

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

FORM 10-Q

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

For the quarterly period ended **June 27, 2021**

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

For the transition period from _____ to _____.

OPTEX SYSTEMS HOLDINGS, INC.

(Exact Name of Registrant as Specified in Charter)

Delaware
(State or other jurisdiction
of incorporation)

000-54114
(Commission
File Number)

90-0609531
(IRS Employer
Identification No.)

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

75081-2439
(Zip Code)

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

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

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 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 such files).

Yes No

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).

Yes No

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. | | |

State the number of shares outstanding of each of the issuer's classes of common equity, as of August 16, 2021: 8,483,295 shares of common stock.

**OPTEX SYSTEMS HOLDINGS, INC.
FORM 10-Q**

For the period ended **June 27, 2021**

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Part 1. Financial Information

Item 1. Consolidated Financial Statements

OPTEX SYSTEMS HOLDINGS, INC.
UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
AS OF JUNE 27, 2021

| | |
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Optex Systems Holdings, Inc.
Condensed Consolidated Balance Sheets

| | (Thousands, except share and per share data) | |
|---------------------------------------------------|----------------------------------------------|--------------------|
| | June 27, 2021 | September 27, 2020 |
| | (Unaudited) | |
| ASSETS | | |
| Cash and Cash Equivalents | \$ 4,758 | \$ 4,700 |
| Accounts Receivable, Net | 1,382 | 2,953 |
| Inventory, Net | 8,645 | 8,791 |
| Prepaid Expenses | 324 | 229 |
| Current Assets | 15,109 | 16,673 |
| Property and Equipment, Net | 1,026 | 1,006 |
| Other Assets | | |
| Deferred Tax Asset | 1,309 | 1,227 |
| Right-of-use Asset | 3,721 | 1,416 |
| Security Deposits | 23 | 23 |
| Other Assets | 5,053 | 2,666 |
| Total Assets | \$ 21,188 | \$ 20,345 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Accounts Payable | \$ 408 | \$ 833 |
| Credit Facility | 377 | - |
| Operating Lease Liability | 529 | 417 |
| Accrued Expenses | 872 | 1,077 |
| Warrant Liability | 519 | 2,544 |
| Accrued Warranty Costs | 68 | 83 |
| Customer Advance Deposits | - | 1 |
| Current Liabilities | 2,773 | 4,955 |
| Other Liabilities | | |
| Credit Facility | - | 377 |
| Operating Lease Liability, net of current portion | 3,254 | 1,037 |
| Other Liabilities | 3,254 | 1,414 |
| Total Liabilities | 6,027 | 6,369 |
| Commitments and Contingencies | | |
| Stockholders' Equity | | |

| | | |
|------------------------------------------------------------------------------------------------------------------------------------------------------|------------------|------------------|
| Common Stock – (\$0.001 par, 2,000,000,000 authorized, 8,334,995 and 8,795,869 shares issued, and 8,334,995 and 8,690,136 outstanding, respectively) | 8 | 9 |
| Treasury Stock (at cost, zero and 105,733 shares held, respectively) | - | (200) |
| Additional Paid in capital | 25,403 | 26,276 |
| Accumulated Deficit | (10,250) | (12,109) |
| Stockholders' Equity | 15,161 | 13,976 |
| Total Liabilities and Stockholders' Equity | \$ 21,188 | \$ 20,345 |

The accompanying notes are an integral part of these financial statements

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Optex Systems Holdings, Inc.
Condensed Consolidated Statements of Operations

| | (Thousands, except share and per share data) | | | |
|-------------------------------------------------------------|----------------------------------------------|------------------|-------------------|------------------|
| | Three months ended | | Nine months ended | |
| | June 27, 2021 | June 28, 2020 | June 27, 2021 | June 28, 2020 |
| Revenue | \$ 4,433 | \$ 5,849 | \$ 13,149 | \$ 18,682 |
| Cost of Sales | 3,687 | 4,368 | 11,190 | 14,114 |
| Gross Margin | 746 | 1,481 | 1,959 | 4,568 |
| General and Administrative Expense | 689 | 855 | 2,238 | 2,442 |
| Operating Income (Loss) | 57 | 626 | (279) | 2,126 |
| Gain (Loss) on Change in Fair Value of Warrants | 1,167 | (585) | 2,025 | (504) |
| Interest Expense | (4) | (5) | (9) | (17) |
| Other Income (Expense) | 1,163 | (590) | 2,016 | (521) |
| Income Before Taxes | 1,220 | 36 | 1,737 | 1,605 |
| Income Tax Expense (Benefit), net | \$ (154) | \$ 131 | (122) | 435 |
| Net Income (Loss) | \$ 1,374 | \$ (95) | \$ 1,859 | \$ 1,170 |
| Deemed dividends on participating securities | (464) | - | (622) | (372) |
| Net income (loss) applicable to common shareholders | \$ 910 | \$ (95) | \$ 1,237 | \$ 798 |
| Basic income (loss) per share | \$ 0.11 | \$ (0.01) | \$ 0.15 | \$ 0.09 |
| Weighted Average Common Shares Outstanding - basic | 8,101,223 | 8,491,803 | 8,204,994 | 8,472,739 |
| Diluted income (loss) per share | \$ 0.11 | \$ (0.01) | \$ 0.15 | \$ 0.09 |
| Weighted Average Common Shares Outstanding - diluted | 8,138,106 | 8,491,803 | 8,292,544 | 8,596,745 |

The accompanying notes are an integral part of these financial statements

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Optex Systems Holdings, Inc.
Condensed Consolidated Statements of Cash Flows

| | (Thousands) | |
|------------------------------------------------------------------------------------------|-------------------|---------------|
| | Nine months ended | |
| | June 27, 2021 | June 28, 2020 |
| Cash Flows from Operating Activities: | | |
| Net Income | \$ 1,859 | \$ 1,170 |
| Adjustments to Reconcile Net Income to Net Cash provided by Operating Activities: | | |
| Depreciation and Amortization | 195 | 185 |
| (Gain) Loss on Change in Fair Value of Warrants | (2,025) | 504 |
| Stock Compensation Expense | 171 | 120 |
| Deferred Tax | (81) | 144 |
| Accounts Receivable | 1,570 | 89 |
| Inventory | 146 | 332 |
| Prepaid Expenses | (95) | 69 |
| Leases | 23 | (32) |
| Accounts Payable and Accrued Expenses | (631) | (782) |

| | | |
|-------------------------------------------------------------------------------|-----------------|-----------------|
| Accrued Warranty Costs | (15) | 65 |
| Customer Advance Deposits | (1) | (3) |
| Increase (Decrease) In Accrued Estimated Loss On Contracts | - | - |
| Total Adjustments | (743) | 691 |
| Net Cash provided by Operating Activities | 1,116 | 1,861 |
| Cash Flows used in Investing Activities | | |
| Purchases of Property and Equipment | (214) | (150) |
| Net Cash used in Investing Activities | (214) | (150) |
| Cash Flows provided by (used in) Financing Activities | | |
| Cash Paid for Taxes Withheld On Net Settled Restricted Stock Unit Share Issue | (44) | (54) |
| Borrowings from Credit Facility | - | 127 |
| Stock Repurchase | (800) | (64) |
| Net Cash (used in) provided by Financing Activities | (844) | 9 |
| Net Increase in Cash and Cash Equivalents | 58 | 1,720 |
| Cash and Cash Equivalents at Beginning of Period | 4,700 | 1,068 |
| Cash and Cash Equivalents at End of Period | \$ 4,758 | \$ 2,788 |

Supplemental Cash Flow Information:

| | | | |
|-------------------------------|----|-------|----------|
| Non Cash Transactions: | | | |
| Right-of-Use Asset | \$ | 3,688 | \$ 1,811 |
| Operating Lease Liabilities | | 3,688 | 1,894 |
| Treasury stock retired | | 1,000 | - |
| Cash Transactions: | | | |
| Cash Paid for Taxes | | 48 | 289 |
| Cash Paid for Interest | | 9 | 16 |

The accompanying notes are an integral part of these financial statements

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Optex Systems Holdings, Inc.
Condensed Consolidated Statements of Stockholders' Equity
(Thousands, except share data)

| | Three months ended June 27, 2021 | | | | | | |
|----------------------------------------|----------------------------------|-----------|-------------|-------------|------------------|--------------------|------------------|
| | Common | Treasury | Common | Treasury | Additional | Retained | Total |
| | Shares | Shares | Stock | Stock | Paid in | Earnings | Stockholders |
| Balance at March 28, 2021 | 8,854,261 | 480,667 | \$ 9 | \$ (930) | \$ 26,346 | \$ (11,624) | \$ 13,801 |
| Stock Compensation Expense | - | - | - | - | 57 | - | 57 |
| Common Stock Repurchase ⁽¹⁾ | - | 38,599 | - | (70) | - | - | (70) |
| Cancellation of Treasury Shares | (519,266) | (519,266) | (1) | 1,000 | (1,000) | - | (1) |
| Net income | - | - | - | - | - | 1,374 | 1,374 |
| Balance at June 27, 2021 | 8,334,995 | - | \$ 8 | \$ - | \$ 25,403 | \$ (10,250) | \$ 15,161 |

| | Nine months ended June 27, 2021 | | | | | | |
|-------------------------------------------------------------|---------------------------------|-----------|-------------|-------------|------------------|--------------------|------------------|
| | Common | Treasury | Common | Treasury | Additional | Retained | Total |
| | Shares | Shares | Stock | Stock | Paid in | Earnings | Stockholders |
| Balance at September 27, 2020 | 8,795,869 | 105,733 | \$ 9 | \$ (200) | \$ 26,276 | \$ (12,109) | \$ 13,976 |
| Stock Compensation Expense | - | - | - | - | 171 | - | 171 |
| Vested restricted stock units issued net of tax withholding | 58,392 | - | - | - | (44) | - | (44) |
| Common Stock Repurchase ⁽¹⁾ | - | 413,533 | - | (800) | - | - | (800) |
| Cancellation of Treasury Shares | (519,266) | (519,266) | (1) | 1,000 | (1,000) | - | (1) |
| Net income | - | - | - | - | - | 1,859 | 1,859 |
| Balance at June 27, 2021 | 8,334,995 | - | \$ 8 | \$ - | \$ 25,403 | \$ (10,250) | \$ 15,161 |

| | Three months ended June 28, 2020 | | | | | | |
|----------------------------|----------------------------------|----------|--------|----------|------------|-------------|--------------|
| | Common | Treasury | Common | Treasury | Additional | Retained | Total |
| | Shares | Shares | Stock | Stock | Paid in | Earnings | Stockholders |
| Balance at March 29, 2020 | 8,495,869 | - | \$ 8 | \$ - | \$ 26,137 | \$ (12,669) | 13,476 |
| Stock Compensation Expense | - | - | - | - | 63 | - | 63 |

| | | | | | | | |
|-------------------------------------------------------------|-----------------------------|------------------------|---------------------|-----------------------|-----------------------------------|--------------------------|----------------------------------|
| Restricted Board Shares Issued ⁽²⁾ | 300,000 | - | 1 | - | (1) | - | - |
| Common Stock Repurchase ⁽¹⁾ | - | 34,243 | - | (64) | - | - | (64) |
| Net loss | - | - | - | - | - | (95) | (95) |
| Balance at June 28, 2020 | 8,795,869 | 34,243 | \$ 9 | \$ (64) | \$ 26,199 | \$ (12,764) | \$ 13,380 |
| Nine months ended June 28, 2020 | | | | | | | |
| | Common Shares Issued | Treasury Shares | Common Stock | Treasury Stock | Additional Paid in Capital | Retained Earnings | Total Stockholders Equity |
| Balance at September 29, 2019 | 8,436,422 | - | \$ 8 | \$ - | \$ 26,134 | \$ (13,934) | 12,208 |
| Stock Compensation Expense | - | - | - | - | 120 | - | 120 |
| Vested restricted stock units issued net of tax withholding | 59,447 | - | - | - | (54) | - | (54) |
| Restricted Board Shares Issued ⁽²⁾ | 300,000 | - | 1 | - | (1) | - | - |
| Common Stock Repurchase ⁽¹⁾ | - | 34,243 | - | (64) | - | - | (64) |
| Net income | - | - | - | - | - | 1,170 | 1,170 |
| Balance at June 28, 2020 | 8,795,869 | 34,243 | \$ 9 | \$ (64) | \$ 26,199 | \$ (12,764) | \$ 13,380 |

(1) Common shares repurchased in the open market through June 27, 2021. Shares were held in treasury stock using the cost method and cancelled in June 2021.

(2) 100,000 restricted common shares issued to each of the Independent Board of Directors (Rimmy Maholtra, Dale Lehman, Larry Hagenbuch) on April 30, 2020 with 20% vesting as of each January 1 each year over a five year period. The value of the shares at issue date is \$525,000 for 300,000 shares to be amortized over the vesting period.

The accompanying notes are an integral part of these financial statements

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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. The Company 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. The Company's consolidated revenues are derived from the U.S. government, 28.3%, three major U.S. defense contractors, 29.7%, 12.4% and 6.0%, one commercial customer 6.8%, and all other customers, 16.8%. Approximately 90.5% of the total company revenue is generated from domestic customers and 9.5% is derived from foreign customers. Optex Systems Holdings' operations are based in Dallas and Richardson, Texas in leased facilities comprising 93,967 square feet. As of June 27, 2021, Optex Systems Holdings operated with 85 full-time equivalent employees.

We may be at risk as a result of the current COVID-19 pandemic. Risks that could affect our business include the duration and scope of the COVID-19 pandemic and the impact on the demand for our products; actions by governments, businesses and individuals taken in response to the pandemic; the length of time of the COVID-19 pandemic and the possibility of its recurrence; the timing required to develop effective treatments and distribute vaccines in the event of future outbreaks; the eventual impact of the pandemic and actions taken in response to the pandemic on global and regional economies; and the pace of recovery when the COVID-19 pandemic subsides.

During the last twelve months, we have experienced a significant reduction in new orders and ending customer backlog across all but one of our product lines. We attribute the lower orders to a combination of factors including a COVID-19 driven slow-down of contract awards for both U.S. military sales and foreign military sales (FMS), combined with some shifting in defense spending budget allocations in US military sales and FMS away from Army ground system vehicles toward other military agency applications. Due to the significant level of uncertainty surrounding the pandemic and its impact to our customers and the defense supply chain, we are unable to ascertain the impact further delays in contract awards and customer orders may have on the next twelve months. We have experienced a reduction of 29.6% in revenue volume during the first nine months of fiscal year 2021, as compared to the first nine months of fiscal year 2020. We have experienced a recent increase in proposal requests, and anticipate an increase in orders over the next six to twelve months, however the timing and nature of new orders in the near term cannot be determined. We have implemented several cost-saving initiatives during the first nine months, including reductions in force, employee compensation and discretionary spending. We are reviewing additional cost reductions during the next sixty to ninety days as required to further minimize the impact of any sustained delays in customer orders beyond the first nine months of fiscal year 2021.

Note 2 - Accounting Policies

Basis of Presentation

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

The condensed consolidated financial statements of Optex Systems Holdings included herein have been prepared by Optex Systems Holdings, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in conjunction with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading.

These condensed consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements and the notes thereto included in the Optex Systems Holdings' Form 10-K for the year ended September 27, 2020 and other reports filed with the SEC.

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

is not required for interim financial reporting purposes has been omitted.

Leases: On January 11, 2021 the Company executed amendments for each of the leased facilities extending the terms for eighty-six (86) months, commencing at the end of the current lease agreements. The Richardson lease amendment commences on April 1, 2021 for an eighty-six (86) month term ending on May 31, 2028. The Dallas lease amendment commences on November 1, 2021 for an eighty-six (86) month term ending on December 31, 2028. Each of the leases include two full months of rent abatement at the beginning of the commencement term. Execution of the new lease amendments resulted in the balance sheet recognition of a right-of-use asset of \$3.7 million and corresponding operating lease liabilities of approximately \$3.7 million during the nine months ended June 27, 2021. See also Note 4.

Inventory: As of June 27, 2021, and September 27, 2020, inventory included:

| | (Thousands) | |
|--------------------------|-----------------|--------------------|
| | June 27, 2021 | September 27, 2020 |
| Raw Material | \$ 4,724 | \$ 5,506 |
| Work in Process | 3,768 | 3,214 |
| Finished Goods | 720 | 638 |
| Gross Inventory | \$ 9,212 | \$ 9,358 |
| Less: Inventory Reserves | (567) | (567) |
| Net Inventory | \$ 8,645 | \$ 8,791 |

Concentration of Credit Risk: Optex Systems Holdings' accounts receivables for the period ended June 27, 2021 are derived from revenues of U.S. government agencies: 19%, six major U.S. defense contractors: 14%, 14%, 11%, 10%, 8%, and 6%, one commercial customer: 15%, and all other customers: 3%. The Company does not believe that this concentration results in undue credit risk because of the financial strength of and its long history with these customers.

Accrued Warranties: Optex Systems Holdings accrues product warranty liabilities based on the historical return rate against period shipments as they occur and reviews and adjusts these accruals quarterly for any significant changes in estimated costs or return rates. The accrued warranty liability includes estimated costs to repair or replace returned warranty backlog units currently in-house plus estimated costs for future warranty returns that may be incurred against warranty covered products previously shipped as of the period end date. As of June 27, 2021, and September 27, 2020, the Company had warranty reserve balances of \$68 thousand and \$83 thousand, respectively.

| | Three months ended | | Nine months ended | |
|------------------------------------------------------------------------------|--------------------|---------------|-------------------|---------------|
| | June 27, 2021 | June 28, 2020 | June 27, 2021 | June 28, 2020 |
| Beginning balance | \$ 63 | \$ 105 | \$ 83 | \$ 46 |
| Incurred costs for warranties satisfied during the period | (4) | (16) | (71) | (16) |
| <i>Warranty Expenses:</i> | | | | |
| Warranties reserved for new product shipped during the period ⁽¹⁾ | 9 | 22 | 18 | 78 |
| Change in estimate for pre-existing warranty liabilities ⁽²⁾ | - | - | 38 | 3 |
| Warranty Expense | <u>9</u> | <u>22</u> | <u>56</u> | <u>81</u> |
| Ending balance | \$ 68 | \$ 111 | \$ 68 | \$ 111 |

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

(2) *Changes in estimated warranty liabilities for associated with the period end customer returned warranty backlog or repaired/replaced warranty units which were shipped to the customer during the period.*

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

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 and accounts payable, 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.

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 6 "Warrant Liabilities". The warrant liability measurement 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.

Revenue Recognition: 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. During the three and nine months ended June 27, 2021 and June 28, 2020, there was \$120 thousand and \$359 thousand in 2021 and \$113 thousand and \$339 thousand in 2020 in service contract revenue recognized over time.

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During the three- and nine-month periods ended June 27, 2021 and June 28, 2020, there was zero and \$1 thousand in 2021 and zero and \$3 thousand in 2020 of revenue recognized from customer deposit liabilities (deferred contract revenue). As of June 27, 2021, there are no customer deposit liabilities. As of the nine months ended June 27, 2021, there are no sales commissions or other significant deferred contract costs.

Income Tax/Deferred Tax: As of June 27, 2021 and September 27, 2020, Optex Systems, Inc. has a deferred tax asset valuation allowance of \$1.0 million against deferred tax assets of \$2.3 million for a net deferred tax asset of \$1.3 million. The valuation allowance has been established due to historical losses resulting in a Net Operating Loss Carryforward for each of the fiscal years 2011 through 2016 which may not be fully recognized due to an IRS Section 382 limitation related to a change in control.

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.

A significant number of our outstanding warrants are participating securities which share dividend distributions and the allocation of any undistributed earnings (deemed dividends) with our common shareholders. During the three and nine months ended June 27, 2021, there were no declared dividends and \$464 and \$622 thousand in allocated undistributed earnings attributable to the participating warrants, respectively. During the three and nine months ended June 28, 2020, there were no declared dividends, and zero and \$372 thousand in undistributed earnings attributable to participating warrants, respectively.

The Company has potentially dilutive securities outstanding which include unvested restricted stock units, stock options and warrants. In computing the dilutive effect of warrants, the numerator is adjusted to add back any deemed dividends on participating securities (warrants) and the denominator is increased to assume the conversion of the number of additional incremental common shares. The Company uses the Treasury Stock Method to compute the dilutive effect of any dilutive shares. Unvested restricted stock units, stock options and warrants that are anti-dilutive are excluded from the calculation of diluted earnings per common share.

For the three months and nine months ended June 27, 2021, 99,000 unvested restricted stock units and 240,000 shares of unvested restricted stock (which convert to 36,883 and 87,550 incremental shares) were included in the diluted earnings per share calculation.

For the three months ended June 28, 2020, 182,000 unvested restricted stock units and 300,000 shares of unvested restricted stock (which convert to 210,112 incremental shares) were excluded from the diluted earnings per share calculation due to the net loss for the period. For the nine months ended June 28, 2020, 182,000 unvested restricted stock units and 300,000 shares of unvested restricted stock (which convert to 124,006 incremental shares) were included in the diluted earnings per share calculation.

For the three and nine-months ended June 27, 2021 and the three and nine-months ended June 28, 2020, 4,125,200 warrants were excluded from the diluted earnings per share calculation due to the antidilutive effect of the undistributed earnings.

Note 3 - 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.

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Optex Systems (OPX) – Richardson, Texas

The Optex Systems segment revenue is comprised of approximately 86.5% domestic military customers and 13.5% foreign military customers. For the nine months ending June 27, 2021, the Optex segment revenue is derived from the U.S. government, 28%, and two major U.S. defense contractors representing 22% and 12%, 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 June 27, 2021, the Richardson facility operated with 53 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 29% and military sales to prime and subcontracted customers represent 71% of the external segment revenue. Approximately 82% of the AOC revenue is derived from external customers and approximately 18% is related to intersegment sales to Optex Systems in support of military contracts. For the nine months ended June 27, 2021, the AOC segment revenue from two major defense contractors represents approximately 8%, and 6% of the Company's consolidated revenue, respectively, and revenue from one commercial customer represents 7% 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 June 27, 2021, AOC operated with 32 full time equivalent employees in a single shift operation.

The financial tables below present the information for each of the reportable segment's 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)

Three months ended June 27, 2021

| | <u>Optex Systems Richardson</u> | <u>Applied Optics Center Dallas</u> | <u>Other (non-allocated costs and intersegment eliminations)</u> | <u>Consolidated Total</u> |
|------------------------------------------|-------------------------------------|---------------------------------------------|--------------------------------------------------------------------------|-------------------------------|
| Revenues from external customers | \$ 3,126 | \$ 1,307 | \$ - | \$ 4,433 |
| Intersegment revenues | - | 41 | (41) | - |
| Total Revenue | \$ 3,126 | \$ 1,348 | \$ (41) | \$ 4,433 |
| Interest expense | - | - | 4 | 4 |
| Depreciation and Amortization | 10 | 57 | - | 67 |
| Income (loss) before taxes | 328 | (214) | 1,106 | 1,220 |
| Other significant noncash items: | | | | |
| Allocated home office expense | \$ (177) | \$ 177 | \$ - | \$ - |
| Gain on change in fair value of warrants | - | - | (1,167) | (1,167) |
| Stock compensation expense | - | - | 57 | 57 |
| Warranty Expense | - | 9 | - | 9 |
| Segment Assets | \$ 14,690 | \$ 6,498 | \$ - | \$ 21,188 |
| Expenditures for segment assets | \$ (3) | \$ 89 | \$ - | \$ 86 |

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**Reportable Segment Financial Information
(thousands)**

Three months ended June 28, 2020

| | <u>Optex Systems Richardson</u> | <u>Applied Optics Center Dallas</u> | <u>Other (non-allocated costs and intersegment eliminations)</u> | <u>Consolidated Total</u> |
|------------------------------------------|-------------------------------------|---------------------------------------------|--------------------------------------------------------------------------|-------------------------------|
| Revenues from external customers | \$ 3,851 | \$ 1,998 | \$ - | \$ 5,849 |
| Intersegment revenues | - | 421 | (421) | - |
| Total Revenue | \$ 3,851 | \$ 2,419 | \$ (421) | \$ 5,849 |
| Interest expense | - | - | 5 | 5 |
| Depreciation and Amortization | 10 | 51 | - | 61 |
| Income before taxes | 97 | 592 | (653) | 36 |
| Other significant noncash items: | | | | |
| Allocated home office expense | \$ (170) | \$ 170 | \$ - | \$ - |
| Loss on Change in Fair Value of Warrants | - | - | 585 | 585 |
| Stock option compensation expense | - | - | 63 | 63 |
| Warranty Expense | - | 22 | - | 22 |
| Segment Assets | \$ 13,602 | \$ 6,522 | \$ - | \$ 20,124 |
| Expenditures for segment assets | \$ 54 | - | - | \$ 54 |

**Reportable Segment Financial Information
(thousands)**

Nine months ended June 27, 2021

| | <u>Optex Systems Richardson</u> | <u>Applied Optics Center Dallas</u> | <u>Other (non-allocated costs and intersegment eliminations)</u> | <u>Consolidated Total</u> |
|------------------------------------------|-------------------------------------|---------------------------------------------|--------------------------------------------------------------------------|-------------------------------|
| Revenues from external customers | \$ 8,958 | \$ 4,191 | \$ - | \$ 13,149 |
| Intersegment revenues | - | 937 | (937) | - |
| Total Revenue | \$ 8,958 | \$ 5,128 | \$ (937) | \$ 13,149 |
| Interest expense | - | - | 9 | 9 |
| Depreciation and Amortization | 31 | 164 | - | 195 |
| Income (loss) before taxes | 351 | (459) | 1,845 | 1,737 |
| Other significant noncash items: | | | | |
| Allocated home office expense | \$ (530) | \$ 530 | \$ - | \$ - |
| Gain on change in fair value of warrants | - | - | (2,025) | (2,025) |
| Stock compensation expense | - | - | 171 | 171 |
| Warranty expense | - | 56 | - | 56 |
| Segment Assets | \$ 14,690 | \$ 6,498 | \$ - | \$ 21,188 |
| Expenditures for segment assets | \$ 17 | \$ 197 | \$ - | \$ 214 |

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Reportable Segment Financial Information
(thousands)

Nine months ended June 28, 2020

| | Optex Systems Richardson | Applied Optics Center Dallas | Other (non-allocated costs and intersegment eliminations) | Consolidated Total |
|------------------------------------------|-------------------------------------|---------------------------------------------|--------------------------------------------------------------------------|-------------------------------|
| Revenues from external customers | \$ 11,917 | \$ 6,765 | \$ - | \$ 18,682 |
| Intersegment revenues | - | 1,202 | (1,202) | - |
| Total Revenue | \$ 11,917 | \$ 7,967 | \$ (1,202) | \$ 18,682 |
| Interest expense | \$ - | \$ - | \$ 17 | \$ 17 |
| Depreciation and Amortization | \$ 24 | \$ 161 | \$ - | \$ 185 |
| Income before taxes | \$ 1,148 | \$ 1,098 | \$ (641) | \$ 1,605 |
| Other significant noncash items: | | | | |
| Allocated home office expense | \$ (510) | \$ 510 | \$ - | \$ - |
| Loss on change in fair value of warrants | \$ - | \$ - | \$ 504 | \$ 504 |
| Stock option compensation expense | \$ - | \$ - | \$ 120 | \$ 120 |
| Warranty Expense | \$ - | \$ 81 | \$ - | \$ 81 |
| Segment Assets | \$ 13,602 | \$ 6,522 | \$ - | \$ 20,124 |
| Expenditures for segment assets | \$ 100 | \$ 50 | \$ - | \$ 150 |

Note 4 - Commitments and Contingencies

Non-cancellable 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, as well as certain office equipment 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. The previous lease expired March 31, 2021 and the monthly base rent was \$24.6 thousand through March 31, 2021. On January 11, 2021 the Company executed a sixth amendment extending the terms of its Optex Systems, Richardson location lease for eighty-six (86) months, commencing on April 1, 2021 and ending on May 31, 2028. The initial base rent is set at \$25.3 thousand and escalates 3% each year thereafter on April 1, each year. The initial term included 2 months of rent abatement for April and May 2021. The monthly rent includes approximately \$11.6 thousand for additional Common Area Maintenance (CAM) fees and taxes, 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. The current lease term will expire on October 31, 2021. The monthly base rent is \$21.9 thousand through October 31, 2021. Our obligations to make payments under the lease are secured by a \$125,000 standby letter of credit. On January 11, 2021 the Company executed a first amendment extending the terms of its current Applied Optics Center, Dallas location lease for eighty-six (86) months, commencing on November 1, 2021 and ending on December 31, 2028. The initial base rent is set at \$23.6 thousand as of January 1, 2022 and escalates 2.75% each year thereafter on January 1, each year. The initial term includes 2 months of rent abatement for November and December of 2021. The amendment provides for a five-year renewal option at the end of the lease term at the greater of the then "prevailing rental rate" or the then current base rent rate. The monthly rent includes approximately \$7.8 thousand for additional CAM, to be adjusted annually based on actual expenses incurred by the landlord.

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The Company has one non-cancellable office equipment lease with a commencement date of October 1, 2018 and a term of 39 months. The lease cost for the equipment is \$1.5 thousand per month from October 1, 2018 through December 31, 2021.

Optex Systems Holdings adopted the provisions of ASC Topic 842 "Leases" as of the fiscal year beginning on September 30, 2019. Optex Systems Holdings has two significant operating facilities leases and one equipment lease which extends beyond twelve months and fall under the guidance of ASC Topic 842. Adoption of ASC Topic 842 resulted in the balance sheet recognition of a right-of-use asset of \$1.8 million and corresponding operating lease liabilities of approximately \$1.9 million as of September 30, 2019, which represented the present value of future lease payments for the term of the equipment lease and both segment facility leases and which assumed the exercise of a five-year renewal option at the Applied Optics Center as of November 1, 2021. Execution of the new lease amendments for the Dallas and Richardson facilities on January 11, 2021 resulted in the balance sheet recognition of a right-of-use asset of \$3.7 million and corresponding operating lease liabilities of approximately \$3.7 million during the nine months ended June 27, 2021.

As of June 27, 2021, the remaining minimum lease and estimated CAM payments under the non-cancelable office and facility space leases are as follows:

Non-cancellable Operating Leases

| Fiscal Year | (Thousands) | | | | |
|---------------------------------------------------|-------------------------------------------------------------|----------------------------------------------------------------------|--------------------------------------------|--------------------------------------------------|----------------------------------------|
| | Optex Richardson Facility Lease Payments | Applied Optics Center Facility Lease Payments | Office Equipment Lease Payments | Consolidated Total Lease Payments | Total Variable CAM Estimate |
| 2021 Base year lease | 76 | 66 | 5 | 147 | 58 |
| 2022 Base year lease | 308 | 234 | 5 | 547 | 237 |
| 2023 Base year lease | 317 | 288 | | 605 | 242 |
| 2024 Base year lease | 327 | 296 | | 623 | 247 |
| 2025 Base year lease | 336 | 305 | | 641 | 252 |
| 2026 Base year lease | 346 | 313 | | 659 | 257 |
| 2027 Base year lease | 357 | 322 | | 679 | 262 |
| 2028 Base year lease | 241 | 330 | | 571 | 188 |
| 2029 Base year lease | - | 83 | | 83 | 27 |
| Total base lease payments | 2,308 | \$ 2,237 | \$ 10 | 4,555 | \$ 1,770 |
| Imputed interest on lease payments ⁽¹⁾ | (363) | (408) | (1) | (772) | |

| | | | | |
|------------------------------------------------------|-----------------|-----------------|-------------|-----------------|
| Total Operating Lease Liability⁽²⁾ | \$ 1,945 | \$ 1,829 | \$ 9 | \$ 3,783 |
| Right-of-use Asset⁽³⁾ | \$ 1,889 | \$ 1,823 | \$ 9 | \$ 3,721 |

- (1) Assumes a discount borrowing rate of 5.0% on the new lease amendments effective as of January 11, 2021 and 7.5% on the remaining lease term for the Applied Optics Dallas facility through October 31, 2021.
- (2) Short-term and Long-term portion of Operating Lease Liability is \$529 thousand and \$3,254 thousand, respectively.
- (3) Includes \$62 thousand of unamortized deferred rent.

Total facilities rental and CAM expense for both facility lease agreements as of the three and nine months ended June 27, 2021 was \$207 thousand and \$569 thousand, respectively. Total facilities rental and CAM expense for both facility lease agreements as of the three and nine months ended June 28, 2020 was \$187 thousand and \$541 thousand, respectively.

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Total office equipment rentals included in operating expenses was \$6 thousand and \$17 thousand for the three and nine months ended June 27, 2021, respectively. Total office equipment rentals included in operating expenses was \$7 thousand and \$19 thousand for the three and nine months ended June 28, 2020, respectively.

Note 5 - Debt Financing

Credit Facility

On April 16, 2020, the Company terminated its facility with Avidbank and entered into a new facility with BBVA USA.

On April 16, 2020, Optex Systems Holdings, Inc. and its subsidiary, Optex Systems, Inc. (and with the Company, the "Borrower") entered into a line of credit facility (the "Facility") with BBVA, USA ("BBVA") The substantive terms are as follows:

- The principal amount of the Facility is \$2.25 million. The Facility matures on April 15, 2022. The interest rate is variable based on BBVA's Prime Rate plus a margin of -0.250%, initially set at 3% at loan origination, and all accrued and unpaid interest is payable monthly in arrears starting on May 15, 2020; and the principal amount is due in full with all accrued and unpaid interest and any other fees on April 15, 2022.
- There are commercially standard covenants including, but not limited to, covenants regarding maintenance of corporate existence, not incurring other indebtedness except trade debt, not changing more than 25% stock ownership of Borrower, and a Fixed Charge Coverage Ratio of 1.25:1, with the Fixed Charge Coverage Ratio defined as (earnings before taxes, depreciation, amortization and rent expense less cash taxes, distribution, dividends and fair value of warrants) divided by (current maturities on long term debt plus interest expense plus rent expense). As of June 27, 2021, the Company was in compliance with the covenants.
- The Facility contains commercially standard events of default including, but not limited to, not making payments when due; incurring a judgment of \$10,000 or more not covered by insurance; not maintaining collateral and the like.
- The Facility is secured by a first lien on all of the assets of Borrower.

The outstanding balance on the facility was \$377 thousand as of June 27, 2021 and September 27, 2020.

Note 6-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 statements of operations.

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The fair value of the warrant liabilities presented below were measured using a Black Scholes Merton (BSM) valuation model. Significant inputs into the respective model at the reporting period measurement dates are as follows:

| Valuation Assumptions | Period ended September 29, 2019 | Period ended September 27, 2020 | Period ended June 28, 2020 | Period ended June 27, 2021 |
|----------------------------------------|--------------------------------------------|--------------------------------------------|---------------------------------------|---------------------------------------|
| 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⁾ | \$ 1.56 | \$ 1.96 | \$ 1.90 | \$ 1.53 |
| Interest Rate (annual) ⁽³⁾ | 1.63% | 0.12% | 0.17% | 0.06% |
| Volatility (annual) | 53.66% | 51.67% | 52.82% | 44.35% |
| Time to Maturity (Years) | 1.9 | 0.9 | 1.2 | 0.2 |
| Calculated fair value per share | \$ 0.49 | \$ 0.62 | \$ 0.62 | \$ 0.13 |

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

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 9/29/2019 | 4,125,200 | \$ 0.49 | \$ 2,036 |
| Loss on Change in Fair Value of Warrant Liability | | | 504 |
| Fair Value as of period ended 6/28/2020 | 4,125,200 | \$ 0.62 | 2,540 |
| Fair Value as of period ended 9/27/2020 | 4,125,200 | \$ 0.62 | \$ 2,544 |
| Gain on Change in Fair Value of Warrant Liability | | | (2,025) |
| Fair Value as of period ended 6/27/2021 | 4,125,200 | \$ 0.13 | \$ 519 |

During the three and nine months ended June 27, 2021 and June 28, 2020, there were no new issues or exercises of existing warrants.

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

Note 7-Stock Based Compensation

Stock Options issued to Employees, Officers and Directors

The Optex Systems Holdings 2009 Stock Option Plan provides for the issuance of up to 75,000 shares to the Company's officers, directors, employees and to independent contractors who provide services to Optex Systems Holdings as either incentive or non-statutory stock options determined at the time of grant. There were no new grants of stock options during the three months ended June 27, 2021. As of June 27, 2021, there are zero stock options outstanding.

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Restricted Stock Units issued to Officers and Employees

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:

| | Restricted Stock Units | Weighted Average Grant Date Fair Value | Restricted Shares | Weighted Average Grant Date Fair Value |
|------------------------------------------|---------------------------|-------------------------------------------------|----------------------|-------------------------------------------------|
| Outstanding at September 29, 2019 | 216,500 | \$ 1.29 | — | — |
| Granted | 50,000 | \$ 2.13 | 300,000 | \$ 1.75 |
| Vested | (84,500) | \$ 1.25 | — | — |
| Forfeited | — | — | — | — |
| Outstanding at September 27, 2020 | 182,000 | \$ 1.54 | 300,000 | \$ 1.75 |
| Granted | — | — | — | — |
| Vested | (83,000) | \$ 1.49 | (60,000) | \$ 1.75 |
| Forfeited | — | — | — | — |
| Outstanding at June 27, 2021 | 99,000 | \$ 1.59 | 240,000 | \$ 1.75 |

On February 17, 2020, the Company granted 50,000 restricted stock units to Bill Bates, General Manager of the Applied Optics Center. The restricted stock units vest 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 \$2.13 per share. The Company will amortize the grant date fair market value of \$107 thousand to stock compensation expense on a straight-line basis across the three-year vesting period beginning on February 17, 2020.

On January 7, 2020, the Company issued 59,447 common shares to one director and two officers, net of tax withholding of \$4 thousand, in settlement of 84,500 restricted stock units which vested on January 1, 2020.

On January 2, 2021, the Company issued 58,392 common shares to directors and officers, net of tax withholding of \$4 thousand, in settlement of 83,000 restricted stock units which vested on January 1, 2021.

On April 30, 2020, the Optex Systems Holdings, Inc. Board of Directors held a meeting and voted to increase the annual board compensation for the three independent directors from \$22,000 to \$36,000 with an effective date of January 1, 2020, in addition to granting 100,000 restricted shares to each independent director which shall vest at a rate of 20% per year (20,000 shares) each January 1st, over the next five years, through January 1, 2025. The total market value for the 300,000 shares is \$525 thousand based on the stock price of \$1.75 as of April 30, 2020. The Company will amortize the fair market value to stock compensation expense on a straight-line basis across the five-year vesting period beginning on April 30, 2020. On January 1, 2021, 60,000 of the restricted director shares vested.

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) | | | | Unrecognized Compensation Expense | |
|---------------------------------|----------------------------------------|------------------|------------------|------------------|--------------------------------------|-----------------------|
| | Recognized Compensation Expense | | | | As of period ended | |
| | Three months ended June 27, 2021 | June 28, 2020 | June 27, 2021 | June 28, 2020 | June 27, 2021 | September 27, 2020 |
| Restricted Shares | \$ 26 | \$ 31 | \$ 79 | \$ 31 | \$ 368 | \$ 446 |
| Restricted Stock Units | 31 | 32 | 92 | 89 | 96 | 188 |
| Total Stock Compensation | \$ 57 | \$ 63 | \$ 171 | \$ 120 | \$ 464 | \$ 634 |

Note 8 Stockholders' Equity**Dividends**

As of the nine months ended June 27, 2021 and the twelve months ended September 27, 2020, there were no declared or outstanding dividends payable.

Common stock

On June 8, 2020 the Company announced authorization for a \$1 million stock repurchase program. The shares authorized to be repurchased under the new repurchase program may be purchased from time to time at prevailing market prices, through open market or in negotiated transactions, depending upon market conditions and subject to Rule 10b-18 as promulgated by the SEC. During the nine months ended June 27, 2021, there were 413,533 common shares repurchased through the program at a cost of \$800 thousand. As of June 27, 2021, the Company has repurchased 519,266 shares at a total cost of \$1.0 million against the stock repurchase plan, with a remaining balance of zero. The shares have been returned to the treasury and were cancelled on June 14, 2021. A summary of the purchases under the plan follows:

(Thousands, except share and price per share data)

| Fiscal Period | Total number of shares purchased | Total purchase cost | Average price paid per share (with commission) | Maximum dollar value that may yet be purchased under the plan |
|----------------------------------------------------------|-----------------------------------------|----------------------------|-------------------------------------------------------|----------------------------------------------------------------------|
| May 24, 2020 through June 28, 2020 | 34,243 | \$ 63 | \$ 1.84 | \$ 937 |
| June 29, 2020 through July 26, 2020 | 6,806 | 13 | 1.89 | 924 |
| July 27, 2020 through August 23, 2020 | 10,688 | 21 | 1.96 | 903 |
| August 23, 2020 through September 27, 2020 | 53,996 | 103 | 1.90 | 800 |
| Total shares repurchases as of September 27, 2020 | 105,733 | \$ 200 | 1.89 | 800 |
| | | | - | |
| September 28, 2020 through October 25, 2020 | 20,948 | 42 | 2.01 | 758 |
| October 26, 2020 through November 22, 2020 | 129,245 | 265 | 2.05 | 493 |
| November 23, 2020 through December 27, 2020 | 58,399 | 109 | 1.86 | 384 |
| December 28, 2020 through January 24, 2021 | 40,362 | 73 | 1.80 | 312 |
| January 25, 2021 through February 21, 2021 | 52,180 | 101 | 1.94 | 211 |
| February 22, 2021 through March 28, 2021 | 73,800 | 140 | 1.90 | 70 |
| March 29, 2021 through April 19, 2021 | 38,599 | 70 | 1.82 | - |
| Total shares repurchased as of June 27, 2021 | 519,266 | \$ 1,000 | \$ 1.93 | \$ - |

As of September 27, 2020, and June 27, 2021, the total outstanding common shares were 8,690,136 and 8,334,995, respectively.

As of September 27, 2020, and June 27, 2021, the total issued common shares were 8,795,869 and 8,334,995, respectively.

Note 9 Subsequent Events*July 2021 Ransomware Attack*

On July 13, 2021, the Company experienced a ransomware attack. The Company isolated the source of the attack and restored normal operations with no material day-to-day impact to the Company or the Company's ability to access its data. Sensitive data may have been breached, and the Company's investigation of the attack is ongoing with assistance from outside experts and the Company is also working with the appropriate US Government officials.

On August 10, 2021, the Company issued 148,300 common shares to an investor on the exercise of warrants at \$1.50 per share. The total amount of the transaction was \$222,450.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**Management's Discussion and Analysis or Plan of Operations**

This MD&A is intended to supplement and complement our audited condensed consolidated financial statements and notes thereto for the fiscal year ended September 27, 2020 and our reviewed but unaudited consolidated financial statements and footnotes thereto for the quarter ended June 27, 2021, prepared in accordance with U.S. generally accepted accounting principles (GAAP). You are encouraged to review our consolidated financial statements in conjunction with your review of this MD&A. The financial information in this MD&A has been prepared in accordance with GAAP, unless otherwise indicated. In addition, we use non-GAAP financial measures as supplemental indicators of our operating performance and financial position. We use these non-GAAP financial measures internally for comparing actual results from one period to another, as well as for planning purposes. We will also report non-GAAP financial results as supplemental information, as we believe their use provides more insight into our performance. When non-GAAP measures are used in this MD&A, they are clearly identified as non-GAAP measures and reconciled to the most closely corresponding GAAP

measure.

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

Background

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

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 NAMSA 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.

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In the event a termination for convenience were to occur, Federal Acquisition Regulation clause 52.249-2 provides for full recovery of all contractual costs and profits reasonably occurred up to and as a result of the terminated contract. In the event a termination for default were to occur, we could be liable for any excess cost incurred by the government to acquire supplies from another supplier similar to those terminated from us. We would not be liable for any excess costs if the failure to perform the contract arises from causes beyond the control and without the fault or negligence of the Company as defined by Federal Acquisition Regulation clause 52.249-8.

In addition, 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.

We may be at risk as a result of the current COVID-19 pandemic. Risks that could affect our business include the duration and scope of the COVID-19 pandemic and the impact on the demand for our products; actions by governments, businesses and individuals taken in response to the pandemic; the length of time of the COVID-19 pandemic and the possibility of its reoccurrence; the timing required to develop effective treatments and to distribute effective vaccines to the general population; the eventual impact of the pandemic and actions taken in response to the pandemic on global and regional economies; and the pace of recovery when the COVID-19 pandemic subsides.

Due to the significant level of uncertainty surrounding the pandemic and its impact to our customers and the defense supply chain, we are unable to ascertain the impact further delays in contract awards and customer orders may have on our total fiscal year 2021 revenues. We have realized a reduction of 29.6% in revenue volume during the first nine months of fiscal year 2021, as compared to the first nine months of fiscal year 2020. We have experienced a recent increase in proposal requests, and anticipate an increase in orders over the next six to twelve months, however the timing and nature of new orders in the near term cannot be determined. Any continued delays in customer orders over the next three months could further impact our total fiscal year 2021 revenue and profitability during the last quarter. We have implemented several cost-saving initiatives during the first and second quarters, including reductions in force, employee compensation and cuts in discretionary spending. We are reviewing additional cost reductions during the next sixty to ninety days as required to further minimize the impact of any sustained delays in customer orders beyond the three quarters of fiscal year 2021.

Optex Systems Holdings, Inc. is defined as essential critical infrastructure as a defense contractor under the guidance of the federal, state and local authorities for both our Optex Systems (Richardson, TX), and Applied Optics Center (Dallas, TX) operating segments. As such, the Company continued to remain open during the COVID-19 shelter in place orders and closures. To date, we have experienced minimal workforce disruption as a result of the pandemic.

Recent Events

Employment Agreements

We entered into an updated employment agreement with Danny Schoening dated October 15, 2020. The term of the agreement commenced as of October 15, 2020 and the current term ends on November 30, 2021. Mr. Schoening’s base salary continues to be \$284,645 per annum. Mr. Schoening will be eligible for a performance bonus which is based upon a rolling three-year operating plan adopted by our Board of Directors. The bonus will be tied to operating metrics decided by our board against the three-year plan, and such metrics will be decided annually and tie to the three-year plan. The target bonus equates to 30% of Mr. Schoening’s base salary. Our board will have discretion to alter the performance bonus upward or downward by 20% based on its good faith discretion.

The employment agreement events of termination consist of: (i) death or permanent disability 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 or permanent disability of Mr. Schoening, Mr. Schoening shall be paid salary and for a termination due to his death or permanent disability, also any 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 nine months’ base salary in effect.

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On December 15, 2020, the Company’s Board of Directors approved executive bonuses for Danny Schoening, CEO, of \$48 thousand which was paid in January, 2021, and

Karen Hawkins, CFO, of \$37 thousand which was paid in December 2020.

On February 1, 2021, the employment agreement for Karen Hawkins, CFO, auto-renewed for an additional 18-month period, expiring on June 30, 2022. The contract automatically renews for subsequent 18-month periods unless Ms. Hawkins or the Company give notice of termination at least 90 days before the end of the term then in effect.

Board Changes

On April 30, 2020, the Optex Systems Holdings, Inc. Board of Directors held a meeting and voted to increase the annual board compensation for the three independent directors from \$22,000 to \$36,000 with an effective date of January 1, 2020, in addition to granting 100,000 restricted shares to each independent director which shall vest at a rate of 20% per year (20,000 shares) each January 1st, over the next five years, through January 1, 2025. The total market value for the 300,000 shares is \$525 thousand based on the stock price of \$1.75 as of April 30, 2020. On January 1, 2021, 60,000 of the restricted shares were vested.

Stock & Warrant Repurchases

On June 8, 2020 the Company announced authorization for a \$1 million stock repurchase program. The shares authorized to be repurchased under the new repurchase program may be purchased from time to time at prevailing market prices, through open market or in negotiated transactions, depending upon market conditions and subject to Rule 10b-18 as promulgated by the SEC. During the year ended September 27, 2020, there were 105,733 common shares repurchased through the program at a cost of \$200 thousand. During the nine months ended June 27, 2021, there were 413,533 common shares repurchased through the program at a cost of \$800 thousand. As of June 27, 2021, the Company has repurchased 519,266 shares at a total cost of \$1.0 million against the stock repurchase plan, with a remaining balance of zero. The shares have been returned to the Treasury and subsequently cancelled on June 14, 2021.

July 2021 Ransomware Attack

On July 13, 2021, Optex Systems Holdings, Inc. (the “Company”) experienced a ransomware attack. The Company isolated the source of the attack and restored normal operations with no material day-to-day impact to the Company or the Company’s ability to access its data. Sensitive data may have been breached, and the Company’s investigation of the attack is ongoing with assistance from outside experts and the Company is also working with the appropriate US Government officials.

Recent Orders

- 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 five-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.

- On January 22, 2020, the Company announced it has been awarded a \$1.1 Million order as part of a multi-year strategic supplier agreement with a domestic manufacturer of premium optical devices. The products will be manufactured at the Applied Optics Center (AOC) Division of Optex Systems, Inc.
- On January 27, 2020, the Company announced a multi-year Indefinite Delivery Indefinite Quantity (IDIQ) award from Defense Logistics Agency Land and Maritime for periscopes for up to \$3.6 million over a five-year period.
- On February 18, 2020, the Company announced a multi-year Indefinite Delivery Indefinite Quantity (IDIQ) award from Defense Logistics Agency Land and Maritime for periscopes for up to \$9.2 million over a five-year period.
- On August 3, 2020, the Company announced a \$2.0 Million order from a U. S. prime contractor for optical subassemblies for shipments starting in 2021.
- On January 11, 2021, the Company announced a contract for Laser Protected Periscopes for a base period of three years plus two one-year option years, not to exceed \$14.4 million pursuant to an Indefinite Delivery - Indefinite Quantity (IDIQ) contract.
- On August 3, 2021, the Company announced a contract award of \$8.4 million as part of a twenty-four-month purchase order for laser filters manufactured at the (AOC) Division of Optex Systems, Inc.

Results of Operations

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 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 tables below summarize our three and nine-month operating results for the periods ended June 27, 2021 and June 28, 2020, 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) | | | |
|-------------------------------------------------|--------------------|---------------|-------------------|---------------|
| | Three months ended | | Nine months ended | |
| | June 27, 2021 | June 28, 2020 | June 27, 2021 | June 28, 2020 |
| Net Income (Loss) (GAAP) | \$ 1,374 | \$ (95) | \$ 1,859 | \$ 1,170 |
| Add: | | | | |
| (Gain) Loss on Change in Fair Value of Warrants | (1,167) | 585 | (2,025) | 504 |
| Federal Income Tax (Benefit) Expense | (154) | 131 | (122) | 435 |
| Depreciation | 67 | 61 | 195 | 185 |

| | | | | |
|-----------------------------------|---------------|---------------|--------------|-----------------|
| Stock Compensation | 57 | 63 | 171 | 120 |
| Interest Expense | 4 | 5 | 9 | 17 |
| Adjusted EBITDA - Non GAAP | \$ 181 | \$ 750 | \$ 87 | \$ 2,431 |

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Our adjusted EBITDA decreased to \$0.2 million during the three months ended June 27, 2021 as compared to \$0.7 million during the three months ended June 28, 2020. Adjusted EBITDA for the nine-month period ended June 27, 2021 decreased to \$0.1 million from \$2.4 million in the prior year nine-month period. The decrease in the three and nine-month periods is primarily driven by lower revenue and gross margin across both operating segments. Operating segment performance is discussed in greater detail throughout the following sections.

During the three months ended June 27, 2021, we recognized a gain on the change in fair value of warrants of \$1.2 million as compared to a loss of \$0.6 million in the prior year three-month period. During the nine months ended June 27, 2021, we recognized a gain on the change in fair value of warrants of \$2.0 million as compared to a loss of \$0.5 million in the prior year nine-month period. As this is a non-cash (gain) loss driven by the current fair market value of our outstanding warrants and unrelated to our core business operating performance, the change in fair value losses and gains have historically been excluded from our adjusted EBITDA calculations presented above. Further discussion regarding the changes in fair value of the warrants and the related warrant liability can be found under "Other (Expense) Income" in the three months comparative narratives of this report, as well as in Item 1, "Consolidated Financial Statements, Note 6 - Warrant Liabilities".

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 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 three and nine months ended June 27, 2021 and June 28, 2020 reconciled to the Condensed Consolidated Results of Operations as presented in Item 1, "Condensed Consolidated Financial Statements."

Results of Operations Selective Financial Info (Thousands)

| | Three months ended | | | | | | | |
|-------------------------------------------------|---------------------|---------------------------------------|-----------------------------------------------------------|-----------------|---------------------|---------------------------------------|-----------------------------------------------------------|--------------|
| | June 27, 2021 | | | | June 28, 2020 | | | |
| | 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 | \$ 3,126 | \$ 1,307 | \$ - | \$ 4,433 | \$ 3,851 | \$ 1,998 | \$ - | \$ 5,849 |
| Intersegment Revenues | - | 41 | (41) | - | - | 421 | (421) | - |
| Total Segment Revenue | 3,126 | 1,348 | (41) | 4,433 | 3,851 | 2,419 | (421) | 5,849 |
| Total Cost of Sales | 2,436 | 1,292 | (41) | 3,687 | 3,271 | 1,518 | (421) | 4,368 |
| Gross Margin | 690 | 56 | - | 746 | 580 | 901 | - | 1,481 |
| Gross Margin % | 22.1% | 4.2% | - | 16.8% | 15.1% | 37.2% | - | 25.3% |
| General and Administrative Expense | 539 | 93 | 57 | 689 | 653 | 139 | 63 | 855 |
| Segment Allocated G&A Expense | (177) | 177 | - | - | (170) | 170 | - | - |
| Net General & Administrative Expense | 362 | 270 | 57 | 689 | 483 | 309 | 63 | 855 |
| Operating Income (Loss) | 328 | (214) | (57) | 57 | 97 | 592 | (63) | 626 |
| Operating Income (Loss) % | 10.5% | (15.9%) | - | 1.3% | 2.5% | 24.5% | - | 10.7% |
| (Loss) Gain on Change in Fair Value of Warrants | - | - | 1,167 | 1,167 | - | - | (585) | (585) |
| Interest Expense | - | - | (4) | (4) | - | - | (5) | (5) |
| Net Income (Loss) before taxes | \$ 328 | \$ (214) | \$ 1,106 | \$ 1,220 | \$ 97 | \$ 592 | \$ (653) | \$ 36 |
| Net Income (Loss) % | 10.5% | (15.9%) | - | 27.5% | 2.5% | 24.5% | - | 0.6% |

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| | Nine months ended | | | | | | | |
|--------------------------------------|---------------------|---------------------------------------|-----------------------------------------------------------|---------------|---------------------|---------------------------------------|-----------------------------------------------------------|---------------|
| | June 27, 2021 | | | | June 28, 2020 | | | |
| | 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 | \$ 8,958 | \$ 4,191 | \$ - | \$ 13,149 | \$ 11,917 | \$ 6,765 | \$ - | \$ 18,682 |
| Intersegment Revenues | - | 937 | (937) | - | - | 1,202 | (1,202) | - |
| Total Segment Revenue | 8,958 | 5,128 | (937) | 13,149 | 11,917 | 7,967 | (1,202) | 18,682 |
| Total Cost of Sales | 7,438 | 4,689 | (937) | 11,190 | 9,390 | 5,926 | (1,202) | 14,114 |
| Gross Margin | 1,520 | 439 | - | 1,959 | 2,527 | 2,041 | - | 4,568 |
| Gross Margin % | 17.0% | 8.6% | - | 14.9% | 21.2% | 25.6% | - | 24.5% |
| General and Administrative Expense | 1,699 | 368 | 171 | 2,238 | 1,889 | 433 | 120 | 2,442 |
| Segment Allocated G&A Expense | (530) | 530 | - | - | (510) | 510 | - | - |
| Net General & Administrative Expense | 1,169 | 898 | 171 | 2,238 | 1,379 | 943 | 120 | 2,442 |

| | | | | | | | | |
|-------------------------------------------------|--------|----------|----------|----------|----------|----------|----------|----------|
| Operating Income (Loss) | 351 | (459) | (171) | (279) | 1,148 | 1,098 | (120) | 2,126 |
| Operating Income (Loss) % | 3.9% | (9.0%) | - | (2.1%) | 9.6% | 13.8% | - | 11.4% |
| (Loss) Gain on Change in Fair Value of Warrants | - | - | 2,025 | 2,025 | - | - | (504) | (504) |
| Interest Expense | - | - | (9) | (9) | - | - | (17) | (17) |
| Net Income (Loss) before taxes | \$ 351 | \$ (459) | \$ 1,845 | \$ 1,737 | \$ 1,148 | \$ 1,098 | \$ (641) | \$ 1,605 |
| Net Income (loss) before taxes % | 3.9% | (9.0%) | - | 13.2% | 9.6% | 13.8% | - | 8.6% |

Our total revenues decreased by \$1.4 and \$5.5 million or 24.2% and 29.6% during the three and nine months ended June 27, 2021, respectively, as compared to the three and nine months ended June 28, 2020. Decreased revenue during the three and nine months was driven by decreased external revenue of \$0.7 and \$3.0 million at the Optex Richardson and \$0.7 and \$2.5 million at the Applied Optics Center, respectively, over the prior year period. We have experienced a reduction in customer demand driven by the pandemic, combined with shifting priorities in domestic and foreign military spending. While we are optimistic that our customer orders will return to pre-pandemic levels over the next twelve months, we currently anticipate a 30-32% reduction in our total fiscal year performance in 2021 as compared to the fiscal year performance of 2020.

Consolidated gross margin decreased by \$0.7 million and \$2.6 million, or 49.6% and 57.1%, respectively during the three and nine-months ending June 27, 2021 as compared to the prior year period. The decreased margin during the three and nine-month periods is primarily attributable to lower revenue across both segments, changes in product mix toward less profitable product groups, and unfavorable manufacturing overhead adjustments on reduced production volume. Optex Systems-Richardson, and the Applied Optics Center-Dallas, have substantial fixed manufacturing costs that are not easily adjusted as production levels decline. We have implemented cost reduction measures during the first and second quarters of fiscal year 2021, but do not expect to mitigate the impact of the revenue reductions on the operating gross margin for the year.

Our operating income decreased by \$0.5 million and \$2.4 million in the three and nine months ended June 27, 2021, to income of \$0.1 million and a loss of (\$0.3) million, as compared to the prior year period operating income of \$0.6 million and \$2.1 million, respectively. The decreased three and nine-month operating income is primarily driven by lower revenue and lower gross margin during the quarter with slightly lower general and administrative costs of \$0.2 during the current year three and nine-month period.

Backlog

Backlog as of June 27, 2021, was \$12.9 million as compared to a backlog of \$16.3 million as of September 27, 2020, representing a decrease of \$3.4 million or 20.9%. During the nine months ended June 27, 2021 the Company booked \$9.8 million in new orders as compared to \$14.0 million during the nine months ended June 28, 2020.

We have experienced a recent increase in proposal requests, and anticipate an increase in orders over the next three to six months. Subsequent to the period ended June 27, 2021, the Company has booked an additional \$11.7 million in customer orders, including a new contract award of \$8.4 million announced on August 3, 2021, as part of a twenty-four-month purchase order for laser filters manufactured at the Applied Optics Center segment.

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The following table depicts the current expected delivery by period of all contracts awarded as of June 27, 2021 in millions of dollars:

| Product Line | (Millions) | | | | | |
|--------------------------------|---------------|----------------|-------------------------|-------------------------|-----------------|----------------|
| | 2021 Delivery | 2022+ Delivery | Total Backlog 6/27/2021 | Total Backlog 9/27/2020 | Variance | % Chg |
| Periscopes | \$ 2.2 | \$ 1.9 | \$ 4.1 | \$ 5.3 | \$ (1.2) | (22.6)% |
| Sighting Systems | 0.2 | 1.1 | 1.3 | 2.9 | (1.6) | (55.2)% |
| Howitzer | - | 2.3 | 2.3 | 2.5 | (0.2) | (8.0)% |
| Other | 0.7 | 0.3 | 1.0 | 2.5 | (1.5) | (60.0)% |
| Optex Systems - Richardson | 3.1 | 5.6 | 8.7 | 13.2 | (4.5) | (34.1)% |
| Applied Optics Center - Dallas | 1.6 | 2.6 | 4.2 | 3.1 | 1.1 | 35.5% |
| Total Backlog | \$ 4.7 | \$ 8.2 | \$ 12.9 | \$ 16.3 | \$ (3.4) | (20.9)% |

During the last 15 months, we experienced a significant reduction in new orders and ending customer backlog across all but one of our product lines. We attribute the lower orders to a combination of factors including a COVID-19 driven slow-down of contract awards for both U.S. military sales and foreign military sales (FMS), combined with some shifting in defense spending budget allocations in US military sales and FMS away from Army ground system vehicles toward other military agency applications. Due to the pandemic, we have experienced a significant slowdown in the U.S. government procurement process increasing the cycle time from contract bid proposal requests to final contract award by three to nine months. We believe many of the delays are process driven as government agencies adapt to new remote work environments, combined with constraints created by travel restrictions, impeding product testing, inspection and overall program management coordination. In addition, the pandemic has caused several program delays throughout the defense supply chain as a result of plant shutdowns, employee illnesses, travel restrictions, remote work arrangements and similar supplier issues.

We have experienced a reduction of 29.6% in revenue volume during the first nine months of fiscal year 2021, as compared to the first nine months of fiscal year 2020, and expect this trend to continue through the fourth quarter. We have implemented several cost-saving initiatives during the first and second quarters, including reductions in force and employee compensation combined with cuts in other discretionary spending. We are reviewing additional cost reductions during the next sixty to ninety days as required to further minimize the impact of any sustained delays in customer orders at the Optex Richardson segment beyond the first three quarters of fiscal year 2021.

Optex Systems - Richardson:

During the nine months ended June 27, 2021, backlog for the Optex Systems Richardson segment decreased by \$4.5 million, or 34.1%, to \$8.7 million from the fiscal year-end backlog of \$13.2 million. Decreased backlog in sighting systems, howitzers, and other product groups is primarily driven by shipments against several of our long running Commander Weapon Sighting Systems "CWSS", Digital Day and Night Sighting Systems "DDAN" and Muzzle Reference Sensor Collimator Assembly "MRS" contracts. Decreases in the periscope backlog is primarily driven by shipments against our ICWS glass periscope order during the current fiscal year, completing the contract.

During the nine months ended June 27, 2021 we booked new periscope orders of \$4.1 million, as compared to \$5.9 million booked during the prior year nine-month period ended June 28, 2020. On January 11, 2021, the Company announced a contract for Laser Protected Periscopes for a base period of three years plus two one-year option years, not to exceed \$14.4 million pursuant to an Indefinite Delivery - Indefinite Quantity (IDIQ) contract. We anticipate additional periscope contracts in addition to task order awards against our existing nine active IDIQ contracts for delivery in 2022 and beyond.

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During the nine months ended June 27, 2021, there was \$0.5 in new orders booked for sighting systems and other products, as compared to \$3.0 million booked during the nine months ended June 28, 2020.

Applied Optics Center - Dallas

During the nine months ended June 27, 2021, the Applied Optics Center backlog increased by \$1.1 million, or 35.5%, to \$4.2 million from the fiscal year end level of \$3.1 million. During the nine months ended June 27, 2021, the Applied Optics Center booked new orders of \$5.2 million as compared to \$5.1 million in the prior year nine-month period. We are seeing increases in demand and proposal activity for both laser coated filters and optical assemblies and anticipate additional order bookings for both our commercial and military products for deliveries beginning in fiscal year 2022. Subsequent to the fiscal period ended June 27, 2021, the Applied Optics Center has booked additional orders of \$9.9 million, inclusive of the new \$8.4 million award announced on August 3, 2021.

The Company continues to aggressively pursue international and commercial opportunities in addition to maintaining its current footprint with U.S. vehicle manufacturers, with existing as well as new product lines. 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 excess capacity.

Three Months Ended June 27, 2021 Compared to the Three Months Ended June 28, 2020

Revenues. In the three months ended June 27, 2021, revenues decreased by \$1.4 million or 24.2% from the respective prior period in fiscal year 2020 as set forth in the table below:

| Product Line | Three months ended (Thousands) | | | |
|--------------------------------|-----------------------------------|-----------------|-------------------|---------------|
| | June 27, 2021 | June 28, 2020 | Variance | % Chg |
| Periscopes | \$ 1,686 | \$ 2,929 | \$ (1,243) | (42.4) |
| Sighting Systems | 789 | 185 | 604 | 326.5 |
| Howitzers | - | - | - | - |
| Other | 650 | 737 | (87) | (11.8) |
| Optical Systems - Richardson | 3,126 | 3,851 | (725) | (18.8) |
| Applied Optics Center - Dallas | 1,307 | 1,998 | (691) | (34.6) |
| Total Revenue | \$ 4,433 | \$ 5,849 | \$ (1,417) | (24.2) |

Revenue on our periscope line decreased by \$1.2 million or 42.4% on lower customer demand during the three months ended June 27, 2021 as compared to the three months ended June 28, 2020.

Sighting systems revenue for the three months ending June 27, 2021 increased by \$0.6 million or 326.5% from revenues in the prior year period on shipments against our CWSS programs not in the prior year three-month period.

Other product revenue decreased by \$0.1 million, or 11.8% during the three months ending June 27, 2021 as compared to the prior year period due to lower contract demand on MRS collimators and cell assemblies.

Applied Optics Center revenue decreased \$0.7 million or 34.6% during the three months ended June 27, 2021 as compared to the three months ended June 28, 2020. The lower revenue was primarily driven by lower customer orders across coated filter and optical assembly lines.

Gross Margin. The gross margin during the three-month period ending June 27, 2021 was 16.8% of revenue as compared to a gross margin of 25.3% of revenue for the period ending June 28, 2020. The decreased margin during the three-month period is primarily attributable lower revenue across both segments and unfavorable manufacturing overhead adjustments on reduced production volume. Cost of sales decreased to \$3.7 million for the current period as compared to the prior year period of \$4.4 million on lower period revenue.

G&A Expenses. During the three months ended June 27, 2021 and June 28, 2020, we recorded operating expenses of \$689 thousand and \$855 thousand, respectively. Operating expenses decreased by 19.4% between the respective periods primarily due to lower spending in salaries and office supplies.

Operating (Loss) Income. During the three months ended June 27, 2021, we recorded operating income of \$57 thousand, as compared to operating income of \$626 thousand during the three months ended June 28, 2020. The \$569 million decrease in operating income in the current year period over the prior year period is primarily due to decreased revenue and gross margin.

Other (Expense) Income. During the three months ended June 27, 2021, we recognized a \$1.2 million gain on change in the fair value of warrants as compared to a \$0.6 million loss in three months ending June 28, 2020. The current period gain in the fair value of warrants is primarily attributable to changes in the common stock volatility, US treasury rates, stock price and remaining warrant term from the prior period end. Additional information related to the change in valuation is discussed under Item 1, "Consolidated Financial Statements, Note 6 – Warrant Liability".

Net (Loss) Income applicable to common shareholders. During the three months ended June 27, 2021, we recorded net income applicable to common shareholders of \$0.9 million as compared to a net loss applicable to common shareholders of \$0.1 million during the three months ended June 28, 2020. The change in net income of \$1.0 million is primarily attributable to a reduction in operating profit of (\$0.6) million, changes in the fair value of warrants of \$1.8 million, decreased income tax expense of \$0.3 million between the respective periods, offset by a reduction in deemed dividends on participating warrants of (\$0.5) million not in the current year period. There were no deemed dividends in the prior year period due to the net loss.

Nine months Ended June 27, 2021 Compared to the Nine months Ended June 28, 2020

Revenues. In the nine months ended June 27, 2021, revenues decreased by \$5.5 million or 29.6% from the respective prior period in fiscal year 2020 as set forth in the table below:

| Product Line | Nine months ended (Thousands) | | | |
|--------------------------------|----------------------------------|------------------|-------------------|---------------|
| | June 27, 2021 | June 28, 2020 | Variance | % Chg |
| Periscopes | \$ 5,253 | \$ 8,257 | \$ (3,004) | (36.4) |
| Sighting Systems | 1,973 | 560 | 1,413 | 252.3 |
| Howitzers | 200 | - | 200 | 100.0 |
| Other | 1,532 | 3,100 | (1,568) | (50.6) |
| Optical Systems - Richardson | 8,958 | 11,917 | (2,959) | (24.8) |
| Applied Optics Center - Dallas | 4,191 | 6,765 | (2,574) | (38.0) |
| Total Revenue | \$ 13,149 | \$ 18,682 | \$ (5,533) | (29.6) |

Revenue on our periscope line decreased by \$3.0 million or 36.4% on lower customer demand during the nine months ended June 27, 2021 as compared to the nine months ended June 28, 2020.

Sighting systems revenue for the nine months ending June 27, 2021 increased by \$1.4 million or 252.3% from revenues in the prior year period on shipments against our DDAN spares and CWSS programs not in the prior year nine-month period.

Other product revenue decreased by \$1.6 million, or 50.6% during the nine months ending June 27, 2021 as compared to the prior year period due to lower contract demand on MRS collimators and cell assemblies.

Applied Optics Center revenue decreased \$2.6 million or 38.0% during the nine months ended June 27, 2021 as compared to the nine months ended June 28, 2020. The lower revenue was primarily driven by lower customer orders across coated filter and optical assembly lines. We expect revenue for the Applied Optics Center to increase in the next quarter on higher customer demand for optical assemblies and laser filter units.

We have experienced a reduction in customer demand driven by the pandemic, combined with shifting priorities in domestic and foreign military spending. While we are optimistic that our customer orders will return to pre-pandemic levels over the next twelve months, we currently anticipate a 30-32% reduction in our total fiscal year performance in 2021 as compared to the fiscal year performance of 2020.

Gross Margin. The gross margin during the nine-month period ending June 27, 2021 was 14.9% of revenue as compared to a gross margin of 24.5% of revenue for the period ending June 28, 2020. The decreased margin during the nine-month period is primarily attributable lower revenue across both segments and unfavorable manufacturing overhead adjustments on reduced production volume. Cost of sales decreased to \$11.2 million for the current period as compared to the prior year period of \$14.1 million on lower period revenue.

G&A Expenses. During the nine months ended June 27, 2021 and June 28, 2020, we recorded operating expenses of \$2.2 million and \$2.4 million, respectively. Operating expenses decreased by 8.4% between the respective periods primarily due to lower spending in salaries and office supplies.

Operating (Loss) Income. During the nine months ended June 27, 2021, we recorded an operating loss of \$0.3 million, as compared to operating income of \$2.1 million during the nine months ended June 28, 2020. The \$2.4 million decrease in operating income in the current year period over the prior year period is primarily due to decreased revenue and gross margin, offset by slightly lower general and administrative spending in the current year as compared to the prior year period.

Other (Expense) Income. During the nine months ended June 27, 2021, we recognized a \$2.0 million gain on change in the fair value of warrants as compared to a \$0.5 million loss in the nine months ending June 28, 2020. The \$2.5 million change in the fair value of warrants is primarily attributable to changes in the common stock volatility, US treasury rates, stock price and remaining warrant term from the prior period end. Additional information related to the change in valuation is discussed under Item 1, "Consolidated Financial Statements, Note 6 – Warrant Liability".

Net Income applicable to common shareholders. During the nine months ended June 27, 2021, we recorded a net income applicable to common shareholders of \$1.2 million as compared to a net income applicable to common shareholders of \$0.8 million during the nine months ended June 28, 2020. The increase in net income of \$0.4 million is primarily attributable to a reduction in operating profit of (\$2.4) million, changes in the fair value of warrants of \$2.5 million, decreased income tax expense of \$0.6 million between the respective periods and an increase in deemed dividends on participating warrants of (\$0.3) million not in the current year period.

Liquidity and Capital Resources

Optex Systems Holdings adopted the provisions of ASC Topic 842 "Leases" as of the fiscal year beginning on September 30, 2019. Optex Systems Holdings has two significant operating facilities leases and one equipment lease which extends beyond twelve months and fall under the guidance of ASC Topic 842. Adoption of ASC Topic 842 resulted in the balance sheet recognition of a right-of-use asset of \$1.8 million and corresponding operating lease liabilities of approximately (\$1.9) million as of September 30, 2019, the beginning of the prior fiscal year, representing the present value of future lease payments for the term of the equipment lease and 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.

On January 11, 2021 the Company executed amendments for each of the leased facilities extending the terms for eighty-six (86) months, commencing at the end of the current lease agreements. The Richardson lease amendment commences on April 1, 2021 for an eighty-six (86) month term ending on May 31, 2028. The Dallas lease amendment commences on November 1, 2021 for an eighty-six (86) month term ending on December 31, 2028. Each of the leases include two full months of rent abatement at the beginning of the commencement term. Execution of the new lease amendments for the Dallas and Richardson facilities on January 11, 2021 resulted in the balance sheet recognition of a right-of-use asset of \$3.7 million and corresponding operating lease liabilities of approximately (\$3.7) million during the nine months ended June 27, 2021.

As of June 27, 2021, the Company had working capital of \$12.3 million, as compared to \$11.7 million as of September 27, 2020. During the nine months ended June 27, 2021, the Company generated an operating loss of (\$0.3) million as compared to operating income of \$2.1 million for the nine-month period ending June 27, 2021. The Company's adjusted EBITDA decreased by \$2.3 million during the nine months ended June 27, 2021 from \$2.4 million to (\$0.1) million. Backlog as of June 27, 2021 has decreased by \$3.4 million or 20.9% to \$12.9 million as compared to a backlog of \$16.3 million as of September 27, 2020. We believe the COVID-19 pandemic is a driving factor in lower contract awards and reduced backlog, as many customers and agencies adapt to remote work arrangements, limited travel and slower Defense Contract Management Agency (DCMA) and Defense Contract Audit Agency (DCAA) responses to solicitations, price audits and contract awards. In addition, the most recent U.S. Department of Defense Budget Request reflects a shift in military priorities away from ground system vehicles to other military agencies. We have experienced a recent increase in proposal requests, and anticipate an increase in orders over the next three to six months. Subsequent to the period ended June 27, 2021, the Company has booked an additional \$11.7 million in customer orders, including a new contract award of \$8.4 million announced on August 3, 2021, as part of a twenty-four-month purchase order for laser filters manufactured at the Applied Optics Center segment.

Optex Systems Holdings, Inc. is defined as essential critical infrastructure as a defense contractor under the guidance of the federal, state and local authorities for both our Optex Systems (Richardson, TX), and Applied Optics Center (Dallas, TX) operating segments. As such, the Company continued to remain open during the COVID-19 shelter in place orders and closures. The Company remains fully operational with a complete workforce while practicing the CDC guidelines and required Dallas County mandates which require keeping a 6' distance between employees, face coverings, and daily employee health screening. To date, we have experienced very limited workforce disruption associated with COVID-19 illnesses, COVID-19 quarantine or childcare leave related issues.

We have reached out to our customers, suppliers and service providers regarding any potential impacts to operating conditions due to COVID-19 and we will continue to monitor any changes to our operations on an ongoing basis during the crisis. As a large majority of our customers and suppliers are engaged in significant defense manufacturing, they also remain open and operational during the pandemic. The Company has experienced several short-term delays in the delivery of some production supplies and materials, in addition to a few customer delivery schedule revisions, however, the impact to our operations to date have been minimal, and we have taken additional steps to mitigate potential key supplier risks. In addition, we have experienced some minor disruptions in activities related to travel restrictions, conferences and trade show cancellations. Our customers continue to pay outstanding accounts receivable balances to terms and we continue to pay to our supplier terms without interruption during the crisis.

During the previous twelve months, we have experienced a significant reduction in new orders and ending customer backlog across all but one of our product lines. We attribute the lower orders to a combination of factors including a COVID-19 driven slow-down of contract awards for both U.S. military sales and foreign military sales (FMS), combined with some shifting in defense spending budget allocations in US military sales and FMS away from Army ground system vehicles toward other military agency applications. We experienced a 29.6% reduction in revenue volume during the first nine months of fiscal year 2021, as compared to the first nine months of fiscal year 2020. We have experienced a reduction in customer demand driven by the pandemic, combined with shifting priorities in domestic and foreign military spending. While we are optimistic that our customer orders will return to pre-pandemic levels over the next twelve months, we currently anticipate a 30-32% reduction in our total fiscal year performance in 2021 as compared to the fiscal year performance of 2020. We have experienced a recent increase in contract awards and proposal requests, and anticipate an increase in orders over the next six to twelve months, however the timing and nature of new orders in the near term cannot be determined. We have implemented several cost-saving initiatives during the first nine months, including reductions in force and employee compensation combined with cuts in other discretionary spending. We are reviewing additional cost reductions during the next sixty to ninety days as required to further minimize the impact of any sustained delays in customer orders at the Optex Richardson segment beyond the first three quarters of fiscal year 2021.

We have not received and are not presently seeking any financial assistance under the Coronavirus Aid, Relief, and Economic Security (CARES) Act or other COVID-19 related federal or state programs beyond the Families First Coronavirus Response Act (FFCRA) tax credit which is available to cover paid sick or family leave for our effected employees. Our current backlog and working capital position remain healthy with additional unused working capital available. On April 16, 2020, we executed a two-year \$2.25 million revolving credit facility with BBVA USA, replacing the existing \$2.25 million AvidBank line of credit which expired on April 21, 2020. Optex intends to use this revolving credit facility to support working capital for the Company's continuing operations and growth needs during the next twelve months. While we anticipate the possibility of some additional unforeseen operational impacts related to the pandemic, we believe we are in a strong position to minimize any significant adverse impact to working capital during the next twelve months.

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The Company has historically funded its operations through working capital, convertible notes, 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 June 27, 2021, the Company had approximately \$4.8 million in cash and an outstanding payable balance of \$0.4 million against our working line of credit. The line of credit allowed for borrowing up to a maximum of \$2.25 million. As of June 27, 2021, our outstanding accounts receivable was \$1.4 million. The Company anticipates an operating loss for the fiscal 2021 year, but is projecting a positive cash flow from operating activities through the last quarter of 2021. Successful transition to attaining and maintaining profitable operations is dependent upon maintaining a level of revenue adequate to support the Company's cost structure. 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, COVID-19 or other program delays combined with increasing inventory and production costs required to support the 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.

As of September 27, 2020, and June 27, 2021, there are no outstanding declared and unpaid dividends.

On June 8, 2020 the Company announced authorization for a \$1 million stock repurchase program. The shares authorized to be repurchased under the new repurchase program may be purchased from time to time at prevailing market prices, through open market or in negotiated transactions, depending upon market conditions and subject to Rule 10b-18 as promulgated by the SEC. As of June 27, 2021, the Company has repurchased 519,266 common shares at a cost of \$1 million. The shares were held in Treasury Stock at cost and cancelled in June 2021.

Cash Flows for the Period from September 27, 2020 through June 27, 2021

Cash and Cash Equivalents: As of June 27, 2021, and September 27, 2020, we had cash and cash equivalents of \$4.8 and \$4.7 million, representing a net increase of \$0.1million.

Net Cash Provided by Operating Activities. Net cash provided by operating activities during the nine months from September 27, 2020 to June 27, 2021 totaled \$1.1 million. The primary sources of cash during the period relate to collections of accounts receivable of \$1.6 million, offset by decreases in accounts payable of (0.6) million and changes in other working capital \$0.1 million.

Net Cash Used in Investing Activities. In the nine months ended June 27, 2021, cash used in investing activities was \$0.2 million for purchases of equipment.

Net Cash Used in Financing Activities. Net cash used in financing activities was \$0.84 million during the nine months ended June 27, 2021 and relate to the repurchases of common stock of \$0.80 million as part of our stock repurchase plan and payments for taxes of \$0.04 for net settled restricted stock units.

Critical Policies and Accounting Pronouncements

Our significant accounting policies are fundamental to understanding our results of operations and financial condition. Some accounting policies require that we use estimates and assumptions that may affect the value of our assets or liabilities and financial results. These policies are described in "Critical Policies and Accounting Pronouncements" and Note 2 (Accounting Policies) to consolidated financial statements in our Annual Report on Form 10-K for the year ended September 27, 2020.

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Cautionary Factors That May Affect Future Results

This Quarterly Report on Form 10-Q 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.

Optex Systems Holdings does not assume the obligation to update any forward-looking statement. You should carefully evaluate such statements in light of factors described in this Form 10-Q. In various filings 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 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by our Quarterly Report on Form 10-Q for the quarter ended June 27, 2021, 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 upon the evaluation described above, our Principal Executive Officer and our Principal Financial Officer concluded that, as of June 27, 2021, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

During the nine months ended June 27, 2021, 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. The Company has not experienced any significant disruptions in controls over financial reporting as a result of COVID-19.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are not aware of any material litigation pending or threatened against us.

Item 1A. Risk Factors

There have been no material changes in risk factors since the risk factors set forth in the Form 10-K filed for the year ended September 27, 2020.

Item 4. Mine Safety Disclosures

Not applicable.

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Item 6. Exhibits

| Exhibit No. | Description |
|-----------------------------------------------|-------------------------------------------------------------------------------------|
| 31.1 and 31.2 | Certifications pursuant to Section 302 of Sarbanes Oxley Act of 2002 |
| 32.1 and 32.2 | Certifications pursuant to Section 906 of Sarbanes Oxley Act of 2002 |
| 104 | Cover Page Interactive Data File (formatted in IXBRL, and included in exhibit 101). |
| 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 |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

OPTEX SYSTEMS HOLDINGS, INC.

Date: August 16, 2021

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

OPTEX SYSTEMS HOLDINGS, INC.

Date: August 16, 2021

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

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**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-Q 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: August 16, 2021

**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-Q 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: August 16, 2021

**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 Quarterly Report of Optex Systems Holdings, Inc. (the "Company") on this Form 10-Q for the quarter ended June 27, 2021, 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: August 16, 2021

**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 Quarterly Report of Optex Systems Holdings, Inc. (the "Company") on this Form 10-Q for the quarter ended June 27, 2021, 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: August 16, 2021
