

Optex Systems Holdings Inc
Form 10-Q
February 10, 2010

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

FORM 10-Q

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

For the quarterly period ended December 27, 2009

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

For the transition period from _____ to _____.

OPTEX SYSTEMS HOLDINGS, INC.
(Exact Name of Registrant as Specified in Charter)

Delaware
(State or other jurisdiction of incorporation)

333-143215
(Commission File Number)

33-143215
(IRS Employer Identification No.)

1420 Presidential Drive, Richardson, TX
(Address of principal executive offices)

75081-2439
(Zip Code)

Registrant's telephone number, including area code: (972) 644-0722

(Former Name or Former Address if Changed Since Last Report)

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the issuer 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 is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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 Not applicable.

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of February 8, 2010:
139,444,940 shares of common stock.

OPTEX SYSTEMS HOLDINGS, INC.
FORM 10-Q
December 27, 2009

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Item 1. Financial Information

OPTEX SYSTEMS HOLDINGS, INC.

UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 27, 2009

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OPTEX SYSTEMS HOLDINGS, INC.

BALANCE SHEETS AS OF DECEMBER 27, 2009 (SUCCESSOR) (UNAUDITED) AND
SEPTEMBER 27, 2009 (SUCCESSOR) F-1

STATEMENTS OF OPERATIONS FOR THE THREE MONTHS ENDED DECEMBER 27, 2009
(SUCCESSOR) AND FOR THE PERIOD OCTOBER 15, 2008 THROUGH DECEMBER 28, 2008
(SUCCESSOR) AND FOR THE PERIOD SEPTEMBER 29, 2008 THROUGH OCTOBER 14, 2008
(PREDECESSOR) (UNAUDITED) F-3

STATEMENTS OF CASH FLOWS FOR THE THREE MONTHS ENDED DECEMBER 27, 2009
(SUCCESSOR) AND FOR THE PERIOD OCTOBER 15, 2008 THROUGH DECEMBER 28, 2008
(SUCCESSOR) AND FOR THE PERIOD SEPTEMBER 29, 2008 THROUGH OCTOBER 14, 2008
(PREDECESSOR) (UNAUDITED) F-4

STATEMENTS OF STOCKHOLDERS' EQUITY FOR THE THREE MONTHS ENDED DECEMBER
27, 2009 (SUCCESSOR) AND THE PERIOD OCTOBER 15, 2008 THROUGH DECEMBER 28,
2008 (SUCCESSOR) AND FOR THE PERIOD SEPTEMBER 29, 2008 THROUGH OCTOBER 14,
2008 (PREDECESSOR) (UNAUDITED) F-6

FINANCIAL STATEMENT FOOTNOTES (UNAUDITED) F-7

Optex Systems Holdings, Inc.
(formerly known as Sustut Exploration, Inc.)
Condensed Consolidated Balance Sheets

	Successor December 27, 2009 (Unaudited)	Successor September 27, 2009
ASSETS		
Current Assets		
Cash	\$ 450,872	\$ 915,298
Accounts Receivable	2,114,015	1,802,429
Net Inventory	8,683,366	8,013,881
Deferred Tax Asset	728,879	711,177
Prepaid Expenses	279,569	318,833
Total Current Assets	\$ 12,256,701	\$ 11,761,618
Property and Equipment		
Property Plant and Equipment	\$ 1,344,487	\$ 1,341,271
Accumulated Depreciation	(1,115,634)	(1,094,526)
Total Property and Equipment	\$ 228,853	\$ 246,745
Other Assets		
Security Deposits	\$ 20,684	\$ 20,684
Intangibles	1,706,201	1,965,596
Goodwill	7,110,415	7,110,415
Total Other Assets	\$ 8,837,300	\$ 9,096,695
Total Assets	\$ 21,322,854	\$ 21,105,058

The accompanying notes are an integral part of these financial statements

Optex Systems Holdings, Inc.
(formerly known as Sustut Exploration, Inc.)
Condensed Consolidated Balance Sheets - Continued

	Successor December 27, 2009 (Unaudited)	Successor September 27, 2009
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts Payable	\$ 2,445,400	\$ 2,497,322
Accrued Expenses	706,950	671,045
Accrued Warranties	81,530	81,530
Accrued Contract Losses	1,228,792	1,348,060
Loans Payable	250,000	-
Total Current Liabilities	\$ 4,712,672	\$ 4,597,957
Stockholders' Equity		
Optex Systems Holdings, Inc. – (par \$0.001, 200,000,000 authorized, 139,444,940 shares issued and outstanding)	\$ 139,445	\$ 139,445
Optex Systems Holdings, Inc. Preferred Stock (\$0.001 par, 5,000 authorized, 1,027 series A preferred issued and outstanding)	1	1
Additional Paid-in-capital	16,761,112	16,643,388
Retained Earnings (Deficit)	(290,376)	(275,733)
Total Stockholders' Equity	16,610,182	16,507,101
Total Liabilities and Stockholders' Equity	\$ 21,322,854	\$ 21,105,058

The accompanying notes are an integral part of these financial statements

Optex Systems Holdings, Inc.
(formerly known as Sustut Exploration, Inc.)
Condensed Consolidated Statements of Operations (unaudited)

	Successor Three months Ended December 27, 2009	Successor For the period October 15, 2008 through December 28, 2008	Predecessor For the period September 29, 2008 through October 14, 2008
Revenues	\$ 5,915,302	\$ 6,392,144	\$ 871,938
Total Cost of Sales	5,160,402	5,565,182	739,868
Gross Margin	\$ 754,900	\$ 826,962	\$ 132,070
General and Administrative			
Salaries and Wages	\$ 165,151	\$ 136,847	\$ 22,028
Employee Benefits & Taxes	48,525	98,165	495
Employee Stock/Option Bonus Plan	22,500	4,812	(4,812)
Amortization of Intangible	79,823	101,159	-
Rent, Utilities and Building Maintenance	53,475	42,840	12,493
Investor Relations	87,405	-	-
Legal and Accounting Fees	50,740	75,860	360
Consulting and Contract Service Fees	55,416	68,795	10,527
Travel Expenses	10,466	13,319	-
Board of Director Fees	37,500	12,500	-
Other Expenses	77,565	20,128	16,155
Total General and Administrative	\$ 688,566	\$ 574,425	\$ 57,246
Operating Income (Loss)	\$ 66,334	\$ 252,537	\$ 74,824
Other Expenses			
Other Income and Expense	\$ -	\$ (436)	\$ -
Interest (Income) Expense - Net	3,455	82,806	9,492
Total Other	\$ 3,455	\$ 82,370	\$ 9,492
Income (Loss) Before Taxes	\$ 62,879	\$ 170,167	\$ 65,332
Income Taxes (Benefit)	(17,702)	263,654	-
Net Income (Loss)	\$ 80,581	\$ (93,487)	\$ 65,332
Less preferred stock dividend	\$ (95,224)	\$ -	\$ -
Net income (loss) applicable to common shareholders	\$ (14,643)	\$ (93,487)	\$ 65,332
Basic and diluted loss per share	\$ (0.00)	\$ (0.00)	\$ 6.53

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Weighted Average Common Shares Outstanding	139,444,940	50,000,000	10,000
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The accompanying notes are an integral part of these financial statements

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Optex Systems Holdings, Inc.
(formerly known as Sustut Exploration, Inc.)
Condensed Consolidated Statements of Cash Flows (unaudited)

	Successor Three months ended December 27, 2009	Successor For the period October 15, 2008 through December 28, 2008	Predecessor For the period September 29, 2008 through October 14, 2008
Cash flows from operating activities:			
Net Income (Loss)	\$ 80,581	\$ (93,487)	\$ 65,332
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	280,504	544,549	9,691
Provision for (use of) allowance for inventory valuation	(44,433)	33,273	27,363
Noncash interest expense	3,455	82,798	9,500
Stock Option Compensation Expense	22,500	-	-
(Increase) decrease in accounts receivable	(311,586)	(720,394)	1,049,802
(Increase) decrease in inventory (net of progress billed)	(625,052)	(497,852)	(863,566)
(Increase) decrease in other current assets	39,264	242,154	18,541
(Increase) decrease in deferred tax asset	(17,702)	-	-
Increase (decrease) in accounts payable and accrued expenses	(19,473)	574,415	(186,051)
Increase (decrease) in accrued warranty costs	-	29,397	-
Increase (decrease) in due to parent	-	-	1,428
Increase (decrease) in accrued estimated loss on contracts	(119,268)	(63,263)	(15,304)
Increase (decrease) in income taxes payable	-	263,654	-
Total adjustments	\$ (791,791)	\$ 488,731	\$ 51,404
Net cash (used)/provided by operating activities	\$ (711,210)	\$ 395,244	\$ 116,736
Cash flows from investing activities:			
Cash Received through Optex Texas acquisition		\$ 253,581	\$ -
Purchased of property and equipment	(3,216)	(12,189)	(13,338)
Net cash used in investing activities	\$ (3,216)	\$ 241,392	\$ (13,338)
Cash flows from financing activities:			
Proceeds (to) from Loans Payable	250,000	(139,484)	(20,000)
Net cash (used in) provided by financing activities	\$ 250,000	\$ (139,484)	\$ (20,000)
	\$ (464,426)	\$ 497,152	\$ 83,398

Net increase (decrease) in cash and cash equivalents				
Cash and cash equivalents at beginning of period		915,298	-	170,183
Cash and cash equivalents at end of period	\$	450,872	\$ 497,152	\$ 253,581

The accompanying notes are an integral part of these financial statements

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Optex Systems Holdings, Inc.
(formerly known as Sustut Exploration, Inc.)
Condensed Consolidated Statements of Cash Flows (unaudited) - continued

	Successor Three months ended December 27, 2009	Successor For the period October 15, 2008 through December 28, 2008	Predecessor For the period September 29, 2008 through October 14, 2008
Noncash investing and financing activities:			
Optex Delaware (Successor) purchase of Optex Texas (Predecessor)			
Cash received	-	253,581	-
Accounts Receivable	-	1,404,434	-
Inventory	-	5,383,929	-
Intangibles	-	4,036,790	-
Other Assets	-	632,864	-
Accounts Payable	-	(1,953,833)	-
Other Liabilities	-	(1,868,180)	-
Debt	-	(6,000,000)	-
Goodwill	-	7,110,415	-
Issuance of Stock	\$ -	\$ 9,000,000	\$ -
Conversion of Debt to Series A Preferred Stock			
Additonal Paid in Capital (6,000,000 Debt Retirement plus accrued interest of \$159,780)	\$ -	\$ 6,159,780	\$ -
Supplemental cash flow information:			
Cash paid for interest	\$ -	3,817	\$ -
Cash paid for taxes	\$ -	-	\$ -

The accompanying notes are an integral part of these financial statements

Note 1 - Organization and Operations

On March 30, 2009, Optex Systems Holdings, Inc., (formerly known as Sustut Exploration, Inc.), a Delaware corporation, along with Optex Systems, Inc., a privately held Delaware corporation, which is a wholly-owned subsidiary of Optex Systems Holdings, also known as Successor, entered into a reorganization agreement and plan of reorganization, pursuant to which Optex Systems, Inc. (Delaware) was acquired by Optex Systems Holdings in a share exchange transaction. Optex Systems Holdings became the surviving corporation. At the closing, Optex Systems Holdings changed its name from Sustut Exploration Inc. to Optex Systems Holdings, Inc. and its year end from December 31 to a fiscal year ending on the Sunday nearest September 30.

On October 14, 2008, certain senior secured creditors of Irvine Sensors Corporation, Longview Fund, L.P. and Alpha Capital Anstalt, formed Optex Systems, Inc. (Delaware), which acquired all of the assets and assumed certain liabilities of Optex Systems, Inc., a Texas corporation and wholly-owned subsidiary of Irvine Sensors Corporation, also known as Predecessor, in a transaction that was consummated via purchase at a public auction. Following this asset purchase, Optex Systems, Inc. (Texas) remained a wholly-owned subsidiary of Irvine Sensors Corporation.

In accordance with FASB ASC 805 (Prior authoritative literature: SFAS No. 141(R), "Business Combinations" and EITF 98-3 "Determining Whether a Non-monetary Transaction Involves Receipt of Productive Assets or of a Business") Optex Systems, Inc. (Delaware)'s purchase of substantially all of the assets and assumption of certain liabilities represented the acquisition of a business. FASB ASC 805 outlines the guidance in determining whether a "business" has been acquired in a transaction. For a transferred set of activities and assets to be a business, it must contain all of the inputs and processes necessary for it to continue to conduct normal operations after the transferred set of assets is separated from the transferor, which include the ability to sustain a revenue stream by providing its outputs to customers. Optex Systems, Inc. (Delaware) obtained the inputs and processes necessary for normal operations.

Optex Systems, Inc. (Texas) was a privately held Subchapter "S" Corporation from inception in 1987 until December 30, 2005 when 70% of the issued and outstanding stock was acquired by Irvine Sensors Corporation, and Optex Systems, Inc. (Texas) was automatically converted to a Subchapter "C" Corporation. On December 29, 2006, the remaining 30% equity interest in Optex Systems, Inc. (Texas) was purchased by Irvine Sensors Corporation.

On February 20, 2009, Sileas Corporation., a newly-formed Delaware corporation, owned by present members of the company's management, purchased 100% of Longview's equity and debt interest in Optex Systems, Inc. (Delaware), representing 90% of the issued and outstanding common equity interests in Optex Systems, Inc. (Delaware), in a private transaction (the "Acquisition"). See Note 4.

Optex Systems, Inc. (Delaware) operated as a privately-held Delaware corporation until March 30, 2009, when as a result of the reorganization agreement (described above and also in Note 5), it became a wholly-owned subsidiary of Optex Systems Holdings. Sileas is the majority owner (parent) of Optex Systems Holdings owning approximately 73.5% of Optex Systems Holdings. Optex Systems Holdings plans to carry on the business of Optex Systems, Inc. (Delaware) as its sole line of business and all of Optex Systems Holdings' operations are conducted by and through its wholly-owned subsidiary, Optex Systems, Inc. (Delaware). Accordingly, in subsequent periods the financial statements presented will be those of the accounting acquirer. The financial statements of Optex Systems Holdings represent subsidiary statements and do not include the accounts of its majority owner.

The Company's operations are based in Richardson, Texas in a leased facility comprising 49,100 square feet. As of December 27, 2009, Optex Systems Holdings operated with 107 full-time equivalent employees.

Optex Systems Holdings manufactures optical sighting systems and assemblies, primarily for Department of Defense applications. Its products are installed on a variety of U.S. military land vehicles such as the Abrams and Bradley fighting vehicles, light armored and advanced security vehicles and have been selected for installation on the Stryker family of vehicles. Optex Systems Holdings also manufactures and delivers numerous periscope configurations, rifle and surveillance sights and night vision optical assemblies. Optex Systems Holdings' products consist primarily of build to customer print products that are delivered both directly to the military and to other defense prime contractors.

In February 2009, Optex Systems Holdings' ISO certification status was upgraded from 9001:2000 to 9001:2008 bringing Optex Systems Holdings into compliance with the new ISO standards rewritten to align with ISO 14001.

Note 2 - Accounting Policies

Basis of Presentation

Principles of Consolidation: The consolidated financial statements include the accounts of Optex Systems Holdings and its wholly-owned subsidiary, Optex Systems, Inc. (Delaware). All significant inter-company balances and transactions have been eliminated in consolidation.

The accompanying financial statements include the results of operations and cash flows of Optex Systems, Inc. (Delaware), the accounting acquirer in the Sustut reorganization and the Successor in the October 14, 2008 Optex Systems, Inc. (Texas) asset purchase transaction, for the three months ending December 27, 2009 and the period from October 15, 2008 through December 28, 2008 and the results of operations and cash flows for the period from September 29, 2008 through October 14, 2008 of Optex Systems, Inc. (Texas), Predecessor. The accompanying financial statements include the balance sheets at December 27, 2009 and September 27, 2009 for Optex Systems, Inc. (Delaware), the accounting acquirer.

These financial statements have been presented as subsidiary-only financial statements, reflecting the statements of operations and cash flows of the subsidiary as a stand-alone entity.

Although, Optex Systems, Inc. (Texas) (Predecessor) has been majority owned by various parent companies described in the preceding paragraphs, no accounts of the parent companies or the effects of consolidation with any parent companies have been included in the accompanying financial statements. The Optex Systems, Inc. (Texas) accounts have been presented on the basis of push down accounting in accordance with FASB ASC 805-50-S99 (Prior authoritative literature: Staff Accounting Bulletin No. 54 Application of "Push Down" Basis of Accounting in Financial Statements of Subsidiaries Acquired by Purchase). FASB ASC 805-50-S99 states that the push down basis of accounting should be used in a purchase transaction in which the entity becomes wholly-owned. Under the push down basis of accounting certain transactions incurred by the parent company, which would otherwise be accounted for in the accounts of the parent, are "pushed down" and recorded on the financial statements of the subsidiary. Accordingly, items resulting from the Optex Systems, Inc. (Texas) purchase transaction such as goodwill, debt incurred by the parent to acquire the subsidiary and other costs related to the purchase have been recorded on the financial statements of Optex Systems Holdings.

The condensed consolidated financial statements of Optex Systems Holdings included herein have been prepared by Optex Systems Holdings, without audit, pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in financial statements prepared in conjunction with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although Optex Systems Holdings believes that the disclosures are adequate to make the information presented not misleading. These condensed financial statements should be read in conjunction with the annual audited financial statements and the notes thereto included in Optex Systems Holdings' Form 10-K and other reports filed with the SEC.

The accompanying unaudited interim financial statements reflect all adjustments of a normal and recurring nature which are, in the opinion of management, necessary to present fairly the financial position, results of operations and cash flows of Optex Systems Holdings for the interim periods presented. The results of operations for these periods are not necessarily comparable to, or indicative of, results of any other interim period or for the fiscal year taken as a whole. Certain information that is not required for interim financial reporting purposes has been omitted.

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

Inventory: Inventory is recorded at the lower of cost or market value, and adjusted, as necessary, for decreases in valuation and obsolescence. Adjustments to the valuation and obsolescence reserves are made after analyzing market conditions, current and projected sales activity, inventory costs and inventory balances to determine appropriate reserve levels. Cost is determined using the first-in first-out method. Under arrangements by which progress payments are received against certain contracts, the customer retains a security interest in the undelivered inventory identified with these contracts. Payments received for such undelivered inventory are classified as unliquidated progress payments and deducted from the gross inventory balance. As of December 27, 2009, and September 27, 2009 inventory included:

	As of December 27, 2009 (unaudited)	As of September 27, 2009
Raw Materials	\$ 6,466,594	\$ 7,161,241
Work in Process	5,204,940	4,043,308
Finished Goods	260,230	245,056
Gross Inventory	\$ 11,931,764	\$ 11,449,605
Less:		
Unliquidated Progress Payments	(2,738,005)	(2,880,898)
Inventory Reserves	(510,393)	(554,826)
Net Inventory	\$ 8,683,366	\$ 8,013,881

Stock-Based Compensation: In December 2004, FASB issued FASB ASC 718 (Prior authoritative literature: SFAS No. 123R, "Share-Based Payment"). FASB ASC 718 establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services, but primarily focuses on transactions whereby an entity obtains employee services for share-based payments. FASB ASC 718 requires that the compensation cost relating to share-based payment transactions be recognized in the financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments.

The Company's accounting policy for equity instruments issued to consultants and vendors in exchange for goods and services follows the provisions of FASB ASC 505-50 (Prior authoritative literature: EITF 96-18, "Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" and EITF 00-18, "Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees"). The measurement date for the fair value of the equity instruments issued is determined at the earlier of (i) the date at which a commitment for performance by the consultant or vendor is reached or (ii) the date at which the consultant or vendor's performance is complete. In the case of equity instruments issued to consultants, the fair value of the equity instrument is recognized over the term of the consulting agreement. Stock-based compensation related to non-employees is accounted for based on the fair value of the related stock or options or the fair value of the services, whichever is more readily determinable in accordance with FASB ASC 718.

Income Tax/Deferred Tax: FASB ASC 740 (Prior Authoritative Literature: SFAS No. 109, "Accounting for Income Taxes"), requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on differing treatment of items for financial reporting and income tax reporting purposes. The deferred tax balances are adjusted to reflect tax rates by tax jurisdiction, based on currently enacted tax laws, which will be in effect in the years in which the temporary differences are expected to reverse. Under FASB ASC 740, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided for certain deferred tax assets if it is more likely than not that the Company will not realize tax assets through future operations. Optex Systems Holdings has recognized deferred income tax benefits on net operating loss carry-forwards to the extent Optex Systems Holdings believes it will be able to utilize them in future tax filings. The difference between the income tax expense and pretax accounting income is primarily attributable to \$114,945 of deductible expenses representing permanent timing differences between book income and taxable income for the amortization of goodwill. This expense is deductible over 15 years for income tax purposes but is not amortized for accounting purposes. The tax effect of this permanent timing difference is a reduction of income tax expense of \$39,081 for the period ended December 27, 2009.

Earnings per Share: Basic earnings per share is computed by dividing income available for common shareholders (the numerator) by the weighted average number of common shares outstanding (the denominator) for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

The potentially dilutive securities the Company has outstanding are convertible preferred stock, stock options and warrants. In computing the dilutive effect of convertible preferred stock, the numerator is adjusted to add back any convertible preferred dividends and the denominator is increased to include the number of additional common shares if converted. The Company uses Treasury Stock Method to compute the diluted effect of stock options and warrants. Convertible preferred stocks, stock options and warrants that are antidilutive are excluded from the calculation of diluted earnings per common share.

For the three months ended December 27, 2009, 1,027 convertible preferred stocks and 2,665,649 stock options were excluded as antidilutive. There were no dilutive convertible securities issued and outstanding for the periods ended December 28, 2008 (successor) or October 14, 2008 (predecessor).

Note 3 - Recent Accounting Pronouncements

In June 2008, FASB issued FASB ASC 260-10-55 (Prior authoritative literature: FASB Staff Position EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities"). FASB ASC 260-10-55 clarifies that share-based payment awards that entitle their holders to receive nonforfeitable dividends or dividend equivalents before vesting should be considered participating securities. As participating securities, we will be required to include these instruments in the calculation of our basic earnings per share, and we will need to calculate basic earnings per share using the "two-class method." Restricted stock is currently included in our dilutive earnings per share calculation using the treasury stock method. The two-class method of computing earnings per share is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. FASB ASC 260-10-55 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years. As such, Optex Systems Holdings adopted these provisions at the beginning of the interim period ended December 27, 2009. Adoption of FASB ASC 260-10-55 did not have a material effect on Optex Systems Holdings' financial statements.

In May 2009, FASB issued FASB ASC 855-10 (Prior authoritative literature: SFAS No. 165, "Subsequent Events"). FASB ASC 855-10 establishes principles and requirements for the reporting of events or transactions that occur after the balance sheet date, but before financial statements are issued or are available to be issued. FASB ASC 855-10 is effective for financial statements issued for fiscal years and interim periods ending after June 15, 2009. As such, Optex Systems Holdings adopted these provisions at the beginning of the interim period ended June 28, 2009. Adoption of FASB ASC 855-10 did not have a material effect on Optex Systems Holdings' financial statements.

In June 2009, FASB issued ASC 105-10 (Prior authoritative literature: SFAS No. 168, "The FASB Accounting Standards Codification TM and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162"). FASB ASC 105-10 establishes the FASB Accounting Standards Codification TM (Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. FASB ASC 105-10 is effective for financial statements issued for fiscal years and interim periods ending after September 15, 2009. Optex Systems Holdings adopted these provisions at the beginning of the interim period ended December 27, 2009. Adoption of FASB ASC 105-10 did not have a material effect on Optex Systems Holding's financial statements.

In December 2007, FASB issued FASB ASC 805 (Prior authoritative literature: SFAS No. 141(R), "Business Combinations") and FASB ASC 810-10-65 (Prior authoritative literature: SFAS No. 160, "Accounting and Reporting of Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51"). These new standards will significantly change the accounting for and reporting of business combinations and non-controlling (minority) interests in consolidated financial statements. FASB ASC 805 and FASB ASC 810-10-65 are required to be adopted simultaneously and are effective for the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited. The adoption of FASB ASC 805 and FASB ASC 810-10-65 did not have a material impact on Optex Systems Holdings' financial position, results of operations, or cash flows.

In March 2008, FASB issued FASB ASC 815-10 (Prior authoritative literature: SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133"). FASB ASC 815-10 requires enhanced disclosures about an entity's derivative and hedging activities. FASB ASC 815-10 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008 with early application encouraged. As such, Optex Systems Holdings is required to adopt these provisions at the beginning of the fiscal year ended September 27, 2009. The adoption of FASB ASC 815-10 did not have a material impact Optex Systems Holdings' financial position, results of operations, or cash flows.

In May 2008, FASB issued FASB ASC 944 (Prior authoritative literature: SFAS No. 163, "Accounting for Financial Guarantee Insurance Contracts—an interpretation of FASB Statement No. 60"). FASB ASC 944 interprets Statement 60 and amends existing accounting pronouncements to clarify their application to the financial guarantee insurance contracts included within the scope of that Statement. FASB ASC 944 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years. Optex Systems Holdings adopted these provisions at the beginning of the interim period ended December 27, 2009. The adoption of issued FASB ASC 944 did not have a material impact on Optex Systems Holdings' financial position, results of operations, or cash flows.

Note 4 — Acquisition of Substantially All of the Assets of Optex Systems, Inc. (Texas)

Acquisition of Assets of Optex Systems, Inc. (Texas) by Optex Systems, Inc. (Delaware) on October 14, 2008

On October 14, 2008, in a purchase transaction that was consummated via public auction, Optex Systems, Inc. (Delaware) (Successor) purchased all of the assets of Optex Systems, Inc. (Texas) (Predecessor) in exchange for \$15 million of Irvine Sensors Corporation debt owned by it and the assumption of approximately \$3.8 million of certain

Optex Systems, Inc. (Texas) liabilities. The \$15 million of Irvine Sensors Corporation debt was contributed by Longview and Alpha to Optex Systems, Inc. (Delaware), in exchange for a \$6 million note payable from Optex Systems, Inc. (Delaware) and a \$9 million equity interest in Optex Systems, Inc. (Delaware) (which consisted of the issuance by Optex Systems, Inc. (Delaware) of 45,081,350 and 4,918,650 shares of its common stock to each of Longview Fund and Alpha, respectively). On October 30, 2008, Alpha sold its Optex Systems, Inc. (Delaware) common stock to Arland Holdings, Ltd. There was no contingent consideration associated with the purchase. Longview and Arland Holdings, Ltd. owned Optex Systems, Inc. (Delaware) together until February 20, 2009, when Longview sold 100% of its equity and debt interests in Optex Systems, Inc. (Delaware) to Sileas, as discussed below.

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Optex Systems, Inc. (Delaware) purchased all of the assets of Optex Systems, Inc. (Texas), including: intellectual property, production processes and know-how, and outstanding contracts and customer relationships. Optex Systems, Inc. (Delaware) also assumed certain liabilities of Optex Systems, Inc. (Texas) consisting of accounts payable and accrued liabilities. Optex Systems Holdings' management intends to improve the business's ability to serve its existing customers and to attract new customers by providing quality products and superior service which will be achieved by improving Optex Systems Holdings' working capital availability as opposed to the limited working capital that was available during the time period in which the assets were owned by Irvine Sensors Corporation.

Pro forma revenue and earnings per share information is presented cumulatively in Note 5.

Secured Promissory Note Issued in Connection with Purchase by Optex Systems, Inc. (Delaware) (Successor)

In connection with the public sale of the Optex Systems, Inc. (Texas) (Predecessor) assets to Optex Systems, Inc. (Delaware) (Successor), Optex Systems, Inc. (Delaware) delivered to Longview and Alpha Secured Promissory Notes, due September 19, 2011, in the principal amounts of \$5,409,762 and \$540,976, respectively. On February 20, 2009, Longview sold its Optex Systems, Inc. (Delaware) promissory note to Sileas, as described below. On March 27, 2009, Sileas and Alpha exchanged their Notes plus accrued and unpaid interest of \$159,780 for 1,027 shares of Optex Systems, Inc. (Delaware) Series A preferred stock.

Acquisition by Sileas on February 20, 2009

On February 20, 2009, Sileas purchased 100% of the equity and debt interest held by Longview, representing 90% of Optex Systems, Inc. (Delaware), in the "Acquisition". As of the date of this transaction, Sileas is the majority owner of Optex Systems Holdings.

Secured Promissory Note Due February 20, 2012/Longview Fund, LP

As a result of the transaction described above between Sileas and Longview Fund, LP on February 20, 2009, Sileas, currently majority owner of Optex Systems Holdings, executed and delivered to Longview, a Secured Promissory Note due February 20, 2012 in the principal amount of \$13,524,405. The Note bears simple interest at the rate of 4% per annum, and the interest rate upon an event of default increases to 10% per annum. In the event Optex Systems Holdings sells or conveys all or substantially all its assets to a third party entity for more than nominal consideration, other than a reorganization into Sileas or reincorporation in another jurisdiction, then this Note shall be immediately due and owing without demand. In the event that such a major transaction occurs prior to the maturity date resulting in Sileas receiving net consideration with a fair market value in excess of the principal and interest due under the terms of the secured note, (the "Optex Consideration"), then in addition to paying the principal and interest due, Sileas shall also pay an amount equal to 90% of the Optex Consideration. The obligations of Sileas under the note are secured by a security interest in Optex Systems Holdings' common and preferred stock owned by Sileas that was granted to Longview pursuant to a Stock Pledge Agreement delivered by Sileas to Longview and also by a lien on all of the assets of Sileas.

Optex Systems Holdings has not guaranteed the note and Longview is not entitled to pursue Optex Systems Holdings in the event of a default by Sileas. Therefore, there are no actual or potential cash flow commitments from Optex Systems Holdings. In the event of default by Sileas on its obligations under the note, Longview would only be entitled to receive the Optex Systems Holdings common and preferred stock held by Sileas.

Note 5 –Reorganization Plan and Private Placement

Reorganization/Share Exchange

On March 30, 2009, the reorganization occurred whereby the then existing shareholders of Optex Systems, Inc. (Delaware) exchanged their shares of common stock with the shares of common stock of Optex Systems Holdings as follows: (i) the outstanding 85,000,000 shares of Optex Systems, Inc. (Delaware) common stock were exchanged by Optex Systems Holdings for 113,333,282 shares of Optex Systems Holdings common stock, (ii) the outstanding 1,027 shares of Optex Systems, Inc. (Delaware) Series A preferred stock were exchanged by Optex Systems Holdings for 1,027 shares of Optex Systems Holdings Series A preferred stock and (iii) the 8,131,667 shares of Optex Systems, Inc. (Delaware) common stock purchased in the private placement were exchanged by Optex Systems Holdings for 8,131,667 shares of Optex Systems Holdings common stock. Following the reorganization, Optex Systems, Inc. (Delaware) remained a wholly-owned subsidiary of Optex Systems Holdings.

Shares outstanding of Optex Systems Holdings just prior to the closing of the reorganization consisted of 17,449,991 shares which included 1,250,000 shares issued on March 27, 2009 as payment for Investor Relations Services. On June 29, 2009, 700,000 of the issued investor relations shares were surrendered to Optex Systems Holdings and cancelled upon termination of one of the Investor Relations contracts.

Private Placement

Prior to the closing of the reorganization agreement, as of March 30, 2009, Optex Systems, Inc. (Delaware) accepted subscriptions from accredited investors for a total of 27.1 units, for \$45,000 per unit, with each unit consisting of 300,000 shares of common stock, of Optex Systems, Inc. (Delaware) and warrants to purchase 300,000 shares of common stock for \$0.45 per share for a period of five years from the initial closing, which were issued by Optex Systems, Inc. (Delaware) after the closing referenced above. Gross proceeds to Optex Systems, Inc. (Delaware) were \$1,219,750, and after deducting (i) a cash finder's fee of \$139,555, (ii) non-cash consideration of indebtedness owed to an investor of \$146,250, and (iii) stock issuance costs of \$59,416, net proceeds were \$874,529. The finder also received five year warrants to purchase 2.39 units, at an exercise price of \$49,500 per unit.

The following table represents the reorganization and private placement transactions which occurred on March 30, 2009 reflected in March 29, 2009 statements due to the election to report as of the accounting acquirers' period end:

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Optex Systems Holdings, Inc.
Balance Sheet Adjusted for Reorganization and Private Placement

	Unaudited Quarter Ended March 29, 2009	Reorganization Adjustments (1)	Private Placement Adjustments	Unaudited Quarter Ended March 29, 2009
Assets				
Current Assets	\$ 8,880,436	\$ 187,500	\$ 929,738	\$ 9,997,674
Non current Assets	10,422,425	-	-	10,422,425
Total Assets	\$ 19,302,861	\$ 187,500	\$ 929,738	\$ 20,420,099
Liabilities				
Loans Payable	146,709		(146,250)	459
Other Current Liabilities	4,416,403	-	55,209	4,471,612
Total Liabilities	\$ 4,563,112	\$ -	\$ (91,041)	\$ 4,472,071
Equity				
Optex Systems Holdings, Inc. – (par \$0.001 per share, 200,000,000 shares authorized, 138,914,940 shares issued and outstanding as of March 29, 2009)	113,333	17,450	8,132	138,915
Optex Systems Holdings, Inc. preferred stock (par value \$0.001 per share, 5,000 shares authorized, 1027 shares of Series A Preferred issued and outstanding)	1			1
Additional Paid in Capital	15,046,446	170,050	1,012,647	16,229,143
Retained Earnings	(420,031)			(420,031)
Total Stockholders Equity	\$ 14,739,749	\$ 187,500	\$ 1,020,779	\$ 15,948,028
Total Liabilities and Stockholders Equity	\$ 19,302,861	\$ 187,500	\$ 929,738	\$ 20,420,099

(1) Sustut Exploration, Inc. Balance Sheet as of the March 30, 2009 reorganization. Other assets include \$187,500 in prepaid expenses for investor relation services to be realized over the next 12 months. The services were prepaid by the issuance of 1,250,000 Sustut shares by Sustut prior to March 30, 2009. The original prepaid expense covered April 2009 through April 2010. On June 29, 2009 700,000 of these shares were returned to Optex Systems Holdings due to the cancellation of one of the investor relations agreements. The amortized expense related to the remaining 550,000 shares has been reflected on the Consolidated Statement of Operations for Optex Systems Holdings as expensed.

The accompanying unaudited pro forma financial information for the consolidated successor three months ended December 27, 2009 and combined successor and predecessor three months ended December 28, 2008 present the historical financial information of the accounting acquirer. The pro forma financial information is presented for information purposes only. Such information is based upon the standalone historical results of each company and does not reflect the actual results that would have been reported had the acquisition been completed when assumed, nor is it indicative of the future results of operations for the combined enterprise.

The following represents condensed pro forma revenue and earnings information for the three months ended December 27, 2009 and December 28, 2008 as if the acquisition of Optex Systems, Inc. (Texas) and reorganization plan had occurred on the first day of each of the years.

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	Unaudited	
	Three Months Ended	
	December 27, 2009	December 28, 2008
Revenues	5,915,302	7,264,082
Net Income (Loss) attributable to common shareholders	(14,643)	(65,010)
Diluted earnings per share	\$ (0.00)	\$ (0.00)
Weighted Average Shares Outstanding	139,444,940	138,914,940

The pro forma information depicted above reflect the impacts of reduced interest expense, increased intangible amortization expenses, the elimination of corporate allocation costs from Irvine Sensors Corporation and the elimination of employee stock bonus compensation previously allocated from Irvine Sensors Corporation to reflect the costs of the ongoing entity.

Note 6 - Commitments and Contingencies

Leases

As of December 27, 2009, Optex Systems Holdings leased its office and manufacturing facilities under two non-cancellable operating leases expiring November 2009 and February 2010 in addition to maintaining several non-cancellable operating leases for office and manufacturing equipment. Optex Systems Holdings concluded negotiations on an extension of its lease on the existing facilities effective as of January 4, 2010 (see Subsequent Events). Total expenses under the existing facility lease agreements as of the three months ended December 27, 2009 was \$77,350 and total expenses for manufacturing and office equipment was \$8,134. Total expenses under these facility lease agreements for the three months ended December 28, 2008 was \$77,350. Total expenses for manufacturing and office equipment for the three months ended December 28, 2008 was \$13,715.

As of December 27, 2009, the remaining minimum lease payments under the non-cancelable operating leases for equipment, office and facility space (taking into effect January 4, 2010 extension of the lease for the existing facilities) are as follows:

		Operating Leases
	Fiscal Year	
	2010	\$ 59,194
	2011	246,292
	2012	229,539
	2013	231,574
	2014	241,748
	2015	201,457
	Total minimum lease payments	\$ 1,209,804

Pursuant to the terms of the amendment to the facilities lease, there is no base rent payment due from March 1, 2010 through July 31, 2010, and the total value of this rent abatement is \$133,898. The value of the deferred rent expense will be amortized monthly at a rate of \$1,998 per month over the remaining life of the lease. The total expected facilities rent expense for the remaining nine months of 2010 is \$154,168 or \$51,389 per quarter.

Note 7 - Debt Financing

Related Parties

Short Term Note Payable/Longview Fund - On October 27, 2009, Optex Systems Holdings borrowed \$250,000 from the Longview Fund pursuant to a promissory note, with an original maturity date of December 1, 2009, but as of an allonge dated January 5, 2010 the term of the note was extended until July 15, 2010. The note bears interest at the rate of 10% per annum, and all accrued and unpaid interest will be due upon maturity. However, Optex Systems Holdings is required to make a prepayment equal to 50% of the then outstanding principal amount plus accrued and unpaid interest thereon upon the closing of a credit facility or other equity or debt financing from which the net proceeds to Optex Systems Holdings are at least \$900,000, with any remaining unpaid balance due on July 15, 2010. In exchange for the extension, Optex Systems Holdings granted Longview a warrant to purchase 100,000 shares of its restricted common stock with an exercise price of \$0.15 per share for a term of three years.

Short term note payable (Qioptic) - On November 20, 2008, Optex Systems, Inc. (Delaware) issued a promissory note to Qioptic Limited in the amount of \$117,780. The note originated as a trade payable as of September 28, 2008 in the amount of \$227,265, and was paid in full including accrued interest as of March 29, 2009.

Note 8 – Intangible Assets and Goodwill

On October 14, 2008, in a purchase transaction that was consummated via public auction, Optex Systems, Inc. (Delaware) (Successor) purchased all of the assets of Optex Systems, Inc. (Texas) (Predecessor) in exchange for \$15 million of Irvine Sensors Corporation debt owned by it and the assumption of approximately \$3.8 million of certain Optex Systems, Inc. (Texas) liabilities (see Note 4). Optex Systems, Inc. (Delaware) has allocated the consideration for its acquisition of the Purchased Assets among tangible and intangible assets acquired and liabilities assumed based upon their fair values. Assets that met the criteria for recognition as intangible assets apart from goodwill were also valued at their fair values.

The purchase price was assigned to the acquired interest in the assets and liabilities of Optex Systems Holdings as of October 14, 2008 as follows:

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Assets:	
Current assets, consisting primarily of inventory of \$5,383,929 and accounts receivable of \$1,404,434	\$ 7,330,910
Identifiable intangible assets	4,036,789
Purchased Goodwill	7,110,416
Other non-current assets, principally property and equipment	343,898
Total assets	\$ 18,822,013
Liabilities:	
Current liabilities, consisting of accounts payable of \$1,953,833 and accrued liabilities of \$1,868,180	3,822,013
Acquired net assets	\$ 15,000,000

Goodwill was tested for impairment as of September 27, 2009 using a fair value approach and based on the review, no impairment was required.

The following table summarizes the estimate of the fair values of the intangible assets as of the asset transfer date:

	Total
Contracted Backlog - Existing Orders	\$2,763,567
Program Backlog - Forecasted Indefinite Delivery/Indefinite Quantity awards	1,273,222
Total Intangible Asset to be amortized	\$4,036,789

The amortization of identifiable intangible assets associated with the Optex Systems Inc. (Texas) acquisition on October 14, 2008 expensed for the three months ended December 27, 2009 was \$259,395. The allocation between manufacturing cost of sales and general and administrative cost was \$179,572 and \$79,823, respectively. The amortization of identifiable intangible assets expensed for the three months ended December 28, 2008 was \$517,798. The allocation between manufacturing cost of sales and general and administrative cost was \$416,640 and \$101,158, respectively. The identifiable intangible assets and recorded goodwill are amortized over five years for book purposes and over 15 years for income tax purposes. As of the December 27, 2009, the total unamortized balance of intangible assets was \$1,706,201. The amortizable intangible assets were tested for impairment as of September 27, 2009 utilizing undiscounted, projected cash flows and based upon this analysis, no impairment was noted. Subsequent to the review, there have been no material changes to our assumptions or estimates that would result in impairment. However, we intend to continue to monitor the value of our intangible assets and goodwill in order to identify any impairment that may occur in the future.

Identifiable intangible assets primarily consist of customer and program backlog. The remaining unamortized balance of intangible assets will be amortized between general and administrative expenses and costs of sales over their remaining respective estimated useful lives as follows:

		2010	2011	2012	2013
Contracted backlog amortized by delivery schedule	COS	\$ 538,718	\$ 126,158	\$ 19,614	\$ 4,762
Contracted backlog amortized by delivery schedule	G&A	48,485	11,354	1,765	427
Program backlog amortized straight line across 5 years	G&A	190,983	254,645	254,645	254,645
Total Amortization by Year		\$ 778,186	\$ 392,157	\$ 276,024	\$ 259,834

Note 9-Stock Based Compensation

On March 26, 2009, the Board of Directors of Optex Systems Holdings adopted the 2009 Stock Option Plan providing for the issuance of up to 6,000,000 shares to Optex Systems Holdings officers, directors, employees and to independent contractors who provide services to Optex Systems Holdings.

Options granted under the 2009 Stock Option Plan vest as determined by the Board of Directors of Optex Systems Holdings or any committee set up to act as a compensation committee of the Board of Directors and terminate after the earliest of the following events: (i) expiration of the option as provided in the option agreement, (ii) 90 days following the date of termination of the employee, or (iii) ten years from the date of grant (five years from the date of grant for incentive options granted to an employee who owns more than 10% of the total combined voting power of all classes of Optex Systems Holdings stock at the date of grant). In some instances, granted stock options are immediately exercisable into restricted shares of common stock, which vest in accordance with the original terms of the related options. Optex Systems Holdings recognizes compensation expense ratably over the requisite service period.

The option price of each share of common stock is determined by the Board of Directors or compensation committee (when one is established), provided that with respect to incentive stock options, the option price per share will in all cases be equal to or greater than 100% of the fair value of a share of common stock on the date of the grant, except an incentive stock option granted under the 2009 Stock Option Plan to a shareholder that owns more than 10% of the total combined voting power of all classes of Optex Systems Holdings' stock, will have an exercise price of not less than 110% of the fair value of a share of common stock on the date of grant. No participant may be granted incentive stock options, which would result in shares with an aggregate fair value of more than \$100,000 first becoming exercisable in one calendar year.

On March 30, 2009, 1,414,649 stock options with an exercise price of \$0.15 per share were granted to an officer of Optex Systems Holdings. These options vest as follows: 34% after the first year, and 33% each after the second and third years. These options have a seven year term from the date of issuance. On May 14, 2009, 1,267,000 stock options were issued to other Optex Systems Holdings employees, including options to purchase 250,000 shares to one executive officer. These stock options vest 25% per year after each year of employment and have a seven year term from the date of issuance. For shares granted as of May 14, 2009, Optex Systems Holdings anticipates an annualized employee turnover rate of 3% per year, and as such anticipates that only 1,174,786 of the 1,267,000 shares will vest as of the end of the contract term. As of December 27, 2009, none of the stock options had vested and 16,000 shares had been forfeited due to employee turnover.

Optex Systems Holdings recorded compensation costs for options and shares granted under the plan amounting to \$22,500 for the three months ended December 27, 2009. There were no stock options or shares granted or outstanding as of December 28, 2008; therefore, no compensation expense was recorded during that period. The impact of this expense was immaterial to the basic and diluted net loss per share for the three months ended December 27, 2009. A deduction is not allowed for income tax purposes until nonqualified options are exercised. The amount of this deduction will be the difference between the fair value of Optex Systems Holdings' common stock and the exercise price at the date of exercise. For the three months ended December 27, 2009 estimated deferred tax assets related to option compensation costs were \$7,650 and have been recorded to reflect the tax effect of the financial statement expense. There was no similar tax effect related to option compensation costs for the three months ended December 27, 2009 related to these stock options. No tax deduction is allowed for incentive stock options. Accordingly, no deferred tax asset is recorded for GAAP expense related to these options.

Management has valued the options at their date of grant utilizing the Black-Scholes-Merton option pricing model. The fair value of the underlying shares was determined based on the closing price of Optex Systems Holdings' publicly-traded shares on the grant date. Further, the expected volatility was calculated using the historical volatility of a diversified index of companies in the defense, homeland security, and space industry in accordance with FASB ASC 718-10-S99-1 (Prior authoritative literature: Question 6 of SAB Topic 14.D.1). In making this determination and trying to find another comparable company, Optex Systems Holdings considered the industry, stage of life cycle, size and financial leverage of such other entities. Based on the development stage of Optex Systems Holdings, similar companies with sufficient historical data were not available. Optex Systems Holdings utilized the three year

volatility of the SPADE Defense Index, which is a diversified index of 58 companies in the same industry as Optex Systems Holdings. The risk-free interest rate is based on the implied yield available on U.S. Treasury issues with an equivalent term approximating the expected life of the options depending on the date of the grant and expected life of the options. The expected life of options used was based on the contractual life of the option grant. Optex Systems Holdings determined the expected dividend rate based on the assumption and expectation that earnings generated from operations are not expected to be adequate to allow for the payment of dividends in the near future and the assumption that the company does not presently have any intention of paying cash dividends on its common stock. The following weighted-average assumptions were utilized in the fair value calculations for options granted:

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Three months ended
December 27, 2009

Expected dividend yield	0 %
Expected stock price volatility	23.6 %
Risk-free interest rate (1)	2.8%-4.07 %
Expected life of options	4.5 to 7 Years

- (1) 2.8% for grant expected life less than 7 years
(2) 4.07% for grant expected life of 7 years.

Optex Systems Holdings has granted stock options to officers and employees as follows:

Date of Grant	Shares Granted	Exercise Price	Shares Outstanding As of 12/27/09	Expiration Date	Vesting Date
03/30/09	480,981	\$ 0.15	480,981	03/29/2016	03/30/2010
03/30/09	466,834	0.15	466,834	03/29/2016	03/30/2011
03/30/09	466,834	0.15	466,834	03/29/2016	03/30/2012
05/14/09	316,750	0.15	312,750	05/13/2016	05/14/2010
05/14/09	316,750	0.15	312,750	05/13/2016	05/14/2011
05/14/09	316,750	0.15	312,750	05/13/2016	05/14/2012
05/14/09	316,750	0.15	312,750	05/13/2016	05/14/2013
Total	2,681,649		2,665,649		

The following table summarizes the status of Optex Systems Holdings' aggregate stock options granted under the incentive stock option plan:

Subject to Exercise	Number of Shares Remaining Options	Weighted Average Intrinsic Price	Weighted Average Life (Years)	Aggregate Value
Outstanding as of September 27, 2009	2,667,649	\$ 0.21	5.14	560,206
Granted – 2010	-	\$ -	-	-
Forfeited – 2010	(2,000)	\$ -	-	-
Exercised – 2010	-	\$ -	-	-
Outstanding as of December 27, 2009	2,665,649	\$ -	4.89	\$ -
Exercisable as of December 27, 2009	0	\$ -	-	\$ -

The weighted-average grant date fair value of options granted during the three months ended December 27, 2009 was \$0.14 and the total intrinsic value of options exercised during the three months ended December 27, 2009 was \$0.

The following table summarizes the status of Optex Systems Holdings' aggregate non-vested shares granted under the 2009 Stock Option Plan:

	Number of Non- vested Shares Subject to Options	Weighted- Average Grant- Date Fair Value
Non-vested as of September 27, 2009	2,667,649	\$ 0.14
Non-vested granted — three months ended December 27, 2009	-	\$ 0.00
Vested — three months ended December 27, 2009	-	\$ 0.00
Forfeited — three months ended December 27, 2009	(2,000)	\$ 0.14
Non-vested as of December 27, 2009	2,665,649	\$ 0.14

As of December 27, 2009, the unrecognized compensation cost related to non-vested share based compensation arrangements granted under the plan that was approximately \$297,999. These costs are expected to be recognized on a straight line basis from March 30, 2009 through May 13, 2013. The total fair value of options and shares vested during the three months ended December 27, 2009 was \$0.

During the fiscal year ended September 27, 2009, Optex Systems issued 480,000 shares of common stock at a market value of \$0.30 per share for a total \$144,000 and paid \$150,000 cash to a vendor in support of an investor relations agreement executed on June 29, 2009. Pursuant to the agreement, the shares are earned over the life of the contract at the rate of 40,000 shares per month through June 2010. During the three months ended December 27, 2009, Optex Systems expensed \$36,000 for shares earned and the unamortized balance of shares issued against the contract is \$72,000 to be expensed through the third fiscal quarter of 2010.

There were no stock options issued to Optex Systems, Inc. (Texas) employees or equity instruments issued to consultants and vendors in three months ended December 28, 2008.

Note 10 – Stockholders Equity

Common stock:

Optex Systems, Inc. (Texas) was authorized to issue 100,000 shares of no par common stock. At September 28, 2008 there were 18,870 shares issued and 10,000 shares outstanding.

The common stock, treasury stock and additional paid in capital accounts have been presented to reflect the ownership structure of Optex Systems, Inc. (Texas) as it existed prior to the acquisition by Irvine Sensors Corporation, since Optex Systems, Inc. (Texas) is presenting its financial statements as a separate, stand-alone entity.

On October 14, 2008, in a purchase transaction that was consummated via public auction, Optex Systems, Inc. (Delaware) (Successor) purchased all of the assets of Optex Systems, Inc. (Texas) (Predecessor) in exchange for \$15 million of Irvine Sensors Corporation debt owned by it and the assumption of approximately \$3.8 million of certain Optex Systems, Inc. (Texas) liabilities. The \$15 million of Irvine Sensors Corporation debt was contributed by Longview and Alpha to Optex Systems, Inc. (Delaware), in exchange for a \$6 million note payable from Optex Systems, Inc. (Delaware) and a \$9 million equity interest in Optex Systems, Inc. (Delaware) (which consisted of the issuance by Optex Systems, Inc. (Delaware) of 45,081,350 and 4,918,650 shares of its common stock to each of Longview Fund and Alpha, respectively). On October 30, 2008, Alpha sold its Optex Systems, Inc. (Delaware) common stock to Arland Holdings, Ltd. There was no contingent consideration associated with the purchase. Longview and Arland Holdings, Ltd. both owned Optex Systems, Inc. (Delaware) until February 20, 2009, when Longview sold 100% of its equity and debt interests in Optex Systems, Inc. (Delaware) to Sileas Corp., as discussed below.

On February 20, 2009, Sileas purchased 100% of the equity and debt interest held by Longview, representing 90% of Optex Systems, Inc. (Delaware). As of the date of this transaction, Sileas is the majority owner of Optex Systems Holdings.

Stock Split

On March 26, 2009, Optex Systems, Inc. (Delaware)'s Board of Directors reconfirmed a 1.7:1 forward split of its common stock to holders of record as of February 23, 2009. Accordingly, as a result of the forward split, the 45,081,350 shares of common stock held by Sileas were split into 76,638,295 shares, and the 4,918,650 shares of common stock held by Arland Holdings, Ltd. were split into 8,361,705 shares.

As of March 30, 2009, Optex Systems, Inc. (Delaware) was authorized to issue 200,000,000 shares of \$0.001 par value common stock, of which 85,000,000 shares were issued and outstanding as follows:

Sileas Corporation	76,638,295
Arland Holdings, Ltd.	8,361,705
Total Outstanding	85,000,000

Reorganization & Private Placement:

On March 29, 2009, as a result of the reorganization agreement and private placement, the 85,000,000 outstanding shares of Optex Systems, Inc. (Delaware) as of March 30, 2009 were exchanged for 113,333,282 shares of Optex Systems Holdings (formerly Sustut Exploration, Inc.). An additional 8,131,667 shares were issued in connection with the private placement closed prior to the reorganization.

On June 29, 2009, 750,000 common shares were sold to in a private transaction for gross proceeds of \$150,000.

Each share of stock entitles the holder to one vote on matters brought to a vote of the shareholders.

The company granted an officer at the consummation of the reorganization, options to purchase 1,414,649 shares with an exercise price of \$0.15 per share. The options vest 34% one year following the date of grant, and 33% on each of the second and third anniversaries following the date of grant. See Note 9 - Stock Based Compensation.

Series A preferred stock

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On March 24, 2009, Optex Systems Holdings filed a Certificate of Designation with the Secretary of State of the State of Delaware authorizing a series of preferred stock, under its articles of incorporation, known as "Series A preferred stock". This Certificate of Designation was approved by Optex Systems Holdings' Board of Directors and Shareholders at a Board Meeting and Shareholders Meeting held on February 25, 2009. The Certificate of Designation sets forth the following terms for the Series A preferred stock: (i) number of authorized shares: 1,027; (ii) per share stated value: \$6,000; (iii) liquidation preference per share: stated value; (iv) conversion price: \$0.15 per share as adjusted from time to time; and (v) voting rights: votes along with the common stock on an as converted basis with one vote per share.

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The Series A preferred stock entitles the holders to receive cumulative dividends at the rate of 6% per annum, payable in cash at the discretion of Board of Directors. Each share of preferred stock is immediately convertible into common shares at the option of the holder which entitles the holder to receive the equivalent number of common shares equal to the stated value of the preferred shares divided by the conversion price, which was initially set at \$0.15 per share.

Holders of preferred shares receive preferential rights in the event of liquidation. Additionally the preferred stock shareholders are entitled to vote together with the common stock on an "as-converted" basis.

On March 27, 2009, Sileas and Alpha exchanged their promissory notes in the total amount of \$6,000,000 plus accrued and unpaid interest thereon into 1,027 shares of Series A preferred stock. On March 30, 2009, shares of Optex Systems, Inc. (Delaware) Series A preferred stock was exchanged on a 1:1 basis for Series A preferred stock of Optex Systems Holdings. As of the three months ended December 27, 2009 Optex Systems Holdings recorded \$95,224 of dividends payable on Series A preferred shares.

Cancellation of Common Stock

On June 29, 2009, Optex Systems Holdings cancelled an investor relations agreement resulting in the return of 700,000 shares of common stock previously issued by Sustut prior to the reverse merger on March 30, 2009. The shares were valued at \$105,000, returned to Optex System Holdings, and then cancelled. (see also Note 9 regarding new investor relations shares issued).

Note 11 — Subsequent Events

Effective as of January 4, 2010, Optex Systems Holdings, Inc. renewed its Richardson, TX lease. Under the terms of the renewal:

- The lease term is extended until July 31, 2015.
- The base rent during the extended term is as follows: until 7/31/2010, \$0.00 per square foot, from 8/1/2010 – 7/31/2013, \$4.70 per square foot and from 8/1/2013 – 7/31/2015, \$4.95 per square foot.
 - A \$195,352.00 improvement allowance is included.
- For the first two years of the extended term, the landlord has granted the option to take over additional space at similar terms as in the amendment.

Optex Systems Holdings has evaluated subsequent events for the period December 27, 2009 through February 9, 2010, the date its financial statements were issued, and concluded there were no other events or transactions occurring during this period that required disclosure in its financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis or Plan of Operations

This management's discussion and analysis reflects information known to management as at December 27, 2009. This MD&A is intended to supplement and complement our audited financial statements and notes thereto for the year ended September 27, 2009, prepared in accordance with U.S. generally accepted accounting principles (GAAP). You are encouraged to review our financial statements in conjunction with your review of this MD&A. The financial information in this MD&A has been prepared in accordance with GAAP, unless otherwise indicated. In addition, we use non-GAAP financial measures as supplemental indicators of our operating performance and financial position. We use these non-GAAP financial measures internally for comparing actual results from one period to another, as well as for planning purposes. We will also report non-GAAP financial results as supplemental information, as we believe their use provides more insight into our performance. When non-GAAP measures are used in this MD&A, they are clearly identified as a non-GAAP measure and reconciled to the most closely corresponding GAAP measure.

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

Background

On March 30, 2009, the reorganization was consummated pursuant to which the then existing shareholders of Optex Systems, Inc. (Delaware) exchanged their shares of common stock with the shares of common stock of Optex Systems Holdings as follows: (i) the outstanding 85,000,000 shares of Optex Systems, Inc. (Delaware) common stock were exchanged by Optex Systems Holdings for 113,333,282 shares of Company common stock, (ii) the outstanding 1,027 shares of Optex Systems, Inc. (Delaware) Series A preferred stock were exchanged by Optex Systems Holdings for 1,027 shares of Company Series A preferred stock, and (iii) the 8,131,667 shares of Optex Systems, Inc. (Delaware) common stock purchased in the private placement were exchanged by Optex Systems Holdings for 8,131,667 shares of Company common stock. Optex Systems, Inc. (Delaware) has remained a wholly-owned subsidiary of Optex Systems Holdings.

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

Immediately prior to the closing under the reorganization agreement (and the shares included above), as of March 30, 2009, Optex Systems, Inc. (Delaware) accepted subscriptions from accredited investors for a total 27.1 units, for \$45,000 per unit, with each unit consisting of 300,000 shares of common stock, no par value, of Optex Systems, Inc. (Delaware) and warrants to purchase 300,000 shares of common stock for \$0.45 per share for a period of five (5) years from the initial closing, which were issued by Optex Systems, Inc. (Delaware) after the closing referenced above. Gross proceeds to Optex Systems, Inc. (Delaware) were \$1,219,750, and after deducting (i) a cash finder’s fee of \$139,555, (ii) non-cash consideration of indebtedness owed to an investor of \$146,250, and (iii) stock issuance costs of \$59,416, the net proceeds were \$874,529. The finder also received five year warrants to purchase 2.39 units, at an exercise price of \$49,500 per unit.

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

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

Optex Systems Holdings also anticipates the opportunity to integrate some of its night vision and optical sights products into commercial applications. Optex Systems Holdings plans to carry on the business of Optex Systems, Inc. (Delaware) as its sole line of business, and all of Optex Systems Holdings' operations are expected to be conducted by and through Optex Systems, Inc. (Delaware).

The successful completion of the separation from Irvine Sensors Corporation, which was accomplished by Optex Delaware's acquisition of all of the assets and assumption of certain liabilities of Optex Systems, Inc. (Texas), reduced the general and administrative costs allocated by Irvine Sensors Corporation. These costs represented services paid by Irvine Sensors Corporation for expenses incurred on Optex Texas' behalf such as legal, accounting and audit, consulting fees and insurance costs in addition to significant amounts of Irvine Sensors Corporation's general overhead allocated to Optex -Texas.

Optex Systems, Inc. (Delaware) delivers high volume products, under multi-year contracts, to large defense contractors. It has the reputation and credibility with those customers as a strategic supplier. Irvine Sensors Corporation is predominately a research and design company with capabilities enabling only prototype or low quantity volumes. Optex Systems, Inc. (Delaware) is predominately a high volume manufacturing company. Therefore the systems and processes needed to meet customer's needs are quite different. While both companies serve the military market, the customers within these markets are different. For example, two of the largest customers for Optex are GDLS and TACOM. Irvine Sensors Corporation did not have any contracts or business relations with either of these two customers. Therefore the separation has allowed Optex Systems, Inc. (Delaware) to fully focus on high volume manufacturing and the use of the six sigma manufacturing methodology. This shift in priorities has allowed Optex Systems, Inc. (Delaware) to improve delivery performance and reduce operational costs.

The estimated total General and Administrative expenses assuming Optex Systems, Inc (Texas) was operated under a stand-alone basis during the 2008 fiscal year are:

Accounting and Auditing Fees	\$ 250,000
Legal Fees	60,000
Consulting Fees	60,000
Workers Comp and General Insurance	70,000
Total	\$ 440,000

As a result of the purchase of Optex Systems, Inc. (Texas) on October 14, 2008, these general and administrative costs are incurred and paid directly by Optex Systems, Inc. (Delaware) and have been reflected in the 2009 and 2010 financial results to the extent incurred for the periods presented herein.

The liabilities not assumed relate to costs that would not have been incurred by Optex Systems, Inc. (Texas) if they were operated on a stand alone basis. Among those liabilities not assumed by Optex Systems, Inc. (Delaware) was a note due to Tim Looney. The 2007 promissory note had a principal amount of \$2,000,000 together with accrued interest unpaid aggregating to approximately \$2,300,000. The note was an amendment to Looney's earn-out agreement which was the consideration for Irvine Sensors Corporation's purchase of Optex Systems, Inc. (Texas).

The promissory note was not assumed by Optex Systems, Inc. (Delaware) in the October 2008 transaction. The note and accrued interest was reported on Optex Systems, Inc. (Texas) financial statements as of September 28, 2008 as a result of push down accounting for the acquisition of Optex Systems, Inc. (Texas) by Irvine Sensors Corporation. These costs would not be incurred by Optex Systems, Inc. (Texas) if operated as a stand alone entity because it relates to Irvine Sensors Corporation's consideration for their purchase of Optex Systems, Inc. (Texas). Since this was not an operating cost associated with Optex Systems, Inc. (Texas) and they would not incur these costs if operating as a stand alone entity, we expect no impact to the future operating results or liquidity of the Company.

Additionally, as of September 28, 2008, Optex Systems, Inc. (Texas) reported \$4.3 million of liabilities attributable to corporate expenses allocated to Optex Systems, Inc. (Texas) through an intercompany payable account "Due to Parent". The outstanding "Due to Parent" balance was not acquired by the company in the acquisition from Irvine Sensors

Corporation.

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To the extent that Optex Systems, Inc. (Delaware) has incurred these similar costs on an ongoing basis, these amounts have been funded from the Optex Delaware's own operating cash flow.

Plan of Operation

Through a private placement offering completed prior to consummation of the reorganization agreement, Optex Systems, Inc. (Delaware) raised \$1,219,750 (\$874,529, net of finders fees, issuance costs and non cash consideration resulting from satisfaction of indebtedness owed to an investor) to fund operations. The proceeds have been used as follows:

Description	Offering
Additional Personnel	\$ 150,000
Legal and Accounting Fees	\$ 100,000
Investor Relations Fees	96,000
Working Capital	\$ 528,529
Totals:	\$ 874,529

Results of Operations

Based on the current level of deliverable backlog, we expect the next three months' revenues to be consistent with the total for the periods September 29, 2008 through October 14, 2008 (Predecessor) and October 15, 2008 through December 27, 2009 (Successor). In addition, future business includes expected awards yet to be determined. Although the current range of products being manufactured is dependent on the receipt of continued and timely funding to existing programs, the most recent proposed federal budget is not expected to impact any of our existing programs in the near term.

The Revenue, Expenses and Income for the fourteen day period of Optex Systems, Inc. (Texas) prior to the acquisition by Optex Systems, Inc. (Delaware) are summarized below (in millions).

Optex Systems, Inc. (Texas)

(Predecessor)

Revenue	\$ 0.9
Cost of Sales	0.7
Gross Margin	0.2
General & Administrative	0.1
Operating Income	\$ 0.1
Net Income	\$ 0.1

The table below summarizes our quarterly and year to date operating results in terms of both a GAAP net income measure and a non GAAP EBITDA measure. We use EBITDA as an additional measure for evaluating the performance of our business as "net income" includes the significant impact of noncash Intangible Amortization on our income performance. Consequently, in order to have a meaningful measure of our operating performance on a continuing basis, we need to evaluate an income measure which does not take into account this Intangible Amortization. We have summarized the quarterly revenue and margin below along with a reconciliation of the GAAP net loss to the non GAAP EBITDA calculation for comparative purposes below. We believe that including both measures allows the reader to have a "complete picture" of our overall performance.

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Combined - Three months ended December 27, 2009
 Predecessor - (September 29, 2008 through December 27, 2008)
 Successor - (October 15, 2008 through December 27, 2008)

	Combined - Three months ended December 27, 2009	Predecessor - (September 29, 2008 through December 27, 2008)	Successor - (October 15, 2008 through December 27, 2008)
Net Loss Applicable to Common Shareholders – GAAP	\$ -	\$ -	\$ (0.1)
Add:			
Interest Expense	-	0.1	0.1
Preferred Stock Dividend	0.1		
Federal Income Taxes (Benefit)	-	0.2	0.2
Depreciation & Amortization	0.3	0.6	0.6
EBITDA - Non GAAP	\$ 0.4	\$ 0.9	\$ (0.1)

Our EBITDA declined by \$0.5 million in the three months ended December 27, 2009 as compared to the prior year performance for the same period. The EBITDA reduction for the quarter was primarily attributable to the lower sales revenue of \$1.3 million, lower product margins related to the mix of product lines shipped during the quarter, and higher general and administrative spending of \$0.1 million. Based on recent increases in periscope orders from multiple customers, we expect our revenues to increase over the next three quarters and our product mix to shift toward more profitable programs beginning in the third quarter of 2010. We continue to pursue cost efficiencies in our production and general and administrative areas.

Product mix is dictated by customer contracted delivery dates and volume of each product to be delivered on such delivery dates. Shifts in gross margin from quarter to quarter are primarily attributable to the differing product mix recognized as revenues during each respective period. The legacy periscope contracts were awarded January 2003, and due to significant material price increases subsequent to the contract award date, we are experiencing a loss on these contracts. We have fully reserved for future contract losses on this program, thus deliveries against these programs yield a product margin of zero. During the three months ended December 27, 2009, we recognized revenue of \$0.7 million from these legacy periscope programs, with a remaining backlog of \$0.5 million, which should be recognized by the end of the third quarter of 2010. We expect our product margins on periscopes to increase each quarter as the legacy programs are completed and are replaced with new awards.

We are aggressively pursuing additional, potentially higher margin periscope business, and in May 2009, Optex Systems Holdings was awarded a multi-year Indefinite Delivery/Indefinite Quantity type contract accompanied by the first delivery order from TACOM. If all government forecasted delivery orders against this Indefinite Delivery/Indefinite Quantity contract are awarded and if we were to share equally with the other supplier in the awarded releases, the total value of the contract to us could be valued at approximately \$7.5 million over the next three years. In June 2009, we received an additional \$3.4 million dollar award from GDLS and in September 2009, an additional \$1.9 million award to provide product beginning with delivery starting in 2011 at the completion of our current production contract. The total orders recorded for all product lines in the three months ended December 27, 2009 was \$7.7 million of which \$7.4 million related to periscope business from several customers. The total backlog increased \$1.7 million during the same period, net of current quarter shipments.

As a result of the October 14, 2008 acquisition of the assets of Optex Systems, Inc. (Texas) (Predecessor), the company's amortizable intangible assets increased significantly in 2009 over prior years. We expect the intangible amortization expense to decline \$1.0 million in the year ended September 27, 2010 from \$2.0 million in the year

ended September 27, 2009.

Backlog as of December 27, 2009 was \$28.2 million as compared to a backlog of \$30.9 million as of December 28, 2008. The following table depicts the current expected delivery by quarter of all contracts awarded as of December 27, 2009.

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Program Backlog (millions)	FY2010				FY2011				FY2012				FY2013	
	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2	
Howitzer Programs	\$ 1.2	\$ 1.8	\$ 2.6	\$ 1.7	\$ 0.1	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	
Periscope Programs														