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

FORM 10-Q

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

For the quarterly period ended December 31, 2023

☐ **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	**001-41644**	**90-0609531**
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

1420 Presidential Drive, Richardson, TX	**75081-2439**
(Address of principal executive offices)	(Zip Code)

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

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $0.001 par value	OPXS	The Nasdaq Stock Market LLC

Indicate by check mark whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the 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 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 a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act:

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 is a shell company as defined in Rule 12b-2 of the Exchange Act. Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of February 12, 2024: 6,823,693 shares of common stock.

OPTEX SYSTEMS HOLDINGS, INC.
FORM 10-Q

For the period ended December 31, 2023

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Part 1. Financial Information

Item 1. Unaudited Condensed Consolidated Financial Statements

OPTEX SYSTEMS HOLDINGS, INC.
UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Optex Systems Holdings, Inc.
Condensed Consolidated Balance Sheets

	(Thousands, except share and per share data)	
	December 31, 2023 (Unaudited)	October 1, 2023
ASSETS		
Cash and Cash Equivalents	$ 2,373	$ 1,204
Accounts Receivable, Net	2,430	3,624
Inventory, Net	12,685	12,153
Contract Asset	258	336
Prepaid Expenses	154	219
Current Assets	**17,900**	**17,536**
Property and Equipment, Net	**964**	**998**
Other Assets		
Deferred Tax Asset	887	922
Right-of-use Asset	2,615	2,740
Security Deposits	23	23
Other Assets	**3,525**	**3,685**
Total Assets	**$ 22,389**	**$ 22,219**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts Payable	$ 1,796	$ 810
Operating Lease Liability	625	620
Federal Income Taxes Payable	326	247
Accrued Expenses	992	1,265
Accrued Selling Expense	280	336
Accrued Warranty Costs	48	75
Contract Loss Reserves	308	243
Customer Advance Deposits	481	481
Current Liabilities	**4,856**	**4,077**
Other Liabilities		
Credit Facility	-	1,000
Operating Lease Liability, net of current portion	2,156	2,282
Other Liabilities	**2,156**	**3,282**
Total Liabilities	**7,012**	**7,359**
Commitments and Contingencies		
Stockholders' Equity		
Common Stock – ($0.001 par, 2,000,000,000 authorized, 6,823,693 and 6,763,070 shares issued and outstanding, respectively)	7	7
Additional Paid in Capital	21,371	21,285
Accumulated Deficit	(6,001)	(6,432)
Stockholders' Equity	**15,377**	**14,860**
Total Liabilities and Stockholders' Equity	**$ 22,389**	**$ 22,219**

The accompanying notes are an integral part of these condensed consolidated financial statements

Optex Systems Holdings, Inc.
Condensed Consolidated Statements of Operations
(Unaudited)

	(Thousands, except share and per share data)	
	Three months ended	
	December 31, 2023	January 1, 2023
Revenue	**$ 6,968**	**$ 4,040**
Cost of Sales	5,284	3,323
Gross Profit	**1,684**	**717**
General and Administrative Expense	1,131	999
Operating Income (Loss)	**553**	**(282)**
Other Expense	**(7)**	**-**
Income (Loss) Before Taxes	**546**	**(282)**
Income Tax Expense (Benefit)	$ 115	$ (59)
Net Income (Loss)	**$ 431**	**$ (223)**
Basic income (loss) per share	**$ 0.06**	**$ (0.03)**
Weighted Average Common Shares Outstanding - basic	**6,666,290**	**6,537,808**
Diluted income (loss) per share	**$ 0.06**	**$ (0.03)**
Weighted Average Common Shares Outstanding - diluted	**6,721,661**	**6,537,808**

The accompanying notes are an integral part of these condensed consolidated financial statements

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

	(Thousands) Three months ended	
	December 31, 2023	**January 1, 2023**
Cash Flows from Operating Activities:		
Net Income (Loss)	$ 431	$ (223)
Adjustments to Reconcile Net Income (Loss) to Net Cash provided by Operating Activities:		
Depreciation and Amortization	92	81
Stock Compensation Expense	113	35
Deferred Tax	35	(59)
Accounts Receivable	1,194	1,303
Inventory	(532)	(1,586)
Contract Asset	78	(336)
Prepaid Expenses	65	79
Leases	4	8
Accounts Payable and Accrued Expenses	713	745
Federal Income Taxes Payable	79	-
Accrued Warranty Costs	(27)	60
Accrued Selling Expense	(56)	336
Customer Advance Deposits	-	15
Contract Loss Reserves	65	(7)
Total Adjustments	**1,823**	**674**
Net Cash provided by Operating Activities	**2,254**	**451**
Cash Flows used in Investing Activities		
Purchases of Property and Equipment	(58)	(90)
Net Cash used in Investing Activities	**(58)**	**(90)**
Cash Flows used in Financing Activities		
Payments to Credit Facility	(1,000)	-
Cash Paid for Taxes Withheld on Net Settled Restricted Stock Unit Shares Issued	(27)	(15)
Net Cash used in Financing Activities	**(1,027)**	**(15)**
Net Increase in Cash and Cash Equivalents	1,169	346
Cash and Cash Equivalents at Beginning of Period	1,204	934
Cash and Cash Equivalents at End of Period	**$ 2,373**	**$ 1,280**
Supplemental Cash Flow Information		
Cash Paid for Interest	$ 7	$ -

The accompanying notes are an integral part of these condensed consolidated financial statements

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

	Three months ended December 31, 2023				
	Common Shares Issued	Common Stock	Additional Paid in Capital	Accumulated Deficit	Total Stockholders Equity
Balance at October 1, 2023	6,763,070	$ 7	$ 21,285	$ (6,432)	$ 14,860
Stock Compensation Expense	-	-	113	-	113
Vested Performance Based Shares net of withheld taxes(1)	60,623	-	(27)	-	(27)
Net Income	-	-	-	431	431
Balance at December 31, 2023	**6,823,693**	**$ 7**	**$ 21,371**	**$ (6,001)**	**$ 15,377**

	Three months ended January 1, 2023				
	Common Shares Issued	Common Stock	Additional Paid in Capital	Accumulated Deficit	Total Stockholders Equity
Balance at October 2, 2022	6,716,638	$ 7	$ 21,096	$ (8,695)	$ 12,408
Stock Compensation Expense	-	-	35	-	35
Vested Restricted Stock Units, net of withheld taxes(2)	46,432	-	(15)	-	(15)
Net loss	-	-	-	(223)	(223)
Balance at January 1, 2023	**6,763,070**	**$ 7**	**$ 21,116**	**$ (8,918)**	**$ 12,205**

(1) Performance based shares vested October 2, 2023, December 22, 2023 and December 29, 2023 issued net of tax withheld. Shares were vested based on reaching 30-day VWAP of $3.70, $4.45 and $5.35 on the respective vesting dates.

(2) Restricted stock units vested January 1, 2023 issued net of tax withheld.

The accompanying notes are an integral part of these condensed consolidated financial statements

Note 1 - Organization and Operations

Optex Systems Holdings, Inc. (the "Company") manufactures optical sighting systems and assemblies for the U.S. Department of Defense, foreign military applications and commercial markets. Its products are installed on a variety of U.S. military land vehicles, such as the Abrams and Bradley fighting vehicles, light armored and advanced security vehicles, and have been selected for installation on the Stryker family of vehicles. 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 for the three months ended December 31, 2023 were derived from the U.S. government (16%), three major U.S. defense contractors (28%, 9%, and 5%, respectively), one major commercial customer (18%) and all other customers (24%). Approximately 91% of the total company revenue is generated from domestic customers and 9% 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 December 31, 2023, Optex Systems Holdings operated with 105 full-time equivalent employees.

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 October 1, 2023 and other reports filed with the SEC.

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.

Inventory: As of December 31, 2023 and October 1, 2023, inventory included:

	(Thousands)	
	December 31, 2023	**October 1, 2023**
Raw Material	$ 8,483	$ 8,211
Work in Process	4,628	4,460
Finished Goods	581	489
Gross Inventory	**$ 13,692**	$ 13,160
Less: Inventory Reserves	(1,007)	(1,007)
Net Inventory	**$ 12,685**	**$ 12,153**

Concentration of Credit Risk: Optex Systems Holdings' accounts receivables as of December 31, 2023 consisted of U.S. government agencies (9%), six major U.S. defense contractors (25%, 7%, 7%, 5%, 5%, and 5%, respectively), one commercial customer (18%), one foreign military customer (10%) and all other customers (9%). The Company does not believe that this concentration results in undue credit risk because of the financial strength of the customers and the Company's 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 December 31, 2023, and October 1, 2023, the Company had warranty reserve balances of $48 and $75 thousand, respectively.

	Three months ended	
	December 31, 2023	January 1, 2023
Beginning balance	$ 75	$ 169
Incurred costs for warranties satisfied during the period	(32)	-
Warranty Expenses:		
Warranties reserved for new product shipped during the period(1)	52	60
Change in estimate for pre-existing warranty liabilities(2)	(47)	-
Warranty Expense	5	60
Ending balance	**$ 48**	**$ 229**

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

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

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, accounts payable and accrued liabilities are carried at, or approximate, fair value as of the reporting date because of their short-term nature. The credit facility is reported at fair value as it bears market rates of interest.

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.

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 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 during the duration of the contract. 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 months ended December 31, 2023 and January 1, 2023, there was $115 thousand and $112 thousand in service contract revenue recognized over time.

During the three months ended December 31, 2023 and January 1, 2023, there was zero and $29 thousand of revenue recognized from customer deposit liabilities (deferred contract revenue). As of December 31, 2023, customer deposit liabilities were $481 thousand.

As of December 31, 2023 and October 1, 2023, there was $280 and $336 thousand in accrued selling expenses and $258 and $336 thousand in contract assets related to a $3.4 million contract booked in November 2022. During the three months ended December 31, 2023, the contract was reduced from $3.4 million to $3.1 million and selling expenses were reduced by 1% as a result of contract price negotiations which resulted in a reduction of contract assets and accrued selling expenses of $56 thousand. The costs will be amortized against the revenue for the contract deliveries which began in the first quarter of fiscal year 2024 and are expected to extend through fiscal year 2025. During the three months ended December 31, 2023, we booked $22 thousand of selling expenses against the contract asset for shipments against the contract.

Contract Loss Reserves: The Company records loss provisions in the event that the current estimated total revenue against a contract and the total estimated cost remaining to fulfill the contract indicate a loss upon completion. When the estimated costs indicate a loss, we record the entire value of the loss against the contract loss reserve in the period the determination is made. The Company has several long-term fixed price contracts that are currently indicative of a loss condition due to recent inflationary pressures on material and labor, combined with increased manufacturing overhead costs. Some of these long-term contracts have option year ordering periods ending in February 2025 with deliveries that may extend into February 2026. As of December 31, 2023 and October 1, 2023, the accrued contract loss reserves were $308 thousand and $243 thousand, respectively.

During the three months ended December 31, 2023, the Company recognized $90 thousand in loss reserves on new contract awards and made shipments resulting in reductions of $25 thousand against existing loss reserves. During the three months ended January 1, 2023, the Company recognized $51 thousand in loss reserves on new contract awards and made shipments resulting in reductions of $58 thousand against existing loss reserves.

Income Tax/Deferred Tax: As of December 31, 2023 and October 1, 2023, Optex Systems, Inc. has a deferred tax asset valuation allowance of ($0.8) million against deferred tax assets of $1.7 million, for a net deferred tax asset of $0.9 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.

The Company has potentially dilutive securities outstanding, which include unvested restricted stock units and unvested shares of restricted stock. The Company uses the Treasury Stock Method to compute the dilutive effect of any dilutive shares. Unvested restricted stock units and shares of restricted stock that are anti-dilutive are excluded from the calculation of diluted earnings per common share.

For the three months ended December 31, 2023, 120,000 shares of unvested restricted stock and 39,000 restricted stock units (which convert to an aggregate of 55,371 incremental shares) were included in the diluted earnings per share calculation and 54,000 performance shares were excluded from diluted earnings per share as they were below the target share price.

For the three months ended January 1, 2023, 120,000 unvested shares of restricted stock (which convert to an aggregate of 36,045 incremental shares) were excluded from the diluted earnings per share calculation as antidilutive due to the net loss for the period.

Note 3 – Recent Accounting Pronouncements

In June 2, 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASC 326 provides guidance on how an entity should measure credit losses on financial instruments. The new guidance requires organizations to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. The new guidance affects organizations that hold financial assets and net investments in leases that are not accounted for at fair value with changes in fair value reported in net income. The new guidance affects loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. The update is effective for smaller reporting entities for fiscal years beginning after December 15, 2022, including interim periods within those years, as such the Company adopted ASU 2016-13 and (ASC Topic 326) on fiscal year beginning October 2, 2023 with no material impact to Optex Systems Holdings' financial statements.

Note 4 - Segment Reporting

The Company's two reportable segments, Applied Optics Center and Optex Systems – Richardson ("Optex Systems"), are strategic businesses offering similar products to similar markets and customers; however, they 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 management at the time of the acquisition was retained.

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 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.

<u>Optex Systems (OPX) – Richardson, Texas</u>

Optex Systems revenues are primarily in support of prime and subcontracted military customers. Military sales to prime and subcontracted customers represented approximately 100% and sales to commercial customers represented less than 1% of the external segment revenue for the three months ended December 31, 2023. The Optex Systems segment revenue is comprised of approximately 81% domestic military customers and 19% foreign military customers. For the three months ended December 31, 2023, Optex Systems represented 49% of the Company's total consolidated revenue and consisted of revenue from one major defense contractor (24%), the U.S. Government (11%) and all other customers (14%).

Optex Systems is located in Richardson Texas, with leased premises consisting of approximately 49,100 square feet. As of December 31, 2023, the Richardson facility operated with 58 full time equivalent employees in a single shift operation which includes 9 home office support employees. The facilities at Optex Systems, Richardson serve as the home office for both the Optex Systems and Applied Optics Center segments.

<u>Applied Optics Center (AOC) – Dallas, Texas</u>

The Applied Optics Center serves primarily domestic U.S. customers. Sales to commercial customers represented approximately 35% and military sales to prime and subcontracted customers represented approximately 65% of the external segment revenue for the three months ended December 31, 2023. Approximately 95% of the AOC revenue was derived from external customers and approximately 5% was related to intersegment sales to Optex Systems in support of military contracts. For the three months ended December 31, 2023, AOC represented 51% of the Company's total consolidated revenue and consisted of revenue from two major defense contractors (9% and 5%), one commercial customer (18%), and all other customers (19%).

The Applied Optics Center is located in Dallas, Texas with leased premises consisting of approximately 44,867 square feet of space. As of December 31, 2023, AOC operated with 47 full time equivalent employees in a single shift operation.

The financial tables below present information on the reportable segments' profit or loss for each period, as well as segment assets as of each period end. The Company does not allocate interest expense, income taxes or unusual items to segments.

Reportable Segment Financial Information (thousands) As of and for the three months ended December 31, 2023

	Optex Systems Richardson	Applied Optics Center Dallas	Other (non-allocated costs and intersegment eliminations)	Consolidated Total
Revenues from external customers	$ 3,394	$ 3,574	$ -	$ 6,968
Intersegment revenues	-	187	(187)	-
Total revenue	$ 3,394	$ 3,761	$ (187)	$ 6,968
Depreciation and amortization	$ 10	$ 82	$ -	$ 92
Interest expense	$ -	-	$ 7	$ 7
Income (loss) before taxes	$ 15	$ 651	$ (120)	$ 546
Other significant noncash items:				
Allocated home office expense	$ (343)	$ 343	$ -	$ -
Stock compensation expense	$ -	$ -	$ 113	$ 113
Warranty expense	$ -	$ 5	$ -	$ 5
Segment assets	$ 14,336	$ 8,053	$ -	$ 22,389
Expenditures for segment assets	$ 33	$ 25	$ -	$ 58

Reportable Segment Financial Information (thousands) As of and for the three months ended January 1, 2023

	Optex Systems Richardson	Applied Optics Center Dallas	Other (non-allocated costs and intersegment eliminations)	Consolidated Total
Revenues from external customers	$ 1,619	$ 2,421	$ -	$ 4,040
Intersegment revenues	-	116	(116)	-
Total revenue	$ 1,619	$ 2,537	$ (116)	$ 4,040
Depreciation and amortization	$ 11	$ 70	$ -	$ 81
Income (loss) before taxes	$ (424)	$ 177	$ (35)	$ (282)
Other significant noncash items:				
Allocated home office expense	$ (280)	$ 280	$ -	$ -
Stock compensation expense	$ -	$ -	$ 35	$ 35
Warranty expense	$ -	60	-	60
		$	$ -	$
Segment assets	$ 11,745	$ 7,628	$ -	$ 19,373
Expenditures for segment assets	$ 23	$ 67	$ -	$ 90

Note 5 - Commitments and Contingencies

Non-cancellable Operating Leases

Optex Systems Holdings leases its office and manufacturing facilities for the Optex Systems, Inc., Richardson location and the Applied Optics Center Dallas location. The Company also leases certain office equipment under non-cancellable operating leases.

The facility leased by Optex Systems Inc. located at 1420 Presidential Drive, Richardson, Texas consists of 49,100 square feet of space at the premises. The previous lease term for this location 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 the 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% on April 1 each year thereafter. The initial term included 2 months of rent abatement for April and May of 2021. The monthly rent includes approximately $13.1 thousand for additional Common Area Maintenance fees and taxes (“CAM”), to be adjusted annually based on actual expenses incurred by the landlord.

The facility leased by Applied Optics Center located at 9839 and 9827 Chartwell Drive, Dallas, Texas, consists of 44,867 square feet of space at the premises. The previous lease term for this location expired on October 31, 2021 and the monthly base rent was $21.9 thousand through the end of the lease. On January 11, 2021 the Company executed a first amendment extending the terms of the 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% on January 1 each year thereafter. The initial term included 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 rental rate. Our obligations to make payments under the lease are secured by a $125,000 standby letter of credit. The monthly rent includes approximately $9.3 thousand for additional CAM, to be adjusted annually based on actual expenses incurred by the landlord.

As of December 31, 2023, the remaining minimum lease and estimated CAM payments under the non-cancelable facility space leases are as follows:

	(Thousands)				
	Optex Richardson	Applied Optics Center	Office Equipment	Consolidated	
Fiscal Year	**Facility Lease Payments**	**Facility Lease Payments**	**Lease Payments**	**Total Lease Payments**	**Total Variable CAM Estimate**
2024 Base year lease	$ 246	$ 224	$ 11	$ 481	$ 225
2025 Base year lease	336	305	15	656	306
2026 Base year lease	346	313	3	662	312
2027 Base year lease	357	322	-	679	318
2028 Base year lease	242	330	-	572	249
2029 Base year lease	-	83	-	83	43
Total base lease payments	**$ 1,527**	**$ 1,577**	**$ 29**	**$ 3,133**	**$ 1,453**
Imputed interest on lease payments (1)	(163)	(188)	(1)	(352)	
Total Operating Lease Liability(2)	**$ 1,364**	**$ 1,389**	**$ 28**	**$ 2,781**	
Right-of-use Asset(3)	**$ 1,275**	**$ 1,312**	**$ 28**	**$ 2,615**	

(1) Assumes a discount borrowing rate of 5.0% on the new lease amendments effective as of January 11, 2021.

(2) Includes $166 thousand of unamortized deferred rent.

(3) Short-term and Long-term portion of Operating Lease Liability is $625 thousand and $2,156 thousand, respectively.

Total facilities rental and CAM expense under both facility lease agreements for the three months ended December 31, 2023 and January 1, 2023 was $217 and $214 thousand, respectively. Total office equipment rentals included in operating expenses was $5 and $5 thousand for the three months ended December 31, 2023 and January 1, 2023, respectively.

Note 6 - Debt Financing

Credit Facility — PNC Bank (formerly BBVA, USA)

On April 16, 2020, Optex Systems Holdings, Inc. and its subsidiary, Optex Systems, Inc. (collectively, the "Borrowers"), entered into a line of credit facility (the "PNC Facility") with BBVA, USA. In June 2021, PNC Bank completed its acquisition of BBVA, USA and the bank name changed to PNC Bank ("PNC"). The substantive terms were as follows:

- The principal amount of the PNC Facility was $2.25 million. The PNC Facility matured on April 15, 2022. The interest rate was variable based on PNC's prime rate minus 0.25%, initially set at 3% at loan origination, and all accrued and unpaid interest was payable monthly in arrears starting on May 15, 2020; and the principal amount was due in full with all accrued and unpaid interest and any other fees on April 15, 2022.

- There were 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 Borrowers, and a Fixed Charge Coverage Ratio of 1.25:1, with the Fixed Charge Coverage Ratio defined as (earnings before taxes, amortization, 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).

- The PNC Facility contained 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 others.

- The PNC Facility was secured by a first lien on all of the assets of Borrowers.

On April 12, 2022, the Borrowers entered into an Amended and Restated Loan Agreement (the "PNC Loan Agreement") with PNC, pursuant to which the PNC Facility was decreased from $2.25 million to $1.125 million, and the maturity date was extended from April 15, 2022 to April 15, 2023.

On November 21, 2022, the Borrowers issued an Amended and Restated Revolving Line of Credit Note (the "PNC Line of Credit Note") to PNC in connection with an increase of the PNC Facility from $1.125 million to $2.0 million. Obligations outstanding under the PNC Facility accrued interest at a rate equal to PNC's prime rate minus 0.25%.

The PNC Line of Credit Note and PNC Loan Agreement contained customary events of default and negative covenants, including but not limited to those governing indebtedness, liens, fundamental changes, investments, and restricted payments. The PNC Facility was secured by substantially all of the operating assets of the Borrowers as collateral. The Borrowers' obligations under the PNC Facility were subject to acceleration upon the occurrence of an event of default as defined in the PNC Line of Credit Note and PNC Loan Agreement.

For the three months ended January 1, 2023, the interest expense under the PNC Facility was zero. The PNC Facility was replaced by the Texas Capital Facility on March 22, 2023.

Credit Facility — Texas Capital Bank

On March 22, 2023, the Borrowers entered into a Business Loan Agreement (the "Loan Agreement") with Texas Capital Bank (the "Lender"), pursuant to which the Lender makes available to the Borrowers a revolving line of credit in the principal amount of $3 million (the "Texas Capital Facility"). The Texas Capital Facility replaced the $2 million PNC Facility.

The commitment period for advances under the Texas Capital Facility is twenty-six months expiring on May 22, 2025. We refer to the expiration of that time period as the "Maturity Date." Outstanding advances under the Texas Capital Facility will accrue interest at a rate equal to the secured overnight financing rate (SOFR) plus a specified margin, subject to a specified floor interest rate. As of December 31, 2023 the interest rate was 8.1% per annum.

The Loan Agreement contains customary events of default (including a 25% change in ownership) and negative covenants, including but not limited to those governing indebtedness, liens, fundamental changes (including changes in management), investments, and restricted payments (including cash dividends). The Loan Agreement also requires the Borrowers to maintain a fixed charge coverage ratio of at least 1.25:1 and a total leverage ratio of 3.00:1. The Texas Capital Facility is secured by substantially all of the operating assets of the Borrowers as collateral. The Borrowers' obligations under the Texas Capital Facility are subject to acceleration upon the occurrence of an event of default as defined in the Loan Agreement. The Loan Agreement further provides for a $125,000 Letter of Credit sublimit.

The outstanding balance under the Texas Capital Facility was zero as of December 31, 2023 and $1.0 million as of October 1, 2023.

For the three months ended December 31, 2023, the interest expense under the Texas Capital Facility was $7 thousand.

Note 7 - Stock Based Compensation

Restricted Stock, Performance Shares and Restricted Stock Units issued to Directors, Officers and Employees

The following table summarizes the status of Optex Systems Holdings' aggregate non-vested restricted stock and restricted stock units, and performance shares:

	Restricted Stock Units	Weighted Average Grant Date Fair Value	Restricted Shares	Weighted Average Grant Date Fair Value	Performance Shares	Weighted Average Grant Date Fair Value
Outstanding at October 2, 2022	**66,000**	**$ 1.52**	**180,000**	**$ 1.75**	**-**	**$ -**
Granted	42,000	3.05	40,000	3.09	135,000	2.37
Vested	(66,000)	1.52	(60,000)	1.75	-	-
Forfeited	(3,000)	3.00	(40,000)	1.75	-	-
Outstanding at October 1, 2023	**39,000**	**$ 3.06**	**120,000**	**$ 2.20**	**135,000**	**$ 2.37**
Granted	-	-	-	-	-	-
Vested	-	-	-	-	(81,000)	2.57
Forfeited	-	-	-	-	-	-
Outstanding at December 31, 2023	**39,000**	**$ 3.06**	**120,000**	**$ 2.20**	**54,000**	**$ 2.06**

On January 2, 2019, the Company granted 150,000 and 50,000 restricted stock units with a January 2, 2019 grant date to Danny Schoening and Karen Hawkins, respectively, vesting as of January 1 each year subsequent to the grant date over a three-year period at a rate of 34% in year one, and 33% each year thereafter. The stock price at grant date was $1.32 per share. Effective December 1, 2021, the vesting terms of Danny Schoening's Restricted Stock Unit (RSU) grant from January 2019 were revised as described below. The Company amortizes the grant date fair value of $264 thousand to stock compensation expense on a straight-line basis across the three-year vesting period beginning on January 2, 2019. As of October 1, 2023, there was no unrecognized compensation cost relating to this award.

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 amortized the grant date fair 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 April 30, 2020, the 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 shares of restricted stock to each independent director which vest at a rate of 20% per year (20,000 shares) each January 1st through January 1, 2025. The total fair value for the 300,000 shares was $525 thousand based on the stock price of $1.75 as of April 30, 2020. On each of January 1, 2021, January 1, 2022, and January 1, 2023, 60,000 of the restricted director shares vested. On February 16, 2023, 40,000 of the unvested restricted shares were forfeited and cancelled when one of the independent directors departed the Board. On May 9, 2023, the Board of Directors approved a grant of 40,000 shares of restricted stock to independent board member Dayton Judd. The shares vest 50% on each of January 1, 2024 and January 1, 2025. As of the grant date, the fair value of the shares was $124 thousand, to be amortized on a straight-line basis through December 31, 2024. The Company amortizes the grant date fair value to stock compensation expense on a straight-line basis across the five-year and two-year vesting periods beginning on April 30, 2020 and May 9, 2023, respectively. As of October 1, 2023, there were 120,000 unvested restricted shares outstanding.

The Company entered into an amended and restated employment agreement with Danny Schoening dated December 1, 2021.The updated employment agreement also served to amend Mr. Schoening's RSU Agreement, dated January 2, 2019, by changing the third and final vesting date for the restricted stock units granted under such agreement from January 1, 2022 to the "change of control date," that being the first of the following to occur with respect to the Company: (i) any "Person," as that term is defined in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), with certain exclusions, is or becomes the "Beneficial Owner" (as that term is defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing fifty percent (50%) or more of the combined voting power of the Company's then outstanding securities; or (ii) the Company is merged or consolidated with any other corporation or other entity, other than: (A) a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) more than fifty percent (50%) of the combined voting power of the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation; or (B) the Company engages in a merger or consolidation effected to implement a recapitalization of the Company (or similar transaction) in which no "Person" (as defined above) acquires fifty percent (50%) or more of the combined voting power of the Company's then outstanding securities. The amended RSU Agreement contains certain exceptions to the definition of change of control.

As of the December 1, 2021 modification date related to the third and final vesting date of the 49,500 unvested restricted stock units held by Danny Schoening, there was no change in the fair value of the modified award as compared to the original award immediately prior to the modification date. The restricted stock units initially were certain to vest on January 1, 2022, but due to the modification, they were less certain to vest, contingent on a "change in control" occurring, which change in control, in case Mr. Schoening was terminated by the Company without cause or he resigns with good reason prior to such change in control, was required to occur prior to March 13, 2023. As of the modification date, there was $5 thousand of unrecognized compensation cost associated with the original award. As a matter of expediency, the unrecognized compensation expense as of the modification date was fully expensed through January 1, 2022. There is no additional compensation expense associated with the modification of the restricted stock unit agreement.

On November 28, 2022, the Company entered into a new employment agreement with Danny Schoening which amended Mr. Schoening's RSU Agreement, dated January 2, 2019, which had been previously amended as of December 1, 2021, by changing the third and final vesting date for the restricted stock units granted under such agreement from the "change of control date" to January 1, 2023.

On January 4, 2022, the Company issued 23,216 common shares to Karen Hawkins, CFO, and Bill Bates (AOC GM), net of tax withholding of $19 thousand, in settlement of 33,000 restricted stock units which vested on January 1, 2022.

On November 28, 2022, the Company entered into a new employment agreement with Danny Schoening which amended Mr. Schoening's RSU Agreement, dated January 2, 2019, which had been previously amended as of December 1, 2021, by changing the third and final vesting date for the restricted stock units granted under such agreement from the "change of control date" to January 1, 2023.

On January 4, 2023, the Company issued 46,432 common shares to Danny Schoening, CEO, and Bill Bates (AOC GM), net of tax withholding of $58 thousand, in settlement of 66,000 restricted stock units which vested on January 1, 2023.

On May 1, 2023, the Company granted an aggregate of 39,000 restricted stock units to eleven employees under its 2023 Equity Incentive Plan. As of the grant date, assuming a 23.1% forfeiture rate based on expected turnover across the three years, the aggregate value of the restricted stock units is $90 thousand which will be amortized across the three-year period on a straight-line basis. During the twelve months ended October 1, 2023, there were 3,000 restricted stock units forfeited. On August 14, 2023 there was an additional grant of 3,000 restricted stock units to one new employee with a fair value of $11 thousand. The restricted stock units will vest at a rate of 33.33% annually on the anniversary date of the grant and any unvested restricted stock units will be forfeited if employment terminates prior to the relevant vesting date. As of October 1, 2023 there were 39,000 unvested restricted stock units outstanding.

On May 3, 2023, the Board of Directors approved a grant of 100,000 and 35,000 performance shares to Danny Schoening, CEO, and Karen Hawkins, CFO, respectively. Each performance share represents a contingent right to receive one share of common stock. The performance shares vest in five equal increments if, in each case and during a five-year performance period beginning on October 2, 2023, the average VWAP per share of common stock over a 30 consecutive trading day period equals or exceeds $3.70, $4.45, $5.35, $6.40, or $7.70. The fair value of the shares, as of the grant date, is $320 thousand and will be amortized through December 31, 2025 based on the derived service periods using a Monte Carlo simulation valuation model.

On October 2, 2023, 27,000 performance shares vested each date for reaching the 30-day VWAP for Tranche 1. The Company issued a total of 21,060 shares on October 24, 2023 in settlement of the vested shares, net of tax withheld of $27 thousand.

On December 22, 2023 and December 29, 2023, 27,000 performance shares vested each date for reaching the 30-day VWAP for Tranche 2 and Tranche 3. On January 8, 2024 the Company issued a total of 39,563 shares in settlement of the vested shares, net of tax withheld of $91 thousand. Tax withholding for the share settlement occurred on January 8, 2024 and as such will be reported during the next three-month period ending March 31, 2024.

The assumptions and results for the Monte Carlo simulation are as follows:

		Assumptions
Performance Period Start		10/2/2023
Performance Period End		10/1/2028
Term of simulation *(1)*		5.42 years
Time steps in simulation		1,365
Time steps per year		252
Common share price at valuation date *(2)*	$	3.04
Volatility (annual) *(4)*		50.0%
Risk-free rate (annual) *(5)*		3.37%
Cost of equity *(6)*		11.5%
Dividend yield *(3)*		0.0%

	Tranche 1	Tranche 2	Tranche 3	Tranche 4	Tranche 5
Number of performance shares in the Tranche (1)	27,000	27,000	27,000	27,000	27,000
Fair Value of One Performance share (7)	$ 2.75	$ 2.58	$ 2.39	$ 2.18	$ 1.93
Total Fair Value of Tranche	$ 74,345	$ 69,742	$ 64,446	$ 58,819	$ 52,238
Derived Service Period (Years) (7)	0.71	1.13	1.60	2.06	2.48

(1) Based on the terms of the Performance Shares agreement issued by the Company on May 3, 2023.
(2) Closing price of OPXS shares on the Valuation Date, as obtained via S&P Capital IQ.
(3) Expected dividends provided by management.
(4) Based on historical volatility of OPXS and comparable public companies.
(5) Interest rate for US Treasury commensurate with the Performance Shares holding period, as of the Valuation Date, as obtained via S&P Capital IQ.
(6) Estimated cost of equity for OPXS as of the Valuation Date.
(7) Based on Monte Carlo simulation.

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 restricted shares granted and restricted stock units and performance shares awarded as well as the unrecognized compensation costs are summarized in the table below:

	Stock Compensation (thousands)			
	Recognized Compensation Expense		**Unrecognized Compensation Expense**	
	Three months ended		**As of**	
	December 31, 2023	**January 1, 2023**	**December 31, 2023**	**October 1, 2023**
Restricted Shares	$ 41	$ 26	$ 132	$ 173
Performance Based Shares	64	-	148	212
Restricted Stock Units	8	9	80	88
Total Stock Compensation	**$ 113**	**$ 35**	**$ 360**	**$ 473**

Note 8 - Stockholders' Equity

Dividends

No dividends were declared or paid during the three months ended December 31, 2023 or the twelve months ended October 1, 2023.

Common stock

On September 22, 2021, the Company announced authorization of a $1 million stock repurchase program. The shares authorized to be repurchased under the repurchase program may be purchased from time to time at prevailing market prices, through open market transactions or in negotiated transactions, depending upon market conditions and subject to Rule 10b-18 as promulgated by the SEC.

During the three months ended December 31, 2023 and January 1, 2023, there were zero common shares repurchased under the program.

During the three months ended December 31, 2023, the Company issued 60,623 shares to Danny Schoening and Karen Hawkins in settlement of 81,000 performance shares which vested during the three months. The shares were issued net of 20,377 shares withheld for taxes. As of December 31, 2023 and October 1, 2023, the total issued and outstanding common shares were 6,823,693 and 6,763,070, respectively.

Note 9 - Subsequent Events

On January 1, 2024, 60,000 restricted shares issued to the independent board members were vested.

On January 8, 2024, $76 thousand and $56 thousand was paid to Danny Schoening, CEO and Karen Hawkins, CFO, respectively for incentive bonuses calculated in accordance with a formula previously approved by the Board of Directors' Compensation Committee for performance against the fiscal year 2023 measurement targets.

On January 18, 2024, Optex Systems Holdings, Inc., through its wholly-owned subsidiary Optex Systems, Inc. (collectively, the "Company"), entered into an asset purchase agreement and a contract manufacturing agreement with RUB Aluminium s.r.o. ("RUB"). Under the agreements, the Company acquired certain intellectual property and technical and marketing information relating to the Speedtracker Mach product line, which is primarily used for firearm projectile speed detection, measuring and tracking. RUB will continue to manufacture Speedtracker Mach products on behalf of the Company. The Company acquired the assets using $1 million in cash on hand, with potential additional future cash payments based on successful completion of defined milestones. The initial term of the contract manufacturing agreement is one year, subject to additional one-year renewal terms to which both parties must agree.

The acquisition is deemed as a non-significant asset acquisition of intangible assets based on the guidance of U.S. GAAP ACS 805 and does not meet the significance test pursuant to SEC Rule 3-05.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to supplement and complement our audited consolidated financial statements and notes thereto for the fiscal year ended October 1, 2023 and our unaudited condensed consolidated financial statements and notes thereto for the quarter ended December 31, 2023, prepared in accordance with U.S. generally accepted accounting principles (GAAP). You are encouraged to review our condensed 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 a non-GAAP measure is used in this MD&A, it is clearly identified as a non-GAAP measure and reconciled to the most closely corresponding GAAP measure.

The following discussion highlights the principal factors that have affected our financial condition and results of operations as well as our liquidity and capital resources for the periods described. The operating results for the periods presented were not significantly affected by inflation.

Cautionary Note Regarding Forward-Looking Information

This Quarterly Report on Form 10-Q, in particular the MD&A, contains certain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Any statements contained in this Quarterly Report on Form 10-Q that are not statements of historical fact may be deemed to be forward-looking statements. When used in this Quarterly Report on Form 10-Q and other reports, statements, and information we have filed with the Securities and Exchange Commission ("Commission" or "SEC"), in our press releases, presentations to securities analysts or investors, or in oral statements made by or with the approval of an executive officer, the words or phrases "believes," "may," "will," "expects," "should," "continue," "anticipates," "intends," "will likely result," "estimates," "projects" or similar expressions and variations thereof are intended to identify such forward-looking statements.

These forward-looking statements represent our expectations, beliefs, intentions or strategies concerning future events, including, but not limited to, any statements regarding growth strategy; product and development programs; financial performance and financial condition (including revenue, net income, profit margins and working capital); orders and backlog; expected timing of contract deliveries to customers and corresponding revenue recognition; increases in the cost of materials and labor; costs remaining to fulfill contracts; contract loss reserves; labor shortages; follow-on orders; supply chain challenges; the continuation of historical trends; the sufficiency of our cash balances for future liquidity and capital resource needs; the expected impact of changes in accounting policies on our results of operations, financial condition or cash flows; anticipated problems and our plans for future operations; and the economy in general or the future of the defense industry.

We caution that these statements by their nature involve risks and uncertainties, certain of which are beyond our control, and actual results may differ materially depending on a variety of important factors. Such risks and uncertainties include, but are not limited to, continued funding of defense programs and military spending, the timing of such funding, general economic and business conditions, including unforeseen weakness in the Company's markets, effects of continued geopolitical unrest and regional conflicts, competition, changes in technology and methods of marketing, delays in completing engineering and manufacturing programs, changes in customer order patterns, changes in product mix, continued success in technological advances and delivering technological innovations, changes in the U.S. Government's interpretation of federal procurement rules and regulations, changes in spending due to policy changes in any new federal presidential administration, market acceptance of the Company's products, shortages in components, production delays due to performance quality issues with outsourced components, inability to fully realize the expected benefits from acquisitions and restructurings or delays in realizing such benefits, challenges in integrating acquired businesses and achieving anticipated synergies, changes to export regulations, increases in tax rates, changes to generally accepted accounting principles, difficulties in retaining key employees and customers, unanticipated costs under fixed-price service and system integration engagements, changes in the market for microcap stocks regardless of growth and value and various other factors beyond our control. Some of these risks and uncertainties are identified in this Management's Discussion and Analysis of Financial Condition and Results of Operations and the section "Risk Factors" in our Annual Report on Form 10-K and you are urged to review those sections. 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.

We do not assume the obligation to update any forward-looking statement. You should carefully evaluate such statements in light of factors described in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K.

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 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, ADS Inc. and others. We are also a military supplier to foreign governments such as Israel, Australia and South American countries and as a subcontractor for several large U.S. defense companies serving foreign governments.

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

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

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

In addition, 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.

Recent Events

January 2024 Asset Acquisition

On January 18, 2024, Optex Systems Holdings, Inc., through its wholly-owned subsidiary Optex Systems, Inc. (collectively, the "Company"), entered into an asset purchase agreement and a contract manufacturing agreement with RUB Aluminium s.r.o. ("RUB"). Under the agreements, the Company acquired certain intellectual property and technical and marketing information relating to the Speedtracker Mach product line, which is primarily used for firearm projectile speed detection, measuring and tracking. RUB will continue to manufacture Speedtracker Mach products on behalf of the Company. The Company acquired the assets using $1 million in cash on hand, with potential additional future cash payments based on successful completion of defined milestones. The initial term of the contract manufacturing agreement is one year, subject to additional one-year renewal terms to which both parties must agree.

Material Trends

Recent supply chain disruptions have strained our suppliers and extended supplier delivery lead times, affecting their ability to sustain operations. We anticipate market wide material shortages for paint and resin products as well as critical epoxies and chemicals used in our manufacturing process. In addition, we are seeing substantial increases in the costs of aluminum, steel and acrylic commodities, which has affected our net income in the year ended October 1, 2023 and the quarter ended December 31, 2023, and is expected to continue to have a negative effect on the margins expected to be generated under our long-term fixed contracts over the next three years. See also "*Item 1A. Risk Factors – Risks Related to Our Business - Certain of our products are dependent on specialized sources of supply potentially subject to disruption which could have a material, adverse impact on our business" in our* Annual Report on Form 10-K for the year ended October 1, 2023.

We have experienced significant material shortages during the year ended October 1, 2023 and extending into the first three months of fiscal year 2024 from several significant suppliers of our periscope covers and housings. These shortages affect several of our periscope products at the Optex Richardson segment. The delays in key components, combined with labor shortages during the year ended October 1, 2023 and continuing into the first three months of fiscal year 2024, have negatively impacted our production levels and continue to push back expected delivery dates. We are aggressively seeking alternative sources and actively expediting our current suppliers for these components as well as increasing employee recruitment initiatives and overtime to attempt to mitigate any continuing risks to the periscope line. We are seeing some recent improvements in the local labor market and are adding to our direct labor force in concert with improvements in our supplier delivery performance. While we are encouraged by improvements in supplier performance for the Optex Richardson segment periscope line which yielded increased revenue performance during fiscal year 2023 and into the first three months of fiscal 2024, our suppliers have yet to ramp up deliveries sufficiently to keep pace with our current customer demands. As such, we cannot give any assurances that expected customer delivery dates for our periscope products will not experience further delays.

In March 2023, we moved our line of credit from PNC Bank to Texas Capital Bank and increased our available line of credit to $3.0 million from the previous $2.0 million line with PNC. The increase in credit limit helps us meet our working capital requirements in light of the increased backlog and delay of revenues from the fiscal year 2023.

We refer also to "*Item 1. Business – Market Opportunity: U.S. Military*" *in our* Annual Report on Form 10-K for the year ended October 1, 2023 for a description of current trends in U.S. government military spending and its potential impact on Optex, which may be material, including particularly the tables included in that section and disclosure on the significant reduction in spending for U.S. ground system military programs, which has a direct impact on the Optex Systems Richardson segment revenue, all of which is incorporated herein by reference.

Results of Operations

Segment Information

We have presented the operating results by segment to provide investors with an additional tool to evaluate our operating results and to have a better understanding of the overall performance of each business segment. 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 months ended December 31, 2023 and January 1, 2023 reconciled to the Condensed Consolidated Results of Operations as presented in Item 1, "Condensed Consolidated Financial Statements."

Results of Operations Selective Financial Information
(Thousands)
Three months ended

	December 31, 2023				**January 1, 2023**			
	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	$ 3,394	3,574	-	6,968	$ 1,619	$ 2,421	$ -	$ 4,040
Intersegment Revenues	-	187	(187)	-	-	116	(116)	-
Total Segment Revenue	**3,394**	**3,761**	**(187)**	**6,968**	**1,619**	**2,537**	**(116)**	**4,040**
Total Cost of Sales	2,841	2,630	(187)	5,284	1,460	1,979	(116)	3,323
Gross Profit	**553**	**1,131**	**-**	**1,684**	**159**	**558**	**-**	**717**
Gross Margin %	***16.3%***	***30.1%***	***-***	***24.2%***	***9.8%***	***22.0%***	***-***	***17.7%***
General and Administrative Expense	881	137	113	1,131	863	101	35	999
Segment Allocated G&A Expense	(343)	343	-	-	(280)	280	-	-
Net General & Administrative Expense	538	480	113	1,131	583	381	35	999
Operating Income (Loss)	**15**	**651**	**(113)**	**553**	**(424)**	**177**	**(35)**	**(282)**
Operating Income (Loss) %	***0.4%***	***17.3%***	***-***	***7.9%***	***(26.2)%***	***7.0%***	***-***	***(7.0)%***
Interest Expense	-	-	(7)	(7)	-	-	-	-
Net Income (Loss) before taxes	**$ 15**	**651**	**(120)**	**546**	**(424)**	**$ 177**	**$ (35)**	**$ (282)**
Net Income (Loss) %	***0.4%***	***17.3%***	***-***	***7.8%***	***(26.2)%***	***7.0%***	***-***	***(7.0)%***

For the three months ended December 31, 2023, our total revenues increased by $2.9 million, or 72.5%, compared to the prior year period. The increase in revenue was driven by increased customer demand in both operating segments, combined with improved supplier performance and higher production levels at the Optex Richardson segment during the most recent three months as compared to the prior year period.

Consolidated gross profit for the three months ended December 31, 2023 increased by $1.0 million, or 134.9%, compared to the prior year period. We realized significantly higher gross margins in both operating segments with increased fixed cost absorption against the higher revenue base, combined with favorable changes in product mix between the segments.

Our operating income for the three months ended December 31, 2023 increased by $0.8 million compared to the prior year period. The increase in operating income was primarily driven by increased revenue and gross profit, which were partially offset by higher general and administrative costs during the period.

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, which we do not consider relevant to our operations. Adjusted EBITDA is a financial measure not required by, or presented in accordance with, U.S. generally accepted accounting principles ("GAAP").

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

The table below summarizes our three-month operating results for the periods ended December 31, 2023 and January 1, 2023, 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 better to evaluate our overall performance.

	(Thousands) Three months ended	
	December 31, 2023	**January 1, 2023**
Net Income (Loss) (GAAP)	$ 431	$ (223)
Add:		
Depreciation and Amortization	92	81
Federal Income Tax Expense (Benefit)	115	(59)
Stock Compensation	113	35
Interest Expense	7	-
Adjusted EBITDA - Non GAAP	**$ 758**	**$ (166)**

Our net income increased by $0.6 million to $0.4 million for the three months ended December 31, 2023, as compared to net loss of $(0.2) million for the prior year period. Our adjusted EBITDA increased by $0.9 million to $0.8 million for the three months ended December 31, 2023, as compared to ($0.2) million for the prior year period.

The increase is primarily driven by higher revenue and gross profit during the period as compared to the prior year period. Operating segment performance is discussed in greater detail throughout the following sections.

New Orders and Backlog

Product backlog represents the value of unfulfilled customer manufacturing orders yet to be recognized as revenue. While backlog is not a non-GAAP financial measure, it is also not defined by GAAP. Therefore, our methodology for calculating backlog may not be consistent with methodologies used by other companies. The booked backlog by period may also not be fully indicative of the predicted revenues for those periods as many of our orders provide for accelerated delivery without penalty and may additionally provide customers the option to adjust schedules to meet their most recent projected demand quantities. However, we provide customer order and backlog information as we believe it provides significant insight into forward demand, with some predictive power to short term future revenues.

During the three months ended December 31, 2023, the Company booked $10.1 million in new orders, representing a 9.8% decrease over the prior year period orders of $11.2 million. The orders for the most recently completed three months consist of $6.2 million for our Optex Richardson segment and $3.9 million attributable to the Applied Optics Center segment.

The following table depicts the new customer orders for the three months ending December 31, 2023 as compared to the prior year period in millions of dollars:

	(Millions)			
Product Line	**Three months ended December 31, 2023**	**Three months ended January 1, 2023**	**Variance**	**% Chg**
Periscopes	$ 4.9	$ 3.7	$ 1.2	32.4%
Sighting Systems	(0.3)	3.4	(3.7)	(108.8)%
Howitzer	-	-	-	-%
Other	1.6	1.5	0.1	6.7%
Optex Systems – Richardson	**6.2**	**8.6**	**(2.4)**	**(27.9)%**
Optical Assemblies	0.9	1.2	(0.3)	(25.0)%
Laser Filters	2.4	1.3	1.1	84.6%
Day Windows	-	-	-	-%
Other	0.6	0.1	0.5	500.0%
Applied Optics Center – Dallas	**3.9**	**2.6**	**1.3**	**50.0%**
Total Customer Orders	**$ 10.1**	**$ 11.2**	**$ (1.1)**	**(9.8)%**

Orders for the Optex Richardson segment decreased by $2.4 million, or 27.9%, from the prior year period. The prior year period ended January 1, 2023 included a $3.4 million order to repair and refurbish night vision equipment for the Government of Israel. During the three months ended December 31, 2023, the order value was reduced by $0.3 million based on a downward price negotiation resulting from lower anticipated material costs against the program. Orders for periscopes and other products increased as compared the prior year period.

Orders for the Applied Optics Center increased by $1.3 million, or 50.0%, from the prior year period with increased orders in laser filters and other products.

Backlog as of December 31, 2023 was $45.0 million as compared to a backlog of $40.1 million as of January 1, 2023, representing an increase of 12.2%. The following table depicts the current expected delivery by quarter of all contracts awarded as of December 31, 2023, as well as the December 31, 2023 backlog as compared to the backlog on January 1, 2023.

Product Line	Q2 2024	Q3 2024	Q4 2024	2024 Delivery	2025+ Delivery	Total Backlog 12/31/2023	Total Backlog 1/1/2023	Variance	% Chg
	(Millions)								
Periscopes	$ 2.4	$ 4.3	$ 5.0	$ 11.7	$ 6.1	$ 17.8	$ 10.0	$ 7.8	78.0%
Sighting Systems	0.3	0.3	0.3	0.9	3.1	4.0	4.9	(0.9)	(18.4)%
Howitzer	-	-	-	-	2.3	2.3	2.3	-	-%
Other	1.4	0.7	0.6	2.7	2.5	5.2	4.8	0.4	8.3%
Optex Systems - Richardson	**4.1**	**5.3**	**5.9**	**15.3**	**14.0**	**29.3**	**22.0**	**7.3**	**33.2%**
Optical Assemblies	0.9	0.7	0.2	1.8	0.7	2.5	6.5	(4.0)	(61.5)%
Laser Filters	2.4	3.2	2.4	8.0	2.5	10.5	9.4	1.2	12.8%
Day Windows	0.2	0.2	0.3	0.7	0.8	1.5	1.8	(0.3)	(16.7)%
Other	0.4	0.2	0.6	1.2	-	1.2	0.4	0.7	175.0%
Applied Optics Center - Dallas	**3.9**	**4.3**	**3.5**	**11.7**	**4.0**	**15.7**	**18.1**	**(2.4)**	**(13.3)%**
Total Backlog	**$ 8.0**	**$ 9.6**	**$ 9.4**	**$ 27.0**	**$ 18.0**	**$ 45.0**	**$ 40.1**	**$ 4.9**	**12.2%**

Optex Systems Richardson backlog as of December 31, 2023, was $29.3 million as compared to a backlog of $22.0 million as of January 1, 2023, representing an increase of $7.3 million or 33.2%. The increased backlog for the Optex segment is primarily driven by higher periscope orders.

Applied Optics Center backlog as of December 31, 2023, was $15.7 million as compared to a backlog of $18.1 million as of January 1, 2023, representing a decrease of $2.4 million or 13.3%. The decrease in backlog for the Applied Optics Center is primarily driven by lower orders and demand for commercial optical assemblies. We anticipate new optical assembly orders in the second half of fiscal year 2024 with deliveries beginning in the fourth quarter.

Please refer to "*Material Trends*" above or "*Liquidity and Capital Resources*" below for more information on recent developments and trends with respect to our orders and backlog, which information is incorporated herein by reference.

The Company continues to pursue domestic, 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 December 31, 2023 Compared to the Three Months Ended January 1, 2023

Revenue. For the three months ended December 31, 2023, revenue increased by $2.9 million or 72.5% compared to the prior year period as set forth in the table below:

Product Line	December 31, 2023	January 1 2023	Variance	% Chg
	Three months ended (Thousands)			
Periscopes	$ 1,976	$ 1,325	$ 651	49.1%
Sighting Systems	359	189	170	89.9%
Howitzers	-	-	-	-
Other	1,059	105	954	908.6%
Optex Systems - Richardson	**3,394**	**1,619**	**1,775**	**109.6%**
Optical Assemblies	1,226	1,508	(282)	(18.7)%
Laser Filters	1,837	557	1,280	229.8%
Day Windows	161	161	-	-
Other	350	195	155	79.5%
Applied Optics Center - Dallas	**3,574**	**2,421**	**1,153**	**47.6%**
Total Revenue	**$ 6,968**	**$ 4,040**	**$ 2,928**	**72.5%**

Optex Systems Richardson revenue increased by $1.8 million or 109.6% for the three months ended December 31, 2023 as compared to the prior year period with higher revenue across all product lines. Periscope revenues continue to increase with higher orders and backlog combined with improved supplier performance against our requirements. The Company has also experienced increased demand in our other product lines for mirrors, windows, beamsplitters and collimator assemblies. During the three months ended December 31, 2023, the Company made its first delivery against the Government of Israel sighting system contract awarded in November 2022.

Applied Optics Center revenue increased by $1.2 million or 47.6% for the three months ended December 31, 2023 as compared to the prior year period. The revenue increase is primarily attributable to increased demand for laser filters during the three months ended December 31, 2023 as compared to the prior year period.

Gross Margin. The gross margin during the three-month period ended December 31, 2023 was 24.2% of revenue as compared to a gross margin of 17.7% of revenue for the prior year period. The increase in gross profit is primarily attributable to increased revenue resulting in higher absorption of our fixed cost base, combined with a favorable change in mix between segments. Cost of sales increased to $5.3 million for the recently completed period as compared to the prior year period of $3.3 million on higher revenue.

G&A Expenses. During the three months ended December 31, 2023 and January 1, 2023, we recorded operating expenses of $1.1 million and $1.0 million, respectively. Operating expenses increased by 13.2% over the prior year period primarily due to increased stock compensation expense, selling expenses and labor fringe costs.

Operating Income. During the three months ended December 31, 2023, we recorded operating income of $553 thousand, as compared to an operating loss of ($282) thousand during the three months ended January 1, 2023. The $0.8 million increase in operating income is primarily due to higher revenue and gross profit, partially offset by increased operating expenses.

Liquidity and Capital Resources

As of December 31, 2023, the Company had working capital of $13.0 million, as compared to $13.5 million as of October 1, 2023.

During the three months ended December 31, 2023, we generated operating cash of $2.3 million, paid $1.0 million against our line of credit and spent $0.1 million on acquisitions of property and equipment. During the period, our inventory increased $0.5 million in support of new program awards and increasing revenues anticipated over the next nine months.

The Company has capital commitments of $90 thousand for the purchase of property and equipment consisting of an automated acrylic buffing system.

Backlog as of December 31, 2023 was $45.0 million as compared to backlog of $40.1 million as of January 1, 2023 and $41.8 million as of October 1, 2023, representing an increase of 12.2% and 7.7%, respectively. For further details, see "*Results of Operations – New Orders and Backlog*" above.

The Company has historically funded its operations through cash from operations, convertible notes, common and preferred stock offerings and bank debt. The Company's ability to generate positive cash flows depends on a variety of factors, including the continued development and successful marketing of the Company's products.

At December 31, 2023, the Company had $2.4 million in cash and an outstanding payable balance of zero against its line of credit. At December 31, 2023, our outstanding accounts receivable balance was $2.4 million. We expect the accounts to be collected during the second quarter of fiscal 2024.

We refer to the disclosure above under "*Material Trends"* with respect to recent supply chain disruptions and material shortages, which disclosure is incorporated herein by reference.

In the short term, the Company plans to utilize its current cash, available line of credit and operating cash flow to fund inventory purchases in support of the backlog growth and higher anticipated revenue during the next twelve months. Short term cash in excess of our working capital needs may be also be used to fund the purchase of product lines and other assets, including property and equipment required to maintain or meet our growing backlog, in addition to repurchasing common stock against our current stock repurchase plan. Longer term, excess cash beyond our operating needs may be used to fund new product development, company or product line acquisitions, or additional stock purchases as attractive opportunities present themselves.

On January 18, 2024, the Company acquired certain intellectual property and technical and marketing information relating to the Speedtracker Mach product line and entered into an asset purchase agreement and a contract manufacturing agreement with RUB Aluminium s.r.o. ("RUB"). The Company acquired the assets using $1 million in cash on hand, with potential additional future cash payments based on successful completion of defined milestones. The initial term of the contract manufacturing agreement is one year, subject to additional one-year renewal terms.

In some instances, new government contract awards may allow for contract financing in the form of progress payments pursuant to Federal Acquisition Regulation 52.232-16, "Progress Payments." Subject to certain limitations, this clause provides for government payment of up to 90% of incurred program costs prior to product delivery for small businesses like us. To the extent any contracts allow for progress payments and the respective contracts would result in significant preproduction cash requirements for design, process development, tooling, material or other resources which could exceed our current working capital or line of credit availability, we intend to utilize this benefit to minimize any potential negative impact on working capital prior to receipt of payment for the associated contract deliveries. Currently none of our existing contracts allow for progress payments.

We refer to "*Note 5 – Commitments and Contingencies – Non-cancellable Operating Leases*" for a tabular depiction of our remaining minimum lease and estimated CAM payments under such leases as of December 31, 2023, which disclosure is incorporated herein by reference.

The Company expects to generate net income and positive cash flow from operating activities over the next twelve months. To achieve and retain profitability, we need to maintain a level of revenue adequate to support our cost structure. Management intends to manage operations commensurate with its level of working capital and line of credit during the next twelve months and beyond; however, uneven revenue levels driven by changes in customer delivery demands, first article inspection requirements or other program delays associated with the pandemic, labor shortages and supply chain issues 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.

On March 22, 2023, the Company and its subsidiary, Optex Systems, Inc. ("Optex", and with the Company, the "Borrowers"), entered into a Business Loan Agreement (the "Loan Agreement") with Texas Capital Bank (the "Lender"), pursuant to which the Lender will make available to the Borrowers a revolving line of credit in the principal amount of $3 million (the "Credit Facility"). The commitment period for advances under the Credit Facility is twenty-six months expiring on May 22, 2025. We refer to the expiration of that time period as the "Maturity Date." Outstanding advances under the Credit Facility will accrue interest at a rate equal to the secured overnight financing rate (SOFR) plus a specified margin, subject to a specified floor interest rate. The interest rate is currently at 8.1% per annum.

The Loan Agreement contains customary events of default (including a 25% change in ownership) and negative covenants, including but not limited to those governing indebtedness, liens, fundamental changes (including changes in management), investments, and restricted payments (including cash dividends). The Loan Agreement also requires the Borrowers to maintain a fixed charge coverage ratio of at least 1.25:1 and a total leverage ratio of 3.00:1. The Credit Facility is secured by substantially all of the operating assets of the Borrowers as collateral. The Borrowers' obligations under the Credit Facility are subject to acceleration upon the occurrence of an event of default as defined in the Loan Agreement. The Loan Agreement further provides for a $125,000 Letter of Credit sublimit. As of December 31, 2023, there was zero borrowed under the Credit Facility. As of December 31, 2023, the Company is in compliance with all covenants under the Credit Facility.

The Credit Facility replaced the prior $2 million line of credit with PNC Bank, National Association.

On September 22, 2021 the Company announced authorization for an additional $1 million stock repurchase program. As of December 31, 2023, there was an authorized balance of $560 thousand remaining to be spent against the repurchase program. During the three months ended December 31, 2023, there were no stock repurchases against the plan.

Critical Accounting Estimates

A critical accounting estimate is an estimate that:

- is made in accordance with generally accepted accounting principles,
- involves a significant level of estimation uncertainty, and
- has had or is reasonably likely to have a material impact on the company’s financial condition or results of operation.

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 October 1, 2023.

Our critical accounting estimates include warranty costs, contract losses and the deferred tax asset valuation. Future warranty costs are based on the estimated cost of replacement for expected returns based upon our most recent experience rate of defects as a percentage of warranty covered sales. Our warranty covered sales primarily include the Applied Optics Center optical assemblies. While our warranty period is 12 months, our reserve balances assume a general 90-day return period for optical assemblies previously delivered plus any returned backlog in-house that has not yet been repaired or replaced to our customer. If our actual warranty returns should significantly exceed our historical rates on new customer products, significant production changes, or substantial customer changes to the 90-day turn-around times on returned goods, the impact could be material to our operating profit. We have not experienced any significant changes to our warranty trends in the preceding three years and do not anticipate any significant impacts in the near term. We monitor the actual warranty costs incurred to the expected values on a quarterly basis and adjust our estimates accordingly. As of December 31, 2023, the Company had accrued warranty costs of $48 thousand, as compared to $75 thousand as of October 1, 2023. The primary reason for the $27 thousand decrease in reserve balances relates to lower shipments against our warranty covered optical assemblies, combined with a favorable change in estimate due to lower historical return trends and repair costs.

As of December 31, 2023 and October 1, 2023, we had $308 thousand, and $243 thousand, respectively, of contract loss reserves included in our balance sheet accrued expenses. These loss contracts are related to some of our older legacy periscope IDIQ contracts which were priced in 2018 through early 2020, prior to Covid-19 and the significant downturn in defense spending on ground system vehicles. Due to inflationary price increases on component parts and higher internal manufacturing costs (as a result of escalating labor costs and higher burden rates on reduced volume), some of these contracts are in a loss condition, or at marginal profit rates. These contracts are typically three-year IDIQ contracts with two optional award years, and as such, we are obligated to accept new task awards against these contracts until the contract expiration. Should contract costs continue to increase above the negotiated selling price, or in the event the customer should release substantial quantities against these existing loss contracts, the losses could be material. For contracts currently in a loss status based on the estimated per unit contract costs, losses are booked immediately on new task order awards. During the three months ended December 31, 2023, the Company recognized $90 thousand in loss reserves on new contract awards, made shipments resulting in reductions of $25 thousand against existing loss reserves.

As of December 31, 2023 and October 1, 2023, Optex Systems, Inc. has a deferred tax asset valuation allowance of ($0.8) million against deferred tax assets of $1.7 million, for a net deferred tax asset of $0.9 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. The valuation allowance covers certain deferred tax assets where we believe we will be unlikely to recover those tax assets through future operations. The valuation reserve includes assumptions related to future taxable income which would be available to cover net operating loss carryforward amounts. Because of the uncertainties of future income forecasts combined with the complexity of some of the deferred assets, these forecasts are subject to change over time. While we believe our current estimate to be reasonable, changing market conditions and profitability, changes in equity structure and changes in tax regulations may impact our estimated reserves in future periods.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Not applicable.

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 December 31, 2023, 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 reports 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 December 31, 2023, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

During the three months ended December 31, 2023, 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.

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 October 1, 2023.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Unregistered Sales

None.

Issuer Purchases of Equity Securities

There were no purchases made by or on behalf of the Company or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) of its common stock under the Exchange Act) during the three months ended December 31, 2023.

Item 3. Defaults upon Senior Securities.

None.

Item 4. Mine Safety Disclosures

Not applicable**.**

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
EX-101.INS	Inline XBRL Instance Document
EX-101.SCH	Inline XBRL Taxonomy Extension Schema Document
EX-101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
EX-101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
EX-101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document
EX-101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (embedded within the Inline XBRL document)

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: February 12, 2024	By: */s/ Danny Schoening*
	Danny Schoening Principal Executive Officer
	OPTEX SYSTEMS HOLDINGS, INC.
Date: February 12, 2024	By: */s/ Karen Hawkins*
	Karen Hawkins Principal Financial Officer and Principal Accounting Officer

Exhibit 31.1

**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: February 12, 2024

Exhibit 31.2

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: February 12, 2024

Exhibit 32.1

**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 December 31, 2023, 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: February 12, 2024

Exhibit 32.2

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 December 31, 2023, 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: *<u>/s/ Karen Hawkins</u>*
Karen Hawkins
Principal Financial Officer and Principal Accounting Officer

Dated: February 12, 2024