LAWSON PRODUCTS INC/NEW/DE/
Form 4
January 10, 2014

FORM 4

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

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

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

OMB Number:	3235-0287
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

(Print or Type Responses)

1. Name and Address of Reporting Person *
McCarthy Shane

(Last) (First) (Middle)

C/O LAWSON PRODUCTS, INC., 8770 WEST BRYN MAWR AVENUE, SUITE 900

(Street)

CHICAGO, IL 60631

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
LAWSON PRODUCTS INC/NEW/DE/ [LAWS]

3. Date of Earliest Transaction (Month/Day/Year)
01/08/2014

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
SVP, Operations

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock, $1.00 par value								1,309	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Underlying (Instr. 3 and
								Date Exercisable	Expiration Date	Title
				Code	V	(A)	(D)			
Restricted Stock Units	$ 13.61	01/08/2014		A		4,852		12/21/2016 (1)	12/31/2021	Common Stock
StockPerformance Rights (2)	$ 12.88	01/08/2014		A		7,299		12/31/2016	12/31/2021	Common Stock

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
McCarthy Shane C/O LAWSON PRODUCTS, INC. 8770 WEST BRYN MAWR AVENUE, SUITE 900 CHICAGO, IL 60631			SVP, Operations	

Signatures

/s/ Neil E. Jenkins, Attorney-in-Fact	01/10/2014
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Represents right to receive an amount of shares of common stock, up to the amount set forth in the table, based upon the appreciation of the common stock from the grant date to December 31, 2016.

(2) Stock Performance Rights, payable solely in cash, which vest on December 31, 2016. The performance rights reflect the right to receive in cash an amount equal to the appreciation in the Company's common stock above $12.88 from the date of the award up to the date that the reporting person exercises the right.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. duce key assemblies or components, such as lenses, for our products. Overseas facilities may subject us to the political and economic risks associated with overseas operations. The loss of or inability to establish or maintain such additional domestic or overseas facilities could materially adversely affect our competitive position and profitability.

LEGAL PROCEEDINGS

Our Company, on occasion, may also be involved in other legal matters arising in the ordinary course of our business. While management believes that such matters are currently insignificant, matters arising in the ordinary course of business for which we are or could become involved in litigation may have a material adverse effect on our business, financial condition or results of operations. We are not aware of any pending or threatened litigation against us or our officers and directors in their capacity as such that could have a material impact on our operations or finances, other than as set forth above.

MARKET PRICE OF AND DIVIDENDS ON COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

Our common stock is quoted on OTCQB, the OTC market tier for companies that report to the SEC, under the symbol PEYE. Our common stock was quoted on the OTCBB until February 23, 2011. The following table sets forth the high and low bid prices for our common stock for each quarter during the last two fiscal years as quoted on OTCQB. Such OTC market quotations reflect inter-dealer prices, without retail markup, markdown or commissions and may not necessarily represent actual transactions.

	High	**Low**
For the Fiscal Year Ended June 30, 2013		
First Quarter ended September 30, 2012	$1.50	$0.85
Second Quarter ended December 31, 2012	$1.19	$0.80
Third Quarter ended March 31, 2013	$0.90	$0.44
Fourth Quarter ended June 30, 2013	$0.86	$0.25
For the Fiscal Year Ended June 30, 2014		
First Quarter ended September 30, 2013	$1.09	$0.33
Second Quarter ended December 31, 2013	$0.95	$0.40
Third Quarter ended March 31, 2014	$1.05	$0.70
Fourth Quarter ended June 30, 2014	$1.00	$0.71
For the Fiscal Year Ended June 30, 2015		
First Quarter ended September 30, 2014	$0.95	$0.72
Second Quarter ended December 31, 2014 (through October 7, 2014)	$0.87	$0.75

Holders

As of October 1, 2014, we had approximately 100 holders of record of our common stock. Holders of record include nominees who may hold shares on behalf of multiple owners.

Dividends

We have not declared any dividends during the last two fiscal years. At present, we intend to retain our earnings, if any, to finance research and development and expansion of our business.

Recent Sales of Unregistered Securities

On July 1 through July 7, 2014, we closed agreements with institutional and accredited investors for the sale and purchase of 1,717,152 shares of our common stock, $0.01 par value at a purchase price of $0.60 per share. We received $1,030,291 in gross proceeds from the offering. We anticipate using the net proceeds from this placement for general working capital purposes. Of this amount, $50,000 was received in June 2014 and the remainder was received in July 2014.

14

In conjunction with the placement, we also entered into a registration rights agreement with the investors, whereby we were obligated to file a registration statement with the Securities Exchange Commission on or before forty-five calendar days after July 1, 2014 to register the resale by the investors of the 1,717,152 shares of the common stock purchased in the placement. Subsequent to the execution of the agreement, the parties agreed to extend the time period by which we are obligated to file a registration statement with the Securities Exchange Commission.

On July 22, 2014, we issued 78,000 restricted shares of our common stock to Mr. Jeff DiRubio as compensation for services rendered to us.

On July 22, 2014, we issued 12,298 restricted shares of our common stock to Mr. Kevin Dahill as compensation for services rendered to us.

We relied on the Section 4(a)(2) exemption from securities registration under the federal securities laws for transactions not involving any public offering. No advertising or general solicitation was employed in offering the securities. The securities were issued to accredited investors. The securities were offered for investment purposes only and not for the purpose of resale or distribution, and the transfers thereof was appropriately restricted by us.

Securities Authorized for Issuance under Equity Compensation Plans

The following table summarizes information about our equity compensation plans as of June 30, 2014.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	201,287	$ 7.72	27,198
Equity compensation plans not approved by security holders	207,800	$ 1.20	117,200

Total	409,087	$ 4.41	144,398

2006 Equity Incentive Plan

On November 28, 2006, our stockholders approved the Precision Optics Corporation, Inc. 2006 Equity Incentive Plan, which succeeded the Precision Optics Corporation, Inc. Amended and Restated 1997 Equity Incentive Plan. No further awards have been or will be granted under the 1997 Plan. The 2006 Plan allows for the grant of stock options to selected employees, directors and other persons who provide services to us or our affiliates.

2011 Equity Incentive Plan

The Precision Optics Corporation, Inc. 2011 Equity Incentive Plan was adopted by our Board of Directors on October 13, 2011. The 2011 Plan allows for the grant of stock options to selected employees, directors and other persons who provide services to us or our affiliates.

15

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the Financial Statements and Notes thereto, and other financial information included elsewhere in this Registration Statement on Form S-1. This Management's Discussion and Analysis of Financial Condition and Results of Operations contains descriptions of our expectations regarding future trends affecting our business. The following discussion sets forth certain factors we believe could cause actual results to differ materially from those contemplated by the forward-looking statements.

Overview

We have been a developer and manufacturer of advanced optical instruments since 1982. Today, the vast majority of our business is the design and manufacture of high-quality medical devices and approximately 10% of our business is the design and manufacture of military and industrial products. Our medical instrumentation line includes traditional endoscopes and endocouplers as well as other custom imaging and illumination products for use in minimally invasive surgical procedures. Much of our recent development efforts have been targeted at the development of next generation endoscopes. For the last ten years, we have funded internal research and development programs to develop next generation capabilities for designing and manufacturing 3D endoscopes and very small Microprecision™ lenses, anticipating future requirements as the surgical community continues to demand smaller and more enhanced imaging systems for minimally invasive surgery. Our unique proprietary technology in these areas, combined with recent developments in the areas of 3D displays and millimeter sized image sensors, has allowed us to begin commercialization of these technologies. We believe that new products based on these technologies provide enhanced imaging for existing surgical procedures and can enable development of many new procedures.

We are registered to the ISO 9001:2008 and ISO 13485:2003 Quality Standards and comply with the FDA Good Manufacturing Practices and the European Union Medical Device Directive for CE marking of our medical products. Our internet website is www.poci.com. Information on our website is not intended to be integrated into this prospectus.

The areas in which we do business are highly competitive and include both foreign and domestic competitors. Many of our competitors are larger and have substantially greater resources than we do. Furthermore, other domestic or foreign companies, some with greater financial resources than we have, may seek to produce products or services that compete with ours. We routinely outsource specialized production efforts as required to obtain the most cost effective production. Over the years, we have achieved extensive experience collaborating with other optical specialists worldwide and since the 1990s, we have maintained a Hong Kong subsidiary to support business and quality control activities as required throughout Asia.

We believe that competition for sales of our medical products and services, which have been principally sold to original equipment manufacturer, or OEM, customers, is based on performance and other technical features, as well as other factors, such as scheduling and reliability, in addition to competitive price.

We believe that our future success depends to a large degree on our ability to continue to conceive and to develop new optical products and services to enhance the performance characteristics and methods of manufacture of existing products. Accordingly, we expect to continue seeking and obtaining product- related design and development contracts with customers and to selectively invest our own funds on research and development, particularly in the areas of Microprecision™ optics, micro medical cameras and 3D endoscopes.

Critical Accounting Policies and Estimates

Our critical accounting policies are included in the Notes to our Financial Statements contained in this Registration Statement of Form S-1.

Results of Operations for the Fiscal Year Ended June 30, 2014 as Compared to the Fiscal Year Ended June 30, 2013

Total revenues for fiscal year 2014 were $3,651,181, an increase of $1,131,438, or 44.9%, from revenues for fiscal year 2013 of $2,519,743. The increase in revenues for fiscal year 2014 as compared to the prior year was due to higher unit volume sales of endocouplers, endoscopes, micro optics and initial sales of scanning otoscopes and 120 degree fiber scopes, which was partially offset by lower unit volume sales of the advanced surgical visualization system used in spinal surgery.

Revenues from our largest customers, as a percentage of total revenues, were as follows:

	Year Ended June 30	
	2014	2013
Customer A	21 %	13 %
Customer B	21	54
Customer C	14	1
All others	44	32
	100 %	100 %

16

Explanation of Responses:

No other customer accounted for more than 10% of our revenues in fiscal years 2014 and 2013.

Gross profit for fiscal year 2014 of $800,795 reflected an increase of $146,367 as compared to gross profit for fiscal year 2013 of $654,428. Gross profit as a percentage of revenues for fiscal year 2014 was 21.9% as compared to gross profit as a percentage of revenues for fiscal year 2013 of 26.0%. The decrease in our gross profit percentage was due primarily to less favorable product mix and certain nonrecurring manufacturing startup expenses related to the introduction of new products, which was partially offset by higher overall unit sales volume.

Research and development expenses, net were $471,106 for fiscal year 2014 as compared to $630,294 for fiscal year 2013. The decrease of $159,188, or 25.3%, for fiscal year 2014 as compared to the prior year was due primarily to lower spending on research and development related efforts. Research and development expenses depend on our assessment of new product opportunities and available resources. Research and development expenses were net of reimbursement from customers of related costs of $45,997 during fiscal year 2014 and $87,496 during fiscal year 2013.

Selling, general and administrative expenses increased by $242,302, or 19.2 %, to $1,503,443 for fiscal year 2014 as compared to $1,261,141 for fiscal year 2013. The increase for fiscal year 2014 was primarily due to higher legal, consulting, stock-based compensation, and selling expenses.

The gain on sale of assets and other in fiscal years 2014 and 2013 of $14,028 and $4,498, respectively, represents primarily the sale of previously written off assets for proceeds of $14,028 and $4,498, respectively.

In December 2012, we settled $106,149 of accounts payable with a vendor for a negotiated payment of $30,000, and recorded a gain of $76,149. The gain is included within other income in the accompanying consolidated statements of operations for fiscal year 2013.

The income tax provisions in fiscal years 2014 and 2013 represent the minimum statutory state income tax liability.

Liquidity and Capital Resources

We believe the following technology areas continue to represent significant opportunities for our future sales growth:

- Microprecision™ optical elements and micro medical camera assemblies with sizes on the order of 1 mm and smaller, that enable the introduction of imaging capabilities in locations in the body previously inaccessible and, when coupled with the latest in small complementary metal-oxide-semiconductor (CMOS) technology, enable production of single-use endoscopes that eliminate the risks associated with re- sterilization of existing endoscopes; and
- next generation handheld 3D endoscopes that provide high definition 3D images for use in minimally invasive surgery.

We compete in a highly technical, very competitive and in most cases, price driven segment of the medical instrument marketplace where products can take years to develop and introduce to distributors and end users. Furthermore, research and development, manufacturing, marketing and distribution activities are strictly regulated by the U.S. Food and Drug Administration, or FDA, International Organization for Standardization, or ISO and other regulatory bodies that, while intended to enhance the ultimate quality and functionality of products produced, can contribute to the significant cost and time needed to maintain existing products, and to develop and introduce product enhancements and new product innovations.

We have traditionally funded working capital needs through product sales, management of working capital components of our business, and by cash received from public and private offerings of our common stock, warrants to purchase shares of our common stock or convertible notes. We have incurred quarter to quarter operating losses during our efforts to develop current products including Microprecision™ optical elements, micro medical camera assemblies and 3D endoscopes. Our management expects that such operating losses will continue until sales increase to breakeven and profitable levels. Our management also believes that the opportunities represented by these products have the potential to generate sales increases to achieve breakeven and profitable results.

Until we achieve breakeven and profitable results, we will be required to pursue several options to manage cash flow and raise capital, including issuing debt or equity or entering into a strategic alliance. The sale of additional equity or convertible debt securities would result in additional dilution to our current stockholders, and debt financing, if available, may involve restrictive covenants that could restrict our operations or finances. Financing may not be available in amounts or on terms acceptable to us, if at all. If we cannot raise funds on acceptable terms or achieve positive cash flow, we may not be able to continue to conduct operations, develop new products, grow market share, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, any of which would negatively impact our business, operating results and financial condition.

During the year ended June 30, 2014, we incurred a net loss from operations of $1,159,726 and used cash in operating activities of $886,031. As of June 30, 2014, cash and cash equivalents were $202,380, accounts receivable were $531,049, and current liabilities were $1,095,877. As of June 30, 2013, cash and cash equivalents were $1,034,587, accounts receivable were $278,700, and current liabilities were $592,886.

On July 1 through July 7, 2014, we closed agreements with institutional and accredited investors for the sale and purchase of 1,717,152 shares of the Company’s common stock at a purchase price of $0.60 per share. We received

$1,030,291 in gross proceeds from the offering. We anticipate using the net proceeds from this placement for general working capital purposes. Of this amount, $50,000 was received in June 2014 and the remainder was received in July 2014.

17

Capital equipment expenditures during fiscal year 2014 and fiscal year 2013 were $1,680 and $11,061, respectively. Future capital equipment expenditures will be dependent upon future sales and success of on-going research and development efforts.

Contractual cash commitments for the fiscal years subsequent to June 30, 2014 are summarized as follows:

	2015	2016	Thereafter	Total
Operating Leases	$13,178	$776	$ 776	$14,730

We have contractual cash commitments related to open purchase orders as of June 30, 2014 of approximately $221,000.

Trends and Uncertainties That May Affect Future Results

We are excited about the continued development, commercialization, and market acceptance of our new products and technical innovations based upon our unique proprietary technology. For the year ended June 30, 2014, approximately 75% of our sales were made to our top six customers. Of these, two are large, international, medical device companies who have been our customers for many years. Both of these customers continue to purchase products that we developed over five years ago, and both now purchase our new products that were developed and launched into production more recently. The other four top customers purchase products that we developed in just the last couple years, and which rely heavily on our unique, proprietary Microprecision™ lens technology and optical visualization system expertise.

In April 2012, we accepted an order from one of these new customers to purchase endoscopes for a total purchase amount of $1,032,000. We have now completed pre-production activities and recently began production shipments against this order, which relies heavily on our proprietary Microprecision™ technology. During the last year, we have supplied engineering and manufacturing services to another of these new customers, who is developing next generation otoscope devices used for the treatment of ears. We have delivered pre-production otoscopes, which have performed well during testing by our customer. We continue to sell engineering and manufacturing services to this customer and expect to ultimately manufacture this product when it is released to production in the next 9 to 12 months. Also during the last year, we provided two of our largest customers with new optical lenses and prisms with small sizes, enabled by our proprietary Microprecision™ technology.

We continue to work with new customers to lay the groundwork for future products. During fiscal 2014, we provided design and engineering services to a major consumer and professional electronics and camera manufacturer to develop a new 3D adapter for use with ophthalmologic microscopes for use in eye treatments. Utilizing our extensive experience and proprietary design approaches for 3D visualization, we have delivered pre-production units that our customer demonstrated to leaders in the ophthalmologic community with very positive response. We received an initial order for production units of this device in July 2014 and are beginning production now.

During fiscal 2014, we began work with two additional customers and continued work with an existing customer to provide design and engineering services for devices that are enabled by our Microprecision™ lenses and proprietary technology for the design and manufacture of small cameras for use in medical applications. For one of these projects, we have begun high volume production. The other two are expected to begin production in the next 12 months.

We have also focused recent operational efforts on sales and marketing activities intended to broaden awareness of the benefits of our new technology platforms, which we believe are ready for general application to medical device projects requiring surgery-grade visualization from sub-millimeter sized devices and handheld 3D endoscopy. We continue to attend trade shows to announce our new technology, most recently at the Medical Design & Manufacturing East show in New York City in June 2014. During fiscal year 2014, we advertised, for the first time, through a business-to-business e-commerce platform. Photonics Online, www.photonicsonline.com, has a target audience of optical engineering design and manufacturing professionals and has over 34,000 subscribers to their monthly email newsletter. Because of the increased awareness of our new technology generated by our presence at trade shows, advertising on Photonics Online and direct email messages to our own customer database that we have built over the last 30 years, we have more than doubled the rate that we received requests for quotes during fiscal year 2014. As we begin fiscal year 2015, we are continuing to build on recent successes in this area by continuing the activities summarized above while adding additional advertising through a second business-to-business e-commerce platform, Med Device Online, www.meddeviceonline.com, which targets technical professionals working in the medical device industry.

18

Due to the introductory stage of many of our new products and the unpredictable timing of orders from customers, it is difficult to predict with certainty the detailed rate of future revenue growth. As summarized above, we have received significant new orders for a number of new products, which rely on our Microprecision™ lens technology and associated capabilities. We believe these orders will help to increase our revenues in future quarters. Also, we expect that current discussions with existing and new potential customers could lead to increases in our revenues. To continue to support orders for new products as well as ongoing and future discussions, we intend to continue to develop and commercialize new products and technical innovations, including:

- new components and instruments utilizing our patented Microprecision™ lens technology for optical components and micro medical camera assemblies with sizes on the order of 1 millimeter and smaller; and
- new 3D imaging technology for use in handheld 3D endoscopes, and for 3D monitor-based visualization through surgical microscopes.

Over the past few years, we have implemented significant changes in new product and technology development by shifting the emphasis of research and development efforts from developing underlying technologies to commercializing the applications of these new technologies. These efforts have already been realized to some degree in the area of Microprecision™ lenses with ongoing shipments now in place, including shipments against orders for micro medical camera assemblies. While most of our current orders for Microprecision™ lenses support medical applications, we are now beginning to explore additional applications including those in the defense and surveillance markets.

We have also developed and manufactured prototypes of a new 3D endoscope with high definition quality imaging and 10 mm diameter for use in general laparoscopic surgery. This next generation 3D endoscope has been evaluated by a number of medical professionals and has been received enthusiastically. We believe that with the advent of commercially available high quality flat panel 3D displays, handheld 3D endoscopy represents an opportunity for sales growth for our Company. In addition, the technology we have developed for 3D endoscopy can also be used for 3D monitor-based visualization through surgical microscopes.

Off-Balance Sheet Arrangements

We currently have no off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

There have been no disagreements with our independent public accountant in regards to accounting and financial disclosure.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company, as defined by Rule 12b-2 of the Exchange Act and in Item 10(f)(1) of Regulation S-K, we are electing scaled disclosure reporting obligations and therefore are not required to provide the information requested by this Item.

DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS

Identification of Directors and Executive Officers

Set forth below is certain information with respect to the individuals who are our directors and executive officers as of October 1, 2014.

Name	Age	Position(s) or Office(s) Held
Joseph N. Forkey	46	Chief Executive Officer, President, Treasurer and Director
Jack P. Dreimiller	66	Senior Vice President, Finance and Chief Financial Officer
Donald A. Major	53	Executive Vice President for Corporate Development and Director
Richard E. Forkey	74	Director Emeritus*
Richard B. Miles	71	Director
Joel R. Pitlor	71	Director
Kenneth S. Schwartz	69	Director**
Peter H. Woodward	41	Chairman of the Board of Directors**

* Director until July 9, 2014, on which date he became Director Emeritus

**Appointed July 9, 2014

Board Composition. Our Board of Directors is divided into three classes that are as nearly equal in number as possible, with each class serving for a staggered term of office. Only one class is elected each year. Each director serves a three year term and until his or her successor has been duly elected and qualified. Our Board currently consists of five directors. As of October 1, 2014, our Class II directors are Joel R. Pitlor and Donald A. Major, and our Class III directors are Joseph N. Forkey and Richard Miles. Due to their recent appointments, Peter Woodward and Kenneth Schwartz have not been added to classes yet.

Biographies and Qualifications of Our Executive Officers and Directors. The biographies of our executive officers and directors and certain information regarding each director’s experience, attributes, skills and/or qualifications that led to the conclusion that the individual should be serving as an executive officer and/or director of our Company are as follows:

Dr. Joseph N. Forkey

Dr. Joseph N. Forkey, son of Richard E. Forkey, has served as Chief Executive Officer, President and Treasurer since February 8, 2011. Dr. Forkey has been a member of our Board of Directors since 2006. He served as our Chairman of the Board from 2011 to July 9, 2014, our Executive Vice President and Chief Scientific Officer from April 2006 to February 2011, and held the position of our Chief Scientist from September 2003 to April 2006. Since joining us, he has been involved in general technical and management activities of our Company, as well as investigations of opportunities that leverage our newly developed technologies. Dr. Forkey holds B.A. degrees in Mathematics and Physics from Cornell University, and a Ph.D. in Mechanical and Aerospace Engineering from Princeton University. Prior to joining us, Dr. Forkey spent seven years at the University of Pennsylvania Medical School as a postdoctoral fellow and research staff member. Dr. Forkey is a valuable member of our Board due to his depth of scientific, operating, strategic, transactional, and senior management experience in our industry. Additionally, Dr. Forkey has held positions of increasing responsibility at our Company and holds an intimate knowledge of our Company due to his longevity in the industry and with us.

Jack P. Dreimiller

Mr. Jack P. Dreimiller has served as our Senior Vice President, Finance and Chief Financial Officer since August 15, 2008. Prior to that time, he served as our Senior Vice President, Finance and Chief Financial Officer from April 1992 until June 2005, and as an independent consultant to our Company from June 2005 to December 2005. Since June 2005, he has served as an independent consultant serving various roles as financial/accounting executive, including interim Chief Financial Officer, for a number of companies. Mr. Dreimiller is a Certified Public Accountant (inactive) and holds a BS in Business Administration from the University of Buffalo. He has over twenty-five years of experience in various senior financial management positions, including audit and consulting experience with an international accounting firm, and Controller and VP Finance experience with both small firms and multi-national corporations.

Donald A. Major

Effective February 9, 2012, our Board of Directors appointed Mr. Donald A. Major as our Executive Vice President for Corporate Development, in addition to his ongoing role as a member of our Board of Directors. He has served as a member of our Board since 2005. Mr. Major is co-founder & Chief Manager of Window2Decor, LLC, a start-up e-commerce retailer of window coverings and complimentary home accent products, and has been employed as an independent consultant since October 2007, providing companies with interim management, turnaround, restructuring and reorganization services as well as sourcing services for a private equity firm. From October 2006 to May 2007, he served as Vice President of Corporate Development of Advanced Duplication Services LLC. From February 2002 to late 2008, Mr. Major served as Vice President and Treasurer of Anderson Entertainment, LLC (formerly Digital Excellence LLC), which was owned by a private equity firm and sold to Advanced Duplication Services LLC. He earned his B.A. in Accounting in 1984 from Michigan State University. He is a Certified Public Accountant (inactive) and has experience in the field of public accounting and in financial officer positions in publicly held and start-up medical device companies. Mr. Major is a valuable member of our Board due to his depth of operating, financial, accounting, management, and corporate efficiency experience.

Richard E. Forkey

Mr. Richard E. Forkey currently serves as Director Emeritus. Effective February 8, 2011, Mr. Forkey resigned as Chief Executive Officer, President, and Treasurer of our Company, and effective July 9, 2014, he resigned as Director. He had served as a Director and Chief Executive Officer since he founded our Company in 1982.

Richard B. Miles

Professor Richard B. Miles was appointed to our Board of Directors in November 2005. He has been a member of the faculty at Princeton University since 1972, and serves as the Director of the Applied Physics Group in Princeton University’s Mechanical and Aerospace Engineering Department. Professor Miles is a valuable member of our Board due to his depth of scientific experience and familiarity with the field of our technologies, insight into the academic community, and familiarity with the latest developments and innovations in science and technology.

20

Joel R. Pitlor

Mr. Joel R. Pitlor has served as a member of our Board of Directors since June 1990. Since 1979, he has held the position of president of J.R. Pitlor, a management consulting firm which he founded that provides strategic business planning for executive officers. Mr. Pitlor has provided business planning consultation to us since 1983. Mr. Pitlor is a valuable member of our Board due to his depth of operating, strategic, financial planning, and management experience. Additionally, Mr. Pitlor has a detailed knowledge of the history of our Company having advised senior management for over 25 years.

Kenneth S. Schwartz

Dr. Schwartz was appointed to our Board effective July 9, 2014 in connection with the sale and purchase agreement we entered into in July 2014. Dr. Schwartz is currently the Medical Director at New York Radiology Alliance, a position he has held since October 2010, and the Director of the Radiology Residency Program at Brookhaven Memorial Hospital Medical Center. He was the founding and managing Partner of S and D Medical LLP, a 60 person radiology group providing radiology services to eleven hospitals and imaging centers in the New York metropolitan area, for over ten years until he sold the Practice in 2010. He has served on the Board of Directors at ARKS Radiology Management, Inc. since June 1999 and serves on the Board of Trustees at the Brookhaven Memorial Hospital Medical Center. Dr. Schwartz also served as the Adjunct Clinical Associate Professor in the Department of Medical Imaging at the New York Institute of Technology in the College of Osteopathic Medicine from July 2007 to July 2012. Dr. Schwartz earned a BS from Brooklyn College and a Medical Degree from Albert Einstein College of Medicine. He was a Diagnostic Radiology Resident at North Shore University Hospital in the Memorial Hospital-Sloan Kettering Cornell Cooperating Program.

Peter H. Woodward

Mr. Woodward was appointed to our Board effective July 9, 2014 and as chairman of the Board in connection with the sale and purchase agreement we entered into in July 2014. Mr. Woodward is the founder of MHW Capital Management, LLC, or MHW, a position he has held since September 2005. MHW specializes in large equity investments in public companies implementing operating strategies to significantly improve their profitability. From 1996 to 2005, Mr. Woodward was the Managing Director for Regan Fund Management, LLC. He currently serves as the Chairman of the Board and member of the Audit Committee for Cartesian, Inc. and TSS, Inc. Mr. Woodward holds a BA in economics from Colgate University and a Masters of International Affairs with a concentration in international economics and finance from Columbia University. He is also a Chartered Financial Analyst.

Other Involvement in Certain Legal Proceedings

None of our directors or executive officers has been involved in any bankruptcy or criminal proceedings, nor have there been any judgments or injunctions brought against any of our directors or executive officers during the last ten years that we consider material to the evaluation of the ability and integrity of any director or executive officer.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our directors, executive officers and persons who own more than 10% of a registered class of our securities to file reports of beneficial ownership and changes in beneficial ownership with the Securities and Exchange Commission on Forms 3 (Initial Statement of Beneficial Ownership), 4 (Statement of Changes of Beneficial Ownership of Securities) and 5 (Annual Statement of Beneficial Ownership of Securities). Officers, directors and greater than 10% beneficial owners are required by SEC regulations to furnish us with copies of all Section 16(a) forms they file.

Based solely upon a review of reports provided to us by our officers and directors, we believe that, during the fiscal year ended June 30, 2014, no person required to file reports under Section 16(a) of the Securities Exchange Act of 1934 failed to file such reports on a timely basis during such fiscal year.

Code of Ethics

We previously adopted a Corporate Code of Ethics and Conduct that applies to all employees, officers and directors of our Company, including our principal executive officer, principal financial officer and principal accounting officer or controller, or persons performing similar functions, a copy of which was filed as Exhibit 14.1 to our annual report on Form 10-K for the Fiscal Year Ended June 30, 2008 with the Securities and Exchange Commission on September 28, 2008. A copy of our Corporate Code of Ethics and Conduct can be obtained free of charge by contacting our Secretary, c/o Precision Optics Corporation, Inc., 22 East Broadway, Gardner, Massachusetts 01440.

Procedure for Nominating Directors

There have been no material changes to the procedures by which security holders may recommend nominees to our Board of Directors.

The Board of Directors will consider candidates for director positions that are recommended by any of our stockholders. Any such recommendation should be provided to our Secretary. Recommendations should be submitted to us in writing addressed to our Secretary, c/o Precision Optics Corporation, Inc., 22 East Broadway, Gardner, Massachusetts 01440. The recommendation should include the following information: name of candidate; address, phone and fax number of candidate; a statement signed by the candidate certifying that the candidate wishes to be considered for nomination to our Board of Directors and stating why the candidate believes that he or she would be a valuable addition to our Board of Directors; a summary of the candidate's work experience for the prior five years and the number of shares of our stock beneficially owned by the candidate.

The Board will evaluate the recommended candidate and shall determine whether or not to proceed with the candidate in accordance with our procedures. We reserve the right to change our procedures at any time to comply with the requirements of applicable laws.

Committees of the Board of Directors

The Board of Directors has the responsibility for establishing broad corporate policies and reviewing our overall performance rather than day-to-day operations. The Board's primary responsibility is to oversee management of our Company and, in so doing, serve the best interests of our Company and our stockholders.

Our Board of Directors has the ability to establish, or disband, such committees as necessary or appropriate to serve the needs of our Company. In February 2012, our Board of Directors made the determination to restructure and unanimously voted to disband its committees, including its Audit Committee. Our full Board of Directors performs all of the functions normally designated to an audit committee, compensation committee and nominating committee.

Audit Committee and Audit Committee Financial Expert

As of February 2012, the Board of Directors no longer has a separately designated audit committee. Now, the functions of the audit committee are conducted by the entire Board, whose members are named above. We do not currently have an "audit committee financial expert," as defined in Item 407(d)(5)(ii) of Regulation S-K.

Mr. Major, whom formerly served as Chair of the Audit Committee and was determined by the Board to qualifies as an audit committee financial expert, no longer meets the criteria set forth in Item 407(d)(5) of Regulation S-K as he is employed by our Company as an executive officer and therefore is not "independent" as independence for audit committee members is defined in the NASDAQ Listing Rules. We believe that each member of our Board is financially literate and possesses sufficient experience, both professionally and by virtue of his service on our Board, to be fully capable of discharging his duties as a member of our Board performing audit committee functions. However, the Board believes that Mr. Major's professional background and services assist the Board when additional financial expertise is warranted.

EXECUTIVE COMPENSATION

Executive and Director Compensation

Summary Compensation

The following table sets forth all compensation for our fiscal years ended June 30, 2014 and 2013 awarded to, earned by, or paid to our Principal Executive Officer and our most highly compensated employee, both of which are referred to herein as the "Named Executive Officers." No other executive officer earned over $100,000 in the last completed fiscal year.

Summary Compensation Table for the Fiscal Years Ended June 30, 2014 and 2013

Name and Principal Position (a)	Year June 30, (b)	Salary ($) (c)	Bonus ($) (d)	Stock Awards ($) (e)	Option Awards ($) (f) (1)	Total ($) (j)
Joseph N. Forkey	2014	120,000	0	0	0	120,000
Chief Executive Officer, President and Treasurer	2013	120,000	0	0		120,000
Richard G. Cyr	2014	170,874	500 (1)	0	0	171,374
Optical Shop Manager	2013	129,439	1,000 (1)	0	0	130,439

(1) Represents a performance award for the respective fiscal year.

22

Employment Contracts and Termination of Employment Arrangements

We have no employment contracts, other than the compensation agreement with Dr. Joseph N. Forkey disclosed below, in place with any Named Executive Officer. We have no compensatory plan or arrangement with respect to any Named Executive Officer where such plan or arrangement will result in payments to such Named Executive Officer upon or following his resignation, or other termination of employment with us and our subsidiaries, or as a result of a change-in-control of our Company or a change in the Named Executive Officers' responsibilities following a change-in-control.

Outstanding Equity Awards at Fiscal Year-End Table for the Fiscal Year Ended June 30, 2014

The following table shows grants of options outstanding on June 30, 2014, the last day of our fiscal year, to each of the Named Executive Officers named in the Summary Compensation Table.

Option Awards

Name	**Number of securities underlying unexercised options exercisable (#)**		**Number of securities underlying unexercised options unexercisable (#)**	**Option exercise price ($)**	**Option expiration date**
Joseph N. Forkey	600	(1)	0	13.75	05/09/2016
	11,208	(2)	0	13.75	06/13/2015
	22,416	(3)	0	20.75	06/13/2015
	150,000	(4)	0	1.20	(1) 03/02/2022
Richard G. Cyr	10,200	(5)	0	13.75	05/09/2016
	40,000	(6)	0	0.27	07/14/2021

(1) The options were granted on May 9, 2006 and vested immediately.

(2) The options were granted on June 13, 2005; 25% of such options vested immediately; 25% of such options vested May 9, 2007; 25% vested on May 9, 2008; and the remaining 25% of such options vested on May 9, 2009.

(3) The options we granted on June 13, 2005; upon the date of grant, 30% of the options, or 6,725 shares, vested immediately. The remaining 70% of the options, or 15,691 shares, vested upon achievement of performance milestones.

(4)

The options were granted on March 2, 2012; the options vested in increments of 25,000 shares on the first day of each quarter, beginning on January 1, 2013, until all shares were fully vested.

(5) The options were granted on May 9, 2006 and vested immediately.

(6) The options were granted on July 14, 2011; 13,333 shares vested on October 15, 2011, 13,333 vested on July 15, 2012 and the remaining shares vested on July 15, 2013.

Profit Sharing and 401(k) Plan

We have a defined contribution 401(k) profit sharing plan. Employer profit sharing and matching contributions to the plan are discretionary. No employer profit sharing contributions were made to the plan in fiscal years 2014 and 2013. No employer matching contributions were made to the plan in fiscal years 2014 and 2013.

Director Compensation

The following table sets forth cash amounts and the value of other compensation paid to our directors, but does not include the compensation of Dr. Joseph N. Forkey, our Chief Executive Officer, President and Treasurer, as his compensation is reflected in the Summary Compensation Table. During the fiscal year ended June 30, 2014, our Board of Directors determined that Dr. Joseph N. Forkey and Mr. Richard E. Forkey were our employee directors and, therefore, would not earn any fees related to service on our Board.

23

Director Compensation Table for the Fiscal Year Ended June 30, 2014

Name of Director	Fees earned or paid in cash ($) (1)	Option awards ($)(2) (3)	All other compensation ($)	Total ($)
Richard E. Forkey (4)	0	0	361 (5)	361
Donald A. Major (6)	1,250 (7)	29,700(8)	30,078 (7)	34,028
Richard B. Miles	1,250	2,700	0	3,950
Joel R. Pitlor	1,000	2,700	0	3,700

(1) Under our director compensation plan, each director receives $250 per board or committee meeting that the director attends. We also reimburse our directors for travel expenses. As our Board has determined that Dr. Joseph N. Forkey and Mr. Richard E. Forkey are employees of our Company, Dr. Forkey and Mr. Forkey do not earn any fees related to service on our Board of Directors.

(2) Represents the aggregate grant date fair value of stock option awards granted in the respective fiscal year as computed in accordance with FASB ASC Topic 718, Compensation — Stock Compensation. The fair value of each stock option award is estimated on the date of grant using the Black-Scholes option valuation model. A discussion of the assumptions used in calculating the amounts in this column may be found in the Notes to our audited consolidated financial statements for the year ended June 30, 2014 set forth in this Registration Statement on Form S-1. These amounts do not represent the actual amounts paid to or realized by the directors during the fiscal year ended June 30, 2014.

(3) On January 2, 2014, we granted Messrs. Major, Miles, and Pitlor options to purchase 3,000 shares of our common stock. These options were fully vested as of the date of grant, have an exercise price of $0.90 and expire on January 2, 2024.

(4) Mr. Forkey served as our Chief Executive Officer until February 8, 2011 and as a Director until July 9, 2014. Mr. Forkey now serves as our founder and Director Emeritus.

(5) Mr. Forkey's compensation consisted of $361 earned as salary compensation for his services in the executive position of Advisor to the Chief Executive Officer. As previously disclosed in our current report on Form 8-K filed with the Securities and Exchange Commission on July 30, 2012, on July 25, 2012, our Board of Directors approved an arrangement with Mr. Forkey to cancel Mr. Forkey's life insurance policy, on which we had been paying the policy premiums. The timing of the cancellation of the policy was based upon mutual agreement between us and Mr. Forkey. As the one-time payment of $40,000 has not been made to date, it is not included in Mr. Forkey's FY 2014 compensation.

(6) Mr. Donald A. Major was appointed to serve as our Executive Vice President for Corporate Development on February 9, 2012, in addition to his continued service as a member of our Board of Directors.

(7) Mr. Major's compensation consisted of: (a) $1,250 earned a compensation for his services as a member of our Board of Directors; and (b) $30,078 earned as salary compensation for his services as our Executive Vice President for Corporate Development.

(8) On September 23, 2014, we granted Mr. Major an option to purchase 30,000 shares of our common stock as compensation for services rendered to us as Executive Vice President of Corporate Development. The option expires September 23, 2024 and the exercise price is $0.90 per share.

Narrative to Director Compensation Table

Under our director compensation plan, each director receives $250 per board or committee meeting that the director attends. We also reimburse our directors for travel expenses.

On February 9, 2012, our Board of Directors made the determination to also award each non-employee director an annual grant of 3,000 options, fully vested upon issuance, to be issued on the first business day of January of each year going forth. On January 2, 2014, in accordance with such resolution, we granted Messrs. Major, Miles, and Pitlor options to purchase 3,000 shares of our common stock. These options were fully vested as of the date of grant, have an exercise price of $0.90 and expire on January 2, 2024.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following tables set forth information regarding our common stock owned as of the close of business on October 1, 2014 by the following persons: (i) each person who is known by us to own beneficially more than 5% of our common stock, (ii) each of our directors who beneficially owns our common stock, (iii) each of our Named Executive Officers who beneficially own our common stock and (iv) all executive officers and directors, as a group, who beneficially own our common stock. The information on beneficial ownership in the table and footnotes thereto is based upon data furnished to us by, or on behalf of, the persons listed in the table.

We have determined beneficial ownership in accordance with the rules of the SEC. Except as indicated by the footnotes below, we believe, based on the information furnished to us, that the persons and entities named in the table below have sole voting and investment power with respect to all shares of common stock that they beneficially own, subject to applicable community property laws.

In computing the number of shares of common stock beneficially owned by a person and the percentage ownership of that person, we deemed outstanding shares of common stock subject to options held by that person that are currently exercisable or exercisable within 60 days after October 1, 2014. We did not deem these shares outstanding, however, for the purpose of computing the percentage ownership of any other person.

Stockholders Known by Us to Own Over 5% of Our Common Stock

	Amount of beneficial ownership (1)			**Percent of**
Name and Address of Beneficial Owner	**Shares Owned**	**Shares – Rights to Acquire**	**Total Number**	**Shares Beneficially Owned (2)**
Austin W. Marxe (3)(4) c/o Special Situations Funds 527 Madison Avenue, Suite 2600 New York, NY 10022	1,269,213	1,208,647	2,477,860	33.2%
David M. Greenhouse (3) c/o Special Situations Funds 527 Madison Avenue, Suite 2600 New York, NY 10022	1,269,213	1,208,443	2,477,656	33.2%
Adam C. Stettner (3) c/o Special Situations Funds 527 Madison Avenue, Suite 2600 New York, NY 10022	1,269,213	1,208,443	2,477,656	33.2%
Arnold Schumsky (5) 145 East 27th Street New York, New York 10016	213,764	112,487	326,251	5.1%
MHW Partners, L.P. (6) 150 East 52nd Street 30th Fl. New York, New York 10022	347,223	155,557	502,780	7.8%
DAFNA Capital Management LLC (7) 10990 Wilshire Boulevard, Suite 1400 Los Angeles, CA 90024	384,193	272,223	556,416	8.5%
Alpha Capital Anstalt (8) 150 Central Park South New York, New York 10019	277,778	194,445	472,223	7.3%
Hershey Strategic Capital, LP (9) 888 7th Ave., 17th Floor	1,166,667	0	1,166,667	18.6%

New York, New York 10019

(1) Represents shares with respect to which each beneficial owner listed has or will have, upon acquisition of such shares upon exercise or conversion of options, warrants, conversion privileges or other rights exercisable within sixty days, sole voting and investment power. Amounts listed have been adjusted, if necessary, to reflect a 1-for-25 reverse split, effective December 11, 2008. For the purposes of this table, we have not assumed the limitations on exercise set forth in certain warrants, which limit the number of shares of common stock that the holder, together with all other shares of common stock beneficially owned by such person, does not exceed 4.999% of the total outstanding shares of common stock.

(2) As of September 23, 2014, there were 6,262,584 shares of our common stock issued and outstanding. Percentages are calculated on the basis of the amount of issued and outstanding common stock plus, for each person or group, any securities that such person or group has the right to acquire within 60 days pursuant to options, warrants, conversion privileges or other rights.

(3) We relied, in part, on a Schedule 13D/A jointly filed with the SEC on June 10, 2014 by Austin W. Marxe, David M. Greenhouse and Adam C. Stettner for this information.

25

Messrs. Marxe and Greenhouse and Stettner are the controlling principals of AWM Investment Company, Inc., the general partner of and investment adviser to Special Situations Cayman Fund, L.P. AWM Investment Company also serves as the general partner of MGP Advisers Limited Partnership, the general partner of Special Situations Fund III QP, L.P. Messrs. Marxe Greenhouse and Stettner are also members of MG Advisers L.L.C., the general partner of Special Situations Private Equity Fund, L.P. AWM Investment Company serves as the investment adviser to Special Situations Fund III QP and Special Situations Private Equity Fund.

Special Situations Cayman Fund owns 1 share of common stock. Special Situations Fund III QP owns 934,212 shares of common stock; 3,630,000 warrants to purchase 215,332 shares of common stock, expiring May 11, 2017; warrants to purchase 427,779 shares of common stock, expiring September 28, 2017; and warrants to purchase 175,000 shares of common stock, expiring February 12, 2016. Special Situations Private Equity Fund owns 335,000 shares of common stock; 3,630,000 warrants to purchase 215,332 shares of common stock, expiring May 11, 2017; and warrants to purchase 175,000 shares of common stock, expiring February 12, 2016. Messrs. Marxe, Greenhouse and Stettner share the power to vote and direct the disposition of all shares of common stock owned by Special Situations Cayman Fund, Special Situations Fund III QP, and Special Situations Private Equity Fund.

Messrs. Marxe and Greenhouse are deemed to beneficially own a total of 1,269,213 shares of common stock; 7,230,000 warrants to purchase an aggregate of 430,664 shares of common stock, expiring May 11, 2017; warrants to purchase 427,779 shares of common stock, expiring September 28, 2017; and warrants to purchase 350,000 shares of common stock, expiring February 12, 2016. However, the aggregate number of shares of common stock into which 427,779 warrants of the total warrants held by Special Situations Fund III QP are exercisable, and which Messrs. Marxe and Greenhouse have the right to acquire beneficial ownership, is limited to the number of shares of common stock that, together with all other shares of common stock beneficially owned by Messrs. Marxe and Greenhouse, does not exceed 4.999% of the total outstanding shares of common stock. Accordingly, the 427,779 warrants expiring September 28, 2017 are not currently exercisable into common stock until the actual shares of common stock held by Messrs. Marxe and Greenhouse is less than 4.999% of the total outstanding shares of common stock. Special Situations Fund III QP may waive this 4.999% restriction with 61 days’ notice to us.

(4) Mr. Marxe holds an additional 204 shares of common stock that may be acquired by Mr. Marxe as an individual upon the exercise of outstanding stock options.

(5) We relied, in part, on a Schedule 13D filed with the SEC on June 6, 2007 by Arnold Schumsky for this information. Mr. Schumsky beneficially owns a total of 326,251 shares of common stock. His ownership consists of (i) 213,764 shares of common stock owned of record by Mr. Schumsky, and (ii) 112,487 shares that may be acquired upon the exercise of outstanding warrants. However, the aggregate number of shares of common stock into which 58,334 warrants of the total warrants held by Mr. Schumsky are exercisable, and which Mr. Schumsky has the right to acquire beneficial ownership, is limited to the number of shares of common stock that, together with all other shares of common stock beneficially owned by Mr. Schumsky, does not exceed 4.999% of the total outstanding shares of common stock. Accordingly, 58,334 warrants are not currently exercisable into common stock until the actual shares of common stock held by Mr. Schumsky is less than 4.999% of the total outstanding shares of common stock. Mr. Schumsky may waive this 4.999% restriction with 61 days’ notice to us.

(6)

We relied, in part, on a Schedule 13D jointly filed with the SEC on July 24, 2014 by MHW Partners, L.P., MHW Capital, LLC, MHW Capital Management, LLC and a form 3 filed by Peter H. Woodward on July 16, 2014 for this information.

MHW Partners, L.P. is a Delaware limited partnership. MHW Capital, LLC is a Delaware limited liability company. MHW Capital Management, LLC is a Delaware limited liability company. MHW Capital, LLC is the general partner of MHW Partners, L.P. Mr. Woodward is the principal of MHW Capital Management, LLC and MHW Capital, LLC and in such capacity, Mr. Woodward holds the power to vote and direct the disposition of all shares of common stock owned by MHW Partners, L.P. MHW Partners, L.P., MHW Capital, LLC, MHW Capital Management, LLC and Mr. Woodward share the power to vote and direct the disposition of all shares of common stock owned by MHW Partners, L.P.

MHW Partners, L.P. beneficially owns 347,223 shares of common stock, and 155,557 shares that may be acquired upon the exercise of outstanding warrants. However, the aggregate number of shares of common stock into which such warrants are exercisable, and which MHW Partners, L.P. has the right to acquire beneficial ownership, is limited to the number of shares of common stock that, together with all other shares of common stock beneficially owned by MHW Partners, L.P., does not exceed 4.999% of the total outstanding shares of common stock. Accordingly, such warrants are not currently exercisable into common stock until the actual shares of common stock held by MHW Partners, L.P. is less than 4.999% of the total outstanding shares of common stock. MHW Partners, L.P. may waive this 4.999% restriction with 61 days’ notice to us.

26

We relied, in part, on a Schedule 13G jointly filed with the SEC on February 13, 2014 by DAFNA Capital Management, LLC, Nathan Fischel and Fariba Ghodsian for this information.

(7) DAFNA Capital Management, LLC is a Delaware limited liability company. DAFNA Capital Management is the investment adviser of DAFNA LifeScience Market Neutral, Ltd., DAFNA LifeScience Select, Ltd., and DAFNA LifeScience, Ltd. DAFNA Capital Management, in its capacity as investment adviser to DAFNA LifeScience Market Neutral, DAFNA LifeScience Select, and DAFNA LifeScience, may be deemed to be the beneficial owner of the shares owned by DAFNA LifeScience Market Neutral, DAFNA LifeScience Select, and DAFNA LifeScience, as in its capacity as investment adviser it has the power to dispose, direct the disposition of, and vote the shares of the issuer owned by DAFNA LifeScience Market Neutral, DAFNA LifeScience Select, and DAFNA LifeScience. Nathan Fischel and Fariba Ghodsian are part-owners of DAFNA Capital Management and managing members of DAFNA Capital Management. As controlling persons of DAFNA Capital Management, Drs. Fischel and Ghodsian may each respectively be deemed to beneficially own the shares owned by DAFNA LifeScience Market Neutral, DAFNA LifeScience Select, and DAFNA LifeScience. Pursuant to Rule 13d-4, Drs. Fischel and Ghodsian disclaim beneficial ownership of the securities.

DAFNA Capital Management beneficially owns 384,193 shares of common stock, in the aggregate. DAFNA Capital Management holds common stock purchase warrants exercisable into 272,223 shares of common stock, in the aggregate. DAFNA LifeScience Market Neutral owns 77,778 shares of common stock and 54,445 shares that be acquired upon the exercise of outstanding warrants. DAFNA LifeScience Select owns 200,000 shares of common stock and 140,000 shares that be acquired upon the exercise of outstanding warrants. DAFNA LifeScience owns 111,111 shares of common stock and 77,778 shares that be acquired upon the exercise of outstanding warrants. However, the aggregate number of shares of common stock into which such warrants are exercisable, and which DAFNA Capital Management has the right to acquire beneficial ownership, is limited to the number of shares of common stock that, together with all other shares of common stock beneficially owned by DAFNA Capital Management, does not exceed 4.999% of the total outstanding shares of common stock. Accordingly, such warrants are not currently exercisable into common stock until the actual shares of common stock held by DAFNA Capital Management is less than 4.999% of the total outstanding shares of common stock. DAFNA LifeScience Market Neutral, DAFNA LifeScience Select, and DAFNA LifeScience may waive this 4.999% restriction with 61 days' notice to us.

(8) Alpha Capital Anstalt beneficially owns 277,778 shares of common stock and 194,445 shares that may be acquired upon the exercise of outstanding warrants. However, the aggregate number of shares of common stock into which such warrants are exercisable, and which Alpha Capital Anstalt has the right to acquire beneficial ownership, is limited to the number of shares of common stock that, together with all other shares of common stock beneficially owned by Alpha Capital Anstalt, does not exceed 4.999% of the total outstanding shares of common stock. Accordingly, such warrants are not currently exercisable into common stock until the actual shares of common stock held by Alpha Capital Anstalt is less than 4.999% of the total outstanding shares of common stock. Alpha Capital Anstalt may waive this 4.999% restriction with 61 days' notice to us.

(9) We relied, in part, on the Schedule 13D filed by Hershey Strategic Capital, LP on July 11, 2014 for this information. Hershey Strategic Capital, LP beneficially owns 1,166,667 shares of common stock. Hershey Strategic Capital, LP is managed by Adam Hershey.

Officers and Directors

Name and address of beneficial owner (1)	Nature of beneficial ownership	Amount of beneficial ownership (2) Shares Owned	Shares – Rights to Acquire	Total Number	Percent of Shares Beneficially Owned (3)
Joseph N. Forkey (4)	Former Chairman of the Board of Directors, Chief Executive Officer, President and Treasurer	33,620	199,781	233,401	3.6%
Jack P. Dreimiller (5)	Senior Vice President and Chief Financial Officer	583	15,000	15,583	*
Donald A. Major (6)	Executive Vice President for Corporate Development and Director	35,778	85,445	121,223	1.9%
Richard E. Forkey (7)	Advisor to the Chief Executive Officer and Director	212,993	49,333	262,326	4.2%
Richard B. Miles (8)	Director	15,112	23,379	38,491	1.0
Joel R. Pitlor (9)	Director	205,395	25,978	231,373	3.7%
Richard G. Cyr (10)	Optical Shop Manager	0	50,200	50,200	1.0
Peter H. Woodward (11)	Director and Chairman	347,223	155,557	502,780	7.8%
Kenneth S. Schwartz	Director	0	0	0	*
All directors and executive officers as a group		850,704	559,116	1,408,820	20.6%

* Percentage of shares beneficially owned does not exceed one percent of issued and outstanding shares of stock.

27

(1) Unless otherwise stated, the address of each beneficial owners listed on the table is c/o Precision Optics Corporation, Inc., 22 East Broadway, Gardner, MA 01440.

(2) Represents shares with respect to which each beneficial owner listed has or will have, upon acquisition of such shares upon exercise or conversion of options, warrants, conversion privileges or other rights exercisable within sixty days, sole voting and investment power.

(3) As of October 1, 2014, we had 6,262,584 shares of our common stock issued and outstanding. Percentages are calculated on the basis of the amount of issued and outstanding common stock plus, for each person or group, any securities that such person or group has the right to acquire within 60 days of September 23, 2014 pursuant to options, warrants, conversion privileges or other rights.

(4) Dr. Forkey is Director and serves as our Chief Executive Officer, President and Treasurer. Dr. Forkey's beneficial ownership consists of (a) 33,620 shares of common stock held in joint ownership with his wife, Heather Forkey, with whom he shares voting and dispositive control, (b) 15,557 shares of common stock that may be acquired upon the exercise of outstanding warrants, and (c) 184,224 shares of common stock that may be acquired upon the exercise of outstanding stock options.

(5) Mr. Dreimiller is our Senior Vice President and Chief Financial Officer. Mr. Dreimiller's beneficial ownership consists of (a) 583 shares of common stock, and (b) 15,000 shares of common stock that may be acquired upon the exercise of outstanding stock options.

(6) Mr. Major is our Executive Vice President for Corporate Development and a member of our Board of Directors. Mr. Major's beneficial ownership consists of (a) 35,778 shares of common stock, (b) 19,445 shares of common stock that may be acquired upon the exercise of outstanding warrants and (c) 66,000 shares of common stock that may be acquired upon the exercise of outstanding stock options.

(7) Mr. Forkey is Director Emeritus. He served as our Chief Executive Officer until February 8, 2011 and Director until July 9, 2014. Mr. Forkey's beneficial ownership consists of (a) 212,993 shares of common stock, (b) 19,445 shares of common stock that may be acquired upon the exercise of outstanding warrants, and (c) 29,888 shares of common stock that may be acquired upon the exercise of outstanding stock options.

(8) Mr. Miles is a member of our Board of Directors. Mr. Miles' beneficial ownership consists of (a) 15,112 shares of common stock, (b) 7,779 shares that may be acquired upon the exercise of outstanding warrants, and (c) 15,600 shares of common stock that may be acquired upon the exercise of outstanding stock options.

(9) Mr. Pitlor is a member of our Board of Directors. Mr. Pitlor's beneficial ownership consists of (a) 205,395 shares of common stock, (b) 10,000 shares that may be acquired upon the exercise of outstanding warrants, and (c) 15,978 shares of common stock that may be acquired upon the exercise of outstanding stock options.

(10) Mr. Cyr is our Optics Laboratory Manager and is considered a “named executive officer” as defined in Item 402(a)(3) of Regulation S-K. Mr. Cyr beneficially owns 50,200 shares of common stock which may be acquired upon the exercise of outstanding stock options.

(11) Mr. Peter Woodward is the Chairman of our Board. Mr. Woodward is the managing member and general partner of MHW Partners and in such capacity, Mr. Woodward holds the power to vote and direct the disposition of all shares of common stock owned by MHW Partners. On July 2, 2014, MHW Partners purchased 125,000 shares of common stock. On September 28, 2012, MHW Partners purchased 222,223 shares of our common stock, and warrants to purchase up to 155,557 shares of our common stock at an exercise price of $1.25 per share, subject to adjustment and a call provision if certain market price targets are reached, and an expiration date of September 28, 2017.

28

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Certain Relationships and Related Transactions

We lease our main facility in Gardner, Massachusetts from Equity Assets, Inc., a company wholly-owned by Mr. Richard E. Forkey, a former member of our Board of Directors and our former President, Chief Executive Officer, and Treasurer. We are currently a tenant-at-will, paying rent of $9,000 per month, or an aggregate of $108,000 per year, for each of fiscal years 2014 and 2013.

On September 28, 2012, we closed on agreements with investors for the sale and purchase of units consisting of an aggregate of (i) 2,777,795 shares of our common stock, and (ii) warrants to purchase an aggregate of 1,944,475 shares of common stock, at a per unit price of $0.90. Each unit consisted of one share of common stock and 70% warrant coverage. The warrants have an exercise price of $1.25 per share, subject to adjustment and a call provision if certain market price targets are reached, expire five years from September 28, 2012, and are exercisable in whole or in part, at any time prior to expiration. We received $2.5 million in gross proceeds from the offering.

Certain of our directors and officers participated in the offering on the same terms as the other investors and purchased a total aggregate amount of approximately $80,000 of units in the offering, in such amounts as follows:

Name of Purchaser	Company Affiliation at the Time of the Transaction	Securities Purchased in Offering Shares of Common Stock	Warrants	Unit Price	Subscription Amount
Forkey, Richard E.	Director	27,778	19,445	$0.90	$25,000.20
Joseph N. Forkey and Heather C. Forkey JTTEN	Chief Executive Officer, President, Treasurer and Director	22,223	15,557	$0.90	$20,000.70
Major, Donald A.	Executive Vice President for Corporate Development and Director	27,778	19,445	$0.90	$25,000.20
Miles, Richard	Director	11,112	7,779	$0.90	$10,000.80

On February 12, 2013, we entered into a settlement agreement with one of our directors and stockholders, Joel Pitlor (the “Pitlor Settlement Agreement”). Under the terms of the Pitlor Settlement Agreement, we issued 10,000 shares of our common stock and warrants to purchase 10,000 shares of our common stock as payment in full of any amounts due to Mr. Pitlor under the registration rights agreement we entered into with Mr. Pitlor, and other parties, on February 1, 2007. The warrants issued in connection with the Pitlor Settlement Agreement have an exercise price of $1.50 per share, subject to adjustment, expire three years from February 12, 2013, and are exercisable in whole or in part, at any time prior to expiration. We valued the securities issued to Mr. Pitlor at $17,000.

Transactions with Stockholders Known by Us to Own 5% or More of Our Common Stock

Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P.

On June 25, 2008, we entered into a purchase agreement, as amended on December 11, 2008, with Special Situations Fund III QP, L.P., Special Situations Private Equity Fund, L.P., and other accredited investors pursuant to which we sold a total of $600,000 of 10% Senior Secured Convertible Notes, referred to as the "Notes," that are convertible into a total of 480,000 shares of our common stock at a conversion rate of $1.25. We also issued warrants to purchase a total of 316,800 shares of our common stock at an exercise price of $1.75 per share, referred to as the "Warrants." Interest accrued on the Notes at a rate of 10% per year and was payable in cash upon the earlier of conversion or maturity of the Notes. The original maturity of the Notes was June 25, 2010 and the original expiration date of the Warrants was June 25, 2015, subject to extension. By mutual agreement with us, Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. agreed to amend its Notes on December 11, 2008, June 25, 2010, July 26, 2010, September 15, 2010, October 15, 2010, November 15, 2010, November 30, 2010, December 1, 2010, December 3, 2010, December 17, 2010, January 10, 2011, January 24, 2011, February 7, 2011, February 25, 2011, March 11, 2011, March 31, 2011, April 14, 2011, April 29, 2011, May 13, 2011, June 3, 2011, June 28, 2011, July 6, 2011, July 20, 2011, July 25, 2011, July 27, 2011, August 31, 2011, September 30, 2011, and October 31, 2011 to extend the "Stated Maturity Date" of the Notes. At the time of each of the amendments of the Notes, Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. owned over 5% of our common stock. Pursuant to the terms of the settlement agreement entered into with Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. on February 12, 2013 (as discussed in further detail below), the expiration date of the Warrants held by Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. was amended from June 25, 2015 to May 11, 2017. The exercise price of the Warrants may be adjusted downward in the event we issue shares of common stock or securities convertible into common stock at a price lower than the exercise price of the Warrants at the time of issuance. On December 15, 2011, we repaid Special Situations Fund III QP, L.P. a principal repayment of $275,000 and accrued interest of $95,486, for a total payment of $370,486. On December 15, 2011, we repaid Special Situations Private Equity Fund, L.P. a principal repayment of $275,000 and accrued interest of $95,486, for a total payment of $370,486. The Notes held by Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. have been satisfied in full and the obligations thereunder have been terminated. We registered the shares and the shares underlying the Warrants purchased by Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. in the June 2008 private placement in a registration statement that is currently effective.

In our private placement of common stock and warrants on September 28, 2012, Special Situations Fund III QP, L.P. purchased 611,112 shares of our common stock, and warrants to purchase up to 427,779 shares of our common stock at an exercise price of $1.25 per share, subject to adjustment and a call provision if certain market price targets are reached, and an expiration date of September 28, 2017. At the time of the transaction, Special Situations Fund III QP, L.P. owned 5% or more of our common stock. We registered the shares and the shares underlying the warrants purchased by Special Situations Fund III QP, L.P. in the September 2012 private placement in a registration statement that is currently effective.

On February 12, 2013, we entered into a settlement agreement with Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. Under the terms of the settlement agreement, we agreed to: (a) issue an aggregate of (i) 350,000 shares of our common stock, and (ii) warrants to purchase an aggregate of 350,000 shares of our common stock, and (b) amend the expiration date of the warrants issued to Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. in conjunction with our June 25, 2008 private placement (the "2008 Warrants"), as payment in full of the alleged damages sought by Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. The expiration date of the 2008 Warrants was amended from June 25, 2015 to May 11, 2017. The warrants issued in connection with the settlement agreement have an exercise price of $1.50 per share, subject to adjustment, expire three years from February 12, 2013, and are exercisable in whole or in part, at any time prior to expiration. We valued the securities issued to Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. at $595,000. At the time of the transaction, Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. owned more than 5% of our common stock.

Arnold Schumsky

On June 25, 2008, we entered into a purchase agreement, as amended on December 11, 2008, with Mr. Arnold Schumsky and other accredited investors pursuant to which we sold a total of $600,000 of 10% Senior Secured Convertible Notes, referred to as the "Notes," that are convertible into a total of 480,000 shares of our common stock at a conversion rate of $1.25. We also issued warrants to purchase a total of 316,800 shares of our common stock at an exercise price of $1.75 per share, referred to as the "Warrants." Interest accrued on the Notes at a rate of 10% per year and was payable in cash upon the earlier of conversion or maturity of the Notes. The original maturity of the Notes was June 25, 2010 and the original expiration date of the Warrants was June 25, 2015, subject to extension. By mutual agreement with us, Mr. Schumsky agreed to amend his Note on December 11, 2008, June 25, 2010, July 26, 2010, September 15, 2010, October 15, 2010, November 15, 2010, November 30, 2010, December 1, 2010, December 3, 2010, December 17, 2010, January 10, 2011, January 24, 2011, February 7, 2011, February 25, 2011, March 11, 2011, March 31, 2011, April 15, 2011, April 29, 2011, May 13, 2011, June 3, 2011, June 28, 2011, July 6, 2011, July 20, 2011, July 25, 2011, July 27, 2011, August 31, 2011, September 30, 2011, October 31, 2011, December 15, 2011, and January 31, 2012 to extend the "Stated Maturity Date." On March 31, 2012, Mr. Schumsky further amended his Note to extend the "Stated Maturity Date" of the principal to July 31, 2012 and to modify the Note such that all accrued and unpaid interest on the Note up to and including March 31, 2012 shall be due on or before April 13, 2012, on the condition that we issue to him a warrant for 5,000 shares of common stock with an exercise price of $1.20 per share and a term of three years. On April 13, 2012, we repaid Mr. Schumsky a payment of the accrued interest of $18,819, and such payment included all accrued and unpaid interest on the Note up to and including March 31, 2012. On May 8, 2012, we issued Mr. Schumsky the warrant according to the terms described in the amended Note. On July 31, 2012, Mr. Schumsky further amended his Note to extend the “Stated Maturity Date” of the principal to August 31, 2012. On August 31, 2012, Mr. Schumsky further amended his Note to extend the “Stated Maturity Date” of the principal to September 30, 2012. On September 28, 2012, we repaid Mr. Schumsky the outstanding and accrued interest of $2,500 due under his Note and such payment satisfied its obligations in regards to the accrued interest due on the Note in full. On that same date, Mr. Schumsky presented the outstanding principal balance of the Note to us and agreed to exchange the $50,000 principal balance of his Note for participation in our September 2012 private placement and was awarded units consisting of 55,555 shares of common stock and 38,889 warrants upon the same terms as the units sold in the September 2012 private placement. Accordingly, the Note held by Mr. Schumsky has been satisfied in full and the obligations thereunder have been terminated. At the time of each of the amendments and the 2012 transactions, Mr. Schumsky owned 5% or more of our common stock. We registered the shares and the shares underlying the Warrants purchased by Mr. Schumsky in the June 2008 private placement in a registration statement that is currently effective.

On September 28, 2012, Mr. Schumsky presented the outstanding principal balance of his Note to us and agreed to exchange the $50,000 principal balance of his Note for participation in our September 2012 private placement. Mr. Schumsky was issued units consisting of 55,555 shares of common stock and warrants to purchase up to 38,889 shares of our common stock at an exercise price of $1.25 per share, subject to adjustment and a call provision if certain market price targets are reached, and an expiration date of September 28, 2017. On September 28, 2012, Mr. Schumsky also purchased additional shares in the private placement consisting of 27,779 shares of our common stock, and warrants to purchase up to 19,445 shares of our common stock at an exercise price of $1.25 per share, subject to adjustment and a call provision if certain market price targets are reached, and an expiration date of September 28, 2017. At the time of the exchange and transaction, Mr. Schumsky owned 5% or more of our common stock. We registered the shares and the shares underlying the warrants purchased by Mr. Schumsky in the September 2012 private placement in a registration statement that is currently effective.

On February 12, 2013, we entered into a settlement agreement with Mr. Schumsky (the “Schumsky Settlement Agreement”). Under the terms of the Schumsky Settlement Agreement, we issued 10,000 shares of our common stock and warrants to purchase 10,000 shares of our common stock as payment in full of any amounts due to Mr. Schumsky under the registration rights agreement we entered into with Mr. Schumsky, and other parties, on February 1, 2007 and under the registration rights agreement we entered into with Mr. Schumsky, and other parties, on June 25, 2008. The warrants issued in connection with the Schumsky Settlement Agreement have an exercise price of $1.50 per share, subject to adjustment, expire three years from February 12, 2013, and are exercisable in whole or in part, at any time prior to expiration. We valued the securities issued to Mr. Schumsky at $17,000. At the time of the transaction, Mr. Schumsky owned 5% or more of our common stock.

On July 1 through July 7, 2014, we closed agreements with institutional and accredited investors for the sale and purchase of 1,717,152 shares of our common stock, $0.01 par value at a purchase price of $0.60 per share. Pursuant to this transaction, Mr. Schumsky purchased 83,343 shares of our common stock. In conjunction with the placement, we also entered into a registration rights agreement with the Investors, whereby we are obligated to file a registration statement with the Securities Exchange Commission on or before forty-five calendar days after July 1, 2014 to register the resale by the investors of the 1,717,152 shares of the common stock purchased in the placement. At the time of the transaction, Mr. Schumsky owned 5% or more of our common stock. Subsequent to the agreement, the parties agreed to extend the time period by which we are obligated to file a registration statement with the Securities Exchange Commission.

MHW Partners, LP

On July 1 through July 7, 2014, we closed agreements with institutional and accredited investors for the sale and purchase of 1,717,152 shares of our common stock, $0.01 par value at a purchase price of $0.60 per share. Pursuant to this transaction, MHW Partners purchased 125,000 shares of our common stock. In conjunction with the placement, we also entered into a registration rights agreement with the Investors, whereby we are obligated to file a registration statement with the Securities Exchange Commission on or before forty-five calendar days after July 1, 2014 to register the resale by the investors of the 1,717,152 shares of the common stock purchased in the placement. Subsequent to the agreement, the parties agreed to extend the time period by which we are obligated to file a registration statement with the Securities Exchange Commission.

At the time of the transaction, MHW was a holder of more than 5% of our common stock. Mr. Woodward is the principal of MHW Capital Management, LLC and MHW Capital, LLC and in such capacity, Mr. Woodward holds the power to vote and direct the disposition of all shares of common stock owned by MHW Partners, LP. Mr. Woodward was subsequently appointed as Chairman of our Board of Directors on July 9, 2014.

Director Independence

During the fiscal year ended June 30, 2014, the Board of Directors determined that Messrs. Richard B. Miles and Joel R. Pitlor were “independent” as defined under the standards of independence set forth in the NASDAQ Listing Rules and the rules under the Securities Exchange Act of 1934.

LEGAL MATTERS

Certain legal matters in connection with the securities will be passed upon for us by the law firm of Trombly Business Law, P.C., Boulder, Colorado. Trombly Business Law, PC will not receive a direct or indirect interest in our Company and has never been a promoter, underwriter, voting trustee, director, officer, or employee of our Company. Nor does Trombly Business Law, PC have any contingent based agreement with us or any other interest in or connection to us.

EXPERTS

The June 30, 2013 and 2012 financial statements included in this prospectus have been audited by Stowe & Degon LLC, independent auditors, and have been included in reliance upon the report of such firm given upon their authority as experts in accounting and auditing. Stowe & Degon LLC, has no direct or indirect interest in us, nor were they a promoter or underwriter.

DISCLOSURE OF COMMISSION POSITION ON INDEMNIFICATION FOR SECURITIES ACT LIABILITIES

We have been advised that, in the opinion of the Securities and Exchange Commission, indemnification for liabilities arising under the Securities Act is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities is asserted by one of our directors, officers, or controlling persons in connection with the securities being registered, we will, unless in the opinion of our legal counsel the matter has been settled by controlling precedent, submit the question of whether such indemnification is against public policy to a court of appropriate jurisdiction. We will then be governed by the court's decision.

Index to Financial Statements

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of

Precision Optics Corporation, Inc.:

We have audited the accompanying consolidated balance sheets of Precision Optics Corporation, Inc. and subsidiaries (the Company) as of June 30, 2014 and 2013 and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Precision Optics Corporation, Inc. and subsidiaries as of June 30, 2014 and 2013 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Stowe & Degon LLC

Westborough, Massachusetts

September 8, 2014

F-2

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

Consolidated Balance Sheets at June 30, 2014 and 2013

	2014	2013
ASSETS		
Current Assets:		
Cash and cash equivalents	$202,380	$1,034,587
Accounts receivable (net of allowance for doubtful accounts of $22,500 in 2014 and $15,000 in 2013)	531,049	278,700
Inventories	988,878	896,173
Prepaid expenses	91,922	61,567
Total current assets	1,814,229	2,271,027
Fixed Assets:		
Machinery and equipment	2,368,709	2,367,029
Leasehold improvements	553,596	553,596
Furniture and fixtures	148,303	148,303
Vehicles	19,674	19,674
	3,090,282	3,088,602
Less—Accumulated depreciation and amortization	3,075,722	3,056,554
Net fixed assets	14,560	32,048
Patents, net	7,672	–
	$1,836,461	$2,303,075
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$715,192	$289,255
Customer advances	26,200	38,044
Accrued employee compensation	200,207	151,915
Accrued professional services	60,250	70,000
Accrued warranty expense	25,000	25,000
Other accrued liabilities	69,028	18,672
Total current liabilities	1,095,877	592,886
Commitments (Note 2)		
Stockholders' Equity:		
Common stock, $0.01 par value: 50,000,000 shares authorized; 4,455,134 shares issued and outstanding at June 30, 2014 and June 30, 2013	44,551	44,551
Additional paid-in capital	42,146,750	41,955,717
Accumulated deficit	(41,450,717)	(40,290,079)
Total stockholders' equity	740,584	1,710,189
	$1,836,461	$2,303,075

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

F-3

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

for the Years Ended June 30, 2014 and 2013

	2014	2013
Revenues	$3,651,181	$2,519,743
Cost of goods sold	2,850,386	1,865,315
Gross profit	800,795	654,428
Research and development expenses, net	471,106	630,294
Selling, general and administrative expenses	1,503,443	1,261,141
Gain on sale of assets	(14,028)	(4,498)
Total operating expenses	1,960,521	1,886,937
Operating loss	(1,159,726)	(1,232,509)
Non-cash provision for claims for liquidated damages	–	(629,000)
Other income	–	76,149
Interest expense	–	(1,408)
Loss before provision for income taxes	(1,159,726)	(1,786,768)
Provision for income taxes	912	912
Net loss	$(1,160,638)	$(1,787,680)
Loss per share:		
Basic	$(0.26)	$(0.51)
Diluted	$(0.26)	$(0.51)
Weighted average common shares outstanding:		
Basic	4,455,134	3,521,387
Diluted	4,455,134	3,521,387

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

F-4

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity

for the Years Ended June 30, 2014 and 2013

	Number of Shares	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Equity (Deficit)
Balance, July 1, 2012	1,251,339	$ 12,513	$ 39,009,215	$ (38,502,399)	$ 519,329
Proceeds from sale of common stock and warrants	2,777,795	27,778	2,163,340	–	2,191,118
Exercise of warrants	50,000	500	49,500	–	50,000
Issuance of common stock to settle claims for liquidated damages	370,000	3,700	625,300	–	629,000
Stock-based compensation	6,000	60	108,362	–	108,422
Net loss	–	–	–	(1,787,680)	(1,787,680)
Balance, June 30, 2013	4,455,134	$ 44,551	$ 41,955,717	$ (40,290,079)	$ 1,710,189
Advance proceeds from private placement of common stock	–	–	50,000	–	50,000
Stock-based compensation	–	–	141,033	–	141,033
Net loss	–	–	–	(1,160,638)	(1,160,638)
Balance, June 30, 2014	4,455,134	$ 44,551	$ 42,146,750	$ (41,450,717)	$ 740,584

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

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows for the

Years Ended June 30, 2014 and 2013

	2014	2013
Cash Flows from Operating Activities:		
Net loss	(1,160,638)	$(1,787,680)
Adjustments to reconcile net loss to net cash used in operating activities-		
Depreciation and amortization	20,020	20,970
Gain on sale of assets	(14,028)	(4,498)
Gain on settlement of accounts payable	–	(76,149)
Provision for inventory write-down	–	19,337
Stock-based compensation expense	141,033	108,422
Non-cash consulting expense	64,507	–
Non-cash provision for settlement of claims for liquidated damages	–	629,000
Non-cash interest expense	–	1,250
Changes in operating assets and liabilities-		
Accounts receivable, net	(252,349)	63,200
Inventories	(92,705)	(232,610)
Prepaid expenses	(30,355)	(27,848)
Accounts payable	425,937	(44,912)
Customer advances	(11,844)	31,657
Accrued expenses	24,391	6,469
Net cash used in operating activities	(886,031)	(1,293,392)
Cash Flows from Investing Activities:		
Proceeds from sale of assets	14,028	4,498
Additional patent costs	(8,524)	–
Purchases of fixed assets	(1,680)	(11,061)
Net cash provided by (used in) investing activities	3,824	(6,563)
Cash Flows from Financing Activities:		
Advance proceeds from July 2014 private placement of common stock	50,000	–
Gross proceeds from September 2012 private placement of common stock and warrants	–	2,500,015
Private placement expenses incurred and paid	–	(308,896)
Payment of principal and interest on 10% Senior Convertible Notes	–	(52,500)
Proceeds from exercise of warrants to purchase common stock (50,000 shares)	–	50,000
Net cash provided by financing activities	50,000	2,188,619
Net (decrease) increase in cash and cash equivalents	(832,207)	888,664
Cash and cash equivalents, beginning of year	1,034,587	145,923
Cash and cash equivalents, end of year	$202,380	$1,034,587
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the year for income taxes	$912	$912

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

F-6

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Nature of Business

Precision Optics Corporation, Inc. (the “Company”) designs, develops, manufactures and sells specialized optical systems and components and optical thin-film coatings. The Company conducts business in one industry segment only and its customers are primarily domestic. The Company’s products and services fall into two principal areas: (i) medical products for use by hospitals and physicians; and (ii) advanced optical system design and development services and products used by military and industrial customers.

(b) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its two wholly-owned subsidiaries. All inter-company accounts and transactions have been eliminated in consolidation.

(c) Revenues

The Company recognizes revenue when four basic criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services rendered; (3) the price to the buyer is fixed and determinable; and (4) collectability is reasonably assured. The Company’s shipping terms are customarily FOB shipping point.

The sales price of products and services sold is fixed and determinable after receipt and acceptance of a customer’s purchase order or properly executed sales contract, typically before any work is performed. Management reviews each customer purchase order or sales contract to determine that the work to be performed is specified and there are no unusual terms and conditions that would raise questions as to whether the sales price is fixed or determinable. The Company assesses credit worthiness of customers based upon prior history with the customer and assessment of financial condition. Accounts receivable are stated at the amount management expects to collect from outstanding balances. An allowance for doubtful accounts is provided for that portion of accounts receivable considered to be uncollectible, based upon historical experience and management's evaluation of outstanding accounts receivable at the end of the year. Bad debts are written off against the allowance when identified.

The Company's revenue transactions typically do not contain multiple deliverable elements for future performance obligations to customers, other than a standard one-year warranty on materials and workmanship, the estimated costs for which are provided for at the time revenue is recognized.

Revenues for industrial and medical products sold in the normal course of business are recognized upon shipment when delivery terms are FOB shipping point and all other revenue recognition criteria have been met. Gross shipping charges reimbursable from customers, to deliver product, are insignificant and are included in "Revenues" section of the Company's consolidated statement of operations, while shipping costs are classified in the "selling, general and administrative expenses" section of the Company's consolidated statement of operations.

(d) Cash and Cash Equivalents

The Company includes in cash equivalents all highly liquid investments with original maturities of three months or less at the time of acquisition. Cash and cash equivalents of $202,380 and $1,034,587 at June 30, 2014 and 2013, respectively, consist primarily of cash at banks and money market funds. The Company maintains its cash and cash equivalents in bank deposit accounts that, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk on its cash and cash equivalents.

(e) Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market and include material, labor and manufacturing overhead. The components of inventories at June 30, 2014 and 2013 are as follows:

	2014	2013
Raw material	$445,210	$302,448
Work-in-progress	385,601	392,991
Finished goods	158,067	200,734
	$988,878	$896,173

F-7

The Company provides for estimated obsolescence on unmarketable inventory based upon assumptions about future demand and market conditions. If actual demand and market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Inventory, once written down, is not subsequently written back up, as these adjustments are considered permanent adjustments to the carrying value of the inventory.

During fiscal year 2014 and 2013, the Company recorded a pre-tax non-cash provision for slow-moving and obsolete inventories of $0 and $19,337, respectively.

(f) Property and Equipment

Property and equipment are recorded at cost. Maintenance and repair items are expensed as incurred. The Company provides for depreciation and amortization by charges to operations, using the straight-line and declining-balance methods, which allocate the cost of property and equipment over the following estimated useful lives:

Asset Classification	**Estimated Useful Life**
Machinery and equipment	2-7 years
Leasehold improvements	Shorter of lease term or estimated useful life
Furniture and fixtures	5 years
Vehicles	3 years

Depreciation expense was $19,168 and $20,970 for the years ended June 30, 2014 and 2013, respectively.

(g) Significant Customers and Concentration of Credit Risk

Financial instruments that subject the Company to credit risk consist primarily of cash equivalents and trade accounts receivable. The Company places its investments with highly rated financial institutions. The Company has not experienced any losses on these investments to date. At June 30, 2014, receivables from the Company’s three largest customers were 30%, 17% and 11% of the total accounts receivable. At June 30, 2013, receivables from the Company’s three largest customers were 26%, 24% and 12%, of the total accounts receivable. No other customer accounted for more than 10% of the Company’s receivables as of June 30, 2014 and 2013. The Company has not experienced any material losses related to accounts receivable from individual customers. The Company generally does not require collateral or other security as a condition of sale, rather it relies on credit approval, balance limitation and monitoring procedures to control credit risk of trade account financial instruments. Management believes that allowances for doubtful accounts, which are established based upon review of specific account balances and historical experience, are adequate.

Revenues from the Company’s largest customers, as a percentage of total revenues, were as follows:

	Year Ended June 30 2014	2013
Customer A	21 %	13 %
Customer B	21	54
Customer C	14	1
All others	44	32
	100 %	100 %

No other customer accounted for more than 10% of the Company’s revenues in fiscal years 2014 and 2013.

(h) Loss per Share

Basic income (loss) per share is computed by dividing net income or net loss by the weighted average number of shares of common stock outstanding during the period. Diluted income (loss) per share is computed by dividing net income or net loss by the weighted average number of shares of common stock outstanding during the period, plus the number of potentially dilutive securities outstanding during the period such as stock options and warrants. For the year ended June 30, 2014 and 2013, the effect of such securities was antidilutive and not included in the diluted calculation because of the net loss generated in those periods.

F-8

The following is the calculation of loss per share for the years ended June 30, 2014 and 2013:

	Year Ended June 30	
	2014	2013
Net Loss– Basic and Diluted	$(1,160,638)	$(1,787,680)
Basic Weighted Average Shares Outstanding	4,455,134	3,521,387
Potentially Dilutive Securities	–	–
Diluted Weighted Average Shares Outstanding	4,455,134	3,521,387
Loss Per Share		
Basic	$(0.26)	$(0.51)
Diluted	$(0.26)	$(0.51)

The number of shares issuable upon the exercise of outstanding stock options and warrants that were excluded from the computation as their effect was antidilutive was approximately 3,393,000 and 3,434,000 for the years ended June 30, 2014 and 2013, respectively.

(i) Stock-Based Compensation

The measurement and recognition of compensation costs for all stock-based awards made to employees and the Board of Directors are based upon fair value over the requisite service period for awards expected to vest. The Company estimates the fair value of share-based awards on the date of grant using the Black-Scholes option-pricing model. Stock-based compensation costs recognized for the years ended June 30, 2014 and 2013 amounted to $141,033 and $108,422, respectively.

(j) Patents

Patent costs are amortized using the straight-line method over the shorter of their legal or estimated useful lives, generally five to ten years. Amortization expense was $852 and $0 for the years ended June 30, 2014 and 2013, respectively.

In July 2011, the Company assigned all of its currently issued and pending patents, as well as new inventions that it conceives before July 28, 2012, to Intuitive Surgical.

(k) Fair Value of Financial Instruments

Financial instruments consist principally of cash equivalents, accounts receivable, senior secured convertible notes payable, accounts payable and accrued expenses. The estimated fair value of these financial instruments approximates their carrying value due to their short-term nature.

(l) Long-Lived Assets

Long-lived assets and certain identifiable intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(m) Warranty Costs

The Company does not incur future performance obligations in the normal course of business other than providing a standard one-year warranty on materials and workmanship to its customers (except in certain unusual and infrequently occurring situations where extended warranty terms beyond one year are negotiated with the customer). The Company provides for estimated warranty costs at the time product revenue is recognized. Warranty costs have been included as a component of cost of goods sold in the accompanying consolidated statements of operations. The following tables summarize warranty reserve activity for the years ended June 30, 2014 and 2013:

	2014	2013
Balance at beginning of period	$25,000	$25,000
Provision for warranty claims	11,917	2,006
Warranty claims incurred	(11,917)	(2,006)
Balance at end of period	$25,000	$25,000

F-9

(n) Research and Development

Research and development expenses are charged to operations as incurred. The Company groups development and prototype costs and related reimbursements in research and development. For the years ended June 30, 2014 and 2013, research and development expense is shown net of reimbursements of $45,997 and $87,496, respectively, in the accompanying statements of operations.

(o) Comprehensive Income

Comprehensive income or loss is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owners sources. The Company’s comprehensive loss or income for the years ended June 30, 2014 and 2013 was equal to its net loss for the same periods.

(p) Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. In assessing the likelihood of utilization of existing deferred tax assets, management has considered historical results of operations and the current operating environment.

(q) Segment Reporting

Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision-making group, in making decisions about how to allocate resources and assess performance. The Company’s chief decision-maker is its Chief Executive Officer. To date, the Company has viewed its operations and manages its business as principally one segment. For all periods presented, over 90% of the Company’s sales have been to customers in the United States.

(r) Use of Estimates

The preparation of financial statements in conformity with accounting standards generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(s) Recent Accounting Pronouncements

In July 2013, the FASB issued Accounting Standards Update (ASU) 2013-11, "Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" ("ASU 2013-11"). The new standard requires the presentation of certain unrecognized tax benefits as reductions to deferred tax assets rather than as liabilities in the consolidated balance sheets when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The new standard is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2013, which for the Company is the first quarter of fiscal 2015. The Company does not expect the adoption of ASU 2013-11 to have a material impact on its consolidated financial statements.

In June 2014, the FASB issued ASU 2014-12, *Accounting for Share-Based Payments When the Terms of an Award Provide that a Performance Target Could Be Achieved After the Requisite Service Period.* The update is intended to resolve the diverse accounting treatment of these types of awards in practice. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in "Compensation - Stock Compensation (Topic 718)" as it relates to awards with performance conditions that affect vesting to account for such awards. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The ASU is effective for interim and annual reporting periods that begin after December 15, 2015. The Company does not expect the adoption of this pronouncement to have an impact on our financial statements as this guidance mirrors our existing policy for such share-based awards.

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"). ASU 2014-09 provides a single, comprehensive accounting model for revenues arising from contracts with customers that supersedes most of the existing revenue recognition guidance, including industry-specific guidance. Under this model, revenue is recognized at an amount that an entity expects to be entitled to upon transferring control of goods or services to a customer, as opposed to when risks and rewards transfer to a customer under existing revenue recognition guidance. ASU 201-09 is effective for the Company beginning in its fiscal year 2018, and may be applied retrospectively to all prior periods presented or through a cumulative adjustment to the opening retained earnings balance in the year of adoption. The Company is currently in the process of evaluation the impact of ASU 2014-09 on its consolidated financial statements.

(2) COMMITMENTS

(a) Related Party Transactions

The Company leases its main Gardner facility from a corporation owned by Mr. Richard E. Forkey, who resigned from our board of directors on July 9, 2014, but continues to be involved with our Company as the Founder and Chairman Emeritus. The Company is currently a tenant-at-will, paying rent of $9,000 per month. Total rent expense paid or accrued to such related party was $108,000 in each of fiscal years 2014 and 2013, and is included in the Company's accompanying consolidated statements of operations.

On September 28, 2012, the Company closed on agreements with investors for the sale and purchase of units consisting of an aggregate of (i) 2,777,795 shares of common stock, and (ii) warrants to purchase an aggregate of 1,944,475 shares of common stock, at a per unit price of $0.90. Each unit consisted of one share of common stock and 70% warrant coverage. The warrants have an exercise price of $1.25 per share, subject to adjustment and a call provision if certain market price targets are reached, expire five years from September 28, 2012, and are exercisable in whole or in part, at any time prior to expiration. The Company received $2.5 million in gross proceeds from the offering.

Certain of the Company's directors and officers participated in the offering on the same terms as the other investors and purchased a total aggregate amount of approximately $80,000 of units in the offering, in such amounts as follows:

Name of Purchaser	Company Affiliation	Securities Purchased in Offering		Unit Price	Subscription Amount
		Shares of Common Stock	Warrants		
Forkey, Richard E.	Director Emeritus	27,778	19,445	$0.90	$25,000.20

Joseph N. Forkey and Heather C. Forkey JTTEN	Chief Executive Officer, President, Treasurer and Director	22,223	15,557	$0.90	$20,000.70
Major, Donald A.	Executive Vice President for Corporate Development and Director	27,778	19,445	$0.90	$25,000.20
Miles, Richard	Director	11,112	7,779	$0.90	$10,000.80

On February 12, 2013, the Company entered into a settlement agreement with one of its directors and stockholders, Joel Pitlor (the "Pitlor Settlement Agreement"). Under the terms of the Pitlor Settlement Agreement, the Company issued 10,000 shares of common stock and warrants to purchase 10,000 shares of common stock as payment in full of any amounts due to Mr. Pitlor under the registration rights agreement the Company entered into with Mr. Pitlor, and other parties, on February 1, 2007. The warrants issued in connection with the Pitlor Settlement Agreement have an exercise price of $1.50 per share, subject to adjustment, expire three years from February 12, 2013, and are exercisable in whole or in part, at any time prior to expiration. The Company valued the securities issued to Mr. Pitlor at $17,000.

F-11

Transactions with Stockholders Known by the Company to Own 5% or More of the Company's Common Stock

Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P.

On June 25, 2008, the Company entered into a purchase agreement, as amended on December 11, 2008, with Special Situations Fund III QP, L.P., Special Situations Private Equity Fund, L.P., and other accredited investors pursuant to which it sold a total of $600,000 of 10% Senior Secured Convertible Notes, referred to as the "Notes," that are convertible into a total of 480,000 shares of common stock at a conversion rate of $1.25. The Company also issued warrants to purchase a total of 316,800 shares of common stock at an exercise price of $1.75 per share, referred to as the "Warrants." Interest accrued on the Notes at a rate of 10% per year and was payable in cash upon the earlier of conversion or maturity of the Notes. The original maturity of the Notes was June 25, 2010 and the original expiration date of the Warrants was June 25, 2015, subject to extension. By mutual agreement with the Company, Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. agreed to amend its Notes on December 11, 2008, June 25, 2010, July 26, 2010, September 15, 2010, October 15, 2010, November 15, 2010, November 30, 2010, December 1, 2010, December 3, 2010, December 17, 2010, January 10, 2011, January 24, 2011, February 7, 2011, February 25, 2011, March 11, 2011, March 31, 2011, April 14, 2011, April 29, 2011, May 13, 2011, June 3, 2011, June 28, 2011, July 6, 2011, July 20, 2011, July 25, 2011, July 27, 2011, August 31, 2011, September 30, 2011, and October 31, 2011 to extend the "Stated Maturity Date" of the Notes. At the time of each of the amendments of the Notes, Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. owned over 5% of the Company's common stock. Pursuant to the terms of the settlement agreement entered into with Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. on February 12, 2013 (as discussed in further detail below), the expiration date of the Warrants held by Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. was amended from June 25, 2015 to May 11, 2017. The exercise price of the Warrants may be adjusted downward in the event the Company issues shares of common stock or securities convertible into common stock at a price lower than the exercise price of the Warrants at the time of issuance. On December 15, 2011, the Company repaid Special Situations Fund III QP, L.P. a principal repayment of $275,000 and accrued interest of $95,486, for a total payment of $370,486. On December 15, 2011, the Company repaid Special Situations Private Equity Fund, L.P. a principal repayment of $275,000 and accrued interest of $95,486, for a total payment of $370,486. The Notes held by Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. have been satisfied in full and the obligations thereunder have been terminated. The Company registered the shares and the shares underlying the Warrants purchased by Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. in the June 2008 private placement in a registration statement that is currently effective.

In the Company's private placement of common stock and warrants on September 28, 2012, Special Situations Fund III QP, L.P. purchased 611,112 shares of common stock, and warrants to purchase up to 427,779 shares of common stock at an exercise price of $1.25 per share, subject to adjustment and a call provision if certain market price targets are reached, and an expiration date of September 28, 2017. At the time of the transaction, Special Situations Fund III QP, L.P. owned 5% or more of the Company's common stock. The Company registered the shares and the shares underlying the warrants purchased by Special Situations Fund III QP, L.P. in the September 2012 private placement in a registration statement that is currently effective.

On February 12, 2013, the Company entered into a settlement agreement with Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. Under the terms of the settlement agreement, the Company agreed to: (a) issue an aggregate of (i) 350,000 shares of common stock, and (ii) warrants to purchase an aggregate of 350,000 shares of common stock, and (b) amend the expiration date of the warrants issued to Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. in conjunction with the Company's June 25, 2008 private placement (the "2008 Warrants"), as payment in full of the alleged damages sought by Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. The expiration date of the 2008 Warrants was amended from June 25, 2015 to May 11, 2017. The warrants issued in connection with the settlement agreement have an exercise price of $1.50 per share, subject to adjustment, expire three years from February 12, 2013, and are exercisable in whole or in part, at any time prior to expiration. The Company valued the securities issued to Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. at $595,000. At the time of the transaction, Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. owned more than 5% of the Company's common stock.

Arnold Schumsky

On June 25, 2008, the Company entered into a purchase agreement, as amended on December 11, 2008, with Mr. Arnold Schumsky and other accredited investors pursuant to which it sold a total of $600,000 of 10% Senior Secured Convertible Notes, referred to as the “Notes,” that are convertible into a total of 480,000 shares of common stock at a conversion rate of $1.25. The Company also issued warrants to purchase a total of 316,800 shares of common stock at an exercise price of $1.75 per share, referred to as the “Warrants.” Interest accrued on the Notes at a rate of 10% per year and was payable in cash upon the earlier of conversion or maturity of the Notes. The original maturity of the Notes was June 25, 2010 and the original expiration date of the Warrants was June 25, 2015, subject to extension. By mutual agreement with the Company, Mr. Schumsky agreed to amend his Note on December 11, 2008, June 25, 2010, July 26, 2010, September 15, 2010, October 15, 2010, November 15, 2010, November 30, 2010, December 1, 2010, December 3, 2010, December 17, 2010, January 10, 2011, January 24, 2011, February 7, 2011, February 25, 2011, March 11, 2011, March 31, 2011, April 15, 2011, April 29, 2011, May 13, 2011, June 3, 2011, June 28, 2011, July 6, 2011, July 20, 2011, July 25, 2011, July 27, 2011, August 31, 2011, September 30, 2011, October 31, 2011, December 15, 2011, and January 31, 2012 to extend the “Stated Maturity Date.” On March 31, 2012, Mr. Schumsky further amended his Note to extend the “Stated Maturity Date” of the principal to July 31, 2012 and to modify the Note such that all accrued and unpaid interest on the Note up to and including March 31, 2012 shall be due on or before April 13, 2012, on the condition that the Company issue to him a warrant for 5,000 shares of common stock with an exercise price of $1.20 per share and a term of three years. On April 13, 2012, the Company repaid Mr. Schumsky a payment of the accrued interest of $18,819, and such payment included all accrued and unpaid interest on the Note up to and including March 31, 2012. On May 8, 2012, the Company issued Mr. Schumsky the warrant according to the terms described in the amended Note. On July 31, 2012, Mr. Schumsky further amended his Note to extend the “Stated Maturity Date” of the principal to August 31, 2012. On August 31, 2012, Mr. Schumsky further amended his Note to extend the “Stated Maturity Date” of the principal to September 30, 2012. On September 28, 2012, the Company repaid Mr. Schumsky the outstanding and accrued interest of $2,500 due under his Note and such payment satisfied its obligations in regards to the accrued interest due on the Note in full. On that same date, Mr. Schumsky presented the outstanding principal balance of the Note to the Company and agreed to exchange the $50,000 principal balance of his Note for participation in the Company’s September 2012 private placement and was awarded units consisting of 55,555 shares of common stock and 38,889 warrants upon the same terms as the units sold in the September 2012 private placement. Accordingly, the Note held by Mr. Schumsky has been satisfied in full and the obligations thereunder have been terminated. At the time of each of the amendments and the 2012 transactions, Mr. Schumsky owned 5% or more of the Company’s stock. The Company registered the shares and the shares underlying the Warrants purchased by Mr. Schumsky in the June 2008 private placement in a registration statement that is currently effective.

On September 28, 2012, Mr. Schumsky presented the outstanding principal balance of his Note to the Company and agreed to exchange the $50,000 principal balance of his Note for participation in the Company’s September 2012 private placement. Mr. Schumsky was issued units consisting of 55,555 shares of common stock and warrants to purchase up to 38,889 shares of common stock at an exercise price of $1.25 per share, subject to adjustment and a call provision if certain market price targets are reached, and an expiration date of September 28, 2017. On September 28, 2012, Mr. Schumsky also purchased additional shares in the private placement consisting of 27,779 shares of common stock, and warrants to purchase up to 19,445 shares of common stock at an exercise price of $1.25 per share, subject to adjustment and a call provision if certain market price targets are reached, and an expiration date of September 28, 2017. At the time of the exchange and transaction, Mr. Schumsky owned 5% or more of the Company’s stock. The

Company registered the shares and the shares underlying the warrants purchased by Mr. Schumsky in the September 2012 private placement in a registration statement that is currently effective.

On February 12, 2013, the Company entered into a settlement agreement with Mr. Schumsky (the "Schumsky Settlement Agreement"). Under the terms of the Schumsky Settlement Agreement, the Company issued 10,000 shares of common stock and warrants to purchase 10,000 shares of common stock as payment in full of any amounts due to Mr. Schumsky under the registration rights agreement the Company entered into with Mr. Schumsky, and other parties, on February 1, 2007 and under the registration rights agreement the Company entered into with Mr. Schumsky, and other parties, on June 25, 2008. The warrants issued in connection with the Schumsky Settlement Agreement have an exercise price of $1.50 per share, subject to adjustment, expire three years from February 12, 2013, and are exercisable in whole or in part, at any time prior to expiration. The Company valued the securities issued to Mr. Schumsky at $17,000. At the time of the transaction, Mr. Schumsky owned 5% or more of the Company's stock.

On July 1 through July 7, 2014, the Company closed agreements with institutional and accredited investors for the sale and purchase of 1,717,152 shares of our common stock, $0.01 par value at a purchase price of $0.60 per share. Pursuant to this transaction, Mr. Schumsky purchased 83,343 shares of the Company's common stock. In conjunction with the placement, the Company also entered into a registration rights agreement with the Investors, whereby the Company was obligated to file a registration statement with the Securities Exchange Commission on or before forty-five calendar days after July 1, 2014 to register the resale by the investors of the 1,717,152 shares of the common stock purchased in the placement. Subsequent to the agreement, the parties agreed to extend the time period by which the Company is obligated to file a registration statement with the Securities Exchange Commission.

MHW Partners, LP

On July 1 through July 7, 2014, the Company closed agreements with institutional and accredited investors for the sale and purchase of 1,717,152 shares of our common stock, $0.01 par value at a purchase price of $0.60 per share. Pursuant to this transaction, MHW Partners purchased 125,000 shares of the Company's common stock. In conjunction with the placement, the Company also entered into a registration rights agreement with the Investors, whereby the Company was obligated to file a registration statement with the Securities Exchange Commission on or before forty-five calendar days after July 1, 2014 to register the resale by the investors of the 1,717,152 shares of the common stock purchased in the placement. Subsequent to the agreement, the parties agreed to extend the time period by which the Company is obligated to file a registration statement with the Securities Exchange Commission.

At the time of the transaction, MHW was a holder of more than 5% of the Company's securities. Mr. Woodward is the principal of MHW Capital Management, LLC and MHW Capital, LLC and in such capacity, Mr. Woodward holds the power to vote and direct the disposition of all shares of common stock owned by MHW Partners, LP. Pursuant to the transaction described above, Mr. Woodward was subsequently appointed as Chairman of the Company's Board of Directors on July 9, 2014.

(b) Operating Lease Commitments

The Company has entered into operating leases for its office space and equipment that expire at various dates through fiscal year 2017. Total future minimum rental payments under all non-cancelable operating leases are $13,178 in fiscal year 2015 and $776 in each of the two fiscal years thereafter.

Rent expense on operating leases, excluding the related party rent described above, was $68,232 and $64,627 for the years ended June 30, 2014 and 2013, respectively.

(3) STOCKHOLDERS' EQUITY

(a) Stock Options

Stock-based compensation costs recognized during the year ended June 30, 2014 and 2013 amounted to $141,033 and $108,422 respectively, and were included in the accompanying consolidated statements of operations in: selling, general and administrative expenses (2014 — $134,800; 2013 — $98,589), cost of goods sold (2014 — $4,033; 2013 — $7,633), and research and development expenses, net (2014 — $2,200; 2013 — $2,200). No compensation has been capitalized because such amounts would have been immaterial. There was no net income tax benefit recognized related to such compensation for the years ended June 30, 2014 or 2013, as the Company is currently in a loss position. There were 9,000 stock options granted during the year ended June 30, 2014 and 9,000 stock options granted during the year ended June 30, 2013.

As of June 30, 2014, the unrecognized compensation costs related to options vesting in the future is $0. The Company uses the Black-Scholes option-pricing model as the most appropriate method for determining the estimated fair value for the stock awards. The Black-Scholes method of valuation requires several assumptions: (1) the expected term of the stock award; (2) the expected future stock volatility over the expected term; and (3) risk-free interest rate. The expected term represents the expected period of time the Company believes the options will be outstanding based on historical information. Estimates of expected future stock price volatility are based on the historic volatility of the Company’s common stock and the risk free interest rate is based on the U.S. Zero-Bond rate. The Company utilizes a forfeiture rate based on an analysis of the Company’s actual experience. The fair value of options at date of grant was estimated with the following assumptions for options granted in fiscal 2014:

	Year Ended June 30, 2014
Assumptions:	
Option life	5.0 years
Risk-free interest rate	3.00%
Stock volatility	479%
Dividend yield	0
Weighted average fair value of grants	$0.90

F-14

Stock Option and Other Compensation Plans:

The type of share-based payments currently utilized by the Company is stock options.

The Company has various stock option and other compensation plans for directors, officers, and employees. The Company has the following stock option plans outstanding as of June 30, 2014: the Precision Optics Corporation, Inc. 2011 Equity Incentive Plan (the “2011 Plan”); the Precision Optics Corporation, Inc. 2006 Equity Incentive Plan (the “2006 Plan”), and the Precision Optics Corporation, Inc. Amended and Restated 1997 Incentive Plan (the “1997 Plan”). Vesting periods under the 2011 Plan, the 2006 Plan, and the 1997 Plan are at the discretion of the Board of Directors and typically average three to five years. Options under these Plans are granted at fair market value on the date of grant and have a term of ten years from the date of grant.

The 2011 Plan, which provides eligible participants (certain employees, directors, consultants, etc.) the opportunity to receive a broad variety of equity based and cash awards. Options granted vest and are exercisable for periods determined by the Board of Directors, not to exceed 10 years from the date of grant. A total of 325,000 shares of common stock, including shares rolled forward from the 1997 Plan, have been reserved for issuance under the 2011 Plan. At June 30, 2014, a total of 207,800 stock options are outstanding and 117,200 shares of common stock were available for future grants under the 2011 Plan.

The 2006 Plan, which provides eligible participants (certain employees, directors, consultants, etc.) the opportunity to receive a broad variety of equity based and cash awards. Options granted vest and are exercisable for periods determined by the Board of Directors, not to exceed 10 years from the date of grant. A total of 139,898 shares of common stock, including shares rolled forward from the 1997 Plan, have been reserved for issuance under the 2006 Plan. At June 30, 2014, a total of 112,700 stock options are outstanding and 27,198 shares of common stock were available for future grants under the 2006 Plan.

The 1997 Plan provided eligible participants (certain employees, directors, consultants, etc.) the opportunity to receive a broad variety of equity based and cash awards. Options granted vested and were exercisable for periods determined by the Board of Directors, not to exceed 10 years from the date of grant. Options for a total of 88,587 shares of common stock were outstanding at June 30, 2013 under the 1997 Plan, as amended and restated in fiscal year 2006. Prior to the adoption of the 2006 Plan, 9,000 stock options were granted in fiscal year 2007 under the 1997 Plan. Upon the adoption of the 2006 Plan, no new awards were granted under the 1997 Plan. No shares are available for future grants under the 1997 Plan.

The following tables summarize stock option activity for the years ended June 30, 2014 and 2013:

	Options Outstanding		
	Number of Shares	Weighted Average Exercise Price	Weighted Average Contractual Life
Outstanding at July 1, 2012	392,587	$ 4.56	8.15 years
Grants	9,000	0.85	
Cancellations	(1,500)	0.55	
Outstanding at June 30, 2013	400,087	$ 4.49	7.21 years
Grants	9,000	0.90	
Outstanding at June 30, 2014	409,087	$ 4.41	6.27 years

F-15

Information related to the stock options outstanding as of June 30, 2014 is as follows:

Range of Exercise Prices	Number of Shares	Weighted-Average Remaining Contractual Life (years)	Weighted-Average Exercise Price	Exercisable Number of Shares	Exercisable Weighted-Average Exercise Price
$1.20	207,800	7.68	$ 1.20	207,800	$ 1.20
$0.90	9,000	9.52	0.90	9,000	0.90
$0.85	9,000	8.52	0.85	9,000	0.85
$0.55	49,500	7.62	0.55	49,500	0.55
$0.27	40,000	7.04	0.27	40,000	0.27
$1.35	1,200	5.41	1.35	1,200	1.35
$1.25	1,200	4.41	1.25	1,200	1.25
$6.25	1,600	2.42	6.25	1,600	6.25
$7.75	1,200	3.41	7.75	1,200	7.75
$11.50	800	1.42	11.50	800	11.50
$13.75	50,427	1.86	13.75	50,427	13.75
$20.75	37,360	0.96	20.75	37,360	20.75
$0.27–$20.75	409,087	6.27	$ 4.41	409,087	$ 6.21

The aggregate intrinsic value of the Company’s “in-the-money” outstanding and exercisable options as of June 30, 2014 was $26,415.

(b) Warrants

During the quarter ended December 31, 2010, the Company issued warrants to purchase 100,000 shares of common stock at an exercise price of $1.00 per share to several consultants to the Company. The warrants became exercisable beginning six months after December 16, 2010 (the issue date) and expired on December 16, 2013. In December 2012, warrants for 50,000 shares were exercised, and accordingly, 50,000 shares of restricted common stock were issued.

On June 25, 2008, the Company entered into a Purchase Agreement, as amended on December 11, 2008, with institutional and other accredited investors pursuant to which it sold a total of $600,000 of 10% senior secured convertible notes (the “Notes”) that were convertible at the investor’s option into a total of 480,000 shares of the Company’s common stock at a conversion rate of $1.25. On March 31, 2012, the remaining investor, Arnold Schumsky, further amended his remaining Note to extend the “Stated Maturity Date” of the principal to July 31, 2012 and to modify the Note such that all accrued and unpaid interest on the Note up to and including March 31, 2012 shall be due on or before April 13, 2012, on the condition that the Company issue to him a warrant for 5,000 shares of common stock with an exercise price of $1.20 per share and a term of three years. On April 13, 2012, the Company repaid Mr. Schumsky a payment of the accrued interest of $18,819, and such payment included all accrued and unpaid interest on the Note up to and including March 31, 2012. On May 8, 2012, the Company issued Mr. Schumsky the warrant according to the terms described in the amended Note.

In conjunction with the sale of the Notes on June 25, 2008 mentioned above, the Company also issued warrants to purchase an aggregate of 316,800 shares of common stock at an exercise price of $1.75 per share. In conjunction with the issuance of warrants to purchase 100,000 shares of common stock in December 2010, certain anti-dilution provisions of the existing warrants were triggered. As a result, the number of existing warrants was increased from 316,800 to 318,621 and the related exercise price was decreased from $1.75 per share to $1.74 per share. In conjunction with the issuance of warrants to purchase 1,944,475 shares of common stock in September 2012, certain anti-dilution provisions of the existing warrants were triggered. As a result, the number of existing warrants was increased from 318,621 to 469,831 and the related exercise price was decreased from $1.74 per share to $1.18 per share. 39,153 of these warrants expire on June 25, 2015, and the remaining 430,678 warrants expire on May 11, 2017.

As of June 30, 2014, there are warrants outstanding for the issuance of an aggregate of 2,983,752 shares of common stock, including warrants for a total of 2,138,921 shares issued on September 28, 2013 as described below under "Sale of Stock," and warrants for a total of 370,000 shares issued on February 12, 2013 as described below under Note 10, "Claims for Liquidated Damages," all at a weighted average exercise price of $1.25 per share.

(c) Sale of Stock

On September 28, 2012, the Company closed on agreements with accredited investors (the "Investors") for the sale and purchase of units consisting of an aggregate of (i) 2,777,795 shares of the Company's common stock, and (ii) warrants to purchase an aggregate of 1,944,475 shares of common stock, at a per unit price of $0.90. Each unit consisted of one share of common stock and 70% warrant coverage. The warrants have an exercise price of $1.25 per share, subject to adjustment and a call provision if certain market price targets are reached, an expiration date of September 28, 2017, and are exercisable in whole or in part, at any time prior to expiration. Certain directors and officers participated in the offering and purchased a total aggregate amount of approximately $80,000 of units in the offering.

The Company received $2.5 million in gross proceeds from the offering. The Company retained Loewen, Ondaatje, McCutcheon USA LTD as the exclusive placement agent for the offering. In addition to the payment of certain cash fees upon closing of the offering, the Company issued a warrant to the placement agent to purchase up to 194,446 shares of common stock on substantially similar terms to the warrants issued in the offering, except that the placement agent warrant has an exercise price of $0.95 per share.

In conjunction with the offering, the Company also entered into a registration rights agreement dated September 28, 2012 with the Investors, whereby it was obligated to file a registration statement with the Securities and Exchange Commission (the "SEC") on or before thirty calendar days after September 28, 2012 to register the resale by the Investors of the 2,777,795 shares of common stock purchased in the offering, and the 1,944,475 shares of common stock underlying the warrants purchased in the offering. The Company filed a registration statement with the SEC on October 26, 2012, prior to the filing deadline. The registration statement became effective on December 14, 2012. The Company is obligated to continue to keep the securities registered and, in the event the Company does not comply with such provision of the registration rights agreement, it may have to pay damages to the Investors.

In conjunction with the offering, certain anti-dilution provisions of the warrants issued in conjunction with the Company's June 25, 2008 financing transaction were triggered. As a result, the number of existing June 25, 2008 warrants increased from 318,621 to 469,831 and the related exercise price of the warrants decreased from $1.74 per share to $1.18 per share. The June 25, 2008 warrants expire on June 25, 2015.

(4) INCOME TAXES

The Company has identified its federal tax return and its state tax return in Massachusetts as "major" tax jurisdictions. The periods subject to examination for its federal and state income tax returns are the years ended in 2012 and thereafter. The Company believes its income tax filing positions and deductions will be sustained on audit and it does not anticipate any adjustments that would result in a material change to its financial position. Therefore, no liabilities for uncertain income tax positions have been recorded.

The provision for income taxes in the accompanying consolidated statements of operations consists of the minimum statutory state income tax liability of $912 for the years ended June 30, 2014 and 2013.

A reconciliation of the federal statutory rate to the Company's effective tax rate for the fiscal years ended June 30, 2014 and 2013 is as follows

	2014	2013
Income tax expense (benefit) at federal statutory rate	(34.0)%	(34.0)%
Increase (decrease) in tax resulting from:		
State taxes, net of federal benefit	(5.3)	(6.3)
Change in valuation allowance	15.0	30.1
Nondeductible items	0.3	1.0
Prior-year tax adjustments	14.0	7.5
Other	9.9	1.6
Effective tax rate	(0.1)%	(0.1)%

The components of deferred tax assets and liabilities at June 30, 2014 and 2013 are approximately as follows:

	2014	2013
Deferred tax assets:		
Net operating loss carry forwards	$2,747,000	$2,582,000
Tax credit carry forwards	405,000	381,000
Reserves and accruals not yet deducted for tax purposes	286,000	301,000
Total deferred tax assets	3,438,000	3,264,000
Valuation allowance	(3,438,000)	(3,264,000)
Net deferred tax asset	$–	$–

F-17

The Company has provided a valuation allowance to reduce the net deferred tax asset to an amount the Company believes is “more likely than not” to be realized. The valuation allowance increased in fiscal 2014, as compared to the prior year, by approximately $174,000.

At June 30, 2014, the Company had federal and state net operating loss carry forwards of approximately $6,600,000 and $2,100,000, respectively, which will, if not used, expire at various dates from 2015 through 2033. In addition, the Company had net operating loss carry forwards from its Hong Kong operations of approximately $2,171,000, which carry forward indefinitely.

(5) PROFIT SHARING PLAN

The Company has a defined contribution 401(k) profit sharing plan. Employer profit sharing and matching contributions to the plan are discretionary. No employer profit sharing or matching contributions were made to the plan in fiscal years 2014 and 2013.

(6) SALE OF ASSETS

In fiscal year 2014, the Company sold equipment that was previously written off for proceeds totaling $14,028 and recorded a gain of $14,028. In fiscal year 2013, the Company sold equipment that was previously written off for proceeds totaling $4,498 and recorded a gain of $4,498. These gains are included within operating expenses in the accompanying consolidated statements of operations.

(7) CLAIMS FOR LIQUIDATED DAMAGES

Settlement Agreement with Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P.

On January 17, 2013, the Company received a demand letter from two of its stockholders, Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. (along with Special Situations Fund III QP, L.P., “Special Situations”). The letter alleged that the Company failed to maintain a current registration statement for the sale of stock purchased by Special Situations pursuant to registration rights agreements entered into with the Company on February 1, 2007 and June 25, 2008, and sought prompt payment of $719,100 as liquidated damages and an amendment to the terms of certain warrants purchased in 2008. A registration statement covering the shares in question is currently effective.

On February 12, 2013, the Company entered into a settlement agreement with Special Situations (the "Settlement Agreement"). Without agreeing to the alleged damages, the Company entered into the Settlement Agreement in order to resolve the claim without requiring a cash payment or extended distraction of its resources away from operational activities. Under the terms of the Settlement Agreement, Special Situations agreed to forego their claims for cash damages. In return, the Company agreed to: (a) issue an aggregate of (i) 350,000 shares of common stock, and (ii) warrants to purchase an aggregate of 350,000 shares of common stock (the "Securities"), and (b) amend the expiration date of the warrants issued to Special Situations in conjunction with the Company's June 25, 2008 private placement (the "2008 Warrants"), as payment in full of the alleged damages sought by Special Situations. The Securities were issued on February 12, 2013. The expiration date of the 2008 Warrants was amended from June 25, 2015 to May 11, 2017. The new warrants issued in connection with the Settlement Agreement have an exercise price of $1.50 per share, subject to adjustment, expire three years from February 12, 2013, and are exercisable in whole or in part, at any time prior to expiration.

In conjunction with the Settlement Agreement, the Company also entered into a registration rights agreement dated February 12, 2013 with Special Situations, whereby it was obligated to register the resale by Special Situations of the Securities, consisting of 350,000 shares of common stock and the 350,000 shares of common stock underlying the warrants issued on February 12, 2013. A registration statement covering the Securities was declared effective on April 26, 2013.

Settlement Agreement with Joel Pitlor

On February 12, 2013, the Company entered into a settlement agreement with one of its directors and stockholders, Joel Pitlor (the "Pitlor Settlement Agreement"). Under the terms of the Pitlor Settlement Agreement, the Company agreed to issue 10,000 shares of common stock and warrants to purchase 10,000 shares of common stock as payment in full of any amounts due to Mr. Pitlor under the registration rights agreement the Company entered into with Mr. Pitlor, and other parties, on February 1, 2007. The shares and warrants were issued on February 12, 2013. The warrants issued in connection with the Pitlor Settlement Agreement have an exercise price of $1.50 per share, subject to adjustment, expire three years from February 12, 2013, and are exercisable in whole or in part, at any time prior to expiration. There are no registration rights associated with the securities acquired pursuant to the Pitlor Settlement Agreement.

By virtue of Mr. Pitlor's directorship with the Company, he is considered a related party of the Company under federal securities law. The Company's Board of Directors has acknowledged that Mr. Pitlor's entry into the Pitlor Settlement Agreement is a related party transaction and has approved such transaction.

Settlement Agreement with Arnold Schumsky

On February 12, 2013, the Company also entered into a settlement agreement with one of its stockholders, Arnold Schumsky (the "Schumsky Settlement Agreement"). The terms of the Schumsky Settlement Agreement and the accompanying Form of Warrant of the Schumsky Settlement Agreement are substantially similar to the terms of the Pitlor Settlement Agreement and the accompanying Form of Warrant of the Pitlor Settlement Agreement. Under the terms of the Schumsky Settlement Agreement, the Company agreed to issue 10,000 shares of common stock and warrants to purchase 10,000 shares of common stock as payment in full of any amounts due to Mr. Schumsky under the registration rights agreement the Company entered into with Mr. Schumsky, and other parties, on February 1, 2007 and under the registration rights agreement the Company entered into with Mr. Schumsky, and other parties, on June 25, 2008. The shares and warrants were issued on February 12, 2013. The warrants issued in connection with the Schumsky Settlement Agreement have an exercise price of $1.50 per share, subject to adjustment, expire three years from February 12, 2013, and are exercisable in whole or in part, at any time prior to expiration. There are no registration rights associated with the securities acquired pursuant to the Schumsky Settlement Agreement.

The Company has estimated the fair value of the non-cash consideration exchanged for the settlement of claims with Special Situations, Mr. Pitlor, and Mr. Schumsky to be a total of $629,000 as of December 31, 2012, and recorded this amount as a non-cash expense and current liability in its consolidated financial statements as of December 31, 2012, and for the quarter and six months then ended.

The Company used the Black-Scholes option-pricing model for determining the estimated fair value of the new warrants to be issued to Special Situations, Mr. Pitlor, and Mr. Schumsky, and for determining the value of the extension of the maturity date of the 2008 Warrants held by Special Situations. The Company valued its issued common stock as of the closing price of the stock at December 31, 2012, which was $0.85 per share.

(8) SETTLEMENT OF ACCOUNTS PAYABLE

In December 2012, the Company settled $106,149 of accounts payable with a vendor for a negotiated payment of $30,000, and recorded a gain of $76,149. The gain is included within other income for the year ended June 30, 2013 in the accompanying consolidated statements of operations.

(9) SUBSEQUENT EVENTS

(a) Equity Issuances

On July 1 through July 7, 2014, the Company closed on agreements with institutional and accredited investors (the "Investors") for the sale and purchase of 1,717,152 shares of the Company's common stock, $0.01 par value at a purchase price of $0.60 per share (the "Shares"). The Company received $1,030,291 in gross proceeds from the offering. The Company anticipates using the net proceeds from this placement for general working capital purposes. Of this amount, $50,000 was received in June 2014 and the remainder was received in July 2014.

In conjunction with the placement, the Company also entered into a registration rights agreement with the Investors, whereby the Company is obligated to file a registration statement with the Securities Exchange Commission on or before forty-five calendar days after July 1, 2014 to register the resale by the Investors of the 1,717,152 shares of the common stock purchased in the placement. Subsequent to the execution of the agreement, the parties agreed to extend the time period by which the Company is obligated to file a registration statement with the Securities Exchange Commission.

In conjunction with the offering, certain anti-dilution provisions of the warrants issued in conjunction with the Company's June 25, 2008 and September 28, 2012 financing transactions were triggered. As a result, the number of existing June 25, 2008 warrants increased from 469,831 to 538,253 and the related exercise price of the warrants decreased from $1.18 per share to $1.03 per share. And the number of existing September 28, 2012 warrants increased from 1,944,475 to 2,189,724 and 194,446 to 217,322, respectively, and the related exercise price decreased from $1.25 to $1.11 and from $0.95 to $0.85, respectively.

On July 22, 2014, the Company issued 78,000 restricted shares of our common stock to Mr. Jeff DiRubio as compensation for services rendered to the Company.

On July 22, 2014, the Company issued 12,298 restricted shares of our common stock to Mr. Kevin Dahill as compensation for services rendered to the Company.

On September 23, 2014, the Company granted an option to purchase 35,000 shares of our common stock to Mr. Bob Hallock as compensation for services rendered to the Company. The option shall expire September 23, 2024 and shall have an exercise price of $0.90 per share.

On September 23, 2014, the Company granted an option to purchase 30,000 shares of our common stock to its Executive Vice President of Corporate Development, Mr. Donald Major as compensation for services rendered to the Company. The option shall expire September 23, 2024 and shall have an exercise price of $0.90 per share.

(b) Departure of Director

On July 9, 2014, Mr. Richard E. Forkey resigned from the Company's Board of Directors. Mr. Forkey shall continue to stay involved with the Company as the Founder and Chairman Emeritus.

(c) Appointment of New Directors

On July 9, 2014, the Board of Directors appointed Dr. Kenneth S. Schwartz, MD and Peter H. Woodward as directors of the Company and Mr. Woodward as Chairman of the Board.

Both Dr. Schwartz and Mr. Woodward were appointed in connection with the sale and purchase agreement between the Company and accredited investors reported on the Company's Periodic Report on Form 8-K filed July 7, 2014. Pursuant to the Agreement, the Company is required to appoint two qualified individuals named by Hershey Strategic Capital LP to the Company's Board of Directors. Those individuals shall serve for three years or until resignation, whichever is earlier.

(d) Amendment of Bylaws

On July 9, 2014, the Board of Directors approved an amendment to the Company's Bylaws. The Bylaws now provide that the Board of Directors shall consist of six directors, rather than five. Additionally, the Bylaws were revised to state that the Chairman of the Board is not required to be an officer of the Company. Massachusetts law provides for a staggered Board by default; however, the Board of Directors believed it would add clarity to revise the Bylaws to explicitly state that the Company has a staggered Board.

F-20