

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

FORM 10-K

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

For the fiscal year ended September 29, 2019

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

For the transition period from ___ until ___

Commission File Number 000-54114

OPTEX SYSTEMS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation organization)

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

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

75081-2439
(Zip Code)

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

Securities Registered under Section 12(b) of the Act
None

Securities Registered under Section 12(g) of the Act
Common Stock, par value \$.001 per share

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 post such files). Yes No

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

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

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

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to section 13(a) of the Exchange Act.

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
None.		

The aggregate market value of the 4,944,573 shares of voting stock held by non-affiliates of the registrant based on the closing price on the OTCQB on March 21, 2019 was \$9,889,146.

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

Title of Class	Shares Outstanding December 16, 2019
Common Stock	8,436,422

DOCUMENTS INCORPORATED BY REFERENCE

None.



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Cautionary Note Regarding Forward-Looking Information

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

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

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

PART I

Item 1 Description of Business

Background

Current Line of Business

We manufacture optical sighting systems and assemblies, primarily for Department of Defense applications. Our products are installed on various types of U.S. military land vehicles, such as the Abrams and Bradley fighting vehicles, light armored and armored security vehicles and have been selected for installation on the Stryker family of vehicles. We also manufacture and deliver numerous periscope configurations, rifle and surveillance sights and night vision optical assemblies. Our 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 us.

We continue to field new product opportunities from both domestic and international customers. Given continuing unrest in multiple global hot spots, the need for precision optics continues to increase. Most of these requirements are for observation and situational awareness applications; however, we continue to see requests for higher magnification and custom reticles in various product modifications. The basic need to protect the soldier while providing information about the mission environment continues to be the primary driver for these requirements.

Recent Events

Board Changes

On November 4, 2019, the Board of Directors of Optex Systems Holdings, Inc. (the "Company") appointed three new directors: Larry Hagenbuch, Dale Lehmann and Rimmy Malhotra, all of whom have been qualified as independent as defined under Nasdaq Listing Rules by the Board. All three new independent directors will be compensated in accordance with the Company's non-employee director compensation policies. Larry Hagenbuch will serve as the Audit Committee Chair and Rimmy Malhotra will serve as the Compensation Committee Chair. Bill Bates and Karen Hawkins have resigned as directors of the Company in order to enable the Company to have this reconstituted Board comprised of a majority of independent directors. David Kittay also resigned from the Company's Board and Audit Committee to pursue other business interests.

Executive and Board Compensation

On November 20, 2018 the Company's executive compensation committee recommended and the board of directors approved executive compensation as follows:

- A 30% officer bonus of base salary to Danny Schoening and Karen Hawkins for fiscal year 2018 performance to be paid during December 2018. The bonuses of \$76 thousand, and \$56 thousand were paid to Danny Schoening and Karen Hawkins, respectively on December 7, 2018.
- A base salary increase of 8% for Danny Schoening and Karen Hawkins effective as of January 1, 2019.
- The issuance of 150,000 and 50,000 restricted stock units with a January 2, 2019 grant date, to Danny Schoening and Karen Hawkins, respectively, and vesting as of January 1 each year subsequent to the grant date over a three year period at a rate of 34% in year one, and 33% each year thereafter.

On November 14, 2019, the Board of Directors reviewed the compensation for nonemployee directors and concluded to keep the compensation at the current \$5.5 thousand per quarter served. The board determined to revisit the independent board compensation during the first calendar quarter of 2020.

On November 19, 2019, the Board of Directors of Optex Systems Holdings, Inc. approved annual executive bonuses for Danny Schoening, CEO and Karen Hawkins, CFO of \$75 thousand and \$54 thousand, respectively, to be paid in December 2019.

Stock & Warrant Repurchases

On May 16, 2018, we announced that our Board of Directors has approved a purchase of 200,000 shares of its common stock in a private transaction. The transaction was priced at \$1.00 per share for a total transaction amount of \$200,000.

On July 10, 2018, we announced that our Board of Directors has approved a purchase of 500,000 shares of its common stock in a private transaction. The transaction was priced at \$1.00 per share for a total transaction amount of \$500,000.

Upon repurchase in the aforementioned transactions, the shares were returned to treasury and cancelled thereby reducing the total outstanding common stock.

On June 26, 2019, we repurchased 88,081 of the outstanding warrants from private investors at a warrant price of \$0.85 per warrant, for a total purchase price of \$75 thousand. Upon repurchase, the warrants were cancelled.

Recent Orders

- On February 19, 2018, we announced we have been awarded three separate multi-year Indefinite Delivery Indefinite Quantity (IDIQ) awards through Defense Logistics Agency (DLA) for Laser Protected Periscopes for a total combined amount of up to \$7.7 million over a 3-5 year period.
- On March 27, 2018, we announced we have been awarded a \$1.62 million purchase order as part of a multi-year strategic supplier agreement with a domestic manufacturer of premium optical devices.

- On September 10, 2018, we announced we have been awarded over \$7 million in new contracts to date during the fourth fiscal quarter of 2018. The majority of these contracts are for Laser Protected Periscopes but also contain Non-Laser Protected Periscopes and various Sighting Systems.
- On November 19, 2018, the Company announced a follow on \$0.9 million order from an international customer for its patented Digital Day Digital Night (DDAN) Weapon System with deliveries through 2021.
- On November 26, 2018, the Company announced a \$1.9 million order from Defense Logistics Agency Land and Maritime for Laser Protected Periscopes for delivery in 2019 and 2020.
- On January 29, 2019, the Company announced a \$1.0 million order associated with a multi-year agreement to supply a variety of optical components in support of the M1 Abrams Tank program. The products will be manufactured at the Applied Optics Center (AOC).
- On February 12, 2019, the Company announced a \$1.9 Million order from Defense Logistics Agency Troop Support, Philadelphia. The products will be manufactured at the Applied Optics Center (AOC) Division of Optex Systems, Inc.
- On March 4, 2019, the Company announced a multi-year Indefinite Delivery Indefinite Quantity (IDIQ) award from Defense Logistics Agency Land and Maritime for periscopes for up to \$1.3 Million over a 3-5 year period and a Firm Fixed Price award for \$0.7 Million for 2019 and 2020 delivery.
- On June 10, 2019, the Company announced it has been awarded a \$1.3 Million order as part of a multi-year strategic supplier agreement with a domestic manufacturer of premium optical devices.
- On November 12, 2019, the Company announced a multi-year Indefinite Delivery Indefinite Quantity (IDIQ) award from Defense Logistics Agency Land and Maritime for periscopes for up to \$2.3 Million over a 5 year period.
- On December 3, 2019 the Company announced a shared award for a maximum of \$35 Million for Improved Commander Weapon System (ICWS) periscopes under a three year Indefinite Delivery - Indefinite Quantity (IDIQ) contract with two additional optional years. Optex and another recipient have been awarded this shared award from Defense Logistics Agency, Land and Maritime. Each company's portion of the award will depend on price and performance over the ordering periods.

Products

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

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

Specific product categories are grouped by product line and include:

Product Line	Product Category
Periscopes	Laser & Non Laser Protected Plastic & Glass Periscopes, Electronic M17 Day/Thermal Periscopes, Vision Blocks
Sighting Systems	Back Up Sights, Digital Day and Night Sighting Systems (DDAN), M36 Thermal Periscope, Unity Mirrors
Howitzers	M137 Telescope, M187 Mount, M119 Aiming Device
Other	Muzzle Reference Systems (MRS), Binoculars, Collimators, Optical Lenses & Elements, Windows
Applied Optics Center	Laser Filter Interface, Optical Assemblies, ACOG Laser filter, Day Windows, Binoculars

Location and Facility

We are headquartered in Richardson, TX and lease approximately 93,967 combined square feet of facilities between Richardson, Texas and Dallas, Texas. As of December 9, 2019, we had 112 full time equivalent employees. We operate with a single shift, and capacity could be expanded by adding a second shift. Our proprietary processes and methodologies provide barriers to entry for other competing suppliers. In many cases, we are the sole source provider or one of only two providers of a product. We have capabilities which include machining, bonding, painting, tracking, engraving and assembly and can perform both optical and environmental testing in-house.

We renewed the lease on our 49,100 square foot, Richardson, Texas facility, effective as of December 10, 2013, with a lease expiration of March 31, 2021. As of December 9, 2019, the Richardson facility operated with 77 full time equivalent employees in a single shift operation.

In November 2014, we acquired the Applied Optics Center (formerly a business unit of L-3 Communications, Inc.), which is located in Dallas, Texas with leased premises consisting of approximately 44,867 square feet of space. As of December 9, 2019, the Applied Optics Center operated with 35 full time equivalent employees in a single shift operation.

Contracts

Some of our contracts may 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 any contracts allow for progress payments and the respective contracts would result in significant preproduction cash requirements for design, process development, tooling, material or other resources which could exceed our current working capital or line of credit availability, we intend to utilize this benefit to minimize any potential negative impact on working capital prior to receipt of payment for the associated contract deliveries.

Our contracts allow for Federal Acquisition Regulation 52.243-1 which entitles the contractor to an "equitable adjustment" for contract or statement of work changes effecting cost 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 U.S. 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 U.S. 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.

Each contract with our customers has specific quantities of material that need to be purchased, assembled, and then shipped. Prior to bidding a contract, we contact potential sources of material and receive qualified quotations for each material. In some cases, the entire volume is given to a single supplier and in other cases, the volume might be split between several suppliers. If a contract has a single source supplier and that supplier fails to meet their obligations (e.g., quality, delivery), then we would attempt to find an acceptable alternate supplier, and if successful, we would then renegotiate contractual deliverables (e.g., specifications, delivery or price). As of November 8, 2019, approximately 5% of our material requirements are single-sourced across 7 suppliers representing approximately 5% of our active supplier orders. Single-sourced component requirements span across all of our major product lines. Of these single sourced components, we have material contracts (purchase orders) with firm pricing and delivery schedules in place with each of the suppliers to supply the parts necessary to satisfy our current contractual needs.

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

Regulation	Summary
Federal Acquisition Regulation (FAR)	The principal set of rules in the Federal Acquisition Regulation System. This system consists of sets of regulations issued by agencies of the federal government of the United States to govern what is called the “acquisition process,” which is the process through which the government acquires goods and services. That process consists of three phases: (1) need recognition and acquisition planning, (2) contract formation, and (3) contract administration. This system regulates the activities of government personnel in carrying out that process. It does not regulate the purchasing activities of private sector firms, except to the extent that those activities involve government solicitations and contracts by reference.
International Traffic in Arms Regulations (ITAR)	United States government regulations that control the export and import of defense-related articles and services on the United States Munitions List. These regulations implement the provisions of the Arms Export Control Act.
Truth in Negotiations Act (TINA)	A public law enacted for the purpose of providing for full and fair disclosure by contractors in the conduct of negotiations with the government. The most significant provision included is the requirement that contractors submit certified cost and pricing data for negotiated procurements above a defined threshold of \$750,000 for contracts entered into prior to June, 30, 2018. On July 1, 2018, the threshold for obtaining certified cost and pricing data increased substantially from \$750,000 to two million dollars. The change was authorized by the Department of Defense pursuant to a class deviation, pending official rulemaking and publication in the Federal Acquisition Regulation (“FAR”) Section 811 of the fiscal year 2018 NDAA. The law requires contractors to provide the government with an extremely broad range of cost or pricing information relevant to the expected costs of contract performance, and it requires contractors and subcontractors to submit cost or pricing data to the government and to certify that, to the best of their knowledge and belief, the data are current, accurate, and complete. A contracting officer may still request cost or price data, if necessary, without certification, to determine whether the proposed cost or price is fair and reasonable for contracts which are below the threshold.

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

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

We are also subject to laws, regulations and executive orders restricting the use and dissemination of information deemed classified for national security purposes and the exportation of certain products and technical data as covered by the International Traffic in Arms Regulation (ITAR). In order to import or export items listed on the U.S. Munitions List, we are required to be registered with the Directorate of Defense Trade Controls office. The registration is valid for one year, and the registration fees are established based on the number of license applications submitted the previous year. We currently have an approved and current registration on file with the Directorate of Defense Trade Controls office. Once the registration is approved, each import/export license must be filed separately. License approval requires the company to provide proof of need, such as a valid contract or purchase order requirement for the specific product or technical data requested on the license and requires a detailed listing of the items requested for export/import, the end-user, the end-user statement, the value of the items, consignees/freight forwarders and a copy of a valid contract or purchase order from the end-user. The approval process for the license can vary from several weeks to six months or more. The licenses we currently use are the Department of State licenses: DSP-5 (permanent export), DSP-6 (license revisions) and DSP-73 (temporary export) and Department of Commerce: BIS-711 (export).

The aforementioned licenses are valid for 48 months from date that each license is issued. A summary of our active ITAR licenses is presented below (updated as of December 9, 2019):

<u>Active ITAR Licenses</u>	<u>Fiscal Year of Expiration</u>	<u>Number of Licenses</u>	<u>Total Contract Value of Licenses</u>
DSP-5			
Issued in Fiscal Year 2016	2020	19	\$ 1,789,141
Issued in Fiscal Year 2017	2021	6	1,686,003
Issued in Fiscal Year 2018	2022	8	2,742,658
Issued in Fiscal Year 2019	2023	4	20,934,845
Total DSP-5 Licenses		37	\$ 27,152,647
DSP-6 (no active licenses)	N/A	—	\$ —
DSP-73			
Issued in Fiscal Year 2019	2023	1	\$ 4,000
Total DSP-73 Licenses		1	\$ 4,000
BIS-711			
Issued in Fiscal Year 2017	2021	8	\$ 1,708,894
Issued in Fiscal Year 2018	2022	4	113,907
Issued in Fiscal Year 2019	2023	4	3,413
Total BIS-711 Licenses		16	\$ 1,826,214
Total All Licenses		54	\$ 28,982,861

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

Our contracts may also be governed by the Truth in Negotiation Act (TINA) requirements where certain of our contracts or proposals exceed the TINA threshold (updated from \$750 thousand to \$2 million for awards after June 30, 2018), and/or are deemed as sole source, or non-competitive awards, covered under this act. For these contracts, we must provide a vast array of cost and pricing data in addition to certification that our pricing data and disclosure materials are current, accurate and complete upon conclusion of the negotiation. Due to the additional disclosure and certification requirements, if a post contract award audit were to uncover that the pricing data provided was in any way not current, accurate or complete as of the certification date, we could be subjected to a defective pricing claim adjustment with accrued interest. We have no history of defective pricing claim adjustments and have no outstanding defective pricing claims pending. Additionally, as a result of this requirement, contract price negotiations may span from two to six months and can result in undefinitized or not to exceed ceiling priced contracts subject to future downward negotiations and price adjustments. Currently, we do not have any undefinitized contracts subject to further price negotiation.

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

The terms of our material contracts are as follows (updated as of September 29, 2019):

Customer	Customer PO/Contract	Contract Type ⁽¹⁾	Total Award Value ⁽²⁾ (millions)	Remaining Value ⁽³⁾ (millions)	Delivery Period
GDLS - Canada ⁽⁴⁾ Periscopes	Subcontract PO 35506523	FFPQ	\$ 1.6	\$ 1.1	Dec 2017- Feb 2022
DLA Land at Aberdeen ⁽⁵⁾ Laser Filter Assemblies (AOC)	Prime SPRBL117D0008	IDIQ	\$ 4.4	\$ 0.3	Jan 2018- Dec 2019
GDLS - Canada ⁽⁶⁾ Sighting Systems	Subcontract PO 35515590	FFPQ	\$ 2.1	\$ 1.2	Oct 2017- Feb 2022
DLA Land and Maritime ⁽⁷⁾ Periscopes	Prime SPE7LX17D0053	IDIQ	\$ 2.2	\$ 0.1	Oct 2017- Dec 2019
DLA Warren ⁽⁸⁾ Collimator Assembly - Other	Prime SPRDL118C0087	FFPQ	\$ 2.6	\$ 1.0	Oct 2018- Oct 2019
DLA Land and Maritime ⁽⁹⁾ Periscopes	Prime SPE7LX18D0038	IDIQ	\$ 1.3	\$ -	No current open task orders
DLA Land and Maritime ⁽¹⁰⁾ Periscopes	Prime SPE7LX18D0039	IDIQ	\$ 1.3	\$ 0.3	Jul 2018- Mar 2020
DLA Land and Maritime ⁽¹¹⁾ Periscopes	Prime SPE7MX18D0061	IDIQ	\$ 3.4	\$ 1.3	Jul 2018- Jan 2020
DLA Land and Maritime ⁽¹²⁾ Periscopes	Prime SPE7LX18D0108	IDIQ	\$ 0.3	\$ 0.3	Aug 2019- Dec 2019
U.S. Army Contracting Command- Warren ⁽¹³⁾ Periscopes	Prime SPRDL116D0062/ W56HZV19F0544	IDIQ	\$ 2.5	\$ 0.3	Apr 2017- Jun 2020
General Dynamics-Canada ⁽¹⁴⁾ Sighting Systems	Subcontract PO 35558221	FFP	\$ 0.9	\$ 0.9	Jul 2020- Dec 2020
DLA Land and Maritime ⁽¹⁵⁾ Glass Periscopes	Prime SPE7M819C003	FFP	\$ 2.0	\$ 2.0	Oct 2019- Jun 2020
General Dynamics ⁽¹⁶⁾ Day Windows (AOC)	Subcontract PO 40269398	IDIQ	\$ 2.0	\$ 1.0	Aug 2017- Oct 2021
DLA Troop Support ⁽¹⁷⁾ Day Windows (AOC)	Prime SPE8E619CF009	IDIQ	\$ 1.9	\$ 1.6	Mar 2019- Sep 2020
DLA Land and Maritime ⁽¹⁸⁾ Periscopes	Prime SPE7LX19D0089	IDIQ	\$ -	\$ -	No task awards as of current date
DLA Land and Maritime ⁽¹⁹⁾ Periscopes	Prime SPE7M819P1690	FFP	\$ 0.7	\$ 0.6	Aug 2019- Dec 2019
ADS Inc. ⁽²⁰⁾ Laser Filter Unit and ARD Assy, 24mm	Subcontract PO 1024867	FFP	\$ 1.3	\$ 0.9	Nov 2019- Apr 2020

- (1) *FFPQ – Firm fixed price and quantity, IDIQ – Indefinite delivery indefinite quantity, PP – Progress Billable. Payment terms on shipments are net 30 or net-45 days.*
- (2) *“Total Award Value” as included in the table represents the total value of all delivery orders against the prime contract that have already been awarded to us. The total award value represents already awarded delivery order contracts. Based on our historical experience with these contracts and other similar contracts, the amount awarded has directly correlated to the amount received.*
- (3) *The “Remaining Value” depicts the open undelivered values remaining to be delivered against the contract awards as of October 30, 2017. Only these undelivered values of the contracts may be subject to the contract termination clause. It has been our experience that these clauses are rarely invoked.*
- (4) *Contract quantity awarded on December 14, 2016 for laser protected periscopes installed on Light Armored Vehicles in the Middle East.*
- (5) *Five year IDIQ contract for Light Interference Filter Assemblies awarded on July 3, 2017. The contract calls for five one-year ordering periods running consecutively commencing on July 5, 2017. The Company expects to generate between \$8.4 and \$12.4 million in revenue over the next five year period from this contract. As of September 29, 2019 three task orders against the contract have been released for a total value of \$4.4 million to date.*
- (6) *Contract awarded on September 11, 2017 to provide LAV 6.0 optimized weapon system support for Optex’s Commander Sighting System. The in-service support will continue over the next three years for their existing fleet of Light Armored Vehicles.*
- (7) *Three year IDIQ contract for periscopes awarded on September 18, 2017. The contract includes three base years and two option years. The based contract expires September 11, 2020. The company expects to generate between \$1.5 and \$2.4 million in revenue over the next five year period from this contract. As of September 29, 2019 total task orders awarded against the contract were \$1.5 million.*
- (8) *Initial contract award on December 7, 2017 for \$0.8 million with subsequent modifications bringing the total contract value to \$2.6 million as of September 29, 2019.*
- (9) *Contract awarded February 11, 2018. This is a long-term, Indefinite Delivery Indefinite Quantity (IDIQ) Contract with firm fixed pricing for the duration of a base period of three (3) years plus two (2) firm fixed priced option years for a potential total of (5) five years. As of September 29, there was \$1.3 million in task orders released against the contract which have been delivered.*
- (10) *Contract awarded February 16, 2018. This is a long-term, Indefinite Delivery Indefinite Quantity (IDIQ) Contract with firm fixed pricing for the duration of a base period of three (3) years plus two (2) firm fixed priced option years for a potential total of (5) five years. As of September 29, there was \$0.7 million in task orders released against the contract.*
- (11) *Contract awarded February 22, 2018. This is a long-term, Indefinite Delivery Indefinite Quantity (IDIQ) Contract with firm fixed pricing for the duration of a base period of three (3) years plus two (2) firm fixed priced option years for a potential total of (5) five years. As of September 29, there was \$1.1 million in task orders released against the contract.*
- (12) *Contract awarded September 5, 2018. This is a long-term, Indefinite Delivery Indefinite Quantity (IDIQ) Contract with firm fixed pricing for the duration of a base period of three (3) years plus two (2) firm fixed priced option years for a potential total of (5) five years. As of September 29, 2019, there was \$0.3 million task orders released against the base contract award.*
- (13) *Contract awarded July 20, 2016. This is a long-term, Indefinite Delivery Indefinite Quantity (IDIQ) Contract with firm fixed pricing for the duration of a base period of five (5) years. As of September 29, 2019, there was \$2.5 million task orders released against the contract award through ordering period 4.*
- (14) *Contract awarded July 20, 2016 for delivery of DDAN sighting system spare units.*
- (15) *Contract awarded November 19, 2018. This is a Firm Fixed Price order for Laser Protected Periscopes for delivery in 2019 and 2020.*
- (16) *Contract awarded February 6, 2017 with an additional quantity executed on January 24, 2019. This is a Firm Fixed Price order for Day Windows manufactured at the Applied Optics Center for delivery through October 2021.*
- (17) *Contract awarded February 11, 2019. This is a Firm Fixed Price order for Day Windows manufactured at the Applied Optics Center for delivery through November 2019.*
- (18) *Contract awarded March 4, 2019. This is a long-term, Indefinite Delivery Indefinite Quantity (IDIQ) Contract with firm fixed pricing for the duration of a base period of three (3) years plus two (2) firm fixed priced option years for a potential total of (5) five years. As of September 29, 2019, there have been no task orders released against the base contract award.*
- (19) *Contract awarded February 27, 2019. This is a Firm Fixed Price order for Laser Protected Periscopes for delivery in August 2019 through December 2019.*
- (20) *Contract awarded May 6, 2019. This is a multi-year strategic supplier agreement for premium optical devices. Delivery for the current purchase order is November 2019 through April 2020 with early delivery accepted.*

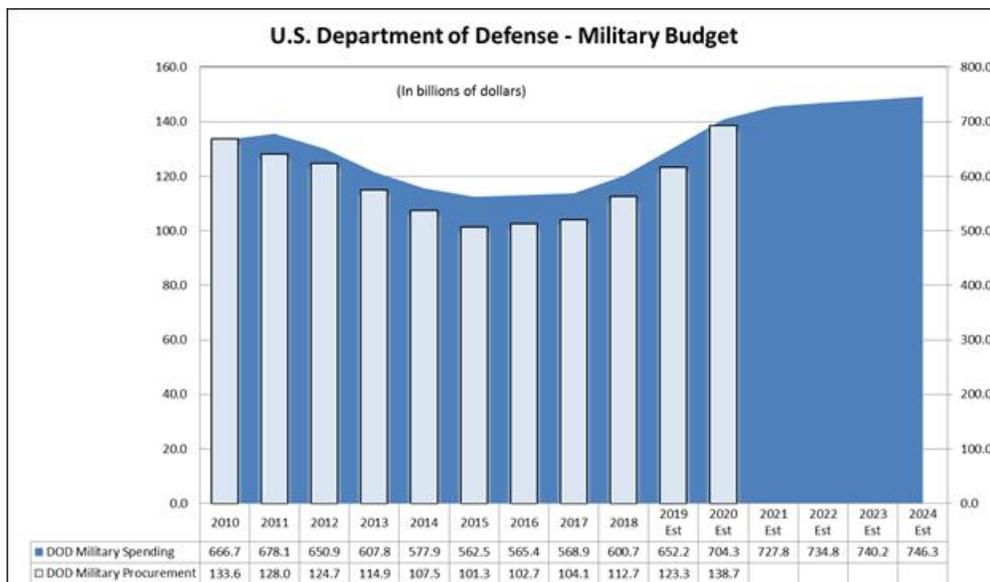
Market Opportunity — U.S. Military

During the twelve months ended September 29, 2019, approximately 87% of our business was in support of U.S. military products. The chart below was derived from public government spending sources and depicts total U.S. military spending from 2010 through 2019 and estimated spending through 2024. The purpose of including this chart is to provide the reader with historical trend data and projected U.S. military defense and procurement spending over time. Military spending peaked at \$678.1 billion in 2011. As of fiscal year 2019 the total projected military spending is projected to be \$652.2 billion, an overall increase of 8.6% over 2018 spending, but 3.8% below the peak spending in 2011. However, the military spending in the chart below depicts increased spending through 2024 of 14.4% from the current projected fiscal year 2019 level. The largest projected increases of 8.0% and 3.3% to occur in the 2020 and 2021 fiscal years, respectively.

Military spending was negatively impacted by the Budget Control Act of 2011 (BCA 2011), which was passed in August 2011. The BCA 2011 mandated a \$917.0 billion reduction in discretionary spending over the next decade, and \$1.2 trillion in automatic spending cuts over a nine-year period to be split between defense and non-defense programs beginning in January 2013. During the years 2015-2019 Congress enacted additional legislative budget measures which eased the strict spending caps set forth in sequestration of the BCA 2011 through the 2021 fiscal budget year.

On February 9, 2018, Congress enacted the Bipartisan Budget Act of 2018 (BBA 2018), a budget stop gap resolution which lifted the sequestration limits on military spending by \$165 billion through fiscal year 2019. On August 2, 2019, the Bipartisan Budget Act of 2019 (BBA 2019) was signed into law. The BBA 2019 raises the budget caps for both defense and nondefense for FY 2020 and FY 2021, the final two years of the BCA 2011 discretionary cap period. The 2019 bill increases the defense base budget by \$171 billion over the BCA 2011 and sets limits on the Overseas Contingency Operations (OCO) Emergency Funding of \$141 billion over the two year period. Under the current law, there are no caps on defense and nondefense discretionary spending for FY 2022 and beyond.

We believe that the procurement budget increases in the federal government’s 2019 National Defense Authorization Act (2019 NDAA) combined with the lifting of the 2011 budget sequestration cap on defense spending levels are favorable to the Company for its U.S. military products during the next two years. As of the filing date, the 2020 NDAA has not been passed through Congress.



Source: Government Publishing Office, U.S. Budget Historical Tables, FY 2020, Table 3.2 Outlays by function and sub function, 1962-2024.

The table below depicts the U.S. Department of Defense budget request for fiscal year 2020 for major ground system programs. The total fiscal year 2020 budget request for major ground system programs is decreased by 4.7% from the fiscal year 2019 levels and increased by 6.1% over the fiscal year 2018 levels. Although it is difficult to directly tie the budget request to specific components provided by Optex Systems, we provide periscopes, collimator assemblies, vision blocks and laser interface filters to the U.S. armed forces on almost all of the ground system platforms categorized below.

Major Weapon System Summary (\$ in Millions)		FY 2018	FY 2019	FY 2020		Total Request
				Base Budget	OCO Budget	
Ground Systems - Joint Service						
JLTV	Joint Light Tactical Vehicle	\$ 1,162.4	\$ 1,928.3	\$ 1,600.6	\$ 41.0	\$ 1,641.6
Ground Systems - USA						
M-1	Abrams Tank Modification/Upgrades	1,784.0	2,652.0	2,221.2	13.1	2,234.3
AMPV	Armored Multi-Purpose Vehicle	742.6	784.5	360.7	221.6	582.3
PIM	Paladin Integrated Management	778.0	525.9	553.4	—	553.4
FMTV	Family of Medium Tactical Vehicles	278.7	172.8	108.8	—	108.8
FHTV	Family Of Heavy Tactical Vehicles	120.3	118.0	265.5	—	265.5
GMV	Ground Mobility Vehicle	44.6	44.0	40.0	—	40.0
Stryker	Stryker	981.3	442.9	750.8	4.1	754.9
Ground Systems - USMC						
ACV	Amphibious Combat Vehicle	307.1	233.6	395.3	—	395.3
Total Ground Systems		\$ 6,199.0	\$ 6,902.0	\$ 6,296.3	\$ 279.8	\$ 6,576.1

Source: Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, "Program Acquisition Cost by Weapon System, United States Department of Defense, Fiscal Year 2020 Budget Request", March 2019

Market Opportunity — Foreign Military

Apart from the significant U.S. military spending increases experienced since 2018 and projected forward, we also continue to see substantial increases in foreign military sales (FMS) in our direct government contracts as well as through our major defense contract customers. Fiscal year 2018 saw a 33% increase in US FMS contracts, with fiscal year 2019 contracts at roughly the same high levels. Thus, we have increased efforts to promote our proven military products, as well as newly improved product solutions directly to foreign military representatives and domestic defense contractors supporting the FMS initiatives. Our products directly support FMS combat vehicles globally, including Canada, the Kingdom of Saudi Arabia, Kuwait, Morocco, Egypt, South America, and Israel.

In addition, we recently partnered with G&H for the supply of acrylic-based sighting system technology to meet European Customer requirements for a total package single-technology source supply. Some foreign customers desire the reduced weight and cost savings provided by acrylic based periscopes when compared directly to glass based periscopes. Our partnership will allow us to deliver this technology through ITAR licenses directly to them or their customers. G&H designs and manufactures periscopes and sighting systems for armored fighting vehicles under the Kent Periscopes brand. With a strong footprint in Europe and Asia, G&H supplies glass based products for both periscope external viewing and system sensor based imaging by commanders, drivers, and gunners.

We are also exploring possibilities to adapt some of our products for commercial use in those markets that demonstrate potential for solid revenue growth, both domestically and internationally.

Market Opportunity — Commercial

Our products are currently sold to military and related government markets. We believe there may be opportunities to commercialize various products we presently manufacture to address other markets. Our initial focus will be directed in four product areas.

- **Big Eye Binoculars** — While the military application we produce is based on mature military designs, we own all castings, tooling and glass technology. These large fixed mount binoculars could be sold to cruise ships, personal yachts and cities/municipalities. The binoculars are also applicable to fixed, land based outposts for private commercial security as well as border patrols and regional law enforcement.
- **Night Vision Sight** — We have manufactured the optical system for the NL-61 Night Vision Sight for the Ministry of Defense of Israel. This technology could be implemented for commercial applications.
- **Thin Film Coatings** — The acquisition of the Applied Optics Center (AOC) also creates a new sector of opportunity for commercial products for us. Globally, commercial optical products use thin film coatings to create product differentiation. These coatings can be used for redirecting light (mirrors), blocking light (laser protection), absorbing select light (desired wavelengths), and many other combinations. They are used in telescopes, rifle scopes, binoculars, microscopes, range finders, protective eyewear, photography, etc. Given this broad potential, the commercial applications are a key opportunity going forward.
- **Optical Assemblies** — Through the Applied Optics Center, we are utilizing our experience in military sighting systems to pursue commercial opportunities associated with products that incorporate multi-lens optical cell assemblies, bonded optical elements and mechanical assemblies. There are a wide variety of products in the medical, machine vision, automotive and outdoor recreation fields that can benefit from our capabilities. Support to domestic customers for these type products has driven significant increases in overall sales during the last two years.

Customer Base

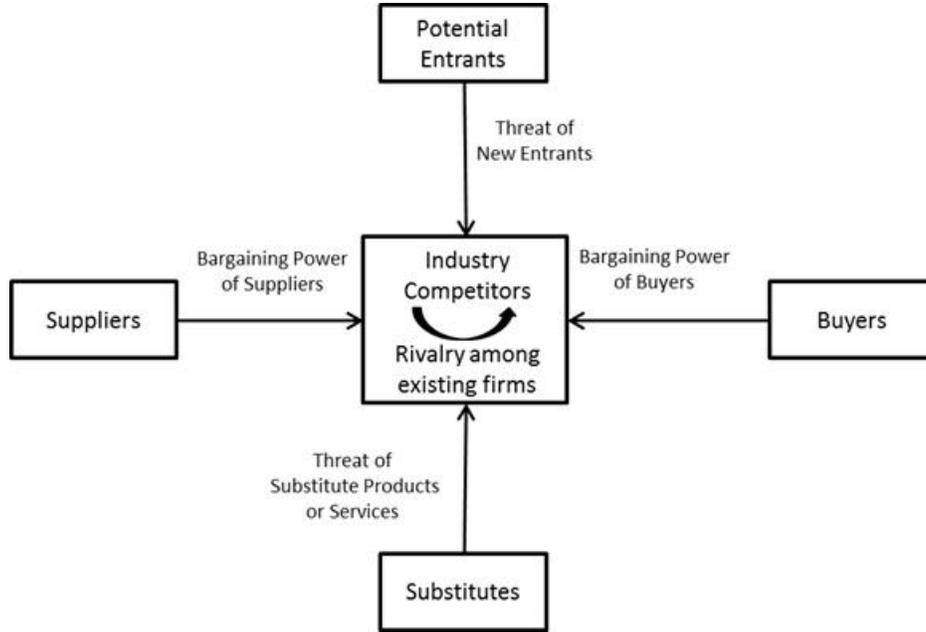
We serve customers in four primary categories: as prime defense contractor (Defense Logistics Agency (DLA) Land and Maritime, DLA Warren, DLA Aviation, U.S. Army, Navy and Marine Corps), as defense subcontractor (General Dynamics, L-3 Communications, Harris Corporations, BAE, and NorcaTec), as a military supplier to foreign governments (Israel, Australia, South America and Canada) and also as a commercial optical assembly supplier (Nightforce Optics, Cabela's, Amazon). During the twelve months ended September 29, 2019, we derived approximately 88% of our gross business revenue from three major customers: U.S. government agencies (60%), one major defense contractor, (22%), one commercial customer (7%). We have approximately 116 discrete contracts for items that are utilized in vehicles, optical product lines and as spare parts. Due to the high percentage of prime and subcontracted U.S. defense revenues, large customer size and the fact that there are multiple contracts with each entity, which are not interdependent, we are of the opinion that this provides us with a fairly well diversified revenue pool.

Marketing Plan

We believe we are well positioned to service both U.S. and foreign military needs by our focus on delivering products that satisfy the following factors important to the U.S. military:

- Product reliability — failure can cost lives
- Speed to delivery and adherence to delivery schedule
- System life cycle extension
- Low cost/best value

- Visual aids for successful execution of mission objectives
- Mission critical products specifically related to soldier safety.



Potential Entrants — Low Risk to us. In order to enter this market, potential competitors must overcome several barriers to entry. The first hurdle is that an entrant would need to prove to the government agency in question the existence of a government approved accounting system for larger contracts. Second, the entrant would need to develop the processes required to produce the product. Third, the entrant would then need to produce the product and then submit successful test requirements (many of which require lengthy government consultation for completion). Finally, in many cases, the customer has an immediate need and therefore cannot wait for this qualification cycle and therefore must issue the contracts to existing suppliers.

Historically, we competed with two other companies in different spaces. First, we previously competed with Miller-Holzwarth in the plastic periscope business. In July 2012, Miller-Holzwarth, Inc. ceased operations apparently as a result of an inability to meet its financial obligations combined with a decline in defense market conditions. Second, we currently compete with Seiler Instruments for fire control products. These contracts are higher value products, but lower quantities. Given the expense of development and qualification testing, the barrier to entry is high for new competitors. During the last four years, overall plastic periscope demand quantities have declined, while competition on the lower level periscope products has significantly increased as new contractors aggressively compete for market share amongst the existing customer base and quantities.

Buyers — Medium Risk to us. In most cases the buyers (usually government agencies or defense contractors) have two fairly strong suppliers. It is in their best interest to keep at least two, and therefore, in some cases, the contracts are split between suppliers. In the case of larger contracts, the customer can request an open book policy on costs and expects a reasonable margin to have been applied.

Substitutes — Low Risk to us. We have both new vehicle contracts and replacement part contracts for the exact same product. Three combat vehicles have a long history of service in the Army. The first M-1 Abrams Tank entered service with the Army in 1980; the M-2/M-3 Bradley Fighting Vehicle in 1981; and the Stryker Combat Vehicle in 2001. Under current Army modernization plans, the Army envisions all three vehicles in service with Active and National Guard forces beyond FY2028. Optex Systems provides periscopes and optical sighting systems in support of all three vehicle platforms. Since the early 2010's, the U.S. Army has been upgrading its outdated Bradley design with the Operation Desert Storm-Situational Awareness model and since 2012, upgrading the underbelly armor to improve mine and improvised explosive device resistance. The Army is massively revving up its fleet of M2A4 and M7A4 Bradley Fighting Vehicles through a 2018 deal to add up to 473 of the new infantry carriers. The army is currently working on an A5 Bradley variant with vastly improved targeting sights and on-board power. The redesigned vehicle will support next-generation weapons systems and resolve the Bradley's long-standing issues with weight and mobility. Since it was first fielded in 1980, the Abrams tank has undergone near-continuous upgrades and improvements. On average, there has been a new improvement package every seven years. The Army is just beginning to receive the first of the latest Abrams upgrade, the System Enhancement Package Version 3 (SEPV3), with additional upgrades in development. Additionally, the US Army has announced contracts to produce 742 Stryker DVH vehicles, redesigned (dual v-hulled vehicles) to be more resistant to land mines, as retrofits and as new production vehicles. The Abrams, Bradley and Striker vehicles are the only production tanks currently in production by the government. This, in conjunction with the 30-year life span, supports their continued use through 2040. The Abrams is the principal battle tank of the United States Army and Marine Corps, and the armies of Egypt, Kuwait, Saudi Arabia, Iraq, and since 2007, Australia.

Suppliers — Low to Medium Risk to Optex Systems Holdings. The suppliers of standard processes (e.g., casting, machining and plating) need to be very competitive to gain and/or maintain contracts. Those suppliers of products that use top secret clearance processes are slightly better off; however, there continues to be multiple avenues of supply and therefore only moderate power.

Consistent with our marketing plan and business model, the AOC acquisition strengthened our overall position by decreasing the bargaining power of their suppliers through the backwards integration of a key supplier and created additional barriers of entry of potential competitors. Overall, the customer base and the competition have seen the acquisition as creating a stronger company.

The second model is a two by two matrix for products and customers.

	Existing Customers	New Customers
New Products	<u>USACC Binoculars</u> <u>GDLS DDAN</u> <u>Commercial Optical Lens</u>	<u>Chile M17 Day/Thermal</u> <u>Brazil M17 Day/Thermal</u> <u>Israel M17 Day/Thermal</u> <u>Commercial: Optical Lens, Spotting Scopes, Monocular Lens</u>
Existing Products	<u>USACC Periscopes, Back Up Sights,</u> <u>Binoculars, Vision Blocks,</u> <u>ACOG Filter Units</u> <u>GDLS Periscopes, Collimators</u> <u>BAE Periscopes</u> <u>L3- Laser Interface Filters</u> <u>DLA Optical Elements</u>	<u>Marines Sighting Systems</u> <u>Commercial: Optical Lens, Spotting Scopes, Monocular Lens</u>

This product/customer matrix sets forth our four basic approaches:

- 1) Sell existing products to existing customers.
- 2) Sell existing products to new customers.
- 3) Develop new products to meet the needs of our existing customers.
- 4) Develop new products to meet the needs of new customers.

Operations Plan

Our operations plan can be broken down into three distinct areas: material management, manufacturing space planning and efficiencies associated with economies of scale.

Materials Management

The largest portion of our costs is materials. We have completed the following activities in order to demonstrate continuous improvement:

- Successful completion of annual surveillance audit for ISO 9001:2008 certificate, with no major nonconformance issues
- Weekly cycle counts on inventory items
- Weekly material review board meeting on non-moving piece parts
- Kanban kitting on products with consistent ship weekly ship quantities
- Daily cross functional floor meetings focused on delivery, yields and labor savings
- Redesigned floor layout using tenant improvement funds
- Daily review of yields and product velocity
- Bill of material reviews prior to work order release

Future continuous improvement opportunities include installation and training of shop floor control module within the ERP system and organizational efficiencies of common procurement techniques among buyers.

Manufacturing Space Planning

We currently lease 93,967 square feet of manufacturing space (see "Location and Facility"). Our current facilities are sufficient to meet our immediate production needs without excess capacity. As our processes are primarily labor driven, we are able to easily adapt to changes in customer demand by adjusting headcounts, overtime schedules and shifts in line with production needs. In the event additional floor space is required to accommodate new contracts, Optex has the option to lease adjacent floor space at the current negotiated lease cost per square foot. Consistent with the space planning, we will drive economies of scale to reduce support costs on a percentage of sales basis. These cost reductions can then be either passed through directly to the bottom line or used for business investment.

Our manufacturing process is driven by the use of six sigma techniques and process standardization. Initial activities in this area have been the successful six sigma projects in several production areas which have led to improved output and customer approval on the aesthetics of the work environment. In addition, we use many tools including 5S programs, six sigma processes, and define, measure, analyze, improve, control (DMAIC) problem solving techniques to identify bottlenecks within the process flow, reduce cost and improve product yields. Successful results can then be replicated across the production floor and drive operational improvements.

Economies of Scale

Plant efficiencies fluctuate as a function of program longevity, complexity and overall production volume. Our internal processes are primarily direct labor intensive and can be more easily adapted to meet fluctuations in customer demand; however, our material purchases, subcontracted operations and manufacturing support costs are extremely sensitive to changes in volume. As our volume increases, our support labor, material and scrap costs decline as a percentage of revenue as we are able to obtain better material pricing, and scrap, start up and support labor (fixed) costs and they are spread across a higher volume base. On the contrary, as production volumes decline, our labor and material costs per unit of production generally increase. Additional factors that contribute to economies of scale relate to the longevity of the program. Long running, less complex programs (e.g., periscopes) do not experience as significant of an impact on labor costs as production volumes change, as the associated workforce is generally less skilled and can be ramped quickly as headcounts shift. Our more complex thin laser filter coatings, Howitzer and thermal day/night programs are more significantly impacted by volume changes as they require a more highly-skilled workforce and ramp time is longer as the training is more complex. We continually monitor customer demand over a rolling twelve-month window and in order to anticipate any changes in necessary manpower and material which allows us to capitalize on any benefits associated with increased volume and minimize any negative impact associated with potential declines in product quantities.

Intellectual Property

We utilize several highly specialized and unique processes in the manufacture of our products. While we believe that these trade secrets have value, it is probable that our future success will depend primarily on the innovation, technical expertise, manufacturing and marketing abilities of our personnel. We cannot assure you that we will be able to maintain the confidentiality of our trade secrets or that our non-disclosure agreements will provide meaningful protection of our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or other disclosure. The confidentiality agreements that are designed to protect our trade secrets could be breached, and we might not have adequate remedies for the breach. Additionally, our trade secrets and proprietary know-how might otherwise become known or be independently discovered by others. We possess three utility patents and two design patents.

Our competitors, many of which have substantially greater resources, may have applied for or obtained, or may in the future apply for and obtain, patents that will prevent, limit or interfere with our ability to make and sell some of our products. Although we believe that our products do not infringe on the patents or other proprietary rights of third parties, we cannot assure you that third parties will not assert infringement claims against us or that such claims will not be successful.

On June 18, 2019 we were issued U.S. Patent No. 10,324,298 titled "Offset Image Wedge with Dual Capability and Alignment Technique". The invention relates to an offset image wedge for use on a bore-sighted rifle mounted directly onto the scope via a clamp mounting device. The wedge allows for a dual image which can be aligned in the field and provides the user with a choice of either a bore-sighted image or an offset image without removing the wedge.

On July 11, 2017, we were issued U.S. Patent No. D791,852 S, for our Red Tail Digital Spotting Scope. We have a retail sales relationship with Cabela's Inc. and Amazon, to distribute these scopes. They are currently the only digital spotting scope offered by Cabela's. Our Red Tail Digital Spotting Scopes also received a favorable review from Trigger Magazine in 2017.

In May 2015, we announced the issuance to us of U.S. Patent No. 13,792,297 titled "ICWS Periscope". This invention improves previously accepted levels of periscope performance that, in turn, improve soldier's safety.

In December 2013, Optex Systems, Inc. was issued U.S. Patent No. 23,357,802 titled "Multiple Spectral Single Image Sighting System Using Single Objective Lens Set." The technology platform, designed for our DDAN program, is applicable to all ground combat vehicles used by the US and foreign militaries. This invention presents a single image to both day and night sensors using precision optics, which in turn allows the user to individually observe day, night, or day and night simultaneously. In addition, it has proven to be especially useful in light transition points experienced at dusk and dawn. We are in production and currently delivering sighting systems with this advanced technology, a significant upgrade in the goal of supporting our customers as they modernize the worldwide inventory of aging armored vehicles. This technology is applicable to many sighting systems, and it has already been designed for implementation on the Light Armored Vehicles, the Armored Security Vehicle, the Amphibious Assault Vehicle, and the M60 Main Battle Tank. Digital Day and Night technology has advanced the capabilities of these installed weapon systems and is the first in a series of patents we have applied for to protect our Intellectual Property portfolio in support of the warfighters who use these systems.

In May 2012, we purchased a perpetual, non-exclusive license, with a single up front license fee of \$200,000 to use Patent 7,880,792 "Optical and Infrared Periscope with Display Monitor" owned by Synergy International Optronics, LLC. We believe the purchase of the license agreement may allow us to extend and expand our market potential for the M113APC vehicle type which has the highest number of commonly used armored vehicles in the world. The current estimated active M113 APC worldwide inventory is over 80,000 units. This licensing of this patent allows us to develop additional products for this vehicle type, including the M17 Day/Thermal and M17 Day/Night periscopes. We are actively marketing the new periscopes internationally and completed our first international shipment utilizing this technology in March 2014. We continue to prototype these products and demonstrate them to potential customers.

Competition

The markets for our products are competitive. We compete primarily on the basis of our ability to design and engineer products to meet performance specifications set by our customers. Our customers include military and government end users as well as prime contractors that purchase component parts or subassemblies, which they incorporate into their end products. Product pricing, quality, customer support, experience, reputation and financial stability are also important competitive factors.

There are a limited number of competitors in each of the markets for the various types of products that we design, manufacture and sell. At this time, we consider our primary competitors for the Optex, Richardson site to be Kent Periscopes and Synergy International Optronics, LLC. The Applied Optics Center thin film and laser coatings products compete primarily with Materion-Barr, Artemis and Alluxa.

Our competitors are often well entrenched, particularly in the defense markets. Some of these competitors have substantially greater resources than we do. While we believe that the quality of our technologies and product offerings provides us with a competitive advantage over certain manufacturers, some of our competitors have significantly more financial and other resources than we do to spend on the research and development of their technologies and for funding the construction and operation of commercial scale plants.

We expect our competitors to continue to improve the design and performance of their products. We cannot assure investors that our competitors will not develop enhancements to, or future generations of, competitive products that will offer superior price or performance features, or that new technology or processes will not emerge that render our products less competitive or obsolete. Increased competitive pressure could lead to lower prices for our products, thereby adversely affecting our business, financial condition and results of operations. Also, competitive pressures may force us to implement new technologies at a substantial cost, and we may not be able to successfully develop or expend the financial resources necessary to acquire new technology. We cannot assure you that we will be able to compete successfully in the future.

Employees

We had 101 full time equivalent employees as of September 29, 2019 which include a small temporary work force to handle peak loads as needed. We are in compliance with local prevailing wage, contractor licensing and insurance regulations, and have good relations with our employees, who are not currently unionized.

Leases

We are headquartered in Richardson, TX and lease 93,967 combined square feet of facilities between Richardson, Texas and Dallas, Texas. We operate with a single shift, and capacity could be expanded by adding a second shift. Our proprietary processes and methodologies provide barriers to entry for other competing suppliers. In many cases, we are the sole source provider or one of only two providers of a product. We have capabilities which include machining, bonding, painting, tracking, engraving and assembly and can perform both optical and environmental testing in-house.

We renewed the lease on our 49,100 square foot, Richardson, Texas facility, effective as of December 10, 2013, with a lease expiration of March 31, 2021. Our Applied Optics Center, is located in Dallas, Texas with leased premises consisting of approximately 44,867 square feet of space. The Applied Optics Center lease effective as of October 1, 2016, expires on October 31, 2021. There are two renewal options available to the tenant, and each renewal term is five years in duration.

Item 1A Risk Factors

Investing in our common stock involves a high degree of risk. Prospective investors should carefully consider the risks described below, together with all of the other information included or referred to in this annual report, before purchasing shares of our common stock. There are numerous and varied risks, known and unknown, that may prevent us from achieving our goals. The risks described below are not the only risks we will face. If any of these risks actually occurs, our business, financial condition or results of operations may be materially adversely affected. In such case, the trading price of our common stock could decline and investors in our common stock could lose all or part of their investment. The risks and uncertainties described below are not exclusive and are intended to reflect the material risks that are specific to us, material risks related to our industry and material risks related to companies that undertake a public offering or seek to maintain a class of securities that is registered or traded on any exchange or over-the-counter market.

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Risks Related to our Business

We expect that we may need to raise additional capital in the future beyond any cash flow from our existing business; additional funds may not be available on terms that are acceptable to us, or at all.

We anticipate we may have to raise additional capital in the future to service our debt and to finance our future working capital needs. We cannot assure you that any additional capital will be available on a timely basis, on acceptable terms, or at all. Future equity or debt financings may be difficult to obtain. If we are not able to obtain additional capital as may be required, our business, financial condition and results of operations could be materially and adversely affected.

We anticipate that our capital requirements will depend on many factors, including:

- our ability to fulfill backlog;
- our ability to procure additional production contracts;
- our ability to control costs;
- the timing of payments and reimbursements from government and other contracts, including but not limited to changes in federal government military spending and the federal government procurement process;

- increased sales and marketing expenses;
- technological advancements and competitors' response to our products;
- capital improvements to new and existing facilities;
- our relationships with customers and suppliers; and
- general economic conditions including the effects of future economic slowdowns, acts of war or terrorism and the current international conflicts.

Even if available, financings may involve significant costs and expenses, such as legal and accounting fees, diversion of management's time and efforts, and substantial transaction costs. If adequate funds are not available on acceptable terms, or at all, we may be unable to finance our operations, develop or enhance our products, expand our sales and marketing programs, take advantage of future opportunities or respond to competitive pressures.

Changes in current economic conditions may adversely affect our ability to continue operations.

Changes in current economic conditions may cause a decline in business, consumer and defense spending and capital market performance, which could adversely affect our business and financial performance. Our ability to raise funds, which could be required for business continuity or expansion of our operations, may be adversely affected by current and future economic conditions, such as a reduction in the availability of credit, financial market volatility and economic recession.

Our ability to fulfill our backlog may have an effect on our long term ability to procure contracts and fulfill current contracts.

Our ability to fulfill our backlog may be limited by our ability to devote sufficient financial and human capital resources and limited by available material supplies. If we do not fulfill our backlog in a timely manner, we may experience delays in product delivery which would postpone receipt of revenue from those delayed deliveries. Additionally, if we are consistently unable to fulfill our backlog, this may be a disincentive to customers to award large contracts to us in the future until they are comfortable that we can effectively manage our backlog.

Our historical operations depend on government contracts and subcontracts. We face risks related to contracting with the federal government, including federal budget issues and fixed price contracts.

Future general political and economic conditions, which cannot be accurately predicted, may directly and indirectly affect the quantity and allocation of expenditures by federal agencies. Even the timing of incremental funding commitments to existing, but partially funded, contracts can be affected by these factors. Therefore, cutbacks or re-allocations in the federal budget could have a material adverse impact on our results of operations. Obtaining government contracts may also involve long purchase and payment cycles, competitive bidding, qualification requirements, delays or changes in funding, budgetary constraints, political agendas, extensive specification development, price negotiations and milestone requirements. In addition, our government contracts are primarily fixed price contracts, which may prevent us from recovering costs incurred in excess of budgeted costs. Fixed price contracts require us to estimate the total project cost based on preliminary projections of the project's requirements. The financial viability of any given project depends in large part on our ability to estimate such costs accurately and complete the project on a timely basis. Some of those contracts are for products that are new to our business and are thus subject to unanticipated impacts to manufacturing costs. Given the current economic conditions, it is also possible that even if our estimates are reasonable at the time made, that prices of materials are subject to unanticipated adverse fluctuation. In the event our actual costs exceed fixed contractual costs of our product contracts, we will not be able to recover the excess costs which could have a material adverse effect on our business and results of operations. We examine these contracts on a regular basis and accrue for anticipated losses on these contracts, if necessary. As of September 29, 2019, there was zero in accrued loss provisions for loss contracts or cost overruns.

Approximately 85% of our contracts contain termination clauses for convenience. In the event these clauses should be invoked by our customer, future revenues against these contracts could be affected, however these clauses allow for a full recovery of any incurred contract costs plus a reasonable fee up through and as a result of the contract termination. We are currently unaware of any pending terminations on our existing contracts.

In some cases, contract awards may be issued that are subject to renegotiation at a date (up to 180 days) subsequent to the initial award date. Generally, these subsequent negotiations have had an immaterial impact (zero to 5%) on the contract price of the affected contracts. Currently, none of our awarded contracts are subject to renegotiation.

We have sought to mitigate the adverse impact from the slower pace of U.S. military orders on our results of operations by seeking to obtain foreign military orders as well as new commercial business. We do not expect these markets to completely mitigate the negative impact of lower U.S. defense spending.

If we fail to scale our operations appropriately in response to growth and changes in demand, we may be unable to meet competitive challenges or exploit potential market opportunities, and our business could be materially and adversely affected.

Our past growth has placed, and any future growth in our historical business is expected to continue to place, a significant strain on our management personnel, infrastructure and resources. To implement our current business and product plans, we will need to continue to expand, train, manage and motivate our workforce, and expand our operational and financial systems and our manufacturing and service capabilities. All of these endeavors will require substantial management effort and additional capital. If we are unable to effectively manage our expanding operations, we may be unable to scale our business quickly enough to meet competitive challenges or exploit potential market opportunities, and our current or future business could be materially and adversely affected.

Low unemployment and tight labor markets may adversely affect our labor costs and our ability to hire and retain a sufficient workforce required to meet the current backlog and increased customer demands. If we are not able to maintain a sufficient workforce and attract additional personnel as required, we may not be able to implement our business plan and our results of operations could be materially and adversely affected.

Current increases in defense spending have resulted in significant increases in customer orders and production volumes over the next twelve months during a period of record low unemployment rates and other business industry expansions within our local labor market. We compete with several other large defense contractors as well as homebuilding, industrial manufacturing and warehousing industries within our immediate regional area for both lower and higher skill level manufacturing employees. The limited market of available of full time workers for hire, including reductions in temporary service employees, combined with increasing competition among other local industries may result in increased production costs associated with higher wages, employee bonuses, overtime premiums and enhanced employee benefits in addition to costs increases associated with employee recruitment, employee turnover, training and labor efficiency reductions. We may be unable to fill the labor positions required to meet our growing customer demands in a timely or cost effective manner which would impede our ability to meet current and increasing production levels in line with our customer expectations and adversely affect our ability to grow revenue or maintain our current margin levels.

We do not have employment agreements with our key personnel, other than our Chief Executive and Financial Officers, and our management has very minimal unencumbered equity ownership in us. If we are not able to retain our key personnel or attract additional key personnel as required, we may not be able to implement our business plan and our results of operations could be materially and adversely affected.

We depend to a large extent on the abilities and continued participation of our executive officers and other key employees. The loss of any key employee could have a material adverse effect on our business. We currently have only two employment agreements, with our Chief Executive Officer which renews on an annual basis and currently expires on December 1, 2020, and our Chief Financial Officer which expires on January 31, 2021, with renewable terms each 18 months thereafter. We do not presently maintain “key man” insurance on any other key employees. Our management also has minimal unencumbered ownership interest in us, thus limiting their direct stake in our outcome. We believe that as our activities increase and change in character, additional, experienced personnel will be required to implement our business plan. Competition for such personnel is intense, and we cannot assure you that they will be available when required, or that we will have the ability to attract and retain them. In addition, due to our small size, we do not presently have depth of staffing in our executive, operational and financial management areas in order to have an effective succession plan should the need arise. Thus, in the event of the loss of one or more of our management employees, our results of operations could be vulnerable to challenges associated with recruiting additional key personnel, if such recruiting efforts are not successful in a timely manner.

Certain of our products are dependent on specialized sources of supply that are potentially subject to disruption which could have a material, adverse impact on our business.

We have selectively single-sourced some of our material components in order to mitigate excess procurement costs associated with significant tooling and startup costs. Furthermore, because of the nature of government contracts, we are often required to purchase selected items from U.S. government approved suppliers, which may further limit our ability to utilize multiple supply sources for these key components.

To the extent any of these single sourced or government approved suppliers may have disruptions in deliveries due to production, quality, or other issues, we may also experience related production delays or unfavorable cost increases associated with retooling and qualifying alternate suppliers. The impact of delays resulting from disruptions in supply for these items could negatively impact our revenue, our reputation with our customers, and our results of operations. In addition, significant price increases from single-source suppliers could have a negative impact on our profitability to the extent that we are unable to recover these cost increases on our fixed price contracts.

Each contract has a specific quantity of material which needs to be purchased, assembled, and shipped. Prior to bidding a contract, we contact potential sources of material and receive qualified quotations for this material. In some cases, the entire volume is given to a single supplier and in other cases; the volume might be split between several suppliers. If a contract has a single source supplier and that supplier fails to meet their obligations (e.g., quality, delivery), then we would find an alternate supplier and bring this information back to the final customer. Contractual deliverables would then be re-negotiated (e.g., specifications, delivery, price. As of November 8, 2019, approximately 5% of our material requirements are single-sourced across 7 suppliers representing approximately 5% of our active supplier orders. Single-sourced component requirements span across all of our major product lines. The vast majority of these single-sourced components could be provided by another supplier with minimal interruption in schedule (supply delay of 3 months or less) or minimally increased costs. We do not believe these single sourced materials to pose any significant risk to us as other suppliers are capable of satisfying the purchase requirements in a reasonable time period with minimal increases in cost. Of these single sourced components, we have contracts (purchase orders) with firm pricing and delivery schedules in place with each of the suppliers to supply parts in satisfaction of our current contractual needs.

We consider only those specialized single source suppliers where a disruption in the supply chain would result in a period of three months or longer for us to identify and qualify a suitable replacement to present a material financial or schedule risk. In the table below, we identify only those specialized single source suppliers and the product lines supported by those materials utilized by us as of November 8, 2019.

Product Line	Supply Item	Risk	Purchase Orders
Sighting Systems M36 DDAN	Digital camera system	Alternative source would take in excess of six months to qualify	This supplier is the designated replacement for Raytheon for the video system boards. One P.O. is currently in place to drive the transfer from Raytheon.
Periscopes	Die-cast housings	All die cast tooling is consolidated at this supplier. It would take approximately six months to move tooling and re-qualify a new supplier.	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.

Product Line	Supply Item	Risk	Purchase Orders
Periscopes	Steel castings	Alternative supplier source would take six months to qualify.	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements.
Periscopes	MIL Spec welded housings for vision blocks	Would take approximately 4-6 months to re-qualify a new supplier source.	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.
Other Big Eye	Sand castings for big eye binocular parts	Would take approximately 4-6 months to re-qualify a new supplier source.	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements.
Applied Optics Center M22/M24 Binocular	Spare Components	Only approved source due to proprietary rights. Alternate source cannot be developed.	Current firm fixed price and quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.
Applied Optics Center Other – Laser Filter Unit and Anti-reflection Device (ARD)	ARD Component	Only approved source due to patent. Alternate source cannot be developed.	Current firm fixed price and quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.

The defense technology supply industry is subject to technological change and if we are not able to keep up with our competitors and/or they develop advanced technology as response to our products, we may be at a competitive disadvantage.

The market for our products is generally characterized by technological developments, evolving industry standards, changes in customer requirements, frequent new product introductions and enhancements, short product life cycles and severe price competition. Our competitors could also develop new, more advanced technologies in reaction to our products. Currently accepted industry standards may change. Our success depends substantially on our ability, on a cost-effective and timely basis, to continue to enhance our existing products and to develop and introduce new products that take advantage of technological advances and adhere to evolving industry standards. An unexpected change in one or more of the technologies related to our products, in market demand for products based on a particular technology or of accepted industry standards could materially and adversely affect our business. We may or may not be able to develop new products in a timely and satisfactory manner to address new industry standards and technological changes, or to respond to new product announcements by others. In addition, new products may or may not achieve market acceptance.

Unexpected warranty and product liability claims could adversely affect our business and results of operations.

The possibility of future product failures could cause us to incur substantial expense to repair or replace defective products. We warrant the quality of our products to meet customer requirements and be free of defects for twelve months subsequent to delivery. We establish reserves for warranty claims based on our historical rate of returned shipments against these contracts. There can be no assurance that this reserve will be sufficient if we were to experience an unexpectedly high incidence of problems with our products. Significant increases in the incidence of such claims may adversely affect our sales and our reputation with consumers. Costs associated with warranty and product liability claims could materially affect our financial condition and results of operations.

We rely on the proper function, availability and security of information technology systems to operate our business and a cyber-attack or other breach of these systems could have a material adverse effect on our business, financial condition or results of operations.

We rely on information technology systems to process, transmit, and store electronic information in our day-to-day operations. Similar to other companies, the size and complexity of our information technology systems makes them vulnerable to a cyber-attack, malicious intrusion, breakdown, destruction, loss of data privacy, or other significant disruption. Our information systems require an ongoing commitment of significant resources to maintain, protect, and enhance existing systems and develop new systems to keep pace with continuing changes in information processing technology, evolving systems and regulatory standards. Any failure by us to maintain or protect our information technology systems and data integrity, including from cyber-attacks, intrusions or other breaches, could result in the unauthorized access to personally identifiable information, theft of intellectual property or other misappropriation of assets, or otherwise compromise our confidential or proprietary information and disrupt our operations. Any of these event may cause us to have difficulty preventing, detecting, and controlling fraud, be subject to legal claims and liability, have regulatory sanctions or penalties imposed, have increases in operating expenses, incur expenses or lose revenues as a result of a data privacy breach or theft of intellectual property, or suffer other adverse consequences, any of which could have a material adverse effect on our business, financial condition or results of operations.

We derive almost all of our revenue from three customers and the loss of any of these customers could have a material adverse effect on our revenues.

For the year ended September 29, 2019, the Company's consolidated revenues are derived from the U.S. government, 60%, one major U.S defense contractor, 22%, one commercial customer, 7%, and all other customers, 11%. Approximately 95% of the total company revenue is generated from domestic customers and 5% is derived from Canada. Procuring new customers and contracts may partially mitigate this risk. In particular, a decision by one of our major defense contract customers, U.S. government agencies, or major commercial customers to cease issuing contracts to us could have a significant material impact on our business and results of operations given that they represent over 95% of our gross business revenue. There can be no assurance that we could replace these customers on a timely basis or at all.

We have approximately 102 discrete contracts with major defense contractors and the U.S. Government (primarily Defense Logistics Agencies (DLA)), and other prime U.S. defense contractors. If they choose to terminate these contracts, we are entitled to fully recover all contractual costs and reasonable profits incurred up to or as a result of the terminated contract.

We only possess five patents and rely primarily on trade secrets to protect our intellectual property.

We utilize several highly specialized and unique processes in the manufacture of our products, for which we rely solely on trade secrets to protect our innovations. We cannot assure you that we will be able to maintain the confidentiality of our trade secrets or that our non-disclosure agreements will provide meaningful protection of our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or other disclosure. The non-disclosure agreements that are designed to protect our trade secrets could be breached, and we might not have adequate remedies for the breach.

It is also possible that our trade secrets will otherwise become known or independently developed by our competitors, many of which have substantially greater resources than us, and these competitors may have applied for or obtained, or may in the future apply for or obtain, patents that will prevent, limit or interfere with our ability to make and sell some of our products. Although based upon our general knowledge (and we have not conducted patent searches), we believe that our products do not infringe on the patents or other proprietary rights of third parties; however, we cannot assure you that third parties will not assert infringement claims against us or that such claims will not be successful.

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

In the future, we may decide to pursue acquisitions of other businesses in our industry. In order to successfully acquire other businesses, we would be forced to spend significant resources for both acquisition and transactional costs, which could divert substantial resources in terms of both financial and personnel capital from our current operations. Additionally, we might assume liabilities of the acquired business, and the repayment of those liabilities could have a material adverse impact on our cash flow. Furthermore, when a new business is integrated into our ongoing business, it is possible that there would be a period of integration and adjustment required which could divert resources from ongoing business operations.

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

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

Risks Related to Our Stock

We have issued a large number of warrants and options, which if converted or exercised would substantially increase the number of common shares outstanding.

On December 13, 2019, we had 8,436,422 shares of common stock outstanding, and (a) we have vested options outstanding to purchase common stock at \$10 per share, that if fully exercised, would generate proceeds of \$250,000 and result in the issuance of an additional 25,000 shares of common stock, and (b) we have 4,125,200 warrants outstanding at an exercise price of \$1.50 per share and (c) we have 216,500 granted unvested restricted stock units outstanding. Future sales of our common stock, warrants, options and restricted stock units may also adversely affect our stock price and our ability to raise funds in new offerings.

As a key component of our growth strategy we have provided and intend to continue offering compensation packages to our management and employees that emphasize equity-based compensation and would thus cause further dilution.

Our stock price is speculative, and there is a risk of litigation.

The trading price of our common stock has in the past and may in the future be subject to wide fluctuations in response to factors such as the following:

- revenue or results of operations in any quarter failing to meet the expectations, published or otherwise, of the investment community;
- speculation in the press or investment community;
- wide fluctuations in stock prices, particularly with respect to the stock prices for other defense industry companies;
- announcements of technological innovations by us or our competitors;
- new products or the acquisition of significant customers by us or our competitors;

- changes in investors' beliefs as to the appropriate price-earnings ratios for us and our competitors;
- changes in management;
- sales of common stock by directors and executive officers;
- rumors or dissemination of false or misleading information, particularly through Internet chat rooms, instant messaging, and other rapid-dissemination methods;
- conditions and trends in the defense industry generally;
- the announcement of acquisitions or other significant transactions by us or our competitors;
- adoption of new accounting standards affecting our industry;
- general market conditions;
- domestic or international terrorism and other factors; and
- other factors as described in this section.

Fluctuations in the price of our common stock may expose us to the risk of securities class action lawsuits. Although no such lawsuits are currently pending against us and we are not aware that any such lawsuit is threatened to be filed in the future, there is no assurance that we will not be sued based on fluctuations in the price of our common stock. Defending against such suits could result in substantial cost and divert management's attention and resources. In addition, any settlement or adverse determination of such lawsuits could subject us to significant liability.

The Financial Industry Regulatory Authority, or FINRA, has adopted sales practice requirements which may also limit a shareholder's ability to buy and sell our stock.

FINRA has adopted rules that require that in recommending an investment to a customer, a broker-dealer must have reasonable grounds for believing that the investment is suitable for that customer. Prior to recommending speculative low priced securities to their non-institutional customers, broker-dealers must make reasonable efforts to obtain information about the customer's financial status, tax status, investment objectives and other information. Under interpretations of these rules, FINRA believes that there is a high probability that speculative low priced securities will not be suitable for at least some customers. FINRA requirements make it more difficult for broker-dealers to recommend that their customers buy our common stock, which may limit your ability to buy and sell our stock and have an adverse effect on the market for our shares.

Future sales of our common stock could depress our stock price.

Sales of a large number of shares of our common stock, or the availability of a large number for sale, could materially adversely affect the per share market price of our common stock and could impair our ability to raise funds in addition offering of our debt or equity securities. In the event that we propose to register shares of common stock under the Securities Act for our own account, certain shareholders are entitled to include their shares in the registration, subject to limitations described in the agreements granting these rights.

Cautionary Note Regarding Forward-Looking Information

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

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

Item 2 Properties

We are headquartered in Richardson, TX and lease 93,967 combined square feet of facilities including Richardson, Texas and Dallas, Texas. As of December 9, 2019, we had 112 full time equivalent employees. We operate with a single shift, and capacity could be expanded by adding a second shift. Our proprietary processes and methodologies provide barriers to entry for other competing suppliers. In many cases, we are the sole source provider or one of only two providers of a product. We have capabilities which include machining, bonding, painting, tracking, engraving and assembly and can perform both optical and environmental testing in-house.

Item 3 Legal Proceedings

From time to time, we are involved in lawsuits, claims, investigations and proceedings, including pending opposition proceedings involving patents that arise in the ordinary course of business. There are no matters pending that we expect to have a material adverse impact on our business, results of operations, financial condition or cash flows.

Item 4 Mine Safety Disclosures

None.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market information

Our common stock is currently quoted on the OTCQB Marketplace under the symbol “OPXS” and warrants under the symbol “OPXSW”. Trading in our common stock has historically lacked consistent volume, and the market price has been volatile.

On December 13, 2019, the closing price for our common stock as reported on the OTCQB was \$1.85 per share.

Securities outstanding and holders of record

On December 13, 2019, there were approximately 79 shareholders of record for our common stock and 8,436,422 shares of our common stock issued and outstanding.

Dividends

On June 26, 2017, the board of directors approved a resolution authorizing a \$0.02 per share (and per warrant) dividend for common and preferred series C shareholders and warrant holders of record as of July 5, 2017 and for three subsequent quarterly record dates thereafter. Total dividends of \$522 thousand were recorded during the twelve months ending October 1, 2017 and \$261 thousand of dividends were paid during the twelve month period. During the twelve months ended September 30, 2018, Optex Systems Holdings recorded a total of \$523 in declared dividends for dividends to share and warrant holders of record as of January 12, 2018 and April 12, 2018 and \$784 thousand in dividends were paid, which included \$261 thousand of dividends in arrears declared in 2017 for shareholders of record as of October 12, 2017. There are no additional dividend payments declared subsequent to the April 12, 2018 record date and as of periods ended September 30, 2018 and September 29, 2019, there were no outstanding dividends payable.

Information respecting equity compensation plans

Summary Equity Compensation Plan Information

Optex Systems Holdings adopted its 2009 Stock Option Plan on March 26, 2009. On December 9, 2011, the Board of Directors of Optex Systems Holdings, Inc. authorized an amendment to its Stock Option Plan to increase the number of issuable shares from 6,000 to 50,000 and authorized the grant of 10,000 options to two board members and a total of 36,070 to Optex Systems Holdings employees including 20,000 options to executive officers. On December 19, 2013, the Board of Directors of Optex Systems Holdings, Inc. authorized an amendment to its Stock Option Plan to increase the number of issuable shares from 50,000 to 75,000 and authorized the grant of 20,000 options to three board members and a grant of 5,000 to an Optex Systems Holdings officer. The options granted in 2011 and 2013 were at exercise prices of \$10.00 per share with each grant to vest 25% per year over four years for each year with which the grantee is still employed by or serving as a director of Optex Systems Holdings, Inc. (with all unvested options automatically expiring on the date of termination of employment by or service as a director of Optex Systems Holdings, Inc.) and all unvested options immediately vesting upon a change of control due to a merger or acquisition of the Company. As of December 13, 2019, 71,070 options had been granted, 41,070 of these options had forfeited due to terminations or expiration, and 30,000 had vested of which 5,000 options were exercised. There were 34,980 vested options which forfeited due to expiration of the option term on December 8, 2018. The remaining 25,000 outstanding options were fully vested as of December 18, 2017 and will expire on December 18, 2020.

2016 Restricted Stock Unit Plan

On June 14, 2016, our Compensation Committee approved our 2016 Restricted Stock Unit Plan. This plan provides for issuance of stock units ("RSUs") for up to 1,000,000 shares of our common stock. Each RSU constitutes a right to receive one share of our common stock, subject to vesting, which unless otherwise stated in an RSU agreement, shall vest in equal amounts on the first, second and third anniversary of the grant date. Shares of our common stock underlying the number of vested RSUs will be delivered as soon as practicable after vesting. During the period between grant and vesting, the RSUs may not be transferred, and the grantee has no rights as a shareholder until vesting has occurred. If the grantee's employment is terminated for any reason (other than following a change in control of us or a termination of an officer other than for cause), then any unvested RSUs under the award will automatically terminate and be forfeited. If an officer grantee's employment is terminated by us without cause or by the grantee for good reason, then, provided that the RSUs have not been previously forfeited, the remaining unvested portion of the RSUs will immediately vest as of the officer grantee's termination date. In the event of a change in control, our obligations regarding outstanding RSUs shall, on such terms as may be approved by the Committee prior to such event, immediately vest, be assumed by the surviving or continuing company or cancelled in exchange for property (including cash).

On June 15, 2016, the Company granted 150,000 RSUs to our Chief Executive Officer, Danny Schoening, and 50,000 RSUs to our Chief Financial Officer, Karen Hawkins. The RSUs granted to Mr. Schoening and Ms. Hawkins vest as follows: 34% on January 1, 2017, 33% on January 1, 2018 and 33% on January 1, 2019. On June 15, 2017, the Company issued 50,000 RSUs to its Applied Optics Center General Manager and new board member, Bill Bates. The RSUs issued to Mr. Bates will vest as follows: 34% on January 1, 2018, 33% on January 1, 2019 and 33% on January 1, 2020.

On January 5, 2017, the Company issued 45,799 common shares to officers and directors in settlement of 68,000 restricted stock units vested on January 1, 2017. On January 2, 2018, the Company issued 55,902 common shares to officers and directors in settlement of 83,000 restricted stock units vested on January 1, 2018. On January 2, 2019, the Company issued 55,565 common shares to officers and directors in settlement of 82,500 restricted stock units vested on January 1, 2019. For each vesting period the vested common shares were issued net of shares withheld for employee federal income tax requirements.

On November 20, 2018 the board of directors approved the issuance of additional grants of 150,000 and 50,000 RSUs with a January 2, 2019 grant date, to Danny Schoening and Karen Hawkins, respectively, and vesting as of January 1 each year subsequent to the grant date over a three year period at a rate of 34% in year one, and 33% each year thereafter.

As of December 13, 2019 there are 216,500 outstanding unvested restricted stock units remaining to vest of which 84,500 will vest on January 1, 2020 and 550,000 authorized restricted stock units from the 2016 Restricted Stock Unit Plan remaining to be granted at a future date.

Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the consolidated financial statements and the related notes that are set forth in our financial statements elsewhere in this annual report.

This management's discussion and analysis reflects information known to management as of our fiscal year end, September 29, 2019, and the date of filing. This MD&A is intended to supplement and complement our audited financial statements and notes thereto for the year ended September 29, 2019, prepared in accordance with U.S. generally accepted accounting principles (GAAP). You are encouraged to read our financial statements in conjunction with your reading 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 a non-GAAP measure is used in this MD&A, it is 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

Optex Systems, Inc. manufactures optical sighting systems and assemblies, primarily for Department of Defense applications. Its products are installed on various types of U.S. military land vehicles, such as the Abrams and Bradley fighting vehicles, light armored and armored security vehicles and have been selected for installation on the Stryker family of vehicles. Optex Systems, Inc. (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).

We are both a prime and sub-prime contractor to the Department of Defense. Sub-prime contracts are typically issued through major defense contractors such as General Dynamics Land Systems, Raytheon Corp., BAE, NorcaTec and others. We are also a military supplier to foreign governments such as Israel, Australia and NAMS and South American countries and as a subcontractor for several large U.S. defense companies serving foreign governments.

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 incurred 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, some 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.

Reference Part I, Item 1 "Recent Events" of this report for updated information on new orders, board changes, executive and board compensation and stock and warrant repurchases.

Results of Operations

Segment Information

We have presented the operating results by segment to provide investors with an additional tool to evaluate our operating results and to have a better understanding of the overall performance of each business segment and its ability to perform in subsequent periods. Management of Optex Systems Holdings uses the selected financial measures by segment internally to evaluate its ongoing segment operations and to allocate resources within the organization accordingly. Segments are determined based on differences in products, location, internal reporting and how operational decisions are made. Management has determined that the Optex Systems, Richardson plant, and the Applied Optics Center, Dallas plant, which was acquired on November 3, 2014, are separately managed, organized, and internally reported as separate business segments. The table below provides a summary of selective statement of operations data by operating segment for the years ended September 29, 2019 and September 30, 2018 reconciled to the Audited Consolidated Results of Operations as presented in Item 8, "Financial Statements and Supplementary Data".

Results of Operations Selected Financial Info by Segment
(Thousands)

	Twelve months ended							
	September 29, 2019				September 30, 2018			
	Optex Richardson	Applied Optics Center Dallas	Other (non- allocated costs and eliminations)	Consolidated	Optex Richardson	Applied Optics Center Dallas	Other (non- allocated costs and eliminations)	Consolidated
Revenue from External Customers	\$ 16,219	\$ 8,311	\$ -	\$ 24,530	\$ 12,739	\$ 8,114	\$ -	\$ 20,853
Intersegment Revenues	-	1,712	(1,712)	-	-	1,556	(1,556)	-
Total Segment Revenue	16,219	10,023	(1,712)	24,530	12,739	9,670	(1,556)	20,853
Total Cost of Sales	12,499	7,490	(1,712)	18,277	10,178	7,716	(1,556)	16,338
Gross Margin	3,720	2,533	-	6,253	2,561	1,954	-	4,515
Gross Margin %	22.9%	25.3%	-	25.5%	20.1%	20.2%	-	21.7%
General and Administrative Expense	2,385	558	113	3,056	2,348	528	153	3,029
Segment Allocated G&A Expense	(684)	684	-	-	(669)	669	-	-
Net General & Administrative Expense	1,701	1,242	113	3,056	1,679	1,197	153	3,029
Operating Income (Loss)	2,019	1,291	(113)	3,197	882	757	(153)	1,486
Operating Income %	12.4%	12.9%	-	13.0%	6.9%	7.8%	-	7.1%
Gain on Change in Fair Value of Warrants	-	-	1,344	1,344	-	-	95	95
Interest Expense	-	-	(23)	(23)	-	-	(20)	(20)
Net Income (Loss) before taxes	\$ 2,019	\$ 1,291	\$ 1,208	\$ 4,518	\$ 882	\$ 757	\$ (78)	\$ 1,561
Net Income before taxes %	12.4%	12.9%	-	18.4%	6.9%	7.8%	-	7.5%

Our total external sales revenues increased by \$3.7 million, or 17.6%, in 2019 over the 2018 revenue levels. The Optex Systems Richardson segment realized a \$3.5 million, or 27.3%, increase in external revenue and the Applied Optics Center segment realized an increase of \$0.2 million, or 2.4%, in external revenue over the prior year period. Intersegment revenues increased by \$0.2 million during the 2019 year, from \$1.5 million to \$1.7 million. Intersegment revenues relate primarily to coated filters provided by the Applied Optics Center to Optex Systems in support of the Optex Systems periscope line.

Gross margin increased \$1.7 million and the gross margin percentage increased by 3.8 points from 21.7% in 2018 to 25.5% in 2019. The gross margin and the gross margin percentages increased significantly in 2019 for the both the Optex Richardson and the Applied Optics Center segments over 2018. During 2019, the Optex Systems gross margin increased \$1.2 million and the gross margin percentage increased to 22.9% points in 2019 as compared to a gross margin percentage of 20.1% in 2018 primarily driven by higher revenue and changes in product mix between the years. The Applied Optics Center gross margin increased by \$0.6 million and the gross margin percent increased by 5.1 points from 20.2% in 2018 to 25.3% in 2019 over the 2018 gross margin. Increases in U.S. government military spending has a significant impact on our product lines as our products directly support various types of U.S. military land vehicle procurements.

During the years ended 2019 and 2018, the Applied Optics Center absorbed (\$0.7) million of fixed general and administrative costs incurred by Optex Systems for support services. These expenses cover accounting, executive, human resources, information technology, board fees and other corporate expenses paid by Optex Systems and shared across both operating segments.

Operating income increased, by \$1.7 million, in 2019, to \$3.2 million, as compared to the prior year operating income of \$1.5 million. Optex Systems operating income increased \$1.1 million, to \$2.0 million in 2019 as compared to \$0.9 million 2018 on higher revenue. The Applied Optics Center operating income increased by \$0.5 million, from a prior year operating income of \$0.8 million to a 2019 operating income of \$1.3 million.

The net income before taxes increased from the prior year by \$2.9 million, to \$4.5 million in 2019 from a prior year net income before taxes of \$1.6 million. The increase in net income year over year is primarily due to increased operating income of \$1.7 million from the prior year, combined with an increase in income for non-cash related changes to the fair value of warrants of \$1.2 million to a gain of \$1.3 million in 2019 from a prior year gain of \$0.1 million in 2018.

Backlog

Backlog as of September 29, 2019 was \$24.6 million as compared to a backlog of \$23.4 million as of September 30, 2018, representing an increase of 5.1%. The following table depicts the current expected delivery by quarter of all contracts awarded as of September 29, 2019.

Product Line	(Millions)						Total Backlog 9/29/2019	Total Backlog 9/30/2018	Variance	% Chg
	Q1 2020	Q2 2020	Q3 2020	Q4 2020	2020 Delivery	2021+ Delivery				
Periscopes	\$ 2.1	\$ 3.0	\$ 3.6	\$ 0.1	\$ 8.8	\$ 1.5	\$ 10.3	\$ 8.3	2.0	24.1%
Sighting Systems	0.1	1.1	0.4	0.6	2.2	1.9	4.1	2.8	1.3	46.4%
Other	1.5	0.6	0.7	0.3	3.1	0.8	3.9	5.6	(1.7)	(30.4)%
Optex Systems - Richardson	3.7	4.7	4.7	1.0	14.1	4.2	18.3	16.7	1.6	9.6%
Applied Optics Center - Dallas	2.1	2.1	1.5	0.2	5.9	0.4	6.3	6.7	(0.4)	(6.0)%
Total Backlog	\$ 5.8	\$ 6.8	\$ 6.2	\$ 1.2	\$ 20.0	\$ 4.6	\$ 24.6	\$ 23.4	1.2	5.1%

During fiscal year 2019, Optex Systems Holdings received new orders totaling \$25.8 million, a (9.6%) decrease, as compared to new orders of \$28.5 million during the prior year. The decrease from the prior year orders is primarily attributable to a decrease of \$2.9 million in "Other" orders, for our MRS collimator assemblies in support of the M1A2 Abrams program. The items are typically long lead items and we continue to deliver against the existing contracts awarded during 2018 and anticipate new awards in the future. The 2019 orders consist of \$11.9 million in support of our periscope product line, \$8.1 million attributable to the Applied Optics Center and \$2.7 million attributable to sighting systems and support, and \$3.1 million in other products. Approximately 14.5% or \$3.7 million of the orders received in fiscal year 2019 were delivered within the 2019 fiscal year, with \$22.1 million of backlog deliverable in 2020 and beyond. We continue to book new orders for deliveries beginning in fiscal year 2020.

We attribute the increase in backlog primarily to the lifting of the 2011 Budget Control Act sequestration caps combined with increases in the U.S. military procurement budgets which were approved for the fiscal years 2019 and 2020 National Defense Authorization Acts and the increase in Foreign Military Sales (FMS) in 2018 through 2019 over the prior year levels.

Optex Systems - Richardson:

Backlog for our periscope product line has increased 24.1% or \$2.0 million to \$10.3 million, from our 2018 fiscal year end level of \$8.3 million. Our total periscope contract awards for fiscal 2019 totaled \$10.4 million as compared to \$11.0 million in the fiscal year 2018, a decrease of (\$0.6), or (5.4%) million from the prior year. The new periscope orders span multiple customers and include both our standard acrylic as well as Integrated Combat Weapon System (ICWS) glass periscopes deliverable in 2020. Many of our existing periscope contracts are Indefinite Delivery, Indefinite Quantity (IDIQ) type multiyear contracts covering 3-5 years. We continue to get new task order releases against these orders for delivery in the current fiscal year and beyond. Subsequent to the year end, on November 11, 2019, the Company announced a multi-year Indefinite Delivery Indefinite Quantity (IDIQ) award from Defense Logistics Agency Land and Maritime for periscopes for up to \$2.3 Million over a 5 year period.

Sighting Systems backlog increased by \$1.3 million or 46.4% in the last twelve months from \$2.8 million in 2018 to \$4.1 million as of the end of 2019. The increase in backlog is primarily attributable to new orders booked during the year for Commander Weapon Sighting Systems for deliveries in 2020 and an extension on our OWSS maintenance contract through February 2022. During 2019, we booked \$2.7 million in new orders, an increase of \$0.5 million from the prior year orders of \$2.2 million.

Our backlog in other product groups decreased by (\$1.7) million or (30.4%) from \$5.6 million in 2018 to \$3.9 million in 2019 as we continue to ship against significant orders for MRS collimator assemblies received in 2018. We are currently quoting new MRS assembly orders for deliveries beyond the 2020 fiscal year.

Applied Optics Center – Dallas

The Applied Optics Center backlog decreased by (\$0.4) million, or (6.0%), for the year ended September 29, 2019 from \$6.7 million in 2018 to \$6.3 million in 2019. New orders for the Applied Optics Center during the 2019 year were \$8.1 million as compared to the 2018 orders of \$8.7 million, a decline of (\$0.6) million. The decrease 2019 orders is primarily driven by lower orders of (\$1.1) million on our commercial optical assemblies which was offset by increases in military orders of \$0.5 million during the year.

We are optimistic that recent proposed boosts in military spending by the government administration will have a favorable impact in the direction of funding or product need for the U.S. military and increased orders for the Company. Optex Systems Holdings continues to pursue new international and commercial opportunities in addition to maintaining its current footprint with U.S. military vehicle manufactures, with existing as well as new product lines. We continue exploring new market opportunities for our M17 day/thermal periscopes and digital optics for commercial applications. We are also reviewing potential products, outside our traditional product lines, which could be manufactured using our current production facilities in order to capitalize on our existing capacity. Further, we continue to look for strategic businesses to acquire that will strengthen our existing product line, expand our operations, and enter new markets.

Twelve month period ended September 29, 2019 compared to the twelve month period ended September 30, 2018

Revenues:

The table below details the revenue changes by segment and product line for the year ended September 29, 2019 as compared to the year ended September 30, 2018.

Product Line	Twelve months ended (Millions)			
	September 29, 2019	September 30, 2018	Variance	% Chg
Periscopes	\$ 9.9	\$ 7.5	\$ 2.4	32.0
Sighting Systems	1.3	3.6	(2.3)	(63.9)
Other	5.0	1.6	3.4	212.5
Optical Systems – Richardson	16.2	12.7	3.5	27.6
Applied Optics Center – Dallas	8.3	8.1	0.2	2.5
Total Revenue	\$ 24.5	\$ 20.8	\$ 3.7	17.8

Our total revenues increased by \$3.7 million, or 17.8%, in 2019 over the 2018 revenue levels. The Optex Systems Richardson segment realized a \$3.5 million, or 27.6%, increase in revenue and the Applied Optics Center segment realized an increase of \$0.2 million, or 2.5%, in revenue over the prior year period.

Revenues increased by 2.4 million or 32.0% on our periscope line during the twelve months ended September 29, 2019 as compared to the twelve months ended September 30, 2018 based on increased customer demand between the respective periods. Based on our strong ended September periscope backlog of \$9.9, with \$8.9 firm orders due in the next twelve months, we anticipate our 2020 periscope revenues to continue at an increased level. We anticipate additional new orders as well as task awards against our existing IDIQ contracts for delivery in the second half of 2020.

Revenues on sighting systems decreased by (\$2.3) million, or (63.9%) from the prior year period due to completion of the DDAN sighting system program in the first quarter of 2019. During the twelve months ended September 29, 2019, we received an additional DDAN spare order of \$0.9 million for delivery in fiscal years 2020 and 2021.

Revenue on other product lines increased by \$3.4 million, or 212.5%, compared to revenues in the prior year due to shipments against the 2018 MRS collimator orders combined with increased customer demand for mirror, cell, beam splitter and other spare assemblies over the prior year levels.

The Applied Optics Center external revenue increased by \$0.2 million, or 2.5%, during the 2019 fiscal year as compared to the prior year period. The slight revenue increase is primarily due to increased demand for laser interface filters, day windows and unity filters of \$1.8 million, offset by a decline in customer demand for our commercial optical assemblies of (\$1.6) million. Increased filter and window revenues were primarily driven by increased U.S. military spending.

Gross Margin. The gross margin during the period ended September 29, 2019 was 25.5% of revenue as compared to a gross margin of 21.7% of revenue for the period ended September 30, 2018. Cost of sales increased by \$1.9 million to \$18.2 million for the fiscal year ended 2019 compared to \$16.3 million for the fiscal year ended 2018. The increased cost of sales was primarily driven by higher revenues. The gross margin increased by \$1.73 million to \$6.25 million in 2019 as compared to \$4.52 million in 2018. We attribute the improvement in gross margin to higher revenue combined with cost efficiency improvements at the Applied Optics Center and changes in product mix between the respective years.

G&A Expenses. During the fiscal years ended September 29, 2019 and September 30, 2018, we recorded operating expenses of \$3.06 million and \$3.03 million. Despite the substantial increase in revenue during the current year over the prior year, the Company was able to minimize any substantial spending impact to the general and administrative costs.

Operating Income. During the period ended September 29, 2019, we recorded operating income of \$3.2 million as compared to operating income of \$1.5 million during the period ended September 30, 2018. The \$1.7 million increase in operating income in the current year over the prior year is primarily due to the increased gross margin of \$1.7 million on higher revenue in 2019 as compared to 2018.

Net income applicable to common shareholders. During the year ended September 29, 2019, we recorded a net income applicable to common shareholders of \$3.8 million as compared to net income applicable to common shareholders of \$0.9 million during the year ended September 30, 2018. The increased net income of \$2.9 million is primarily attributable to an increase in operating income of \$1.7 million and changes in the fair value of warrants of \$1.2 million, a change in income taxes of \$1.3 million as a result of a deferred tax benefit, offset by changes in dividends distributed and deemed dividends of (\$1.4) million as compared to the year ended 2018.

Non GAAP Adjusted EBITDA

We use adjusted earnings before interest, taxes, depreciation and amortization (EBITDA) as an additional measure for evaluating the performance of our business as “net income” includes the significant impact of noncash valuation gains and losses on warrant liabilities, noncash compensation expenses related to equity stock issues, as well as depreciation, amortization, interest expenses and federal income taxes. We believe that Adjusted EBITDA is a meaningful indicator of our operating performance because it permits period-over-period comparisons of our ongoing core operations before the excluded items. Adjusted EBITDA is a financial measure not required by, or presented in accordance with, U.S. generally accepted accounting principles (“GAAP”).

Adjusted EBITDA has limitations and should not be considered in isolation or a substitute for performance measures calculated under GAAP. This non-GAAP measure excludes certain cash expenses that we are obligated to make. In addition, other companies in our industry may calculate Adjusted EBITDA differently than we do or may not calculate it at all, which limits the usefulness of Adjusted EBITDA as a comparative measure.

The table below summarizes our twelve month operating results for periods ended September 29, 2019 and September 30, 2018, in terms of both the GAAP net income measure and the non-GAAP Adjusted EBITDA measure. We believe that including both measures allows the reader to have a “complete picture” of our overall performance.

	(Thousands)	
	Twelve months ended	
	September 29, 2019	September 30, 2018
Net Income — GAAP	\$ 5,668	\$ 1,394
<i>Add:</i>		
Gain on Change in Fair Value of Warrants	(1,344)	(95)
Federal Income Tax (Benefit) Expense	(1,150)	167
Depreciation	340	327
Stock Compensation	113	153
Royalty License Amortization	30	30
Interest Expense	23	20
Adjusted EBITDA - Non GAAP	\$ 3,680	\$ 1,996

Our adjusted EBITDA increased by \$1.7 million to \$3.7 million during the twelve months ended September 29, 2019 as compared \$2.0 million during the twelve months ended September 30, 2018. EBITDA improvements are directly correlated with significant increases in revenue, changes in product mix and improvements in our gross margins. During the year, we experienced product revenue growth of 17.6% and improved gross margin percentages of 3.8% over the prior year. Each of our operating segments realized impressive revenue growth and increases in gross margin from the prior year. Operating segment performance is discussed in greater detail throughout the following sections.

During the year ended September 29, 2019, we recognized a gain on the change in fair value of warrants of (\$1.3) million as compared to a gain of (\$0.1) million in the prior year ended September 30, 2018. As this is a non-cash gain driven by the current fair market value of our outstanding warrants and unrelated to our core business operating performance, the gain has been excluded from our adjusted EBITDA calculations presented above. Further discussion regarding the gain on changes in fair value of the warrants and the related warrant liability can be found in Item 1, “Consolidated Financial Statements, Note 12 - Warrant Liabilities”.

Liquidity and Capital Resources

As of September 29, 2019, Optex Systems Holdings had working capital of \$11.7 million, as compared to \$8.5 million as of September 30, 2018. During the year ended September 29, 2019, the Company generated a net income of \$5.7 million as compared to a net income of \$1.4 million, and an increase in revenues of \$3.7 million, or 17.8%, up to \$24.5 million, from \$20.8 million, as compared to the prior year ended September 30, 2018. Backlog has increased by \$1.2 million, or 5.1% to \$24.6 million over the prior year backlog of \$23.4 million.

During the prior two years, the Company has seen significant increases in revenue growth primarily in the U.S. military products. We attribute the higher demand to increases in the U.S. military procurement budget which was approved for the fiscal years 2019 and the anticipated 2020 National Defense Authorization Acts (NDAA). We believe that the procurement budget increases in the federal government’s approved 2019 and anticipated 2020 NDAA combined with the lifting of the 2011 budget sequestration cap on defense spending levels are favorable to the Company for its U.S. military products during the next twelve months. Significant increases in orders could cause a strain on our working capital as we purchase additional inventories and ramp up production personnel required to meet the higher production schedules.

As of September 29, 2019, Optex Systems Inc. has a net carrying value of \$1.4 million in deferred tax assets represented by deferred tax assets of \$2.4 million and a deferred tax asset valuation allowance of (\$1.0) million against those assets. Due to historical losses resulting in a Net Operating Loss Carryforward for each of the fiscal years 2010 through 2016, our valuation allowance reserve was set at 100% of the deferred tax asset for the years 2014 through 2018 for a net carrying value of zero. As of September 29, 2019, we reviewed the deferred tax assets and determined it was more likely than not that we would be able to utilize at least \$1.4 million of the deferred tax asset balance. Our assumptions were based on the last three years earning trend as well as anticipated future earnings expected with the increases in U.S defense and Foreign Military market spending projections. Release of the \$1.4 million against the valuation allowance resulted in the recognition of a tax benefit for the twelve months ended September 29, 2019. We will continue to review the deferred tax assets and related valuation reserves in accordance with ASC 740 on an annual basis.

The Company has historically funded its operations through operations, convertible notes, common and preferred stock offerings and bank debt. The Company's ability to generate positive cash flows depends on a variety of factors, including the continued development and successful marketing of the Company's products. At September 29, 2019, the Company had approximately \$1.1 million in cash and an outstanding payable balance of \$0.3 million against our working line of credit. The line of credit allows for borrowing up to a maximum of \$2.2 million, which fluctuates based on our open accounts receivable balance. As of September 29, 2019, our outstanding accounts receivable was \$3.1 million. We expect the accounts to be collected during the first quarter of fiscal 2020. The Company expects to generate net income and positive cash flow from operating activities over the next twelve months on higher projected revenue growth and contribution toward fixed costs, combined with increased gross margins for existing and planned productivity and cost efficiency improvements. Our net income of \$5.7 million during the fiscal year 2019 marked a significant improvement of \$4.3 million from the prior year net income of \$1.4 million. Successful transition to attaining and maintaining profitable operations is dependent upon maintaining a level of revenue adequate to support the Company's cost structure. We are entering 2020 with a 5.1% increase in backlog from the prior year end on increased customer demand. Management intends to manage operations commensurate with its level of working capital and facilities line of credit during the next twelve months; however, uneven revenue levels driven by changes in customer delivery demands, first article inspection requirements or other program delays combined with increasing inventory and production costs required to support the increases in backlog could create a working capital shortfall. In the event the Company does not successfully implement its ultimate business plan, certain assets may not be recoverable.

In 2018 the Board of Directors approved two separate purchases 200,000 shares and 500,000 shares of its common stock in two separate private transactions for \$1.00 per share each for a total of \$700,000. All of the stock repurchases from 2018 have been returned to the treasury and cancelled. There were no common stock repurchases in 2019. In 2019, we repurchased 88,081 of the outstanding warrants from private investors at a warrant price of \$0.85 per warrant, for a total purchase price of \$75 thousand. Upon repurchase, the warrants were cancelled.

During the twelve months ended September 29, 2019 the Company declared and paid no dividends. As of September 29, 2019 there are no outstanding declared and unpaid dividends.

Period from September 30, 2018 through September 29, 2019

Cash and Cash Equivalents. As of September 29, 2019 and September 30, 2018, we had cash and cash equivalents of \$1.1 million.

Net Cash Provided by Operating Activities. Net cash provided by operating activities during the period beginning September 30, 2018 and ended September 29, 2019 was \$0.2 million. The primary source of cash provided by operations was driven by net income of \$5.7 offset by increases in inventory (\$2.9) million, deferred tax assets (\$1.4) million, warrant liabilities of (\$1.3) million, and other changes in working capital of \$0.1 million.

Net Cash (Used) by Investing Activities. In the twelve months ended September 29, 2019, cash provided by investing activities was (\$0.1) million for new asset purchases used in support of production.

Net Cash (Used) by Financing Activities Net cash used in financing activities was (\$0.1) million during the twelve months ended September 29, 2019 due to the repurchase of warrants of (\$0.1) million and the payment against the line of credit of (\$0.1) million, offset by \$0.1 million cash received for the exercise of warrants. As of September 29, 2019, the outstanding line of credit balance was \$0.25 million as compared to \$0.3 million as of September 30, 2018.

Critical Accounting Policies

Revenue Recognition: As of fiscal year beginning on October 1, 2018, the Company has adopted FASB ASC 606—Revenue from Contracts with Customers, which is required for public business entities for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The Company has selected a modified retrospective application of the standard for all periods presented as of the October 1, 2018 implementation date. The new revenue recognition standard requires revenue recognition based on a five-step model that includes: identifying the contract, identifying the performance obligations, determining the transaction price, allocating the transaction price and recognizing the revenue. The standard results in the recognition of revenue depicting the transfer of promised goods or services to customers in an amount reflecting the expected consideration to be received from the customer for such goods and services, based on the satisfaction of performance obligations, occurring when the control of the goods or services transfer to the customer. The majority of the Company’s contracts and customer orders originate with fixed determinable unit prices for each deliverable quantity of goods defined by the customer order line item (performance obligation) and include the specific due date for the transfer of control and title of each of those deliverables to the customer at pre-established payment terms, which are generally within thirty to sixty days from the transfer of title and control. We have elected to account for shipping and handling costs as fulfillment costs after the customer obtains control of the goods. In addition, the Company has one ongoing service contract which began in October 2017 which relates to optimized weapon system support (OWSS) and includes ongoing program maintenance, repairs and spare inventory support for the customer’s existing fleet units in service over a three year period. Revenue recognition for this program has been recorded by the Company, and compensated by the customer, at fixed monthly increments over time, consistent with the defined contract maintenance period.

The adoption of the ASC 606 revenue standard had no material effect on the financial statement presentation on a retrospective or prospective basis for the twelve month annual and comparative period covered through the current year end date September 29, 2019. The Company believes its previous recognition policy as related to the production contracts (“units of delivery”), and maintenance contract (“passage of time”), are consistent with the new revenue recognition standard defined within FASB ASC 606 which requires unique performance obligations be recognized upon satisfaction of the customers’ own performance obligation at the point in time when the control of goods is transferred to the customer, or over time as the customer benefits from provided maintenance and support services. The Company has on occasion, outside of the presented periods, received selective contract awards and modifications which included substantive milestone performance obligations, contract modifications, negotiated settlements and financing arrangements which could fall within the scope of the new revenue recognition guidance on recurrence, and as such, the Company has expanded their contract review process to ensure any new contract awards, changes, modifications, financing arrangements or potential negotiated settlements are recorded in compliance to the new standard guidance.

During the twelve months ended September 29, 2019 there was \$289 of revenue recognized during the period from customer deposit liabilities (deferred contract revenue), and \$19 thousand of customer deposits refunded to the customer on order cancellation. As of September 29, 2019 there is \$3 thousand in customer deposit liabilities. As of the twelve months ended September 29, 2019, there are no significant contract costs such as sales commissions or costs deferred.

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.

Optex Systems Holdings’ accounting policy for equity instruments issued to consultants and vendors in exchange for goods and services follows the provisions of FASB ASC 505-50. 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 Optex Systems Holdings will not realize tax assets through future operations. When assessing the recoverability of deferred tax assets, management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies and results of recent operations. Based on those estimates, management has determined that a portion of the deferred tax assets may not be realized and has established a valuation allowance against the deferred tax asset balance. We record uncertain tax positions in accordance with ASC 740 on the basis of a two-step process in which (1) we determine whether it is more likely than not that the tax positions will be sustained on the basis of the technical merits of the position and (2) for those tax positions that meet the more-likely-than-not recognition threshold, we recognize the largest amount of tax benefit that is more than 50 percent likely to be realized upon ultimate settlement with the related tax authority.

As of September 29, 2019 Optex Systems Inc. has a net carrying value of \$1.4 million in deferred tax assets represented by deferred tax assets of \$2.4 million and a deferred tax asset valuation allowance of (\$1.0) million against those assets. Due to historical losses resulting in a Net Operating Loss Carryforward for each of the fiscal years 2010 through 2016, our valuation allowance reserve was set at 100% of the deferred tax asset for the years 2014 through 2018 for a net carrying value of zero. As of September 29, 2019, we reviewed the deferred tax assets and determined it was more likely than not that we would be able to utilize at least \$1.4 million of the deferred tax asset balance. Our assumptions were based on the last three years earning trend as well as anticipated future earnings expected with the increases in U.S defense and Foreign Military market spending projections. Release of the \$1.4 million against the valuation allowance resulted in the recognition of a tax benefit for the twelve months ended September 29, 2019. We will continue to review the deferred tax assets and related valuation reserves in accordance with ASC 740 on an annual basis.

Leases: In February 2016, FASB issued ASU 2016-02—*Leases (Topic 842)*. The update is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. As such, Optex Systems Holdings is required to adopt these provisions as of the fiscal year beginning on September 30, 2019. Optex Systems Holdings has two significant operating facilities leases which extend beyond twelve months and fall under the guidance of ASC Topic 842. Optex Systems Holdings is currently evaluating the impact of FASB ASU 2016-02 and expects the adoption thereof will have a material effect on Optex Systems Holdings' presentation of balance sheet assets and liabilities based on the present value of future lease payments, but does not expect a material effect on the presentation of expenses and cash flows. The Company has elected the date of initial application of September 30, 2019, as the beginning of the period of adoption. Based on the initial assessment, the Company anticipates the change will result in recognition of a right-of-use asset and a corresponding lease liability of approximately \$1.7 million, representing the present value of future lease payments for the term of both segment facility leases and which assumes the exercise of a five year renewal option at the Applied Optics Center as of November 1, 2021.

Recent Accounting Pronouncements

Recent Accounting Pronouncements are detailed under Note 3 of Item 8 "Financial Statements and Supplementary Data" of this report.

Cautionary Factors That May Affect Future Results

This Report on Form 10-K and other written reports and oral statements made from time to time by Optex Systems Holdings may contain so-called “forward-looking statements,” all of which are subject to risks and uncertainties. You can identify these forward-looking statements by their use of words such as “expects,” “plans,” “will,” “estimates,” “forecasts,” “projects” and other words of similar meaning. You can identify them by the fact that they do not relate strictly to historical or current facts. These statements are likely to address Optex Systems Holdings’ growth strategy, financial results and product and development programs. You must carefully consider any such statement and should understand that many factors could cause actual results to differ from Optex Systems Holdings’ forward-looking statements. These factors include inaccurate assumptions and a broad variety of other risks and uncertainties, including some that are known and some that are not. No forward-looking statement can be guaranteed and actual future results may vary materially.

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

Item 8 Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Optex Systems Holdings, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Optex Systems Holdings, Inc. and subsidiaries (the “Company”), as of September 29, 2019 and September 30, 2018, and the related consolidated statements of operations, stockholders’ equity, and cash flows for the years then ended, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of September 29, 2019 and September 30, 2018, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Whitley Penn LLP

We have served as the Company’s auditor since 2017.

Fort Worth, Texas
December 16, 2019

Optex Systems Holdings, Inc.
Condensed Consolidated Balance Sheets

(Thousands, except share and per share data)
September 29, 2019 September 30, 2018

ASSETS			
Cash and Cash Equivalents	\$	1,068	\$ 1,133
Accounts Receivable, Net		3,066	2,458
Inventory, Net		10,535	7,639
Prepaid Expenses		348	104
Current Assets		15,017	11,334
Property and Equipment, Net		1,102	1,300
Other Assets			
Deferred Tax Asset		1,414	-
Prepaid Royalties		-	30
Security Deposits		23	23
Other Assets		1,437	53
Total Assets	\$	17,556	\$ 12,687
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current Liabilities			
Accounts Payable	\$	1,833	\$ 943
Federal Income Taxes Payable		-	22
Accrued Expenses		1,180	1,169
Accrued Warranties		46	101
Customer Advance Deposits		3	308
Credit Facility		250	300
Current Liabilities		3,312	2,843
Warrant Liability		2,036	3,500
Total Liabilities		5,348	6,343
Commitments and Contingencies			
Stockholders' Equity			
Common Stock – (\$0.001 par, 2,000,000,000 authorized, 8,436,422 and 8,333,353 shares issued and outstanding, respectively)		8	8
Additional Paid in capital		26,134	25,938
Accumulated Deficit		(13,934)	(19,602)
Stockholders' Equity		12,208	6,344
Total Liabilities and Stockholders' Equity	\$	17,556	\$ 12,687

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

Optex Systems Holdings, Inc.
Condensed Consolidated Statements of Operations

	(Thousands, except share and per share data)	
	Twelve months ended	
	September 29, 2019	September 30, 2018
Revenue	\$ 24,530	\$ 20,853
Cost of Sales	18,277	16,338
Gross Margin	6,253	4,515
General and Administrative Expense	3,056	3,029
Operating Income	3,197	1,486
Gain on Change in Fair Value of Warrants	1,344	95
Interest Expense	(23)	(20)
Other Income	1,321	75
Income Before Taxes	4,518	1,561
Income Tax (Benefit) Expense, net	(1,150)	167
Net income	\$ 5,668	\$ 1,394
Dividends declared on participating securities	-	(178)
Deemed dividends on participating securities	(1,868)	(286)
Net income applicable to common shareholders	\$ 3,800	\$ 930
Basic income per share	\$ 0.45	\$ 0.11
Weighted Average Common Shares Outstanding - basic	8,388,794	8,458,466
Diluted income per share	\$ 0.45	\$ 0.11
Weighted Average Common Shares Outstanding - diluted	8,492,884	8,795,799

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

Optex Systems Holdings, Inc.
Consolidated Statements of Cash Flows

	(Thousands)	
	Twelve months ended	
	September 29, 2019	September 30, 2018
Cash Flows from Operating Activities:		
Net Income	\$ 5,668	\$ 1,394
Adjustments to Reconcile Net Income to Net Cash provided by (used in) Operating Activities:		
Depreciation and Amortization	340	327
(Gain) on Change in Fair Value of Warrants	(1,344)	(95)
Stock Compensation Expense	113	153
Deferred Tax	(1,414)	-
(Gain) On Sale of Fixed Assets	(7)	-
Accounts Receivable	(608)	666
Inventory, net	(2,896)	(75)
Prepaid Expenses	(243)	(41)
Accounts Payable and Accrued Expenses	903	(700)
Federal Income Taxes Payable	(22)	22
Accrued Warranty Costs	(55)	(73)
Prepaid Royalties	30	30
Customer Advance Deposits	(305)	(619)
Total Adjustments	(5,508)	(355)
Net Cash provided by Operating Activities	160	1,039
Cash Flows (used in) provided by Investing Activities		
Purchases of Property and Equipment	(143)	(167)
Proceeds From Sale of Fixed Assets	8	-
Net Cash used in Investing Activities	(135)	(167)
Cash Flows (used in) provided by Financing Activities		
Dividends Paid	-	(784)
Cash Paid for Taxes Withheld On Net Settled Restricted Stock Unit Share Issue	(37)	(30)
Payments on Credit Facility	(50)	-
Proceeds From Warrant Exercise	72	93
Warrant Repurchase	(75)	-
Stock Repurchase	-	(700)
Net Cash used in Financing Activities	(90)	(1,421)
Net Decrease in Cash and Cash Equivalents	(65)	(549)
Cash and Cash Equivalents at Beginning of Year	1,133	1,682
Cash and Cash Equivalents at End of Year	\$ 1,068	\$ 1,133
Supplemental Cash Flow Information:		
Non Cash Transactions:		
Exchange of Preferred Stock for Common Stock	\$ -	\$ 870
Correction for Warrants	-	41
Cash Transactions:		
Cash Paid for Taxes	360	144
Cash Paid for Interest	23	20

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

Optex Systems Holdings, Inc.
Consolidated Statement of Stockholders' Equity

	(Thousands, except share data)					Total Stockholders Equity
	Common Shares Outstanding	Series C Preferred Shares	Common Stock	Additional Paid in Capital	Retained Earnings	
Balance at October 1, 2017	8,190,101	174	\$ 8	\$ 26,411	\$ (20,473)	\$ 5,946
Stock Compensation Expense	-	-	-	153	-	153
Vested restricted stock units issued net of tax withholding	55,902	-	-	(30)	-	(30)
Conversions of Series C Preferred Shares	725,000	(174)	1	(1)	-	-
Stock Buyback and Cancellation	(700,000)	-	(1)	(700)	-	(701)
Declared Dividends	-	-	-	-	(523)	(523)
Correction for Warrants ⁽¹⁾	-	-	-	(41)	-	(41)
Exercise of Warrants for Common Shares at \$1.50 ⁽²⁾	62,350	-	-	146	-	146
Net income	-	-	-	-	1,394	1,394
Balance at September 30, 2018	8,333,353	-	\$ 8	\$ 25,938	\$ (19,602)	\$ 6,344
Stock Compensation Expense	-	-	-	113	-	113
Vested restricted stock units issued net of tax withholding	55,565	-	-	(37)	-	(37)
Exercise of Warrants for Common Shares at \$1.50 ⁽³⁾	47,504	-	-	120	-	120
Net income	-	-	-	-	5,668	5,668
Balance at September 29, 2019	8,436,422	-	\$ 8	\$ 26,134	\$ (13,934)	\$ 12,208

(1) Correction related to 197,935 outstanding warrants issued to underwriters for August 26, 2016 public offering

(2) Exercise of warrants for gross proceeds of \$93 thousand and a warrant liability fair market value of \$53 thousand as of the exercise date

(3) Exercise of warrants for gross proceeds of \$72 thousand and a warrant liability fair market value of \$48 thousand as of the exercise date.

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

Note 1 — Organization and Operations

Optex Systems Holdings, Inc. (“the Company”) manufactures optical sighting systems and assemblies for the U.S. Department of Defense, foreign military applications and commercial markets. 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 or commercial customers. Optex Systems Holdings’ operations are based in Dallas and Richardson, Texas in leased facilities comprising 93,967 square feet. As of September 29, 2019, the Company operated with 101 full-time equivalent employees.

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.

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.

Segment Reporting: FASB ASC 280 requires that a public business enterprise report financial and descriptive information about its reportable operating segments. Operating segments are components of an enterprise about which separate financial information is available and evaluated regularly by the chief operating decision maker in decisions regarding resource allocations and performance assessments. Generally, financial information is required to be reported on the basis that it is used internally for evaluating segment performance and deciding how to allocate resources to segments. Segments are determined based on differences in products, internal reporting and how operational decisions are made. Management has determined that the Optex Systems, Richardson plant, and the Applied Optics Center, Dallas plant are separately managed, organized, and internally reported as separate business segments. The FASB ASC 280 requires that a public business enterprise report a measure of segment profit or loss, certain specific revenue and expense items, and segment assets. It requires reconciliations of total segment revenues, total segment profit or loss, total segment assets, and other amounts disclosed for segments to corresponding amounts in the enterprise’s general-purpose financial statements.

Fiscal Year: Optex System Holdings’ fiscal year ends on the Sunday nearest September 30. Fiscal year 2019 ended on September 29, 2019 and included 52 weeks. Fiscal year 2018 ended on September 30, 2018 and included 52 weeks.

Fair Value of Financial Instruments: Fair value estimates discussed herein are based upon certain market assumptions and pertinent information available to management as of the financial statement presentation date.

The carrying value of cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, are carried at, or approximate, fair value as of the reporting date because of their short-term nature. The credit facility is reported at fair value as it bears market rates of interest. Fair values for the Company’s warrant liabilities and derivatives are estimated by utilizing valuation models that consider current and expected stock prices, volatility, dividends, market interest rates, forward yield curves and discount rates. Such amounts and the recognition of such amounts are subject to significant estimates that may change in the future.

The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value and requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs reflecting the reporting entity's own assumptions.

The accounting guidance establishes a hierarchy which requires an entity to maximize the use of quoted market prices and minimize the use of unobservable inputs. An asset or liability's level is based on the lowest level of input that is significant to the fair value measurement. Fair value estimates are reviewed at the origination date and again at each applicable measurement date and interim or annual financial reporting dates, as applicable for the financial instrument, and are based upon certain market assumptions and pertinent information available to management at those times.

Each of the measurements is considered a Level 3 measurement based on the availability of market data and inputs and the significance of any unobservable inputs as of the measurement date. The methods and significant inputs and assumptions utilized in estimating the fair value of the warrant liabilities, as well as the respective hierarchy designations are discussed further in Note 12 "Warrant Liabilities".

Cash and Cash Equivalents: For financial statement presentation purposes, Optex Systems Holdings considers those short-term, highly liquid investments with original maturities of three months or less to be cash or cash equivalents. Optex Systems Holdings has \$1,068 thousand in cash on deposit with our bank. Only a portion of the cash, currently \$250 thousand, would be covered by federal deposit insurance and the uninsured balances are substantially greater than the insured amounts.

Concentration of Credit Risk: The Company's revenues for fiscal year ended September 29, 2019 are derived from sales to U.S. government agencies (60%), one major U.S. defense contractor (22%), one major commercial customer (7%) and all other customers (11%). The Company's revenues for fiscal year ended September 30, 2018 are derived from sales to U.S. government agencies (38%), one major U.S. defense contractor (29%), one major commercial customer (20%) and all other customers (13%). Optex Systems Holdings does not believe that this concentration results in undue credit risk because of the financial strength of the obligees.

Accounts Receivable: Optex Systems Holdings records its accounts receivable at the original sales invoice amount less liquidations for previously collected advance/progress bills and an allowance for doubtful accounts. An account receivable is considered to be past due if any portion of the receivable balance is outstanding beyond its scheduled due date. On a quarterly basis, Optex Systems Holdings evaluates its accounts receivable and establishes an allowance for doubtful accounts, based on its history of past write-offs and collections, and current credit conditions. No interest is accrued on past due accounts receivable. As of September 29, 2019 and September 30, 2018, Optex Systems Holdings had an allowance for doubtful accounts of \$5 thousand, for non U.S. government account balances greater than 120 days. As the customer base is primarily U.S. government and government prime contractors, Optex Systems Holdings allowance for doubtful accounts is minimal. Optex Systems Holdings charges uncollectible accounts to bad debt expense in the period as they are first deemed uncollectible. In the fiscal year 2019 we recognized \$4 thousand in bad debt expenses associated with uncollectible accounts. In the fiscal year 2018 we recognized \$3 thousand in bad debt expenses associated with uncollectible accounts.

As of September 29, 2019, 85% of the accounts receivable balance was comprised of four customers: the U.S. government, 41%, two major defense contractors, 25% and 13%, and a commercial customer, 6%. As of September 30, 2018, 88% of the accounts receivable balance was comprised of three customers: the U.S. government, 25%, a major defense contractor, 53%, and a commercial customer, 10%.

Inventory: Inventory is recorded at the lower of cost or net realizable value, and adjusted as appropriate 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. As of September 29, 2019 and September 30, 2018 inventory included:

	(Thousands)	
	As of September 29, 2019	As of September 30, 2018
Raw Materials	\$ 7,395	\$ 5,580
Work in Process	3,599	3,478
Finished Goods	254	254
Gross Inventory	11,248	9,312
Less: Inventory Reserves	(713)	(1,673)
Net Inventory	\$ 10,535	\$ 7,639

In the twelve months ended September 29, 2019 Optex Systems physically disposed of \$959 thousand of obsolete and excess inventories against the reserve balance and made other reserve adjustments of \$1 thousand. Net Inventory increased by \$2.9 million in support of new customer orders deliverable in the 2020 fiscal year.

Warranty Costs: Some of Optex Systems Holdings' customers require that the Company warrant the quality of its products to meet customer requirements and be free of defects for up to twelve months subsequent to delivery. Future warranty costs are based on the estimated cost of replacement for expected returns based upon our most recent experience rate of defects as a percentage of warranty covered sales. Throughout the year, warranty costs are expensed as incurred, and as of each year end, Optex Systems Holdings reviews the prior 12 month warranty experience rate and may adjust the warranty accrual as required to cover any estimated warranty expenses associated the period end backlog of returned customer units awaiting repair or replacement plus any estimated warranty expenses related to anticipated future returns on previous deliveries. As of September 29, 2019 and September 30, 2018, the existing warranty reserve balances of \$46 thousand and \$101 thousand, respectively, were reviewed and determined to be adequate to satisfy any future warranty claims that may have existed as of the end of each fiscal year for shipments occurring in the prior 12 months. The decrease in warranty reserves represents a reduction in the estimated returns on current year deliveries and a reduction in the ending backlog of warranty returns awaiting repairs or replacement for quality issues encountered on our Applied Optics Center optical assemblies. We have made numerous improvements to our supplier bases and internal production process to reduce the return rate on future shipments but will continue to review and monitor the reserve balances related to this product line against any existing warranty backlog and current trend data as we repair and replace our current warranty backlog and process future warranty returns.

The table below summarizes the warranty expenses and incurred warranty costs for the twelve months ended September 29, 2019 and September 30, 2018.

	Years ended	
	2019	2018
Beginning balance	\$ 101	\$ 174
Incurred costs for warranties satisfied during the period	(115)	(346)
Warranty Expenses:		
Warranties reserved for new product shipped during the period ⁽¹⁾	86	175
Change in estimate for pre-existing warranty liabilities ⁽²⁾	(26)	98
Warranty Expense	60	273
Ending balance	\$ 46	\$ 101

(1) Warranty expenses accrued to cost of sales (based on current period shipments and historical warranty return rate).

(2) Changes in estimated warranty liabilities recognized in cost of sales associated with: the period end customer returned warranty backlog, or the actual costs of repaired/replaced warranty units which were shipped to the customer during the current period.

Property and Equipment: Property and equipment are recorded at cost. Depreciation is computed using the straight line method over the estimated useful lives of the assets, ranging from three to seven years. Expenditures for renewals and betterments are capitalized. Expenditures for minor items, repairs and maintenance are charged to operations as incurred. Gain or loss upon sale or retirement due to obsolescence is reflected in the operating results in the period the event takes place.

Leases: In February 2016, FASB issued ASU 2016-02—*Leases (Topic 842)*. The update is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. As such, Optex Systems Holdings is required to adopt these provisions as of the fiscal year beginning on September 30, 2019. Optex Systems Holdings has two significant operating facilities leases which extend beyond twelve months and fall under the guidance of ASC Topic 842. Optex Systems Holdings is currently evaluating the impact of FASB ASU 2016-02 and expects the adoption thereof will have a material effect on Optex Systems Holdings' presentation of balance sheet assets and liabilities based on the present value of future lease payments, but does not expect a material effect on the presentation of expenses and cash flows. The Company has elected the date of initial application of September 30, 2019, as the beginning of the period of adoption. Based on the initial assessment, the Company anticipates the change will result in recognition of a right-of-use asset and a corresponding lease liability of approximately \$1.7 million, representing the present value of future lease payments for the term of both segment facility leases and which assumes the exercise of a five year renewal option at the Applied Optics Center as of November 1, 2021. See also Note 7.

Revenue Recognition: As of fiscal year beginning on October 1, 2018, the Company has adopted FASB ASC 606—Revenue from Contracts with Customers, which is required for public business entities for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The Company has selected a modified retrospective application of the standard for all periods presented as of the October 1, 2018 implementation date. The new revenue recognition standard requires revenue recognition based on a five-step model that includes: identifying the contract, identifying the performance obligations, determining the transaction price, allocating the transaction price and recognizing the revenue. The standard results in the recognition of revenue depicting the transfer of promised goods or services to customers in an amount reflecting the expected consideration to be received from the customer for such goods and services, based on the satisfaction of performance obligations, occurring when the control of the goods or services transfer to the customer. The majority of the Company's contracts and customer orders originate with fixed determinable unit prices for each deliverable quantity of goods defined by the customer order line item (performance obligation) and include the specific due date for the transfer of control and title of each of those deliverables to the customer at pre-established payment terms, which are generally within thirty to sixty days from the transfer of title and control. We have elected to account for shipping and handling costs as fulfillment costs after the customer obtains control of the goods. In addition, the Company has one ongoing service contract which began in October 2017 which relates to optimized weapon system support (OWSS) and includes ongoing program maintenance, repairs and spare inventory support for the customer's existing fleet units in service over a three year period. Revenue recognition for this program has been recorded by the Company, and compensated by the customer, at fixed monthly increments over time, consistent with the defined contract maintenance period.

The adoption of the ASC 606 revenue standard had no material effect on the financial statement presentation on a retrospective or prospective basis for the twelve month annual and comparative period covered through the current year end date September 29, 2019. The Company believes its previous recognition policy as related to the production contracts ("units of delivery"), and maintenance contract ("passage of time"), are consistent with the new revenue recognition standard defined within FASB ASC 606 which requires unique performance obligations be recognized upon satisfaction of the customers' own performance obligation at the point in time when the control of goods is transferred to the customer, or over time as the customer benefits from provided maintenance and support services. The Company has on occasion, outside of the presented periods, received selective contract awards and modifications which included substantive milestone performance obligations, contract modifications, negotiated settlements and financing arrangements which could fall within the scope of the new revenue recognition guidance on reoccurrence, and as such, the Company has expanded their contract review process to ensure any new contract awards, changes, modifications, financing arrangements or potential negotiated settlements are recorded in compliance to the new standard guidance.

During the twelve months ended September 29, 2019 there was \$289 of revenue recognized during the period from customer deposit liabilities (deferred contract revenue), and \$19 thousand of customer deposits refunded to the customer on order cancellation. As of September 29, 2019 there is \$3 thousand in customer deposit liabilities. As of the twelve months ended September 29, 2019, there are no significant contract costs such as sales commissions or costs deferred.

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 September 29, 2019 and September 30, 2018, Optex Systems, Inc. had a balance of \$3 thousand and \$308 thousand, respectively, in customer advance deposits. Customer deposits as of September 29, 2019 represent advance customer credit card payments for product yet to be delivered. The customer deposit balance as of September 30, 2018 was related to contracts for our sighting system product line.

Government Contracts: Many of Optex Systems Holdings' contracts are prime or subcontracted directly with the Federal government and as such, are subject to Federal Acquisition Regulation (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 prime military contracts and are generally, "flowed down" to Optex Systems Holdings as subcontractors on other military business. It has been Optex Systems Holdings' experience that the termination for convenience is rarely invoked, except where it has been mutually beneficial for both parties. Optex Systems Holdings is not currently aware of any pending terminations for convenience or default on its existing contracts.

Impairment or Disposal of Long-Lived Assets: Optex Systems Holdings follows the provisions of FASB ASC 360-10, "Accounting for the Impairment or Disposal of Long-lived Assets". This standard requires, among other things, that long-lived assets be reviewed for potential impairment whenever events or circumstances indicate that the carrying amounts may not be recoverable. The assessment of possible impairment is based on the ability to recover the carrying value of the asset from the expected future pre-tax cash flows (undiscounted and without interest charges) of the related operations. If these cash flows are less than the carrying value of such assets, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires management to estimate future cash flows and the fair value of long-lived assets. No impairment of long-lived assets was recorded for the periods presented.

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.

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 Optex Systems Holdings will not realize tax assets through future operations. When assessing the recoverability of deferred tax assets, management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies and results of recent operations. Based on those estimates, management has determined that a portion of the deferred tax assets may not be realized and has established a valuation allowance against the deferred tax asset balance. We record uncertain tax positions in accordance with ASC 740 on the basis of a two-step process in which (1) we determine whether it is more likely than not that the tax positions will be sustained on the basis of the technical merits of the position and (2) for those tax positions that meet the more-likely-than-not recognition threshold, we recognize the largest amount of tax benefit that is more than 50 percent likely to be realized upon ultimate settlement with the related tax authority.

As of September 29, 2019 Optex Systems Inc. has a net carrying value of \$1.4 million in deferred tax assets represented by deferred tax assets of \$2.4 million and a deferred tax asset valuation allowance of (\$1.0) million against those assets. Due to historical losses resulting in a Net Operating Loss Carryforward for each of the fiscal years 2010 through 2016, our valuation allowance reserve was set at 100% of the deferred tax asset for the years 2014 through 2018 for a net carrying value of zero. As of September 29, 2019, we reviewed the deferred tax assets and determined it was more likely than not that we would be able to utilize at least \$1.4 million of the deferred tax asset balance. Our assumptions were based on the last three years earning trend as well as anticipated future earnings expected with the increases in U.S defense and Foreign Military market spending projections. Release of the \$1.4 million against the valuation allowance resulted in the recognition of a tax benefit for the twelve months ended September 29, 2019. We will continue to review the deferred tax assets and related valuation reserves in accordance with ASC 740 on an annual basis.

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 twelve months ended September 29, 2019, 216,500 unvested restricted stock units (which converts to 104,101 incremental dilutive shares) were included in the diluted earnings per share calculation as dilutive, and 4,125,200 warrants and 25,000 stock options were excluded as anti-dilutive. For the twelve months ended September 30, 2018, 4,260,785 warrants and 59,980 stock options were excluded as anti-dilutive as the instruments were "Out of the money" and not exercisable during the year and 325,000 series C preferred shares that were converted to common shares throughout the year (which converts to 314,492 incremental dilutive shares) and 82,500 unvested restricted stock units (which converts to 22,841 incremental dilutive shares) were included in the diluted earnings per share as dilutive.

A significant number of our outstanding warrants during the twelve months ended September 29, 2019 and September 30, 2018, and previously outstanding series C preferred shares during the twelve months ending September 30, 2018, are participating securities which share dividend distributions and the allocation of any undistributed earnings (deemed dividends) with our common shareholders. During the twelve months ended September 29, 2019, there were no declared dividends and allocated undistributed earnings of \$1.9 million attributable to the participating warrants. During the twelve months ended September 30, 2018, declared dividends of \$178 thousand was attributable to participating warrants and series C shareholders and there was \$286 thousand in undistributed earnings attributable to participating securities during the respective periods.

Note 3 — Recent Accounting Pronouncements

In August 2018, the SEC adopted the final rule under SEC Release No. 33-10532, Disclosure Update and Simplification, amending certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. The rule eliminates certain disclosure requirements while adding or modifying others. One of the amendments relates to changes in stockholders' equity for interim periods. The final rule extends to interim periods the annual disclosure requirement in SEC Regulation S-X, Rule 3-04, of presenting (1) changes in stockholders' equity and (2) the amount of dividends per share for each class of shares. An analysis of changes in stockholders' equity will now be required for the current and comparative year-to-date interim periods. The analysis should present a reconciliation of the beginning balance to the ending balance of each period for which a statement of comprehensive income is required to be filed. This final rule was effective on November 5, 2018. The Company has determined that the impact of this guidance on its presentation of consolidated financial statements is immaterial.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement (“ASU 2018-13”). ASU 2018-13 modifies the disclosure requirements on recurring and nonrecurring fair value measurements in Topic 820. The amendments in the update are effective for all entities for fiscal years and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted. As such Optex Systems Holdings is required to adopt these provisions as of the fiscal year beginning on September 28, 2020. Entities are permitted to early adopt any removed or modified disclosure upon issuance of ASU 2018-13 and delay adoption of the additional disclosures until their effective date. We do not anticipate any material impact on our financial statement disclosures as a result of the amendment and are currently assessing the changes in disclosure requirements as applicable for the potential of early adoption.

In May 2017, the FASB issued ASU 2017-09, Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting (“ASU 2017-09”). ASU 2017-09 provides clarity and reduce both (1) diversity in practice and (2) cost and complexity when applying the guidance in Topic 718, Compensation—Stock Compensation, to a change to the terms or conditions of a share-based payment award. The amendments in this update provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. The amendments in this update are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted. As such, Optex Systems Holdings adopted these provisions as of the fiscal year beginning on October 1, 2018. There was no material impact on our consolidated financial statements and results of operations as a result of the October 1, 2018 adoption of ASU 2017-09.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). ASU 2016-15 reduces diversity in practice in how certain transactions are classified in the statement of cash flows. The amendments in ASU 2016-15 provide guidance on specific cash flow issues including debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, and distributions received from equity method investees. ASU 2016-15 is effective for annual and interim periods beginning after December 15, 2017. As such, Optex Systems Holdings adopted these provisions as of the fiscal year beginning on October 1, 2018. There was no material impact of ASU 2016-15 on our consolidated financial statements and results of operations as a result of the October 1, 2018 adoption of ASU 2016-15.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (“ASU 2016-13”). ASU 2016-13 changes the impairment model for most financial assets and certain other instruments, including trade and other receivables, held-to-maturity debt securities and loans, and requires entities to use a new forward-looking expected loss model that will result in the earlier recognition of allowance for losses. This update is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for a fiscal year beginning after December 15, 2018, including interim periods within that fiscal year. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. As such, Optex Systems Holdings is required to adopt these provisions as of the fiscal year beginning on September 30, 2019. We do not expect any material impact on our consolidated financial statements and results of operations as a result of adopting ASU 2016-13.

In February 2016, FASB issued ASU 2016-02—*Leases (Topic 842)*. The update is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application of the amendments in this update is permitted. As such, Optex Systems Holdings is required to adopt these provisions as of the fiscal year beginning on September 30, 2019. Optex Systems Holdings is currently evaluating the impact of FASB ASU 2016-02 and expects the adoption thereof will have a material effect on Optex Systems Holdings' presentation of balance sheet assets and liabilities based on the present value of future lease payments, but does not expect a material effect on the presentation of expenses and cash flows. The Company has elected the date of initial application of September 30, 2019, as the beginning of the period of adoption and does not intend to restate the comparative periods for the year ending September 29, 2019. Based on the initial assessment, the Company anticipates the change will result in recognition of a right-of-use asset and a corresponding lease liability of approximately \$1.7 million, representing the present value of future lease payments for the term of both segment facility leases and which assumes the exercise of a five year renewal option at the Applied Optics Center as of November 1, 2021. See also Note 7.

Note 4 Segment Reporting

The Company's reportable segments are strategic businesses offering similar products to similar markets and customers; however, the companies are operated and managed separately due to differences in manufacturing technology, equipment, geographic location, and specific product mix. Applied Optics Center was acquired as a unit, and the management at the time of the acquisition was retained. Both the Applied Optics Center and Optex Systems – Richardson operate as reportable segments under the Optex Systems, Inc. corporate umbrella.

The Applied Optics Center segment also serves as the key supplier of laser coated filters used in the production of periscope assemblies for the Optex Systems-Richardson ("Optex Systems") segment. Intersegment sales and transfers are accounted for at annually agreed to pricing rates based on estimated segment product cost, which includes segment direct manufacturing and general and administrative costs, but exclude profits that would apply to third party external customers.

Optex Systems (OPX) – Richardson, Texas

Optex Systems revenues are primarily in support of prime and subcontracted military customers. Approximately 92% of the Optex Systems segment revenue is comprised of domestic military customers, and 8% is comprised of foreign military customers. The Optex Systems segment revenue from the U.S. government and one other major U.S. defense contractor represent approximately 45% and 18% of the Company's consolidated revenue, respectively.

Optex Systems is located in Richardson Texas, with leased premises consisting of approximately 49,100 square feet. As of September 29, 2019, the Richardson facility operated with 66 full time equivalent employees in a single shift operation. Optex Systems, Richardson serves as the home office for both the Optex Systems and Applied Optics Center segments.

Applied Optics Center (AOC) – Dallas, Texas

The Applied Optics Center serves primarily domestic U.S. customers. Sales to commercial customers represent 23% and military sales to prime and subcontracted customers represent 77% of the total segment revenue. Approximately 83% of the AOC revenue is derived from external customers and approximately 17% is related to intersegment sales to Optex Systems in support of military contracts. The AOC segment revenue from the U.S. government represents approximately 15%, revenue from one major commercial customer represents approximately 7%, and revenue from one large defense contractor represents approximately 5% of the Company's consolidated revenue.

The Applied Optics Center is located in Dallas, Texas with leased premises consisting of approximately 44,867 square feet of space. As of September 29, 2019, AOC operated with 35 full time equivalent employees in a single shift operation.

The financial table below presents the information for each of the reportable segments profit or loss as well as segment assets for each year. The Company does not allocate interest expense, income taxes or unusual items to segments.

Reportable Segment Financial Information
(thousands)

Twelve months ended September 29, 2019

	Optex Systems Richardson	Applied Optics Center Dallas	Other (non-allocated costs and intersegment eliminations)	Consolidated Total
Revenues from external customers	\$ 16,219	\$ 8,311	\$ -	\$ 24,530
Intersegment revenues	-	1,712	(1,712)	-
Total Revenue	\$ 16,219	\$ 10,023	\$ (1,712)	\$ 24,530
Interest expense	\$ -	\$ -	\$ 23	\$ 23
Depreciation and Amortization	\$ 29	\$ 311	\$ -	\$ 340
Income before taxes	\$ 2,019	\$ 1,291	\$ 1,208	\$ 4,518
Other significant noncash items:				
Allocated home office expense	\$ (684)	\$ 684	\$ -	\$ -
Gain on change in fair value of warrants	\$ -	\$ -	\$ (1,344)	\$ (1,344)
Stock compensation expense	\$ -	\$ -	\$ 113	\$ 113
Royalty expense amortization	\$ 30	\$ -	\$ -	\$ 30
Warranty expense	\$ -	\$ 60	\$ -	\$ 60
Segment Assets	\$ 11,570	\$ 5,986	\$ -	\$ 17,556
Expenditures for segment assets	\$ 47	\$ 96	\$ -	\$ 143

Reportable Segment Financial Information
(thousands)

Twelve months ended September 30, 2018

	Optex Systems Richardson	Applied Optics Center Dallas	Other (non-allocated costs and intersegment eliminations)	Consolidated Total
Revenues from external customers	\$ 12,739	\$ 8,114	\$ -	\$ 20,853
Intersegment revenues	-	1,556	(1,556)	-
Total Revenue	\$ 12,739	\$ 9,670	\$ (1,556)	\$ 20,853
Interest expense	\$ -	\$ -	\$ 20	\$ 20
Depreciation and Amortization	\$ 39	\$ 288	\$ -	\$ 327
Income (loss) before taxes	\$ 882	\$ 757	\$ (78)	\$ 1,561
Other significant noncash items:				
Allocated home office expense	\$ (669)	\$ 669	\$ -	\$ -
Gain on change in fair value of warrants	\$ -	\$ -	\$ (95)	\$ (95)
Stock option compensation expense	\$ -	\$ -	\$ 153	\$ 153
Royalty expense amortization	\$ 30	\$ -	\$ -	\$ 30
Warranty Expense	\$ -	\$ 273	\$ -	\$ 273
Segment Assets	\$ 8,343	\$ 4,344	\$ -	\$ 12,687
Expenditures for segment assets	\$ 54	\$ 113	\$ -	\$ 167

Note 5 — Property and Equipment

A summary of property and equipment at September 29, 2019 and September 30, 2018 is as follows:

	Estimated Useful Life	(Thousands)	
		Year Ended September 29, 2019	Year Ended September 30, 2018
Property and Equipment			
Furniture and Fixtures	3-5 yrs	\$ 378	\$ 378
Machinery and Equipment	5 yrs	3,650	3,521
Leasehold Improvements	7 yrs	276	276
Less: Accumulated Depreciation		(3,202)	(2,875)
Net Property & Equipment		\$ 1,102	\$ 1,300
<i>Depreciation Expense</i>		\$ 340	\$ 327

During the twelve months ended September 29, 2019, Optex Systems Holdings' purchased \$143 thousand in new machinery and equipment. During the twelve months ended September 29, 2019, Optex recorded proceeds on the sale of fixed assets of \$8 thousand for the sale of \$14 thousand in machinery and equipment with a net book carrying value of \$1 thousand generating a gain on sale of \$7 thousand. During the twelve months ended September 30, 2018, Optex Systems Holdings' purchased \$10 thousand and \$157 thousand in new furniture and fixtures and new machinery and equipment, respectively. There were no sales or retirements of property and equipment during the twelve month period ended September 30, 2018.

Note 6 — Accrued Expenses

The components of accrued liabilities for the years ended September 29, 2019 and September 30, 2018 are summarized below:

	Thousands	
	Year Ended September 29, 2019	Year Ended September 30, 2018
Deferred Rent Expense	\$ 83	\$ 111
Accrued Vacation	361	345
Property Taxes	113	111
Operating Expenses	476	470
Payroll & Payroll Related	147	132
Total Accrued Expenses	\$ 1,180	\$ 1,169

Note 7 — Commitments and Contingencies*Rental Payments under Non-cancelable Operating Leases*

Optex Systems Holdings leases its office and manufacturing facilities for the Optex Systems, Inc., Richardson address and the Applied Optics Center Dallas address, under non-cancellable operating leases.

The leased facility under Optex Systems Inc. at 1420 Presidential Drive, Richardson, Texas consists of 49,100 square feet of space and expires March 31, 2021. Pursuant to the terms of the most recent amendment to the Richardson site facilities lease, there was no base rent payment due from January 1, 2014 through March 31, 2014, with payments beginning April 2014. The monthly base rent was \$23.0 thousand through March 31, 2019, and annual rental payment inflationary increases between 3.4% and 4.8% occurring April 1, each year. The monthly rent includes approximately \$10.4 thousand for additional Common Area Maintenance fees and taxes (CAM), to be adjusted annually based on actual expenses incurred by the landlord.

The leased facility under the Applied Optics Center at 9839 and 9827 Chartwell Drive, Dallas, Texas, consists of 44,867 square feet of space at the premises. On November 17, 2016, we received a countersigned new lease for the Applied Optics Center from the landlord, dated October 21, 2016, and which commenced retroactive to October 1, 2016. The new lease term will expire on October 31, 2021, with two renewal options available to the tenant, each with a renewal term duration of five years. The monthly base rent was \$20.0 thousand through September 30, 2018 and escalates approximately 3% October 1, each year thereafter through 2021. The lease includes a one month base rent abatement for October 1 through October 31, 2016 for \$19.4 thousand. The monthly rent includes approximately \$6.4 thousand for additional Common Area Maintenance fees and taxes (CAM), to be adjusted annually based on actual expenses incurred by the landlord. Our obligations to make payments under the lease are secured by a \$250,000 standby letter of credit which was reduced to \$125,000 on October 31, 2019.

As of September 29, 2019 the unamortized deferred rent was \$83 thousand as compared to \$111 thousand as of September 30, 2018. Deferred rent expense is amortized monthly over the life of the leases.

As of September 29, 2019, the remaining minimum base lease and estimated common area maintenance (CAM) payments under the non-cancelable office and facility space leases are as follows:

Non-cancellable Operating Leases Minimum Payments

Fiscal Year	(Thousands)				Total Payments
	Optex Systems Richardson		Applied Optics Center Dallas		
	Lease Payments	CAM Estimate	Lease Payments	CAM Estimate	
2020	291	125	255	76	747
2021	147	65	262	78	552
2022	—	—	22	7	29
Total minimum lease payments	\$ 438	\$ 190	\$ 539	\$ 161	\$ 1,328

Total expense under both facility lease agreements for the twelve months ended September 29, 2019 was \$700 thousand. Total expense under both facility lease agreements as of the twelve months ended September 30, 2018 was \$688 thousand.

Note 8 — Debt Financing

Credit Facility — Avidbank

The Company amended its revolving credit facility with Avidbank pursuant to a Seventh Amendment to Amended and Restated Loan Agreement, dated as of April 5, 2018. The new renewable revolving maturity date is April 21, 2020. The facility provides up to \$2.2 million in financing against eligible receivables and is subject to meeting certain covenants including an asset coverage ratio test for up to twenty months. The material terms of the amended revolving credit facility are as follows:

- The interest rate for all advances shall be the then in effect prime rate plus 2.5% and is subject to a minimum interest payment requirement per six month period of \$10,000.
- Interest shall be paid monthly in arrears.

- The loan period is from April 5, 2018 through April 21, 2020 at which time any outstanding advances, and accrued and unpaid interest thereon, will be due and payable.
- 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.
- On April 21, 2018 and each anniversary thereof for so long as the Revolving Facility is in effect, the Company shall pay a facility fee equal to one half of one percent (0.5%) of the Revolving Line.
- The Company can maintain accounts at third party banks so long as the total in those other bank accounts does not exceed 20% of the total on deposit at Avidbank, and it shall remit to Avidbank monthly statements for all of those accounts within 30 days of the end of each month.

In order to meet the security requirement under the lease, we entered into a letter of credit with Avidbank on October 17, 2016 in the amount of \$250,000, which expires on October 17, 2019 and is renewable by us for successive one year periods unless the bank notifies us no later than 60 days prior to the end of the initial or any extended term that it shall not renew the letter of credit. Effective as of October 31, 2019 the letter of credit was reduced to \$125,000 pursuant to the lease terms.

As of September 29, 2019 and September 30, 2018, the outstanding principal balance on the line of credit was \$250 thousand and \$300 thousand, respectively. For the years ended September 29, 2019 and September 30, 2018, the total interest expense against the outstanding line of credit balance was \$23 thousand and \$20 thousand.

Note 9 — Stock Based Compensation

The Optex Systems Holdings 2009 Stock Option Plan provides for the issuance of up to 75,000 shares to Optex Systems Holdings officers, directors, employees and to independent contractors who provide services to Optex Systems Holdings as either incentive or nonstatutory stock options determined at the time of grant. As of September 29, 2019, Optex Systems Holdings has granted stock options to officers and employees as follows:

<u>Date of Grant</u>	<u>Options Granted</u>	<u>Exercise Price</u>	<u>Options Outstanding As of 09/29/19</u>	<u>Expiration Date</u>	<u>Vesting Period</u>
12/19/13	25,000	\$ 10.00	25,000	12/18/2020	4 years
Total	25,000		25,000		

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 Remaining Options	Weighted Average Fair Value	Weighted Average Life (Years)	Aggregate Value (Thousands)
Outstanding as of October 1, 2017	60,010	\$ —	2.03	\$ —
Granted – 2018	—	—	—	—
Forfeited – 2018	(30)	—	—	—
Exercised – 2018	—	—	—	—
Outstanding as of September 30, 2018	59,980	\$ —	1.03	\$ —
Granted – 2019	—	—	—	—
Forfeited – 2019	(34,980)	—	—	—
Exercised – 2019	—	—	—	—
Outstanding as of September 29, 2019	25,000	\$ —	1.47	\$ —
Exercisable as of September 30, 2018	59,980	\$ —	1.03	\$ —
Exercisable as of September 29, 2019	25,000	\$ —	1.47	\$ —

There were no options granted in the twelve months ended September 29, 2019 and September 30, 2018.

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 Options	Weighted-Average Grant Date Fair Value
Non-vested as of October 1, 2017	3,750	\$ 8.00
Non-vested granted — year ended September 30, 2018	—	—
Vested — year ended September 30, 2018	(3,750)	8.00
Forfeited — year ended September 30, 2018	—	—
Non-vested as of September 30, 2018	-0-	\$ 8.00
Non-vested granted — year ended September 29, 2019	—	—
Vested — year ended September 29, 2019	—	—
Forfeited — year ended September 29, 2019	—	—
Non-vested as of September 29, 2019	-0-	\$ —

Restricted Stock Units issued to Officers and Employees

On June 14, 2016, the Compensation Committee (“Committee”) of the Board of Directors of Optex Systems Holdings, Inc. approved the Company’s 2016 Restricted Stock Unit Plan (the “Plan”). The Plan provides for the issuance of stock units (“RSU”) for up to 1,000,000 shares of the Company’s common stock to Optex Systems Holdings officers and employees. Each RSU constitutes a right to receive one share of the Company’s common stock, subject to vesting, which unless otherwise stated in an RSU agreement, shall vest in equal amounts on the first, second and third anniversary of the grant date. Shares of the Company’s common stock underlying the number of vested RSUs will be delivered as soon as practicable after vesting. During the period between grant and vesting, the RSUs may not be transferred, and the grantee has no rights as a shareholder until vesting has occurred. If the grantee’s employment is terminated for any reason (other than following a change in control of the Company or a termination of an officer other than for cause), then any unvested RSUs under the award will automatically terminate and be forfeited. If an officer grantee’s employment is terminated by the Company without cause or by the grantee for good reason, then, provided that the RSUs have not been previously forfeited, the remaining unvested portion of the RSUs will immediately vest as of the officer grantee’s termination date. In the event of a change in control, the Company’s obligations regarding outstanding RSUs shall, on such terms as may be approved by the Committee prior to such event, immediately vest, be assumed by the surviving or continuing company or cancelled in exchange for property (including cash).

On June 15, 2016, the Company issued 150,000 RSUs to its Chief Executive Officer, Danny Schoening, and 50,000 RSUs to its Chief Financial Officer, Karen Hawkins. The RSUs issued to Mr. Schoening and Ms. Hawkins vest as follows: 34% on January 1, 2017, 33% on January 1, 2018 and 33% on January 1, 2019. The total market value of the restricted stock units based on the share price of \$1.85 as of June 15, 2016 is \$372 thousand. The cost of the shares is amortized on a straight line basis across the vesting periods. These restricted stock units were fully vested as of January 1, 2019.

On June 15, 2017, the Company issued 50,000 RSUs to its Applied Optics Center General Manager and new board member, Bill Bates. Pursuant to the RSU agreements the RSUs issued to Mr. Bates will vest as follows: 34% on January 1, 2018, 33% on January 1, 2019 and 33% on January 1, 2020. The total market value of the restricted stock units based on the share price of \$0.95 as of June 15, 2016 is \$47.5 thousand. The cost of the shares is amortized on a straight line basis across the vesting periods. As of September 29, 2019 there were 16,500 unvested restricted stock units remaining from the June 15, 2017 issue which will vest on January 1, 2020.

On January 2, 2019, the Company granted 150,000 and 50,000 restricted stock units with a January 2, 2019 grant date, to Danny Schoening and Karen Hawkins, respectively, vesting as of January 1 each year subsequent to the grant date over a three year period at a rate of 34% in year one, and 33% each year thereafter. The stock price at grant date was \$1.32 per share. The Company is amortizing the grant date fair market value of \$264 thousand to stock compensation expense on a straight line basis across the three year vesting period beginning on January 2, 2019.

The following table summarizes the status of Optex Systems Holdings' aggregate non-vested restricted stock units granted under the Company's 2016 Restricted Stock Unit Plan:

	Outstanding Unvested RSU's
Unvested as of October 1, 2017	182,000
Granted	—
Vested	(83,000)
Unvested as of September 30, 2018	99,000
Granted	200,000
Vested	(82,500)
Unvested as of September 29, 2019	216,500

On January 2, 2018, Optex Systems Holdings issued 55,902 common shares related to the vesting of the 83,000 restricted stock units on January 1, 2018. The shares issued were net of 27,098 common shares withheld for employee federal income tax requirements. On January 7, 2019, the Company issued 55,565 common shares the three directors and officers, net of tax withholding of \$37 thousand, in settlement of 82,500 restricted stock units which vested on January 1, 2019.

Stock Based Compensation Expense

Equity compensation is amortized based on a straight line basis across the vesting or service period as applicable. The recorded compensation costs for options and shares granted and restricted stock units awarded as well as the unrecognized compensation costs are summarized in the table below:

	Stock Compensation (thousands)			
	Recognized Compensation Expense Twelve months ended		Unrecognized Compensation Expense As of period ending	
	September 29, 2019	September 30, 2018	September 29, 2019 ⁽¹⁾	September 30, 2018
Stock Options	\$ —	\$ 8	\$ —	\$ —
Restricted Stock Units	113	145	200	49
Total Stock Compensation	\$ 113	\$ 153	\$ 200	\$ 49

(1) The unamortized stock compensation as of September 29, 2019 includes \$3 thousand in restricted stock units that will be fully amortized as of December 31, 2019, and \$197 thousand that is amortized on a straight line basis from January 1, 2019 through December 31, 2021.

Note 10 — Defined Contribution Plan

The Company sponsors a defined contribution pension plan under Section 401(k) of the Internal Revenue Code for all employees. Company contributions are voluntary and are determined annually at the discretion of the Board of Directors at the beginning of each fiscal year. For the fiscal years ended September 29, 2019 and September 30, 2018, the Company offered a qualified automatic contribution arrangement (QACA) with a 100% match of the first 1% and 50% matching of the next 5% and a 2 year vesting requirement. The Company's contribution expense for the fiscal years ended September 29, 2019 and September 30, 2018 were \$153 thousand and \$136 thousand, respectively.

Note 11 — Stockholders Equity

The table below depicts the Optex Systems Holdings stock equity transactions and ending share balances by equity class for the twelve months ended September 30, 2018 and September 29, 2019, respectively.

	Common	Series C	Warrants
Shares outstanding as of October 1, 2017	8,190,101	174	4,323,135
Preferred share conversions to common shares	725,000	(174)	
Common shares issued for vested restricted stock units, net of tax withheld	55,902	—	
Common stock repurchases	(700,000)	—	
Common stock issued for warrants exercised	62,350	—	(62,350)
Shares outstanding as of September 30, 2018	8,333,353	—	4,260,785
Warrant repurchases	—	—	(88,081)
Common shares issued for vested restricted stock units, net of tax withheld	55,565	—	
Common stock issued for warrants exercised	47,504	—	(47,504)
Shares outstanding as of September 29, 2019	8,436,422	—	4,125,200

Dividends

On June 26, 2017, the board of directors approved a resolution authorizing a \$0.02 per share (and per warrant) dividend for common and preferred series C shareholders and warrant holders of record as of July 5, 2017 and for three subsequent quarterly record dates thereafter. Total dividends of \$522 thousand were recorded during the twelve months ending October 1, 2017 and \$261 thousand of dividends were paid during the twelve month period. During the twelve months ended September 30, 2018, Optex Systems Holdings recorded a total of \$523 in declared dividends for dividends to share and warrant holders of record as of January 12, 2018 and April 12, 2018 and \$784 thousand in dividends were paid, which included \$261 thousand of dividends in arrears declared in 2017 for shareholders of record as of October 12, 2017. There are no additional dividend payments declared subsequent to the April 12, 2018 record date and as of periods ended September 30, 2018 and September 29, 2019, there were no outstanding dividends payable.

Common stock

During the twelve months ended September 30, 2018, Optex Systems Holdings issued 725,000 common shares due to conversions of Series C preferred stock, and 55,902 common shares were issued related to the vesting of restricted stock units. On September 17, 2018, we issued 62,350 common shares for the exercise of 62,350 warrants at an exercise price of \$1.50 per share for a total transaction value of \$93,525 cash.

On May 16, 2018 and on July 10, 2018 we announced that our Board of Directors approved a purchase of 200,000 and 500,000 shares of its common stock two separate private transactions. Each of the transactions were priced at \$1.00 per share for total transaction amounts of \$700,000. Upon repurchase, the shares were returned to treasury and cancelled. There were no other issuances of common or preferred stock during the twelve months ended September 30, 2018. As of September 30, 2018, the outstanding common shares were 8,333,353.

On January 7, 2019 there were 55,565 common shares issued, net of tax withholding, in settlement of 82,500 restricted stock units with vested on January 1, 2019. On June 12, 2019, we issued 47,504 common shares for the exercise of 47,504 warrants at an exercise price of \$1.50 per share for a total transaction value of \$71,256 cash.

There were no other issuances of common or preferred stock during the twelve months ended September 29, 2019. As of September 29, 2019, the outstanding common shares were 8,436,422.

Series C Preferred Stock

Our board of directors designated 400 shares of our preferred stock as Series C convertible preferred stock (“Series C preferred stock”). The preferences and rights of the Series C preferred stock are set forth in a Certificate of Designation (the “Series C Certificate of Designation”).

As of September 30, 2018 and September 29, 2019 all 400 of the Series C shares have been converted into common shares and there are zero outstanding Series C preferred shares.

Warrants

On August 26, 2016, Optex Systems Holdings Inc. issued 4,323,135 warrants to new shareholders and the underwriter, in connection with a public share offering. The warrants entitle the holder to purchase one share of our common stock at an exercise price equal to \$1.50 per share at any time on or after August 26, 2016 (the “Initial Exercise Date”) and on or prior to the close of business on August 26, 2021 (the “Termination Date”).

Pursuant to a warrant agreement between Optex Systems Inc. and Equity Stock Transfer, LLC, as warrant agent, the warrants will be issued in book-entry form and shall initially be represented only by one or more global warrants deposited with the warrant agent, as custodian on behalf of The Depository Trust Company, or DTC, and registered in the name of Cede & Co., a nominee of DTC, or as otherwise directed by DTC.

The exercise price and number of shares of common stock issuable upon exercise of the warrants may be adjusted in certain circumstances, including in the event of a stock splits, stock dividend, extraordinary dividend on or recapitalization, reorganization, merger or consolidation.

Under the terms of the warrant agreement, Optex Systems Holdings Inc. has agreed to use their best efforts to maintain the effectiveness of the registration statement and current prospectus relating to common stock issuable upon exercise of the warrants until the expiration of the warrants. During any period Optex fails to have maintained an effective registration statement covering the shares underlying the warrants, the warrant holder may exercise the warrants on a cashless basis. The warrant holders do not have the rights or privileges of holders of common stock and any voting rights until they exercise their warrants and receive shares of common stock, except as set forth in the warrants. After the issuance of shares of common stock upon exercise of the warrants, each holder will be entitled to one vote for each share held of record on all matters to be voted on by stockholders.

Subject to limited exceptions, a holder of warrants will not have the right to exercise any portion of its warrants if the holder (together with such holder's affiliates, and any persons acting as a group together with such holder or any of such holder's affiliates) would beneficially own a number of shares of common stock in excess of 4.99% of the shares of our common stock then outstanding after giving effect to such exercise (the "Beneficial Ownership Limitation"); provided, however, that, upon notice to the Company, the holder may increase or decrease the Beneficial Ownership Limitation, provided that in no event shall the Beneficial Ownership Limitation exceed 9.99% and any increase in the Beneficial Ownership Limitation will not be effective until 61 days following notice of such increase from the holder to us.

No fractional shares of common stock will be issued upon exercise of the warrants. If, upon exercise of the warrants, a holder would be entitled to receive a fractional interest in a share, Optex Systems Holdings Inc. will, upon exercise, round up to the nearest whole number of shares of common stock to be issued to the warrant holder. If multiple warrants are exercised by the holder at the same time, Optex Systems Holdings Inc. will aggregate the number of whole shares issuable upon exercise of all the warrants. There is no established trading market for the warrants. The warrants have been approved for quotation on the OTCQB under ticker symbol "OPXXW".

In the event of a fundamental transaction (as defined in warrant), then the Company or any successor entity will pay at the holder's option, exercisable at any time concurrently with or within 30 days after the consummation of the fundamental transaction, an amount of cash equal to the value of the remaining unexercised portion of the warrants on the date of consummation of the fundamental transaction as determined in accordance with the Black Scholes option pricing model.

During the twelve months ended September 30, 2018, 62,350 of the warrants had been exercised. During the twelve months ended September 29, 2019, 47,504 of the warrants were exercised. On June 26, 2019 the Company repurchased 88,081 warrants at \$0.85 per warrant for a total transaction cost of \$74,869. As of September 29, 2019 there were 4,125,200 outstanding warrants remaining.

Note 12 — Warrant Liabilities

On August 26, 2016, Optex Systems Holdings, Inc. issued 4,323,135 warrants to new shareholders and the underwriter, in connection with a public share offering. The warrants entitle the holder to purchase one share of our common stock at an exercise price equal to \$1.50 per share at any time on or after August 26, 2016 (the "Initial Exercise Date") and on or prior to the close of business on August 26, 2021 (the "Termination Date"). The Company determined that these warrants are free standing financial instruments that are legally detachable and separately exercisable from the common stock included in the public share offering. Management also determined that the warrants are puttable for cash upon a fundamental transaction at the option of the holder and as such required classification as a liability pursuant to ASC 480 "Distinguishing Liabilities from Equity". The Company has no plans to consummate a fundamental transaction and does not believe a fundamental transaction is likely to occur during the remaining term of the outstanding warrants. In accordance with the accounting guidance, the outstanding warrants are recognized as a warrant liability on the balance sheet and are measured at their inception date fair value and subsequently re-measured at each reporting period with changes being recorded as a component of other income in the consolidated statement of operations.

The fair value of the warrant liabilities presented below were measured using either a BSM valuation model. Significant inputs into the respective model at the inception and reporting period measurement dates are as follows:

Valuation Assumptions	Issuance date ⁽¹⁾ August 26, 2016 ⁽⁴⁾	Period ended October 1, 2017 ⁽⁴⁾	Period ended September 30, 2018	Period ended September 29, 2019
Exercise Price ⁽¹⁾	\$ 1.50	\$ 1.50	\$ 1.50	\$ 1.50
Warrant Expiration Date ⁽¹⁾	8/26/2021	8/26/2021	8/26/2021	8/26/2021
Stock Price ⁽²⁾	\$ 0.95	\$ 0.98	\$ 1.71	\$ 1.56
Interest Rate (annual) ⁽³⁾	1.23%	1.62%	2.88%	1.63%
Volatility (annual) ⁽⁴⁾	246.44%	179.36%	64.05%	53.66%
Time to Maturity (Years)	5.0	3.9	2.9	1.9
Calculated fair value per share	\$ 0.93	\$ 0.87	\$ 0.82	\$ 0.49

(1) Based on the terms provided in the warrant agreement to purchase common stock of Optex Systems Holdings, Inc. dated August 26, 2016.

(2) Based on the trading value of common stock of Optex Systems Holdings, Inc. as of each presented period ending date.

(3) Interest rate for U.S. Treasury Bonds, as of each presented period ending date, as published by the U.S. Federal Reserve.

(4) Based on the historical daily volatility of Optex Systems Holdings, Inc. as of each presented period ending date.

The warrants outstanding and fair values at each of the respective valuation dates are summarized below:

Warrant Liability	Warrants Outstanding	Fair Value per Share	Fair Value (000's)
Fair Value as of period ended 10/01/2017	4,323,135	\$ 0.87	\$ 3,607
Reclassification to additional paid in capital for correction to underwriter warrants outstanding ⁽¹⁾			41
Reclassification to additional paid in capital upon exercise of warrants ⁽²⁾	(62,350)		(53)
Gain on Change in Fair Value of Warrant Liability			(95)
Fair Value as of period ended 9/30/2018	4,260,785	\$ 0.82	\$ 3,500
Reclassification to additional paid in capital upon exercise of warrants ⁽³⁾	(47,504)		(48)
Warrant buyback and cancellation ⁽⁴⁾	(88,081)		(72)
Gain on Change in Fair Value of Warrant Liability			(1,344)
Fair Value as of period ended 9/29/2019	4,125,200	\$ 0.49	\$ 2,036

(1) Correction to Additional Paid in Capital and Warrant Liability for 197,935 outstanding warrants issued to underwriters on August 26, 2016. Total warrants were incorrectly reflected as 4,125,200 and should have been 4,323,135.

(2) Warrants exercised on September 17, 2018 for gross proceeds of \$93.5 thousand. The fair market value of the warrants as of the exercise date was \$53 thousand and was reclassified to additional paid in capital.

(3) Exercise of warrants for gross proceeds of \$72 thousand and a warrant liability fair market value of \$48 thousand as of the exercise date.

(4) Buyback of 88,081 warrants at \$0.85 per warrant for a total consideration of (\$75) thousand and a warrant liability fair market value of \$72 thousand.

The warrant liabilities are considered Level 3 liabilities on the fair value hierarchy as the determination of fair value includes various assumptions about of future activities and the Company's stock prices and historical volatility as inputs.

Note 13 — Income Taxes

The income tax provision for the years ended September 29, 2019 and September 30, 2018 include the following:

	(Thousands)	
	2019	2018
Current income tax expense:		
Federal 2019	\$ 279	\$ 167
Federal 2018 Tax Adjustment	(15)	—
	<u>264</u>	<u>167</u>
Deferred income tax provision (benefit):		
Federal	(1,414)	—
Provision for (Benefit from) income taxes, net	\$ (1,150)	\$ 167

As of September 29, 2019, we reviewed the deferred tax assets and determined it was more likely than not that we would be able to utilize at least (\$1.4) million of the \$2.4 million deferred tax asset balance. Our assumptions were based on the last three years earning trend as well as anticipated future earnings expected with the increases in U.S defense and Foreign Military market spending projections. Release of the (\$1.4) million against the valuation allowance resulted in the recognition of a tax benefit for the twelve months ended September 29, 2019 and a net valuation allowance of \$1.0 million against the deferred tax asset.

The income tax provision for Optex Systems as of September 29, 2019 differs from those computed using the statutory federal tax rate in the respective years due to the following permanent differences:

	2019	%	2018	%
Tax provision (benefit) at statutory federal rate ⁽¹⁾	\$ 949	21	\$ 378	24
Nontaxable expenses	(281)	(6)	(20)	(1)
True up of deferred balance	-	-	(377)	(24)
Rate change	-	-	1,894	120
Other	79	2	(26)	(1)
2018 Federal Income Tax adjustment	(15)	-	-	-
Change in Deferred Tax Valuation Allowance	(1,882)	(42)	(1,682)	(107)
Provision for (Benefit from) income taxes, net	<u>\$ (1,150)</u>	<u>(25)</u>	<u>\$ 167</u>	<u>11</u>

(1) Due the Company fiscal period beginning date of October 2, 2017 and the effective date of January 1, 2018 of the statutory rate change from 34% to 21%, the Company is required to use a weighted average statutory rate for the fiscal year period. The statutory rate for the fiscal year period ended September 29, 2019 is 21.0%.

Deferred income taxes recorded in the balance sheets result from differences between financial statement and tax reporting of income and deductions. A summary of the composition of the deferred income tax assets (liabilities) follows:

	(Thousands)	
	Deferred Tax Asset	
	As of September 29, 2019	As of September 30, 2018
Stock Options	\$ 88	\$ 139
Inventory Reserve	150	351
Unicap	39	31
Deferred Compensation	31	46
Fixed assets	(13)	(23)
Goodwill Amortization	398	498
Intangible Asset Amortization	226	283
Net Operating Losses	1,407	1,451
Other	99	117
Subtotal	\$ 2,425	\$ 2,893
Valuation allowance	(1,011)	(2,893)
Net deferred asset (liability)	\$ 1,414	\$ -0-

The Company has a net loss carryforward of \$6.7 million as of September 29, 2019 as compared to a net loss carryforward of \$6.9 million as of September 30, 2018. Due to an IRS section 382 change in control limitation which was effective during the fiscal year ended 2017, it is anticipated that the company may only realize \$2.8 million of the current net operating loss carryforward for a net tax benefit of \$0.6 million over the next eighteen years.

As the result of the application of the FASB ASC 740-10, Optex Systems Holdings has no unrecognized tax benefits. By statute, the tax years ended in September 29, 2019, September 30, 2018 and October 1, 2017 are open to examination by the major taxing jurisdictions to which the Optex Systems Holdings is subject.

During the twelve months ended September 29, 2019 the Company paid \$360 thousand in income taxes, and has a net tax refund due related to the fiscal year 2019 tax year of (\$75) thousand included in prepaid expenses. There were \$144 thousand in income taxes paid during the fiscal year ended September 30, 2018 and had an outstanding accrued tax liability of \$22 thousand as of the fiscal year 2018 period.

Note 14 — Subsequent Events

On November 4, 2019, the Board of Directors of Optex Systems Holdings, Inc. (the “Company”) appointed three new directors: Larry Hagenbuch, Dale Lehmann and Rimmy Malhotra, all of whom have been qualified as independent as defined under Nasdaq Listing Rules by the Board. All three new independent directors will be compensated in accordance with the Company’s non-employee director compensation policies. Larry Hagenbuch will serve as the Audit Committee Chair and Rimmy Malhotra will serve as the Compensation Committee Chair. Bill Bates and Karen Hawkins have resigned as directors of the Company in order to enable the Company to have this reconstituted Board comprised of a majority of independent directors. David Kittay also resigned from the Company’s Board and Audit Committee to pursue other business interests.

On November 19, 2019, the Board of Directors of Optex Systems Holdings, Inc. approved annual executive bonuses for Danny Schoening, CEO and Karen Hawkins, CFO of \$75 thousand and \$54 thousand, respectively, to be paid in December 2019.

On November 14, 2019, the Board of Directors reviewed the independent director compensation and concluded to leave the pay as is currently in place for former independent directors, currently set at \$5.5 thousand per quarter served. The board determined to revisit the independent board compensation during the first calendar quarter of 2020.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of September 29, 2019, management performed, with the participation of our Principal Executive Officer and Principal Financial Officer, an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Our disclosure controls and procedures are designed to ensure that information required to be disclosed in the report we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's forms, and that such information is accumulated and communicated to our management including our Principal Executive Officer and our Principal Financial Officer, to allow timely decisions regarding required disclosures. Based on the evaluation, our Principal Executive Officer and our Principal Financial Officer concluded that, as of September 29, 2019, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

During the year ended September 29, 2019, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projection of any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has conducted, with the participation of our Principal Executive Officer and our Principal Financial Officer, an assessment, including testing of the effectiveness, of our internal control over financial reporting as of September 29, 2019. Management's assessment of internal control over financial reporting was conducted using the criteria in the *2013 Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. In connection with our management's assessment of our internal control over financial reporting as required under Section 404 of the Sarbanes-Oxley Act of 2002, we have not identified any material weaknesses in our internal control over financial reporting as of September 29, 2019. We have thus concluded that our internal control over financial reporting was effective as of September 29, 2019.

PART III

Item 10 Directors, Executive Officers and Corporate Governance

Our board of directors directs the management of the business and affairs of our company as provided in our certificate of incorporation, our by-laws and the General Corporation Law of Delaware. Members of our board of directors keep informed about our business through discussions with senior management, by reviewing analyses and reports sent to them, and by participating in regularly scheduled board and committee meetings.

Our company is led by Danny Schoening, who has served as COO since 2009 and was appointed CEO and Director in 2013, and became Chairman in 2017.

On November 4, 2019, the Board of Directors of Optex Systems Holdings, Inc. (the “Company”) appointed three new directors: Larry Hagenbuch, Dale Lehmann and Rimmy Malhotra, all of whom have been qualified as independent as defined under Nasdaq Listing Rules by the Board. All three new independent directors will be compensated in accordance with the Company’s non-employee director compensation policies. Larry Hagenbuch will serve as the Audit Committee Chair and Rimmy Malhotra will serve as the Compensation Committee Chair. Bill Bates and Karen Hawkins have resigned as directors of the Company in order to enable the Company to have this reconstituted Board comprised of a majority of independent directors. David Kittay also resigned from the Company’s Board and Audit Committee to pursue other business interests.

As of December 16, 2019, our board of directors consists of four directors which includes three independent directors and one non-independent directors as discussed below.

Our board leadership structure is used by other smaller public companies in the United States, and we believe that this leadership structure is effective for us. We believe that our directors provide effective oversight of the risk management function, especially through dialogue between the full board and our management. Our directors serve for a one year term and until their successors are elected and duly qualify.

We do not currently consider diversity in identifying nominees for director. Due to our small size, the priority has been in attracting qualified directors, and issues such as diversity have not yet been considered.

Directors and Executive Officers

The following table sets forth information regarding the members of our board of directors and our executive officers and other significant employees. Three of our current officers and directors were appointed on November 4, 2019, and three board member resigned as of November 4, 2019.

The following table sets forth certain information with respect to our directors and executive officers:

Name	Age	Position
Danny Schoening ⁽⁴⁾	55	Chairman and Director, Chief Executive Officer, Chief Operating Officer
Karen L. Hawkins ⁽¹⁾	54	Chief Financial Officer (<i>resigned as Director on November 4, 2019</i>)
Larry Hagenbuch ⁽³⁾	53	Director, Audit Committee Chair (<i>appointed November 4, 2019</i>)
Dale Lehmann ⁽³⁾	61	Director (<i>appointed November 4, 2019</i>)
Rimmy Malhotra ⁽³⁾	44	Director, Compensation Committee Chair (<i>appointed November 4, 2019</i>)
Billy Bates ⁽²⁾	57	General Manager, Applied Optics Center, (<i>resigned as Director on November 4, 2019</i>)

(1) Effective June 9, 2017, Karen Hawkins, Chief Financial Officer and was appointed as a Director. Ms. Hawkins stepped down from the board on November 4, 2019 to enable the appointment of new independent board members.

(2) Billy Bates was appointed as a Director on June 9, 2017. Mr. Bates stepped down from the board on November 4, 2019 to enable the appointment of new independent board members.

(3) Appointed to the board as a director effective as of November 4, 2019 as independent directors as such term is defined under NASDAQ Listing Rule 5605(b)(2) and Exchange Act Rule 10A-3.

(4) Danny Schoening has served as COO since 2009 and CEO and Director since 2013 and was elected to Chairman of the board on June 9, 2017.

Danny Schoening. Mr. Schoening joined Optex Systems, Inc. (Texas) in January 2008. Upon the acquisition of the assets of Optex Systems, Inc. (Texas) by Optex Systems, Inc. (Delaware), Mr. Schoening became the COO of Optex Systems, Inc. (Delaware) (as of September 28, 2008) and he commenced service with Optex Systems Holdings as its Chief Operating Officer as of the date of the reorganization, March 30, 2009 and was appointed Chief Executive Officer and as a Director in 2013. He has been instrumental in establishing the systems and infrastructure required to continue Optex System's rapid growth. This activity was rewarded with Optex System's recent ISO 9001:2000 Certification. From February 2004 to January 2008, Danny was the Vice President of Operations for The Finisar Corporation AOC Division for 4 years where he led a team of up to 200 employees to produce vertical cavity lasers for the data communications industry at production rates of hundreds of thousands of units per week. Prior to Finisar, Danny was the Director of Operations for multiple divisions of Honeywell International. Serving the Automotive, Medical, Aerospace, and Consumer Commercial Markets. During this 17-year period, Danny was recognized with Honeywell's Lund Award, their highest award for developing employee resources. Danny has a broad experience level in the following technologies: Mechanical Assembly Processes, Micro-Electronic Assembly Processes, Laser Manufacturing, Plastic Molding, Metal Machining, Plating, Thick Film Printing, Surface Mount Technology, Hall Effect Technology and MEMS based Pressure Devices. Danny received a Bachelor's of Science in Manufacturing Engineering Technology from the University of Nebraska, an MBA from Southern Methodist University, and holds three U.S. patents. The Board of Directors has determined that Mr. Schoening is suited to sit on our Board because of his industry experience and as he is the CEO.

Karen L. Hawkins. On November 19, 2014, Karen Hawkins was appointed as our Chief Financial Officer. Ms. Hawkins had previously served as our Vice President, Finance and Controller, since the date of the reorganization, March 30, 2009 and was the controller of Optex Systems, Inc. (Delaware), effective September 28, 2009. She began her employment with Optex Systems, Inc. (Texas) in April 2007. Ms. Hawkins has over 30 years' experience in Financial Accounting and Management, primarily focused in the Defense and Transportation Industries. She has a strong background in both Financial & Cost Accounting, with extensive Government Pricing, Financial Analysis, and Internal Auditing experience. Her past history also includes Program Management, Materials Management and Business Development. She brings over 25 years' direct experience in Government Contracting with a strong knowledge of Cost Accounting Standards Board and Federal Acquisition Regulation. Her previous employment includes General Dynamics — Ordnance and Tactical Division, Garland (formerly known as Intercontinental Manufacturing) for over 13 years from November, 1994 through March, 2007. During her tenure there she served in the roles of Controller (Accounting & IT), Program Manager over a \$250M 3-year Army Indefinite Delivery/Indefinite Quantity (Indefinite Delivery/Indefinite Quantity) type contract, as well as Materials Manager with oversight of Purchasing, Production Control & Warehousing functions. Prior to her employment at General Dynamics, Ms. Hawkins served in various finance and accounting positions at Luminator, a Mark IV Industries Co, and Johnson Controls, Battery Division - Garland. Karen received her Bachelor's Degree in Business Administration in Accounting from Stephen F. Austin State University in Texas in 1986 and became a Certified Public Accountant in 1992.

Larry Hagenbuch joins the Board and has accepted the role of Audit Committee Chair. Larry is currently a Managing Director at Huron Consulting Group. Prior to that, Larry was the Chief Operating Officer and Chief Financial Officer for J. Hilburn, Inc., a custom clothier for men from Dec 2009 to May 2019. He served on the board of directors of Remy International (REMY) from November 2008 until that company's sale to BorgWarner in November 2015, where he served on the audit and compensation committees. Larry also currently serves on the board of directors for both Arotech (ARTX) and HireQuest (HQI). Larry has served in senior management positions for SunTx Capital Partners, Alix Partners, GE / GE Capital, and American National Can Group, Inc. Larry began his professional career in the United States Navy.

Dale Lehmann joins the Board as an industry expert having over 30 years of management, strategy, product development, delivery and operational experience in the electro-optical industry. Dale was the Director of Business Development & Strategy for General Dynamics Global Imaging Technologies Group from 2014 through 2017. Prior to that, Dale was the Senior Vice President & General Manager of the Infrared Products Group for L-3 Communications/Cincinnati Electronics from 1995 through 2014. Dale currently sits on the Board of Directors for Adimec USA, a provider of application specific imaging solutions.

Rimmy Malhotra joins the Board and has accepted the role of Compensation Committee Chair. Rimmy currently manages The Nicoya Fund, an investment partnership whose partners include, high net worth individuals, entrepreneurs and family offices and has acted in that capacity since 2013. He currently serves as Vice-Chairman of HireQuest, a NASDAQ listed staffing operator. He holds an MBA from The Wharton School in Finance, MA in International Affairs from The University of Pennsylvania and a Bachelor of Science in Computer Science from Johns Hopkins University.

Bill Bates. Mr. Bates has thirty-five years of experience related to optical component and system manufacturing. He is currently the General Manager of the Applied Optics Center in Dallas, Texas where he oversees the Thin-film Coating and Optical Assembly Operations. He has held various positions throughout his thirty-five years of experience within Litton Industries, Northrop Grumman Corporation, and L-3 Communications. He previously served as Vice President and General Manager within the Warrior Systems Division of L-3 Communications. Mr. Bates received a Bachelor of Science of Business Administration from DeVry University and an MBA from the University of Texas at Dallas.

Family Relationships

There are no family relationships among the officers and directors.

Presiding Director

Our Chairman, Danny Schoening, is the presiding director at meetings. In the event that the Chairman is unavailable to serve at a particular meeting, responsibility for the presiding director function will rotate among the directors in attendance.

Corporate Governance

Our board of directors believes that sound governance practices and policies provide an important framework to assist them in fulfilling their duty to stockholders. Our board of directors actively supports management's adoption and implementation of many "best practices" in the area of corporate governance, including annual review of internal control changes, compensation practices, executive management and auditor retention. In 2019 and 2018, all directors attended a minimum of 75% of the meetings of the board of directors.

Code of Ethics

Our board of directors has adopted a Code of Ethics which has been distributed to all directors, and executive officers, and will be distributed to employees and will be given to new employees at the time of hire. The Financial Code of Ethics contains a number of provisions that apply principally to our Principal Executive Officer, Principal Financial Officer and other key accounting and financial personnel. A copy of our Code of Business Conduct and Ethics can be found under the "Investor Relations" section of our website (www.optexsys.com) under the section for corporate governance. We also intend to disclose any amendments or waivers of our Code on our website.

Board Meetings

We are incorporated under the laws of the State of Delaware. The interests of our stockholders are represented by the board of directors, which oversees our business and management.

The board of directors meets regularly during the year and holds special meetings and acts by unanimous written consent whenever circumstances require. The board held 1 meetings (including special meetings) and took action by unanimous written consent 1 time during our fiscal year ended September 29, 2019.

Board Committees

As of November 4, 2019, Larry Hagenbuch was appointed to the board as an independent director and has accepted the role of Audit Committee Chair and Rimmy Malhotra was appointed to the board as an independent director and has accepted the role of Compensation Committee Chair. Each committee has three independent board members including Dale Lehmann.

Mr. Kittay, resigned as of November 4, 2019 and previously served as our only independent director, and as chair of the Audit and Compensation Committee until November 3, 2019.

Board nominations

Stockholders wishing to bring a nomination for a director candidate before a stockholders meeting must give written notice to our Corporate Secretary, either by personal delivery or by United States mail, postage prepaid. The stockholder's notice must be received by the Corporate Secretary not later than (a) with respect to an Annual Meeting of Stockholders, 90 days prior to the anniversary date of the immediately preceding annual meeting, and (b) with respect to a special meeting of stockholders for the election of directors, the close of business on the tenth day following the date on which notice of the meeting is first given to stockholders. The stockholder's notice must set forth all information relating to each person whom the stockholder proposes to nominate that is required to be disclosed under applicable rules and regulations of the SEC, including the written consent of the person proposed to be nominated to being named in the proxy statement as a nominee and to serving as a director if elected. The stockholder's notice must also set forth as to the stockholder making the nomination (i) the name and address of the stockholder, (ii) the number of shares held by the stockholder, (iii) a representation that the stockholder is a holder of record of stock of the Optex Systems Holdings, entitled to vote at the meeting and intends to appear in person or by proxy at the meeting to nominate the person named in the notice, and (iv) a description of all arrangements or understandings between the stockholder and each nominee.

Stockholder Communications with the Board of Directors

Stockholders may communicate directly with the board of directors or any board member by writing to them at Optex Systems Holdings, Inc., 1420 Presidential Drive, Richardson, TX 75081. The outside of the envelope should prominently indicate that the correspondence is intended for the board of directors or for a specific director. The secretary will forward all such written communications to the director to whom it is addressed or, if no director is specified, to the entire board of directors.

Director Attendance at Annual Meetings of Stockholders

Directors are encouraged to attend annual meetings, although such attendance is not required.

Board Independence

Our board of directors has determined that three of our directors would meet the independence requirements of the Nasdaq Capital Market, if such standards applied to the Company. In reaching its conclusions, the board of directors considered all relevant facts and circumstances with respect to any direct or indirect relationships between the Company and each of the directors, including those discussed under the caption "Certain Relationships and Related Transactions" below. Our board of directors determined that any relationships that exist or existed in the past between the Company and each of the independent directors were immaterial on the basis of the information set forth in the above-referenced sections.

Director Compensation

See table below under "Executive Compensation — Director Compensation."

Item 11 Executive Compensation

The board of directors administers our option compensation plan. Our Principal Executive Officer and other members of management regularly discuss our compensation issues with the Board of Directors. Subject to Board review, modification and approval, Danny Schoening typically makes recommendations respecting bonuses and equity incentive awards for the other members of the executive management team. The Board establishes all bonus and equity incentive awards for officers and directors in consultation with other members of the management team.

Summary Compensation Table

The following table sets forth, for the years indicated, all compensation paid, distributed or accrued for services, including salary and bonus amounts, rendered in all capacities by our principal executive officer, principal financial officer and all other executive officers who received or are entitled to receive remuneration in excess of \$100,000 during the stated periods. These officers are referred to herein as the “named executive officers.” Except as provided below, none of our executive officers received annual compensation in excess of \$100,000 during the last two fiscal years.

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)(2)	Option Awards (\$)(1)	All Other Compensation (\$)	Total (\$)
Danny Schoening, CEO & Board Chairman	2019	\$ 279,504	\$ 76,216	\$ 73,740	\$ -	\$ -	\$ 429,460
	2018	262,417	152,432	93,000	4,273	-	512,122
	2017	256,416	48,856	93,000	19,943	-	418,215
Karen Hawkins CFO & Board Director	2019	\$ 201,537	\$ 55,691	\$ 24,580	\$ -	\$ -	\$ 281,808
	2018	188,055	55,691	31,000	2,137	-	276,883
	2017	184,124	35,699	31,000	9,971	-	260,794
Bill Bates AOC GM & Board Director	2019	\$ 148,269	\$ 28,561	\$ 15,675	\$ -	\$ -	\$ 192,505
	2018	140,220	28,044	19,210	-	-	187,474
	2017	135,631	6,681	8,696	-	-	151,009
Stanley A. Hirschman, President, resigned ⁽³⁾	2018	\$ -	\$ -	\$ -	\$ 2,137	\$ -	\$ 2,137
	2017	-	-	-	9,971	-	9,971

(1) The amounts in the “Option awards” column reflect the dollar amounts recognized as the executive portion of compensation expense for financial statement reporting purposes for each named executive officer during fiscal 2014 through fiscal 2016, as required by FASB ASC 718, disregarding any estimates for forfeitures relating to service-based vesting conditions. For the assumptions relating to these valuations, see note 10 to our fiscal 2014 audited financial statements.

(2) On June 15, 2016, the Company issued 150,000 RSUs to its Chief Executive Officer, Danny Schoening, and 50,000 RSUs to its Chief Financial Officer, Karen Hawkins. The RSUs issued to Mr. Schoening and Ms. Hawkins vest as follows: 34% on January 1, 2017, 33% on January 1, 2018 and 33% on January 1, 2019. The total market value of the restricted stock units based on the shares price of \$1.85 as of June 15, 2016 is \$372 thousand. The restricted stock units were fully vested on January 1, 2019. On June 15, 2017, the Company issued 50,000 RSUs to its General Manager (Applied Optical Products). The RSUs issued to Mr. Bates vest as follows: 34% on January 1, 2018, 33% on January 1, 2019 and 33% on January 1, 2020. The total market value of the restricted stock units granted to Mr. Bates based on the shares price of \$0.95 as of June 15, 2017 is \$47.5 thousand. On January 2, 2019, the Company issued 150,000 RSUs to its Chief Executive Officer, Danny Schoening, and 50,000 RSUs to its Chief Financial Officer, Karen Hawkins. The RSUs issued to Mr. Schoening and Ms. Hawkins vest as follows: 34% on January 1, 2020, 33% on January 1, 2021 and 33% on January 1, 2022. The total market value of the restricted stock units based on the shares price of \$1.32 as of January 2, 2019 is \$264 thousand. The cost of the shares is amortized on a straight line basis across the vesting periods. The amounts in the “Stock awards” column reflect the dollar amounts recognized as the executive portion of compensation expense for financial statement reporting purposes for each named executive officer during the fiscal years, as required by FASB ASC 718 (prior authoritative literature SFAS 123(R), disregarding any estimates for forfeitures relating to service-based vesting conditions.

(3) Stanley Hirschman retired as our President as of July 20, 2017 and resigned as a director effective on November 4, 2015.

Option Grants in Last Fiscal Year

There were no Option Grants during the twelve months ended September 29, 2019 or September 30, 2018.

Employment Agreements - Danny Schoening

We entered into an employment agreement with Danny Schoening dated December 1, 2008. The term of the agreement commenced as of December 1, 2008 and the current term has automatically renewed through December 1, 2020. The term of the agreement shall be automatically extended for successive 18 month periods, unless we shall provide a written notice of termination at least ninety (90) days, or Mr. Schoening shall provide a written notice of termination at least 90 days, prior to the end of the initial term or any extended term, as applicable.

On each subsequent renewal date of the commencement of employment, Schoening's base salary shall be reviewed by the Board and may be increased to such rate as the Board, in its sole discretion, may hereafter from time to time determine. During the term of the agreement, Schoening shall be entitled to receive bonuses of up to 30% of his base salary per year at the discretion of our Board of Directors pursuant to performance objectives to be determined by the Board of Directors. Any bonuses shall be payable in cash and shall be paid within ninety (90) days of any year anniversary of the date of the agreement.

The employment agreement events of termination consist of: (i) death of Mr. Schoening; (ii) termination by us for cause (including conviction of a felony, commission of fraudulent acts, willful misconduct by Mr. Schoening, continued failure to perform duties after written notice, violation of securities laws and breach of the employment agreement), (iii) termination without cause by us and (iv) termination by Mr. Schoening for good reason (including breach by us of its obligations under the agreement, the requirement for Mr. Schoening to move more than 100 miles away for his employment without consent, and merger or consolidation that results in more than 66% of the combined voting power of the then outstanding securities of us or our successor changing ownership or a sale of all or substantially all of our assets, without the surviving entity assuming the obligations under the agreement). For a termination by us for cause or upon death of Mr. Schoening, Mr. Schoening shall be paid salary and bonus earned through the date of termination. For a termination by us without cause or by Mr. Schoening with good reason, Mr. Schoening shall also be paid six months' base salary in effect and all granted stock options shall remain exercisable for a period of two years after such termination, with all unvested stock options immediately vesting. The agreement contains a standard non-solicitation and non-compete agreement that extends for one year subsequent to termination thereof.

- On November 4, 2016, our Board of Directors Compensation Committee held a meeting and approved a bonus payment of \$48.9 thousand awarded to Danny Schoening for 2016 performance.
- On March 31, 2017, our Board of Directors Compensation Committee held a meeting and approved a base salary increase of 4% for Danny Schoening, CEO.
- On June 9, 2017, through Unanimous Written Consent, our Board of Directors approved an amendment to Danny Schoening's employment agreement to increase his annual bonus from a maximum of 30% to 60% of his base salary.
- On December 19, 2017, our Board of Directors approved a bonus payment of 60% of the base salary, or \$152.4 thousand for 2017 performance.

- On November 20, 2018 the Company's Board of Directors approved a 30% bonus payable in December 2018, an 8% salary increase as of January 1, 2019 and the issuance of 150,000 restricted stock units with a January 2, 2019 grant date, vesting as of January 1 each year subsequent to the grant date over a three year period at a rate of 34% in year one, and 33% each year thereafter. The base salary effective as of January 1, 2019 is \$284,645.
- On November 19, 2019, the Company's Board of Directors approved an executive bonus for Danny Schoening, CEO of \$75 thousand to be paid December 2019.

Karen Hawkins

On August 4, 2016, our Board of Directors approved an employment agreement for Karen Hawkins, Chief Financial Officer, dated as of August 1, 2016. This agreement has the following salient terms:

- The term of the agreement commenced on August 1, 2016 and expires on January 31, 2018 and automatically renews for subsequent 18 month periods unless Ms. Hawkins or we give notice of termination at least 90 days before the end of the term then in effect. As of July 31, 2019 the contract automatically renewed to January 31, 2021.
- On each subsequent renewal date of the commencement of employment, Hawkins' base salary shall be reviewed by the Board and may be increased to such rate as the Board, in its sole discretion, may hereafter from time to time determine and Ms. Hawkins is entitled to annual bonuses of up to 30% of her base salary as approved by the Board.
- Ms. Hawkins is entitled to 15 days' vacation and all other benefits accorded to our other senior executives.
- The employment agreement events of termination consist of: (i) death of Ms. Hawkins; (ii) termination by us for cause (including conviction of a felony, commission of fraudulent acts, willful misconduct by Ms. Hawkins, continued failure to perform duties after written notice, violation of securities laws and breach of the employment agreement), (iii) termination without cause by us and (iv) termination by Ms. Hawkins for good reason (including breach by us of its obligations under the agreement, the requirement for Ms. Hawkins to move more than 100 miles away for her employment without consent, and merger or consolidation that results in more than 66% of the combined voting power of the then outstanding securities of us or our successor changing ownership or a sale of all or substantially all of our assets, without the surviving entity assuming the obligations under the agreement). For a termination by us for cause or upon death of Ms. Hawkins, Ms. Hawkins shall be paid salary and bonus earned through the date of termination. For a termination by us without cause or by Ms. Hawkins with good reason, Ms. Hawkins shall also be paid six months' base salary in effect and all granted stock options shall remain exercisable for a period of two years after such termination, with all unvested stock options immediately vesting. The agreement contains a standard non-solicitation and non-compete agreement that extends for one year subsequent to termination thereof.
- On November 4, 2016, our Board of Directors Compensation Committee held a meeting and approved a bonus payment of \$35.7 thousand awarded to Karen Hawkins for 2016 performance.
- On March 31, 2017, our Board of Directors Compensation Committee held a meeting and approved a base salary increase of 4% for Karen Hawkins, CFO.
- On December 19, 2017, our Board of Directors approved a bonus payment of 30% of the base salary, or \$55.7 thousand for 2017 performance.
- On November 20, 2018 the Company's board of directors approved a 30% bonus payable in December 2018, or \$55.7 thousand, and an 8% salary increase as of January 1, 2019, and the issuance of 50,000 restricted stock units with a January 2, 2019 grant date, vesting as of January 1 each year subsequent to the grant date over a three year period at a rate of 34% in year one, and 33% each year thereafter. The base salary effective as of January 1, 2019 is \$205,425.

- On November 19, 2019, the Company's Board of Directors approved an executive bonus for Karen Hawkins, CEO of \$54 thousand to be paid in December 2019.

We do not have any other employment agreements with our executive officers and directors.

Equity Compensation Plan Information

We currently have an option compensation plan covering the issuance of both incentive and nonstatutory options, determined at the time of grant, for the purchase of up to 75,000 shares, which was increased from 50,000 shares on December 19, 2013. The purpose of the Plan is to assist us in attracting and retaining highly competent employees and to act as an incentive in motivating selected officers and other employees of us and our subsidiaries, and directors and consultants of us and our subsidiaries, to achieve long-term corporate objectives. On December 19, 2013, the Board of Directors authorized the grant of 20,000 options to three board members and a grant of 5,000 to an officer. There are 75,000 shares of common stock reserved for issuance under this Plan.

As of September 29, 2019, 71,070 options had been granted, 41,070 of these options had forfeited due to terminations or expiration, and 30,000 had vested of which 5,000 options were exercised. The remaining outstanding options as of December 16, 2019 are 25,000 and are fully vested with an expiration of December 18, 2020.

The vested options represent potential future cash proceeds to our company of \$250,000. There are no additional options that will become vested and exercisable within 60 days. The following table provides summary information on our outstanding options as of December 16, 2019.

	Vested Option Grants			Unvested Option Grants		
	Shares	Price	Proceeds	Shares	Price	Proceeds
FY2014 Directors plan options	25,000	10.00	250,000	—	10.00	—

The holders of options are not required to exercise their rights at any time and we are unable to predict the amount and timing of any future option exercises. We reserve the right to temporarily reduce the exercise prices of our options from time to time in order to encourage the early exercise of the options.

Outstanding Director and Officer Equity Awards as of December 16, 2019

Name	Option Awards				Expiration Date	Footnotes
	Number of shares underlying unexercised options		Equity Incentive Plan Awards Total Granted	Exercise Price		
	Non-Plan Number Exercisable	Number Unexercisable				
Danny Schoening	10,000	—	10,000	10.00	12/18/2020	(1)
Karen Hawkins	5,000	—	5,000	10.00	12/18/2020	(1)
Stan Hirschman	5,000	—	5,000	10.00	12/18/2020	(1)(2)
Merrick Okamoto	5,000	—	5,000	10.00	12/18/2020	(1)(2)

(1) Options granted on December 19, 2013 pursuant to employee stock option compensation plan. Shares vest over 4 years at a rate of 25% per year each respective anniversary date subsequent to 2013 and expire after seven years. As of September 29, 2019 100% of the options had vested.

(2) Merrick Okamoto resigned as an officer on November 19, 2014, upon resignation, the board approved vesting of 100% of his outstanding unvested options. Stan Hirschman resigned as a director effective on November 4, 2015. On December 8, 2015, the board of directors approved vesting of 100% of his outstanding unvested options effective on his resignation.

Restricted Stock Units issued to Officers and Employees

On June 14, 2016, the Compensation Committee (“Committee”) of the Board of Directors of Optex Systems Holdings, Inc. approved the Company’s 2016 Restricted Stock Unit Plan (the “Plan”). The Plan provides for the issuance of stock units (“RSU”) for up to 1,000,000 shares of the Company’s common stock to Optex Systems Holdings officers and employees. Each RSU constitutes a right to receive one share of the Company’s common stock, subject to vesting, which unless otherwise stated in an RSU agreement, shall vest in equal amounts on the first, second and third anniversary of the grant date. Shares of the Company’s common stock underlying the number of vested RSUs will be delivered as soon as practicable after vesting. During the period between grant and vesting, the RSUs may not be transferred, and the grantee has no rights as a shareholder until vesting has occurred. If the grantee’s employment is terminated for any reason (other than following a change in control of the Company or a termination of an officer other than for cause), then any unvested RSUs under the award will automatically terminate and be forfeited. If an officer grantee’s employment is terminated by the Company without cause or by the grantee for good reason, then, provided that the RSUs have not been previously forfeited, the remaining unvested portion of the RSUs will immediately vest as of the officer grantee’s termination date. In the event of a change in control, the Company’s obligations regarding outstanding RSUs shall, on such terms as may be approved by the Committee prior to such event, immediately vest, be assumed by the surviving or continuing company or cancelled in exchange for property (including cash).

On June 15, 2016, the Company issued 150,000 RSUs to its Chief Executive Officer, Danny Schoening, and 50,000 RSUs to its Chief Financial Officer, Karen Hawkins. The RSUs issued to Mr. Schoening and Ms. Hawkins vest as follows: 34% on January 1, 2017, 33% on January 1, 2018 and 33% on January 1, 2019. The total market value of the restricted stock units based on the shares price of \$1.85 as of June 15, 2016 is \$372 thousand. The cost of the shares is amortized on a straight line basis across the vesting periods.

On January 5, 2017, Optex Systems Holdings issued 45,799 common shares related to the vesting of the 68,000 restricted stock units on January 1, 2017. The shares issued were net of 22,201 common shares withheld for employee federal income tax requirements.

On June 15, 2017, the Company issued 50,000 RSUs to its Applied Optics Center General Manager and new board member, Bill Bates. Pursuant to the RSU agreements the RSUs issued to Mr. Bates will vest as follows: 34% on January 1, 2018, 33% on January 1, 2019 and 33% on January 1, 2020. The total market value of the restricted stock units based on the shares price of \$0.95 as of June 15, 2016 is \$47.5 thousand. The cost of the shares is amortized on a straight line basis across the vesting periods.

On November 20, 2018 the Company’s board of directors approved the issuance of 150,000 and 50,000 restricted stock units to Danny Schoening and Karen Hawkins, respectively, with a January 2, 2019 grant date, vesting as of January 1 each year subsequent to the grant date over a three year period at a rate of 34% in year one, and 33% each year thereafter. The total market value of the restricted stock units based on the shares price of \$1.32 as of January 2, 2019 is \$264 thousand.

As of September 29, 2019 there are 216,500 outstanding unvested restricted stock units remaining to vest, of which 84,500 will vest as of January 1, 2020 and the remaining 132,000 will vest on January 1, 2021 and January 1, 2022 for 66,000 shares on each date.

Consulting and Vendor Equity Compensation

There was no equity compensation to consultants or vendors during the years ended September 29, 2019 or September 30, 2018.

Nonqualified deferred compensation

We had no non-qualified deferred compensation plans during year ended September 29, 2019.

Post-Termination Compensation

We have not entered into change in control agreements with any of our named executive officers or other members of the executive management team other than the provision with respect to Mr. Schoening and Ms. Hawkins described above. No awards of equity incentives under our 2009 Stock Option Plan provide for immediate vesting upon a change in control. However, our Board of Directors has the full and exclusive power to interpret the plans, including the power to accelerate the vesting of outstanding, unvested awards. A “change in control” is generally defined as (1) the acquisition by any person of 66% or more of the combined voting power of our outstanding securities or (2) the occurrence of a transaction requiring stockholder approval and involving the sale of all or substantially all of our assets or the merger of us with or into another corporation.

Director Compensation

The following table provides information regarding compensation paid to directors for services rendered during the year ended September 29, 2019.

Name	Fees Earned or Paid in Cash (\$)
David Kittay ⁽¹⁾	\$ 24,000
Danny Schoening	-
Karen Hawkins	-
Bill Bates	-

(1) Director and meeting fees paid quarterly from October 2018 through September 2019. Each independent director receives \$5,500 for each quarter served from October 2018 through September 2019, plus travel and incidental expenses associated with board activities. Mr. Kittay resigned as a Director on November 4, 2019.

The members of our board of directors are actively involved in various aspects of our business ranging from relatively narrow board oversight functions to providing hands-on guidance to our executives and scientific staff with respect to matters within their personal experience and expertise. We believe that the active involvement of all directors in our principal business and policy decisions increases our board of directors’ understanding of our needs and improves the overall quality of our management decisions.

With the exception of Danny Schoening, Karen Hawkins and Bill Bates, our directors are compensated separately for service as independent members of our board of directors.

On November 4, 2019, the Board of Directors of Optex Systems Holdings, Inc. (the “Company”) appointed three new directors: Larry Hagenbuch, Dale Lehmann and Rimmy Malhotra, all of whom have been qualified as independent as defined under Nasdaq Listing Rules by the Board. All three new independent directors will be compensated in accordance with the Company’s non-employee director compensation policies. Larry Hagenbuch will serve as the Audit Committee Chair and Rimmy Malhotra will serve as the Compensation Committee Chair. Bill Bates and Karen Hawkins have resigned as directors of the Company in order to enable the Company to have this reconstituted Board comprised of a majority of independent directors. David Kittay also resigned from the Company’s Board and Audit Committee to pursue other business interests.

On November 14, 2019, the Board of Directors reviewed the independent director compensation and concluded to leave the pay as is currently in place for former independent directors, currently set at \$5.5 thousand per quarter served. The board determined to revisit the independent board compensation during the first calendar quarter of 2020.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

On December 16, 2019, we had 8,436,422 shares of common stock, 4,125,200 warrants, 216,500 granted and unvested restricted stock units and 25,000 vested and exercisable stock options. The following table sets forth certain information with respect to the beneficial ownership of our securities as of December 16, 2019, for (i) each of our directors and executive officers; (ii) all of our directors and executive officers as a group (not noting our four new directors who have not yet been issued any stock or options which have vested); and (iii) each person who we know beneficially owns more than 5% of our common stock.

Beneficial ownership data in the table has been calculated based on Commission rules that require us to identify all securities that are exercisable or convertible into shares of our common stock within 60 days of December 16, 2019 and treat the underlying stock as outstanding for the purpose of computing the percentage of ownership of the holder.

Except as indicated by the footnotes following the table, and subject to applicable community property laws, each person identified in the table possesses sole voting and investment power with respect to all capital stock held by that person. The address of each named executive officer and director, unless indicated otherwise by footnote, is c/o our corporate headquarters.

Except as otherwise set forth below, the address of each of the persons listed below is our address.

Title of Class	Name of Beneficial Owner	Number of Shares	Percentage of Outstanding Shares
5% Holders	Gate City Capital Management LLC ⁽¹⁾	1,320,609	15.7%
	Ephraim Fields ⁽²⁾	1,179,174	14.0%
	David W. Wright ⁽³⁾	830,100	9.8%
Directors and Officers:	Danny Schoening ⁽⁴⁾	827,627	9.7%
	Karen Hawkins ⁽⁵⁾	233,176	2.7%
	Bill Bates ⁽⁶⁾	39,063	0.5%
Directors and officers as a group (3 Individuals) ⁽⁷⁾		1,099,866	12.9%

1 Represents 1,320,609 common shares reported as held by Gate City Capital Management LLC, 70 West Madison Street, Suite 1400 Chicago, IL 60602 on SEC schedule 13G/A (filed on February 13, 2019).

2 Represents 1,179,174 common shares reported as held by Ephraim Fields (c/o Echo Lake Capital) located at 501 Madison Avenue, Floor 12A New York, NY 10022 on SEC schedule 13D (filed on October 3, 2019).

3 Represents 830,100 common shares controlled by David W. Wright for Henry Partners, L.P. Matthew Partners, L.P. Henry Investment Trust, L.P. and David W. Wright, located at 255 South 17th Street, Ste. 1102 Philadelphia, PA 19103, as reported on SEC schedule 13D (filed on October 3, 2019).

4 Includes common shares held of 758,327, restricted stock units of 51,000 expected to vest on January 1, 2020, and options to purchase 10,000 shares of our common stock which have vested and are currently exercisable, and 8,300 warrants.

5 Represents common shares held of 211,176 and restricted stock units of 17,000 expected to vest on January 1, 2020 and options to purchase 5,000 shares of our common stock which have vested and are currently exercisable.

6 Represents common shares held of 22,563 and restricted stock units of 16,500 expected to vest on January 1, 2020.

7 Represents common shares, options, and warrants held by Danny Schoening, Karen Hawkins, and Bill Bates.

Item 13 Certain Relationships and Related Transactions, and Director Independence

None

Transactions with Executive Management

See the “Executive Compensation” section for a discussion of the material elements of compensation awarded to, earned by or paid to our named executive officers. Other than as stated in the “Executive Compensation” section, we have not entered into any transactions with executive management.

Director Independence

As of the date of filing of this Annual Report, the Company has three independent directors, as such term is defined under NASDAQ standards and one non independent director.

Item 14 Principal Accountant Fees and Services

The following table sets forth the fees paid to date for audit services rendered during fiscal years ended September 29, 2019 and September 30, 2018, respectively.

Fee Category	2019	2018
Audit Fees ⁽¹⁾	\$ 75,650	\$ 81,239
Audit-Related Fees-registration statement consents ⁽²⁾	5,000	5,000
Tax Fees	7,300	9,300

(1) Audit Fees are fees for professional services performed for the audit of our annual consolidated financial statements and review of consolidated financial statements included in our 10-Q filings for the fiscal years ended September 29, 2019 and September 30, 2018, respectively.

(2) Fees paid in related to consent for S-1 registration statement and procedures associated with SEC comment letter for S-1 registration statement.

Item 15 Exhibits

Exhibits

<u>Exhibit No.</u>	<u>Description</u>
1.1	<u>Form of Underwriting Agreement⁽²⁸⁾</u>
2.1	<u>Agreement and Plan of Reorganization, dated as of the March 30, 2009, by and between registrant, a Delaware corporation and Optex Systems, Inc., a Delaware corporation⁽¹⁾</u>
3.1	<u>Certificate of Incorporation, as amended, of Optex Systems Holdings, Inc.⁽²⁾</u>
3.2	<u>Bylaws of Optex Systems Holdings⁽¹⁾</u>
3.3	<u>Charters of the Audit Committee, Compensation Committee and Nominating Committee⁽²⁶⁾</u>
4.1	<u>Certificate of Powers, Designations, Preferences and Rights of the Series B Preferred Stock of Optex Systems Holdings, Inc. dated March 26, 2015⁽²³⁾</u>
4.2	<u>Form of Warrant for Offering⁽²⁵⁾</u>
4.3	<u>Form of Underwriter Warrant for Offering⁽²⁵⁾</u>
4.4	<u>Certificate of Designation of Series C Convertible Preferred Stock⁽²⁹⁾</u>
10.1	<u>2009 Stock Option Plan⁽¹⁾</u>
10.2	<u>Employment Agreement with Danny Schoening⁽¹⁾</u>
10.3	<u>Lease for 1420 Presidential Blvd., Richardson, TX⁽¹⁾</u>
10.4	<u>Form of Warrant⁽³⁾</u>
10.5	<u>Specimen Stock Certificate⁽³⁾</u>
10.6	<u>Contract W52H0905D0248 with Tank-automotive and Armaments Command, dated August 19, 2005⁽⁵⁾⁽⁶⁾</u>
10.7	<u>Contract W52H0909D0128 with Tank-automotive and Armaments Command, dated March 24, 2009⁽⁵⁾</u>
10.8	<u>Contract W52H0905D0260 with Tank-automotive and Armaments Command, dated August 3, 2005⁽⁵⁾⁽⁶⁾</u>
10.9	<u>PO# 40050551 with General Dynamics, dated June 8, 2009⁽⁵⁾⁽⁶⁾</u>
10.10	<u>Contract 9726800650 with General Dynamics, dated April 9, 2007⁽⁵⁾⁽⁶⁾</u>
10.11	<u>Form of Subscription Agreement⁽⁴⁾</u>

Exhibit No.	Description
10.12	Single Source Supplier Purchase Orders with TSP Inc. ⁽⁵⁾
10.13	Single Source Supplier Purchase Orders with SWS Trimac ⁽⁵⁾
10.14	Single Source Supplier Purchase Orders with Danaher Controls ⁽⁵⁾
10.15	Single Source Supplier Purchase Orders with Spartech Polycast ⁽⁵⁾
10.16	Third Amendment to Lease, between Aquiport DFWIP and Optex Systems, Inc., dated January 7, 2010 ⁽⁵⁾
10.17	\$250,000 principal amount Note in favor of the Longview Fund, L.P., dated October 27, 2009 ⁽⁹⁾
10.18	Investor Relations Agreement, dated April 1, 2009 between Optex Systems and American Capital Ventures, Inc. ⁽⁹⁾
10.19	Form of Loan and Security Agreement between Optex Systems, Inc. and Peninsula Bank Business Funding, dated March 4, 2010 ⁽⁵⁾
10.20	Form of Unconditional Guaranty executed by Optex Systems Holdings, Inc. in favor of Peninsula Bank Business Funding, dated March 4, 2010 ⁽⁵⁾
10.21	Form of Warrant issued by Optex Systems Holdings, Inc. to Peninsula Bank Business Funding, dated March 4, 2010 ⁽⁵⁾
10.22	Allonge to Promissory Note, dated January 5, 2010 ⁽⁹⁾
10.23	Showcase Agreement between Optex Systems, Inc. and ECON Corporate Services, Inc., dated April 1, 2009 ⁽⁹⁾
10.24	Consulting Agreement dated June 29, 2009, between ZA Consulting, Inc. and Optex Systems, Inc. ⁽⁹⁾
10.25	Purchase Order dated June 28, 2010 with TACOM-Warren ⁽⁷⁾
10.26	First Amendment to Loan and Security Agreement, dated August 3, 2010, by and between Peninsula Bank Business Funding and Optex Systems, Inc. ⁽⁸⁾
10.27	Waiver by Peninsula Bank Business Funding to Optex Systems, Inc., dated November 24, 2010 ⁽¹⁰⁾
10.28	Second Amendment to Loan and Security Agreement, dated November 29, 2010, by and between Peninsula Bank Business Funding and Optex Systems, Inc. ⁽¹⁰⁾
10.29	Third Amendment to Loan and Security Agreement, dated February 15, 2011, by and between Peninsula Bank Business Funding and Optex Systems, Inc. ⁽¹¹⁾
10.30	Fourth Amendment to Loan and Security Agreement, dated March 22, 2011, by and between Peninsula Bank Business Funding and Optex Systems, Inc. ⁽¹²⁾
10.31	Waiver of Series A preferred shareholders ⁽¹⁴⁾
10.32	Form of Subscription Agreement ⁽¹⁵⁾

Exhibit No.	Description
10.33	PO# SPRDL1-12-C-0023 with DLA Land-Warren, dated October 24, 2011⁽¹⁶⁾
10.34	Agreement with GDLS-Canada, dated as of November 3, 2011⁽¹⁹⁾
10.35	Amendment to 2009 Stock Option Plan⁽¹⁷⁾
10.36	Amendment to the Articles of Incorporation⁽¹⁸⁾
10.37	Amendment to Credit Facility with Avidbank⁽²⁰⁾
10.38	Purchase Agreement dated November 3, 2014⁽²¹⁾
10.39	Assignment of Lease dated October 30, 2014⁽²¹⁾
10.40	Form of Subscription Agreement⁽²²⁾
10.41	Form of Convertible Note⁽²²⁾
10.42	Form of Registration Rights Agreement⁽²²⁾
10.43	Form of Make Whole Agreement⁽²²⁾
10.44	Supply Agreement, dated May 26, 2015, between Optex Systems Holding, Inc. and Nightforce Optics, Inc.⁽²⁴⁾
10.45	First Amendment to Amended and Restated Loan Agreement with Avidbank⁽²⁶⁾
10.46	Restricted Stock Unit Plan⁽²⁷⁾
10.47	Form of RSU Agreement⁽²⁷⁾
10.48	Employment Agreement with Karen Hawkins, dated as of August 1, 2016⁽²⁵⁾
10.49	Form of Lease⁽³⁰⁾
10.50	Form of Letter of Credit⁽³⁰⁾
10.51	Form of Second Amendment to Loan Agreement⁽³⁰⁾
10.52	Form of Stock Repurchase Agreement⁽³¹⁾
10.53	Form of Note Satisfaction Agreement⁽³²⁾
10.54	Form of Stock Purchase Agreement⁽³²⁾
10.55	Form of Award/Contract between the Company and US DLA, dated July 3, 2017⁽³³⁾
10.56	Amendment to AvidBank Facility dated April 5, 2018⁽³⁴⁾
14.1	Code of Ethics⁽³⁾
21.1	List of Subsidiaries — Optex Systems, Inc.⁽¹⁾

- 31.1 [Certifications pursuant to Section 302 of Sarbanes Oxley Act of 2002](#)
- 31.2 [Certifications pursuant to Section 302 of Sarbanes Oxley Act of 2002](#)
- 32.1 [Certifications pursuant to Section 906 of Sarbanes Oxley Act of 2002](#)
- 32.2 [Certifications pursuant to Section 906 of Sarbanes Oxley Act of 2002](#)

EX-101.INS	XBRL Instance Document
EX-101.SCH	XBRL Taxonomy Extension Schema Document
EX-101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
EX-101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
EX-101.LAB	XBRL Taxonomy Extension Label Linkbase Document
EX-101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

- (1) Incorporated by reference from our Current Report on Form 8-K dated April 3, 2009.
- (2) Incorporated by reference from our Amendment No. 4 to Registration Statement on Form S-1 filed on September 28, 2009
- (3) Incorporated by reference from our Registration Statement on Form S-1 filed on May 19, 2009
- (4) Incorporated by reference from our Form 10-K for the fiscal year ended September 27, 2009, filed on January 11, 2010
- (5) Incorporated by reference from our Amendment No. 4 to Registration Statement on Form S-1 filed on June 14, 2010
- (6) This exhibit is missing part of the original bid/solicitation package as such information can only be obtained from third parties with which the registrant has no affiliation, and registrant has made requests from such third parties for such information, and such parties have not been able to provide such information.
- (7) Incorporated by reference from our Current Report on Form 8-K dated July 2, 2010
- (8) Incorporated by reference from our Form 10-Q for the quarter ended on June 27, 2010, filed on September 11, 2010
- (9) Incorporated by reference from our Amendment No. 5 to Registration Statement on Form S-1 filed on September 3, 2010
- (10) Incorporated by reference from our Amendment No. 20 to Registration Statement on Form S-1 filed on January 13, 2011
- (11) Incorporated by reference from our Form 10-Q for the quarter ended on January 2, 2011, filed on February 16, 2011
- (12) Incorporated by reference from our Current Report on Form 8-K filed on March 28, 2011
- (13) Intentionally left blank
- (14) Incorporated by reference from our Form S-1 filed on August 1, 2011
- (15) Incorporated by reference from our Form S-1 filed on September 2, 2011

- (16) Incorporated by reference from our Current Report on Form 8-K filed on November 7, 2011
- (17) Incorporated by reference from our Form 10-K filed on December 27, 2011
- (18) Incorporated by reference from our Amendment No. 5 to Registration Statement on Form S-1 filed on January 27, 2012
- (19) Incorporated by reference from our Form 10-K/A for the year ended September 30, 2018, filed on March 27, 2012
- (20) Incorporated by reference from our Form 10-Q for the quarter ended on April 1, 2012, filed on May 15, 2012
- (21) Incorporated by reference from our Current Report on Form 8-K, dated November 7, 2014
- (22) Incorporated by reference from our Current Report on Form 8-K, dated November 18, 2014
- (23) Incorporated by reference from our Current Report on Form 8-K, dated April 1, 2015
- (24) Incorporated by reference from our Current Report on Form 8-K, dated July 13, 2015
- (25) Incorporated by reference from our Current Report on Form 8-K, filed on August 10, 2016
- (26) Incorporated by reference from our Current Report on Form 8-K, filed on April 28, 2016
- (27) Incorporated by reference from our Current Report on Form 8-K, filed on June 17, 2016
- (28) Incorporated by reference from our Amendment No. 2 to Form S-1, filed on August 12, 2016
- (29) Incorporated by reference from our Amendment No. 5 to Form S-1, filed on August 22, 2016
- (30) Incorporated by reference from our Current Report on Form 8-K, filed on November 23, 2016
- (31) Incorporated by reference from our Current Report on Form 8-K, filed on May 1, 2017
- (32) Incorporated by reference from our Current Report on Form 8-K, filed on June 15, 2017
- (33) Incorporated by reference from our Current Report on Form 8-K, filed on July 10, 2017
- (34) Incorporated by reference from our Current Report on Form 8-K, dated April 11, 2018

Item 16. Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

OPTEX SYSTEMS HOLDINGS, INC.

By: /s/ Danny Schoening
Danny Schoening, Principal Executive Officer and Director

Date: December 16, 2019

By: /s/ Karen Hawkins
Karen Hawkins, Principal Financial Officer and Principal Accounting Officer

Date: December 16, 2019

Pursuant to the requirements of the Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Danny Schoening</u> Danny Schoening	Chairman, Principal Executive Officer and Director	December 16, 2019
<u>/s/ Karen Hawkins</u> Karen Hawkins	Principal Financial Officer and Principal Accounting Officer	December 16, 2019
<u>/s/ Larry Hagenbuch</u> Larry Hagenbuch	Director and Audit Committee Chair	December 16, 2019
<u>/s/ Rimmy Malhotra</u> Rimmy Malhotra	Director and Compensation Committee Chair	December 16, 2019
<u>/s/ Dale Lehmann</u> Dale Lehmann	Director	December 16, 2019

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002**

I, Danny Schoening, certify that:

1. I have reviewed this Form 10-K of Optex Systems Holdings, Inc.:
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ Danny Schoening
Danny Schoening
Principal Executive Officer

Dated: December 16, 2019

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002**

I, Karen Hawkins, certify that:

1. I have reviewed this Form 10-K of Optex Systems Holdings, Inc.:
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ Karen Hawkins
Karen Hawkins
Principal Financial Officer and
Principal Accounting Officer

Dated: December 16, 2019

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with this Annual Report of Optex Systems Holdings, Inc. (the "Company") on this Form 10-K for the year ended September 29, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Danny Schoening, Principal Executive Officer of the Company, certify to the best of my knowledge, pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Sec. 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

By: /s/ Danny Schoening
Danny Schoening
Principal Executive Officer

Dated: December 16, 2019

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with this Annual Report of Optex Systems Holdings, Inc. (the "Company") on this Form 10-K for the year ended September 29, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Karen Hawkins, Principal Financial Officer and Principal Accounting Officer of the Company, certify to the best of my knowledge, pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Sec. 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

By: /s/ Karen Hawkins
Karen Hawkins
Principal Financial Officer and Principal Accounting Officer

Dated: December 16, 2019
