis could delay sales and have a material adverse effect on our operating results.

Provisions of our charter documents and Delaware law may have anti-takeover effects.

Certain provisions of our certificate of incorporation and bylaws, such as our ability to offer blank check preferred stock and the inability of our stockholders to act by written consent, could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. We are also subject to the provisions of Section 203 of the Delaware General Corporation Law, which restricts certain business combinations with interested stockholders and could inhibit a non-negotiated merger or other business combination.

Our management and larger stockholders exercise significant control over our company and may approve or take actions that may be adverse to your interests.

As of June 30, 2004, our executive officers, directors and 5% stockholders beneficially own approximately 38.5% of our voting power. As a result, these stockholders will be able to exercise significant control over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, which could delay or prevent someone from acquiring or merging with us. These stockholders may use their influence to approve or take actions that may be adverse to your interests.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Exchange. Revenue originating outside the U.S. in the quarters ended June 30, 2004 and 2003 was 15.4% and 33.4 % of total revenues, respectively. Revenue originating outside the U.S. in the six months ended June 30, 2004 and 2003 was 26.3% and 42.4% of total revenues, respectively. International sales are made mostly from our foreign sales subsidiaries in the local countries and are typically denominated in U.S. dollars. These subsidiaries incur most of their expenses in the local currency.

Our international business is subject to risks typical of an international business, including, but not limited to: differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions and foreign exchange rate volatility. Accordingly, our future results could be materially adversely affected by changes in these or other factors. The effect of foreign exchange rate fluctuations on us in 2004 and 2003 was not material.

On January 1, 2003, the Company elected to change the functional currency of its foreign operations to the United States dollar. This change in functional currency is supported by the fact that all foreign operations are funded monthly in United States dollars and the majority of a revenue contracts are denominated in United States dollars. Under United States dollar functional currency, the financial statements of foreign locations are remeasured from the recording currency to the United States dollar. The resulting remeasurement adjustment is recorded as foreign exchange gain or loss in the statement of operations. There is no translation adjustment to the separate component of stockholders equity or adjustment to comprehensive income. The effect of the change in functional currency had no material impact on results of operations. The accumulation of prior years translation adjustments remains on the balance sheet as a separate component of stockholders equity until part, or all, of the respective entities are disposed.

Interest Rates. We invest our cash in a variety of financial instruments, including bank time deposits, fixed rate obligations of corporations, municipalities, and state and national governmental entities and agencies. These investments are denominated in U.S. dollars. Cash balances in foreign currencies overseas are operating balances and are invested in short-term time deposits of the local operating bank.

Interest income on our investments is carried in Interest income, net . We account for our investment instruments in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities . All of the cash equivalents and short-term investments are treated as available-for-sale under SFAS 115.

Investments in fixed rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities, which have seen a decline in market value due to changes in interest rates. Our investment securities are held for purposes other than trading. The weighted-average of the stated coupon interest rate on investment securities at June 30, 2004 was 6.0%. Due to the amortization of premiums and discounts paid, the actual rate of return will vary from the weighted-average of the stated coupon interest rate. The fair value of investments held at June 30, 2004 approximated amortized cost.

Item 4. CONTROLS AND PROCEDURES

We have carried out an evaluation, under the supervision and the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of June 30, 2004, pursuant to Rule 13a-15(b) under the Exchange Act. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in ensuring that information required to be disclosed is recorded, processed, summarized and reported in a timely manner.

We have carried out an evaluation, under the supervision and participation of our management, including our Chief Executive Officer and Chief Financial Officer, of any changes in our internal controls over financial reporting that occurred during the quarterly period ended June 30, 2004, and our Chief Executive Officer and Chief Financial Officer have concluded that there was no change during the quarterly period ended June 30, 2004 that has materially affected or is reasonably expected to materially affect our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

We are subject to legal proceedings and claims that arise in the ordinary course of business. We do not believe that the outcome of those matters will have a material adverse affect on our consolidated financial position, operating results or cash flows. However, there can be no assurance such legal proceedings will not have a material impact.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Annual Meeting of Stockholders was held on May 29, 2004, at the Radisson Hotel, Dallas North in Richardson, Texas. The following is a brief description of each matter voted upon by stockholders, including a number of votes cast for, against, or withheld with regard to each matter of nominee.

(1) Election of five (5) directors to serve until the next Annual Meeting of Stockholders and until their respective successors are duly elected and qualified.

	FOR	WITHHELD
G. Ward Paxton	6,631,093	12,839
T. Joe Head	6,631,545	12,387
James F. Gero	6,609,921	34,011
J. Fred Bucy, Jr.	6,609,361	34,571
Donald M. Johnston	6,609,771	34,161

(2) Ratification and approval of selection by the Board of Directors of KBA Group LLP as independent auditors of the Registrant for the fiscal year ending December 31, 2004.

FOR	AGAINST	ABSTAIN
6,577,411	29,879	36,642

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) The following Exhibits are filed with this report form 10-Q:

31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Exchange Act.
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Exchange Act.
32.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) During the quarter ended June 30, 2004, we did not file any reports on Form 8-K:

S I G N A T U R E S

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

INTRUSION INC.

Date: August 13, 2004

/s/ Michael L. Paxton
Michael L. Paxton
Vice President, Chief Financial Officer,
Treasurer & Secretary
(Principal Financial & Accounting Officer)