

Optex Systems Holdings Inc
Form 10-K
December 15, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended September 27, 2015

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

For the transition period from ___ until ___

Commission File Number 000-54114

OPTEX SYSTEMS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation organization)

33-143215
(I.R.S. Employer
Identification No.)

1420 Presidential Drive

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Richardson, TX

(Address of principal executive offices)

75081-2439

(Zip Code)

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

Securities Registered under Section 12(b) of the Act

None

Securities Registered under Section 12(g) of the Act

Common Stock, par value \$.001 per share

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

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

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

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

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

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

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

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

The aggregate market value of the 170,914 (post-split effective October 7, 2015) shares of voting stock held by non-affiliates of the registrant based on the closing price on the OTC Markets on March 30, 2015 was \$5,127,418.

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

	Shares Outstanding
Title of Class	December 15, 2015
Common Stock	429,898

DOCUMENTS INCORPORATED BY REFERENCE

None.

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Cautionary Note Regarding Forward-Looking Information

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

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

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

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PART I

Item 1 Description of Business

Background

Prior History — Sustut Exploration, Inc.

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

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

Reorganization

On March 30, 2009, a reorganization occurred whereby the then existing shareholders of Optex Systems, Inc., a private Delaware corporation (“Optex Systems, Inc. (Delaware)”), exchanged their shares of Optex Systems, Inc. (Delaware) common stock with the shares of common stock of us as follows (all on a pre-split basis due to the historical context): (i) the outstanding 85,000,000 shares of Optex Systems, Inc. (Delaware) common stock were exchanged for 113,333,282 shares of us common stock, (ii) the outstanding 1,027 shares of Optex Systems, Inc. (Delaware) Series A preferred stock were exchanged for 1,027 shares of Series A preferred stock and (iii) the 8,131,667 shares of Optex Systems, Inc. (Delaware) common stock purchased in the private placement were exchanged for 8,131,667 (presplit) shares of us common stock. Optex Systems, Inc. (Delaware) has remained our wholly-owned subsidiary. As a result of the reorganization, Sileas Corporation beneficially owns approximately 68.4% of our issued and outstanding common stock and Alpha Capital Anstalt owns approximately 12.1% of our issued and outstanding common stock.

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

Recent Events

Approval of Reverse Stock Split

On August 31, 2015, our board of directors and the shareholders holding a majority of our issued and outstanding Common Stock approved an amendment to our Certificate of Incorporation to effect a reverse stock split which would combine the outstanding shares of our common stock into a lesser number of outstanding shares with our board of directors having been given the sole discretion to effect the amendment and reverse stock split at any time prior to March 31, 2016, and to fix the specific ratio for the combination, provided that the ratio would be not less than 1-for-400 and not more than 1-for-1000. A 1-for-1000 reverse stock split was effected on October 7, 2015.

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Election of New Board Members and Committees

On May 27, 2015, our board of directors and shareholders elected the following four individuals as directors to serve until their successors are elected and duly qualify: Kerry Craven, David Kittay, Owen Naccarato and Charles Trego, all of whom meet the standards for independent directors as applicable for the NASDAQ Capital Market.

On July 14, 2015, our board of directors confirmed the appointment of the following independent directors to serve on the following committees of our board of directors:

Audit Committee: Charles Trego (Chair), Kerry Craven and David Kittay

Compensation Committee: Owen Naccarato (Chair), David Kittay and Kerry Craven

Nominating Committee: David Kittay (Chair), Kerry Craven, Owen Naccarato and Charles Trego.

The board also acknowledged the charters for each committee which are approved.

Applied Optics Center Contracts

On May 26, 2015, and effective as of May 21, 2015, we entered into a supply agreement with Nightforce Optics, Inc. for supply by us to Nightforce of certain critical optical assemblies through our Applied Optics Center segment. The production rate and delivery schedule shall be agreed upon by the parties and are subject to aggregate annual minimum order values of \$3,000,000 in 2015 and \$3,900,000 in 2016. The initial term of the agreement is two years, and can be extended by Nightforce for an additional year. We are the primary supplier of the covered products to Nightforce as we agree to work exclusively with Nightforce on its markets of interest in commercial sporting optics and select military optics; however, our existing business arrangements with certain Department of Defense manufacturers are not subject to this exclusivity covenant.

On June 8, 2015, we announced that we have been awarded a purchase order from a customer for 11,200 ACOG Laser Filter units valued at \$1.3 million at our Applied Optics Center. This award also includes an option quantity up to an additional 11,200 units for up to an additional \$1.3 million.

Purchase of the Applied Optics Center

On November 3, 2014, we entered into a Purchase Agreement with L-3 Communications, Inc. pursuant to which we purchased the assets comprising L-3's Applied Optics Center Products Line, which is engaged in the production and marketing and sales of precision optical assemblies utilizing thin film coating capabilities for optical systems and components primarily used for military purposes. The purchased assets consist of personal property, inventory, books and records, contracts, prepaid expenses and deposits, intellectual property, and governmental contracts and licenses utilized in the business comprised of the purchased assets.

The purchase price for the acquisition was \$1,013,053, which was paid in full at closing, plus the assumption of certain liabilities associated with the Purchased Assets in the approximate amount of \$271,000. The source of funds for the acquisition consisted of an advance of \$800,000 from the November 2014 sale of our convertible notes to certain accredited investors in a transaction exempt from registration under Section 4(2) of the Securities Act, with the balance of the funds derived directly from working capital.

In conjunction with the acquisition of the assets comprising L-3's Applied Optics Center Product Line, Optex Systems, Inc. assumed the obligations of L-3 pursuant to this certain Assignment to Lease and Consent of Landlord Agreement dated as of October 30, 2014, between L-3, as tenant, Optex Systems Inc., as assignee, and CABOT II TX1W04, LP, as landlord, with respect to those certain Leases dated as of August 27, 1996 covering Premises located at 9839 and 9827 Chartwell Drive, respectively, Dallas, Texas, as amended by First Amendments dated May 14, 2001, Second Amendments dated January 9, 2004, Third Amendments dated February 21, 2005 and the Fourth Amendment dated March 13, 2009. The leased premises under the lease consist of approximately 56,633 square feet of space at the premises. The term of the lease expires September 30, 2016, and there are four renewal options available to the tenant, and each renewal option has a five year term.

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Issuance of Convertible Notes and Conversion to Series B Preferred Stock

On November 17, 2014, we entered into a Subscription Agreement with certain accredited investors pursuant to which we sold to them \$1.55 million principal amount convertible promissory notes in a private placement. On March 26, 2015, we filed a Certificate of Designation with respect to our Certificate of Incorporation to authorize a series of preferred stock known as “Series B Preferred Stock” under Article FOURTH thereof, with 1010 authorized shares of Series B preferred stock issuable thereunder. The amendment was approved by our Board of Directors under Article FOURTH of our Certificate of Incorporation. The stated value of each share of Series B preferred stock is \$1,629.16, and each share of Series B preferred stock is convertible into shares of our common stock at a conversion price of \$2.50. Holders of the Series B preferred stock receive preferential rights in the event of liquidation to other classes of preferred and common stock other than our Series A preferred stock. Additionally, the holders of the Series B preferred stock are entitled to vote together with the common stock and the Series A preferred stock on an “as-converted” basis.

On March 29, 2015, the holders of \$1,560,000 in principal amount of convertible promissory notes issued in November 2014 converted the entire principal amount thereof and all accrued and unpaid interest thereon, into 1,000 shares of our Series B preferred stock.

Appointment of Chief Financial Officer, Resignation and Appointment of Chairman and Director

Effective November 19, 2014, Karen Hawkins, the Vice President of Finance and Controller, was appointed as our Chief Financial Officer.

Also effective November 19, 2014, Merrick Okamoto resigned as our Chairman of the Board and as a Director. In recognition of his service, all of his unvested stock options were deemed to vest immediately, and the termination date of all of his stock options was extended to December 31, 2018.

Also effective November 19, 2014, Peter Benz was appointed as a Director to our Board of Directors and was also elected as our Chairman of the Board of Directors.

New Product Development

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

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

Products

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

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

Specific product categories include:

Electronic sighting systems

Mechanical sighting systems

Laser protected plastic and glass periscopes

Non-laser protected plastic and glass periscopes

Howitzer sighting systems

M36 Thermal Day/Night Periscopes

M17 Day/Thermal Periscopes

Ship binoculars

Replacement optics (e.g. filters, mirrors)

Optical assemblies and laser filters

Product Line

Product Category

Periscopes

Laser & Non Laser Protected Plastic & Glass Periscopes, Electronic M17 Day/Thermal Periscopes, Vision Blocks

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

Location and Facility

We are headquartered in Richardson, TX and lease approximately 93,733 combined square feet of facilities including Richardson, Texas and Dallas, Texas. As of December 11, 2015, we had 92 full time equivalent employees. We operate with a single shift, and capacity could be expanded by adding a second shift. Our proprietary processes and methodologies provide barriers to entry for other competing suppliers. In many cases, we are the sole source provider or one of only two providers of a product. We have capabilities which include machining, bonding, painting, tracking, engraving and assembly and can perform both optical and environmental testing in-house.

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We renewed the lease on our 49,100 square foot, Richardson, Texas facility, effective as of December 10, 2013, with a lease expiration of March 31, 2021. As of December 11, 2015, the Richardson facility operates with 58 full time equivalent employees in a single shift operation.

In November 2014, we also acquired a business unit from L-3 Communications, Inc., which is described herein below under “Recent Events — Acquisition”. The acquisition, Applied Optics Center, is located in Dallas, Texas with leased premises consisting of approximately 56,633 square feet of space, of which 12,000 square feet is currently subleased to L3 Mobile Vision. As of December 11, 2015, the Applied Optics Center operates with 34 full time equivalent employees in a single shift operation.

Contracts

Each contract with our customers has specific quantities of material that need to be purchased, assembled, and then shipped. Prior to bidding a contract, we contact potential sources of material and receive qualified quotations for each material. In some cases, the entire volume is given to a single supplier and in other cases, the volume might be split between several suppliers. If a contract has a single source supplier and that supplier fails to meet their obligations (e.g., quality, delivery), then we would attempt to find an acceptable alternate supplier, and if successful, we would then renegotiate contractual deliverables (e.g., specifications, delivery, price). As of December 11, 2015, approximately 25% of our material requirements are single-sourced across 7 suppliers representing approximately 14% of our active supplier orders. Single-sourced component requirements span across all of our major product lines. Of these single sourced components, we have material contracts (purchase orders) with firm pricing and delivery schedules in place with each of the suppliers to supply the parts necessary to satisfy our current contractual needs.

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

Regulation	Summary
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Federal Acquisition Regulation	The principal set of rules in the Federal Acquisition Regulation System. This system consists of sets of regulations issued by agencies of the federal government of the United States to govern what is called the “acquisition process,” which is the process through which the government acquires goods and services. That process consists of three phases: (1) need recognition and acquisition planning, (2) contract formation, and (3) contract administration. This system regulates the activities of government personnel in carrying out that process. It does not regulate the purchasing activities of private sector firms, except to the extent that those activities involve government solicitations and contracts by reference.
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International Traffic in Arms Regulations United States government regulations that control the export and import of defense-related articles and services on the United States Munitions List. These regulations implement the provisions of the Arms Export Control Act.

Truth in Negotiations Act A public law enacted for the purpose of providing for full and fair disclosure by contractors in the conduct of negotiations with the government. The most significant provision included is the requirement that contractors submit certified cost and pricing data for negotiated procurements above a defined threshold of \$750,000. It requires contractors to provide the government with an extremely broad range of cost or pricing information relevant to the expected costs of contract performance, and it requires contractors and subcontractors to submit cost or pricing data to the government and to certify that, to the best of their knowledge and belief, the data are current, accurate, and complete.

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

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

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

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The aforementioned licenses are valid for 48 months from date that each such license is issued as set forth on the table below (updated as of December 11, 2015).

DSP – 5 licenses	Issue Date	Expiration Date (48 months of issue)
50343382	12/21/2011	12/21/2015
50343483	12/28/2011	12/28/2015
50355614	2/1/2012	2/1/2016
50355650	1/31/2012	1/31/2016
50346638	2/13/2012	2/13/2016
50362079	2/29/2012	2/29/2016
50362307	3/19/2012	3/19/2016
50362221	3/19/2012	3/19/2016
50360195	3/23/2012	3/23/2016
(TA-0018-12B) 50374118	4/18/2012	4/18/2016
50381011	5/24/2012	5/24/2016
50382421	5/31/2012	5/31/2016

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DSP – 5 licenses	Issue Date	Expiration Date (48 months of issue)
50386018	7/12/2012	7/12/2016
50397890	8/8/2012	8/8/2016
50398181	8/10/2012	8/10/2016
50398178	8/10/2012	8/10/2016
50402338	8/29/2012	8/29/2016
50403055	9/6/2012	9/6/2016
50399603	9/18/2012	9/18/2016
50401835	9/12/2012	9/12/2016
50430589	1/25/2013	1/23/2017
50435218	3/7/2013	3/6/2017
50435219	3/7/2013	3/6/2017
50439431	3/7/2013	11/5/2017
50455029	6/10/2013	6/9/2017
50459204	6/28/2013	6/27/2017
50468553	7/29/2013	7/29/2017
50468550	8/30/2013	8/29/2017
50470855	9/9/2013	9/9/2017
50486913	11/20/2013	11/20/2017
50486760	12/5/2013	12/5/2017
50486727	12/6/2013	12/6/2017
50490381	12/11/2013	12/11/2017
50490628	1/3/2014	1/3/2018
50490371	1/14/2014	1/14/2018
50497324	2/1/2014	2/1/2018
50497307	2/12/2014	2/12/2018
50497324	2/20/2014	2/20/2018
50497162	2/20/2014	2/20/2018
50501481	2/26/2014	2/26/2018
50504795	3/27/2014	3/27/2018
50511388	4/21/2014	4/21/2018
50510061	5/19/2014	5/19/2018
50521562	6/27/2014	6/27/2018
50521680	7/7/2014	7/7/2018
50521706	7/15/2014	7/15/2018
50521673	7/15/2014	7/15/2018
50521555	7/17/2014	7/17/2018
50530555	9/22/2014	9/22/2018
50537697	10/30/2014	10/30/2018
50539610	11/14/2014	11/14/2018
50486913	11/20/2014	11/20/2018
50537673	11/25/2014	11/25/2018
50546222	1/9/2015	1/9/2019
50549789	2/18/2015	2/18/2019
50549846	2/23/2015	2/23/2019

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50549534	2/25/2015	2/25/2019
50549933	2/27/2015	2/27/2019
50549843	3/23/2015	3/23/2019
50553876	3/27/2015	3/27/2019
50553879	3/23/2015	3/23/2019
50560846	5/21/2015	5/21/2019
50560953	5/29/2015	5/29/2019
50560953	5/29/2015	5/29/2019
50561878	6/05/2015	6/05/2019
50562319	6/12/2015	6/12/2019
50568890	8/7/2015	8/7/2019
50565738	7/9/2015	7/9/2019

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		Expiration Date	
DSP – 5 licenses	Issue Date	(48 months of issue)	
50570373	8/21/2015	8/21/2019	
50574185	9/25/2015	9/25/2019	
50573342	10/7/2015	10/7/2019	

		Expiration Date	
DSP – 73 Licenses	Date Issued	(48 months of issue)	
730038566	6/26/2012	6/26/2016	
730038918	8/13/2012	8/13/2016	

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

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

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

The terms of our material contracts are as follows (updated as of December 11, 2015):

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Customer	Customer PO/Contract	Contract Type ⁽¹⁾	Total Award Value ⁽²⁾ (millions)	Order Period Expiration	Remaining Value ⁽³⁾ (millions)	Delivery Period
GDLS – Canada ⁽⁴⁾						
DDAN Sighting Systems	Subcontract PO 35334144	FFPQ	\$ 8.7	N/A	\$ 2.4	Mid 2012 – Dec 2016
GDLS – Canada ⁽⁵⁾						
DDAN Sighting Systems	Subcontract PO 35419634	FFPQ	\$ 1.0	N/A	\$ 1.0	Apr 2016 – Jun 2016
USACC – Warref ⁽⁶⁾						
ACOG Laser Filters (AOC)	Prime Contract W56HZV-15-C-0139	FFPQ PP	\$ 1.3	July 7, 2016	\$ 1.3	Dec 2015-Aug 2016
USACC – Warref ⁽⁷⁾						
Plastic Periscopes	Prime Contract W56HZV-15-C-0071	FFPQ PP	\$ 1.4	June 11, 2015	\$ 0.3	Jun 2015-Dec 2016
Nightforce Optics Inc ⁽⁸⁾						
Optical Assemblies (AOC)	15452	FFPQ	\$ 1.1	N/A	\$ 0.7	May 2015-Feb 2016

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- (1) *FFPQ – Firm fixed price and quantity. Payment terms on shipments are net 30-45 days. PP – Progress Billable. “Total Award Value” as included in the table represents the total value of all delivery orders against the prime contract that have already been awarded to us. The total award value represents already awarded delivery order*
- (2) *contracts. Based on our historical experience with these contracts and other similar contracts, the amount awarded has directly correlated to the amount received.*
- The “Remaining Value” depicts the open undelivered values remaining to be delivered against the contract*
- (3) *awards as of September 28, 2014. Only these undelivered values of the contracts may be subject to the contract termination clause. It has been our experience that these clauses are rarely invoked.*
- Contract was awarded on October 24, 2011 but effective November 3, 2011 as the date on which approved for*
- (4) *disclosure by contractor. This contract provided for milestone billing, in part, which have already been completed as of September 27, 2015. Total award value includes all statement of work change orders through September 28, 2015.*
- (5) *New contract award quantity added on December 3, 2013 as a follow on quantity to the original PO 35334144.*
- (6) *New prime U.S. government contract award on July 8, 2015. The awarded contract includes a 100%, 1 year option quantity, up to an additional \$1.3 million from the base award.*
- (7) *New prime U.S. government contract award on April 29, 2015. The contract included a 100% option quantity which was exercised on June 11, 2015.*
- (8) *New purchase order award on February 4, 2015, which includes multiple optical assemblies.*

Market Opportunity — U.S. Military

The impact on us of U.S. congressionally mandated defense spending reductions is reflected in the lower annual sales and based on the most recent U.S. Budget projections. The projected spending will approximate or decline slightly from the current reduced spending levels through fiscal year 2020. The chart below was derived from public government spending sources and depicts total U.S. military spending from 2004 through 2014 and forecasted spending through 2020. It is difficult to directly tie this spending to any specific military vehicles; however, we serve the U.S. armed forces, active duty and reserves, plus various state national guards. The purpose of including this chart is to provide the reader with actual trend data showing U.S. military defense and procurement spending from 2004 through 2014. The total military spending increased from \$436.4 billion in 2004 and peaked at \$678.1 billion in 2011 representing a total increase in military spending of 55.4% during that period. As of fiscal year 2015 the total projected military spending is projected to decline by 16.3% from the peak 2011 level. However, the military procurement budget in the below chart depicts a more significant decline through 2015 of 20.5% to \$106.2 billion from its peak level of \$133.6 billion in 2010. The U.S. government spending reductions have had a significant impact on our product lines as our products directly support various types of U.S. military land vehicle procurements. As a result of lower U.S. government spending, the Company has continued to explore other opportunities for manufacturing outside of our traditional product lines for products which could be manufactured using our existing lines in order to fully utilize our existing capacity. Further, we continue to look for additional strategic businesses to acquire that will strengthen our existing product line, expand our operations, and enter new markets.