

Optex Systems Holdings Inc  
Form S-1/A  
July 06, 2012

As filed with the Securities and Exchange Commission on July 6, 2012    Registration Statement No. 333-173502

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**AMENDMENT NO. 7 TO REGISTRATION STATEMENT**

**ON FORM S-1 UNDER**

**THE SECURITIES ACT OF 1933**

**OPTEX SYSTEMS HOLDINGS, INC.**

(Exact name of registrant as specified in its charter)

Delaware	90-0609531	3795
(State or other jurisdiction of incorporation or organization)	(I.R.S. Identification Number)	(Primary Standard Industrial Classification Code Number)

1420 Presidential Drive

Richardson, TX 75081-2439

Telephone (972) 644-0722

(Address, including zip code, and telephone number, including  
area code, of registrant's principal executive offices)

Stanley A. Hirschman

1420 Presidential Drive

Richardson, TX 75081-2439

Telephone (972) 644-0722

(Name, address, including zip code, and telephone number,  
including area code, of agent for service)

Copies to:

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**Approximate Date of Commencement of Proposed Sale to the Public:** At such time or times after the effective date of this registration statement as we may determine. This offering is made to U.S. residents only.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. "

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

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 "small reporting company" in Rule 12b-2 of the Exchange Act.

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

**CALCULATION OF REGISTRATION FEE**

Title of Each Class of Securities to be Registered	Amount to be Registered	Proposed Maximum Offering Price per unit(1)	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee
Common Stock, par value \$0.001 per share (3)(4)	25,000,000	\$ 0.01	\$ 250,000	\$ 29.03

The offering price has been arbitrarily determined by the Company and bears no relationship to assets, earnings, or (1) any other valuation criteria. No assurance can be given that the shares offered hereby will have a market value or that they may be sold at this, or at any price.

(2) Estimated for the purpose of determining the registration fee pursuant to Rule 457(a). All shares offered hereunder shall be at a fixed price of \$.01 per share.

(3) The offering will conclude at the earlier of the sale for all shares or 90 days after this registration statement becomes effective with the Securities and Exchange Commission.

(4) An indeterminate number of additional shares of common stock shall be issuable pursuant to Rule 416 to prevent dilution resulting from stock splits, stock dividends or similar transactions and in such an event the number of shares registered shall automatically be increased to cover the additional shares in accordance with Rule 416 under the Securities Act.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act or until this registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

The information in the prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell and is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

Subject to Completion, dated July 6, 2012

PROSPECTUS

OPTEX SYSTEMS HOLDINGS, INC.

**25,000,000 Shares of Common Stock**

This prospectus relates to the offer and sale of up to 25,000,000 shares of common stock of Optex Systems Holdings, Inc., a Delaware corporation, to be offered to the public.

The offering of the 25,000,000 shares is a "best efforts" offering, which means that our directors and officers will use their best efforts to sell the common stock and there is no commitment by any person to purchase any shares. The shares will be offered at a fixed price of \$0.01 per share for the duration of the offering. There is no minimum number of shares required to be sold to close the offering. This offering will continue for the earlier of: (i) 90 days after this registration statement becomes effective with the Securities and Exchange Commission, or (ii) the date on which all 25,000,000 shares registered hereunder have been sold. We may at our discretion extend the offering for an additional 90 days. Proceeds from the sale of the shares will be used to fund the initial stages of our business development. This offering will end no later than six (6) months from the offering date. The offering date is the date by which this registration statement becomes effective. This is a direct participation offering since our officers and directors, and not an underwriter, are offering the stock under an exemption from the broker requirements available under Rule 3a4-1, as amended, promulgated under the Securities Exchange Act of 1934, which exempts officers and directors offering our common stock from broker registration requirements under the Securities Exchange Act of 1934. Funds raised under this offering will not be held in trust or in any escrow account, and all funds raised regardless of the amount will be available to us. We will incur offering expenses even if we are unable to sell any shares of common stock under this registration, and there is no guarantee that any amount of common stock will be sold hereunder. Please refer to "Risk Factors", "Use of Proceeds" and "Plan of Distribution" in this Prospectus for further information.

SHARES OFFERED BY COMPANY	PRICE TO PUBLIC	SELLING AGENT COMMISSIONS	PROCEEDS TO THE COMPANY
Per Share	\$0.01	Not applicable	\$0.01
Minimum Purchase	None	Not applicable	Not applicable
Total (25,000,000 shares)	\$250,000	Not applicable	\$250,000

On May 1, 2009, our common stock received a symbol change from FINRA and now trades on the Over the Counter Bulletin Board under the symbol "OPXS.OB". The closing sale price on the OTC Bulletin Board on May 25, 2012, was \$0.01 per share.

**Investing in the common stock offered by this prospectus is speculative and involves a high degree of risk. See “Risk Factors” commencing on p. 6 in this prospectus.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.**

The date of this prospectus is July 6, 2012

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## **ABOUT THIS PROSPECTUS**

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission using the Commission's registration rules for a delayed or continuous offering and sale of securities. Under the registration rules, using this prospectus and, if required, one or more prospectus supplements, we may distribute the shares of common stock covered by this prospectus. This prospectus also covers any shares of common stock that may become issuable as a result of stock splits, stock dividends or similar transactions.

A prospectus supplement may add, update or change information contained in this prospectus. We recommend that you read carefully this entire prospectus, especially the section entitled "Risk Factors" and any supplements before making a decision to invest in our common stock.

## **PROSPECTUS SUMMARY**

*This summary highlights important information about this offering and our business. It does not include all information you should consider before investing in our common stock. Please review this prospectus in its entirety, including the risk factors and our financial statements and the related notes, before you decide to invest.*

### **Our Company**

### **Organizational History**

On March 30, 2009, Optex Systems Holdings, Inc. (formerly known as Sustut Exploration, Inc.), a Delaware corporation, along with Optex Systems, Inc. (Delaware), which was a privately held Delaware corporation that has since become Optex Systems Holdings' wholly-owned subsidiary, entered into a reorganization agreement and plan of reorganization, pursuant to which Optex Systems, Inc. (Delaware) was acquired by Optex Systems Holdings in a share exchange transaction. At the closing of the reorganization, the registrant 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) has remained a wholly-owned subsidiary of Optex Systems Holdings, and Optex Systems, Inc. (Delaware)'s shareholders are now shareholders of Optex Systems Holdings.

Immediately prior to the closing under this reorganization agreement and plan of reorganization, as of March 30, 2009, Optex Systems, Inc. (Delaware) accepted subscriptions from accredited investors for a total of \$1,219,750 in gross proceeds and \$874,529 in net proceeds.

Previously, on October 14, 2008, in a transaction that was consummated via public auction, Optex Systems, Inc. (Delaware) purchased all of the assets of Optex Systems, Inc. (Texas) in exchange for \$15 million of Irvine Sensors Corporation debt and the assumption of approximately \$3.8 million of certain liabilities of Optex Systems, Inc. (Texas). Optex Systems, Inc. (Delaware) was formed by the Longview Fund, LP and Alpha Capital Antstalt, former secured creditors of Irvine Sensors Corporation, to consummate the October 2008 transaction, and subsequently, on February 20, 2009, Longview Fund conveyed its ownership interest in Optex Systems Holdings to Sileas Corporation, an entity owned by three of Optex Systems Holdings' officers (one of whom is also one of Optex Systems Holdings' three directors).

## **Our Business**

Optex Systems Holdings manufactures optical sighting systems and assemblies primarily for United States Department of Defense applications. Optical sighting systems are used to enable a soldier to have improved vision and in some cases, protected vision. One type of system would be a binocular which would have a special optical filter applied to the external lens which would block long wave length light (from a laser) from reaching the soldier's eyes. Another type of system would be a periscope where the soldier inside an armored vehicle needs to view the external environment outside of the tank. In this case, the visual path is reflected at two 90 degree angles enabling the soldier to be at a different plane than that of the external lens.

Optex Systems Holdings recorded a net loss applicable to common shareholders of \$(0.01) million during the six months ended April 1, 2012. In the fiscal years ending October 2, 2011 and October 3, 2010, Optex Systems Holdings recorded a net income applicable to common shareholders of \$0.2 million and a net loss applicable to common shareholders of (\$10.0) million respectively. As of April 1, 2012 Optex Systems Holdings accumulated deficit is (\$10.1) million.

For the year ended October 2, 2011, we derived approximately 95% of the gross business revenue from four customers, with 67% from General Dynamics Land Systems Divisions, 18% from TACOM, 6% from DLA, and 4% from BAE Systems. Procuring new customers and contracts may partially mitigate this risk. In particular, a decision by either General Dynamics Land System Divison or Tank-automotive and Armaments Command or DLA/Warren to cease issuing contracts to us could have a significant material impact on our business and results of operations given that they represent 95% of our gross business revenue. There can be no assurance that we could replace these customers on a timely basis or at all.

The following table describes the approximate percentage of revenue represented by the types of systems mentioned in the third and fourth sentences of the above paragraph. The table below reflects approximate product revenues for the year ended October 2, 2011 and is a balanced overview of our business based on the percentages.

	% of Revenue	
Howitzer Programs	28	%
Periscope Programs	64	%
All Other	8	%
Total	100	%

Optex Systems Holdings' products consist primarily of build-to-customer print products that are delivered both directly to the armed services and to other defense prime contractors. Build-to-customer print products are those devices where the customer completes the design of the product and then brings these drawings to the supplier for production. In this case, the supplier would procure the piece parts from suppliers, build the final assembly, and then supply this product back to the original customer who designed it.

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. Optex Systems Holdings also manufactures and delivers numerous periscope configurations, rifle and surveillance sights and night vision optical assemblies. Approximately 39% of our current revenue is in support of Abrams vehicles, 29% in support of Stryker vehicles, and 3% in support of Bradley vehicles (all percentages in this sentence for the year ended October 2, 2011). The products that we produce can be used on other vehicles; however, they were originally designed for the Abrams, the Bradley, and the Stryker vehicles. In addition, some of the periscopes that we produce can be used on both the Bradley and the Stryker vehicle. Finally, some customers combine their volumes for new vehicles with those requirements for replacement parts for vehicles coming back from the field. At this time, no vehicle generates more revenues than the Stryker vehicle other than the Abrams and Bradley vehicles.

Optex Systems, Inc. (Delaware), and its predecessor, Optex Systems, Inc. (Texas), have been in business since 1987. Optex Systems Holdings is located in Richardson, TX and is ISO 9001:2008 certified.

## The Offering

Common stock offered by us: 25,000,000 shares of common stock, par value \$0.001 per share.

Offering prices: The shares offered by this prospectus shall be \$0.01 per share.

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Common stock  
outstanding: 144,444,940 shares as of May 25, 2012.

Dividend policy: Dividends on our common stock may be declared and paid when and as determined by our board of directors. We have not paid and do not expect to pay dividends on our common stock.

OTCBB symbol: OPXS.OB

Use of proceeds: We will use the proceeds from this offering to finance sales and marketing and program development needs. Offering expenses of \$11,029 are being paid directly by us in connection with the offering.

Minimum Number of Shares Offered: None.

Termination of the Offering: This offering will terminate upon the earlier to occur of (i) 90 days after this registration statement becomes effective with the Securities and Exchange Commission, or (ii) the date on which all 25,000,000 shares registered hereunder have been sold. We may, at our discretion, extend the offering for an additional 90 days. In any event, the offering will end within six months of this Registration Statement being declared effective.

Terms of the Offering: Our officers and directors will sell the common stock upon effectiveness of this registration statement on a best efforts basis. There is no minimum offering amount, and there will be no proceeds held in escrow. We will incur our offering expenses regardless of whether any securities are sold hereunder.

In order to accommodate the number of shares being offered and to have adequate numbers of shares to effect further future offerings and for other purposes, such as having shares available for acquiring synergistic business concerns, we also intend to obtain the consent of our shareholders to increase our authorized shares of common stock to 2 billion, as well as offering our warrant holders the right for a period of 30 days following the date of effectiveness of this registration statement the right to exercise their warrants at a reduced price of \$.01 per share, which if fully exercised would result in an additional \$99,487 raised (with all warrants not so exercised reverting to their original exercise price at the end of the 30 day period). Also, our preferred shareholders have agreed to waive our obligation to pay existing (in exchange for an increase in the per share stated value of the Series A preferred stock to \$6,860.34) and future dividends on their shares of preferred stock thereafter in conjunction with the reduction in their per share conversion price to \$0.01 triggered by the February 22, 2012 private sale of 50,000,000 shares of our common stock at a price of \$.01 per share. As a result of the post-offering reduction in exercise price of our warrants to \$.01 per share for 30 days and the resulting permanent decrease in the conversion price of our Series A preferred stock from \$.15 per share to \$.01 per share, the number of shares of common stock which can be received by both our warrant holders and holders of Series A preferred stock before and after giving effect to the offering (and for the preferred stock, the increase in the stated value thereof) set forth in this prospectus are set forth in the below table. Note that given the high level of dilution to be experienced, it is likely that this will cause a material adverse effect upon the price at which shares of our Common Stock are quoted on the OTC Bulletin Board.

Security	Pre-Offering Per Share Exercise/Conversion Price	Number of Shares	Post-Offering per Share Exercise/Conversion Price	Number of Shares	Percentage Dilution to Common Stockholders as a Result of Decrease in Exercise/Conversion Price
Warrants	\$ .45	8,131,667	\$ .01	(1) 8,131,667	0 %

Series A preferred stock	\$ .15	41,080,000	\$ .01	704,556,918	94.17	%
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(1) This \$.01 exercise price shall only be in effect for 30 days from the date of effectiveness of this registration statement.

**Risk Factors**

See “Risk Factors” for a full discussion of factors you should carefully consider before deciding to invest in our common stock. Among other risk factors and other information, we suggest that you consider the following:

- We anticipate that we will have to raise additional funding in the future to finance our future working capital needs and service debt (should we incur any in the future);
- Two customers represent approximately 84% of our revenue and the loss of either could result in a material adverse effect on our business and operations;
- 73.52% (approximately) of our issued and outstanding common stock is controlled by one of our officers and directors;
  - All of the stock owned by that officer and director has been pledged to secure an obligation of an entity which is controlled by that officer and director and an inability to pay that note when due could result in a change in control in Optex Systems Holdings; and
- Our gross revenues declined 29.2% in fiscal 2011 as compared to fiscal 2010 and could decline further in fiscal 2012 and this could have a material adverse effect on our operations and financial condition.

**Our Address**

Our principal executive offices are located at 1420 Presidential Drive, Richardson, TX 75081-2439.

## **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 prospectus, 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 prospectus, 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.

### **Risks Related to our Business**

*We expect that we may need to raise additional capital in the future beyond any proceeds received from this offering; 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 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, 2011, previous loss contracts have been shipped completed and there are no future losses anticipated on our current backlog, thus we had no loss provision accrued for these fixed price contracts.

Approximately 95% of our contracts contain contract 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 on our results of operations from U.S. military orders by seeking to obtain foreign military orders. We recently won our first successful bid in securing the \$7.8 million five year contract with a foreign military contractor; however, since we have yet to begin delivery under this contract, we cannot yet determine if this contract win and our other efforts will mitigate the impact that the slower pace of U.S. military orders has had on our results from operations.

***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, as well as 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 long-term employment agreements with our key personnel, other than our Chief Operating Officer. 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 one employment agreement, with our Chief Operating Officer, and we do not presently maintain “key man” insurance on any key employees. 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.***

Optex Systems Holdings has 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 should have disruptions in deliveries due to production, quality, or other issues, Optex Systems Holdings 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 customer reputation, 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 finally shipped. Prior to bidding a contract, Optex Systems Holdings contacts potential sources of material and receives 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 Optex Systems Holdings 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 8, 2011, approximately 7% of our material requirements are single-sourced across 5 suppliers representing approximately 8% of our active supplier base. 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 increased costs. We do not believe these single sourced materials to pose any significant risk to Optex Systems Holdings 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 Optex Systems Holdings 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 May 25, 2012.

Product Line	Supplier	Supply Item	Risk	Purchase Orders
Periscopes	TSP, Inc.	Window used on all glass & plastic periscopes	Proprietary coatings would take in excess of 6 months to identify and qualify an alternative source	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.
Periscopes	Spartec Polycast	Acrylic raw material used in plastic periscope assemblies	This material has quality characteristics which would take in excess of 6 months to identify and qualify an alternative source.	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.
Other	SWS Trimac	Subcontracted Electron Beam Welding	Subcontracted welder that is the only qualified supplier for General Dynamics Land Systems muzzle reference system collimator assemblies. This operation would take in excess of 6 months to identify and qualify an alternative supplier.	Current firm fixed price & 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.

***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 up to fifteen months subsequent to delivery. Approximately 60% of our current (as of October 2, 2011) contract deliveries are 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, 2011, we derived approximately 95% of the gross business revenue from four customers, with 67% from General Dynamics Land Systems Divisions, 18% from TACOM, 6% from DLA, and 4% from BAE Systems. Procuring new customers and contracts may partially mitigate this risk. In particular, a decision by either General Dynamics Land System Division or Tank-automotive and Armaments Command or DLA/Warren to cease issuing contracts to us could have a significant material impact on our business and results of operations given that they represent 95% 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 51 discrete contracts with General Dynamics Land System Division, Tank-automotive and Armaments Command and DLA/Warren. If they choose to terminate these contracts, Optex Systems Holdings is entitled to fully recover all contractual costs and reasonable profits incurred up to or as a result of the terminated contract.

Due to the November 2011 award of the \$7.8 million international defense customer contract, the risk profile of our customer base has increased; however, we have yet to have material deliveries under this contract and cannot yet assess the total impact on diversification of our revenue base.

***We do not possess any patents and rely solely 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 confidentiality 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, 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 exhaustive 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.

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

At some time 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 in 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.

***Conversion of our Series A preferred stock could cause substantial dilution to our existing common stock holders, and certain other rights of the preferred stock holders present other risks to our existing common stock holders.***

As of May 25, 2012, we had 144,444,940 shares of our common stock issued and outstanding, as well as 1,027 shares of our Series A preferred stock issued and outstanding. The Series A preferred stock is currently convertible into 704,556,918 shares of our common stock, which represents 94.17% of our outstanding common stock assuming a full conversion of the Series A preferred stock into shares of our common stock. This would greatly dilute the holdings of our existing common stockholders. In addition, the preferred shareholders vote on a one-to-one basis with our common shareholders on an as converted basis.

Furthermore, in the event of a liquidation, the holders of our Series A preferred stock would receive priority liquidation payments before payments to common shareholders equal to the amount of the stated value of the preferred stock before any distributions would be made to our common shareholders. The total stated value of our preferred stock is \$7,045,569, so the preferred shareholders would be entitled to receive that amount before any distributions could be made to common shareholders. The liabilities on our balance sheet exceed the liquidation value of our assets; therefore, upon a liquidation, there would be no assets remaining for distribution to common shareholders.

The preferred shareholders also have the right, by majority vote of the shares of preferred stock, to generally approve any issuances by us of equity and/or indebtedness, which is not ordinary course of trade indebtedness. Therefore, the preferred shareholders can effectively prevent us from entering into a transaction which they feel is not in their best interests, even if the transaction might otherwise be in the best interests of Optex Systems Holdings and its common shareholders.

***If resales of our stock by the selling shareholders listed in our original SB-2 were held to be in violation of the Securities Act of 1933, we could experience significant negative consequences.***

We have attempted to determine whether the selling shareholders listed in our original Form SB-2, declared effective in May 2007, complied with the prospectus delivery requirements set forth in Section 5 of the Securities Act of 1933. If the prospectus delivery requirements were not met by the selling shareholders, then we could also be liable for violating Section 5. As current management was not appointed until 2009, we have to rely on third parties to obtain information from 2007. We have contacted prior company counsel for historical information, but they were unable to supply specific details, thus we still have insufficient information to form a definitive opinion regarding this matter. If a section 5 violation was found by a court or other legal body to have occurred, and the alleged violation was not barred by the statute of limitations of 5 years under Section 13 of the Securities Act of 1933, purchasers of the shares registered under the 2007 SB-2 could have a right of rescission or a claim for other damages, and the SEC could commence an enforcement action against us. Any of these actions could potentially have a material adverse effect on us and our stock price.

***We have utilized various investor relations firms which have published materials regarding us; however, there may be materials published without our knowledge or consent. To the extent any of these materials describes our securities without disclosing the receipt of consideration by these investor relations firms, there may be liability under Section 17(b) of the Securities Act of 1933.***

Section 17(b) of the Securities Act of 1933 states: "It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof." With regard to services provided by ECON Corporate Services, there may have been materials published, without our knowledge or consent, that contained a description of our securities without appropriate disclosure of consideration received or to be received directly or indirectly from us. This nondisclosure could give rise to liability under Section 17(b).

#### *Risks Relating to the Reorganization*

***One of our directors, who is also one of our executive officers, beneficially owns a substantial percentage of Optex Systems Holdings' outstanding common stock, which gives him control over certain major decisions on which Optex Systems Holdings' stockholders may vote, which may discourage an acquisition of Optex Systems Holdings.***

As a result of the reorganization, Sileas Corp., which is owned by Optex Systems Holdings' three officers (one of whom is also one of Optex Systems Holdings' three directors), beneficially owns (before taking into account the additional dilution upon consummation of the transactions contemplated by this registration statement), in the aggregate, 73.52% of Optex Systems Holdings' outstanding common stock. One director who is also an executive officer, Stanley Hirschman, owns the majority equity interest in Sileas. The interests of Optex Systems Holdings' management may differ from the interests of other stockholders. As Optex Systems Holdings' executive management has the right and ability to control virtually all corporate actions requiring stockholder approval, irrespective of how Optex Systems Holdings' other stockholders may vote, including the following actions:

- confirming or defeating the election of directors;
- amending or preventing amendment of Optex Systems Holdings' certificate of incorporation or bylaws;
- effecting or preventing a reorganization, sale of assets or other corporate transaction; and
- controlling the outcome of any other matter submitted to the stockholders for vote.

Optex Systems Holdings' management's beneficial stock ownership may discourage a potential acquirer from seeking to acquire shares of Optex Systems Holdings' common stock or otherwise attempting to obtain control of Optex Systems Holdings, which in turn could reduce the stock price or prevent Optex Systems Holdings' stockholders from realizing a premium over Optex Systems Holdings' stock price.

***If Sileas is unable to meet its obligations under the purchase money note to the party from which it purchased its stock holdings in Optex Systems Holdings, there could be a change in control in Optex Systems Holdings.***

On February 20, 2009, Sileas purchased 100% of the equity and debt interest held by Longview Fund, L.P., representing 90% of Optex Systems, Inc. (Delaware), in a private transaction. The purchase price for the acquisition of Longview's position was \$13.5 million, and the consideration was paid in the form of a promissory note. The obligations of Sileas under the promissory note are secured by a security interest in Optex Systems Holdings' common and preferred stock owned by Sileas. The promissory note owned by Sileas is now due on February 20, 2014, due to a November 22, 2011 extension, which also caused an increase in the principal amount to \$13.8 million from \$13.5 million as the result of the addition of a \$270 thousand extension fee.

As Sileas has no operations or business activities other than holding the purchased assets, Sileas is depending upon the value of its common stock and preferred stock holdings in Optex Systems Holdings to increase over time in order to pay its obligations under the promissory note. As of October 2, 2011, the market value of Optex Systems Holdings common stock owned by Sileas is \$1,373,924 on an as converted basis. If the value of the holdings does not sufficiently increase, and Sileas is unable to meet its payment obligations, Longview could exercise its remedies with respect to its security interest and take control of the pledged stock, and thus there would be a change in control of Optex Systems Holdings, as Sileas is currently the majority owner of Optex Systems Holdings. There can be no guarantee that the investment objectives of Longview will be the same as those of Sileas or our other shareholders. In the event that control shifts to Longview from Sileas, Longview may vote its shares differently than Sileas would have voted under similar circumstances. Merrick Okamoto, a director of Optex Systems Holdings, is a control person of Viking Asset Management, which controls Longview Fund.

***We did not give separate notice by mailing to then current shareholders of Sustut of the written consent by Andrey Oks as the majority shareholder of the reorganization.***

Section 228(e) of the Delaware General Corporation Law requires "[p]rompt notice of the taking of the corporate action without a meeting by less than unanimous written consent shall be given to those stockholders . . . who have not consented in writing." Prior management of Sustut did not give notice to the other then existing shareholders of Sustut of the written consent of Andrey Oks in lieu of a meeting of stockholders approving the reorganization on March 26, 2009 in compliance with Section 228(e). On April 3, 2009, current management filed a Form 8-K which detailed the transaction although it did not specifically mention approval of the transaction by Andrey Oks as the majority shareholder of Sustut. Potential ramifications of this lack of compliance with Section 228(e) could include possible inquiry or litigation from then existing shareholders of Sustut for failure of being made aware of the consent. To the knowledge of current management of Optex Systems Holdings, there have been no claims or inquiries made and/or any litigation filed by then current shareholders of Sustut for failure to receive notice under Section 228(e) of the Delaware General Corporation Law.

***As we do not have an escrow or trust account with subscriptions for investors, if we file for or are forced into bankruptcy, investors will lose the entire investment.***

Invested funds for this offering will not be placed in an escrow or trust account, and if we file for bankruptcy or a petition for involuntary bankruptcy is filed by creditors against us, your funds will become part of the bankruptcy estate and administered according to the bankruptcy laws. As such, you will lose your investment and your funds will be used to pay creditors.

*Risks Relating to our Common Stock*

***Optex Systems Holdings' stock price may be volatile.***

The market price of Optex Systems Holdings' common stock is likely to be highly volatile and could fluctuate widely in price in response to various factors, many of which are beyond Optex Systems Holdings' control, including the following:

- additions or departures of key personnel;
-

limited “public float” following the reorganization, in the hands of a small number of persons whose sales or lack of sales could result in positive or negative pricing pressure on the market price for the common stock;

- operating results that fall below expectations;
- economic and other external factors, including but not limited to changes in federal government military spending and the federal government procurement process; and
- period-to-period fluctuations in Optex Systems Holdings’ financial results.

In addition, the securities markets have from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. These market fluctuations may also materially and adversely affect the market price of Optex Systems Holdings’ common stock.

***There is currently no liquid trading market for Optex Systems Holdings' common stock, and Optex Systems Holdings cannot ensure that one will ever develop or be sustained.***

Our common stock is currently approved for quotation on the OTC Bulletin Board trading under the symbol OPXS.OB. However, there is limited trading activity and not currently a liquid trading market. There is no assurance as to when or whether a liquid trading market will develop, and if such a market does develop, there is no assurance that it will be maintained. Furthermore, for companies whose securities are quoted on the Over-The-Counter Bulletin Board maintained by Financial Industry Regulatory Authority, it is more difficult (1) to obtain accurate quotations, (2) to obtain coverage for significant news events because major wire services generally do not publish press releases about such companies, and (3) to raise needed capital. As a result, purchasers of Optex Systems Holdings' common stock may have difficulty selling their shares in the public market, and the market price may be subject to significant volatility.

***Offers or availability for sale of a substantial number of shares of Optex Systems Holdings' common stock may cause the price of Optex Systems Holdings' common stock to decline or could affect Optex Systems Holdings' ability to raise additional working capital.***

There are currently 14,999,991 unrestricted shares of Optex Systems Holdings which were outstanding prior to the March 2009 reorganization. Additionally, through a combination of the shares available under our pending registration statement when it becomes effective, and Rule 144, additional shares will become available. Under Rule 144(i)(2), Optex Systems Holdings' stockholders can commence selling significant amounts of shares into the market one year after the filing of "Form 10" information with the SEC as long as the other requirements of Rule 144(i)(2) are met. While affiliates would be subject to volume limitations under Rule 144(e), which is one percent of the shares outstanding as shown by our then most recent report or statement published, nonaffiliates would then be able to sell their stock without volume limitations. If Optex Systems Holdings' current stockholders seek to sell substantial amounts of common stock in the public market either upon expiration of any required holding period under Rule 144 or pursuant to an effective registration statement, it could create a circumstance commonly referred to as "overhang," in anticipation of which the market price of Optex Systems Holdings' common stock could decrease substantially. The existence of an overhang, whether or not sales have occurred or are occurring, could also make it more difficult for Optex Systems Holdings to raise additional financing in the future through sale of securities at a time and price that Optex Systems Holdings deems acceptable.

The date on which current shareholders can sell a substantial amount of shares into the public market would be the earlier of the date on which the registration statement is effective and the one year anniversary of the date on which all Form 10 information is filed with the SEC (we have determined that September 28, 2009 is the date on which all Form 10 information was filed), which would then allow sales under Rule 144. The amount of shares which are available would be 25,000,000 shares (all of those being registered for resale under the currently pending S-1, when it becomes effective) and 8,131,667 shares (under Rule 144, which are the remaining shares of common stock underlying warrants purchased in the private placement which took place just prior to the reorganization). There are also 6,780,000 shares which were issued in transactions exempt from registration under Rule 144 since the date of the



reorganization which became eligible for legend removal under Rule 144 on September 29, 2010.

The shares to become available either through a prospectus on Form S-1 upon effectiveness and under Rule 144 are set forth in the following table:

Prospectus	25,000,000
Shares from warrants issued in the reorganization	8,131,677
Shares issued since the reorganization, all with restrictive legends	6,780,000

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

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

**USE OF PROCEEDS**

Our offering is being made on a self-underwritten basis: no minimum number of shares must be sold in order for the offering to proceed. The offering price per share is \$0.01. The following table sets forth the uses of proceeds assuming the sale of 25%, 50%, 75% and 100%, respectively, of the securities offered for sale by us.

	25%	50%	75%	100%
Shares sold	6,250,000	12,500,000	18,750,000	25,000,000
Gross proceeds	\$62,500	\$125,000	\$187,500	\$250,000
Offering costs:				
SEC registration fee	\$29	\$29	\$29	\$29
Printing and engraving	1,000	1,000	1,000	1,000
Edgarization expenses	5,000	5,000	5,000	5,000
Legal fees and expenses	-	-	-	-
Accounting fees and expenses	5,000	5,000	5,000	5,000
Total offering costs	\$11,029	\$11,029	\$11,029	\$11,029
Net proceeds	\$51,471	\$113,971	\$176,471	\$238,971
Use of proceeds:				
Sales and marketing	\$36,029	\$79,780	\$123,530	\$167,279
Program development (1)	15,442	34,191	52,941	71,692
Total Use of Proceeds	\$51,471	\$113,971	\$176,471	\$238,971

1) Program development relates to efforts to survey and develop new commercial uses for our technology.

As offering costs are relatively minimal at \$11,029, we do not believe that the failure to raise funds hereunder will have a material adverse effect on us even if we do not raise adequate funds to cover our offering costs. Additionally, we are not utilizing proceeds for any one discreet project, thus the failure to sell any specific amount of shares offered hereunder will not hinder or delay the completion of any specific project.

**MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS****Market Information**

Effective with the start of trading on May 1, 2009, our stock received a ticker symbol change from “SSTX” to “OPXS” from FINRA and commenced trading under the new symbol on the OTC Bulletin Board. Trading in our stock has historically been sporadic, trading volumes have been low, and the market price has been volatile.

The following table shows the range of high and low prices for our common stock as reported by the OTC Bulletin Board for each quarter since the fourth quarter of 2010. All prices through the date of the reorganization are as reported on Sustut's periodic filings, as adjusted for the 2.5:1 forward split of Sustut's common stock authorized on February 27, 2009. All prices since the reorganization are derived from market information as to OTCBB prices as reported through the AOL Finance look up system. The quotations reflect inter-dealer prices, without retail markup, markdown or commission and may not represent actual transactions.

Period	High	Low
First Quarter 2010	\$ 0.50	\$ 0.09
Second Quarter 2010	\$ 0.15	\$ 0.08
Third Quarter 2010	\$ 0.09	\$ 0.04
Fourth Quarter 2010	\$ 0.055	\$ 0.02
First Quarter 2011	\$ 0.025	\$ 0.011
Second Quarter 2011	\$ 0.02	\$ 0.014
Third Quarter 2011	\$ 0.02	\$ 0.005
Fourth Quarter 2011	\$ 0.019	\$ 0.0055
First Quarter 2012	\$ 0.01	\$ 0.001
Second Quarter 2012	\$ 0.029	\$ 0.0022

On May 25, 2012, the sale price for our common stock as reported on the OTCBB was \$0.01 per share.

### **Securities outstanding and holders of record**

On May 25, 2012, there were approximately 79 record holders of our common stock and 144,444,940 shares of our common stock issued and outstanding.

### **Dividend Policy**

We have not paid and do not expect to pay dividends on our common stock. Any future decision to pay dividends on our common stock will be at the discretion of our board and will depend upon, among other factors, our results of operations, financial condition and capital requirements.

## **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 6,000,000 to 50,000,000 and authorized the grant of 10,000,000 options to two board members and a total of 36,070,000 to Optex Systems Holdings employees including 20,000,000 options to executive officers, at an exercise price of \$0.01 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, with the options to be issued within 60 days of December 9, 2011.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Management's Discussion and Analysis or Plan of Operations

This management's discussion and analysis reflects information known to management as at October 2, 2011 and April 1, 2012 and through the date of this filing. This MD&A is intended to supplement and complement our audited financial statements and notes thereto for the fiscal year ended October 2, 2011 and the quarter ended April 1, 2012, prepared in accordance with U.S. generally accepted accounting principles (GAAP). You are encouraged to review our financial statements in conjunction with your review 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 non-GAAP measures are used in this MD&A, they are clearly identified as 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) remained a wholly-owned subsidiary of Optex Systems Holdings.

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).

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.

Many 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.

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. In addition, Optex has a significant contract that allows for milestone payments in advance of delivery, based on achieving significant milestone events in accordance with the contract schedule. To the extent our contracts allow for progress or milestone payments, we intend to utilize these benefits, 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 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 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. Optex has submitted an equitable adjustment request on the Aiming Circle Howitzer program due to significant design issues impacting the manufacturability of the product. Discussions with the contracting agency are ongoing; however, as of April 1, 2012, we have not yet received resolution from the contracting officer regarding the status of our request.

## **Results of Operations**

*As of October 2, 2011*



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The table below summarizes our quarterly and full year operating results for fiscal years ending October 2, 2011 and October 3, 2010, in terms of both a GAAP net income measure and a non-GAAP EBITDA measure. We use EBITDA as an additional measure for evaluating the performance of our business as “net income” includes the significant impact of noncash intangible amortization on our income performance. Consequently, in order to have a meaningful measure of our operating performance on a continuing basis, we need to also consider an income measure which does not take into account this intangible amortization. We have summarized the quarterly revenue and margin below along with a reconciliation of the GAAP net loss to the non-GAAP EBITDA calculation for comparative purposes below. We believe that including both measures allows the reader to have a “complete picture” of our overall performance.

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	FY 2011	Qtr 1	Qtr 2	Qtr 3	Qtr 4	FY 2010
Net Loss Applicable to Common Shareholders – GAAP	\$(0.05)	\$(0.12)	\$(0.13)	\$0.48	\$ 0.18	\$-	\$(0.10)	\$(0.30)	\$(9.60)	\$(10.00 )
Add:										-
Interest Expense	0.02	0.03	0.01	0.01	0.07	-	-	-	0.10	0.10
Preferred Stock Dividend	0.10	0.10	0.10	0.11	0.41	0.10	0.10	0.10	0.10	0.40
Federal Income Taxes (Benefit)	0.03	(0.01)	(0.02)	(0.59)	(0.59 )	-	(0.10)	(0.20)	-	(0.30 )
Asset Impairment	-	-	-	-	-	-	-	-	8.00	8.00
Depreciation & Amortization	0.02	0.02	0.01	0.02	0.07	0.30	0.30	0.30	0.20	1.10
EBITDA - Non GAAP	\$0.12	\$0.02	\$(0.03)	\$0.03	\$ 0.14	\$0.40	\$0.20	\$(0.10)	\$(1.20)	\$(0.70 )

The potential ramifications of the circumstances surrounding the 2011 Congressional budget have resulted in yet more cuts in spending by the U.S. military, and we have had to explore other avenues of revenue. As a result of new periscope orders from non-traditional sources and an aggressive pursuit of increased market share for all of our existing product lines, we expect to mitigate some of the current decreased U.S. government requirements with other new business, such as the new \$7.8 million contract from a major international defense contractor which we announced on November 8, 2011. We also continue 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.

Our EBITDA increased by \$0.84 million in the year ending October 2, 2011 as compared to the year ending October 3, 2010 despite a significant decrease in revenue of 29.3%. The increase in EBITDA is primarily the result of a shift in revenue to more profitable product lines from the prior year combined with the completion of the Howitzer loss programs during the year. The prior year gross margin included substantial EAC and inventory loss adjustments related to these loss programs. In fiscal year 2010, Optex had experienced a significant shift in revenue toward the less favorable Howitzer programs that exacerbated the losses on those programs as their share of the overhead pools increased, and as overall volume declined, our labor efficiencies were impacted across all product lines due to layoff/reorganization and lower economies of scale. Further, in September 2010, Optex received an unanticipated order against a loss Howitzer program which resulted in an immediate, realized loss of \$0.2 million. During fiscal year 2011, Optex experienced improved labor efficiencies across the periscopes product line as the impact of the prior reductions in force and reorganization stabilized at the reduced volume level. As a business for which the major source of revenues is government contracts, we rely heavily on program cost estimates to determine our product margins. These estimates are very sensitive to any significant changes in revenue, production volume and product mix. We continued to pursue cost reductions in our production and general and administrative areas to mitigate any further margin impacts related to lower volume and to improve overall product profitability.

Product mix is dictated by customer contracted delivery dates and volume of each product to be delivered on such delivery dates. Shifts in gross margin from period to period are primarily attributable to the differing product mix recognized as revenues during each respective period. In addition, the Howitzer contracts which were awarded in August 2005 and September 2006 experienced losses as a result of unanticipated manufacturing costs due to design and technical data package issues impacting product manufacturability. During the year ended October 2, 2011, we recognized revenue of \$4.2 million on our Howitzer programs as compared to \$6.1 million in the year ended October 3, 2010. As of October 2, 2011 the remaining backlog for the last remaining Howitzer contract is \$1.7 million scheduled to ship in fiscal year 2012. The remaining backlog relates to the final delivery order against the program at a slight gross margin, hence there are no expected future losses to be incurred on these deliveries. Contract loss reserves on these programs were \$1.3 million as of October 3, 2010, and \$0 as of October 2, 2011.

We are aggressively pursuing additional, potentially higher margin periscope business. While the U.S. periscope market has declined since 2009, we have seen a 625% increase in new orders from a significant foreign military contractor from \$0.6 million per year, to \$3.8 million per year for fiscal years 2010 and 2011, and received additional orders of \$1.5 million in the first 60 days of fiscal year 2012.

As a result of the October 14, 2008 acquisition of the assets of Optex Systems, Inc. (Texas), our amortizable intangible assets had increased significantly over prior years. The non cash amortization expense of intangible assets was \$1 million in 2010. We reviewed the fair market value of our goodwill and intangible assets as of October 3, 2010 and based on significant reductions in anticipated government military spending, a reduction in customer order trends, and lower contract backlog, we determined that that goodwill was impaired. The review was based on a projected cash flow analysis of our future operations. The impairment loss for goodwill was \$7.1 million and was charged to general and administrative costs and impairment for intangible assets was \$0.9 million. The impairment loss was split between cost of goods sold and general and administrative costs in the amount of \$0.1 million and \$0.8 million, respectively. As of the year ended October 3, 2010, the total balance of unamortized intangible assets and goodwill was \$0.

Backlog as of October 2, 2011 was \$11.5 million as compared to a backlog of \$19.0 million as of October 3, 2010, representing a decline of 39.5%. The following table depicts the current expected delivery by quarter of all contracts awarded as of October 2, 2011.

Program Backlog (millions)	2012			2013			Total	
	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2		Qtr 3
Howitzer Programs	0.7	1.0	-	-	-	-	-	1.7
Periscope Programs	2.1	2.6	2.3	1.1	0.3	0.4	0.1	8.9
Sighting Systems	0.2	-	-	-	-	-	-	0.2
All Other	0.2	0.1	0.1	0.1	0.1	0.1	0	0.7
Total	3.2	3.7	2.4	1.2	0.4	0.5	0.1	11.5

In the first 60 days of fiscal year 2012, Optex Systems Holdings received additional orders totaling \$11.0 million consisting of a \$7.8 million M36 contract deliverable over 5 years from a major international defense contractor which we announced on November 8, 2011, a \$1.2 million award other product line award deliverable in 12 months from the Defense Logistics Agency for a Gunner's Head Assembly on the M1 Abrams Tank which we announced on October 26, 2011 and \$2.0 million in additional orders from several customers primarily in support of our periscope product line which will be delivered in fiscal years 2012 and 2013. As of November 27, 2011, Optex Systems Holdings' backlog has increased to \$21.5 million.

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.

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 \$700,000 (changed from \$650,000 effective October 1, 2010), 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, 2011, none of our outstanding backlog fell under this criterion.

**Twelve month period ended October 2, 2011 compared to the twelve month period ended October 3, 2010**

*Revenues:*

The table below details the revenue changes by product line for the year ended October 2, 2011 as compared to the year ended October 3, 2010.

Product Line	Year ended 10/02/2011	Year ended 10/03/2010	Change
Howitzer Programs	\$ 4.2	\$ 6.1	\$(1.90 )
Periscope Programs	10.7	11.8	(1.00 )
Sighting Systems	0.2	0.9	(0.70 )
All Other	1.1	4.1	(3.1 )
Total	\$ 16.2	\$ 22.9	\$(6.70 )
Percent decrease			-29.30%

Total revenues decreased by \$6.7 million or 29.3 % across all product groups primarily as a result of an overall decline in markets due to reduced government and prime contractor spending in support of tactical vehicles, components and supporting optical equipment. In addition, funding on several programs has been suspended or delayed due to uncertainty in the U.S. military budgets and challenging economic conditions surrounding the recession and deficit spending.

Revenue declined by \$1.0 million or 8.5% on our periscope line during fiscal year 2011 as compared to fiscal year 2010 primarily due to lower U.S. government spending. Although the U.S. periscope revenue declined, we were able to offset approximately \$2.2 million of the decline with an increase in periscope sales to a significant foreign military contractor, which consisted of 72 individual sales orders, none of which was material in terms of the dollar amount of the sales order. Based on our current backlog demand, we expect fiscal year 2012 revenue to slightly increase or remain flat over the fiscal year 2011 level. We continue to quote and receive awards for additional periscopes from multiple customers and we are aggressively pursuing increased market share in the periscope market by drawing business away from our competitors; however, we cannot yet determine if we will be successful in gaining sufficient new additional periscope business to offset the downturn caused by the decline in new federal government orders in the last year.

Revenues from the Howitzer programs decreased by \$1.9 million, or 31.1%, over the prior year due to completion of two of our major Howitzer programs with no current follow on contract. We expect the volume to decline significantly over the next twelve months as we wind down deliveries on the remaining \$1.7 million backlog associated with the final delivery order during the first six months of fiscal year 2012. Currently, we do not foresee any material, near term orders for additional Howitzer products, however we look forward to new orders in the program as current military supplies diminish and require replacement.

Sighting systems revenues decreased \$0.7 million, or 77.89%, during fiscal year 2011 over the prior fiscal year as our U.S. government delivery order on back up sighting units was completed during fiscal 2010. We currently do not have a follow-on delivery order for additional sighting units; however, the primary contract ordering period does not expire until December 31, 2012. We continue to ship sighting systems pursuant to other contracts to both federal government and non-U.S. government customers and continue to pursue business on several substantial programs for commander weapon sighting systems and M36 thermal sighting units. We expect deliveries on sighting systems to increase significantly in fiscal year 2012 and beyond due to the recent award of a significant \$7.8 million 5 year M36 contract booked in November 2011. Fiscal year 2012 deliveries against the program are expected to be approximately \$0.6 million, while full production for the contract is not expected to commence until the first quarter of fiscal year 2013 and will continue at a rate of approximately \$1.5 million per year thereafter through contract completion.

Decreases in the other product line of \$3.1 million, or 75.61%, for 2011 as compared to 2010 are primarily a result of decreased sales of big eye binoculars, mirror assemblies and TVS4 and PVS Objective assembly sales to multiple customers associated with contracts completed in fiscal year 2010. We expect revenues in fiscal year 2012 to increase by approximately 45% with the award of the Defense Logistics Agency Gunner's Head Assemblies of \$1.2 million, deliverable in the next 12 months.

We experienced losses in our Howitzer programs as a result of unanticipated manufacturing costs due to design and technical data package issues impacting the product manufacturability. These issues have resulted in increased labor and material costs due to higher scrap and extensive engineering costs incurred during the initiation phase of the programs. In addition some of our older "legacy" periscope programs, which were completed in the third fiscal quarter of 2010, experienced losses due to significant material price increases since the initial five year contract award in 2004. As of October 2, 2011, all of the loss contracts have been shipped complete. During 2010 we realized additional losses of \$1.1 million to cover increased estimated completion costs as a result of higher production labor and material scrap rates, combined with increased sharing of fixed manufacturing overhead due to the significant decline in volume across the other product lines. Included in the total realized losses against the Howitzer programs for fiscal year 2010 is \$0.8 million related specifically to production issues encountered on one of our Howitzer product lines. Optex has requested an equitable adjustment on this program due to significant design issues impacting the manufacturability of the product. As there is no guarantee that the request will be granted in part or in full, Optex realized the entire loss in fiscal year 2010. In the event we are unsuccessful in obtaining an equitable adjustment, there will be no future margin impact for on these programs as the losses have been previously recognized through the completion of the programs.

*Cost of Goods Sold.* During the fiscal year ended October 2, 2011, we recorded cost of goods sold of \$13.7 million as compared to \$22.0 million during the fiscal year ended October 3, 2010, a decrease of \$8.3 million or 37.7%. This decrease in cost of goods sold was primarily associated with decreased revenue across all of our product groups, combined with a change in revenue mix toward higher margin products. The gross margin during the period ending October 2, 2011 was 15.4% of revenue as compared to a gross margin of 3.9% of revenue for the period ending October 3, 2010. The increase in gross margin percentage is primarily due a shift in product mix toward more profitable programs and improved performance on our periscope lines in fiscal year 2011. In addition, prior year cost of sales included higher contract EAC losses on Howitzer programs, combined with unfavorable year-end physical inventory valuation losses in all product lines. As the Howitzer loss programs completed during 2011 the shift of revenue has moved toward more profitable programs. In addition, reductions in force and plant reorganization completed in the second half of 2010 contributed to more favorable performance on all product lines in 2011 as more efficient economies of scale were achieved. We expect this trend to continue into fiscal year 2012 as there are no remaining loss contracts in our backlog and efficiencies have stabilized a the reduced production volumes.

*G&A Expenses.* During the fiscal year ended October 2, 2011, we recorded operating expenses of \$2.4 million as opposed to \$10.7 million during the period ending October 3, 2010, a decrease of \$8.3 million or 77.6%. The decline in general and administrative costs related primarily to the write-off of \$8 million in 2010 for impairment of goodwill and intangible assets combined with a decrease of \$0.3 million of intangible asset amortization in 2011 following the write-off. In addition, Optex realized significant cost reductions globally across almost all spending accounts in general and administrative, with the exception of salaries, travel and research and development. The spending reductions were offset by approximately 0.3 million of increased spending with the addition of a Vice President of Business Development in mid 2011 of \$0.1 million, increased research and development costs of \$0.1 million, and increased management incentives of \$0.1 million, which were all necessary to facilitate new product and customer growth into day and night thermal vision (M36) markets..We believe these investments in product development have contributed significantly to the new orders booked in the first 60 days of fiscal year 2012 and expect these changes to increase our overall footprint in the optical vision market for tactical vehicles moving forward.

*Operating Income (Loss) .* During the period ending October 2, 2011, we recorded operating income of \$0.1 million, as compared to an operating loss of (\$9.9) million during the period ending October 3, 2010. Operating income is significantly higher in 2011 as compared to losses in 2010, due to higher gross margin on revenue due to changes in product mix and improved production efficiencies, combined with decreased general and administrative costs as related to the 2010 impairment and amortization of goodwill and intangible asset as discussed in the previous sections..

*Net Income (Loss) applicable to common shareholders.* During the period ended October 2, 2011, we recorded a net income of \$0.2 million, as compared to a net loss of (\$10.0) million for the period October 3, 2010. In fiscal 2011, we recognized a tax benefit of \$0.6 million as compared to \$0.3 million in the same period of fiscal year 2010. The tax benefit is primarily attributable to the effect of temporary and permanent timing differences related to goodwill, intangible amortization, net operating loss carry forwards, and changes in deferred tax asset reserve balances. The goodwill and intangible amortization expense is amortized over 15 years for income tax purposes whereas the remaining unamortized balance of both goodwill and intangibles was written off prior to year end for book purposes.



*As of April 1, 2012*

Backlog as of April 1, 2012, was \$18.0 million as compared to a backlog of \$13.8 million as of April 3, 2011, representing an increase of 30.4%. The following table depicts the current expected delivery by of all contracts awarded as of April 1, 2012.

Product Line	Qtr 3	Qtr 4	2012	2013	2014	2015	2016	2017	Total
Howitzer	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Periscopes	2.7	2.4	5.1	2.1	0.3	0.1	0.0	0.0	7.6
Sighting Systems	0.5	0.2	0.7	1.7	1.6	1.4	1.4	1.2	8.0
Other	0.3	1.6	1.9	0.3	0.1	0.1	0.0	0.0	2.4
Total	3.5	4.2	7.7	4.1	2.0	1.6	1.4	1.2	18.0

In the first two fiscal quarters of 2012, Optex Systems Holdings received \$14.7 million in new orders consisting of a \$8.0 million M36 contract deliverable over 5 years from General Dynamics Land Systems - Canada, a \$1.2 million other product line award from the Defense Logistics Agency for a Gunner's Head Assembly on the M1 Abrams Tank deliverable in fiscal year 2012, and \$5.5 million in additional orders from several customers primarily in support of our periscope and other product line which will be delivered in fiscal years 2012 through 2015. The \$8.0 million M36 contract provides for milestone billings in the current fiscal year of \$3.9 million of which approximately \$3.3 million relates to customer advance deposits for future year deliverables.

### Three Months Ended April 1, 2012 Compared to the Three Months Ended April 3, 2011

*Revenues.* In the three months ended April 1, 2012, revenues increased by 2.6% from the respective prior period in 2011 as set forth in the table below (dollar amounts in millions):

Product Line	Three months ended		Variance	% Chg
	April 1, 2012	April 3, 2011		
Howitzer	0.7	0.8	(0.1 )	-12.5 %
Periscopes	3.0	2.6	0.4	15.4 %
Other	0.2	0.4	(0.2 )	-50.0 %
Total	3.9	3.8	0.1	2.6 %

Revenues increased by \$0.4 million, or 15.4%, on our periscope line during the three months ended April 1, 2012 as compared to the three months ended April 3, 2011. The primary reason for the increase is due to higher production quantities of glass periscope ICWS orders. The increase in glass periscopes is partially offset by an overall decline in plastic periscope shipments as compared to the prior year period.

Revenues from the Howitzer programs decreased \$(0.1) million, or 12.5%, over the same three months in the prior year. The decline in revenue is primarily due to completion of two of our Howitzer programs in FY2011 and completion of our one remaining Howitzer program in March 2012 with no current follow-on contracts.

Decreases in the other product lines of \$(0.2) million, or 50.0%, for the three months ending April 1, 2012 compared to the prior year period are due to lower orders and production quantities from GDLS on collimator muzzle reference system assemblies as our current contracts for these units are winding down. The prior year period also included a short onetime order for big eye binocular assemblies.

*Cost of Goods Sold* . During the three months ended April 1, 2012 and April 3, 2011, we recorded cost of goods sold of \$3.2. The gross margin during the three months ended April 1, 2012 was \$0.64 million or 16.4% of revenues as compared to a gross margin of \$0.59 million or 15.5% for the three months ended April 3, 2011. The increase in gross margin percentage for the quarter as compared to the prior year is primarily due to a shift in product mix toward more profitable programs and completion of the Howitzer loss programs in 2011.

*G&A Expenses* . During the three months ended April 1, 2012, we recorded operating expenses of \$0.65 million as opposed to \$0.59 million, during the three months ended April 3, 2011, an increase of \$0.06 million or 10.2%. Operating expenses increased over prior year levels primarily due to increased sales and marketing expenses associated with the direct hire of a Vice President of Business Development (\$0.04 million) and securing an advertising/public relations agreement (\$0.02 million). The additional costs were necessary to facilitate new product and customer growth into day and night thermal vision (M36) markets. We expect the increased general and administrative costs to continue throughout fiscal year 2012 with an overall increase of approximately 20% over the prior year level. We believe these investments in product development have contributed significantly to the new orders booked in the first quarter of fiscal year 2012 and expect these changes to increase our overall footprint in the optical vision market for tactical vehicles.

*Operating Income (Loss)* . During the three months ended April 1, 2012, we recorded an operating loss of (\$0.01) million, as compared to operating income of \$0.0 million during the three months ended April 3, 2011. The decline in operating income of (\$0.01) million is primarily due to increased spending in general and administrative costs in the current year over prior year levels partially offset by a higher gross margin.

*Net Income (Loss) applicable to common shareholders* . During the three months ended April 1, 2012, we recorded a net income applicable to common shareholders of \$0.14 million, as compared to a loss of \$(0.12) million for the three months ended April 3, 2011, representing an decreased loss of \$0.26 million. The primary reason for the decreased loss relates to the waiver of accrued dividends on preferred stock of \$0.21 million in February 2012. In the three months ended April 1, 2012, we recognized deferred tax benefit \$0.05 million as compared to a deferred tax expense of (\$0.01) in the same period of fiscal year 2011. The change in taxes is primarily due to the effect of temporary and permanent timing differences related to intangible amortization and goodwill. Interest expense decreased by \$0.02 million in the current quarter as compared to the prior year quarter.

### Six Months Ended April 1, 2012 Compared to the Six Months Ended April 3, 2011

*Revenues*. In the six months ended April 1, 2012, revenues decreased by (6.9)% from the respective prior period in 2011 as set forth in the table below (dollar amounts in millions):

Product Line	Six months ended		Variance	% Chg
	April 1, 2012	April 3, 2011		
Howitzer	1.7	2.4	(0.7 )	-29.2 %
Periscopes	5.8	5.6	0.2	3.6 %
Sighting Systems	0.3	-	0.3	100.0 %
Other	0.3	0.7	(0.4 )	-57.1 %
Total	8.1	8.7	(0.6 )	-6.9 %

Revenues increased by \$0.2 million, or 3.6%, on our periscope line during the six months ended April 1, 2012 as compared to the six months ended April 3, 2011. The primary increases are due to higher production levels on our glass periscope business partially offset by lower revenues on our plastic periscope lines. Based on our current backlog demand and projected orders for the remaining two quarters of fiscal 2012, we expect the periscope product line revenues to approximate the revenues in the same quarters in 2011. We continue to quote and receive awards for additional periscopes from multiple customers and are aggressively pursuing increased market share in the periscope market by drawing business away from our competitors; however, we cannot yet determine if we will be successful in gaining sufficient new additional periscope business to offset the downturn caused by the decline in new federal government orders.

Revenues from the Howitzer programs decreased \$(0.7) million, or 29.2%, over the same six months in the prior year. The decline in revenue is primarily due to completion of two of our Howitzer programs in FY2011 and the completion of the one remaining Howitzer program in March 2012 with no current follow-on contracts. We do not expect any additional Howitzer revenues during the last six months of fiscal 2012 as the contracts are complete.

Sighting systems revenues increased \$0.3 million, or 100%, over the same six months in the prior year, due to milestone invoices related to prototype development of M36 Day/Night vision units for a foreign customer, and M36 refurbishments and repair revenues for a domestic customer, combined with the shipment of spare of back up sights to a domestic customer in the first quarter of fiscal year 2012. We expect deliveries on sighting systems to increase significantly throughout fiscal year 2012 and beyond due to the recent award of a significant \$8.0 million, 5 year M36 contract booked in November 2011. Fiscal year 2012 deliveries against the program are expected to be approximately \$0.7 million, while full production for the contract is not expected to commence until the first quarter of fiscal year 2013 and will continue at a rate of approximately \$1.5 million per year thereafter through contract completion. In addition, we continue to ship small sighting systems orders pursuant to other contracts to both federal government and non-U.S. government customers and continue to pursue business on several substantial programs for commander weapon sighting systems and M36 thermal sighting units.

Decreases in the other product lines of \$(0.4) million, or 57.1%, for the six months ending April 1, 2012 compared to the prior year period are due to lower orders and production quantities from GDLS on collimator muzzle reference system assemblies as our current contracts for these units are winding down. We expect overall revenues for the other product lines to increase by approximately 73% in fiscal year 2012 as compared to fiscal year 2011, primarily in the fourth fiscal quarter due to the award of the Defense Logistics Agency Gunner's Head Assemblies of \$1.2 million due later in the year.

We experienced losses in our Howitzer programs as a result of unanticipated manufacturing costs due to design and technical data package issues impacting the product manufacturability. These issues resulted in increased labor and material costs due to higher scrap and extensive engineering costs incurred during the initiation phase of the programs. Included in the total realized losses against these programs is \$0.8 million related specifically to one of the contracts for which Optex Systems Holdings has requested an equitable adjustment due to significant design issues impacting the manufacturability of the product. As there is no guarantee that the request will be granted in part or in full, Optex Systems Holdings realized the entire loss in fiscal year 2010 and as of October 2, 2011, all of the loss Howitzer contracts were complete. Optex Systems Holdings has been engaged in ongoing conversations with the contracting agency regarding the equitable adjustment claim and expects resolution sometime in the current fiscal year. In the event we are unsuccessful in obtaining an equitable adjustment settlement, there will be no future margin impact for on these programs as the losses have been previously recognized through the completion of the program.

*Cost of Goods Sold* . During the six months ended April 1, 2012, we recorded cost of goods sold of \$6.8 million as opposed to \$7.5 million during the six months ended April 3, 2011, a decrease of \$0.7 million or 9.3%. This decrease in cost of goods sold was primarily associated with decreased revenues from the comparable six month period in the prior year, in addition to changes in revenue mix to more profitable product lines. The gross margin during the six months ended April 1, 2012 was \$1.3 million or 16.1% of revenues as compared to a gross margin of \$1.3 million or 14.9% for the six months ended April 3, 2011. The increase in gross margin percentage for the year as compared to the prior year is primarily due to a shift in product mix toward more profitable programs and completion of the Howitzer loss programs in 2011 and 2012.

*G&A Expenses* . During the six months ended April 1, 2012, we recorded operating expenses of \$1.3 million as opposed to \$1.1 million, during the six months ended April 3, 2011, an increase of \$0.2 million or 18.2%. Operating expenses increased over prior year levels primarily due to increased sales and marketing expenses associated with the direct hire of a Vice President of Business Development (\$0.07 million), securing an advertising/public relations agreement (\$0.05 million), increased management and employee incentive costs (\$0.06 million), increased travel and exposition expenses (\$0.02 million) and research and development costs (\$0.02 million). The additional costs were necessary to facilitate new product and customer growth into day and night thermal vision (M36) markets. We expect the increased general and administrative costs to continue throughout fiscal year 2012 with an overall increase of approximately 20% over the prior year level. We believe these investments in product development have contributed significantly to the new orders booked in the first six months of fiscal year 2012 and expect these changes to increase our overall footprint in the optical vision market for tactical vehicles moving forward.

*Operating Income (Loss)* . During the six months ended April 1, 2012, we recorded operating income of \$0.02 million, as compared to operating income of \$0.11 million during the six months ended April 3, 2011. The decline in operating income of \$0.9 million is primarily due to lower revenues and increased spending in general and administrative costs in the current year over prior year levels.

*Net Income (Loss) applicable to common shareholders* . During the six months ended April 1, 2012, we recorded a net loss applicable to common shareholders of \$(0.01) million, as compared to \$(0.17) million for the six months ended

April 3, 2011, representing a decreased loss of \$0.16 million. The primary reason for the decreased loss relates to the waiver of accrued dividends on preferred stock of \$0.21 million in February 2012. In the first six months of fiscal 2012, we recognized deferred tax benefit of \$0.12 million as compared to \$0.02 in the same period of fiscal year 2011. The change in taxes is primarily due to the effect of temporary and permanent timing differences related to intangible amortization and goodwill. Interest expense decreased by \$0.03 million in the current year as compared to the prior year.

### **Liquidity and Capital Resources**

On October 27, 2009, Optex Systems Holdings secured a short term note payable from the Longview Fund in the amount of \$250,000 bearing interest at 10% per annum. On March 22, 2010, Optex Systems Holdings repaid \$125,000 in principal plus \$10,000 in accrued interest on the outstanding Longview note. The balance of principal and interest due on the note were satisfied on June 4, 2010.

On March 10, 2010, the Company entered into a revolving credit facility with Peninsula Bank Business Funding, a division of the Private Bank of the Peninsula, which provides up to \$2,000,000 in financing against eligible receivables. The material terms of the revolving credit facility are as follows:

o The interest rate for all advances shall be the greater of 8.5% and the then in effect prime rate plus 3.5% and subject to a minimum quarterly interest payment of \$16,000.

o Interest shall be paid monthly in arrears.

o The expiration date of the facility is March 4, 2011, at which time any outstanding advances, and accrued and unpaid interest thereon, will be due and payable.

o In connection with the entry into the facility by Peninsula Bank Business Funding, Optex Systems, Inc.(Delaware) paid Peninsula Bank Business Funding a facility fee of \$20,000 and issued a warrant to Peninsula Bank Business Funding to purchase 1,000,000 shares of its common stock. The warrant bears an exercise price of \$0.10 per share and expires on March 3, 2016.

o The obligations of Optex Systems, Inc. (Delaware) to Peninsula Bank Business Funding 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 Peninsula Bank Business Funding.

o The facility contains affirmative and negative covenants that require Optex Systems, Inc. (Delaware) to maintain certain minimum cash and EBITDA levels on a quarterly basis and contains other customary covenants. The facility also contains customary events of default. Upon the occurrence of an event of default that remains uncured after any applicable cure period, Peninsula Bank Business Funding's commitment to make further advances may terminate, and Peninsula Bank Business Funding would also be entitled to pursue other remedies against Optex Systems, Inc. (Delaware) and the pledged collateral.

o Pursuant to a guaranty executed by Optex Systems Holdings in favor of Peninsula Bank Business Funding, Optex Systems Holdings has guaranteed all obligations of Optex Systems, Inc. (Delaware) to Peninsula Bank Business Funding.

On August 3, 2010, Peninsula Bank Business Funding waived the Company's requirement to meet the EBITDA requirement set forth in Section 6.8 of its agreement with the Company for the quarter ended June 27, 2010. In addition, Peninsula Bank Business Funding agreed to amend Sections 6.8(c) and (d) of the aforesaid agreement to adjust the minimum EBITDA covenant for the fiscal quarter ending October 3, 2010 to \$20,000, and for the fiscal quarter ending January 2, 2011 to \$200,000.



On November 23, 2010, Peninsula Bank Business Funding waived the Company's requirement to meet the EBITDA requirement set forth in Section 6.8 (c) of the August 3, 2010 amended Agreement for the fourth quarter ended October 3, 2010. In addition, on November 29, 2010 Peninsula Bank Business Funding agreed to a second amendment for Sections 6.8 (d) of the Agreement to adjust the minimum EBITDA covenant for the fiscal quarter ending January 2, 2011 to \$95,000.

On March 22, 2011, Peninsula Bank Business Funding (now known as Avid Bank) and the Company, entered into a fourth amendment to the existing credit facility agreement between them to extend the maturity date to March 15, 2012 (a prior third amendment entered into on February 15, 2011 was in all material respects superseded by the amendments made in the fourth amendment). Section 1.1 was amended (i) to define "Borrowing Base" as \$175,000, (ii) to delete the definition of "EBITDA", and (iii) to amend subsection (i) of the definition of "Eligible Accounts" so as to exclude any accounts for any account debtor (other than GDLS) which exceed 30% of all accounts and for GDLS to exclude those total obligations which exceed the lesser of 50% of all accounts or the aggregate sum of \$500,000. Section 2.3(a)(ii) was amended so that the minimum semiannual interest payment is \$20,000, and Section 6.8 was amended in its entirety so as to require the Company to maintain a zero balance on the revolving line for a period of at least 30 consecutive days during the period from March 15, 2011 and March 15, 2012.

As of October 2, 2011, the outstanding balance on the line of credit is \$0.5 million, and on December 20, 2011, the latest practicable date, the balance was \$0.3 million. For the period ended October 2, 2011 the total interest expense was \$0.06 million.

On April 16, 2012, the Company amended its revolving credit facility with Avidbank, which provides up to \$1 million in financing against eligible receivables for up to two years. The material terms of the amended revolving credit facility are as follows:

The interest rate for all advances shall be the greater of 7.0% and the then in effect prime rate plus 3.5%. The additional minimum interest payment requirement has been eliminated.

Interest shall be paid monthly in arrears.

The loan period is from April 15<sup>th</sup> through April 14<sup>th</sup> of the following year, beginning with the period of April 15, 2012 through April 14, 2013 and a revolving maturing date of April 14, 2014, at which time any outstanding advances, and accrued and unpaid interest thereon, will be due and payable.

A renewal fee of \$10,000 is due on the 15<sup>th</sup> day of April each year beginning with April 15, 2012.

The obligations of Optex Systems, Inc. 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 Optex Systems, Inc. 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.

The facility contains a requirement for the Company to maintain a zero balance on the revolving line for a period of at least 30 consecutive days during each loan period.

We have historically met our liquidity requirements from a variety of sources, including government and customer funding through contract progress bills, short term loans, notes from related parties, and the sale of equity securities. Based upon our current working capital position and potential for expanded business revenues, we believe that our working capital is sufficient to fund our current operations for at least the next 12 months. However, based on our

strategy and the anticipated growth in our business, we believe that our liquidity needs may increase in the future. The amount of such increase will depend on many factors, including the costs associated with the fulfillment of our projects, whether we upgrade our technology, and the amount of inventory required for our expanding business. If our liquidity needs do increase, we believe additional capital resources will be obtained from a variety of sources including, but not limited to, cash flow from operations and the issuance of our common stock and/or debt, including receivables funding through a commercial lender .

Our ability to utilize progress billing on government contracts was temporarily on hold since March 2011 pending completion of a 2011 Defense Contract Audit Agency (DCAA) Progress Billing Audit and Accounting System Review. Progress billing audits and accounting system reviews are conducted periodically by the government to ensure the Company's systems meet the necessary requirements. The progress billing audit was successfully completed in July 2011 and based upon the audit results, the contracting officer approved a pending progress payment of \$1.3 million related to incurred contract cost through April 2011 on one of our Howitzer programs. The progress bill payment was subsequently received by the Company on August 3, 2011. The Accounting System Review was completed by DCAA without issue in September, 2011 and an additional \$0.3 million of progress bills against the program for cost incurred through August 2011 was submitted in September. Payment was received in early October.

In addition, Optex Systems Holdings has requested an equitable adjustment on another Howitzer program due to significant design issues that impacted the manufacturability of the product. As there is no guarantee that the request will be granted in part or in full, we realized the entire loss in fiscal year 2010. The program was completed in fiscal year 2011. However, we believe there is a reasonable possibility that we will be able to recover a substantial amount of the incurred loss in the next fiscal year, pending the outcome of the negotiations. To the extent we are able to recover increased costs (losses) against the program; we expect the settlement would have a positive impact on working capital.

#### **Period of October 3, 2010 through October 2, 2011**

*Cash and Cash Equivalents.* As of October 2, 2011, we had cash and cash equivalents of \$1.5 million as compared to \$1.0 million on October 3, 2010. We increased cash and cash equivalents by \$0.5 million primarily due to collections on progress bills in August of \$1.3 million offset by a reduction in the credit facility of \$0.6 million and increased material purchases in support of the M137 Howitzer final delivery order quantities shipping in fiscal year 2012, net of the progress billed amounts.. As of October 2, 2011 our outstanding balance on the line of credit was \$0.5 million.

*Net Cash (Used by) Provided by Operating Activities.* Net cash provided by operating activities during the period beginning October 3, 2010 and ending October 2, 2011 totaled \$1.1 million. The primary sources of cash during this period resulted from a significant decrease in inventory of \$1.5 million due to lower production volume and the completion of several loss Howitzer contracts, increased reserve requirements for excess and obsolete inventories of \$0.3 million primarily related to the completed Howitzer programs, combined with net income of \$0.6 million. These increases were offset by the depletion of reserve balances related to the loss contracts of (\$1.4) million.

*Net Cash used in Investing Activities.* In the twelve months ended October 2, 2011, net cash used by investing activities totaled \$0.03 million and consisted of fixed asset purchases during the period.

*Net Cash Provided by Financing Activities.* Net cash used by financing activities totaled \$0.6 million during the twelve months ended October 2, 2011 due to a payment of \$0.6 million against the revolving credit facility.

**Cash Flows for the Period from October 2, 2011 through April 1, 2012**

*Cash and Cash Equivalents .* As of April 1, 2012, we had cash and cash equivalents of \$3.4 million. During the period from October 3, 2011 through April 1, 2012, we increased cash and cash equivalents by \$1.8 million primarily attributable to collections of milestone payments made against M36 Day/Night vision contract during the six months ending April 1, 2012.

*Net Cash Provided by Operating Activities .* Net cash provided by operating activities during the period from October 3, 2011 to April 1, 2012 totaled \$2.3 million. The primary sources of cash during this period were a \$1.6 million increase in customer advance deposits associated with the M36 milestone billings and decreases in accounts receivable of \$0.4 million and increases in accounts payable and accrued expenses of \$0.2 million.

*Net Cash (Used) by Investing Activities .* In the six months ended April 1, 2012, cash used by investing activities for the purchase of property and equipment was \$0.03 million as compared to \$0.02 million in the prior year period.

*Net Cash (Used) by Financing Activities* . Net cash used by financing activities totaled (\$0.45) million during the six months ended April 1, 2012 primarily due to the payment of (\$0.5) million against the line of credit offset by \$0.05 million collected for the sale of common stock.

### **Critical Accounting Policies**

*Stock-Based Compensation:* In December 2004, FASB issued FASB ASC 718 which establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. 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. FASB ASC 718 focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. 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.

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, which establish 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.

*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. We have provided deferred income tax benefits on net operating loss carry-forwards to the extent we believe we will be able to utilize them in future tax filings.

*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 whereas a defined order quantity is delivered to the customer in a continuous or sequential production process to buyers specifications (build to print). Our 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 (loss) against a fixed price contract/order, management generally seeks to reduce costs and /or revise the program plan in a manner consistent with customer objectives in order to eliminate or minimize any overrun and to secure necessary customer agreement to proposed revisions.

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 to still 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.

For the fiscal years ended October 2, 2011 and October 3, 2010, estimated loss reserves were \$0 and \$1.4 million, respectively. During 2010, Optex Systems Holdings realized increases losses against the Howitzer programs of \$1.1 million of which \$763 thousand relates specifically to production issues encountered on one of our Howitzer product lines. Increased losses were primarily attributable to manufacturing issues on our U.S. government Howitzers 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 has requested an equitable adjustment on this program due to significant design issues impacting the manufacturability of the product. As there is no guarantee that the request will be granted in part or in full, we realized the entire loss in fiscal year 2010. However, we believe there is a reasonable possibility that we will be able to recover a substantial amount of the incurred loss in fiscal year 2011 pending the outcome of the negotiations. As of the end of fiscal year 2011, all shipments against the loss contracts had been completed, thus there is no carryforward of the loss reserves required for future periods.

*Government Contracts:* Virtually all 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".

*Warranty Costs:* Some of Optex Systems Holdings' customers require that the company warrant the quality of its products to meet customer requirements and be free of defects for up to fifteen months subsequent to delivery. Future warranty costs are based on the estimated cost of replacement for expected returns based upon our most recent experience rate of defects as a percentage of warranty covered sales. Throughout the year, warranty costs are expensed as incurred, and as of each year end, Optex Systems Holdings reviews the prior 15 month warranty experience rate and may adjust the warranty accrual as required to cover any additional anticipated warranty costs related to prior shipments. In the year ending October 3, 2010, Optex Systems Holdings, Inc. recognized income \$57 thousand, related to improvements in the warranty experience rate for warranties expiring in fiscal year 2010. As of October 2, 2011 the existing warranty reserve balance of \$25 thousand was reviewed and determined to be adequate to satisfy any future warranty claims that may have existed as of October 2, 2011 for shipments occurring in the prior 15 months.

***Recent Accounting Pronouncements.***



In February 2010, FASB issued ASU 2010-09 "Subsequent Event (Topic 855) Amendments to Certain Recognition and Disclosure Requirements". ASU 2010-09 removes the requirement for an SEC filer to disclose a date in both issued and revised financial statements. Revised financial statements include financial statements revised as a result of either correction of an error or retrospective application of GAAP. All of the amendments in ASU 2010-09 are effective upon issuance of the final ASU, except for the use of the issued date for conduit debt obligors, which is effective for interim or annual periods ending after June 15, 2010. The Company adopted ASU 2010-09 in February 2010 and therefore omitted the disclosure previously required as referenced above.

In June 2009, FASB issued ASC 105-10 (Prior authoritative literature: SFAS No. 168, *"The FASB Accounting Standards Codification TM and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162"*). FASB ASC 105-10 establishes the FASB Accounting Standards Codification TM (Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. FASB ASC 105-10 is effective for financial statements issued for fiscal years and interim periods ending after September 15, 2009. As such, Optex Systems Holdings is required to adopt these provisions at the beginning of the interim period ending October 3, 2010. Adoption of FASB ASC 105-10 did not have a material effect on Optex Systems Holding's financial statements.

In September 2006, the FASB issued FASB ASC 820-10 (Prior authoritative literature: FASB Statement 157, “*Fair Value Measurements*”). FASB ASC 820-10 defines fair value, establishes a framework for measuring fair value under GAAP and expands disclosures about fair value measurements. FASB ASC 820-10 applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, FASB ASC 820-10 does not require any new fair value measurements. However, for some entities, the application of FASB ASC 820-10 will change current practice. The changes to current practice resulting from the application of FASB ASC 820-10 relate to the definition of fair value, the methods used to measure fair value and the expanded disclosures about fair value measurements. The provisions of FASB ASC 820-10 are effective as of January 1, 2008, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. However, delayed application of this statement is permitted for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The adoption of FASB ASC 820-10 did not have a material impact on Optex Systems Holdings’ financial position, results of operations, or cash flows.

### **Cautionary Factors That May Affect Future Results**

This registration statement on Form S-1 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 prospectus. In this prospectus 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.

### **BUSINESS**

## **Background**

### *Prior History - Sustut Exploration, Inc.*

Sustut was a Delaware corporation formed on April 11, 2006 to search for available properties in North Central British Columbia. In May 2006, Sustut entered into an agreement, which was negotiated at arms-length with Richard Simpson, to acquire a 100% interest in the WILLOW claim purported to be located in the Omineca Mining Division, NTS map sheet 94D/10E