Optex Systems Holdings Inc
Form 10-K
December 23, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended October 2, 2016

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ___ until ___

Commission File Number 000-54114

OPTEX SYSTEMS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**33-143215**
(State or other jurisdiction of incorporation organization)	(I.R.S. Employer Identification No.)
1420 Presidential Drive	
Richardson, TX	**75081-2439**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code **(972) 764-5700**

Securities Registered under Section 12(b) of the Act

None

Securities Registered under Section 12(g) of the Act

Common Stock, par value $.001 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

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

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

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The aggregate market value of the 227,610 shares of voting stock held by non-affiliates of the registrant based on the closing price on the OTC Markets on March 31, 2016 was $500,742.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Title of Class	Shares Outstanding December 22, 2016
Common Stock	8,144,302

DOCUMENTS INCORPORATED BY REFERENCE

None.

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Cautionary Note Regarding Forward-Looking Information

This Report on Form 10-K, in particular Part II Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” contains certain “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These forward-looking statements represent our expectations, beliefs, intentions or strategies concerning future events, including, but not limited to, any statements regarding our assumptions about financial performance; the continuation of historical trends; the sufficiency of our cash balances for future liquidity and capital resource needs; the expected impact of changes in accounting policies on our results of operations, financial condition or cash flows; anticipated problems and our plans for future operations; and the economy in general or the future of the defense industry, all of which were subject to various risks and uncertainties.

When used in this Report on Form 10- K and other reports, statements, and information we have filed with the Securities and Exchange Commission (“Commission” or “SEC”), in our press releases, presentations to securities analysts or investors, in oral statements made by or with the approval of an executive officer, the words or phrases “believes,” “may,” “will,” “expects,” “should,” “continue,” “anticipates,” “intends,” “will likely result,” “estimates,” “projects” or similar and variations thereof are intended to identify such forward-looking statements. However, any statements contained in this Report on Form 10-K that are not statements of historical fact may be deemed to be forward-looking statements. We caution that these statements by their nature involve risks and uncertainties, certain of which are beyond our control, and actual results may differ materially depending on a variety of important factors.

We do not assume the obligation to update any forward-looking statement. You should carefully evaluate such statements in light of factors described in this annual report. In this Form 10-K, Optex Systems Holdings, Inc. (“Optex Systems Holdings”) has identified important factors that could cause actual results to differ from expected or historic results. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider any such list to be a complete list of all potential risks or uncertainties.

PART I

Item 1 Description of Business

Background

Prior History — Sustut Exploration, Inc.

Sustut Exploration, Inc. was a Delaware corporation formed on April 11, 2006 to search for available mining properties in North Central British Columbia. It entered into an option agreement in 2006 to purchase a mineral claim, and the option expired in May 2008 without any payment being made. Thus, as of May 2008, Sustut had no operating business.

As a result of the reorganization on March 30, 2009, which is described below, Optex Systems Holdings changed its name from Sustut Exploration Inc. to Optex Systems Holdings, Inc.

Reorganization

On March 30, 2009, a reorganization occurred whereby the then existing shareholders of Optex Systems, Inc., a private Delaware corporation (“Optex Systems, Inc. (Delaware)”), exchanged their shares of Optex Systems, Inc. (Delaware) common stock with the shares of common stock of us as follows (all on a pre-split basis due to the historical context): (i) the outstanding 85,000,000 shares of Optex Systems, Inc. (Delaware) common stock were exchanged for 113,333,282 shares of our common stock, (ii) the outstanding 1,027 shares of Optex Systems, Inc. (Delaware) Series A preferred stock were exchanged for 1,027 shares of Series A preferred stock and (iii) the 8,131,667 shares of Optex Systems, Inc. (Delaware) common stock purchased in the private placement were exchanged for 8,131,667 (presplit) shares of us common stock. Optex Systems, Inc. (Delaware) has remained our wholly-owned subsidiary. As a result of the reorganization, Sileas Corporation currently beneficially owns approximately 52.8% of our issued and outstanding common stock and Alpha Capital Anstalt owns approximately 0.1% of our issued and outstanding common stock.

Current Line of Business

We manufacture optical sighting systems and assemblies, primarily for Department of Defense applications. Our products are installed on various types of U.S. military land vehicles, such as the Abrams and Bradley fighting vehicles, light armored and armored security vehicles and have been selected for installation on the Stryker family of vehicles. We also manufacture and deliver numerous periscope configurations, rifle and surveillance sights and night vision optical assemblies. Our products consist primarily of build-to-customer print products that are delivered both directly to the armed services and to other defense prime contractors. Less than 1% of today's revenue is related to the resale of products substantially manufactured by others. In this case, the product would likely be a simple replacement part of a larger system previously produced by us.

We continue to field new product opportunities from both domestic and international customers. Given continuing unrest in multiple global hot spots, the need for precision optics continues to increase. Most of these requirements are for observation and situational awareness applications; however, we continue to see requests for higher magnification and custom reticles in various product modifications. The basic need to protect the soldier while providing information about the mission environment continues to be the primary driver for these requirements.

We do not believe that the change in government administration will cause a major change in the direction of funding or product need for the U.S. military. Maintenance will still be required, and the opportunities for us to upgrade existing systems with higher performing systems will continue to present themselves. Spending levels may change, but given the mix between foreign spending, domestic/prime demand, and the more recent commercial opportunities, we do not expect any negative trends arising from political domestic changes into fiscal 2017.

Recent Events

Reverse Stock Split

On October 6, 2015, 20 calendar days had passed since the mailing to our shareholders of the Definitive Schedule 14C filed on September 11, 2015 regarding the approval by our Board of Directors and shareholders of a reverse stock split of our common stock, in a ratio to be determined by our board of directors, of not less than 1-for-400 nor more than 1-for-1000 and on October 7, 2015, we effected a 1-for-1000 reverse split of our common stock.

Resignations of Directors

Effective November 4, 2015, Stanley Hirschman retired as one of our directors. In recognition of his service, all of his unvested stock options were deemed to vest immediately, and the termination date of all of his stock options was extended to December 31, 2019. On May 26, 2016, Kerry Craven resigned as one of our directors.

Compensation Changes

On January 21, 2016, our Board of Directors Compensation Committee held a meeting and approved the following compensation changes:

- A base salary increase of 10% for Danny Schoening, CEO, and Karen Hawkins, CFO.

- A bonus payment of $7.5 thousand awarded to Karen Hawkins for 2015 performance.

- A $10 thousand monthly director fee for Peter Benz, Chairman, effective for calendar 2016.

Credit Facility — Avidbank

On April 20, 2016, we amended our revolving credit facility with Avidbank. The new renewable revolving maturity date is January 22, 2018. The facility provides up to $2 million in financing against eligible receivables and is subject to meeting certain covenants including an asset coverage ratio test for up to twenty months. The material terms of the amended revolving credit facility are as follows:

- The interest rate for all advances shall be the then in effect prime rate plus 2.5% and is subject to a minimum interest payment requirement per six month period of $10,000.

- Interest shall be paid monthly in arrears.

- A facility fee of (0.5%) of the revolving line ($10,000) was due (and paid) on May 22, 2016 and each anniversary thereof for so long as the revolving credit facility is in effect.

- The loan period is from April 20 through January 22, 2018 at which time any outstanding advances, and accrued and unpaid interest thereon, will be due and payable.

- Our obligations to Avidbank are secured by a first lien on all of its assets (including intellectual property assets should it have any in the future) in favor of Avidbank.

- The facility contains customary events of default. Upon the occurrence of an event of default that remains uncured after any applicable cure period, Avidbank's commitment to make further advances may terminate, and Avidbank would also be entitled to pursue other remedies against us and the pledged collateral.

- Pursuant to a guaranty executed by Optex Systems Holdings in favor of Avidbank, Optex Systems Holdings has guaranteed all obligations of Optex Systems, Inc. to Avidbank.

On October 17, 2016, we further amended our revolving credit facility with Avidbank to increase the facility to $2.2 million and to allow for a $250 thousand letter of credit sublimit with an annual fee of 1.5% of the face amount of the letter of credit. On October 17, 2016, we secured a $250 thousand irrevocable letter of credit from Avidbank with Cabot Industrial Value Fund II Operating Partnership, L.P. as the beneficiary. The letter of credit was issued as a condition of our facility lease, executed on October 21, 2016t for the Applied Optics Center facility in Dallas, Texas.

2016 Restricted Stock Unit Plan

On June 14, 2016, our Compensation Committee approved our 2016 Restricted Stock Unit Plan. This plan provides for issuance of stock units ("RSUs") for up to 1,000,000 shares of our common stock. Each RSU constitutes a right to receive one share of our common stock, subject to vesting, which unless otherwise stated in an RSU agreement, shall vest in equal amounts on the first, second and third anniversary of the grant date. Shares of our common stock underlying the number of vested RSUs will be delivered as soon as practicable after vesting. During the period between grant and vesting, the RSUs may not be transferred, and the grantee has no rights as a shareholder until vesting has occurred. If the grantee's employment is terminated for any reason (other than following a change in control of us or a termination of an officer other than for cause), then any unvested RSUs under the award will automatically terminate and be forfeited. If an officer grantee's employment is terminated by us without cause or by the grantee for good reason, then, provided that the RSUs have not been previously forfeited, the remaining unvested portion of the RSUs will immediately vest as of the officer grantee's termination date. In the event of a change in control, our obligations regarding outstanding RSUs shall, on such terms as may be approved by the Committee prior to such event, immediately vest, be assumed by the surviving or continuing company or cancelled in exchange for property (including cash).

On June 15, 2016, we issued 150,000 RSUs to our Chief Executive Officer, Danny Schoening, and 50,000 RSUs to our Chief Financial Officer, Karen Hawkins. The RSUs issued to Mr. Schoening and Ms. Hawkins vest as follows: 34% on January 1, 2017, 33% on January 1, 2018 and 33% on January 1, 2019.

Public Offering

On August 26, 2016, we consummated a public offering of 2,291,000 Class A units consisting of common stock and warrants and 400 Class B units consisting of shares of Series C convertible stock and warrants for a total gross purchase price of $4,750,280.

New Product Development

During the first six months of 2015, we released a new digital spotting scope called Red Tail (patent pending). This device is targeted towards long range observation and image recording used by military, border patrol, and select consumer/commercial applications. The device is designed to deliver high definition images with military grade resolution, but at commercial “off the shelf” pricing. Using high grade optics to deliver a 45X magnified image onto a 5 megapixel CMOS sensor, the Red Tail device then transmits this image via Wi-Fi to the user’s smartphone or tablet. Digital still images or videos can then be captured and/or emailed using a custom Red Tail app available for either iOS or Android devices. We demonstrated this device in April 2015 at the Border Security Expo in Phoenix, Arizona and received positive feedback from U.S. border agents, police officers, and other Expo attendees.

On November 10, 2015, we entered into a retail sales relationship with Cabela’s Inc., to distribute our Red Tail Digital Spotting Scope as well as our new Stabilized Monocular. We are presently in negotiations to make these devices available via General Services Administration schedules for government personnel.

Products

Our products are installed on various types of U.S. military land vehicles, such as the Abrams and Bradley, and Stryker families of fighting vehicles, as well as light armored and armored security vehicles. We also manufacture and deliver numerous periscope configurations, rifle and surveillance sights and night vision optical assemblies. We deliver our products both directly to the federal government and to prime contractors.

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We deliver high volume products, under multi-year contracts, to large defense contractors and government customers. Increased emphasis in the past two years has been on new opportunities to promote and deliver our products in foreign military sales, where U.S.-manufactured, combat and wheeled vehicles, are supplied (and upgraded) in cooperation with the U.S. Department of Defense. We have a reputation for quality and credibility with our customers as a strategic supplier. We also anticipate the opportunity to integrate some of our night vision and optical sights products into commercial applications.

Specific product categories include:

- Electronic sighting systems
- Mechanical sighting systems
- Laser protected plastic and glass periscopes
- Non-laser protected plastic and glass periscopes
- Howitzer sighting systems
- M36 Thermal Day/Night Periscopes
- M17 Day/Thermal Periscopes
- Ship binoculars
- Replacement optics (e.g. filters, mirrors)
- Optical assemblies and laser filters

Product Line	**Product Category**
Periscopes	Laser & Non Laser Protected Plastic & Glass Periscopes, Electronic M17 Day/Thermal Periscopes, Vision Blocks
Sighting Systems	

	Back Up Sights, Digital Day and Night Sighting Systems (DDAN), M36 Thermal Periscope, Unity Mirrors
Howitzers	M137 Telescope, M187 Mount, M119 Aiming Device
Other	Muzzle Reference Systems (MRS), Binoculars, Collimators, Optical Lenses & Elements, Windows
Applied Optics Center	ACOG Laser filter, Laser Filter Interface, Optical Assemblies

Location and Facility

We are headquartered in Richardson, TX and lease approximately 93,967 combined square feet of facilities including Richardson, Texas and Dallas, Texas. As of December 7, 2016, we had 90 full time equivalent employees. We operate with a single shift, and capacity could be expanded by adding a second shift. Our proprietary processes and methodologies provide barriers to entry for other competing suppliers. In many cases, we are the sole source provider or one of only two providers of a product. We have capabilities which include machining, bonding, painting, tracking, engraving and assembly and can perform both optical and environmental testing in-house. We renewed the lease on our 49,100 square foot, Richardson, Texas facility, effective as of December 10, 2013, with a lease expiration of March 31, 2021. As of December 7, 2016, the Richardson facility operates with 52 full time equivalent employees in a single shift operation.

In November 2014, we also acquired a business unit from L-3 Communications, Inc., which is described herein below under “Recent Events — Acquisition”. The acquisition, Applied Optics Center, is located in Dallas, Texas with leased premises consisting of approximately 44,867 square feet of space. As of December 7, 2016, the Applied Optics Center operates with 38 full time equivalent employees in a single shift operation.

Contracts

Many of our contracts allow for government contract financing in the form of contract progress payments pursuant to Federal Acquisition Regulation 52.232-16, “Progress Payments”. As a small business, and subject to certain limitations, this clause provides for government payment of up to 90% of incurred program costs prior to product delivery. To the extent our contracts allow for progress payments, we intend to utilize this benefit, thereby minimizing the working capital impact on us for materials and labor required to complete the contracts.

Our contracts allow for Federal Acquisition Regulation 52.243-1 which entitles the contractor to an “equitable adjustment” to the contract if the contract changes result in a change in contract costs or time of performance. In essence, an equitable price adjustment request is a request for a contract price modification (generally an increase) that allows for the contractor to be “made whole” for additional costs incurred which were necessitated by some modification of the contract effort. This modification may come from an overt change in U.S. Government requirements or scope, or it may come from a change in the conditions surrounding the contract (e.g., differing site conditions or late delivery of U.S. Government-furnished property) which result in statement of work additions, deletions, part substitutions, schedule or other changes to the contract which impact the contractor’s overall cost to complete.

Each contract with our customers has specific quantities of material that need to be purchased, assembled, and then shipped. Prior to bidding a contract, we contact potential sources of material and receive qualified quotations for each material. In some cases, the entire volume is given to a single supplier and in other cases, the volume might be split between several suppliers. If a contract has a single source supplier and that supplier fails to meet their obligations (e.g., quality, delivery), then we would attempt to find an acceptable alternate supplier, and if successful, we would then renegotiate contractual deliverables (e.g., specifications, delivery, price). As of December 7, 2016, approximately 17% of our material requirements are single-sourced across 10 suppliers representing approximately 13% of our active supplier orders. Single-sourced component requirements span across all of our major product lines. Of these single sourced components, we have material contracts (purchase orders) with firm pricing and delivery schedules in place with each of the suppliers to supply the parts necessary to satisfy our current contractual needs.

We are subject to, and must comply with, various governmental regulations that impact, among other things, our revenue, operating costs, profit margins and the internal organization and operation of our business. The material regulations affecting our U.S. government business are summarized in the table below.

Regulation	**Summary**
Federal Acquisition Regulation	The principal set of rules in the Federal Acquisition Regulation System. This system consists of sets of regulations issued by agencies of the federal government of the United States to govern what is called the “acquisition process,” which is the process through which the government acquires goods and services. That process consists of three phases: (1) need recognition and acquisition planning, (2) contract formation, and (3) contract administration. This system regulates the activities of government personnel in carrying out that process. It does not regulate the purchasing activities of private sector firms, except to the extent that those activities involve government solicitations and contracts by reference.
International Traffic in Arms Regulations	United States government regulations that control the export and import of defense-related articles and services on the United States Munitions List. These regulations implement the provisions of the Arms Export Control Act.
Truth in Negotiations Act	A public law enacted for the purpose of providing for full and fair disclosure by contractors in the conduct of negotiations with the government. The most significant provision included is the requirement that contractors submit certified cost and pricing data for negotiated procurements above a defined threshold of $750,000. It requires contractors to provide the government with an extremely broad range of cost or pricing information relevant to the expected costs of contract performance, and it requires contractors and subcontractors to submit cost or pricing data to the government and to certify that, to the best of their knowledge and belief, the data are current, accurate, and complete.

We are responsible for full compliance with the Federal Acquisition Regulation. Upon award, the contract may identify certain regulations that we need to meet. For example, a contract may allow progress billing pursuant to specific Federal Acquisition Regulation clauses incorporated into the contract. Other contracts may call for specific first article acceptance and testing requirements. The Federal Acquisition Regulation will identify the specific regulations that we must follow based on the type of contract awarded. The Federal Acquisition Regulation also contains guidelines and regulations for managing a contract after award, including conditions under which contracts may be terminated, in whole or in part, at the government's convenience or for default. These regulations also subject us to financial audits and other reviews by the government of our costs, performance, accounting and general business practices relating to our government contracts, which may result in adjustment of our contract-related costs and fees and, among other things and impose accounting rules that define allowable and unallowable costs governing our right to reimbursement under certain contracts.

First Article Testing and Acceptance requirements consist of specific steps. For example, the first article testing associated with Howitzer-type product is comprehensive and time consuming. The dimensions and material specifications of each piece of the assembly must be verified, and each product has in excess of 100 piece parts. Once the individual piece parts are verified to be compliant to the specification, the assembly processes are documented and verified. A sample of the production (typically three units) is verified to meet final performance specifications. Once the units meet the final performance specification, they are then subjected to accelerated life testing, a series of tests which simulate the lifetime use of the product in the field. This consists of exposing the units to thermal extremes, humidity, mechanical shock, vibration, and other physical exposure tests. Once completed, the units undergo a final verification process to ensure that no damage has occurred as a result of the testing and that they continue to meet the performance specification. All of the information and data is recorded into a final first article inspection and test report and submitted to the customer along with the test units for final approval. First Article Acceptance and Testing is generally required on new contracts/product awards but may also be required on existing products or contracts where there has been a significant gap in production, or where the product has undergone significant manufacturing process, material, tooling, equipment or product configuration changes.

We are also subject to laws, regulations and executive orders restricting the use and dissemination of information deemed classified for national security purposes and the exportation of certain products and technical data as covered by the International Traffic in Arms Regulation. In order to import or export items listed on the U.S. Munitions List, we are required to be registered with the Directorate of Defense Trade Controls office. The registration is valid for one year, and the registration fees are established based on the number of license applications submitted the previous year. We currently have an approved and current registration on file with the Directorate of Defense Trade Controls office. Once the registration is approved, each import/export license must be filed separately. License approval requires the company to provide proof of need, such as a valid contract or purchase order requirement for the specific product or technical data requested on the license and requires a detailed listing of the items requested for export/import, the end-user, the end-user statement, the value of the items, consignees/freight forwarders and a copy of a valid contract or purchase order from the end-user. The approval process for the license can vary from several weeks to six months or more. The licenses we currently use are the DSP-5 (permanent export), DSP-6 (license revisions) and DSP-73 (temporary export).

The aforementioned licenses are valid for 48 months from date that each such license is issued as set forth on the table below (updated as of November 28, 2016).

DSP - 5 licenses	Issue Date	Expiration Date (48 months of issue)	Total Contract Value ($)
050430589	1/25/2013	1/24/2017	$ 2,568
050426798	2/8/2013	2/7/2017	1,000
050435218	3/7/2013	3/6/2017	88,760

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DSP - 5 licenses	Issue Date	Expiration Date (48 months of issue)	Total Contract Value ($)
050439431	3/7/2013	3/6/2017	9,741
050455029	6/10/2013	6/9/2017	4,203
050457320	6/24/2013	6/23/2017	187,721
050459204	6/28/2013	6/27/2017	185,879
050468553	7/29/2013	7/28/2017	88,182
050468550	8/30/2013	8/29/2017	81,142
050470855	9/9/2013	9/8/2017	1,969
050486760	12/5/2013	12/4/2017	2,542
050486727	12/6/2013	12/5/2017	21,040
050490628	1/3/2014	1/2/2018	45,928
050490371	1/14/2014	1/13/2018	14,290
050497324	2/1/2014	1/31/2018	15,384
050497307	2/12/2014	2/11/2018	11,881
050497162	2/20/2014	2/19/2018	2,122
050501481	2/26/2014	2/25/2018	255,700
050504795	3/27/2014	3/26/2018	26,794
050511388	4/21/2014	4/20/2018	30,086
050510061	5/19/2014	5/18/2018	10,564
050521562	6/27/2014	6/26/2018	3,108
050521680	7/7/2014	7/6/2018	10,572
050521706	7/15/2014	7/14/2018	7,441
050521673	7/15/2014	7/14/2018	1,236
050521555	7/17/2014	7/16/2018	18,970
050530555	9/22/2014	9/21/2018	4,930
050537697	11/4/2014	11/3/2018	6,028
050539610	11/14/2014	11/13/2018	7,746
050486913	11/20/2014	11/19/2018	79,882
050490381	12/11/2014	12/10/2018	36,250
050546222	1/9/2015	1/8/2019	2,950
050549789	2/18/2015	2/17/2019	53,720
050549846	2/23/2015	2/22/2019	165,372
050549534	2/25/2015	2/24/2019	88,555
050549933	2/27/2015	2/26/2019	34,888
050549843	3/23/2015	3/22/2019	1,213
050553879	3/23/2015	3/22/2019	4,066
050553874	3/27/2015	3/26/2019	3,472
050553876	3/27/2015	3/26/2019	1,021
050560846	5/21/2015	5/20/2019	6,418
050560953	5/29/2015	5/28/2019	1,792
050561878	6/5/2015	6/4/2019	75,047
050562319	6/12/2015	6/11/2019	2,815
050560740	6/30/2015	6/29/2019	3,308
050565738	7/9/2015	7/8/2019	1,543
050566061	7/22/2015	7/21/2019	27,401
050561747	7/27/2015	7/26/2019	250

050565746	7/30/2015	7/29/2019	1,543
050568890	8/7/2015	8/6/2019	4,204
050570373	8/21/2015	8/20/2019	4,297
050571083	9/8/2015	9/7/2019	92,042
050574185	9/25/2015	9/24/2019	413,263

DSP - 5 licenses	Issue Date	Expiration Date (48 months of issue)	Total Contract Value ($)
050581564	12/11/2015	12/10/2019	2
050581341	12/17/2015	12/16/2019	30,541
050582302	12/17/2015	12/16/2019	402
050581218	12/18/2015	12/17/2019	4,298
050573342	10/7/2015	10/6/2019	203,832
050581341	12/17/2015	12/16/2019	30,541
050573343	10/7/2015	10/6/2019	8,446
050582108	1/20/2016	1/19/2020	1,075
050586060	2/24/2016	2/23/2020	931
050598474	6/10/2016	6/9/2020	35,713
050596660	6/23/2016	6/22/2020	631
050598467	6/23/2016	6/22/2020	4,519
050601710	7/12/2016	7/11/2020	6,757
050596660	6/20/2016	6/19/2020	631
050607056	10/5/2016	10/4/2020	10,001
050587550	3/1/2016	2/29/2020	1
050602855	7/27/2016	7/26/2020	75,552
050603610	8/9/2016	8/8/2020	6,094
050596718	6/28/2016	6/27/2020	917
050612378	11/28/2016	11/27/2020	292,670
050612416	11/28/2016	11/27/2020	151,761
050612399	11/28/2016	11/27/2020	46,301
050612547	11/28/2016	11/27/2020	6,976
050612382	11/28/2016	11/27/2020	83,902
050612402	11/28/2016	11/27/2020	45,801

DSP - 6 Licenses	Issue Date	Expiration Date (48 months of issue)	Total Contract Value ($)
060046631	10/22/2015	10/6/2019	$ -
060046632	10/21/2015	10/6/2019	-

DSP - 73 Licenses	Date Issued	Expiration Date (48 months of issue)	Total Contract Value ($)
730053549	7/29/2015	7/28/2019	$ 30,000.00

Licenses are subject to termination if a licensee is found to be in violation of the Arms Export Control Act or the International Traffic in Arms Regulations requirements. If a licensee is found to be in violation, in addition to a termination of its licenses, it can be subject to fines and penalties by the government.

Our contracts may also be governed by the Truth in Negotiation Act requirements where certain of our contracts or proposals exceed the $750,000 threshold and/or are deemed as sole source, or non-competitive awards, covered under this act. For these contracts, we must provide a vast array of cost and pricing data in addition to certification that our pricing data and disclosure materials are current, accurate and complete upon conclusion of the negotiation. Due to the additional disclosure and certification requirements, if a post contract award audit were to uncover that the pricing data provided was in any way not current, accurate or complete as of the certification date, we could be subjected to a defective pricing claim adjustment with accrued interest. Currently, we do not have any pending defective pricing claim adjustments. Additionally, as a result of this requirement, contract price negotiations may span from two to six months and can result in undefinitized or not to exceed ceiling priced contracts subject to future downward negotiations and price adjustments. Currently, we do not have any undefinitized contracts subject to further price negotiation.

Our failure to comply with applicable regulations, rules and approvals or misconduct by any of our employees could result in the imposition of fines and penalties, the loss of security clearances, the loss of our U.S. government contracts or our suspension or debarment from contracting with the U.S. government generally, any of which could have a material adverse effect our business, financial condition, results of operations and cash flows. We are currently in compliance with all applicable regulations and do not have any pending claims as a result of noncompliance.

The terms of our material contracts are as follows (updated as of October 2, 2016):

Customer	**Customer PO/Contract**	**Contract Type**[(1)]	**Total Award Value**[(2)] **(millions)**	**Order Period Expiration**	**Remaining Value**[(3)] **(millions)**	**Delivery Period**
GDLS – Canada[(4)] DDAN Sighting Systems	Subcontract PO 35334144	FFPQ	$ 8.7	N/A	$ 1.0	Mid 2012 – Sept 2017
GDLS – Canada[(5)] DDAN Sighting Systems	Subcontract PO 35419634	FFPQ	$ 1.0	N/A	$ 1.0	Sept 2017
USACC – Warren[(6)] Plastic Periscopes	Prime Contract W56HZV-16-C-0091	FFPQ PP	$ 1.1	April 13, 2017	$ 0.7	Oct 2016 – Dec 2016
General Dynamics[(7)]	Subcontract PO 40242047	FFPQ	$ 1.3	N/A	$ 1.1	Aug 2016 – Jan 2018
DLA Aviation[(8)]	Prime Contract SPE4A616C0228	FFPQ	0.6	N/A	$ 0.6	May 2017
DLA Warren[(9)]	Prime Contract SPRDL116C0280	FFPQ	0.5	N/A	$ 0.5	May 2017

(1) FFPQ – Firm fixed price and quantity. Payment terms on shipments are net 30-45 days. PP – Progress Billable.

(2) “Total Award Value” as included in the table represents the total value of all delivery orders against the prime contract that have already been awarded to us. The total award value represents already awarded delivery order contracts. Based on our historical experience with these contracts and other similar contracts, the amount awarded has directly correlated to the amount received.

(3) The “Remaining Value” depicts the open undelivered values remaining to be delivered against the contract awards as of June 26, 2016. Only these undelivered values of the contracts may be subject to the contract

termination clause. It has been our experience that these clauses are rarely invoked.

(4) *Contract was awarded on October 24, 2011 but effective November 4, 2011 as the date on which approved for disclosure by contractor. Total award value includes all statement of work change orders through June 26, 2016.*

(5) *New contract award quantity added on December 3, 2013 as a follow on quantity to the original PO 35334144.*

(6) *New prime U.S. government contract award on April 13, 2016 for $0.84 million. The awarded contract includes a 100%, one year option quantity, up to an additional $0.84 million from the base award. As of July 12, 2016 $0.22 million in option quantity values had been awarded.*

(7) *New contract award quantity awarded on January 24, 2016.*

(8) *New contract award quantity awarded on July 16, 2016.*

(9) *New contract award quantity awarded on August 16, 2016.*

Market Opportunity — U.S. Military

During the twelve months ending October 2, 2016, approximately 64% of our business was in support of U.S. military products. The chart below was derived from public government spending sources and depicts total U.S. military spending from 2007 through 2015 and forecasted spending through 2021. The purpose of including this chart is to provide the reader with historical trend data and projected U.S. military defense and procurement spending over time. Military spending peaked at $678.1 billion in 2011. As of fiscal year 2016 the total projected military spending is projected to decline by 15.0% from the peak 2011 level. However, the military procurement in the below chart depicts a more significant decline through 2016 of 22.4% to $103.6 billion from its peak level of $133.6 billion in 2010. It is difficult to directly tie this spending to any specific military vehicles; however, we serve the U.S. armed forces, active duty and reserves, plus various state national guards.

The U.S. government spending reductions have had a significant impact on our product lines during these years as our products directly support various types of U.S. military land vehicle procurements. The projected total military spending will approximate or decline slightly from the current spending levels through fiscal year 2021. As a result of lower U.S. government spending, the Company has continued to explore other opportunities for manufacturing outside of our traditional product lines for products which could be manufactured using our existing lines in order to fully utilize our existing capacity. We do not believe that the recent presidential election will cause a major change in the direction of funding or product need for the U.S. military. Maintenance will still be required, and the opportunities for us to upgrade existing systems with higher performing systems will continue to present themselves. Further, we continue to look for additional strategic businesses to acquire that will strengthen our existing product line, expand our operations, and enter new markets.

The following factors are important to the U.S. military:

- Product reliability — failure can cost lives

- Speed to delivery and adherence to delivery schedule

- System life cycle extension
- Low cost/best value
- Visual aids for successful execution of mission objectives
- Mission critical products specifically related to soldier safety.

We focus on delivering products that satisfy these factors and believes it is well positioned to continue to service U.S. and foreign military needs.

Market Opportunity — Foreign Military

Despite the downturn in U.S. military spending, foreign military funding for products built in the United States for selected foreign militaries has held to peak funding levels. Thus, we have increased efforts to promote our proven military products, as well as newly improved product solutions directly to foreign military representatives. In 2014, we completed the first shipments of M17 Day/Thermal Periscope (NSN 6650-01-619-6545) to a country in South America. During fiscal year 2016, Optex Systems completed its first order of its patented M17 Day / Thermal Periscope for $0.6 million to Brazil. These direct sales transactions allow us to directly serve South American customers and affect influence into their future procurements. Additionally, shipment of the new M17 Day/Thermal Periscope validates our efforts to upgrade existing platforms with new technology. The M17 Day/Thermal Periscope is a cost effective upgrade to existing systems in that it provides both day and thermal views specifically designed for driving armored vehicles. It can be installed in vehicles which were originally designed without this technology and may be used as a backup to existing systems. We anticipate our efforts in South America will culminate in new orders for this technology in the near term. We are now bidding on several substantial government contracts to expand sales and production beyond the current production and backlog. For example, we are supporting General Dynamics Land Systems in their efforts related to the production of the Israeli Namer Armored Personnel Carrier (aka Merkava APC). We will continue to pursue international opportunities through direct sales (e.g., General Dynamics Land Systems — Canada), International Parts Supply and through other existing customers (e.g., General Dynamics Land Systems — Israeli Namer Project).

We are also exploring possibilities to adapt some of our products for commercial use in those markets that demonstrate potential for solid revenue growth, both domestically and internationally.

Market Opportunity — Commercial

Our products are currently sold to military and related government markets. We believe there may be opportunities to commercialize various products we presently manufacture to address other markets. Our initial focus will be directed in four product areas.

- Big Eye Binoculars — While the military application we produce is based on mature military designs, we own all castings, tooling and glass technology. These large fixed mount binoculars could be sold to cruise ships, personal yachts and cities/municipalities. The binoculars are also applicable to fixed, land based outposts for private commercial security as well as border patrols and regional law enforcement.

- Night Vision Sight — We have manufactured the optical system for the NL-61 Night Vision Sight for the Ministry of Defense of Israel. This technology could be implemented for commercial applications.

- Infrared Imaging Equipment — We manufacture and assemble infrared imaging equipment and components for Raytheon's Thermal Imaging M36 Mount product and has recently added a low-cost, uncooled, thin film, thermal imager through its partnership with selective suppliers. This combined equipment and technology has potential applications with the border patrol, police and governmental or commercial security agencies.

- Thin Film Coatings — The acquisition of the Applied Optics Center (AOC) also creates a new sector of opportunity for commercial products for us. Globally, commercial optical products use thin film coatings to create product differentiation. These coatings can be used for redirecting light (mirrors), blocking light (laser protection), absorbing select light (desired wavelengths), and many other combinations. They are used in telescopes, rifle scopes, binoculars, microscopes, range finders, protective eyewear, photography, etc. Given this broad potential, the commercial applications are a key opportunity going forward.

- Optical Assemblies – Through the Applied Optics Center, we are utilizing our experience in military sighting systems to pursue commercial opportunities associated with products that incorporate multi-lens optical cell assemblies, bonded optical elements and mechanical assemblies. There are a wide variety of products in the medical, machine vision, automotive and outdoor recreation fields that can benefit from our capabilities. Support to domestic customers for these type products has driven significant increases in overall sales during the last two years.

Customer Base

We serve customers in four primary categories: as prime defense contractor (TACOM Life Cycle Command, DLA (Defense Logistics Agency) Warren, U.S. Army, Navy and Marine Corps), as defense subcontractor (General Dynamics, L-3 Communications, BAE, and NorcaTec) and also as a military supplier to foreign governments (Israel, Australia, South America and NAMSA) and a commercial optical assembly supplier (Nightforce Optics, Cabela's). During the twelve months ended October 2, 2016, we derived approximately 84% of our gross business revenue from four major customers: U.S. government agencies (45%), General Dynamics (18%), Exelis (6%), Nightforce Optics, Inc. (15%). We have approximately 80 discrete contracts for items that are utilized in vehicles, product lines and spare parts. Due to the high percentage of prime and subcontracted U.S. defense revenues, large customer size and the fact that there are multiple contracts with each entity, which are not interdependent, we are of the opinion that this provides us with a fairly well diversified revenue pool.

Marketing Plan

Potential Entrants — Low Risk to us. In order to enter this market, potential competitors must overcome several barriers to entry. The first hurdle is that an entrant would need to prove to the government agency in question the existence of a government approved accounting system for larger contracts. Second, the entrant would need to develop the processes required to produce the product. Third, the entrant would then need to produce the product and then submit successful test requirements (many of which require lengthy government consultation for completion). Finally, in many cases, the customer has an immediate need and therefore cannot wait for this qualification cycle and therefore must issue the contracts to existing suppliers.

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Historically, we competed with two other companies in different spaces. First, we previously competed with Miller-Holzwarth in the plastic periscope business. In July 2012, Miller-Holzwarth, Inc. ceased operations apparently as a result of an inability to meet its financial obligations combined with a decline in defense market conditions. Second, we currently compete with Seiler Instruments for fire control products. These contracts are higher value products, but lower quantities. Given the expense of development and qualification testing, the barrier to entry is high for new competitors. During the last four years, overall plastic periscope demand quantities have declined, while competition on the lower level periscope products has significantly increased as new contractors aggressively compete for market share amongst the existing customer base and quantities.

Buyers — Medium Risk to us. In most cases the buyers (usually government agencies or defense contractors) have two fairly strong suppliers. It is in their best interest to keep at least two, and therefore, in some cases, the contracts are split between suppliers. In the case of larger contracts, the customer can request an open book policy on costs and expects a reasonable margin to have been applied.

Substitutes — Low Risk to us. We have both new vehicle contracts and replacement part contracts for the exact same product. The U.S. government has declared that the Abrams/Bradley base vehicles will be the ground vehicle of choice through 2040.

The Bradley vehicle has been in service for 28 years, the Abrams for 27 years. In February 2008, the U.S. Army signed a multiyear third party contract for the delivery of improved Abrams and Bradleys. The contract is for up to 435 tanks and 540 Bradley vehicles. These are the only production tanks currently in production by the government. This, in conjunction with the 30-year life span, supports their continued use through 2040. The Abrams is the principal battle tank of the United States Army and Marine Corps, and the armies of Egypt, Kuwait, Saudi Arabia, and since 2007, Australia. The new contract terms allow efficiencies within the supply chain and a very long return on investment on new vehicle proposals.

Suppliers — Low to Medium Risk to Optex Systems Holdings. The suppliers of standard processes (e.g., casting, machining and plating) need to be very competitive to gain and/or maintain contracts. Those suppliers of products that use top secret clearance processes are slightly better off; however, there continues to be multiple avenues of supply and therefore only moderate power.

Consistent with our marketing plan and business model, the AOC acquisition strengthened our overall position by decreasing the bargaining power of their suppliers through the backwards integration of a key supplier and created additional barriers of entry of potential competitors. Overall, the customer base and the competition have seen the acquisition as creating a stronger company.

The second model is a two by two matrix for products and customers.

	Existing Customers	New Customers
New Products	USACC Binoculars GDLS DDAN Commercial Optical Lens	Chile M17 Day/Thermal Brazil M17 Day/Thermal Israel M17 Day/Thermal Commercial: Optical Lens, Spotting Scopes, Monocular Lens
Existing Products	USACC Periscopes, Back Up Sights, Binoculars, Vision Blocks, ACOG Filter Units GDLS Periscopes, Collimators BAE Periscopes L3- Laser Interface Filters DLAOptical Elements	Marines Sighting Systems Commercial: Optical Lens, Spotting Scopes, Monocular Lens

This product/customer matrix sets forth our four basic approaches:

1) Sell existing products to existing customers.

2) Sell existing products to new customers.

3) Develop new products to meet the needs of our existing customers.

4) Develop new products to meet the needs of new customers.

The product categories described in the above matrix are associated with the product lines set forth below:

Product Line	**Product Category**
Periscopes	Laser & Non Laser Protected Plastic & Glass Periscopes, Electronic M17 Day/Thermal Periscopes, Vision Blocks
Sighting Systems	Back Up Sights, Digital Day and Night Sighting Systems (DDAN), M36 Thermal Periscope, Unity Mirrors
Howitzers	M137 Telescope, M187 Mount, M119 Aiming Device
Other	Muzzle Reference Systems (MRS), Binoculars, Collimators, Optical Lenses & Elements, Windows
Applied Optics Center	ACOG Laser filter, Laser Filter Interface, Optical Assemblies

Operations Plan

Our operations plan can be broken down into three distinct areas: material management, manufacturing space planning and efficiencies associated with economies of scale.

Materials Management

The largest portion of our costs is materials. We have completed the following activities in order to demonstrate continuous improvement:

- Successful completion of annual surveillance audit for ISO 9001:2008 certificate, with no major nonconformance issues
- Weekly cycle counts on inventory items
- Weekly material review board meeting on non-moving piece parts
- Kanban kitting on products with consistent ship weekly ship quantities
- Daily cross functional floor meetings focused on delivery, yields and labor savings
- Redesigned floor layout using tenant improvement funds
- Daily review of yields and product velocity
- Bill of material reviews prior to work order release

Future continuous improvement opportunities include installation and training of shop floor control module within the ERP system and organizational efficiencies of common procurement techniques among buyers.

Manufacturing Space Planning

We currently lease 93,967 square feet of manufacturing space (see “Location and Facility”), including the additional leased space in conjunction with our recent acquisition as described under “Recent Events”. Our current facilities are sufficient to meet our immediate production needs without excess capacity. As our processes are primarily labor driven, we are able to easily adapt to changes in customer demand by adjusting headcounts, overtime schedules and shifts in line with production needs. In the event additional floor space is required to accommodate new contracts, Optex has the option to lease adjacent floor space at the current negotiated lease cost per square foot. Consistent with the space planning, we will drive economies of scale to reduce support costs on a percentage of sales basis. These cost reductions can then be either passed through directly to the bottom line or used for business investment.

Our manufacturing process is driven by the use of six sigma techniques and process standardization. Initial activities in this area have been the successful six sigma projects in several production areas which have led to improved output and customer approval on the aesthetics of the work environment. In addition, we use many tools including 5S programs, six sigma processes, and define, measure, analyze, improve, control (DMAIC) problem solving techniques to identify bottlenecks within the process flow, reduce cost and improve product yields. Successful results can then be replicated across the production floor and drive operational improvements.

Economies of Scale

Plant efficiencies fluctuate as a function of program longevity, complexity and overall production volume. Our internal processes are primarily direct labor intensive and can be more easily adapted to meet fluctuations in customer demand; however, our material purchases, subcontracted operations and manufacturing support costs are extremely sensitive to changes in volume. As our volume increases, our support labor, material and scrap costs decline as a percentage of revenue as we are able to obtain better material pricing, and scrap, start up and support labor (fixed) costs and they are spread across a higher volume base. On the contrary, as production volumes decline, our labor and material costs per unit of production generally increase. Additional factors that contribute to economies of scale relate to the longevity of the program. Long running, less complex programs (e.g., periscopes) do not experience as significant of an impact on labor costs as production volumes change, as the associated workforce is generally less skilled and can be ramped quickly as headcounts shift. Our more complex thin laser filter coatings, Howitzer and thermal day/night programs are more significantly impacted by volume changes as they require a more highly-skilled workforce and ramp time is longer as the training is more complex. We continually monitor customer demand over a rolling twelve-month window and in order to anticipate any changes in necessary manpower and material which allows us to capitalize on any benefits associated with increased volume and minimize any negative impact associated with potential declines in product quantities.

Intellectual Property

We utilize several highly specialized and unique processes in the manufacture of our products. While we believe that these trade secrets have value, it is probable that our future success will depend primarily on the innovation, technical expertise, manufacturing and marketing abilities of our personnel. We cannot assure you that we will be able to maintain the confidentiality of our trade secrets or that our non-disclosure agreements will provide meaningful protection of our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or other disclosure. The confidentiality agreements that are designed to protect our trade secrets could be breached, and we might not have adequate remedies for the breach. Additionally, our trade secrets and proprietary know-how might otherwise become known or be independently discovered by others. We possess two patents and have applied for another in the US and in foreign countries. While we are optimistic that our application will be approved, we cannot guarantee that this patent application will ever transpire into an awarded patent. The claims were based on technology which is believed to be unique; however, there are many companies and many patents already awarded in this space. Further, the time frame for the US Patent and Trademark Office to review the patent application and engage in negotiations cannot be guaranteed.

Our competitors, many of which have substantially greater resources, may have applied for or obtained, or may in the future apply for and obtain, patents that will prevent, limit or interfere with our ability to make and sell some of our products. Although we believe that our products do not infringe on the patents or other proprietary rights of third parties, we cannot assure you that third parties will not assert infringement claims against us or that such claims will not be successful.

In May 2015, we announced the issuance to us of U.S. Patent No. 13,792,297 titled "ICWS Periscope". This invention improves previously accepted levels of periscope performance that, in turn, improve soldier's safety.

In December 2013, Optex Systems, Inc. was issued U.S. Patent No. 23,357,802 titled "Multiple Spectral Single Image Sighting System Using Single Objective Lens Set." The technology platform, designed for our DDAN program, is applicable to all ground combat vehicles used by the US and foreign militaries. This invention presents a single image to both day and night sensors using precision optics, which in turn allows the user to individually observe day, night, or day and night simultaneously. In addition, it has proven to be especially useful in light transition points experienced at dusk and dawn. We are in production and currently delivering sighting systems with this advanced technology, a significant upgrade in the goal of supporting our customers as they modernize the worldwide inventory of aging armored vehicles. This technology is applicable to many sighting systems, and it has already been designed for implementation on the Light Armored Vehicles, the Armored Security Vehicle, the Amphibious Assault Vehicle, and the M60 Main Battle Tank. Digital Day and Night technology has advanced the capabilities of these installed weapon systems and is the first in a series of patents we have applied for to protect our Intellectual Property portfolio in support of the warfighters who use these systems.

In May 2012, we purchased a perpetual, non-exclusive license, with a single up front license fee of $200,000 to use Patent 7,880,792 "Optical and Infrared Periscope with Display Monitor" owned by Synergy International Optronics, LLC. We believe the purchase of the license agreement may allow us to extend and expand our market potential for the M113APC vehicle type which has the highest number of commonly used armored vehicles in the world. The current estimated active M113 APC worldwide inventory is over 80,000 units. This licensing of this patent allows us to develop additional products for this vehicle type, including the M17 Day/Thermal and M17 Day/Night periscopes. We are actively marketing the new periscopes internationally and completed our first international shipment utilizing this technology in March 2014. We continue to prototype these products and demonstrate them to potential customers.

Competition

The markets for our products are competitive. We compete primarily on the basis of our ability to design and engineer products to meet performance specifications set by our customers. Our customers include military and government end users as well as prime contractors that purchase component parts or subassemblies, which they incorporate into their end products. Product pricing, quality, customer support, experience, reputation and financial stability are also important competitive factors.

There are a limited number of competitors in each of the markets for the various types of products that we design, manufacture and sell. At this time, we consider our primary competitors for the Optex, Richardson site to be Seiler Instruments, Kent Periscopes and Synergy International Optronics, LLC. The Applied Optics Center thin film and laser coatings products compete primarily with Materion-Barr, Artemis and Alluxa.

Our competitors are often well entrenched, particularly in the defense markets. Some of these competitors have substantially greater resources than we do. While we believe that the quality of our technologies and product offerings provides us with a competitive advantage over certain manufacturers, some of our competitors have significantly more financial and other resources than we do to spend on the research and development of their technologies and for funding the construction and operation of commercial scale plants.

We expect our competitors to continue to improve the design and performance of their products. We cannot assure investors that our competitors will not develop enhancements to, or future generations of, competitive products that will offer superior price or performance features, or that new technology or processes will not emerge that render our products less competitive or obsolete. Increased competitive pressure could lead to lower prices for our products, thereby adversely affecting our business, financial condition and results of operations. Also, competitive pressures may force us to implement new technologies at a substantial cost, and we may not be able to successfully develop or expend the financial resources necessary to acquire new technology. We cannot assure you that we will be able to compete successfully in the future.

Employees

We had 91 full time equivalent employees as of October 2, 2016. We also utilize small temporary work forces to handle peak loads as needed. To the best of our knowledge, we are compliant with local prevailing wage, contractor licensing and insurance regulations, and has good relations with its employees, who are not currently unionized.

Leases

We are headquartered in Richardson, TX and lease 93,967 combined square feet of facilities including Richardson, Texas and Dallas, Texas. We operate with a single shift, and capacity could be expanded by adding a second shift. Our proprietary processes and methodologies provide barriers to entry for other competing suppliers. In many cases, we are the sole source provider or one of only two providers of a product. We have capabilities which include machining, bonding, painting, tracking, engraving and assembly and can perform both optical and environmental testing in-house.

We renewed the lease on our 49,100 square foot, Richardson, Texas facility, effective as of December 10, 2013, with a lease expiration of March 31, 2021. As of October 2, 2016, the Richardson facility operates with approximately 53 full time equivalent employees in a single shift operation.

In November 2014, we also acquired a new business unit from L-3 Communications, Inc., which is described herein below under “Recent Events — Acquisition”. The acquisition, the Applied Optics Center, is located in Dallas, Texas with leased premises consisting of approximately 44,867 square feet of space. We executed a new lease for the Applied Optics Center location, effective as of October 1, 2016, which was countersigned by the landlord on October 21, 2016. The term of the lease expires October 31, 2021. There are two renewal options available to the tenant, and each renewal term is five years in duration. As of October 2, 2016, Applied Optics Center operates with approximately 38 full time equivalent employees in a single shift operation.

Item 1A Risk Factors

Investing in our common stock involves a high degree of risk. Prospective investors should carefully consider the risks described below, together with all of the other information included or referred to in this annual report, before purchasing shares of our common stock. There are numerous and varied risks, known and unknown, that may prevent us from achieving our goals. The risks described below are not the only risks we will face. If any of these risks actually occurs, our business, financial condition or results of operations may be materially adversely affected. In such case, the trading price of our common stock could decline and investors in our common stock could lose all or part of their investment. The risks and uncertainties described below are not exclusive and are intended to reflect the material risks that are specific to us, material risks related to our industry and material risks related to companies that undertake a public offering or seek to maintain a class of securities that is registered or traded on any exchange or over-the-counter market.

Investing in our common stock involves a high degree of risk. Prospective investors should carefully consider the risks described below, together with all of the other information included or referred to in this annual report, before purchasing shares of our common stock. There are numerous and varied risks, known and unknown, that may prevent us from achieving our goals. The risks described below are not the only risks we will face. If any of these risks actually occurs, our business, financial condition or results of operations may be materially adversely affected. In such case, the trading price of our common stock could decline and investors in our common stock could lose all or part of their investment. The risks and uncertainties described below are not exclusive and are intended to reflect the material risks that are specific to us, material risks related to our industry and material risks related to companies that undertake a public offering or seek to maintain a class of securities that is registered or traded on any exchange or over-the-counter market.

<u>Risks Related to our Business</u>

We expect that we may need to raise additional capital in the future beyond any cash flow from our existing business; additional funds may not be available on terms that are acceptable to us, or at all.

We anticipate we may have to raise additional capital in the future to service our debt and to finance our future working capital needs. We cannot assure you that any additional capital will be available on a timely basis, on acceptable terms, or at all. Future equity or debt financings may be difficult to obtain. If we are not able to obtain additional capital as may be required, our business, financial condition and results of operations could be materially and adversely affected.

We anticipate that our capital requirements will depend on many factors, including:

- our ability to fulfill backlog;
- our ability to procure additional production contracts;
- our ability to control costs;
- the timing of payments and reimbursements from government and other contracts, including but not limited to changes in federal government military spending and the federal government procurement process;
- increased sales and marketing expenses;
- technological advancements and competitors' response to our products;
- capital improvements to new and existing facilities;
- our relationships with customers and suppliers; and

- general economic conditions including the effects of future economic slowdowns, acts of war or terrorism and the current international conflicts.

Even if available, financings may involve significant costs and expenses, such as legal and accounting fees, diversion of management's time and efforts, and substantial transaction costs. If adequate funds are not available on acceptable terms, or at all, we may be unable to finance our operations, develop or enhance our products, expand our sales and marketing programs, take advantage of future opportunities or respond to competitive pressures.

Current economic conditions may adversely affect our ability to continue operations.

Current economic conditions may continue to cause a decline in business and consumer spending and capital market performance, which could adversely affect our business and financial performance. Our ability to raise funds, upon which we are fully dependent to continue to conduct and expand our operations, may be adversely affected by current and future economic conditions, such as a reduction in the availability of credit, financial market volatility and economic recession.

Our ability to fulfill our backlog may have an effect on our long term ability to procure contracts and fulfill current contracts.

Our ability to fulfill our backlog may be limited by our ability to devote sufficient financial and human capital resources and limited by available material supplies. If we do not fulfill our backlog in a timely manner, we may experience delays in product delivery which would postpone receipt of revenue from those delayed deliveries. Additionally, if we are consistently unable to fulfill our backlog, this may be a disincentive to customers to award large contracts to us in the future until they are comfortable that we can effectively manage our backlog.

Our historical operations depend on government contracts and subcontracts. We face risks related to contracting with the federal government, including federal budget issues and fixed price contracts.

Future general political and economic conditions, which cannot be accurately predicted, may directly and indirectly affect the quantity and allocation of expenditures by federal agencies. Even the timing of incremental funding commitments to existing, but partially funded, contracts can be affected by these factors. Therefore, cutbacks or re-allocations in the federal budget could have a material adverse impact on our results of operations. Given the continued adverse economic conditions, the federal government has slowed its pace with regard to the release of orders for the U.S. military. Since we depend on orders for equipment for the U.S. military for a significant portion of our revenues, this slower release of orders will continue to have a material adverse impact on our results of operations. Obtaining government contracts may also involve long purchase and payment cycles, competitive bidding, qualification requirements, delays or changes in funding, budgetary constraints, political agendas, extensive specification development, price negotiations and milestone requirements. In addition, our government contracts are primarily fixed price contracts, which may prevent us from recovering costs incurred in excess of budgeted costs. Fixed price contracts require us to estimate the total project cost based on preliminary projections of the project's requirements. The financial viability of any given project depends in large part on our ability to estimate such costs accurately and complete the project on a timely basis. Some of those contracts are for products that are new to our business and are thus subject to unanticipated impacts to manufacturing costs. Given the current economic conditions, it is also possible that even if our estimates are reasonable at the time made, that prices of materials are subject to unanticipated adverse fluctuation. In the event our actual costs exceed fixed contractual costs of our product contracts, we will not be able to recover the excess costs which could have a material adverse effect on our business and results of operations. We examine these contracts on a regular basis and accrue for anticipated losses on these contracts, if necessary. As of October 2, 2016, there was zero in accrued loss provisions for loss contracts or cost overruns.

Approximately 85% of our contracts contain termination clauses for convenience. In the event these clauses should be invoked by our customer, future revenues against these contracts could be affected, however these clauses allow for a full recovery of any incurred contract costs plus a reasonable fee up through and as a result of the contract termination. We are currently unaware of any pending terminations on our existing contracts.

In some cases, contract awards may be issued that are subject to renegotiation at a date (up to 180 days) subsequent to the initial award date. Generally, these subsequent negotiations have had an immaterial impact (zero to 5%) on the contract price of the affected contracts. Currently, none of our awarded contracts are subject to renegotiation.

We have sought to mitigate the adverse impact from the slower pace of U.S. military orders on our results of operations by seeking to obtain foreign military orders as well as new commercial business. We do not expect these markets to completely mitigate the negative impact of lower U.S. defense spending.

There is further uncertainty which arises from the sequestration in early 2013 which may continue to affect business opportunities at the federal government level.

Military spending has been negatively impacted by the Budget Control Act of 2011, which was passed in August 2011. The Budget Control Act mandated a $917.0 billion reduction in discretionary spending over the next decade, and $1.2 trillion in automatic spending cuts over a nine-year period to be split between defense and non-defense programs beginning in January 2013.

On November 2, 2015 Congress passed the Bipartisan Budget Act of 2015 which sets federal spending through the 2016 and 2017 fiscal years, and eases strict caps on spending set forth in the 2011 sequestration. The plan lifted caps on the appropriated spending each year by $50 billion in 2016 and $30 billion in 2017, evenly divided between defense and domestic programs with an additional $16 billion added each year in the form of inflated war spending, evenly split between the Defense and State departments. The agreed budget framework for the fiscal 2016 and 2017 budget years combined with the increased spending limits provides the needed stability for the defense agencies to plan the required programs over the next two years. On November 10, 2015, Congress passed the National Defense Authorization Act 2016, which is the comprehensive legislation to authorize the budget authority of the Department of Defense and the national security programs of the Department of Energy. The bill authorizes $607 billion in defense funding for fiscal year 2016, a 3.9% increase from the authorized funding of $584 billion in fiscal year 2015. As of December 7, 2017 the National Defense Authorization funding for fiscal year 2017 has been approved by Congress, pending Presidential approval. The approved estimates on the fiscal year 2017 spending are up slightly, 2%, from 2016 levels to $619 billion. It is further anticipated that the new administration will request a defense supplemental to increase defense spending above the current compromised amounts within its first 100 days of office. We are unable to tie the budget increase to any specific military vehicle and as such, the impact of the funding increase to our company is unknown as of December 7, 2016.

If we fail to scale our operations appropriately in response to growth and changes in demand, we may be unable to meet competitive challenges or exploit potential market opportunities, and our business could be materially and adversely affected.

Our past growth has placed, and any future growth in our historical business is expected to continue to place, a significant strain on our management personnel, infrastructure and resources. To implement our current business and product plans, we will need to continue to expand, train, manage and motivate our workforce, and expand our operational and financial systems and our manufacturing and service capabilities. All of these endeavors will require substantial management effort and additional capital. If we are unable to effectively manage our expanding operations, we may be unable to scale our business quickly enough to meet competitive challenges or exploit potential market opportunities, and our current or future business could be materially and adversely affected.

We do not have employment agreements with our key personnel, other than our Chief Executive and Financial Officers, and our management has very minimal unencumbered equity ownership in us. If we are not able to retain our key personnel or attract additional key personnel as required, we may not be able to implement our business plan and our results of operations could be materially and adversely affected.

We depend to a large extent on the abilities and continued participation of our executive officers and other key employees. The loss of any key employee could have a material adverse effect on our business. We currently have only two employment agreements, with our Chief Executive Officer which renews on an annual basis and currently expires on December 1, 2017, and our Chief Financial Officer which expires on January 31, 2018, with renewable terms each 18 months thereafter. We do not presently maintain "key man" insurance on any other key employees. Our management also has minimal unencumbered ownership interest in us, thus limiting their direct stake in our outcome. We believe that as our activities increase and change in character, additional, experienced personnel will be required to implement our business plan. Competition for such personnel is intense, and we cannot assure you that they will be available when required, or that we will have the ability to attract and retain them. In addition, due to our small size, we do not presently have depth of staffing in our executive, operational and financial management areas in order to have an effective succession plan should the need arise. Thus, in the event of the loss of one or more of our management employees, our results of operations could be vulnerable to challenges associated with recruiting additional key personnel, if such recruiting efforts are not successful in a timely manner.

Certain of our products are dependent on specialized sources of supply that are potentially subject to disruption which could have a material, adverse impact on our business.

We have selectively single-sourced some of our material components in order to mitigate excess procurement costs associated with significant tooling and startup costs. Furthermore, because of the nature of government contracts, we are often required to purchase selected items from U.S. government approved suppliers, which may further limit our ability to utilize multiple supply sources for these key components.

To the extent any of these single sourced or government approved suppliers may have disruptions in deliveries due to production, quality, or other issues, we may also experience related production delays or unfavorable cost increases associated with retooling and qualifying alternate suppliers. The impact of delays resulting from disruptions in supply for these items could negatively impact our revenue, our reputation with our customers, and our results of operations. In addition, significant price increases from single-source suppliers could have a negative impact on our profitability to the extent that we are unable to recover these cost increases on our fixed price contracts.

Each contract has a specific quantity of material which needs to be purchased, assembled, and shipped. Prior to bidding a contract, we contact potential sources of material and receive qualified quotations for this material. In some cases, the entire volume is given to a single supplier and in other cases; the volume might be split between several suppliers. If a contract has a single source supplier and that supplier fails to meet their obligations (e.g., quality, delivery), then we would find an alternate supplier and bring this information back to the final customer. Contractual deliverables would then be re-negotiated (e.g., specifications, delivery, price. As of December 7, 2016, approximately 17% of our material requirements are single-sourced across 10 suppliers representing approximately 13% of our active supplier orders. Single-sourced component requirements span across all of our major product lines. The vast majority of these single-sourced components could be provided by another supplier with minimal interruption in schedule (supply delay of 3 months or less) or minimally increased costs. We do not believe these single sourced materials to pose any significant risk to us as other suppliers are capable of satisfying the purchase requirements in a reasonable time period with minimal increases in cost. Of these single sourced components, we have contracts (purchase orders) with firm pricing and delivery schedules in place with each of the suppliers to supply parts in satisfaction of our current contractual needs.

We consider only those specialized single source suppliers where a disruption in the supply chain would result in a period of three months or longer for us to identify and qualify a suitable replacement to present a material financial or schedule risk. In the table below, we identify only those specialized single source suppliers and the product lines supported by those materials utilized by us as of December 7, 2016.

Product Line	**Supplier**	**Supply Item**	**Risk**	**Purchase Orders**
Sighting Systems M36 DDAN	L3 Communications Corp	Image intensifier tube	Alternative source would take in excess of six months to qualify	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.
Sighting Systems M36 DDAN	Libra Industries	Digital camera system	Alternative source would take in excess of six months to qualify	This supplier is the designated replacement for Raytheon for the video system boards. One P.O. is currently in place to drive the transfer from Raytheon.
Sighting Systems M36 DDAN	Raytheon EO Innovations	Digital camera system	Alternative source would take in excess of six months to qualify	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.
Periscopes	Brown Die Casting	Die-cast housings	Consolidated all die cast tooling at this	

			supplier. Would take approximately six months to move tooling and re-qualify.	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.
Periscopes	Harbor Castings	Steel castings	Alternative source would take six months to qualify	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements.
Periscopes	Lanzen	MIL Spec welded housings for vision blocks	Would take approximately 4-6 months to re-qualify a new supplier	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.
Other Big Eye	Corbett-Steeves Pattern Works	Sand castings for big eye binocular parts	Would take approximately 4-6 months to re-qualify a new supplier	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements.
Applied Optics Center M22/M24 Binocular	FujiFilm North America	Spare Components	Only approved source due to proprietary rights. Alternate source cannot be developed.	Current firm fixed price and quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.

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Product Line	Supplier	Supply Item	Risk	Purchase Orders
Applied Optics Center Coated Filters	Carter Glass Blowing	Quartz Blocks	Alternative source would take in excess of six months to develop and qualify	Current firm fixed price and quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.

The defense technology supply industry is subject to technological change and if we are not able to keep up with our competitors and/or they develop advanced technology as response to our products, we may be at a competitive disadvantage.

The market for our products is generally characterized by technological developments, evolving industry standards, changes in customer requirements, frequent new product introductions and enhancements, short product life cycles and severe price competition. Our competitors could also develop new, more advanced technologies in reaction to our products. Currently accepted industry standards may change. Our success depends substantially on our ability, on a cost-effective and timely basis, to continue to enhance our existing products and to develop and introduce new products that take advantage of technological advances and adhere to evolving industry standards. An unexpected change in one or more of the technologies related to our products, in market demand for products based on a particular technology or of accepted industry standards could materially and adversely affect our business. We may or may not be able to develop new products in a timely and satisfactory manner to address new industry standards and technological changes, or to respond to new product announcements by others. In addition, new products may or may not achieve market acceptance.

As a result of our November 2014 acquisition of the Applied Optics Center from L-3, we believe we have incurred the following additional risks, which may have a material adverse effect on our business results as we integrate the operations.

As a result of the purchase and integration of the Applied Optics Center from L-3 with our traditional business lines, the combined businesses are subject to some additional risks which were not formerly present.

AOC has a substantial fixed cost base that is inflexible in the short term to changes in market conditions. This is due to the highly skilled and specialized workforce with established benefits for severance and vacation accruals that may exceed 6 months. In the short term, we may not be able to generate sufficient business revenue to cover these costs, so there will likely be increased cash flow requirements that exceed our availability and would entail our raising additional funds to cover cash flow.

- The manufacturing process entails use of coating equipment chambers which require utilization of high amounts of electrical power and are thus highly sensitive to changes in energy costs. Current energy rates are locked in through May 28, 2018; however, if energy costs or usage increase significantly, it would have a material impact on future financials if AOC were unable to successfully incorporate the increases into priced contracts. Further, significant interruptions or surges in the electrical power supply could result in equipment damage, repair expenses and machine down time.

- Above and beyond the normal risks to retain skilled personnel, there may be an inability to retain the specialized work force of AOC as a result of the changed corporate climate and the difference in corporate values of L-3 and us. A failure to retain such personnel could result in a material adverse ability to produce the traditional AOC products or cause delays and additional costs as we would need to train new personnel.

Unexpected warranty and product liability claims could adversely affect our business and results of operations.

The possibility of future product failures could cause us to incur substantial expense to repair or replace defective products. Some of our customers require that we warrant the quality of our products to meet customer requirements and be free of defects for twelve to fifteen months subsequent to delivery. As of October 2, 2016, approximately 85% of our current contract deliveries were covered by these warranty clauses. We establish reserves for warranty claims based on our historical rate of less than one percent of returned shipments against these contracts. There can be no assurance that this reserve will be sufficient if we were to experience an unexpectedly high incidence of problems with our products. Significant increases in the incidence of such claims may adversely affect our sales and our reputation with consumers. Costs associated with warranty and product liability claims could materially affect our financial condition and results of operations.

We derive almost all of our revenue from four customers and the loss of any of these customers could have a material adverse effect on our revenues.

For the year ended October 2, 2016, we derived approximately 84% of our gross operating revenue from four customers: 45% from the U.S. Government (primarily USACC — Warren and DLA Land and Maritime), 18% from General Dynamics Land Systems Divisions, 15% from Nightforce Optics Inc. , and 6% from Exelis, Inc. Procuring new customers and contracts may partially mitigate this risk. In particular, a decision by General Dynamics Land System Divisions, USACC-Warren, or DLA to cease issuing contracts to us could have a significant material impact on our business and results of operations given that they represent over 60% of our gross business revenue. There can be no assurance that we could replace these customers on a timely basis or at all.

We have approximately 70 discrete contracts with General Dynamics Land System Division and the U.S. Government (primarily USACC-Warren and DLA), and other prime contractors. If they choose to terminate these contracts, we are entitled to fully recover all contractual costs and reasonable profits incurred up to or as a result of the terminated contract.

We only possess two patents and one patent license and rely primarily on trade secrets to protect our intellectual property.

We utilize several highly specialized and unique processes in the manufacture of our products, for which we rely solely on trade secrets to protect our innovations. We cannot assure you that we will be able to maintain the confidentiality of our trade secrets or that our non-disclosure agreements will provide meaningful protection of our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or other disclosure. The non-disclosure agreements that are designed to protect our trade secrets could be breached, and we might not have adequate remedies for the breach.

It is also possible that our trade secrets will otherwise become known or independently developed by our competitors, many of which have substantially greater resources than us, and these competitors may have applied for or obtained, or may in the future apply for or obtain, patents that will prevent, limit or interfere with our ability to make and sell some of our products. Although based upon our general knowledge (and we have not conducted patent searches), we believe that our products do not infringe on the patents or other proprietary rights of third parties; however, we cannot assure you that third parties will not assert infringement claims against us or that such claims will not be successful.

We have one outstanding patent application. While we are optimistic that our application will be approved, we cannot guarantee that this patent application will ever result in an actual patent being awarded. The application was based on technology which is believed to be unique; however, there are many companies and many patents already awarded in this space. Further, the time frame for the US Patent and Trademark Office to review the patent application and engage in negotiations cannot be guaranteed.

In the future, we may look to acquire other businesses in our industry and the acquisitions will require us to use substantial resources.

In the future, we may decide to pursue acquisitions of other businesses in our industry. In order to successfully acquire other businesses, we would be forced to spend significant resources for both acquisition and transactional costs, which could divert substantial resources in terms of both financial and personnel capital from our current operations. Additionally, we might assume liabilities of the acquired business, and the repayment of those liabilities could have a material adverse impact on our cash flow. Furthermore, when a new business is integrated into our ongoing business, it is possible that there would be a period of integration and adjustment required which could divert resources from ongoing business operations.

The Financial Industry Regulatory Authority, or FINRA, has adopted sales practice requirements which may also limit a shareholder's ability to buy and sell our stock.

FINRA has adopted rules that require that in recommending an investment to a customer, a broker-dealer must have reasonable grounds for believing that the investment is suitable for that customer. Prior to recommending speculative low priced securities to their non-institutional customers, broker-dealers must make reasonable efforts to obtain information about the customer's financial status, tax status, investment objectives and other information. Under interpretations of these rules, FINRA believes that there is a high probability that speculative low priced securities will not be suitable for at least some customers. FINRA requirements make it more difficult for broker-dealers to recommend that their customers buy our common stock, which may limit your ability to buy and sell our stock and have an adverse effect on the market for our shares.

The elimination of monetary liability against our directors, officers and employees under Delaware law and the existence of indemnification rights to our directors, officers and employees may result in substantial expenditures by us and may discourage lawsuits against our directors, officers and employees.

We provide indemnification to our directors and officers to the extent provided by Delaware law. The foregoing indemnification obligation could result in our incurring substantial expenditures to cover the cost of settlement or damage awards against directors and officers, which we may be unable to recoup. These provisions and resultant costs may also discourage us from bringing a lawsuit against directors and officers for breaches of their fiduciary duties and may similarly discourage the filing of derivative litigation by our stockholders against our directors and officers even though such actions, if successful, might otherwise benefit us and our stockholders.

Risks Related to Our Stock

We have issued a large number of shares of preferred stock, warrants and options, which if converted or exercised would substantially increase the number of common shares outstanding.

On December 22, 2016, we had 8,144,302 shares of common stock outstanding, and (a) we have vested options outstanding to purchase common stock that, if fully exercised, would generate proceeds of $562,900 and result in the issuance of an additional 56,290 shares of common stock, and (b) we have 342 shares of Series C preferred stock that, if fully converted at the 4,167 common shares per preferred share, would result in the issuance of an additional 1,425,000 shares of common stock and (c) we have 4,125,200 warrants outstanding at an exercise price of $1.50 per share. Future sales of our common stock, warrants, options and Series C preferred stock may also adversely affect our stock price and our ability to raise funds in new offerings.

As a key component of our growth strategy we have provided and intend to continue offering compensation packages to our management and employees that emphasize equity-based compensation and would thus cause further dilution.

Historically, we have not paid dividends on our common stock, and we do not anticipate paying any cash dividends in the foreseeable future.

We have never paid cash dividends on our common stock. We intend to retain our future earnings, if any, to fund operational and capital expenditure needs of our business, and we do not anticipate paying any cash dividends in the foreseeable future. As a result, capital appreciation, if any, of our common stock will be the sole source of gain for our common stockholders in the foreseeable future.

The warrants and our Series C preferred stock are unlisted securities and there is no public market for them.

There is no established public trading market for the warrants or the Series C preferred stock, and we do not expect a market to develop. In addition, the warrants and Series C preferred stock are not listed, and we do not intend to apply for listing of the warrants or the Series C preferred stock on any securities exchange or trading system. Without an active market, the liquidity of the warrants and the Series C preferred stock is limited, and investors may be unable to liquidate their investments in the warrants and Series C preferred stock.

Our stock price is speculative and there is a risk of litigation.

The trading price of our common stock has in the past and may in the future be subject to wide fluctuations in response to factors such as the following:

- revenue or results of operations in any quarter failing to meet the expectations, published or otherwise, of the investment community;
- speculation in the press or investment community;
- wide fluctuations in stock prices, particularly with respect to the stock prices for other defense industry companies;
- announcements of technological innovations by us or our competitors;
- new products or the acquisition of significant customers by us or our competitors;
- changes in investors’ beliefs as to the appropriate price-earnings ratios for us and our competitors;
- changes in management;
- sales of common stock by directors and executive officers;
- rumors or dissemination of false or misleading information, particularly through Internet chat rooms, instant messaging, and other rapid-dissemination methods;
- conditions and trends in the defense industry generally;
- the announcement of acquisitions or other significant transactions by us or our competitors;
- adoption of new accounting standards affecting our industry;

- general market conditions;

- domestic or international terrorism and other factors; and

- the other factors described in this section.

Fluctuations in the price of our common stock may expose us to the risk of securities class action lawsuits. Although no such lawsuits are currently pending against us and we are not aware that any such lawsuit is threatened to be filed in the future, there is no assurance that we will not be sued based on fluctuations in the price of our common stock. Defending against such suits could result in substantial cost and divert management's attention and resources. In addition, any settlement or adverse determination of such lawsuits could subject us to significant liability.

Future sales of our common stock could depress our stock price.

Sales of a large number of shares of our common stock, or the availability of a large number for sale, could materially adversely affect the per share market price of our common stock and could impair our ability to raise funds in addition offering of our debt or equity securities. In the event that we propose to register shares of common stock under the Securities Act for our own account, certain shareholders are entitled to include their shares in the registration, subject to limitations described in the agreements granting these rights.

If you are not an institutional investor, you may purchase securities in this offering only if you reside within the states in which we will apply to have the securities registered or are exempt from registration, and, if required, meet any requisite suitability standards.

Cautionary Note Regarding Forward-Looking Information

This prospectus, in particular the "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing herein, contains certain "forward-looking statements" within the meaning of Section 27A of the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended ("Exchange Act"). These forward-looking statements represent our expectations, beliefs, intentions or strategies concerning future events, including, but not limited to, any statements regarding our assumptions about financial performance; the continuation of historical trends; the sufficiency of our cash balances for future liquidity and capital resource needs; the expected impact of changes in accounting policies on our results of operations, financial condition or cash flows; anticipated problems and our plans for future operations; and the economy in general or the future of the electrical storage device industry, all of which are subject to various risks and uncertainties.

When used in this prospectus as well as in reports, statements, and information we have filed with the Securities and Exchange Commission, in our press releases, presentations to securities analysts or investors, in oral statements made by or with the approval of an executive officer, the words or phrases "believes," "may," "will," "expects," "should," "continue, "anticipates," "intends," "will likely result," "estimates," "projects" or similar expressions and variations thereof are intended t identify such forward-looking statements. However, any statements contained in this prospectus that are not statements of historical fact may be deemed to be forward-looking statements. We caution that these statements by their nature involve risks and uncertainties, certain of which are beyond our control, and actual results may differ materially depending on a variety of important factors.

Item 2 Properties

We are headquartered in Richardson, TX and lease 93,967 combined square feet of facilities including Richardson, Texas and Dallas, Texas. As of December 7, 2016, we had 90 full time equivalent employees. We operate with a single shift, and capacity could be expanded by adding a second shift. Our proprietary processes and methodologies provide barriers to entry for other competing suppliers. In many cases, we are the sole source provider or one of only two providers of a product. We have capabilities which include machining, bonding, painting, tracking, engraving and assembly and can perform both optical and environmental testing in-house.

We renewed the lease on our 49,100 square foot, Richardson, Texas facility, effective as of December 10, 2013 with a lease expiration of March 31, 2021. As of December 7, 2016, the Richardson facility operates with 52 full time equivalent employees in a single shift operation.

In November 2014, we also acquired a new business unit from L-3 Communications, Inc., which is described herein below under “Recent Events — Acquisition”. The acquisition, the Applied Optics Center, is located in Dallas, Texas with leased premises consisting of approximately 44,867 square feet of space. We executed a new lease for the Applied Optics Center location, effective as of October 1, 2016, which was countersigned by the landlord on October 21, 2016. The term of the lease expires October 31, 2021. There are two renewal options available to the tenant, and each renewal term is five years in duration. As of December 7, 2016, Applied Optics Center operates with approximately 38 full time equivalent employees in a single shift operation.

Item 3 Legal Proceedings

From time to time, we are involved in lawsuits, claims, investigations and proceedings, including pending opposition proceedings involving patents that arise in the ordinary course of business. There are no matters pending that we expect to have a material adverse impact on our business, results of operations, financial condition or cash flows.

Item 4 Mine Safety Disclosures

None.

PART II

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

Market information

Our common stock is currently quoted on the OTCQB Marketplace under the symbol “OPXS”. Trading in our common stock has historically lacked consistent volume, and the market price has been volatile.

The following table shows the range of high and low bid prices for our common stock as reported by the OTCQB Marketplace. The quotations reflect inter-dealer prices, without retail markup, markdown or commission and may not represent actual transactions.

Period	High	Low
Fourth Quarter 2013	$20.00	$8.00
First Quarter 2014	$9.00	$8.00
Second Quarter 2014	$30.00	$30.00
Third Quarter 2014	$10.00	$10.00
Fourth Quarter 2014	$20.00	$10.00
First Quarter 2015	$10.00	$10.00
Second Quarter 2015	$10.00	$8.00
Third Quarter 2015	$7.00	$5.00
Fourth Quarter 2015	$8.00	$8.00
First Quarter 2016	$7.30	$2.60
Second Quarter 2016	$3.50	$2.00
Third Quarter 2016	$2.60	$1.75
Fourth Quarter 2016	$2.75	$0.68

On December 21, 2016, the closing price for our common stock as reported on the OTCQB was $0.73 per share.

Securities outstanding and holders of record

On December 22, 2016, there were approximately 81 shareholders of record for our common stock and 8,144,302 shares of our common stock issued and outstanding.

Dividends

We have never paid dividends. We currently anticipate that we will retain all future earnings for the expansion and operation of our business and do not anticipate paying cash dividends in the foreseeable future.

Information respecting equity compensation plans

Summary Equity Compensation Plan Information

Optex Systems Holdings adopted its 2009 Stock Option Plan on March 26, 2009. On December 9, 2011, the Board of Directors of Optex Systems Holdings, Inc. authorized an amendment to its Stock Option Plan to increase the number of issuable shares from 6,000 to 50,000 and authorized the grant of 10,000 options to two board members and a total of 36,070 to Optex Systems Holdings employees including 20,000 options to executive officers. On December 19, 2013, the Board of Directors of Optex Systems Holdings, Inc. authorized an amendment to its Stock Option Plan to increase the number of issuable shares from 50,000 to 75,000 and authorized the grant of 20,000 options to three board members and a grant of 5,000 to an Optex Systems Holdings officer. The options granted in 2011 and 2013 were at exercise prices of $10.00 per share with each grant to vest 25% per year over four years for each year with which the grantee is still employed by or serving as a director of Optex Systems Holdings, Inc. (with all unvested options automatically expiring on the date of termination of employment by or service as a director of Optex Systems Holdings, Inc.) and all unvested options immediately vesting upon a change of control due to a merger or acquisition of the Company. As of December 18, 2016, 73,752 options had been granted, 8,712 of these options had forfeited due to terminations or expiration, and 61,290 had vested of which 5,000 options were exercised. The outstanding vested and unvested options are 56,290 and 3,750, respectively.

2016 Restricted Stock Unit Plan

On June 14, 2016, our Compensation Committee approved our 2016 Restricted Stock Unit Plan. This plan provides for issuance of stock units (“RSUs”) for up to 1,000,000 shares of our common stock. Each RSU constitutes a right to receive one share of our common stock, subject to vesting, which unless otherwise stated in an RSU agreement, shall vest in equal amounts on the first, second and third anniversary of the grant date. Shares of our common stock underlying the number of vested RSUs will be delivered as soon as practicable after vesting. During the period between grant and vesting, the RSUs may not be transferred, and the grantee has no rights as a shareholder until vesting has occurred. If the grantee’s employment is terminated for any reason (other than following a change in control of us or a termination of an officer other than for cause), then any unvested RSUs under the award will automatically terminate and be forfeited. If an officer grantee’s employment is terminated by us without cause or by the grantee for good reason, then, provided that the RSUs have not been previously forfeited, the remaining unvested portion of the RSUs will immediately vest as of the officer grantee’s termination date. In the event of a change in control, our obligations regarding outstanding RSUs shall, on such terms as may be approved by the Committee prior to such event, immediately vest, be assumed by the surviving or continuing company or cancelled in exchange for property (including cash).

On June 15, 2016, we issued 150,000 RSUs to our Chief Executive Officer, Danny Schoening, and 50,000 RSUs to our Chief Financial Officer, Karen Hawkins. The RSUs issued to Mr. Schoening and Ms. Hawkins vest as follows: 34% on January 1, 2017, 33% on January 1, 2018 and 33% on January 1, 2019.

Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the consolidated financial statements and the related notes that are set forth in our financial statements elsewhere in this annual report.

This management’s discussion and analysis reflects information known to management as of our fiscal year end, October 2, 2016, and the date of filing. This MD&A is intended to supplement and complement our audited financial statements and notes thereto for the year ended October 2, 2016, prepared in accordance with U.S. generally accepted accounting principles (GAAP). You are encouraged to read our financial statements in conjunction with your reading of this MD&A. The financial information in this MD&A has been prepared in accordance with GAAP, unless otherwise indicated. In addition, we use non-GAAP financial measures as supplemental indicators of our operating performance and financial position. We use these non-GAAP financial measures internally for comparing actual results from one period to another, as well as for planning purposes. We will also report non-GAAP financial results as supplemental information, as we believe their use provides more insight into our performance. When a non-GAAP measure is used in this MD&A, it is clearly identified as a non-GAAP measures and reconciled to the most closely corresponding GAAP measure.

The following discussion highlights the principal factors that have affected our financial condition and results of operations as well as our liquidity and capital resources for the periods described. This discussion contains forward-looking statements. Please see "Special cautionary statement concerning forward-looking statements" and "Risk factors" for a discussion of the uncertainties, risks and assumptions associated with these forward-looking statements. The operating results for the periods presented were not significantly affected by inflation.

Background

On March 30, 2009, a reorganization was consummated pursuant to which the then existing shareholders of Optex Systems, Inc. (Delaware) exchanged their shares of common stock for shares of common stock of Optex Systems Holdings as follows: (i) the outstanding 85,000,000 shares of Optex Systems, Inc. (Delaware) common stock were exchanged by Optex Systems Holdings for 113,333,282 shares of Optex Systems Holdings common stock, (ii) the outstanding 1,027 shares of Optex Systems, Inc. (Delaware) Series A preferred stock were exchanged by Optex Systems Holdings for 1,027 shares of Optex Systems Holdings Series A preferred stock, and (iii) the 8,131,667 shares of Optex Systems, Inc. (Delaware) common stock purchased in the private placement were exchanged by Optex Systems Holdings for 8,131,667 shares of Optex Systems Holdings common stock. Optex Systems, Inc. (Delaware) has remained a wholly-owned subsidiary of Optex Systems Holdings. The common shares above are presented at their pre reverse split share quantities to preserve historical information. Optex Systems Holdings effected a 1000:1 reverse stock split on October 7, 2015.

As a result of the reorganization, Optex Systems Holdings changed its name from Sustut Exploration Inc. to Optex Systems Holdings, Inc., and its year end from December 31 to a fiscal year ending on the Sunday nearest September 30.

Optex Systems, Inc. (Delaware) manufactures optical sighting systems and assemblies, primarily for Department of Defense applications. Its products are installed on various types of U.S. military land vehicles, such as the Abrams and Bradley fighting vehicles, light armored and armored security vehicles and have been selected for installation on the Stryker family of vehicles. Optex Systems, Inc. (Delaware) also manufactures and delivers numerous periscope configurations, rifle and surveillance sights and night vision optical assemblies. Optex Systems, Inc. (Delaware) products consist primarily of build-to-customer print products that are delivered both directly to the armed services and to other defense prime contractors. Less than 1% of today’s revenue is related to the resale of products substantially manufactured by others. In this case, the product would likely be a simple replacement part of a larger system previously produced by Optex Systems, Inc. (Delaware).

A majority of our contracts are prime or subcontracted directly with the Federal government and, as such, are subject to Federal Acquisition Regulation Subpart 49.5, “Contract Termination Clauses” and more specifically Federal Acquisition Regulation clauses 52.249-2 “Termination for Convenience of the Government Fixed-Price)”, and 49.504 “Termination of fixed-price contracts for default”. These clauses are standard clauses on our prime military contracts and generally apply to us as subcontractors. It has been our experience that the termination for convenience is rarely invoked, except where it is mutually beneficial for both parties. We are currently not aware of any pending terminations for convenience or for default on our existing contracts.

By way of background, the Federal Acquisition Regulation is the principal set of regulations that govern the acquisition process of government agencies and contracts with the U.S. government. In general, parts of the Federal Acquisition Regulation are incorporated into government solicitations and contracts by reference as terms and conditions effecting contract awards and pricing solicitations.

In the event a termination for convenience were to occur, Federal Acquisition Regulation clause 52.249-2 provides for full recovery of all contractual costs and profits reasonably occurred up to and as a result of the terminated contract. In the event a termination for default were to occur, we could be liable for any excess cost incurred by the government to acquire supplies from another supplier similar to those terminated from us. We would not be liable for any excess costs if the failure to perform the contract arises from causes beyond the control and without the fault or negligence of the company as defined by Federal Acquisition Regulation clause 52.249-8. In addition, the Government may require us to transfer title and deliver to the Government any completed supplies, partially completed supplies and materials, parts, tools, dies, jigs, fixtures, plans, drawings, information, and contract rights that we have specifically produced or acquired for the terminated portion of this contract. The Government shall pay contract price for completed supplies delivered and accepted, and we and the Government would negotiate an agreed upon amount of payment for manufacturing materials delivered and accepted and for the protection and preservation of the property. Failure to agree on an amount for manufacturing materials is subject to the Federal Acquisition Regulation Disputes clause 52.233-1.

Many of our contracts allow for government contract financing in the form of contract progress payments pursuant to Federal Acquisition Regulation 52.232-16, “Progress Payments”. As a small business, and subject to certain limitations, this clause provides for government payment of up to 90% of incurred program costs prior to product delivery. To the extent our contracts allow for progress payments, we intend to utilize this benefit, thereby minimizing the working capital impact on Optex Systems Holdings for materials and labor required to complete the contracts.

Our contracts allow for Federal Acquisition Regulation 52.243-1 which entitles the contractor to an “equitable adjustment” to the contract if the contract changes result in a change in contract costs or time of performance. In essence, an equitable price adjustment request is a request for a contract price modification (generally an increase) that allows for the contractor to be “made whole” for additional costs incurred which were necessitated by some modification of the contract effort. This modification may come from an overt change in U.S. Government requirements or scope, or it may come from a change in the conditions surrounding the contract (e.g., differing site conditions or late delivery of U.S. Government-furnished property) which result in statement of work additions, deletions, part substitutions, schedule or other changes to the contract which impact the contractor’s overall cost to complete. During 2010, Optex Systems Holdings realized increased losses against the Howitzer programs of $1.1 million of which $0.8 million related specifically to production issues encountered on our Howitzer product line. Increased losses were primarily attributable to manufacturing issues on our U.S. government Howitzer Aiming Circles culminating in higher material scrap and labor hours, combined with a reduction in total production volume in 2010 which further impacted production efficiencies across all product lines. Optex Systems Holdings requested an equitable adjustment on this program due to significant design issues impacting the manufacturability of the product. As there was no guarantee that the request would be granted in part or in full, we realized the entire loss in fiscal year 2010. The initial equitable adjustment claim was formally rejected by the contracting agency on May 31, 2012; however, Optex Systems Holdings appealed the decision with the Armed Services Board of Contract Appeals (ASBCA). In September 2015, the U.S. Government agreed to a $0.9 million settlement against the claim for the Aiming Circle contract number W52H09-06-D-0229. The settlement is the result of a negotiation and fact gathering process managed through the Armed Services Board of Contract Appeals (ASBCA). A contract modification was issued on September 23, 2015 increasing the total contract price by the agreed amount. As the respective units were shipped complete in 2011, the contract was essentially complete on execution of the modification and the entire amount was recorded as revenue for the twelve months ended September 27, 2015.

In some cases, we may receive an “undefinitized” (i.e., price, specifications and terms are not agreed upon before performance commenced) contract award for contracts that exceed the $750,000, which is the federal government simplified acquisition threshold. These contracts are considered firm contracts at an undefinitized, but not to exceed specified limits threshold. Cost Accounting Standards Board covered contracts are subject to the Truth in Negotiations Act disclosure requirements and downward only price negotiation. As of October 2, 2016, none of our outstanding backlog fell under this criterion.

We manufacture optical sighting systems and assemblies, primarily for Department of Defense applications. Its products are installed on various types of U.S. military land vehicles, such as the Abrams and Bradley fighting vehicles, light armored and armored security vehicles and have been selected for installation on the Stryker family of vehicles. We also manufacture and deliver numerous periscope configurations, rifle and surveillance sights and night vision optical assemblies. We have capabilities which include machining, bonding, painting engraving and assembly and can perform both optical and environmental testing in-house. Our products consist primarily of build-to-customer print products that are delivered both directly to the armed services and to other defense prime contractors. We are both a prime and sub-prime contractor to the Department of Defense. Sub-prime contracts are typically issued through major defense contractors such as General Dynamics Land Systems, Raytheon Corp., BAE, NorcaTec and others. We are also a military supplier to foreign governments such as Israel, Australia and NAMSA and South American countries and as a subcontractor for several large U.S. defense companies serving foreign governments.

Recent Orders

- In February 2016, we received a $1.2 million award from General Dynamics Land Systems.
- In April 2016, we received $841,000 in initial orders for advanced laser protected periscopes from U.S. Army Contracting Command.
- In May 2016, we received a new $1.12 million purchase order from a domestic customer.
- In June 2016, we completed shipment of $518,000 of periscopes to Brazil.
- In July 2016, we secured a five-year contract with the Defense Logistics Agency with a value of $5.99 million.

- In September 2016, we received two orders from the Defense Logistics Agency: a $450,000 order for collimators for the Abrams Main Battle Tank and a $570,000 order for cable periscopes.

- In October 2016, we received a $765,000 order from L-3 Communications for night vision goggle laser interference filter assemblies.

- In October 2016, we were awarded a $1.3 million portion of a commercial multi-year strategic supplier agreement with a domestic manufacturer of premium optical devices to supply its optical assemblies.

- In December 2016, we were awarded a $1.5 million purchase order from one of the world's largest defense companies for laser protected periscopes. The periscopes will be delivered over the next three years for installation into Light Armored Vehicles in the Middle East.

New Product Development

We continue to field new product opportunities from both domestic and international customers. Given continuing unrest in multiple global hot spots, the need for precision optics continues to increase. Most of these requirements are for observation and situational awareness applications; however, we continue to see requests for higher magnification and custom reticles in various product modifications. The basic need to protect the soldier while providing information about the mission environment continues to be the primary driver for these requirements.

We do not believe that the change in government administration will cause a major change in the direction of funding or product need for the U.S. military. Maintenance will still be required, and the opportunities for us to upgrade existing systems with higher performing systems will continue to present themselves. Spending levels may change, but given the mix between foreign spending, domestic/prime demand, and the more recent commercial opportunities, we do not expect any negative trends arising from political domestic changes into fiscal 2017.

During the first six months of 2015, we released a new digital spotting scope called Red Tail (patent pending). This device is targeted towards long range observation and image recording used by military, border patrol, and select consumer/commercial applications. The device is designed to deliver high definition images with military grade resolution, but at commercial "off the shelf" pricing. Using high grade optics to deliver a 45X magnified image onto a 5 megapixel CMOS sensor, the Red Tail device then transmits this image via Wi-Fi to the user's smartphone or tablet. Digital still images or videos can then be captured and/or emailed using a custom Red Tail app available for either iOS or Android devices. We demonstrated this device in April 2015 at the Border Security Expo in Phoenix, Arizona and received positive feedback from U.S. border agents, police officers, and other Expo attendees.

On November 10, 2015, we entered into a retail sales relationship with Cabela's Inc., to distribute our Red Tail Digital Spotting Scope as well as our new Stabilized Monocular. We are presently in negotiations to make these devices available via General Services Administration schedules for government personnel.

Results of Operations

Segment Information

We have presented the operating results by segment to provide investors with an additional tool to evaluate our operating results and to have a better understanding of the overall performance of each business segment and its ability to perform in subsequent periods. Management of Optex Systems Holdings uses the selected financial measures by segment internally to evaluate its ongoing segment operations and to allocate resources within the organization accordingly. Segments are determined based on differences in products, location, internal reporting and how operational decisions are made. Management has determined that the Optex Systems, Richardson plant, and the Applied Optics Center, Dallas plant, which was acquired on November 3, 2014, are separately managed, organized, and internally reported as separate business segments. The table below provides a summary of selective statement of operations data by operating segment for the years ended October 2, 2016 and September 27, 2015 reconciled to the Audited Consolidated Results of Operations as presented in Item 8,"Financial Statements and Supplementary Data".

Results of Operations Selected Financial Info by Segment
(Thousands)

	Twelve months ending October 2, 2016				September 27, 2015			
	Optex Richardson	Applied Optics Center Dallas	Other (non allocated costs and eliminations)	Consolidated	Optex Richardson	Applied Optics Center Dallas [1]	Other (non allocated costs and eliminations)	Consolidated
Revenue from External Customers	$ 11,052	$ 6,227	$ -	$ 17,279	$ 8,172	$ 4,831	$ -	$ 13,003
Intersegment Revenues	-	1,892	(1,892)	-	-	526	(526)	-
Total Segment Revenue	11,052	8,119	(1,892)	17,279	8,172	5,357	(526)	13,003
Cost of Goods Sold from Inventory	8,891	7,229	(1,892)	14,228	6,403	4,923	(526)	11,326
Intangible Amortization - COS	-	-	-	-	-	291	-	291
Total Cost of Sales	8,891	7,229	(1,892)	14,228	6,929	5,214	(526)	11,617
Gross Margin	2,161	890	-	3,051	1,243	143	-	1,386
Gross Margin %	19.6 %	11.0 %	0.0 %	17.7 %	15.2 %	3.0 %	0.0 %	10.7 %
General and Administrative Expense	2,744	507	-	3,251	2,061	714	-	2,775
Intangible Amortization - G&A	-	-	-	-	-	51	-	51
Segment Allocated G&A Expense	(728)	728	-	-	(387)	387	-	-
Net General & Administrative Expense	2,016	1,235	-	3,251	1,674	1,152	-	2,826
Operating Profit (Loss)	145	(345)	-	(200)	(431)	(1,009)	-	(1,440)

Operating Profit (Loss) %	1.3 %	(4.2 %)	0.0 %	(1.2 %)	(5.3 %)	(18.8 %)	0.0 %	(11.1 %)
Gain on Purchased Asset	-	-	-	-	-	2,110	-	2,110
Interest Expense	-	-	(36)	(36)	-	-	(179)	(179)
Net Income (Loss) before taxes	$ 145	$ (345)	$ (36)	$ (236)	$ (431)	$ 1,101	$ (179)	$ 491
Net Income (Loss) %	1.3 %	(5.5 %)	0.0 %	(1.4 %)	(5.3 %)	22.8 %	0.0 %	3.8 %

(1) The Applied Optics Center was acquired on November 3, 2014.

Our total revenues increased by $4.3 million, or 33.1%, in 2016 over the 2015 revenue levels. The Optex Systems Richardson segment realized a $2.9 million, or 35.4%, increase in revenue and the Applied Optics Center segment which was acquired on November 4, 2014, realized an increase of $1.4 million, or 29.2%, in revenue over the prior year period. Intersegment revenues increased by $1.4 million during the 2016 year, from $0.5 million to $1.9 million. Intersegment revenues relate primarily to coated filters provided by the Applied Optics Center to Optex Systems in support of the Optex Systems periscope line.

Both the gross margin and the gross margin percentages increased significantly in 2016 for both the Optex Systems and Applied Optics Center segments over 2015. In 2016 compared to 2015 the gross margin increased by $1.7 million and the gross margin percent increased by 7.0% points. U.S. government military spending has a significant impact on our product lines as our products directly support various types of U.S. military land vehicle procurements. Reduced military spending in 2015 resulted in revenues below the required levels necessary to cover fixed plant operating costs against our contracts. The reduced revenue, and corresponding contribution margins toward fixed costs, resulted in lower gross margin percentages for both the Optex and Applied Optics Centers during the 2015 fiscal year. In addition, the prior year cost of sales included $0.3 million of intangible amortization associated with the Applied Optics Center acquisition on November 3, 2014, which was not included in the year ending 2016. During 2016, the gross margin percentage on Optex Systems revenue increased from 15.2% to 19.6% over the prior year, whereas the Applied Optics Center gross margin percentage increased from 3.0% to 15.2%, inclusive of the intersegment sales to Optex Systems. We expect these higher margin rates to continue to grow for both segments as we our revenues on our higher margin Optex Systems periscopes increase and production efficiencies on the Applied Optics Center commercial optical assemblies improve through new vendor management and quality controls.

During the year ending 2016, the Applied Optics Center absorbed ($0.7) million of fixed general and administrative costs incurred by Optex Systems for support services, as compared to ($0.4) million in the prior year period. These expenses cover accounting, executive, human resources, information technology, board fees and other corporate expenses paid by Optex Systems and shared across both operating segments.

Our operating loss also decreased significantly, by $1.2 million, in 2016, to ($0.2) million, as compared to the prior year operating loss of ($1.4) million. We experienced improvements in both operating segments year over year, with Optex Systems increasing operating profit by $0.6 million, from a prior year operating loss of ($0.4) million to a $0.2 million operating profit in 2016. The Applied Optics Center operating profit increased by $0.7 million, from a prior year operating loss of ($1.0) million to a 2016 operation loss of ($0.3) million.

Net income before taxes decreased from the prior year by ($0.7) million, from a prior year net income before taxes of $0.5 million to a current year net loss before taxes of ($0.2) million. The decline in net income year over year is primarily due to a nonrecurring $2.1 million gain recognized in 2015 on the acquisition of the Applied Optics Center on November 3, 2014.

As a result of lower U.S. government spending trends from 2011 levels, the Company has continued to explore other revenue opportunities for manufacturing outside of our traditional product lines for products which could be manufactured using our existing lines in order to fully utilize our existing capacity. Further, we continue to look for additional strategic businesses to acquire that will strengthen our existing product line, expand our operations, and enter new markets.

Backlog

Backlog as of October 2, 2016 was $12.0 million as compared to a backlog of $11.7 million as of September 27, 2015, representing an increase of 2.6%. The following table depicts the current expected delivery by quarter of all contracts awarded as of October 2, 2016.

	(Millions)									
Product Line	Q1 2017	Q2 2017	Q3 2017	Q4 2017	2017 Delivery	2018 Delivery	Total Backlog 10/02/2016	Total Backlog 9/27/2015	Variance	% Chg
Periscopes	1.8	0.9	0.5	0.1	$ 3.3	0.1	$ 3.4	$ 3.7	$ (0.3)	-8.1 %
Sighting Systems	0.1	-	1.4	1.5	3.0	0.2	3.2	4.6	(1.4)	(30.4)%
Other	0.5	0.6	1.1	0.1	2.3	-	2.3	0.3	2.0	666.7 %
Optex Systems - Richardson	2.4	1.5	3.0	1.7	8.6	0.3	8.9	8.6	0.3	3.5 %
Applied Optics Center - Dallas	2.3	0.8	-	-	3.1	-	3.1	3.1	-	0.0 %
Total Backlog	$4.7	$ 2.3	$ 3.0	$ 1.7	$ 11.7	$ 0.3	$ 12.0	$ 11.7	$ 0.3	2.6 %

During 2016, Optex Systems Holdings received new orders totaling $17.6 million, a 26.6% increase, as compared to new orders of $13.9 million during the prior year. The 2016 orders consist of $7.8 million in support of our periscope product line, $6.2 million attributable to the Applied Optics Center and $3.6 million attributable to other products. Approximately 48.4% or $8.5 million of the orders received in fiscal year 2016 were delivered within the year, with the remaining balance to be delivered in fiscal year 2017. As of October 2, 2016 our shippable backlog for fiscal year 2017 is $11.7 million. As of December 14, 2016, Optex Systems Holdings, Inc. has received additional new orders of $6.2 million, which includes $3.5 million in periscopes, $0.5 million in Optex other and $2.2 million of Applied Optics Center products for deliveries in fiscal year 2017. We expect our orders during fiscal year 2017 to meet or exceed the fiscal year 2016 orders, with a substantial portion, approximately 45-50%, to be deliverable within the fiscal year 2017 period.

The Bipartisan Budget Act of 2015 eased the strict spending caps established in the 2011 sequestration and set forth federal spending through the 2016 and 2017 fiscal years. The plan lifted the caps on the appropriated spending each year by $50 billion in 2016 and will lift the cap another$30 billion in 2017, evenly divided between defense and domestic programs and provides an additional $16 billion each year in the form of inflated war spending, evenly split between the Defense and State departments. We believe that the defense industry effects of the sequestration from 2011 have reached a plateau and we will begin to see small but steady increases in defense military procurement orders in the coming year. As of December 7, 2017 the National Defense Authorization funding for fiscal year 2017 has been approved by Congress, pending Presidential approval. The approved estimates on the fiscal year 2017 spending are up slightly, 2%, from 2016 levels to $619 billion. It is further anticipated that the new administration will request a defense supplemental to increase defense spending above the current compromised amounts within its first 100 days of office.

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The U.S. military supply industry has become highly competitive as suppliers fight for increased market share to offset the impacts of the reduced government spending. We compete with other suppliers on the basis of quality, delivery, price, and overall customer service, among other things. Our competitors include a number of suppliers, some of which have established strong relationships with the defense contracting agencies. Competition can lead to price reductions, reduced margins and an inability to gain or hold market share. We are aggressively pursuing additional periscope market share in both foreign and domestic defense contractor markets in order to mitigate the effect the reduced U.S. military orders has on our operations.

Optex Systems - Richardson:

Backlog for our periscope product line has decreased (8.1%) or ($0.3) million to $3.4 million, from our ending 2015 fiscal year level of $3.7 million. We attribute the lower backlog to delayed timing of U.S. government contract awards during the fourth quarter of 2016. Our total periscope contract awards for fiscal 2016 totaled $7.8 million as compared to $6.6 million in the fiscal year 2015. Optex Systems, Inc. has experienced an increase in US government demand for laser protected periscopes in support of ongoing maintenance of US combat vehicles in addition to increased orders for foreign markets in support of Saudi Arabia’s Light Armored Vehicle, Morocco’s conversion of M1A1 vehicles to the situational awareness configuration and US Department of State Foreign Military Sales (FMS) in support of the M113 Periscope Upgrade program for Brazil. As of December 9, 2016, our new periscope awards for the first quarter of 2017 are $3.5 million and have already exceeded our first quarter awards for 2016 by $2.1 million. On November 10, 2016 Optex Systems received its first purchase order of $1.5 million for its laser protected periscopes from Defense Logistics Agency (DLA). The purchase order is the first task order delivery executed against a five year Indefinite Delivery, Indefinite Quantity (IDIQ) contract with DLA totaling $6 million which was awarded in July 2016. On December 14, 2016, we were awarded a $1.5 million purchase order from one of the world’s largest defense companies for laser protected periscopes. The periscopes will be delivered over the next three years for installation into Light Armored Vehicles in the Middle East. We continue to quote periscopes as a U.S. military prime and subcontracted supplier on an ongoing basis and expect additional awards throughout the next fiscal year to meet or exceed our 2016 orders. We anticipate our acquisition of the Applied Optics Center, combined with our expanded footprint into foreign vehicle platforms has positioned Optex Systems Inc. to effectively compete for the domestic market and foreign defense market share as the best value supplier for laser protected periscopes.

Sighting Systems backlog decreased by ($1.4) million or (30.4%) in the last twelve months as we continued to deliver against our existing M36 DDAN contract. We anticipate the possibility of new sighting systems orders for DDANs as well as similar sighting systems for delivery beyond 2017. Our current sighting system backlog deliveries have been rescheduled for the second half of fiscal 2017.

Our backlog increased by $2.0 million or 666.7% on other products in the last twelve months due to new orders booked for collimator assemblies of $1.3 million in support of the U.S government and General Dynamics, and periscope cable assemblies of $0.7 million for the U.S. Government.

Applied Optics Center – Dallas

The Applied Optics Center backlog remained flat at $3.1 million for the year ending 2016 as compared to the year ending 2015, although we have seen a significant shift in external revenues from our military filter business toward commercial optical assemblies. Our commercial backlog for Nightforce optical assembly products has increased $1.5 million from the prior year level. The increase was offset by reductions in U.S. military laser filters of $1.5 million. New orders booked for fiscal year 2016 were $6.2 million, an increase of 5.1%, as compared to $5.9 million in the prior year. As of December 9, 2016, the Applied Optics Center new orders for fiscal year 2017 has already reached the 2016 first quarter order value of $2.2 million.

The Applied Optics Center also serves as a primary filter supplier to the Optex Systems – Richardson plant. During the fiscal year 2016, the Applied Optex Center received intracompany orders for laser coated filters in support of Optex periscopes of $1.9 million, as compared to $0.5 million in the prior year. The increased volume in support of Optex Systems – Richardson, has offset the decline in AOC filter volume from external customers and mitigated the impact to the coating production lines.

The AOC acquisition has expanded our ability to bring our technology and products into commercial markets. Commercial optical products around the world use thin film coatings to create product differentiation. These coatings can be used for redirecting light (mirrors), blocking light (laser protection), absorbing select light (desired wavelengths), and many other combinations. They are used in telescopes, rifle scopes, binoculars, microscopes, range finders, protective eyewear, photography, etc. Given this broad potential, the commercial applications are a key opportunity going forward. Further, the AOC acquisition has strengthened our overall position by decreasing the bargaining power of our suppliers through backwards integration of a key supplier and most importantly, creates additional barriers of entry of potential competitors. Overall, the customer base and the competition have seen the acquisition as creating a stronger Optex Systems Holdings.

Optex Systems Holdings continues to aggressively pursue international and commercial opportunities in addition to maintaining its current footprint with U.S. vehicle manufactures, with existing as well as new product lines. We continue exploring new market opportunities for our M17 day/thermal periscopes and digital optics for commercial applications. We are also reviewing potential products, outside our traditional product lines, which could be manufactured using our current production facilities in order to capitalize on our existing capacity. Further, we continue to look for strategic businesses to acquire that will strengthen our existing product line, expand our operations, and enter new markets.

Twelve month period ended October 2, 2016 compared to the twelve month period ended September 27, 2015

Revenues:

The table below details the revenue changes by segment and product line for the year ended October 2, 2016 as compared to the year ended September 27, 2015.

	Twelve months ended (Millions)			
Product Line	October 2, 2016	September 27, 2015	Variance	% Chg
Periscopes	$ 8.1	$ 4.5	$ 3.6	80.00
Sighting Systems	1.8	2.2	(0.4)	(18.2)
Howitzer / Aiming Circle	-	0.9	(0.9)	(100.0)
Other	1.2	0.6	0.6	100.0
Optical Systems - Richardson	11.1	8.2	2.9	35.4
Applied Optics Center - Dallas	6.2	4.8	1.4	29.2

Total Revenue	$ 17.3	$ 13.0	$ 4.3	$ 33.1

Our total revenues increased by $4.3 million, or 33.1%, in 2016 over the 2015 revenue levels. The Optex Systems Richardson segment realized a $2.9 million, or 35.4%, increase in revenue and the Applied Optics Center segment which was acquired on November 4, 2014, realized an increase of $1.4 million, or 29.2%, in revenue over the prior year period. Approximately 50% of our total revenue recognized during the fiscal year was from new orders booked during the twelve months ending October 2, 2016.

Revenues increased by $3.6 million or 80% on our periscope line during the twelve months ended October 2, 2016 as compared to the twelve months ended September 27, 2015. During the period, Optex Systems, Inc. experienced higher revenue across all periscope types due to increased customer demand for the U.S. government as well as foreign military sales during the year. Optex Systems, Inc. has experienced an increase in US government demand for laser protected periscopes in support of ongoing maintenance of US combat vehicles in addition to increased orders for foreign markets in support of Saudi Arabia’s Light Armored Vehicle, Morocco’s conversion of M1A1 vehicles to the situational awareness configuration and US Department of State Foreign Military Sales (FMS) in support of the M113 Periscope Upgrade program for Brazil. Based on our ending September backlog of $3.4 million and new orders of $2.0 million received in the first quarter of fiscal 2017, we expect these higher revenue levels to continue through the next year as we continue to bid new contracts on both foreign and domestic periscope business.

Revenues on sighting systems declined by ($0.4) million, or (18.2%) from the prior year period due to software issues causing a delay in the required video controller equipment necessary to ship complete units during the year. While the software issues have been resolved, delays in video controller equipment, combined with a customer request to push out scheduled contract delivery, we expect the sighting systems revenue to decline over the next six months, with increased production deliveries occurring in the second half of fiscal year 2017.

Revenues on Howitzer Aiming Circles declined by ($0.9) million, or (100%) from the prior year period, this is due to revenue recognized in the fiscal year 2015 for the settlement of a $0.9 million equitable adjustment claim with the U.S. government on a contract which had previously completed in 2011. We are currently not in production for additional Howitzers and as such do not anticipate additional revenues on this program in the near term.

Revenue on other product lines increased by $0.6 million, or 100%, compared to revenues in the prior year. The increased revenue in the year ending October 2, 2016 as compared to the prior year period relate to increased shipments in the year ending October 2, 2016 for big eye binoculars of $0.1 million to assorted customers, periscope cable assemblies of $0.4 million to the U.S. government, and $0.1 million in spare orders to multiple customers. We continue to bid on smaller miscellaneous spare orders on an ongoing basis.

The Applied Optics Center external revenue increased by $1.4 million, or 29.2%, during the 2016 fiscal year as compared to the prior year period. The increased revenue was primarily attributable to increases in commercial sales of $1.2 million for Nightforce optical assemblies. The U.S. military shipments increased by $1.3 million due to shipments against a new ACOG laser filter contract shipped during the year; however, reductions in laser interface filters supplied to other U.S military contractors declined by $1.2 million. Applied Optics Center also serves as a primary supplier of laser coated filters to the Optex Systems Richardson site in support of Optex Systems periscope orders. During the fiscal year ending 2016, intracompany revenues to Optex Systems-Richardson increased by $1.4 million, to $1.9 million in 2016, from the prior year amount of $0.5 million. During the year ending in 2016, approximately 50% of the revenue recognized was derived from new orders booked during the 2016 fiscal year. Based on the ending Applied Optics Center backlog of $3.1 million as of October 2, 2016, combined with an additional $2.2 million in new orders booked through December 9, 2016, we expect continued growth into 2017 Applied Optics Center product lines.

Gross Margin. The gross margin during the period ending October 2, 2016 was 17.7% of revenue as compared to a gross margin of 10.7% of revenue for the period ending September 27, 2015. The increase in cost of sales of $2.6 million, and increase in gross margin percentage of 7.0% pts., is primarily attributable to costs associated with the increased revenue of $4.3 million, or 33.1% over the prior year period, combined with changes in product mix and higher efficiencies on our periscope, and Applied Optics Center product lines. The 2015 reductions in military spending created excess and idle capacity, whereas Optex Systems Holdings was unable to fully absorb the fixed manufacturing overhead against our contracts. As the factory labor and overhead costs are relatively fixed at low production rates, idle and excess capacity associated with the lower Optex periscope and Applied Optics Center revenues contributed to lower gross margins on our contracts during the 2015 year. In addition, the prior year cost of sales included $0.3 million of intangible amortization associated with the Applied Optics Center acquisition on November 3, 2014, which was not included in the year ending 2016.

G&A Expenses. During the fiscal year ended October 2, 2016, we recorded operating expenses of $3.3 million as opposed to $2.8 million during the period ending September 27, 2015, an increase of $0.5 million or 17.9%. The increased general and administrative expenses in the current year period over the prior year period is primarily due to the write off of costs attributable to the suspended capital raise during the first half of the fiscal year 2016 of $0.2 million, increased costs for investor relations of $0.2 million, and increased board of director fees of $0.1 million in the current year as compared to the prior year period.

Operating Income (Loss). During the period ending October 2, 2016, we recorded, an operating loss of ($0.2) million as compared to an operating loss of ($1.4) million during the period ending September 27, 2015. The $1.2 million decrease in operating loss in the current year over the prior year is primarily due to the increased gross margin of $1.7 million on higher revenue which is partially offset with higher general and administrative costs of ($0.5).

Net loss applicable to common shareholders. During the year ended October 2, 2016, we recorded a net loss applicable to common shareholders of ($1.0) million as compared to net loss applicable to common shareholders of ($6.0) million during the year ended September 27, 2015. The decreased loss of $5.0 million is primarily attributable to a decrease in operating losses of $1.2 million, a decrease in interest expense of $0.2 million and decreased premiums on preferred stock for the beneficial conversion features recognized on Series A and Series B preferred shares of $5.7 million in the current year as compared to the prior year. In addition, during 2015 we recognized a gain on asset purchase of ($2.1) million which was associated with the acquisition of the Applied Optics Center on November 3, 2014.

Liquidity and Capital Resources

As of October 2, 2016, Optex Systems Holdings had working capital of $8.6 million, as compared to $6.1 million as of September 27, 2015. During the year ended October 2, 2016, the Company experienced a net loss of ($0.2) million as compared to a net loss of $(6.0) million, and an increase in revenues of $4.3 million, or 33.1%, up to $17.3 million, from $13.0 million, as compared to the prior year ended September 27, 2015. New orders increased 26.6% to $17.6 million, as compared to new orders of $13.9 million during the prior year. Backlog has increased by $0.3 million, or 2.6% to 12.0 million over the prior year backlog. Approximately 50% of annual revenue is derived from new orders booked during the fiscal year.

U.S. military spending has been significantly reduced from the 2011 spending levels as a result a decrease in military operations in Iraq and Afghanistan and as a result of the Congressional sequestration cuts to defense spending, which began in fiscal year 2013. As a result of lower U.S. government spending, the Company has continued to explore other opportunities for manufacturing outside of our traditional product lines for products which could be manufactured using our existing lines in order to fully utilize our existing capacity. During the 2016 fiscal year, as the U.S. government The Bipartisan Budget Act of 2015 eased the strict spending caps established in the 2011 sequestration and set forth increased federal spending through the 2016 and 2017 fiscal years. We do not anticipate the recent change in the government administration to adversely affect the established spending plan set forth in the recently approved National Defense Authorization Act for 2017. Further, we continue to look for additional strategic businesses to acquire that will strengthen our existing product line, expand our operations, and enter new markets.

The Company has historically funded its operations through operations, convertible notes, common and preferred stock offerings and bank debt. The Company's ability to generate positive cash flows depends on a variety of factors, including the continued development and successful marketing of the Company's products. At October 2, 2016, the Company had approximately $2.6 million in cash and an outstanding payable balance of $0.3 million against our working line of credit. The line of credit allows for borrowing up to a maximum of $2.2 million, which fluctuates based on our open accounts receivable balance. As of October 2, 2016, our outstanding accounts receivable was $2.1 million. We expect the accounts to be collected during the first quarter of fiscal 2017. The Company expects to continue to incur net losses into the first half of fiscal year 2017, but anticipates that the 2017 fiscal year will be profitable based on projected revenue growth. Successful transition to attaining profitable operations is dependent upon achieving a level of revenue adequate to support the Company’s cost structure. Management intends to manage operations commensurate with its level of working capital and facilities line of credit during the next twelve months; however, uneven revenue levels driven by changes in customer delivery demands, first article inspection requirements or other program delays could create a working capital shortfall. In the event the Company does not successfully implement its ultimate business plan, certain assets may not be recoverable.

On August 26, 2016, we consummated a public offering of 2,291,000 Class A units consisting of common stock and warrants and 400 Class B units consisting of shares of Series C convertible stock and warrants for a total gross purchase price of $4.8 million. The net proceeds of the offering were $4.2 million after underwriter expenses. We used $0.3 million of the proceeds for offering expenses paid by Optex Systems Holdings and $1.7 million of the proceeds for the redemption of Series A and Series B preferred shares which were a condition of the offering. The remaining $2.2 million of funds will be used to fund working capital needs to support revenue growth and acquisitions.

Period from September 27, 2015 through October 2, 2016

Cash and Cash Equivalents. As of October 2, 2016, we had cash and cash equivalents of $2.6 million as compared to $0.7 million as of September 27, 2015, and increase in cash and cash equivalents of $1.9 million.

Net Cash (Used by) Provided by Operating Activities. Net cash provided by operating activities during the period beginning September 27, 2015 and ending October 2, 2016 totaled $0.2 million. The primary source of cash was collections against in accounts receivable of $0.8 million which was offset by a net loss of ($0.2) million and increases in inventory purchases associated with higher revenue of ($0.5) million and other working capital changes of $0.1 million

Net Cash (Used) by Investing Activities. In the twelve months ended October 2, 2016, cash used by investing activities was $0.0 million.

Net Cash (Used) by Financing Activities. Net cash provided by financing activities was $1.7 million during the twelve months ended October 2, 2016 due to net proceeds of $4.2 million for investments received by Optex Systems Holdings Inc., as a result of our public offering in August 2016, which was offset by ($1.7) million in cash paid for redemptions of preferred Series A and Series B shares, ($0.3) of public offering expenses paid by Optex, and ($0.5) million of cash used to pay down the line of credit. As of October 2, 2016, the outstanding line of credit balance was $0.3 million.

Critical Accounting Policies

Revenue Recognition: Optex Systems Holdings recognizes revenue based on the modified percentage of completion method utilizing the units-of-delivery method, in accordance with FASB ASC 605-35:

The units-of-delivery method recognizes as revenue the contract price of units of a basic production product delivered during a period and as the cost of earned revenue the costs allocable to the delivered units. Costs allocable to undelivered units are reported in the balance sheet as inventory or work in progress. The method is used in circumstances in which an entity produces units of a basic product under production-type contracts in a continuous or sequential production process to buyers' specifications.

Optex Systems Holdings contracts are fixed price production type contracts whereby a defined order quantity is delivered to the customer during a continuous or sequential production process tailored to the buyer's specifications (build to print). Optex Systems Holdings' deliveries against these contracts generally occur in monthly increments across fixed delivery periods spanning from 3 to 36 months.

Estimated Costs at Completion and Accrued Loss on Contracts: Optex Systems Holdings reviews and reports on the performance of its contracts and production orders against the respective resource plans for such contracts/orders. These reviews are summarized in the form of estimates at completion. Estimates at completion include Optex Systems Holdings' incurred costs to date against the contract/order plus management's current estimates of remaining amounts for direct labor, material, other direct costs and subcontract support and indirect overhead costs based on the completion status and future contractual requirements for each order.

If an estimate at completion indicates a potential overrun against budgeted resources for a fixed price contract/order, management first attempts to implement lower cost solutions that will profitably meet the requirements of the fixed price contract. If such solutions do not appear practicable, management makes a determination whether to seek renegotiation of contract or order requirements from the customer. If neither cost reduction nor renegotiation appears probable, an accrual for the contract loss/overrun is recorded against earnings and the loss is recognized in the first period the loss is identified based on the most recent estimates at completion of the particular contract or product order. As of October 2, 2016 there was $0 in contract loss reserves. As of September 27, 2015 the contract loss reserves were $54 thousand.

During 2010, Optex Systems Holdings realized increased losses against the Howitzer programs of $1.1 million of which $0.8 million related specifically to production issues encountered on our Howitzer product line. Increased losses were primarily attributable to manufacturing issues on our U.S. government Howitzer Aiming Circles culminating in higher material scrap and labor hours, combined with a reduction in total production volume in 2010 which further impacted production efficiencies across all product lines. Optex Systems Holdings requested an equitable adjustment on this program due to significant design issues impacting the manufacturability of the product. As there was no guarantee that the request would be granted in part or in full, we realized the entire loss in fiscal year 2010. The initial equitable adjustment claim was formally rejected by the contracting agency on May 31, 2012; however, Optex Systems Holdings appealed the decision with the Armed Services Board of Contract Appeals (ASBCA). In September 2015, the U.S. Government agreed to an $850,000 settlement against the claim for the Aiming Circle contract number W52H09-06-D-0229. The settlement is the result of a negotiation and fact gathering process managed through the Armed Services Board of Contract Appeals (ASBCA). A contract modification was issued on September 23, 2015 increasing the total contract price by the agreed amount. As the respective units were shipped complete in 2011, the contract was essentially complete on execution of the modification and the entire amount was recorded as revenue for the twelve months ended September 27, 2015.

Stock-Based Compensation: FASB ASC 718 establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services, but primarily focuses on transactions whereby an entity obtains employee services for share-based payments. FASB ASC 718 requires that the compensation cost relating to share-based payment transactions be recognized in the financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity’s equity instruments or that may be settled by the issuance of those equity instruments.

Optex Systems Holdings’ accounting policy for equity instruments issued to consultants and vendors in exchange for goods and services follows the provisions of FASB ASC 505-50. The measurement date for the fair value of the equity instruments issued is determined at the earlier of (i) the date at which a commitment for performance by the consultant or vendor is reached or (ii) the date at which the consultant or vendor’s performance is complete. In the case of equity instruments issued to consultants, the fair value of the equity instrument is recognized over the term of the consulting agreement. Stock-based compensation related to non-employees is accounted for based on the fair value of the related stock or options or the fair value of the services, whichever is more readily determinable in accordance with FASB ASC 718.

Beneficial Conversion Features of Convertible Securities: Conversion options that are not bifurcated as a derivative pursuant to ASC 815 and not accounted for as a separate equity component under the cash conversion guidance are evaluated to determine whether they are beneficial to the investor at inception (a beneficial conversion feature) or may become beneficial in the future due to potential adjustments. The beneficial conversion feature guidance in ASC 470-20 applies to convertible stock as well as convertible debt which are outside the scope of ASC 815. A beneficial conversion feature is defined as a nondetachable conversion feature that is in the money at the commitment date. In addition, our preferred stock issues contain conversion terms that may change upon the occurrence of a future event, such as antidilution adjustment provisions. The beneficial conversion feature guidance requires recognition of the conversion option's in-the-money portion, the intrinsic value of the option, in equity, with an offsetting reduction to the carrying amount of the instrument. The resulting discount is amortized as a dividend over either the life of the instrument, if a stated maturity date exists, or to the earliest conversion date, if there is no stated maturity date. If the earliest conversion date is immediately upon issuance, the dividend must be recognized at inception. When there is a subsequent change to the conversion ratio based on a future occurrence, the new conversion price may trigger the recognition of an additional beneficial conversion feature on occurrence.

Optex Systems Holdings has preferred stock, convertible into common shares, containing beneficial conversion features at inception as well as potential beneficial conversion features that could be triggered by future adjustments to the conversion price. Because our preferred stock is perpetual, with no stated maturity date, and the conversions may occur any time from inception, the dividend is recognized immediately when a beneficial conversion exists at issuance. During the twelve months ending September 27, 2015, Optex Systems Holdings recognized preferred stock dividends of $6.4 million on Series A and Series B preferred stock related to the beneficial conversion feature arising from a common stock conversion rate of $2.50 versus the commitment date price of $10.00 per common share (post-split). During the twelve months ending October 2, 2016, Optex Systems Holdings recognized an additional preferred stock dividend of $0.8 million as a result of the August 26, 2016 public offering which reset the preferred stock conversion rate from $2.50 per common share to $1.20 per common share and resulted in an additional beneficial conversion for the series A and Series b preferred shares.

Intangible Assets: Optex Systems Holdings has acquisition-related intangible assets which include the fair market value of customer order backlog as of the acquisition date. We determine the fair value of intangible assets using the income approach methodology of valuation that includes the discounted cash flow method as well as other generally accepted valuation methodologies, which requires some judgment by management. Amortization of acquisition-related intangible assets is expensed to total operating expenses as cost of sales and general and administrative expenses on a straight-line basis over their estimated useful lives, unless such lives are deemed indefinite. Amortizable intangible assets are tested for impairment based on undiscounted cash flows and, if impaired, written down to fair value based on either discounted cash flows or appraised values. The residual values and useful lives are reviewed at each balance sheet date and adjusted, if appropriate. Optex Systems Holdings identified intangible assets of $342 thousand from the acquisition of the Applied Optics Center from L3 on November 3, 2014 which consisted primarily of customer backlog, with an initial useful life of less than one year. As of October 2, 2016 the unamortized balance of the intangible assets was zero. See Note 6.

Intangible assets with indefinite lives are tested annually for impairment, during the fiscal fourth quarter and between annual periods, if impairment indicators exist, and are written down to fair value as required.

Income Tax/Deferred Tax: FASB ASC 740 requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on differing treatment of items for financial reporting and income tax reporting purposes. The deferred tax balances are adjusted to reflect tax rates by tax jurisdiction, based on currently enacted tax laws, which will be in effect in the years in which the temporary differences are expected to reverse. Under FASB ASC 740, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided for certain deferred tax assets if it is more likely than not that Optex Systems Holdings will not realize tax assets through future operations. When assessing the recoverability of deferred tax assets, management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies. Based on those estimates, management has determined that the deferred tax assets may not be realized and has established a valuation allowance against the deferred tax asset balance. As of October 2, 2016 Optex Systems Inc. has a deferred tax asset valuation allowance of ($4.7) million against deferred tax assets of $4.7 million.

Recent Accounting Pronouncements

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"). ASU 2016-15 reduces diversity in practice in how certain transactions are classified in the statement of cash flows. The amendments in ASU 2016-15 provide guidance on specific cash flow issues including debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, and distributions received from equity method investees. ASU 2016-15 is effective for annual and interim periods beginning after December 15, 2017. We are currently assessing the potential impact of ASU 2016-15 on our consolidated financial statements and results of operations.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (“ASU 2016-13”). ASU 2016-13 changes the impairment model for most financial assets and certain other instruments, including trade and other receivables, held-to-maturity debt securities and loans, and requires entities to use a new forward-looking expected loss model that will result in the earlier recognition of allowance for losses. This update is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for a fiscal year beginning after December 15, 2018, including interim periods within that fiscal year. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. We are currently assessing the potential impact of ASU 2016-13 on our consolidated financial statements and results of operations.

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-09 amending several aspects of share-based payment accounting. This guidance requires all excess tax benefits and tax deficiencies to be recorded in the income statement when the awards vest or are settled, with prospective application required. The guidance also changes the classification of such tax benefits or tax deficiencies on the statement of cash flows from a financing activity to an operating activity, with retrospective or prospective application allowed. Additionally, the guidance requires the classification of employee taxes paid when an employer withholds shares for tax-withholding purposes as a financing activity on the statement of cash flows, with retrospective application required. This ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. Early adoption is permitted. We are currently evaluating the impact of the new guidance on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net) (“ASU 2016-08”). ASU 2016-08 does not change the core principle of Topic 606 but clarifies the implementation guidance on principal versus agent considerations. ASU 2016-08 is effective for the annual and interim periods beginning after December 15, 2017. We are currently assessing the potential impact of ASU 2016-08 on our consolidated financial statements and results of operations.

In February 2016, FASB issued ASU 2016-02—*Leases (Topic 842).* The update is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application of the amendments in this update is permitted. Optex Systems Holdings is currently evaluating the impact of FASB ASU 2016-02 and expects the adoption thereof will have a material effect on Optex Systems Holdings’ presentation of balance sheet assets and liabilities based on the present value of future lease payments, but does not expect a material effect on the presentation of expenses and cash flows

In July 2015, FASB issued ASU 2015-11—*Inventory (Topic 330): “Simplifying the Measurement of Inventory”.* The update is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The amendments in this Update should be applied prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. The update is part of FASB's Simplification Initiative, the objective of which is to identify, evaluate, and improve areas of generally accepted accounting principles (GAAP) for which cost and complexity can be reduced. Pursuant to the update, an entity should measure inventory at the lower of cost and net realizable value. The amendments in the update more closely align the measurement of inventory in GAAP with the measurement of inventory in International Financial Reporting Standards (IFRS). . Optex Systems Holdings is currently evaluating the impact of FASB ASU 2015-11 but does not expect the adoption thereof to have a material effect on Optex Systems Holdings' financial statements.

In August 2015, FASB Issued ASU 2015-14—"Revenue from Contracts with Customers (Topic 606): *Deferral of the Effective Date"* The amendments in this update defer the effective date of ASU 2014-09 for all entities by one year. Public business entities should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. See also ASU 2014-09 issued in May 2014.

In August 2014, FASB issued ASU 2014-15—Presentation of Financial Statements—Going Concern (ASC Subtopic 205-40): *"Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern"*. The update requires management to assess a company's ability to continue as a going concern and to provide related footnote disclosures in certain circumstances. All entities are required to apply the new requirements in annual periods ending after December 15, 2016, and interim periods thereafter. Early application is permitted. As such, Optex Systems Holdings is required to adopt these provisions for the annual period ending October 1, 2017. Optex Systems Holdings is currently evaluating the impact of FASB ASU 2014-15 but does not expect the adoption thereof to have a material effect on Optex Systems Holdings' financial statements.

In May 2014, FASB issued ASU 2014-09—Revenue from Contracts with Customers (Topic 606): *“Section A—Summary and Amendments That Create Revenue from Contracts with Customers, (Topic 606) and Other Assets and Deferred Costs—Contracts with Customers (Subtopic 340-40), Section B—Conforming Amendments to Other Topics and Subtopics in the Codification and Status Tables, Section C—Background Information and Basis for Conclusions”*. The guidance in this update affects any entity that enters into contracts with customers to transfer goods or services and supersedes the revenue recognition requirements in Topic 605, Revenue Recognition. The update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. As such, Optex Systems Holdings is required to adopt these provisions as of October 2, 2017, the beginning of the annual period ending September 30, 2018 and at the beginning of all interim periods ending after October 1, 2017. Optex Systems Holdings is currently evaluating the impact of FASB ASU 2014-09 but does not expect the adoption thereof to have a material effect on Optex Systems Holdings’ financial statements. See also ASU 2015-14 issued in August, 2015.

Cautionary Factors That May Affect Future Results

This Report on Form 10-K and other written reports and oral statements made from time to time by Optex Systems Holdings may contain so-called “forward-looking statements,” all of which are subject to risks and uncertainties. You can identify these forward-looking statements by their use of words such as “expects,” “plans,” “will,” “estimates,” “forecasts,” “projects” and other words of similar meaning. You can identify them by the fact that they do not relate strictly to historical or current facts. These statements are likely to address Optex Systems Holdings’ growth strategy, financial results and product and development programs. You must carefully consider any such statement and should understand that many factors could cause actual results to differ from Optex Systems Holdings’ forward-looking statements. These factors include inaccurate assumptions and a broad variety of other risks and uncertainties, including some that are known and some that are not. No forward-looking statement can be guaranteed and actual future results may vary materially.

We do not assume the obligation to update any forward-looking statement. You should carefully evaluate such statements in light of factors described in this annual report. In this annual report Optex Systems Holdings has identified important factors that could cause actual results to differ from expected or historic results. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider any such list to be a complete list of all potential risks or uncertainties.

Item 8 Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and

Stockholders of Optex Systems Holdings, Inc.

Richardson, Texas

We have audited the accompanying consolidated balance sheets of Optex Systems Holdings, Inc. (the Company) as of October 2, 2016 and September 27, 2015, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended. The Company's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Optex Systems Holdings, Inc. as of October 2, 2016, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/PMB Helin Donovan, LLP

PMB Helin Donovan, LLP

December 22, 2016

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Optex Systems Holdings, Inc.

Condensed Consolidated Balance Sheets

	(Thousands, except share data)	
	October 2, 2016	September 27, 2015
ASSETS		
Current Assets		
Cash and Cash Equivalents	$ 2,568	$ 683
Accounts Receivable, Net	2,095	2,866
Net Inventory	6,214	5,713
Prepaid Expenses	120	170
Current Assets	10,997	9,432
Property and Equipment, Net	1,651	1,971
Other Assets		
Prepaid Royalties - Long Term	90	120
Security Deposits	23	23
Other Assets	113	143
Total Assets	$ 12,761	$ 11,546
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts Payable	$ 706	$ 575
Accrued Expenses	810	812
Accrued Warranties	28	28
Customer Advance Deposits - Short Term	559	1,091
Credit Facility	300	817
Current Liabilities	2,403	3,323
Customer Advance Deposits - Long Term	-	65
Total Liabilities	2,403	3,388
Stockholders' Equity		
	-	-

Preferred Stock Series A ($0.001 par 5,000 authorized, 0 and 1,001 issued and outstanding, respectively)		
Preferred Stock Series B ($0.001 par 1,010 authorized, 0 and 994 issued and outstanding, respectively)	-	-
Preferred Stock Series C ($0.001 par 400 authorized, 360 and 0 issued and outstanding, respectively)	-	-
Common Stock – ($0.001 par, 2,000,000,000 authorized, 8,266,601 and 314,867 shares issued and outstanding, respectively)	8	-
Additional Paid-in-capital	29,583	26,394
Accumulated Deficit	(19,233)	(18,236)
Stockholders' Equity	10,358	8,158
Total Liabilities and Stockholders' Equity	$ 12,761	$ 11,546

The accompanying notes are an integral part of these financial statements

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Optex Systems Holdings, Inc.

Consolidated Statements of Operations

	(Thousands, except share data) Twelve months ended October 2, 2016	September 27, 2015
Revenue	$ 17,279	$ 13,003
Cost of Sales	14,228	11,617
Gross Margin	3,051	1,386
General and Administrative Expense	3,251	2,826
Operating Income (Loss)	(200)	(1,440)
Gain on Purchased Asset	-	2,110
Interest Income (Expense)	(36)	(179)
Other (Expense) and Income	(36)	1,931
Income (Loss) Before Taxes	(236)	491
Current Income Taxes (Benefit)	-	-
Deferred Income Taxes (Benefit)	-	-
Net Income (Loss) After Taxes	(236)	491
Preferred stock dividend/premium	(761)	(6,441)
Net income (loss) applicable to common shareholders	$ (997)	$ (5,950)
Basic and diluted income (loss) per share	$ (0.64)	$ (19.06)
Weighted Average Common Shares Outstanding - basic and fully diluted	1,546,774	312,219

The accompanying notes are an integral part of these financial statements

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Optex Systems Holdings, Inc.

Consolidated Statements of Cash Flows

	(Thousands) Twelve months ended October 2, 2016	September 27, 2015
Cash flows from operating activities:		
Net (loss) income	$ (236)	$ 491
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	345	334
Noncash interest expense	(17)	154
Stock compensation expense	192	140
Provision for inventory valuation	60	247
Loss on sale of fixed assets	5	-
(Increase) decrease in accounts receivable	771	(2,135)
(Increase) decrease in inventory (net of progress billed)	(562)	(49)
(Increase) decrease in prepaid expenses	51	(130)
(Increase) decrease in security deposits	-	3
Increase (decrease) in accounts payable and accrued expenses	129	622
Increase (decrease) in accrued warranty costs	-	3
Decrease in prepaid royalties - long term	30	30
Increase (decrease) in customer advance deposits	(597)	(898)
Total adjustments	407	(1,679)
Net cash provided by (used in) operating activities	171	(1,188)
Cash flows from investing activities		
Purchases of property and equipment	(34)	(2,100)
Proceeds from sale of fixed assets	4	-
Net cash used in investing activities	(30)	(2,100)
Cash flows from financing activities		
Net proceeds from sale of common stock	4,247	-
Redemption of preferred stock	(1,751)	-
Deferred public offering costs	(252)	-
Proceeds from convertible notes issued	-	1,560
Debt issuance fees	-	(74)
Proceeds (to) from credit facility (net)	(500)	800
Net cash provided by financing activities	1,744	2,286

Net increase (decrease) in cash and cash equivalents	1,885	(1,002)
Cash and cash equivalents at beginning of period	683	1,685
Cash and cash equivalents at end of period	$ 2,568	$ 683
Supplemental cash flow information:		
Cash paid for interest	$ 53	$ 25
Exchange of convertible note and accrued interest to series B preferred stock	-	1,629
Beneficial conversion feature on Series A and Series B preferred stock	761	6,441
Exchange of preferred stock for common stock	6,939	10

The accompanying notes are an integral part of these financial statements

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Optex Systems Holdings, Inc.

Consolidated Statement of Stockholders' Equity

(Thousands, except share data)

	Common Shares Outstanding	Series A Preferred Shares	Series B Preferred Shares	Series C Preferred Shares	Common Stock	Preferred Series A Stock	Preferred Series B Stock	Additional Paid in Capital	Retained Earnings	Total Stockholders Equity
Balance at September 28, 2014 (post split(1))	310,867	1,001	-	-	$ -	$ -	$ -	$ 18,184	$(12,286)	$ 5,898
Stock Option Compensation Expense	-	-	-	-	-	-	-	140	-	140
Preferred Series B Issued in Exchange of Convertible Notes	-	-	1,000	-	-	-	-	1,629	-	1,629
Conversion of Preferred Series B	4,000	-								