PRECISION OPTICS Corp INC
Form 10-Q
November 14, 2011

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

FORM 10-Q

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

For the quarterly period ended September 30, 2011

or

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

For the transition period from to

Commission File Number: 001-10647

PRECISION OPTICS CORPORATION, INC.
(Exact name of registrant as specified in its charter)

Massachusetts	04-2795294
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

22 East Broadway, Gardner, Massachusetts 01440-3338
(Address of principal executive offices) (Zip Code)

(978) 630-1800
(Registrant’s telephone number, including area code)

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

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 o

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 o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

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

The number of shares outstanding of the issuer's common stock, par value $0.01 per share, at November 14, 2011 was 1,245,339 shares.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	September 30, 2011	June 30, 2011
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$1,788,473	$19,556
Accounts Receivable, net	232,169	148,824
Inventories, net	661,701	666,285
Prepaid Expenses	83,145	37,664
Total Current Assets	2,765,488	872,329
PROPERTY AND EQUIPMENT		
Machinery and Equipment	2,355,968	2,355,968
Leasehold Improvements	553,596	553,596
Furniture and Fixtures	148,303	148,303
Vehicles	19,674	19,674
	3,077,541	3,077,541
Less: Accumulated Depreciation	(3,020,153)	(3,015,315)
Net Property and Equipment	57,388	62,226
OTHER ASSETS		
Patents, net	-	188,260
TOTAL ASSETS	$2,822,876	$1,122,815
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES		
10% Senior Secured Convertible Notes	$795,833	$780,833
Accounts Payable	476,921	709,395
Customer Advances	19,779	36,292
Accrued Employee Compensation	684,712	711,015
Accrued Professional Services	4,822	54,000
Accrued Warranty Expense	25,000	25,000
Other Accrued Liabilities	-	912
Total Current Liabilities	2,007,067	2,317,447
STOCKHOLDERS' EQUITY (DEFICIT)		
Common Stock, $0.01 par value -		
Authorized - 50,000,000 shares		
Issued and Outstanding – 971,013 shares at September 30, 2011 and at June 30, 2011, respectively	9,710	9,710
Additional Paid-in Capital	38,271,029	38,259,029
Accumulated Deficit	(37,464,930)	(39,463,371)
Total Stockholders' Equity (Deficit)	815,809	(1,194,632)

TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY (DEFICIT)	$2,822,876	$1,122,815

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

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED
SEPTEMBER 30, 2011 AND 2010
(UNAUDITED)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010
Revenues	$504,749	$683,902
Cost of Goods Sold	365,455	331,665
Gross Profit	139,294	352,237
Research and Development Expenses, net	151,190	227,494
Selling, General and Administrative Expenses	253,356	279,772
Gain on Sale of Assets	(2,050)	(12,053)
Total Operating Expenses	402,496	495,213
Operating Loss	(263,202)	(142,976)
Gain on Sale of Patents	2,276,286	-
Interest Income	357	130
Interest Expense	(15,000)	(15,000)
Net Income (Loss)	$1,998,441	$(157,846)
Income (Loss) Per Share:		
Basic	$2.06	$(0.15)
Diluted	$1.15	$(0.15)
Weighted Average Common Shares Outstanding:		
Basic	971,013	1,018,411
Diluted	1,749,339	1,018,411

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

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED
SEPTEMBER 30, 2011 AND 2010
(UNAUDITED)

	Three Months Ended September 30, 2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income (Loss)	$1,998,441	$(157,846)
Adjustments to Reconcile Net Loss to Net Cash		
Used In Operating Activities -		
Depreciation and Amortization	7,937	14,645
Gain on Sale of Patents	(2,276,286)	-
Gain on Sale of Assets	(2,050)	(12,053)
Stock-based Compensation Expense	12,000	3,176
Non-cash Interest Expense	15,000	15,000
Changes in Operating Assets and Liabilities-		
Accounts Receivable, net	(83,345)	34,080
Inventories	4,584	21,793
Prepaid Expenses	(45,481)	(9,000)
Accounts Payable	(232,474)	11,074
Customer Advances	(16,513)	(49,500)
Accrued Expenses	(76,393)	(29,750)
Net Cash Used In Operating Activities	(694,580)	(158,381)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net Proceeds from Sale of Patents	2,463,171	-
Proceeds from Sale of Assets	2,050	12,053
Additional Patent Costs	(1,724)	(3,304)
Net Cash Provided By Investing Activities	2,463,497	8,749
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,768,917	(149,632)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	19,556	416,040
CASH AND CASH EQUIVALENTS, END OF PERIOD	$1,788,473	$266,408
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash Paid for Income Taxes	$912	$912

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

PRECISION OPTICS CORPORATION, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Operations

The accompanying consolidated financial statements include the accounts of Precision Optics Corporation, Inc. and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. All shares and per share data reflect the 1-for-25 reverse stock split that became effective on December 11, 2008.

These consolidated financial statements have been prepared by the Company, without audit, and reflect normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the results of the first quarter of the Company's fiscal year 2012. These consolidated financial statements do not include all disclosures associated with annual consolidated financial statements and, accordingly, should be read in conjunction with footnotes contained in the Company's consolidated financial statements for the year ended June 30, 2011 together with the Report of Independent Registered Public Accounting Firm filed under cover of the Company's 2011 Annual Report on Form 10-K.

Use of Estimates

The preparation of these consolidated financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Income (Loss) Per Share

Basic income (loss) per share is computed by dividing net income or net loss by the weighted average number of shares of common stock outstanding during the period. Diluted income (loss) per share is computed by dividing net income or net loss (adjusted by adding back interest expense on senior convertible notes) by the weighted average number of shares of common stock outstanding during the period, plus the number of potentially dilutive securities outstanding during the period such as stock options and warrants, shares issuable upon conversion of senior convertible notes and shares issuable to satisfy deferred compensation and consulting obligations. For the three months ended September 30, 2010, the effect of such securities was antidilutive and not included in the diluted calculation because of the net loss generated in that period.

Following is the calculation of income (loss) per share for the three months ended September 30, 2011 and 2010:

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010
Net Income (Loss) – Basic	$1,998,441	$ (157,846)
Interest Expense on Senior Convertible Notes	15,000	-
Net Income (Loss) – Diluted	$2,013,441	$ (157,846)

Basic Weighted Average Shares Outstanding	971,013	1,018,411
Potentially Dilutive Securities	778,326	-
Diluted Weighted Average Shares Outstanding	1,749,339	1,018,411
Income (Loss) Per Share		
Basic	$2.06	$ (0.15)
Diluted	$1.15	$ (0.15)

The number of shares issuable upon the exercise of outstanding stock options and warrants that were excluded from the computation as their effect was antidilutive was approximately 1,112,000 and 1,012,000 for the three months ended September 30, 2011 and 2010, respectively.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. 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.

In assessing the likelihood of utilization of existing deferred tax assets, management has considered historical results of operations and the current operating environment. Based on this evaluation, a full valuation reserve has been provided for the deferred tax assets.

2. INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out) or market and consist of the following:

	September 30, 2011	June 30, 2011
Raw Materials	$256,115	$271,608
Work-In-Progress	324,030	312,097
Finished Goods	81,556	82,580
Total Inventories	$661,701	$666,285

3. 10% SENIOR SECURED CONVERTIBLE NOTES

On June 25, 2008, the Company entered into a Purchase Agreement, as amended on December 11, 2008, with institutional and other accredited investors (the “Investors”) pursuant to which it sold a total of $600,000 of 10% Senior Secured Convertible Notes (the “Notes”) that are convertible at the Investor’s option into a total of 480,000 shares of the Company’s common stock at a conversion rate of $1.25. The Company also issued warrants to purchase a total of 316,800 shares of its common stock at an exercise price of $1.75 per share (the “Warrants”). Interest accrues on the Notes at a rate of 10% per year and is payable in cash upon the earlier of conversion or maturity of the Notes. The original maturity of the Notes was June 25, 2010 and the Warrants expire on June 25, 2015, subject to extension. By mutual agreement with the Company, the Investors have since amended the Notes on several dates to extend the “Stated Maturity Date” of the Notes. On October 31, 2011, the Investors further amended the Notes to extend the “Stated Maturity Date” to December 15, 2011. The conversion price of the Notes and the exercise price of the Warrants may be adjusted downward in the event the Company issues shares of common stock or securities convertible into common stock at a price lower than the conversion price of the Notes or exercise price of the Warrants at the time of issuance.

Pursuant to the Purchase Agreement, the Notes and Warrants were not convertible or exercisable until the Company implemented a 1 for 6 reverse stock split, which required the approval of its stockholders. On November 25, 2008, the Company entered into a Side Letter Agreement in which the Investors agreed to change the ratio of the reverse split from 1 for 6 to 1 for 25. On December 11, 2008, the Company effected a 1 for 25 reverse split of its common stock.

Pursuant to a Registration Rights Agreement entered into with the Investors on June 25, 2008, the Company agreed to file a registration statement with the Securities and Exchange Commission by the earlier of (i) two days following the effectiveness of the amendment to implement a reverse stock split and (ii) December 15, 2008, to register the resale of the common stock issuable upon the conversion of the Notes and the exercise of the Warrants. The Company agreed to keep the registration statement effective until the earlier of (i) the date on which all the securities covered by the registration statement, as amended from time to time, have been sold and (ii) the date on which all the securities covered by such registration statement may be sold without restriction pursuant to Rule 144 of the Securities Act of 1933.

The Notes contain covenants binding on the Company and certain events of default, including but not limited, to:

- the failure of the Company to make a scheduled payment;
- the failure of the Company to make payments in excess of $100,000 on any liability or obligation, or if there is an acceleration of the stated maturity of any liability or obligation in excess of $100,000; or
- the Company entering bankruptcy.

If an event of default occurs and is uncured within the allowable grace period, if any, the Investors may declare all amounts under the Notes immediately due and payable and may pursue any other available remedies.

The 10% Senior Secured Convertible Notes consist of the following:

	September 30, 2011	June 30, 2011
10% Senior Secured Convertible Notes issued on June 25, 2008, convertible into common stock at $1.25 per share, bearing interest at 10% per annum. Outstanding principal and accrued interest are due at maturity, December 15, 2011	$600,000	$600,000
Accrued interest—10% coupon	195,833	180,833
	$795,833	$780,833

4. STOCK-BASED COMPENSATION

Stock-based compensation costs recognized during each of the three month periods ended September 30, 2011 and 2010 amounted to $12,000 and $3,176, respectively, and were included in the accompanying consolidated statements of operations in: selling, general and administrative expenses (2011 - $7,500; 2010 - $0), and cost of goods sold (2011 - $4,500, 2010 - $3,176). No compensation has been capitalized because such amounts would have been immaterial. There was no net income tax benefit recognized related to such compensation for the three month periods ended September 30, 2011 and 2010 because of (1) the availability of loss carryforwards to offset any anticipated taxable income in fiscal year 2012, and (2) the loss incurred in the first quarter of fiscal year 2011.

The following tables summarize stock option activity during the first three months of fiscal year 2012:

		Options Outstanding	
	Number of Shares	Weighted Average Exercise Price	Weighted Average Contractual Life
Outstanding at June 30, 2011	94,138	$ 15.97	4.50 years
Grants	40,000	0.27	
Outstanding at September 30, 2011	134,138	$ 11.30	&#16