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

FORM 10-Q

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

For the quarterly period ended March 31, 2019

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIESEXCHANGE ACT OF 1934**

For the transition period from ______to______.

OPTEX SYSTEMS HOLDINGS, INC.

(Exact Name of Registrant as Specified in Charter)

Delaware (State or other jurisdiction of incorporation)	**000-54114** (Commission File Number)	**90-0609531** (IRS Employer Identification No.)

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

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

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

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

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

☐ Emerging growth company

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

Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).
Yes ☒ No ☐

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

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

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

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of May 13, 2019: 8,388,918 shares of common stock.

OPTEX SYSTEMS HOLDINGS, INC.
FORM 10-Q

For the period ended March 31, 2019

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Part 1. Financial Information

Item 1. Consolidated Financial Statements

OPTEX SYSTEMS HOLDINGS, INC.
UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
AS OF MARCH 31, 2019

Optex Systems Holdings, Inc.

Condensed Consolidated Balance Sheets

	(Thousands, except share and per share data) March 31, 2019 (Unaudited)	September 30, 2018
ASSETS		
Cash and Cash Equivalents	$ 1,580	$ 1,133
Accounts Receivable, Net	2,584	2,458
Net Inventory	9,213	7,639
Prepaid Expenses	118	104
Current Assets	**13,495**	**11,334**
Property and Equipment, Net	**1,227**	**1,300**
Other Assets		
Prepaid Royalties	15	30
Security Deposits	23	23
Other Assets	**38**	**53**
Total Assets	**$ 14,760**	**$ 12,687**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts Payable	$ 1,815	$ 943
Federal Income Taxes Payable	55	22
Accrued Expenses	1,085	1,169
Accrued Warranties	91	101
Customer Advance Deposits	—	308
Credit Facility	250	300
Current Liabilities	**3,296**	**2,843**
Warrant Liability	4,047	3,500
Total Liabilities	**7,343**	**6,343**
Commitments and Contingencies		
Stockholders' Equity		
Common Stock – ($0.001 par, 2,000,000,000 authorized, 8,388,918 and 8,333,353 shares issued and outstanding, respectively)	8	8
Additional Paid-in-capital	25,959	25,938
Accumulated Deficit	(18,550)	(19,602)
Stockholders' Equity	**7,417**	**6,344**
Total Liabilities and Stockholders' Equity	**$ 14,760**	**$ 12,687**

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

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

	(Thousands, except share and per share data) Three months ended		Six months ended	
	March 31, 2019	**April 1, 2018**	**March 31, 2019**	**April 1, 2018**
Revenue	$ **7,088**	$ **4,550**	$ **12,979**	$ **9,327**
Cost of Sales	5,107	3,557	9,556	7,218
Gross Margin	**1,981**	**993**	**3,423**	**2,109**
General and Administrative Expense	799	786	1,542	1,559
Operating Income	**1,182**	**207**	**1,881**	**550**
Gain (Loss) on Change in Fair Value of Warrants	(1,932)	2,350	(547)	2,006
Total Other Income	**(1,932)**	**2,350**	**(547)**	**2,006**
Other Expenses				
Interest Expense	(6)	(9)	(12)	(12)
Other Income (Expense)	**(1,938)**	**2,341**	**(559)**	**1,994**
Income (Loss) Before Taxes	**(756)**	**2,548**	**1,322**	**2,544**
Current Income Tax Expense (Benefit)	$ 217	$ (83)	270	8
Net income (loss)	$ **(973)**	$ **2,631**	$ **1,052**	$ **2,536**
Dividends declared on participating securities	—	(88)	—	(178)
Deemed dividends on participating securities	—	(820)	(348)	(693)
Net income (loss) applicable to common shareholders	$ **(973)**	$ **1,723**	$ **704**	$ **1,665**
Basic income (loss) per share	$ **(0.12)**	$ **0.20**	$ **0.08**	$ **0.20**
Weighted Average Common Shares Outstanding - basic	**8,387,086**	**8,417,438**	**8,360,220**	**8,482,273**
Diluted income (loss) per share	$ **(0.12)**	$ **0.20**	$ **0.08**	$ **0.19**
Weighted Average Common Shares Outstanding - diluted	**8,387,086**	**8,744,759**	**8,846,253**	**8,815,922**

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

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

	(Thousands) Six months ended March 31, 2019	(Thousands) Six months ended April 1, 2018
Cash Flows from Operating Activities:		
Net Income	$ 1,052	$ 2,536
Adjustments to Reconcile Net Income to Net Cash provided by Operating Activities:		
Depreciation and Amortization	169	161
(Gain) Loss on Change in Fair Value of Warrants	547	(2,006)
Noncash Interest Expense	—	2
Stock Compensation Expense	58	81
Provision for Inventory Valuation	49	—
Accounts Receivable	(126)	1,724
Inventory	(1,623)	(323)
Prepaid Expenses	(14)	(74)
Accounts Payable and Accrued Expenses	788	(1,102)
Federal Income Taxes Payable	33	7
Accrued Warranty Costs	(10)	(53)
Prepaid Royalties	15	15
Customer Advance Deposits	(308)	(250)
Total Adjustments	**(422)**	**(1,818)**
Net Cash provided by Operating Activities	**630**	**718**
Cash Flows used in Investing Activities		
Purchases of Property and Equipment	(96)	(17)
Net Cash used in Investing Activities	**(96)**	**(17)**
Cash Flows used in Financing Activities		
Dividends Paid	—	(522)
Cash Paid for Taxes Withheld On Net Settled Restricted Stock Unit Share Issue	(37)	(30)
Payments on Credit Facility	(50)	—
Net Cash used in Financing Activities	**(87)**	**(552)**
Net Increase in Cash and Cash Equivalents	447	149
Cash and Cash Equivalents at Beginning of Period	1,133	1,682
Cash and Cash Equivalents at End of Period	**$ 1,580**	**$ 1,831**
Supplemental Cash Flow Information:		
Non Cash Transactions:		
Exchange of Preferred Stock for Common Stock	$ —	$ 480
Dividends Declared and Unpaid	—	262
Cash Transactions:		
Cash Paid for Taxes	237	—
Cash Paid for Interest	12	10

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

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

	Three months ended March 31, 2019					
	Common Shares Outstanding	Series C Preferred Shares	Common Stock	Additional Paid in Capital	Retained Earnings	Total Stockholders Equity
Balance at December 30, 2018	**8,333,353**	**—**	**$ 8**	**$ 25,974**	**$ (17,577)**	**$ 8,405**
Stock Compensation Expense	—	—	—	22	—	22
Vested restricted stock units issued net of tax withholding	55,565	—	—	(37)	—	(37)
Net loss	—	—	—	—	(973)	(973)
Balance at March 31, 2019	**8,388,918**	**—**	**$ 8**	**$ 25,959**	**$ (18,550)**	**$ 7,417**

	Three months ended April 1, 2018					
	Common Shares Outstanding	Series C Preferred Shares	Common Stock	Additional Paid in Capital	Retained Earnings	Total Stockholders Equity
Balance at December 31, 2017	**8,590,101**	**78**	**$ 9**	**$ 26,454**	**$ (20,829)**	**$ 5,634**
Stock Compensation Expense	—	—	—	37	—	37
Vested restricted stock units issued net of tax withholding	55,902	—	—	(30)	—	(30)
Declared Dividends	—	—	—	—	(262)	(262)
Net income	—	—	—	—	2,631	2,631
Balance at April 1, 2018	**8,646,003**	**78**	**$ 9**	**$ 26,461**	**$ (18,460)**	**$ 8,010**

	Six months ended March 31, 2019					
	Common Shares Outstanding	Series C Preferred Shares	Common Stock	Additional Paid in Capital	Retained Earnings	Total Stockholders Equity
Balance at September 30, 2018	**8,333,353**	**—**	**$ 8**	**$ 25,938**	**$ (19,602)**	**$ 6,344**
Stock Compensation Expense	—	—	—	58	—	58
Vested restricted stock units issued net of tax withholding	55,565	—	—	(37)	—	(37)
Net income	—	—	—	—	1,052	1,052
Balance at March 31, 2019	**8,388,918**	**—**	**$ 8**	**$ 25,959**	**$ (18,550)**	**$ 7,417**

	Six months ended April 1, 2018					
	Common Shares Outstanding	Series C Preferred Shares	Common Stock	Additional Paid in Capital	Retained Earnings	Total Stockholders Equity
Balance at October 1, 2017	**8,190,101**	**174**	**$ 8**	**$ 26,411**	**$ (20,473)**	**$ 5,946**
Stock Compensation Expense	—	—	—	81	—	81
Vested restricted stock units issued net of tax withholding	55,902	—	—	(30)	—	(30)
Conversions of Series C Preferred Shares	400,000	(96)	1	(1)	—	—
Declared Dividends	—	—	—	—	(523)	(523)
Net income	—	—	—	—	2,536	2,536
Balance at April 1, 2018	**8,646,003**	**78**	**$ 9**	**$ 26,461**	**$ (18,460)**	**$ 8,010**

The accompanying notes are an integral part of these 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. Optex Systems Holdings also manufactures and delivers numerous periscope configurations, rifle and surveillance sights and night vision optical assemblies. Optex Systems Holdings' products consist primarily of build to customer print products that are delivered both directly to the military and to other defense prime contractors or commercial customers. The Company's consolidated revenues are derived from the U.S. government, 56%, one major U.S defense contractor, 26%, one commercial customer, 10%, and all other customers, 8%. Approximately 93% of the total company revenue is generated from domestic customers and 7% is derived from Canada. Optex Systems Holdings' operations are based in Dallas and Richardson, Texas in leased facilities comprising 93,967 square feet. As of March 31, 2019, Optex Systems Holdings operated with 109 full-time equivalent employees.

Note 2 - Accounting Policies

Basis of Presentation

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

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

These condensed consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements and the notes thereto included in the Optex Systems Holdings' Form 10-K for the year ended September 30, 2018 and other reports filed with the SEC.

The accompanying unaudited interim 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 March 31, 2019 and September 30, 2018, inventory included:

	(Thousands)	
	March 31, 2019	**September 30, 2018**
Raw Material	$ 6,747	$ 5,580
Work in Process	3,929	3,478
Finished Goods	259	254
Gross Inventory	**$ 10,935**	**$ 9,312**
Less: Inventory Reserves	(1,722)	(1,673)
Net Inventory	**$ 9,213**	**$ 7,639**

Concentration of Credit Risk: Optex Systems Holdings' accounts receivables for the period ended March 31, 2019 are derived from revenues to one major U.S. defense contractor, 33%, U.S. government agencies, 52%, one large commercial customer, 7%, and all other customers, 8%. The Company does not believe that this concentration results in undue credit risk because of the financial strength of the obligees.

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 March 31, 2019 and September 30, 2018, the Company had warranty reserve balances of $91 thousand and $101 thousand, respectively. We believe we have made sufficient improvements to the production process to minimize the return rate on future shipments but we will continue to review and monitor the reserve balances related to our product lines against any existing warranty backlog and current trend data on an interim basis until the current warranty backlog is depleted.

	Three months ended		Six months ended	
	March 31, 2019	**April 1, 2018**	**March 31, 2019**	**April 1, 2018**
Beginning balance	$ 73	$ 251	$ 101	$ 174
Incurred costs for warranties satisfied during the period	(20)	(263)	(27)	(263)
Warranty Expenses:				
Warranties reserved for new product shipped during the period*(1)*	23	50	52	112
Change in estimate for pre-existing warranty liabilities*(2)*	15	84	(35)	99
Warranty Expense (Gain) / Loss	38	134	17	211
Ending balance	**$ 91**	**$ 122**	**$ 91**	**$ 122**

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

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

Level 1: Quoted market prices in active markets for identical assets or liabilities.
Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.
Level 3: Unobservable inputs reflecting the reporting entity's own assumptions.

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

Each of the measurements is considered a Level 3 measurement based on the availability of market data and inputs and the significance of any unobservable inputs as of the measurement date. The methods and significant inputs and assumptions utilized in estimating the fair value of the warrant liabilities, as well as the respective hierarchy designations are discussed further in Note 6 "Warrant Liabilities".

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

For the six months ended March 31, 2019 and April 1, 2018, the adoption of the ASC 606 revenue standard had no material effect on the financial statement presentation. Optex Systems Holdings does not expect the adoption of the new revenue recognition standard to have a material effect on the financial statement presentation on a retrospective or prospective basis for the upcoming interim, annual and comparative periods covered through the current year end date September 29, 2019. The Company believes it's previous recognition policy as related to the production contracts ("units of delivery"), and maintenance contract ("passage of time"), are consistent with the new revenue recognition standard defined within FASB ASC 606 which requires unique performance obligations be recognized upon satisfaction of the customers' own performance obligation at the point in time when the control of goods is transferred to the customer, or over time as the customer benefits from provided maintenance and support services. The Company has on occasion, outside of the presented periods, received selective contract awards and modifications which included substantive milestone performance obligations, contract modifications, negotiated settlements and financing arrangements which could fall within the scope of the new revenue recognition guidance on reoccurrence, and as such, the Company has expanded their contract review process to ensure any new contract awards, changes, modifications, financing arrangements or potential negotiated settlements are recorded in compliance to the new standard guidance.

During the three and six months ended March 31, 2019 there was $5 and $289 respectively of revenue recognized during the period from customer deposit liabilities (deferred contract revenue), and $0 and $19 thousand respectively of customer deposits refunded to the customer on order cancellation. As of March 31, 2019 there is zero in customer deposit liabilities. As of the period ended September 30, and the six months ended March 31, 2019, there are no significant contract costs such as sales commissions or costs deferred.

Income Tax/Deferred Tax: As of March 31, 2019 Optex Systems, Inc. has a deferred tax asset valuation allowance of ($2.7) million against deferred tax assets of $2.7 million, as compared to a valuation allowance of ($2.9) million against deferred tax assets of $2.9 million as of September 30, 2018. The valuation allowance has been established due to historical losses resulting in a Net Operating Loss Carryforward for each of the fiscal years 2010 through 2017. During the six months ended March 31, 2019, our deferred tax assets and corresponding valuation account decreased by ($0.2) million related to the expiration of 34,980 unexercised stock options on December 8, 2018 with a deferred tax asset balance of $0.1 million, and current year tax adjustments for amortization expenses and an applied net operating loss carryforward of $0.1 million. We intend to continue maintaining a full valuation allowance on our deferred tax assets until there is sufficient evidence to support the reversal of all or some portion of these allowances.

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 convertible preferred stock, unvested restricted stock units, stock options and warrants. In computing the dilutive effect of convertible preferred stock, the numerator is adjusted to add back any convertible preferred dividends and the denominator is increased to assume the conversion of the number of additional common shares. The Company uses the Treasury Stock Method to compute the dilutive effect of any dilutive shares. Convertible preferred stock, unvested restricted stock units, stock options and warrants that are anti-dilutive are excluded from the calculation of diluted earnings per common share.

For the three months ended March 31, 2019, 4,260,785 warrants and 216,500 unvested restricted stock units, and 25,000 stock options were excluded from the earnings per share calculation as antidilutive due to the three month period loss. For six months ended March 31, 2019, 4,260,785 warrants (which convert to 376,890 incremental dilutive shares) and 216,500 unvested restricted stock units (which converts to 109,143 dilutive shares), were included in the diluted earnings per share calculation as dilutive, and 25,000 stock options were excluded from the earnings per share calculation as antidilutive as they were “out of the money” and not exercisable during the period. For the three and six months ended April 1, 2018, 78 preferred Series C shares (which converts to 325,000 common shares), and 33,000 unvested restricted stock units (which converts to 2,321 and 8,649 incremental dilutive shares for the three and six months, respectively) were included in the diluted earnings per share calculation and 66,000 unvested restricted stock units, 60,000 stock options and 4,323,135 warrants were excluded from the earnings per share calculation as they were antidilutive.

A significant number of our outstanding warrants and series C preferred shares are participating securities which share dividend distributions and the allocation of any undistributed earnings (deemed dividends) with our common shareholders. During the three and six months ended March 31, 2019, there were no declared dividends and allocated undistributed earnings of $0 and $348 thousand respectively attributable to the participating warrants. During the three and six months ended April 1, 2018, declared dividends of $88 and $178 thousand was attributable to participating warrants and series C shareholders and there was $820 thousand and $693 thousand in undistributed earnings attributable to participating securities during the respective periods.

The basic net income applicable to common shareholders for the three and six month periods ended April 1, 2018, previously reflected as $0.31 and $0.30 per share has been corrected to $0.20 and $0.20 per common share, respectively, to include the effect of the prior year period dividends distributed and deemed dividends to participating securities on the earnings per common share. The dilutive net income applicable to common shareholders for the three and six month periods ended April 1, 2018, previously reflected as $0.30 and $0.29 per share has been corrected to $0.20 and $0.19 per common share, respectively, to include the effect of the prior year period dividends distributed and deemed dividends to participating securities on the earnings per common share.

Note 3 - Segment Reporting

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

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

Optex Systems (OPX) – Richardson, Texas

Optex Systems revenues are primarily in support of prime and subcontracted military customers. Approximately 89% of the Optex Systems segment revenue is comprised of domestic military customers and 11% is comprised of foreign military customers. The Optex Systems segment revenue from the U.S. government and one other major U.S. defense contractor represent approximately 40% and 22% of the Company's consolidated revenue, respectively.

Optex Systems is located in Richardson Texas, with leased premises consisting of approximately 49,100 square feet. As of March 31, 2019, the Richardson facility operated with 74 full time equivalent employees in a single shift operation. Optex Systems, Richardson serves as the home office for both the Optex Systems and Applied Optics Center segments.

Applied Optics Center (AOC) – Dallas, Texas

The Applied Optics Center serves primarily domestic U.S. customers. Sales to commercial customers represent 36% and military sales to prime and subcontracted customers represent 64% of the total segment revenue. Approximately 85% of the AOC revenue is derived from external customers and approximately 15% is related to intersegment sales to Optex Systems in support of military contracts. The AOC segment revenue from the U.S. government and one major commercial customer represents approximately 16% and 10% of the Company's consolidated revenue, respectively.

The Applied Optics Center is located in Dallas, Texas with leased premises consisting of approximately 44,867 square feet of space. As of March 31, 2019, AOC operated with 35 full time equivalent employees in a single shift operation.

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

Reportable Segment Financial Information (thousands) Three months ended March 31, 2019	Optex Systems Richardson	Applied Optics Center Dallas	Other (non-allocated costs and intersegment eliminations)	Consolidated Total
Revenues from external customers	$ 4,648	$ 2,440	$ —	$ 7,088
Intersegment revenues	—	395	(395)	—
Total Revenue	$ 4,648	$ 2,835	$ (395)	$ 7,088
Interest expense	$ —	$ —	$ 6	$ 6
Depreciation and Amortization	$ 7	$ 77	$ —	$ 84
Income (loss) before taxes	$ 826	$ 378	$ (1,960)	$ (756)
Other significant noncash items:				
Allocated home office expense	$ (171)	$ 171	$ —	$ —
Loss on change in fair value of warrants	$ —	$ —	$ 1,932	$ 1,932
Stock compensation expense	$ —	$ —	$ 22	$ 22
Royalty expense amortization	$ 8	$ —	$ —	$ 8
Warranty Expense	$ —	$ 38	$ —	$ 38
Segment Assets	$ 10,024	$ 4,736	$ —	$ 14,760
Expenditures for segment assets	$ —	$ 78	$ —	$ 78

Reportable Segment Financial Information (thousands) Three months ended April 1, 2018	Optex Systems Richardson	Applied Optics Center Dallas	Other (non-allocated costs and intersegment eliminations)	Consolidated Total
Revenues from external customers	$ 2,322	$ 2,228	$ —	$ 4,550
Intersegment revenues	—	457	(457)	—
Total Revenue	$ 2,322	$ 2,685	$ (457)	$ 4,550
Interest expense	$ —	$ —	$ 9	$ 9
Depreciation and Amortization	$ 8	$ 71	$ —	$ 79
Income before taxes	$ 16	$ 228	$ 2,304	$ 2,548
Other significant noncash items:				
Allocated home office expense	$ (161)	$ 161	$ —	$ —
Gain on Change in Fair Value of Warrants	$ —	$ —	$ (2,350)	$ (2,350)
Stock option compensation expense	$ —	$ —	$ 37	$ 37
Royalty expense amortization	$ 8	$ —	$ —	$ 8
Warranty Expense	$ —	$ 134	$ —	$ 134
Segment Assets	$ 8,703	$ 3,987	$ —	$ 12,690
Expenditures for segment assets	$ 17	$ —	$ —	$ 17

Reportable Segment Financial Information
(thousands)
Six months ending March 31, 2019

	Optex Systems Richardson	Applied Optics Center Dallas	Other (non-allocated costs and intersegment eliminations)	Consolidated Total
Revenues from external customers	$ 8,477	$ 4,502	$ —	$ 12,979
Intersegment revenues	—	810	(810)	—
Total Revenue	$ 8,477	$ 5,312	$ (810)	$ 12,979
Interest expense	$ —	$ —	$ 12	$ 12
Depreciation and Amortization	$ 16	$ 153	$ —	$ 169
Income (Loss) before taxes	$ 1,231	$ 708	$ (617)	$ 1,322
Other significant noncash items:				
Allocated home office expense	$ (341)	$ 341	$ —	$ —
Loss on change in fair value of warrants	$ —	$ —	$ 547	$ 547
Stock compensation expense	$ —	$ —	$ 58	$ 58
Royalty expense amortization	$ 15	$ —	$ —	$ 15
Warranty expense	$ —	$ 17	$ —	$ 17
Segment Assets	$ 10,024	$ 4,736	$ —	$ 14,760
Expenditures for segment assets	$ 4	$ 92	$ —	$ 96

Reportable Segment Financial Information
(thousands)
Six months ending April 1, 2018

	Optex Systems Richardson	Applied Optics Center Dallas	Other (non-allocated costs and intersegment eliminations)	Consolidated Total
Revenues from external customers	$ 4,988	$ 4,339	$ —	$ 9,327
Intersegment revenues	—	829	(829)	—
Total Revenue	$ 4,988	$ 5,168	$ (829)	$ 9,327
Interest expense	$ —	$ —	$ 12	$ 12
Depreciation and Amortization	$ 19	$ 142	$ —	$ 161
Income before taxes	$ 154	$ 477	$ 1,913	$ 2,544
Other significant noncash items:				
Allocated home office expense	$ (317)	$ 317	$ —	$ —
Gain on change in fair value of warrants	$ —	$ —	$ (2,006)	$ (2,006)
Stock option compensation expense	$ —	$ —	$ 81	$ 81
Royalty expense amortization	$ 15	$ —	$ —	$ 15
Warranty Expense	$ —	$ 211	$ —	$ 211
Segment Assets	$ 8,703	$ 3,987	$ —	$ 12,690
Expenditures for segment assets	$ 17	$ —	$ —	$ 17

Note 4 - Commitments and Contingencies

Rental Payments under Non-cancellable Operating Leases

As of March 31, 2019, the remaining minimum lease and estimated adjusted common area maintenance (CAM) payments under the non-cancelable office and facility space leases are as follows:

Non-cancellable Operating Leases Minimum Payments

(Thousands)

	Optex Systems Richardson		Applied Optics Center Dallas		
Fiscal Year	**Lease Payments**	**CAM Estimate**	**Lease Payments**	**CAM Estimate**	**Total Payments**
2019	$ 143	$ 55	$ 124	$ 31	$ 353
2020	291	112	255	62	720
2021	147	57	262	63	529
2022	—	—	22	5	27
Total minimum lease payments	**$** 581	**$** 224	**$** 663	**$** 161	**$** 1,629

Total facilities rental and CAM expense for both facility lease agreements as of the three and six months ended March 31, 2019 was $175 and $347 thousand, respectively. Total expense under facility lease agreements as of the three and six months ended April 1, 2018 was $174 and $341 thousand, respectively.

As of March 31, 2019, the unamortized deferred rent was $100 thousand as compared to $111 thousand as of September 30, 2018. Deferred rent expense is amortized monthly over the life of the lease.

Note 5 - Debt Financing

Credit Facility — Avidbank

As of March 31, 2019 and September 30, 2018, the outstanding principal balance on the line of credit was $250 thousand and $300 thousand, respectively. For the three and six months ended March 31, 2019 and April 1, 2018, the total interest expense against the outstanding line of credit balance was $6 thousand and $12 thousand, respectively, and $9 thousand and $12 thousand, respectively.

The Company amended its revolving credit facility with Avidbank pursuant to a Seventh Amendment to Amended and Restated Loan Agreement, dated as of April 5, 2018. The substantive amendments are as follows:

- The new revolving maturity date is April 21, 2020.

- On April 21, 2018 and each anniversary thereof for so long as the Revolving Facility is in effect, the Company shall pay a facility fee equal to one half of one percent (0.5%) of the Revolving Line.

- The Company can maintain accounts at third party banks so long as the total in those other bank accounts does not exceed 20% of the total on deposit at Avidbank, and it shall remit to Avidbank monthly statements for all of those accounts within 30 days of the end of each month.

Note 6-Warrant Liabilities

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

On April 1, 2018 the Company reviewed the valuation technique and inputs used to determine the fair value of the outstanding warrants. For each of the prior period measurement dates through period ended December 31, 2017, the Company engaged an outside valuation company to calculate the fair value of warrants based on both the binomial lattice model ("Binomial") and the Black Scholes-Merton option pricing model ("BSM"). For each of the periods previously presented through period ended December 31, 2017, the Company disclosed the valuation technique as binomial, although the two models yielded comparable results with minimal or no variation in the fair value calculation of the warrants at each of the respective measurement dates. As the BSM model yielded similar results with the Binomial model and can be completed with in-house expertise at a lower cost, effective as of April 1, 2018, the Company determined the BSM model will be used exclusively to value the outstanding warrants throughout the remaining term of the warrants.

The fair value of the warrant liabilities presented below were measured using either a BSM (September 30, 2018 and March 31, 2019) or Binomial (August 26, 2016 and October 1, 2017) valuation model. Significant inputs into the respective model at the inception and reporting period measurement dates are as follows:

Valuation Assumptions	Issuance date(1) August 26, 2016(4)	Period ended October 1, 2017(4)	Period ended April 1, 2018(5)	Period ended September 30, 2018(5)	Period ended March 31, 2019(5)
Exercise Price(1)	$ 1.50	$ 1.50	$ 1.50	$ 1.50	$ 1.50
Warrant Expiration Date (1)	8/26/2021	8/26/2021	8/26/2021	8/26/2021	8/26/2021
Stock Price (2)	$ 0.95	$ 0.98	$ 1.02	$ 1.71	$ 2.00
Interest Rate (annual) (3)	1.23%	1.62%	2.39%	2.88%	2.32%
Volatility (annual) (4)(5)	246.44%	179.36%	66.25%	64.05%	60.54%
Time to Maturity (Years)	5	3.9	3.4	2.9	2.4
Calculated fair value per share	$ 0.93	$ 0.87	$ 0.38	$ 0.82	$ 0.95

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

(2) Based on the trading value of common stock of Optex Systems Holdings, Inc. as of August 26, 2016 and each presented period ended date.

(3) Interest rate for U.S. Treasury Bonds, as of August 26, 2016 and each presented period ended date, as published by the U.S. Federal Reserve.

(4) Based on the historical daily volatility of Optex Systems Holdings, Inc. for the term of the warrants as of August 26, 2016 and October 1, 2017. The original fair value calculations were derived using the Binomial model, however, the yielded results were consistent with fair market valuation using the Black Scholes Merton Option Pricing model for each of the respective periods.

(5) Based on the historical daily volatility of Optex Systems Holdings, Inc. from the consummation of the public raise on August 26, 2016 through the current presented measurement date. As of the period ended April 1, 2018 and the year ended September 30, 2018, the company determined that the historical volatility prior to the August 26, 2016 public offering was not representative of the current market expectations due to the significant change in company capital structure and increase in public float shares (liquidity) arising from the common stock issued during the public offering and concurrent conversions of outstanding preferred shares into common stock and converted to an adjusted historical volatility calculated from the date of the public offering. The fair value calculation was derived using the Black Scholes Merton Option Pricing model. As of March 31, 2019, the historical volatility rate calculation period is consistent with the remaining term of the warrants.

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

Warrant Liability	**Warrants Outstanding**		**Fair Value per Share**		**Fair Value (000's)**
Fair Value as of period ended 10/01/2017	4,323,135	$	0.87	**$**	**3,607**
Gain on Change in Fair Value of Warrant Liability					(2,006)
Fair Value as of period ended 4/1/2018	4,323,135	$	0.38		**1,601**
Fair Value as of period ended 09/30/2018	4,260,785	$	0.82	**$**	**3,500**
Loss on Change in Fair Value of Warrant Liability					547
Fair Value as of period ended 3/31/2019	4,260,785	$	0.95		**4,047**

During the three and six months ended March 31, 2019 or April 1, 2018, none of the warrants were exercised. During the three and six months ended March 31, 2019 and April 1, 2018, the Company recognized a $1.9 million and $0.5 million loss, respectively, and a ($2.4) million and ($2.0) million gain, respectively on the change in fair value of warrants, respectively.

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

Note 7-Stock Based Compensation

Stock Options issued to Employees, Officers and Directors

The Optex Systems Holdings 2009 Stock Option Plan provides for the issuance of up to 75,000 shares to the Company's officers, directors, employees and to independent contractors who provide services to Optex Systems Holdings as either incentive or non-statutory stock options determined at the time of grant. As of March 31, 2019, there were 25,000 fully vested stock options outstanding at an exercise price of $10 per share and an expiration date of December 18, 2020. During the six months ended March 31, 2019, 34,980 vested stock options expired (forfeited) unexercised. There were no new grants of stock options during the six months ended March 31, 2019.

Restricted Stock Units issued to Officers and Employees

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

	Outstanding Unvested RSU's
Unvested as of October 1, 2017	182,000
Granted - year ended September 30, 2018	—
Vested - year ended September 30, 2018	(83,000)
Unvested as of September 30, 2018	99,000
Granted – six months ended March 31, 2019	200,000
Vested - six months ended March 31, 2019	(82,500)
Unvested as of March 31, 2019	216,500

Pursuant to the executive compensation package approved by our board of directors on November 20, 2018:

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

- Effective as of January 1, 2019, Danny Schoening, CEO and Karen Hawkins, CFO received an 8% salary increase.

On January 7, 2019, the Company issued 55,565 common shares the three directors and officers, net of tax withholding of $37 thousand, in settlement of 82,500 restricted stock units which vested on January 1, 2019.

Stock Based Compensation Expense

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

Stock Compensation (thousands)

	Recognized Compensation Expense				Unrecognized Compensation Expense	
	Three months ended		Six months ended		As of period ended	
	March 31, 2019	April 1, 2018	March 31, 2019	April 1, 2018	March 31, 2019	September 30, 2018
Stock Options	$ —	$ —	$ —	$ 8	$ —	$ —
Restricted Stock Units	22	37	58	73	253	49
Total Stock Compensation	**$ 22**	**$ 37**	**$ 58**	**$ 81**	**$ 253**	**$ 49**

Note 8 Stockholders' Equity

Dividends

On June 26, 2017, the board of directors approved a resolution authorizing a $0.02 per share (and per warrant) dividend payment on July 12, 2017, for common and preferred series C shareholders and warrant holders of record as of July 5, 2017 and for three subsequent quarterly record dates thereafter. During the three and six months ended April 1, 2018, Optex Systems Holdings recorded $262 and $523 thousand in declared dividends for share and warrant holders of record as of the 12th day of January and April 2018. The dividends were paid on the 19th of each of the respective months with the last payment on April 19, 2018. As of period ended March 31, 2019, there were no declared or outstanding dividends payable.

Common stock

As of September 30, 2018, the outstanding common shares were 8,333,353. On January 7, 2019, there were 55,565 common shares issued, net of tax withholding, in settlement of 82,500 restricted stock units which vested on January 1, 2019. As of March 31, 2019, the outstanding common shares are 8,388,918.

Series C Preferred Stock

During the six months ended April 1, 2018 there were no new issues of preferred Series C shares. As of September 30, 2018 and December 31, 2018, there were zero preferred Series C shares outstanding.

Note 9 Subsequent Events

None.

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

Management's Discussion and Analysis or Plan of Operations

This MD&A is intended to supplement and complement our audited consolidated financial statements and notes thereto for the fiscal year ended September 30, 2018 and our reviewed but unaudited consolidated financial statements and footnotes thereto for the quarter ended March 31, 2019, prepared in accordance with U.S. generally accepted accounting principles (GAAP). You are encouraged to review our consolidated financial statements in conjunction with your review of this MD&A. The financial information in this MD&A has been prepared in accordance with GAAP, unless otherwise indicated. In addition, we use non-GAAP financial measures as supplemental indicators of our operating performance and financial position. We use these non-GAAP financial measures internally for comparing actual results from one period to another, as well as for planning purposes. We will also report non-GAAP financial results as supplemental information, as we believe their use provides more insight into our performance. When non-GAAP measures are used in this MD&A, they are clearly identified as non-GAAP measures and reconciled to the most closely corresponding GAAP measure.

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

Background

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

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

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

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

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 Orders

- On February 19, 2018, we announced we havebeen awarded three separate multi-year Indefinite Delivery Indefinite Quantity (IDIQ) awards through Defense Logistics Agency (DLA) for Laser Protected Periscopes for a total combined amount of up to $7.7 million over a 3-5 year period.

- On March 27, 2018, we announced we havebeen awarded a $1.62 million purchase order as part of a multi-year strategic supplier agreement with a domestic manufacturer of premium optical devices.

- On September 10, 2018, we announced we have been awarded over $7 million in new contracts to date during the fourth fiscal quarter of 2018. The majority of these contracts are for Laser Protected Periscopes but also contain Non-Laser Protected Periscopes and various Sighting Systems.

- On November 19, 2018, the Company announced a follow on $0.9 million order from an international customer for its patented Digital Day Digital Night (DDAN) Weapon System with deliveries through 2021.

- On November 26, 2018, the Company announced a $1.9 million order from Defense Logistics Agency Land and Maritime for Laser Protected Periscopes for delivery in 2019 and 2020.

- On January 29, 2019, the Company announced a $1.0 million order associated with a multi-year agreement to supply a variety of optical components in support of the M1 Abrams Tank program. The products will be manufactured at the Applied Optics Center (AOC).

- On February 12, 2019, the Company announced a $1.9 Million order from Defense Logistics Agency Troop Support, Philadelphia. The products will be manufactured at the Applied Optics Center (AOC) Division of Optex Systems, Inc.

- On March 4, 2019, the Company announced a multi-year Indefinite Delivery Indefinite Quantity (IDIQ) award from Defense Logistics Agency Land and Maritime for periscopes for up to $1.3 Million over a 3-5 year period and a Firmed Fixed Price award for $0.7 Million for 2019 and 2020 delivery.

Recent Events

Stock Repurchases

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

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

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

Executive and Board Compensation

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

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

Results of Operations

Non GAAP Adjusted EBITDA

We use adjusted earnings before interest, taxes, depreciation and amortization (EBITDA) as an additional measure for evaluating the performance of our business as "net income" includes the significant impact of noncash valuation gains and losses on warrant liabilities, noncash compensation expenses related to equity stock issues, as well as depreciation, amortization, interest expenses and federal income taxes. We believe that Adjusted EBITDA is a meaningful indicator of our operating performance because it permits period-over-period comparisons of our ongoing core operations before the excluded items. Adjusted EBITDA is a financial measure not required by, or presented in accordance with, 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 three and six month periods ended March 31, 2019 and April 1, 2018, in terms of both the GAAP net income measure and the non-GAAP Adjusted EBITDA measure. We believe that including both measures allows the reader to have a "complete picture" of our overall performance.

	(Thousands)			
	Three months ending		**Six months ending**	
	March 31, 2019	**April 1, 2018**	**March 31, 2019**	**April 1, 2018**
Net Income (Loss) (GAAP)	$ (973)	$ 2,631	$ 1,052	$ 2,536
Add:				
Loss (Gain) on Change in Fair Value of Warrants	1,932	(2,350)	547	(2,006)
Federal Income Tax Expense (Benefit) - Current	217	(83)	270	8
Depreciation	84	79	169	161
Stock Compensation	22	37	58	81
Royalty License Amortization	8	8	15	15
Interest Expense	6	9	12	12
Adjusted EBITDA - Non GAAP	**$ 1,296**	**$ 331**	**$ 2,123**	**$ 807**

Our adjusted EBITDA increased by $1.0 million to $1.3 million during the three months ended March 31, 2019 as compared to $0.3 million during the three months ended April 1, 2018. For the six months ended March 31, 2019, our adjusted EBITDA increased by $1.3 million to $2.1 million as compared to $0.8 million during the six months ended April 1, 2018. EBITDA improvements are directly correlated with significant increases in revenue, changes in product mix and improvements in our gross margins during the three and six month periods over the prior year period performance. During the three and six months ended March 31, 2019, we experienced product revenue growth of 55.8% and 39.2% and improved gross margin percentages of 6.1% and 3.8%, respectively, over the prior year three and six months ended April 1, 2018. Revenue growth was primarily concentrated in our Optex-Richardson segment, which represents a 100.2% increase over the prior year second quarter and a 69.9% increase for the six month period. The Applied Optics Center realized a 9.5% and 3.8% increase in revenue during the three and six months ended March 31, 2019 as compared to the prior year periods. Revenue growth for both segments is primarily driven by increased defense spending on our periscopes, Applied Optics laser filters and other product lines. Gross margin performance improvements were driven by revenue shifts from our less profitable commercial products toward higher margin military laser filters at our Applied Optics Center segment, and favorable changes in the "fixed" manufacturing overhead costs as a percentage of revenue. Operating segment performance is discussed in greater detail throughout the following sections.

During the three and six months ended March 31, 2019, we recognized a loss on the change in fair value of warrants of ($1.9) million and ($0.5) million, respectively, as compared to a gain of $2.4 million and $2.0 million in the prior year three and six month periods. As this is a non-cash gain driven by the current fair market value of our outstanding warrants and unrelated to our core business operating performance, the change in fair value losses and gains have been excluded from our adjusted EBITDA calculations presented above. Further discussion regarding the changes in fair value of the warrants and the related warrant liability can be found under "Other Income (Expense)" in the three and six months comparative narratives of this report, as well as in Item 1, "Consolidated Financial Statements, Note 6 - Warrant Liabilities".

Segment Information

We have presented the operating results by segment to provide investors with an additional tool to evaluate our operating results and to have a better understanding of the overall performance of each business segment and its ability to perform in subsequent periods. Management of Optex Systems Holdings uses the selected financial measures by segment internally to evaluate its ongoing segment operations and to allocate resources within the organization accordingly. Segments are determined based on differences in products, location, internal reporting and how operational decisions are made. Management has determined that the Optex Systems, Richardson plant and the Applied Optics Center, Dallas plant are separately managed, organized, and internally reported as separate business segments. The table below provides a summary of selective statement of operations data by operating segment for the three and six months ended March 31, 2019 and April 1, 2018 reconciled to the Consolidated Results of Operations as presented in Item 1, "Consolidated Financial Statements."

	Results of Operations Selective Financial Info (Thousands)							
	Three months ended							
	March 31, 2019				April 1, 2018			
	Optex Richardson	Applied Optics Center Dallas	Other (non-allocated costs and eliminations)	Consolidated	Optex Richardson	Applied Optics Center Dallas	Other (non-allocated costs and eliminations)	Consolidated
Revenue from External Customers	$ 4,648	$ 2,440	$ —	$ 7,088	$ 2,322	$ 2,228	$ —	$ 4,550
Intersegment Revenues	—	395	(395)	—	—	457	(457)	—
Total Segment Revenue	**4,648**	**2,835**	**(395)**	**7,088**	**2,322**	**2,685**	**(457)**	**4,550**
Total Cost of Sales	3,371	2,131	(395)	5,107	1,853	2,161	(457)	3,557
Gross Margin	**1,277**	**704**	**—**	**1,981**	**469**	**524**	**—**	**993**
Gross Margin %	***27.5%***	***24.8%***	**—**	***27.9%***	***20.2%***	***19.5%***	**—**	***21.8%***
General and Administrative Expense [1]	622	155	22	799	614	135	37	786
Segment Allocated G&A Expense	(171)	171	—	—	(161)	161	—	—
Net General & Administrative Expense	451	326	22	799	453	296	37	786
Operating Income (Loss)	**826**	**378**	**(22)**	**1,182**	**16**	**228**	**(37)**	**207**
Operating (Loss) %	***17.8%***	***13.3%***	**—**	***16.7%***	***0.7%***	***8.5%***	**—**	***4.5%***
Gain (Loss) on Change in Fair Value of Warrants	—	—	(1,932)	(1,932)	—	—	2,350	2,350
Interest Expense	—	—	(6)	(6)	—	—	(9)	(9)
Net Income (Loss) before taxes	**$ 826**	**$ 378**	**$ (1,960)**	**$ (756)**	**$ 16**	**$ 228**	**$ 2,304**	**$ 2,548**
Net Income (Loss) %	***17.8%***	***13.3%***	**—**	***(10.7%)***	***0.7%***	***8.5%***	**—**	***56.0%***

Our total revenues increased by $2.5 million or 55.8% during the three months ended March 31, 2019 as compared to the three months ended April 1, 2018. Increased revenues during the three months were driven by increased revenue of $2.3 million at the Optex Richardson segment and $0.2 million for the Applied Optics Center. Higher U.S. defense spending in periscopes, collimator assemblies and laser filters is the primary contributor to increased revenue for both operating segments during the period. Current quarter Intersegment revenues are slightly below the prior year level due to use of a secondary external laser filter source in support of the higher periscope production demands. Intersegment revenues relate primarily to coated filters provided by the Applied Optics Center to Optex Richardson in support of the Optex Systems periscope line.

Both the gross margin and the gross margin percentages increased on a consolidated basis during the three months ending March 31, 2019 as compared to the prior year period. Total gross margin increased by $1.0 million, and 6.1% to 27.9% from 21.8%. The Optex Richardson gross margin increased by $0.8 million and the gross margin percentage increased by 7.3% from 20.2% to 27.5%. The increased gross margin for Optex Richardson is driven by increased revenue and the corresponding contribution margin towards fixed costs and changes in product mix toward more profitable MRS collimator assemblies. The Applied Optic Center gross margin increased by $0.2 million and the gross margin percentage increased by 5.3% from 19.5% to 24.8%. The increase in Applied Optics Center margin is primarily driven by a shift in revenue mix from our commercial optical assemblies toward more profitable military products combined with manufacturing yield and quality improvements on the military filter and commercial optical assembly lines.

During the three months ending March 31, 2019 and April 1, 2018, the Applied Optics Center absorbed $0.17 million of fixed general and administrative costs incurred by Optex Systems for support services. These expenses cover accounting, executive, human resources, information technology, board fees and other corporate expenses paid by Optex Systems and shared across both operating segments.

Our operating income increased by $1.0 million in the three months ending March 31, 2019, to $1.2 million, as compared to the prior year period operating income of $0.2 million. Increased operating income was primarily attributable to the increase in revenue and gross margins at both operating segments.

During the three months ending March 31, 2019 we recognized a ($1.9) million loss on change in valuation of warrant liabilities as compared to a $2.4 million gain in the prior year quarter. The loss during the current three month period was primarily driven by an increase in the stock price from $1.31 as of December 31, 2018 to $2.00 as of March 31, 2019. The changes in valuation on warrants are not allocated by segment as they relate to non-cash expenses which recognize fair value changes on warrants due to market conditions beyond the control of the segment operating activities.

Results of Operations Selected Financial Info by Segment
(Thousands)

	Six months ended							
	March 31, 2019				**April 1, 2018**			
	Optex Richardson	**Applied Optics Center Dallas**	**Other (non-allocated costs and eliminations)**	**Consolidated**	**Optex Richardson**	**Applied Optics Center Dallas**	**Other (non-allocated costs and eliminations)**	**Consolidated**
Revenue from External Customers	$ 8,477	$ 4,502	$ —	$ 12,979	$ 4,988	$ 4,339	$ —	$ 9,327
Intersegment Revenues	—	810	(810)	—	—	829	(829)	—
Total Segment Revenue	**8,477**	**5,312**	**(810)**	**12,979**	**4,988**	**5,168**	**(829)**	**9,327**
Total Cost of Sales	6,395	3,971	(810)	9,556	3,925	4,122	(829)	7,218
Gross Margin	**2,082**	**1,341**	**—**	**3,423**	**1,063**	**1,046**	**—**	**2,109**
Gross Margin %	***24.6%***	***25.2%***	***—***	***26.4%***	***21.3%***	***20.2%***	***—***	***22.6%***
General and Administrative Expense	1,192	292	58	1,542	1,226	252	81	1,559
Segment Allocated G&A Expense	(341)	341	—	—	(317)	317	—	—
Net General & Administrative Expense	851	633	58	1,542	909	569	81	1,559
Operating Income (Loss)	**1,231**	**708**	**(58)**	**1,881**	**154**	**477**	**(81)**	**550**
Operating Income (Loss) %	***14.5%***	***13.3%***	***—***	***14.5%***	***3.1%***	***9.2%***	***—***	***5.9%***
Gain (Loss) on Change in Fair Value of Warrants	—	—	(547)	(547)	—	—	2,006	2,006
Interest Expense	—	—	(12)	(12)	—	—	(12)	(12)
Net Income (Loss) before taxes	**$ 1,231**	**$ 708**	**$ (617)**	**$ 1,322**	**$ 154**	**$ 477**	**$ 1,913**	**$ 2,544**
Net Income (Loss) before taxes %	***14.5%***	***13.3%***	***—***	***10.2%***	***3.1%***	***9.2%***	***—***	***27.3%***

Our total revenues increased by $3.7 million or 39.2% during the six months ending March 31, 2019 as compared to the six months ending April 1, 2018. Increased revenues during the six month period were primarily driven by increased revenue of $3.5 at the Optex Richardson plant and increased revenues of $0.2 million at the Applied Optics Center plant. Higher U.S. defense spending in periscopes, collimator assemblies and laser filters is the primary contributor to increased revenue for both operating segments during the period. Intersegment revenues decreased slightly by ($19) thousand during the period, from $829 thousand to $810 thousand due to the use of a secondary external laser filter source in support of the higher periscope production demands.. Intersegment revenues relate primarily to coated filters provided by the Applied Optics Center to Optex Systems in support of the Optex Systems periscope line. We anticipate a strong third quarter 2019 revenue as compared to our prior year third quarter and the first two quarters of fiscal year 2019. The projected increase is driven by increased production rates for the Optex Richardson "other" product line for MRS collimators, mirror, cell and beam-splitter assemblies which are deliverable during the next three months. We anticipate the Optex Richardson periscope revenues during the second half to approximate the first half, with significantly higher revenues for other products occurring over the next three months on increased production for MRS collimator assemblies. We anticipate revenues for Optex Richardson sighting systems to below slightly below the first half revenue due to completion of the DDAN sighting system contract during the first quarter of 2019. We anticipate revenues for the Applied Optics Center for the next six months to exceed the prior year second half levels, but fall slightly below the first half segment revenue.

The consolidated gross margin and gross margin percentages increased by $1.3 million, and 3.8% during the six months ending March 31, 2019 as compared to the prior year period. Total gross margin increased to 26.4% from 22.6%. The Optex Richardson gross margin increased by $1.0 million and the gross margin percentage increased by 3.3% from 21.3% to 24.6%. The increased gross margin for Optex Richardson is driven by increased revenue and the corresponding contribution margin towards fixed costs and changes in product mix toward more profitable MRS collimator and spare part assemblies. The Applied Optic Center gross margin increased by $0.3 million and the gross margin percentage increased by 5.0% from 20.2% to 25.2%. The increase in Applied Optics Center margin is primarily driven by a shift in revenue mix from our commercial optical assemblies toward more profitable military products combined with manufacturing yield and quality improvements on the military filter and commercial optical assembly lines. We expect consolidated gross margin rates in the second half of 2019 to remain consistent with the first half performance, with slight shifts between segments for revenue and product line mix changes.

During the six months ending March 31, 2019 and April 1, 2018, the Applied Optics Center absorbed $0.34 million of fixed general and administrative costs incurred by Optex Systems for support services. These expenses cover accounting, executive, human resources, information technology, board fees and other corporate expenses paid by Optex Systems and shared across both operating segments.

Our consolidated operating income increased by $1.3 million, in the six months ending March 31, 2019, to $1.9 million, as compared to the prior year period operating income of $0.6 million. Increased operating income was primarily attributable to the increase in revenue and gross margins at both operating segments. We anticipate a continued favorable operating profit trend during the remainder of the 2019 fiscal year on additional revenue growth in the Optex Richardson segment, continued gross margin improvements and changes in product mix.

During the six months ending March 31, 2019 we recognized a ($0.5) million loss on change in valuation of warrant liabilities as compared to a $2.0 million gain in the prior year period. The loss during the current three month period was primarily driven by an increase in the stock price from $1.71 as of September 30, 2018 to $2.00 as of March 31, 2019. The changes in valuation on warrants are not allocated by segment as they relate to non-cash expenses which recognize fair value changes on warrants due to market conditions beyond the control of the segment operating activities.

Backlog

Backlog as of March 31, 2019, was $25.8 million as compared to a backlog of $23.3 million as of September 30, 2018, representing an increase of $2.5 million or 10.7%. During the six months ended March 31, 2019, the Company booked $15.2 million in new orders, representing a $3.0 million, or a 24.6% increase from the booked orders of $12.2 million in the prior year six months ended April 1, 2018.

The following table depicts the current expected delivery by period of all contracts awarded as of March 31, 2019 in millions of dollars:

					(Millions)			
Product Line	**Q3 2019**	**Q4 2019**	**2019 Delivery**	**2020+ Delivery**	**Total Backlog 3/31/2019**	**Total Backlog 9/30/2018**	**Variance**	**% Chg**
Howitzer			—		—	—	—	0.0%
Periscopes	$ 2.4	$ 2.7	$ 5.1	$ 5.0	$ 10.1	$ 8.3	$ 1.8	21.7%
Sighting Systems	0.4	0.3	0.7	2.9	3.6	1.7	1.9	111.8%
Other	2.6	1.2	3.8	1.5	5.3	6.6	(1.3)	(19.7%)
Optex Systems - Richardson	$ 5.4	$ 4.2	$ 9.6	$ 9.4	$ 19.0	$ 16.6	$ 2.4	14.5%
Applied Optics Center - Dallas	1.3	1.0	2.3	4.5	6.8	6.7	0.1	1.5%
Total Backlog	**$ 6.7**	**$ 5.2**	**$ 11.9**	**$ 13.9**	**$ 25.8**	**$ 23.3**	**$ 2.5**	10.7%

Optex Systems - Richardson:

During the six months ended March 31, 2019, backlog for the Optex Systems Richardson segment increased by $2.4 million, or 14.5%, to $19.0 million from the fiscal year-end backlog of $16.6 million. The increased backlog was primarily driven by an increase of $1.8 million, or 21.7% in the periscope product group and an increase of $1.9 million, or 111.8% in sighting systems. Optex Richardson backlog declined on other products by ($1.3) million, or (19.7%) from our fiscal year-end backlog as we continue ship muzzle reference system (MRS) collimator assembly units and assorted spare window, mirror and cell assembly units against our existing contracts.

During the six months ended March 31, 2019 we booked new periscope orders of $7.2 million, representing a 41.2% increase of $2.1 million over the $5.1 million in periscope orders booked during the prior year six months ended April 1, 2018. The new periscope orders span multiple customers and include both our standard acrylic periscopes as well as Integrated Combat Weapon System (ICWS) glass periscopes deliverable in 2019 and 2020. We anticipate additional periscope contracts in addition to task order awards against our existing IDIQ contracts for delivery in 2019 and beyond.

We booked new orders of $1.8 million in sighting systems and $1.6 million in other product lines during the six months ended March 31, 2019 for a total of $3.4 million in new orders as compared to the prior year levels of $2.5, consisting of $0.6 million and $0.9 million in sighting systems and other product lines, respectively.

Applied Optics Center – Dallas

During the six months ended March 31, 2019, the Applied Optics Center backlog increased by 1.5%, or $0.1 million, to $6.8 million from the fiscal year end level of $6.7 million. New orders for our Applied Optics Center were $4.6 million in the six months ended March 31, 2019 as compared to $4.6 million in the prior year six month period. We anticipate additional orders during the next six months for deliveries in fiscal year 2019 and 2020.

The Company continues to aggressively pursue international and commercial opportunities in addition to maintaining its current footprint with U.S. vehicle manufactures, with existing as well as new product lines. We continue exploring new market opportunities for our M17 day/thermal periscopes and digital optics for commercial applications. We are also reviewing potential products, outside our traditional product lines, which could be manufactured using our current production facilities in order to capitalize on our existing capacity. Further, we continue to look for strategic businesses to acquire that will strengthen our existing product line, expand our operations, and enter new markets.

Three Months Ended March 31, 2019 Compared to the Three Months Ended April 1, 2018

Revenues. In the three months ended March 31, 2019, revenues increased by $2.5 million or 55.8% from the respective prior period in fiscal year 2018 as set forth in the table below:

	Three months ended (Thousands)			
Product Line	**March 31, 2019**	**April 1, 2018**	**Variance**	**% Chg**
Periscopes	$ 2,881	$ 1,588	$ 1,293	81.4
Sighting Systems	168	381	(213)	(55.9)
Other	1,599	353	1,246	353.0
Optical Systems – Richardson	4,648	2,322	2,326	100.2
Applied Optics Center – Dallas	2,440	2,228	212	9.5
Total Revenue	**$ 7,088**	**$ 4,550**	**$ 2,538**	**55.8**

Revenues on our periscope line increased by $1.3 million or 81.4% during the three months ended March 31, 2019 as compared to the three months ended April 1, 2018 on increased orders.

Sighting systems revenues for the three months ending March 31, 2019 decreased by ($0.2) million or (55.9%) from revenues in the prior year period due to completion of the previous DDAN sighting system contract in the first quarter of 2019.

Applied Optics Center revenue increased $0.2 million or 9.5% during the three months ended March 31, 2019 as compared to the three months ended April 1, 2018 primarily due to increased deliveries on military laser filters and windows. During the quarter, we experienced a sizable shift in product mix from commercial to military products as compared to the prior year period due to higher military spending, and lower customer demand for optical assemblies used in commercial rifle scopes.

Other product revenues increased by $1.2 million to $1.6 million or 353.0% during the three months ending March 31, 2019 as compared to $0.4 million in the prior year period primarily due to increased orders for MRS collimator, mirror, cell and beam-splitter assemblies over the prior year level.

Gross Margin. The gross margin during the period ending March 31, 2019 was 27.9% of revenue as compared to a gross margin of 21.8% of revenue for the period ending April 1, 2018. Cost of sales increased to $5.1 million for the current period as compared to the prior year period of $3.6 million on increased revenues of $2.5 million. The gross margin increased by $1.0 million in the current year period to $2.0 million as compared to the prior year period of $1.0 million. We attribute the improvement in gross margin to increased revenue and the corresponding contribution margin towards fixed costs combined with cost efficiency improvements and changes in product mix between the respective periods.

G&A Expenses. During the three months ended March 31, 2019 and April 1, 2018, we recorded operating expenses of $0.8 million.

Operating Income. During the three months ended March 31, 2019, we recorded an operating income of $1.2 million, as compared to operating income of $0.2 million during the three months ended April 1, 2018. The $1.0 million increased operating income in the current year period over the prior year period is primarily due to increased gross margin on higher revenue the current year quarter as compared to the prior year quarter.

Other Income (Expense). During the three months ended March 31, 2019, we recognized a ($1.9) million loss on change in the fair value of warrants as compared to a $2.4 million gain in three months ending April 1, 2018. The current period loss in the fair value of warrants is primarily attributable to a substantial increase in the common stock market price from $1.31 as of December 31, 2018 to $2.00 as of March 31, 2019. The prior year gain in fair value of warrants is attributable to a change in accounting estimate on the warrant liability of our outstanding warrants to incorporate new market information into the valuation model related to the volatility of the stock prices and OTC market trading data. Additional information related to the change in valuation is discussed under Item 1, "Consolidated Financial Statements, Note 6 – Warrant Liability"

Net Income (Loss) applicable to common shareholders. During the three months ended March 31, 2019, we recorded a net loss applicable to common shareholders of ($1.0) million as compared to a net income applicable to common shareholders of $1.7 million during the three months ended April 1, 2018. The decrease in net income of ($2.7) million is primarily attributable to increased operating income of $1.0 million, changes in the gain on the fair value of warrant liabilities of ($4.3) million, increased federal income tax expenses of ($0.3) million, and changes in the dividends declared and deemed dividends on participating securities of $0.9 million between the respective periods.

Six Months Ended March 31, 2019 Compared to the Six Months Ended April 1, 2018

Revenues. In the six months ended March 31, 2019, revenues increased by $3.7 million or 39.2% from the respective prior period in fiscal year 2018 as set forth in the table below:

	Six months ended (Thousands)			
Product Line	**March 31, 2019**	**April 1, 2018**	**Variance**	**% Chg**
Periscopes	$ 5,421	$ 3,177	$ 2,244	70.6
Sighting Systems	889	1,239	(350)	(28.2)
Other	2,167	572	1,595	278.8
Optical Systems – Richardson	8,477	4,988	3,489	69.9
Applied Optics Center – Dallas	4,502	4,339	163	3.8
Total Revenue	**$ 12,979**	**$ 9,327**	**$ 3,652**	**39.2**

Revenues on our periscope line increased by 70.6%, or $2.2 million from $3.2 million to $5.4 million during the six months ended March 31, 2019 as compared to the six months ended April 1, 2018 on higher customer demand driven by increased U.S. government military spending. Based on our current backlog, we anticipate the second half of fiscal year 2019 to approximate the first six months and exceed the fiscal year 2018 second half level. We anticipate our total periscope revenue to increase 40-45% for fiscal year 2019 as compared to the fiscal year 2018.

Sighting systems revenues for the six months ending March 31, 2019 decreased by ($0.3) million or (28.2%) from revenues in the prior year period. We anticipate the reduction in sighting system revenue will continue through the end of the year as the previous DDAN sighting system contract was completed in the first quarter of 2019. During the six months ending March 31, 2019, we received an additional DDAN spare order of $0.9 million for delivery in fiscal years 2020 and 2021.

Applied Optics Center revenue increased $0.2 million or 3.8% during the six months ended March 31, 2019 as compared to the six months ended April 1, 2018 primarily due to increased deliveries on military laser filters and windows. We anticipate the total annual Applied Optics Center revenue to increase over the prior year with a sizable shift in product mix from commercial to military products. We continue to book orders for deliveries in the current fiscal year.

Other product revenues increased by $1.6 million, or 278.8%, to $2.2 million during the six months ending March 31, 2019 as compared to $0.6 million in the prior year period primarily due to increased orders for MRS collimator, mirror, cell and beam-splitter assemblies over the prior year level. Based on our current backlog as compared to the prior year second quarter, we expect significantly higher revenues in the other product group during the fiscal year 2019 as compared to fiscal year 2018.

Gross Margin. The gross margin during the period ending March 31, 2019 was 26.4% of revenue as compared to a gross margin of 22.6% of revenue for the period ending April 1, 2018. Cost of sales increased to $9.6 million for the current period as compared to the prior year period of $7.2 million on increased revenues of $2.4 million. The gross margin increased by $1.3 million in the current year period to $3.4 million as compared to the prior year period of $2.1 million. We attribute the improvement in gross margin to increased revenue and the corresponding contribution margin towards fixed costs combined with cost efficiency improvements and changes in product mix between the respective periods.

G&A Expenses. During the six months ended March 31, 2019, we recorded operating expenses of $1.5 million as opposed to $1.6 million, during the six months ended April 1, 2018, a net decrease of ($0.1) million. The lower general and administrative expenses are primarily due to decreases in stock compensation expense, investor relations and accounting fees from the prior year period.

Operating Income. During the six months ended March 31, 2019, we recorded an operating income of $1.9 million, as compared to an operating income of $0.6 million during the six months ended April 1, 2018. The $1.3 million increased operating income in the current year period over the prior year period is primarily due to increased gross margin on higher revenue in the current year quarter as compared to the prior year period.

Other Income (Expense). During the six months ended March 31, 2019, we recognized a ($0.5) million loss on change in the fair value of warrants as compared to a $2.0 million gain in six months ending April 1, 2018. The current period loss in the fair value of warrants is primarily attributable to a substantial increase in the common stock market price from $1.71 as of December 31, 2018 to $2.00 as of March 31, 2019. The prior year gain in fair value of warrants is attributable to a change in accounting estimate on the warrant liability of our outstanding warrants to incorporate new market information into the valuation model related to the volatility of the stock prices and OTC market trading data. Additional information related to the change in valuation is discussed under Item 1, "Consolidated Financial Statements, Note 6 – Warrant Liability"

Net Income applicable to common shareholders. During the six months ended March 31, 2019, we recorded a net income applicable to common shareholders of $0.7 million as compared to net income applicable to common shareholders of $1.7 million during the six months ended April 1, 2018. The decrease in net income of ($1.0) million is primarily attributable to increased operating income of $1.3 million offset by the increase in the fair value of warrant liability of ($2.5) million, increased federal income tax expense of ($0.3) million and changes in declared and deemed dividends on participating securities of $0.5 million.

Liquidity and Capital Resources

As of March 31, 2019, the Company had working capital of $10.2 million, as compared to $8.5 million as of September 30, 2018. During the six months ended March 31, 2019, the Company generated operating income of $1.9 million and net income of $1.1 million before dividends, as compared to operating income of $0.6 million and net income of $2.5 million and an increase of $3.7 million in revenues to $13.0 million as compared to the $9.3 million in the prior year period ended April 1, 2018. The Company's adjusted EBITDA increased by $1.3 million during the six months ended March 31, 2019 to $2.1 million from $0.8 million during the six months ended April 1, 2018. Backlog as of March 31, 2019 has increased by $2.5 million or 10.7% to $25.8 million as compared to backlog of $23.3 million as of September 30, 2018.

During the prior two years, the Company has seen significant increases in new orders and revenue growth primarily in the U.S. military products. We attribute the higher demand to increases in the U.S. military procurement budgets which were approved for the fiscal years 2018 and 2019 National Defense Authorization Acts (NDAA). We believe that the procurement budget increases in the federal government's 2018 and 2019 NDAA combined with the lifting of the 2011 budget sequestration cap on defense spending levels are favorable to the Company for its U.S. military products during the next twelve months. Significant increases in orders could cause a strain on our working capital as we purchase additional inventories and ramp up production personnel required to meet the higher production schedules.

The Company has historically funded its operations through working capital, convertible notes, 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 March 31, 2019, the Company had approximately $1.6 million in cash and an outstanding payable balance of $0.3 million against our working line of credit. The line of credit allows for borrowing up to a maximum of $2.2 million, which fluctuates based on our open accounts receivable balance. As of March 31, 2019 our outstanding accounts receivable was $2.6 million. The Company expects to incur net income, increased adjusted EBITDA and positive cash flow from operating activities throughout 2019 on revenue growth and increased product gross margins. Our operating income of $1.9 million during the first six months of fiscal year 2019 marked a significant improvement of $1.3 million from the prior year first six month operating income of $0.6 million. Successful transition to attaining and maintaining profitable operations is dependent upon maintaining a level of revenue adequate to support the Company's cost structure. We have experienced significant increases in our customer backlog from the prior year on increased customer orders and multiyear contracts, primarily in our defense products. Management intends to manage operations commensurate with its level of working capital and facilities line of credit during the next twelve months; however, uneven revenue levels driven by changes in customer delivery demands, first article inspection requirements or other program delays combined with increasing inventory and production costs required to support the increases in backlog could create a working capital shortfall. In the event the Company does not successfully implement its ultimate business plan, certain assets may not be recoverable. Maintaining the Company profitability is dependent upon maintaining a level of revenue adequate to support the Company's cost structure. Management intends to manage operations commensurate with its level of working capital and facilities line of credit during the next twelve months; however, uneven revenue levels driven by changes in customer delivery demands, first article inspection requirements or other program delays combined with increasing inventory and production costs required to support a higher backlog could create a working capital shortfall. In the event the Company does not successfully implement its ultimate business plan, certain assets may not be recoverable.

In 2018 the Board of Directors approved two separate purchases 200,000 shares and 500,000 shares of its common stock in two separate private transactions for $1.00 per share each for a total of $700,000. All of the stock repurchases have been returned to the treasury.

During the twelve months ended September 30, 2018 the Company declared $523 thousand in dividends and paid $784 thousand during the fiscal year. As of September 30, 2018 and March 31, 2019 there are no outstanding declared and unpaid dividends.

Cash Flows for the Period from September 30, 2018 through March 31, 2019

Cash and Cash Equivalents: As of March 31, 2019 and September 30, 2018, we had cash and cash equivalents of $1.6 and $1.1 million, representing a net change of $0.5 million.

Net Cash Provided by Operating Activities. Net cash provided by operating activities during the six months from September 30, 2018 to March 31, 2019 totaled $0.6 million. The sources of cash during the period relate to net income of $1.1 million, non-cash depreciation and loss on change in the fair value of warrants of $0.7 million, increases in accrued expenses and accounts payable of $0.8 million offset by increases in inventory of ($1.6) million in support of new orders, decreases in customer deposits of ($0.3) million and other working capital changes of ($0.1) million.

Net Cash Used in Investing Activities. In the six months ended March 31, 2019, cash used in investing activities was $0.1 million for purchases of equipment.

Net Cash Used In by Financing Activities. Net cash used in by financing activities was ($0.1) million during the six months ended March 31, 2019 and relate to payment of $50 thousand against the revolving credit facility and cash paid for taxes withheld on net settled restricted stock units.

Critical Policies and Accounting Pronouncements

Our significant accounting policies are fundamental to understanding our results of operations and financial condition. Some accounting policies require that we use estimates and assumptions that may affect the value of our assets or liabilities and financial results. These policies are described in “Critical Policies and Accounting Pronouncements” and Note 2 (Accounting Policies) to consolidated financial statements in our Annual Report on Form 10-K for the year ended September 30, 2018.

Cautionary Factors That May Affect Future Results

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

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

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by our Quarterly Report on Form 10-Q for the quarter ended March 31, 2019, management performed, with the participation of our Principal Executive Officer and Principal Financial Officer, an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Our disclosure controls and procedures are designed to ensure that information required to be disclosed in the report we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s forms, and that such information is accumulated and communicated to our management including our Principal Executive Officer and our Principal Financial Officer, to allow timely decisions regarding required disclosures. Based upon the evaluation described above, our Principal Executive Officer and our Principal Financial Officer concluded that, as of March 31, 2019, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

During the three and six months ended March 31, 2019, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

There have been no material changes in risk factors since the risk factors set forth in the Form 10-K filed for the year ended September 30, 2018.

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

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: May 14, 2019

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

OPTEX SYSTEMS HOLDINGS, INC.

Date: May 14, 2019

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: *Danny Schoening*
Danny Schoening
Principal Executive Officer

May 14, 2019

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: Karen Hawkins
Karen Hawkins
Principal Financial Officer and Principal Accounting Officer

May 14, 2019

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 March 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Danny Schoening, Principal Executive Officer of the Company, certify to the best of my knowledge, pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Sec. 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Dated: May 14, 2019

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 March 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Karen Hawkins, Principal Financial Officer and Principal Accounting Officer of the Company, certify to the best of my knowledge, pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Sec. 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

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

Dated: May 14, 2019