Optex Systems Holdings Inc
Form 424B3
October 10, 2012

Prospectus Supplement No. 1

(To Amendment No. 2 to Post Effective Amendment No. 1. to Prospectus dated July 6, 2012)

Filed Pursuant to Rule 424(b)(3)

Registration No. 333-159334

Optex Systems Holdings, Inc.

11,784,177 Shares of Common Stock

This prospectus supplement relates to the offer and sale from time to time of up to 11,784,177 shares of common stock of Optex Systems Holdings, Inc., a Delaware corporation, by the selling stockholders named in the post effective amendment no. 1 to prospectus dated July 6, 2012 (the "Prospectus"). The Prospectus relates to the offer and sale of up to 11,784,177 shares of common stock registered on Registration Statement No. 333-159334. You should read this prospectus supplement in conjunction with the Prospectus, and this prospectus supplement is qualified in its entirety by reference to the Prospectus, except to the extent that the information contained in this prospectus supplement supersedes or supplements the information contained in the Prospectus.

The information contained herein supplements the information in the Prospectus related to the Financial Statements and Supplementary Data by including our audited financial statements and related notes for the three months ended July 1, 2012. This prospectus supplement also contains certain other information included in our report on Form 10-Q for the quarter ended July 1, 2012.

Our report on Form 10-Q for the quarter ended July 1, 2012, reflects a total of 144,444,940 shares of our common stock issued and outstanding as of August 14, 2012.

Investing in our common stock is speculative and involves a high degree of risk. See "Risk Factors" beginning on page 2 of the Prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if the Prospectus or this prospectus supplement is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is October 10, 2012.

Optex Systems Holdings, Inc.

Condensed Consolidated Balance Sheets

	(Thousands)	
	July 1, 2012 (Unaudited)	October 2, 2011
ASSETS		
Current Assets		
Cash	$2,302	$1,514
Accounts Receivable	2,067	2,392
Net Inventory	5,024	4,088
Prepaid Expenses	37	17
Total Current Assets	$9,430	$8,011
Property and Equipment		
Property Plant and Equipment	$1,573	$1,488
Accumulated Depreciation	(1,372)	(1,227)
Total Property and Equipment	$201	$261
Other Assets		
Deferred Tax Asset - Long Term	$1,069	$1,204
Prepaid Royalties - Long Term	208	-
Security Deposits	21	21
Total Other Assets	$1,298	$1,225
Total Assets	$10,929	$9,497
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts Payable	$882	$716
Accrued Expenses	644	547
Accrued Warranties	25	25
Customer Advance Deposits - Short Term	600	-
Credit Facility	-	507
Total Current Liabilities	$2,151	$1,795

Other Liabilities		
Customer Advance Deposits - Long Term	1,172	-
Total Other Liabilities	$1,172	$-
Total Liabilities	$3,323	$1,795
Stockholders' Equity		
Optex Systems Holdings, Inc. – (par $0.001, 2,000,000,000 authorized, 144,444,940 and 139,444,940 shares issued and outstanding, respectively)	$144	$139
Optex Systems Holdings, Inc. Preferred Stock ($0.001 par 5,000 authorized, 1,027 series A preferred issued and outstanding)	-	-
Additional Paid-in-capital	17,711	17,662
Retained Earnings (Deficit)	(10,249)	(10,099)
Total Stockholders' Equity	$7,606	$7,702
Total Liabilities and Stockholders' Equity	$10,929	$9,497

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

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Optex Systems Holdings, Inc.

Condensed Consolidated Statements of Operations (Unaudited)

	(Thousands) Three months ended		Nine months ended	
	July 1, 2012 (Unaudited)	July 3, 2011 (Unaudited)	July 1, 2012 (Unaudited)	July 3, 2011 (Unaudited)
Revenues	$3,476	$3,231	$11,608	$11,971
Total Cost of Sales	2,807	2,681	9,602	10,166
Gross Margin	$669	$550	$2,006	$1,805
General and Administrative	787	592	2,108	1,741
Operating Income (Loss)	$(118)	$(42)	$(102)	$64
Other Expenses				
Interest (Income) Expense - Net	2	10	19	64
Total Other	$2	$10	$19	$64
Income (Loss) Before Taxes	$(120)	$(52)	$(121)	$-
Deferred Income Taxes (Benefit)	17	(17)	135	2
Net Income (Loss) After Taxes	$(137)	$(35)	$(256)	$(2)
Less preferred stock dividend (accrued) waived	$-	$(104)	$106	$(307)
Net income (loss) applicable to common shareholders	$(137)	$(139)	$(150)	$(309)
Basic and diluted income (loss) per share	$(0.00)	$(0.00)	$(0.00)	$(0.00)
Weighted Average Common Shares Outstanding	144,444,939	139,444,940	141,697,686	139,444,940

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

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Optex Systems Holdings, Inc.

Condensed Consolidated Statements of Cash Flows (Unaudited)

	(Thousands)	
	Nine months ended July 1, 2012 (Unaudited)	Nine months ended July 3, 2011 (Unaudited)
Cash flows from operating activities:		
Net income (loss)	$(256)	$ (2)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	145	50
Provision for allowance for inventory valuation	73	-
Noncash interest expense (income)	(16)	22
Stock option compensation expense	111	73
(Increase) decrease in accounts receivable	325	488
(Increase) decrease in inventory (net of progress billed)	(1,008)	(253)
(Increase) decrease in prepaid expenses	(20)	183
(Increase) decrease in deferred tax asset (net of valuation allowance)	135	378
Increase (decrease) in accounts payable and accrued expenses	277	143
Increase (decrease) in customer advance deposits	1,772	-
Increase (decrease) in accrued estimated loss on contracts	-	(698)
Total adjustments	$1,794	$ 386
Net cash (used)/provided by operating activities	$1,538	$ 384
Cash flows from investing activities:		
(Increase) decrease in prepaid royalties - long term	(208)	-
Purchased of property and equipment	(85)	(25)
Net cash (used in) provided by investing activities	$(293)	$ (25)
Cash flows from financing activities:		
Proceeds (to) from credit facility (net)	(507)	(707)
Proceeds from issuance of common stock	50	-
Net cash (used In) provided by financing activities	$(457)	$ (707)
Net increase (decrease) in cash and cash equivalents	$788	$ (348)
Cash and cash equivalents at beginning of period	1,514	1,030
Cash and cash equivalents at end of period	$2,302	$ 682

Supplemental cash flow information:		
Cash paid for interest	$35	42

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

Optex Systems Holdings' operations are based in Richardson, Texas in a leased facility comprising 49,100 square feet. As of July 1, 2012, Optex Systems Holdings operated with 64 full-time equivalent employees.

Optex Systems Holdings manufactures optical sighting systems and assemblies, primarily for Department of Defense and foreign military applications. Its products are installed on a variety of U.S. and foreign 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. All significant inter-company balances and transactions have been eliminated in consolidation.

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 consolidated financial statements should be read in conjunction with the annual audited financial statements and the notes thereto included in the Optex Systems Holdings' Form 10-K for the year ended October 2, 2011 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.

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 July 1, 2012 and October 2, 2011, inventory included:

	(Thousands) As of July 1, 2012 (unaudited)	As of October 2, 2011
Raw Materials	$3,829	$3,917
Work in Process	1,678	1,930
Finished Goods	774	176
Gross Inventory	$6,281	$6,023
Less:		
Unliquidated Progress Payments	(431)	(1,181)
Inventory Reserves	(826)	(754)
Net Inventory	$5,024	$4,088

Revenue Recognition: Optex Systems Holdings recognizes revenue based on the modified percentage of completion method utilizing the units-of-delivery method, in accordance with FASB ASC 605-35.

The units-of-delivery method recognizes as revenue the contract price of units of a basic production product delivered during a period and as the cost of earned revenue the costs allocable to the delivered units. Costs allocable to undelivered units are reported in the balance sheet as inventory or work in progress. The method is used in circumstances in which an entity produces units of a basic product under production-type contracts in a continuous or sequential production process to buyers' specifications.

Optex Systems Holdings contracts are fixed price production type contracts whereby a defined order quantity is delivered to the customer during a continuous or sequential production process tailored to the buyer's specifications (build to print). Optex Systems Holdings' deliveries against these contracts generally occur in monthly increments across fixed delivery periods spanning from 3 to 36 months.

Optex Systems Holdings may at times have contracts that allow for invoicing based on achievement of milestone events. In such cases, Optex Systems Inc. recognizes revenue based on the milestone method in accordance with FASB ASC 605-28, as applicable. On October 24, 2011, Optex Systems Inc. was awarded an $8.0 million dollar contract with General Dynamics Land Systems - Canada which provides for milestone invoices up to a total of $3.9 million as outlined in the summarized contract table below. In accordance with FASB 605-28, Optex Systems, Inc. recognizes milestone payments as revenue upon completion of a substantive milestone as commensurate with the following guidelines: our performance to achieve the milestone, the milestone relates solely to past performance and is reasonable relative to all of the deliverables and payment terms within the arrangement. Milestones are not considered as substantive if any portion of the associated milestone consideration relates to the remaining deliverables in the unit of accounting. Non-substantive milestone payments are reported as a liability on the balance sheet as Short Term and Long Term Customer Advance Deposits.

The following table depicts the current contract milestone schedule as of July 1, 2012.

Milestone Event	Estimated Completion / Invoice Date	Thousands Revenue	Customer Deposits / Liability
Start of Work Meeting System Functional Review Production Start of Work	Nov-11	$34.4	$552.9
Delivery of Two Prototypes	Nov-11	63.7	61.8
Preliminary Design Review PRM #1 (Meeting) Production Readiness Review	Nov-11	25.0	1,032.4
Critical Design Review PRM #2 (Meeting)	Apr-12	25.0	150.0
Placement of Long Lead Material (LLM)	Jul-12	25.0	100.4
Delivery of Two Engineering Development Units	May-12	55.0	100.0
Delivery of One Production Ready Unit	May-12	68.2	125.6
PRM #3 (Meeting)	May-12	84.2	570.0
Delivery of Two Final Production Ready Units	Jul-12	275.2	575.0
Total Milestones		$655.7	$3,268.1

In the three and nine months ending July 1, 2012, Optex recognized $233 thousand and $356 thousand of revenue, respectively, as a result of achieving substantive milestone events. During the three and nine months ending July 3, 2011, there were no existing contracts providing for milestone billing, and no revenue was recognized as a result of milestone events.

Customer Advance Deposits: Customer advance deposits represent amounts collected from customers in advance of shipment or revenue recognition which relate to undelivered product due to non-substantive milestone payments or other cash in advance payment terms. As of July 1, 2012, Optex Systems, Inc. had collected $1.8 million in customer advance deposits related to non-substantive milestone billings. The terms of the contract extend through 2017 during which time we are required to purchase the necessary materials to fulfill the delivery of products required by the contract. Of the total collected customer advance deposits, $600 thousand related to short term customer advance deposits for deliveries to occur within the next twelve months and $1.2 million related to long term customer advance deposits for deliveries occurring after June 2013. As of October 2, 2011, there were no milestone or advance payment agreements; thus the customer advance deposit balance was $0.

Stock-Based Compensation: 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. The measurement date for the fair value of the equity instruments issued is determined at the earlier of (i) the date at which a commitment for performance by the consultant or vendor is reached or (ii) the date at which the consultant or vendor’s performance is complete. In the case of equity instruments issued to consultants, the fair value of the equity instrument is recognized over the term of the consulting agreement. Stock-based compensation related to non-employees is accounted for based on the fair value of the related stock or options or the fair value of the services, whichever is more readily determinable in accordance with FASB ASC 718.

Income Tax/Deferred Tax: FASB ASC 740 requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on differing treatment of items for financial reporting and income tax reporting purposes. The deferred tax balances are adjusted to reflect tax rates by tax jurisdiction, based on currently enacted tax laws, which will be in effect in the years in which the temporary differences are expected to reverse. 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 statutory income tax expense and the accounting tax expense is primarily attributable to non-deductible expenses representing permanent timing differences between book income and taxable income during the three and nine months ended July 1, 2012.

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 reflect 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 that Optex Systems Holdings 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 assume the conversion of the number of additional common shares. Optex Systems Holdings uses the Treasury Stock Method to compute the dilutive effect of stock options and warrants. Convertible preferred stock, stock options and warrants that are anti-dilutive are excluded from the calculation of diluted earnings per common share.

For the three and nine months ended July 1, 2012, 1,027 shares of Series A preferred stock, 48,488,649 stock options and 9,948,667 warrants were excluded from the earnings per share calculation as anti-dilutive. For the three and nine months ended July 3, 2011, 1,027 shares of Series A preferred stock, 2,537,649 stock options and 9,948,667 warrants were excluded from the earnings per share calculation as anti-dilutive.

Note 3 - Commitments and Contingencies

Leases

Pursuant to a lease amendment effective January 4, 2010, Optex Systems Holdings leases its office and manufacturing facilities under a non-cancellable operating lease expiring July 31, 2015, in addition to maintaining several non-cancellable operating leases for office and manufacturing equipment. Total expense under facility lease agreements as of the three and nine months ended July 1, 2012 was $73 thousand and $213 thousand, respectively, and total expense for manufacturing and office equipment was $3 and $10 thousand, respectively. Total expense under facility lease agreements as of the three and nine months ended July 3, 2011 was $74 and $219 thousand, respectively, and total expense for manufacturing and office equipment was $6 and $26 thousand, respectively.

As of July 1, 2012, the remaining minimum lease payments under the non-cancelable operating leases for equipment, office and facility space are as follows:

	Operating Leases (Thousands)
Fiscal Year	
2012	$ 59
2013	232
2014	242
2015	201
Total minimum lease payments	$ 734

Pursuant to the terms of the amendment to the facilities lease, there was no base rent payment due from January 1, 2010 through July 31, 2010, and the total value of this rent abatement was $134 thousand. The value of this deferred rent expense is amortized monthly at a rate of $2 thousand per month over the life of the lease. The total unamortized deferred rent as of July 1, 2012 was $74 thousand as compared to $98 thousand as of July 3, 2011. Commencing on August 1, 2010, the base rent payment is $19 thousand per month.

Note 4 – Prepaid Royalties-

Prepaid royalties represent payments made for the purchase of non-transferable, non-exclusive patent rights associated with a patent license. We expect the patent license to allow for development of future products in our digital line of periscopes. We anticipate orders and deliveries on the new periscope product line to begin in 2013 for an estimated commercial life of 7 years. As of July 1, 2012, the unamortized balance of the patent license is $208 thousand. Amortized royalty expenses for the three and nine months ending July 1, 2012 and July 3, 2011 were zero. We expect to begin amortizing the associated royalty expenses on a straight line basis starting in FY2013.

Note 5 - Debt Financing

Credit Facility – Avidbank

On March 22, 2011, Optex Systems Holdings, Inc. amended its revolving credit facility with Avidbank, which provided up to $1 million in financing against eligible receivables. The line expired on March 15, 2012 and as of July

1, 2012, the outstanding balance on the line of credit was $0. For the three months and nine months ended July 1, 2012, the total interest expense against the outstanding line of credit balance was $2 thousand and $19 thousand, respectively. For the three months and nine months ended July 3, 2011, the total interest expense against the outstanding line of credit balance was $10 thousand and $64 thousand, respectively.

In April 2012, the Company amended its revolving credit facility with Avidbank. The new renewable revolving maturity date is July 15, 2014. The facility provides up to $1 million in financing against eligible receivables for up to two years. The material terms of the amended revolving credit facility are as follows:

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

Interest shall be paid monthly in arrears.

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

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

The obligations of Optex Systems, Inc. to Avidbank are secured by a first lien on all of its assets (including intellectual property assets should it have any in the future) in favor of Avidbank.

The facility contains customary events of default. Upon the occurrence of an event of default that remains uncured after any applicable cure period, Avidbank's commitment to make further advances may terminate, and Avidbank would also be entitled to pursue other remedies against Optex Systems, Inc. and the pledged collateral.

Pursuant to a guaranty executed by Optex Systems Holdings in favor of Avidbank, Optex Systems Holdings has guaranteed all obligations of Optex Systems, Inc. to Avidbank.

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

Note 6-Stock Based Compensation

On March 26, 2009, the Board of Directors 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 a 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 a committee set up to act as a compensation committee, 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 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.

Optex Systems Holdings adopted its 2009 Stock Option Plan on March 26, 2009. On December 9, 2011, Optex Systems Holdings Board of Directors authorized an amendment to its Stock Option Plan to increase the number of issuable shares from 6,000,000 to 50,000,000 and authorized the grant of 10,000,000 options to two board members and a total of 36,070,000 to Optex Systems Holdings employees including 20,000,000 options to executive officers, at an exercise price of $0.01per share with each grant to vest 25% per year over four years for each year with which the grantee is still employed by or serving as a director of Optex Systems Holdings (with all unvested options automatically expiring on the date of termination of employment by or service as a director of Optex Systems Holdings) and all unvested options immediately vesting upon a change of control due to a merger or acquisition of Optex Systems Holdings, with the options to be issued within 60 days of December 9, 2011. For shares granted as of December 9, 2011, Optex Systems Holdings anticipates an annualized employee turnover rate of 3% per year, and as such anticipates that only 42,716,864 of the 46,070,000 shares will vest as of the end of the contract term.

As of July 1, 2012, 2,242,649 of awarded stock options had vested and 263,000 shares had been forfeited due to employee turnover. As of July 3, 2011, 1,509,315 of the awarded stock options had vested and 144,000 shares had been forfeited due to employee turnover.

Optex Systems Holdings recorded compensation costs for options and shares granted under the plan amounting to $42 and $111 thousand for the three and nine months ended July 1, 2012, respectively, as opposed to $23 and $73 thousand for the three and nine months ended July 3, 2011, respectively. The impact of this expense was immaterial to the basic and diluted net loss per share for the quarters ended July 1, 2012 and July 3, 2011, respectively. 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 and nine months ended July 1, 2012, the estimated deferred tax assets related to option compensation costs were $14 thousand and $38 thousand, respectively. For the three and nine months ended July 3, 2011, the estimated deferred tax assets related to option compensation costs were $8 thousand and $25 thousand, respectively. These tax effects have been recorded in the financial statement expenses. No tax deduction is allowed for incentive stock options. Accordingly no deferred tax asset is recorded for GAAP expense related to these options.

Optex Systems Holdings records its stock based compensation expense in accordance with ASC 718-10, "Compensation – Stock Compensation". In estimating the value of stock options issued, management has valued the options at their date of grant utilizing the Black-Scholes-Merton option pricing model. For options issued on December 9, 2011, the fair value of the underlying shares was determined based on the closing price of Optex Systems Holdings' publicly-traded shares as of December 9, 2011. Further, Optex used an expected volatility of 364.2% which was calculated using the historical Optex Systems Holdings stock prices over the prior 12 month trading period. Estimation of these equity instruments' fair value is affected by our stock price, as well as assumptions regarding subjective and complex variables such as employee exercise behavior and our expected stock price volatility over the term of the award. As our assumptions are based on historical information, judgment is required to determine if historical trends are fair indicators of future outcomes.

The risk-free interest rates used of 1.5% to 2.2% were determined based on the implied yield available on U.S. Treasury issues with an equivalent term approximating the expected life of the options of 4.5 to 7 years 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 Optex Systems Holdings does not presently have any intention of paying cash dividends on its common stock.

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

Date of Grant	Shares Granted	Exercise Price	Shares Outstanding As of 07/01/12	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	276,000	05/13/2016	05/14/2010
05/14/09	316,750	$ 0.15	276,000	05/13/2016	05/14/2011
05/14/09	316,750	$ 0.15	276,000	05/13/2016	05/14/2012
05/14/09	316,750	$ 0.15	276,000	05/13/2016	05/14/2013
12/09/11	11,517,500	$ 0.01	11,492,500	12/08/2018	12/08/2012
12/09/11	11,517,500	$ 0.01	11,492,500	12/08/2018	12/08/2013
12/09/11	11,517,500	$ 0.01	11,492,500	12/08/2018	12/08/2014
12/09/11	11,517,500	$ 0.01	11,492,500	12/08/2018	12/08/2015
Total	48,751,649		48,488,649		

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 Fair Value	Weighted Average Life (Years)	Aggregate Value (Thousands)
Outstanding as of October 3, 2010	2,598,649	$ —	4.13	—
Granted – 2011	—	$ —	—	—
Forfeited – 2011	(71,000)	$ —	—	—
Exercised – 2011	—	$ —	—	—
Outstanding as of October 2, 2011	2,527,649	$ —	3.38	—
Granted – 2012	46,070,000	$ 0.01	5.94	$ 322
Forfeited – 2012	(109,000)	$ —	—	—
Exercised – 2012	—	$ —	—	—
Outstanding as of July 1, 2012	48,488,649	$ —	4.81	—
Exercisable as of July 1, 2012	2,242,649	$ —	2.2	$ —

There were zero and 46,070,000 new options granted in the three and nine months ended July 1, 2012, respectively and zero options exercised during the three and nine months ended July 1, 2012. The total intrinsic value of options granted during the nine months ended July 1, 2012 is $368 thousand.

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 October 3, 2010	1,821,668	$ 0.15
Non-vested granted — year ended October 2, 2011	—	$ 0.00
Vested — year ended October 2, 2011	(727,334)	$ 0.12
Forfeited — year ended October 2, 2011	(71,000)	$ 0.15
Non-vested as of October 2, 2011	1,023,334	$ 0.15
Non-vested granted — nine months ended July 1, 2012	46,070,000	$ 0.01
Vested — nine months ended July 1, 2012	(738,334)	$ —
Forfeited — nine months ended July 1, 2012	(109,000)	$ —
Non-vested as of July 1, 2012	46,246,000	$ 0.01

As of July 1, 2012, the unrecognized compensation cost related to non-vested share based compensation arrangements granted under the plan was approximately $313 thousand. These costs are expected to be recognized on a straight line basis through December 8, 2018.

Warrant Agreements: Optex Systems Holdings calculates the fair value of warrants issued with debt or preferred stock using the Black-Scholes-Merton valuation method. The total proceeds received in the sale of debt or preferred stock and related warrants are allocated among these financial instruments based on their relative fair values. The discount arising from assigning a portion of the total proceeds to the warrants issued is recognized as interest expense for debt from the date of issuance to the earlier of the maturity date of the debt or the conversion dates using the effective yield method.

As of July 1, 2012, Optex Systems Holdings had the following warrants outstanding:

	Grant Date	Warrants Granted	Exercise Price	Outstanding as of 7/01/12	Expiration Date	Term
Private Placement Stock Holders	3/30/2009	8,131,667	$ 0.450	8,131,667	3/29/2014	5 years
Finder Fee on Private Placement	3/30/2009	717,000	$ 0.165	717,000	3/29/2014	5 years
Longview Fund Allonge Agreement	1/5/2010	100,000	$ 0.150	100,000	1/4/2013	3 years
Peninsula Bank Business Funding - Line of Credit	3/4/2010	1,000,000	$ 0.100	1,000,000	3/3/2016	6 years

Total Warrants	9,948,667	9,948,667

During the three and nine months ended July 1, 2012, Optex Systems Holdings recorded no interest expense related to the outstanding warrants. During the three and nine months ended July 3, 2011, Optex Systems Holdings recorded a total of $0 thousand and $12 thousand in interest expense related to the outstanding warrants. Interest expense related to outstanding warrants was fully amortized as of October 2, 2011. These warrants are not included in the computation of weighted average of shares as it would be anti-dilutive.

Note 7 Stockholder's Equity

Common stock:

On February 22, 2012, Alpha Capital Anstalt purchased 5,000,000 restricted shares of Common Stock of Registrant at a purchase price of $0.01 per share, for a total purchase price of $50,000. The purchase price for the Common Stock was negotiated on February 2, 2012 when the stock price was $0.01. The $50,000 has been utilized by Optex Systems Holdings for operating expenses. The Common Stock was purchased by Alpha in a private transaction exempt from registration under Section 4(2) of the Securities Act of 1934 and is restricted from resale and the stock certificate issued will bear the appropriate restrictive legend. There were no other issues of common or preferred stock during the three and nine months ended July 1, 2012. During the three and nine months ended July 3, 2011 there were no new issues of common or preferred stock.

On June 22, 2011, our shareholders approved an amendment to our articles of incorporation to increase our authorized shares of common stock to 2 billion. This amendment was the subject of a Definitive Information Statement on Scheduled 14C which was filed with the SEC on September 23, 2011 and filed with the Secretary of State of the State of Delaware on November 23, 2011.

On July 14, 2011 Optex filed a Registration Statement on Form S-1 which provides for the sale of up to 25,000,000 shares of our common stock at a fixed price (currently anticipated to be $0.01 per share). The S-1 also contemplates a reduction in the warrant exercise price to $0.01 per share for the 2009 private placement investors for 30 days from the date of effectiveness of this registration statement, and a waiver of accrued dividends from the Series A preferred shareholders. This Registration Statement was declared effective on July 19, 2012, and the 30 day reduction in warrant exercise price to $.01 commenced on that date.

Series A preferred stock

Optex Systems Holdings has 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". The Certificate of Designation currently sets forth the following terms for the Series A preferred stock: (i) number of authorized shares: 1,027; (ii) per share stated value: $6,830.64; (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. The conversion price was subsequently reset to $0.01 per share as discussed below.

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. The dividends were subsequently waived and the price per share was reset to $0.01 on February 21, 2012 as discussed below.

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.

As of July 3, 2011, the preferred shareholders agreed to waive the past dividends in arrears through July 3, 2011 of $884 thousand in exchange for an increase in the stated value to $6,830.64. On February 21, 2012, in connection with the purchase of the 5,000,000 shares of common stock of Optex Systems Holdings by Alpha Capital, the preferred shareholders executed an irrevocable waiver for any and all previously accrued and outstanding dividends and the right to receive any future dividends on the Series A Preferred Stock. The per share conversion price of the Registrant’s Series A Preferred Stock has been automatically reset to $0.01 per share in accordance with the reset provision as set forth in paragraph 4(d)(ii) of the Series Designation for the Registrant’s Series A Preferred Stock. The total amount of dividends waived as a result of the February 21, 2012 waiver is $213 thousand. As of the three months ended July 1, 2012 there were no recorded preferred dividends payable and as of the nine months ended July 1, 2012, Optex Systems Holdings reversed previously recorded preferred dividends payable of ($106) thousand. As of the three and nine months ended July 3, 2011, Optex Systems Holdings recorded preferred dividends payable of $104 thousand and $307 thousand, respectively. As of July 1, 2012 as a result of the executed waiver dated February 21, 2012, there were no dividends in arrears on preferred shares and no future dividends will accrue on the preferred shares.

Note 8 Subsequent Events

There are no subsequent events.

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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 July 1, 2012 and through the date of this filing. This MD&A is intended to supplement and complement our audited financial statements and notes thereto for the fiscal year ended October 2, 2011 and the quarter ended July 1, 2012, prepared in accordance with U.S. generally accepted accounting principles (GAAP). You are encouraged to review our financial statements in conjunction with your review of this MD&A. The financial information in this MD&A has been prepared in accordance with GAAP, unless otherwise indicated. In addition, we use non-GAAP financial measures as supplemental indicators of our operating performance and financial position. We use these non-GAAP financial measures internally for comparing actual results from one period to another, as well as for planning purposes. We will also report non-GAAP financial results as supplemental information, as we believe their use provides more insight into our performance. When non-GAAP measures are used in this MD&A, they are clearly identified as non-GAAP measures and reconciled to the most closely corresponding GAAP measure.

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

Background

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

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

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

By way of background, the Federal Acquisition Regulation is the principal set of regulations that govern the acquisition process of government agencies and contracts with the U.S. government. In general, parts of the Federal Acquisition Regulation are incorporated into government solicitations and contracts by reference as terms and conditions effecting contract awards and pricing solicitations.

Many of our contracts are prime or subcontracted directly with the Federal government and, as such, are subject to Federal Acquisition Regulation Subpart 49.5, “Contract Termination Clauses” and more specifically Federal Acquisition Regulation clauses 52.249-2 “Termination for Convenience of the Government Fixed-Price)”, and 49.504 “Termination of fixed-price contracts for default”. These clauses are standard clauses on our prime military contracts and generally apply to us as subcontractors. It has been our experience that the termination for convenience is rarely invoked, except where it is mutually beneficial for both parties. We are currently not aware of any pending terminations for convenience or for default on our existing contracts.

In the event a termination for convenience were to occur, Federal Acquisition Regulation clause 52.249-2 provides for full recovery of all contractual costs and profits reasonably occurred up to and as a result of the terminated contract. In the event a termination for default were to occur, we could be liable for any excess cost incurred by the government to acquire supplies from another supplier similar to those terminated from us. We would not be liable for any excess costs if the failure to perform the contract arises from causes beyond the control and without the fault or negligence of the company as defined by Federal Acquisition Regulation clause 52.249-8. In addition, the Government may require us to transfer title and deliver to the Government any completed supplies, partially completed supplies and materials, parts, tools, dies, jigs, fixtures, plans, drawings, information, and contract rights that we have specifically produced or acquired for the terminated portion of this contract. The Government shall pay contract price for completed supplies delivered and accepted, and we and the Government would negotiate an agreed upon amount of payment for manufacturing materials delivered and accepted and for the protection and preservation of the property. Failure to agree on an amount for manufacturing materials is subject to the Federal Acquisition Regulation Disputes clause 52.233-1.

Many of our contracts allow for government contract financing in the form of contract progress payments pursuant to Federal Acquisition Regulation 52.232-16, “Progress Payments”. As a small business, and subject to certain limitations, this clause provides for government payment of up to 90% of incurred program costs prior to product delivery. In addition, Optex has a significant contract that allows for milestone payments in advance of delivery, based on achieving significant milestone events in accordance with the contract schedule. To the extent our contracts allow for progress or milestone payments, we intend to utilize these benefits, thereby minimizing the working capital impact on Optex Systems Holdings for materials and labor required to complete the contracts.

Our contracts allow for Federal Acquisition Regulation 52.243-1 which entitles the contractor to an “equitable adjustment" to the contract if the contract changes result in a change in contract costs or time of performance. In essence, an equitable price adjustment request is a request for a contract price modification (generally an increase) that allows for the contractor to be "made whole" for additional costs incurred which were necessitated by some modification of the contract effort. This modification may come from an overt change in Government requirements or scope, or it may come from a change in the conditions surrounding the contract (e.g., differing site conditions or late delivery of Government-furnished property) which result in statement of work additions, deletions, part substitutions, schedule or other changes to the contract which impact the contractor's overall cost to complete. Optex has submitted an equitable adjustment request on the Aiming Circle Howitzer program due to significant design issues impacting the manufacturability of the product. As of July 1, 2012, the equitable adjustment request is under appeal with the Armed Services Board of Contracts Appeal (ASBCA).

Results of Operations

Backlog as of July 1, 2012, was $16.9 million as compared to a backlog of $13.5 million as of July 3, 2011, representing an increase of 30.4%. The following table depicts the current expected delivery by of all contracts awarded as of July 1, 2012 in millions of dollars.

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Product Line	Q4 - 2012	2013	2014	2015	2016	2017	Total
Howitzer	0.1	0.0	0.0	0.0	0.0	0.0	0.1
Periscopes	1.9	4.3	0.3	0.0	0.0	0.0	6.5
Sighting Systems	0.5	1.8	1.6	1.4	1.4	1.2	7.9
Other	1.7	0.6	0.1	0.0	0.0	0.0	2.4
Total	4.2	6.7	2.0	1.4	1.4	1.2	16.9

In the first three fiscal quarters of 2012, Optex Systems Holdings received $17.0 million in new orders consisting of a $8.0 million M36 contract deliverable over 5 years from General Dynamics Land Systems - Canada, a $1.2 million other product line award from the Defense Logistics Agency for a Gunner's Head Assembly on the M1 Abrams Tank deliverable in fiscal year 2012, and $7.8 million in additional orders from several customers primarily in support of our periscope and other product line which will be delivered in fiscal years 2012 through 2014. The $8.0 million M36 contract provides for milestone billings in the current fiscal year of $3.9 million of which approximately $3.3 million relates to customer advance deposits for future year deliverables.

On July 30, 2012, Miller-Holzwarth Inc, Optex System’s Holdings primary competitor on plastic periscopes, closed its business and told employees not to return to work. We are currently working with our customers to determine any impact the closure of our primary periscope competitor may have on future Optex business. Information related to the closure of Miller-Holzwarth can be obtained from Salem News, based in Salem, Ohio.

Three Months Ended July 1, 2012 Compared to the Three Months Ended July 3, 2011

Revenues. In the three months ended July 1, 2012, revenues increased by $0.3 million or 9.4% from the respective prior period in 2011 as set forth in the table below:

	Three months ended (Millions)			
Product Line	July 1, 2012	July 3, 2011	Variance	% Chg
Howitzer	-	0.5	(0.5)	(100.0)
Periscopes	3.0	2.5		