PRECISION OPTICS CORPORATION INC
Form 10QSB
November 12, 2004

FORM 10-QSB

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

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

For the quarterly period ended September 30, 2004

Commission file number 001-10647

PRECISION OPTICS CORPORATION, INC.

(Exact name of small business issuer as specified in its charter)

Massachusetts (State or other jurisdiction of incorporation or organization)	04-2795294 (I.R.S. Employer Identification No.)

22 East Broadway, Gardner, Massachusetts 01440-3338
(Address of principal executive offices) (Zip Code)

(978) 630-1800

(Issuer's telephone number, including area code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes (X) No ( )

The number of shares outstanding of issuer's common stock, par value $.01 per share, at October 31, 2004 was 7,008,212 shares.

Transitional Small Business Disclosure Format (check one):
Yes ( ) No (X)

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

INDEX

Item 1

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
ASSETS

		September 30, 2004		June 30, 2004
CURRENT ASSETS				
Cash and Cash Equivalents	$	4,733,474	$	343,260
Accounts Receivable, Net		106,124		80,195
Inventories, Net		816,462		917,998
Prepaid Expenses and Other Current Assets		125,268		80,646
Deferred Financing Costs		-		171,885
Total Current Assets		5,781,328		1,593,984
PROPERTY AND EQUIPMENT		4,201,147		4,199,835
Less: Accumulated Depreciation		(3,958,986)		(3,920,593)
Net Property and Equipment		242,161		279,242
OTHER ASSETS		218,541		224,088
TOTAL ASSETS	$	6,242,030	$	2,097,314
LIABILITIES AND STOCKHOLDERS' EQUITY				
CURRENT LIABILITIES				
Accounts Payable	$	267,194		235,050
Accrued Employee Compensation		218,452		230,110
Accrued Professional Services		56,850		75,439
Accrued Warranty Expense		50,000		50,000
Other Accrued Liabilities		37		2,743
Total Current Liabilities		592,533		593,342
STOCKHOLDERS' EQUITY				
Common Stock, $.01 par value-				
Authorized -- 20,000,000 shares				
Issued and Outstanding - 7,008,212 shares				
at September 30, 2004 and 1,752,053 shares				
at June 30, 2004		70,082		17,521
Additional Paid-in Capital		32,796,597		27,770,175
Accumulated Deficit		(27,217,182)		(26,283,724)
Total Stockholders' Equity		5,649,497		1,503,972
TOTAL LIABILITIES AND				
STOCKHOLDERS' EQUITY	$	6,242,030	$	2,097,314

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED
SEPTEMBER 30, 2004 AND SEPTEMBER 30, 2003
(UNAUDITED)

	Three Months Ended September 30, 2004		Three Months Ended September 30, 2003	
REVENUES	$	263,810	$	638,806
COST OF GOODS SOLD		356,015		586,263
Gross Profit (Loss)		(92,205)		52,543
RESEARCH and DEVELOPMENT EXPENSES		356,406		267,070
SELLING, GENERAL and ADMINISTRATIVE EXPENSES		497,439		429,330
Total Operating Expenses		853,845		696,400
Operating Loss		(946,050)		(643,857)
INTEREST INCOME		12,592		7,454
INTEREST EXPENSE		--		(46)
Net Loss	$	(933,458)	$	(636,449)
Basic and Diluted Loss Per Share	$	(0.16)	$	(0.36)
Weighted Average Common Shares Outstanding		5,979,832		1,752,053

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED
SEPTEMBER 30, 2004 AND 2003
(UNAUDITED)

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Loss	$ (933,458)	$ (636,449)
Adjustments to Reconcile Net Loss to Net Cash		
Used In Operating Activities -		
Depreciation and Amortization	49,665	49,927
Provision for Inventory Write-Down	57,300	62,900
Changes in Operating Assets and Liabilities-		
Accounts Receivable, Net	(25,929)	(181,036)
Inventories	44,236	(63,595)
Prepaid Expenses	(44,622)	(156,756)
Accounts Payable	131,269	225,919
Other Accrued Expenses	(32,953)	(10,571)
Net Cash Used In Operating Activities	(754,492)	(709,661)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of Property and Equipment	(1,312)	(25,383)
Increase in Other Assets	(5,724)	(15,648)
Net Cash Used In Investing Activities	(7,036)	(41,031)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of Capital Lease Obligation	-	(3,353)
Gross Proceeds from Rights Offering	5,256,159	-
Payment of Deferred Financing Costs	(104,417)	-
Net Cash Generated (Used) In Financing Activities	5,151,742	(3,353)
NET INCREASE (DECREASE) IN CASH AND		
CASH EQUIVALENTS	4,390,214	(754,045)
CASH AND CASH EQUIVALENTS AT BEGINNING		
OF PERIOD	343,260	3,504,414
CASH AND CASH EQUIVALENTS AT END		
OF PERIOD	$ 4,733,474	$ 2,750,369
SUPPLEMENTAL DISCLOSURE OF CASH FLOW		
INFORMATION:		
Cash Paid for-		
Interest	$ --	$ 46
Income Taxes	$ 912	$ --

PRECISION OPTICS CORPORATION, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying consolidated financial statements include the accounts of Precision Optics Corporation, Inc. and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

These consolidated financial statements have been prepared by the Company, without audit, and reflect normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the results of the first quarter of the Company's fiscal year 2005. These consolidated financial statements do not include all disclosures associated with annual consolidated financial statements and, accordingly, should be read in conjunction with footnotes contained in the Company's consolidated financial statements for the year ended June 30, 2004 together with the auditors' report filed under cover of the Company's 2004 Annual Report on Form 10-KSB.

The preparation of these consolidated financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Basic loss per share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. For the three months ended September 30, 2004 and 2003, the effect of stock options and warrants was antidilutive; therefore, they were not included in the computation of diluted loss per share. The number of shares issuable upon the exercise of outstanding stock options and warrants that were excluded from the computation as their effect would be antidilutive were approximately 218,765 and 217,914 for the three months ended September 30, 2004 and 2003, respectively.

2. INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out) or market and consist of the following:

		September 30, 2004		June 30, 2004
Raw Materials	$	289,271	$	345,483
Work-In-Progress		306,096		307,522
Finished Goods		221,095		264,993
Total Inventories	$	816,462	$	917,998

3. STOCK-BASED COMPENSATION

The Company accounts for its stock-based compensation using the intrinsic value method provided for under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* and related interpretations. Under APB No. 25 and related interpretations, compensation cost is recognized based on the difference, if any, on the date of grant between the fair value of the Company s stock and the amount an employee must pay to acquire the stock. Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, establishes a fair-value-based method of accounting for stock-based compensation plans. The Company has adopted the disclosure-only alternative under SFAS No. 123, which requires the disclosure of the pro forma effects on net loss and net loss per share as if the fair value accounting prescribed by SFAS No. 123 had been adopted.

No stock-based employee compensation cost is reflected in net loss, as all options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation:

	3 Months Ended September 30			
		2004		**2003**
Net loss, as reported	$	(933,458)	$	(636,449)
Add: Total stock-based employee compensation expense determined under fair value based method for all awards		(9,212)		(25,284)
Pro forma net loss	$	(942,670)	$	(661,733)
Net loss per share:				
As reported - basic and diluted	$	(.16)	$	(.36)
Pro forma- basic and diluted	$	(.16)	$	(.38)

4. RIGHTS OFFERING

In July 2004, the Company completed a rights offering to stockholders of record on June 7, 2004 by issuing 5,256,159 shares of common stock at a price of $1.00 per share. Net cash proceeds to the Company (after offering costs of $177,176) were $5,078,983.

The costs of the rights offering estimated to have been incurred through June 30, 2004 of $171,885, have been deferred and are included in deferred financing costs in the accompanying consolidated balance sheets as of June 30, 2004. The actual offering costs of $177,176 have been charged against additional paid-in capital in the accompanying consolidated balance sheets as of September 30, 2004.

5. NOTIFICATION FROM NASDAQ

On October 19, 2004, the Company received a letter from the Nasdaq Stock Market notifying the Company that for the 30 consecutive trading days preceding October 19, 2004, the bid price of the Company s common stock had closed below the $1.00 per share minimum required for continued inclusion on The Nasdaq SmallCap Market. The letter further stated that the Company has been provided 180 calendar days, or until April 18, 2005, to regain compliance with the $1.00 per share bid price requirement. To regain compliance with the bid price requirement, the bid price of the Company s common stock must close at or above $1.00 per share for a minimum of ten consecutive trading days prior to April 18, 2005. If by April 18, 2005 the Company has not regained compliance with the minimum bid price requirement, the Company may be granted an additional 180 day grace period to regain compliance under applicable Nasdaq rules, provided it meets The Nasdaq SmallCap Market initial listing criteria (other than the minimum bid price requirement) at that time.

The delisting of the Company s common stock from the Nasdaq SmallCap Market may materially impair the stockholder s ability to buy and sell shares of the Company s common stock, and could have an adverse effect on the market price of, and the efficiency of the trading market for, the Company s common stock. In addition, the delisting of the Company s common stock could significantly impair the Company s ability to raise capital should it desire to do so in the future.

The Company intends to monitor the bid price for its common stock between now and April 18, 2005. If its common stock does not trade at a level that is likely to regain compliance, the Company s Board of Directors will consider options available to the Company to achieve compliance.

Item 2

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

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

Important Factors Regarding Forward-Looking Statements

When used in this discussion, the words "believes", "anticipates", "intends to", and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties which could cause actual results to differ materially from those projected. These risks and uncertainties, many of which are not within the Company s control, include, but are not limited to, uncertainty of future demand for the Company s products; the uncertainty and timing of the successful development of the Company s new products; the risks associated with reliance on a few key customers; the Company s ability to regain and maintain compliance with requirements for continued listing on the Nasdaq SmallCap Market; the Company s ability to attract and retain personnel with the necessary scientific and technical skills; the timing and completion of significant orders; the timing and amount of the Company s research and development expenditures; the timing and level of market acceptance of customers products for which the Company supplies components; the level of market acceptance of competitors products; the ability of the Company to control costs associated with performance under fixed price contracts; the performance and reliability of the Company s vendors; and the continued availability to the Company of essential supplies, materials and services; which are described further in Exhibit 99.1 to the Company s Annual Report on Form 10-KSB for the fiscal year ended June 30, 2004. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to publicly release the result of any revision to these forward-looking statements which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Overview

Precision Optics Corporation, a developer and manufacturer of advanced optical instruments since 1982, designs and produces high-quality optical thin film coatings, medical instruments, and other advanced optical systems. The Company s medical instrumentation line includes laparoscopes, arthroscopes and endocouplers and a world-class product line of 3-D endoscopes for use in minimally invasive surgical procedures.

The Company is currently developing specialty instruments incorporating its patent-pending LENSLOCKTM technology which ensures lower cost, easier repairability and enhanced durability as well as ultra-small instruments (some with lenses less than one millimeter in diameter) utilizing patent-pending micro-precisionTM lens technology. The Company is also exploring new initiatives in single-molecule technology and nanotechnology for biomedical and other applications.

Precision Optics Corporation is certified to the ISO 9001 Quality Standard, and complies with the FDA Good Manufacturing Practices and the European Union Medical Device Directive for CE Marking of its medical products. The Company s Internet Website is www.poci.com.

The areas in which the Company does business are highly competitive and include both foreign and domestic competitors. Many of the Company s competitors are larger and have substantially greater resources than the Company. Furthermore, other domestic or foreign companies, some with greater experience in the optics industry and greater financial resources than the Company, may seek to produce products or services that compete with those of the Company. The Company uses production facilities overseas to produce key components for the Company s business, such as lenses. The Company believes that the cost savings from such production is essential to the Company s ability to compete on a price basis in the medical products area particularly and to the Company s profitability generally.

The Company believes that competition for sales of its medical products and services, which have been principally sold to Original Equipment Manufacturer (OEM) customers, is based on performance and other technical features, as well as other factors, such as scheduling and reliability, in addition to competitive price.

The Company believes that its future success depends to a large degree on its ability to continue to conceive and to develop new optical products and services to enhance the performance characteristics and methods of manufacture of existing products. Accordingly, it expects to continue to seek to obtain product-related design and development contracts with customers and to invest its own funds on research and development, to the extent funds are available.

The Company relies, in part, upon patents, trade secrets and proprietary knowledge as well as personnel policies and employee confidentiality agreements concerning inventions and other creative efforts to develop and to maintain its competitive position. The Company does not believe that its business is dependent upon any particular patent, patent pending, or license, although it believes that trade secrets and confidential know-how may be important to the Company s scientific and commercial success.

The Company conducts its domestic operations at two leased facilities in Gardner, Massachusetts. The Company rents office space in Hong Kong for sales, marketing and supplier quality control and liaison activities of its Hong Kong subsidiary. The Company believes these facilities are adequate for its current operations. Significant increases in production or the addition of significant equipment or manufacturing capabilities in connection with the production for the Company s line of endoscopes, optical thin films, and other products may, however, require the acquisition or lease of additional facilities.

Notification from Nasdaq

On October 19, 2004, the Company received a letter from the Nasdaq Stock Market notifying the Company that for the 30 consecutive trading days preceding October 19, 2004, the bid price of the Company s common stock had closed below the $1.00 per share minimum required for continued inclusion on The Nasdaq SmallCap Market. The letter further stated that the Company has been provided 180 calendar days, or until April 18, 2005, to regain compliance with the $1.00 per share bid price requirement. To regain compliance with the bid price requirement, the bid price of the Company s common stock must close at or above $1.00 per share for a minimum of ten consecutive trading days prior to April 18, 2005. If by April 18, 2005 the Company has not regained compliance with the minimum bid price requirement, the Company may be granted an additional 180 day grace period to regain compliance under applicable Nasdaq rules, provided it meets The Nasdaq SmallCap Market initial listing criteria (other than the minimum bid price requirement) at that time.

The delisting of the Company s common stock from the Nasdaq SmallCap Market may materially impair the stockholder s ability to buy and sell shares of the Company s common stock, and could have an adverse effect on the market price of, and the efficiency of the trading market for, the Company s common stock. In addition, the delisting of the Company s common stock could significantly impair the Company s ability to raise capital should it desire to do so in the future.

The Company intends to monitor the bid price for its common stock between now and April 18, 2005. If its common stock does not trade at a level that is likely to regain compliance, the Company s Board of Directors will consider options available to the Company to achieve compliance.

Critical Accounting Policies and Estimates

General

Management s discussion and analysis of financial condition and results of operations are based upon the Company s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

Revenue Recognition

The Company recognizes revenue in accordance with U.S. GAAP and SEC Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition.* SAB No. 104 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the price to the buyer is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criteria (3) and (4) are based on management s judgments regarding the fixed nature of the price to the buyer charged for products delivered or services rendered and collectibility of the sales price. The Company assesses credit worthiness of customers based upon prior history with the customer and assessment of financial condition. The Company s shipping terms are customarily FOB shipping point.

Bad Debt

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Allowances for doubtful accounts are established based upon review of specific account balances and historical experience. If the financial condition of the Company s customers were to deteriorate, resulting in an impairment of their ability to make future payments, additional allowances may be required.

Inventories

The Company provides for estimated obsolescence on unmarketable inventory based upon assumptions about future demand and market conditions. If actual demand and market conditions are less favorable than those projected by management, additional inventory write downs may be required. Inventory, once written down, is not subsequently written back up, as these adjustments are considered permanent adjustments to the carrying value of the inventory.

Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed of

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* the Company assesses impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the asset. Estimating the future cash flows expected to be generated by the asset is dependent upon significant judgments made by management. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. The Company classifies assets to be sold as held for sale in the period in which all of the following criteria are met:

a) Management, having the authority to approve the action, commits to a plan to sell the asset.

b) The asset is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets.

c) An active program to locate a buyer and other actions required to complete the plan to sell the asset have been initiated.

d) The sale of the asset is probable, and transfer of the asset is expected to qualify for recognition as a completed sale, generally within one year.

e) The asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value.

f) Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Assets classified as held for sale are carried at the lower of cost or fair value less cost to sell and the asset is no longer depreciated. When determining the fair value, management considers the condition of the assets and pertinent market conditions. When considered necessary, management will engage third party valuation experts to assist in the determination of fair value. At each balance sheet date, management makes an assessment of the assets fair value and whether the assets continue to meet the criteria to be classified as held for sale.

Results of Operations

Total revenues for the quarter ended September 30, 2004 (the first quarter of fiscal year 2005) decreased by approximately $375,000 or 58.7% from the same period in the prior year. The decrease was due primarily to lower sales of medical products (down by approximately $360,000, or 60%), and lower sales of non-medical products (down by approximately $15,000, or 40%). Sales of medical products were lower due primarily to one-time shipments last year to a customer of specialty endoscopes used for cardiac surgical applications, and lower sales of endoscopes and endocouplers. Non-medical product sales were lower due primarily to lower sales of industrial lenses and couplers.

Revenues from the Company s largest customers, as a percentage of total revenues for the three months ended September 30, 2004 and 2003, were as follows:

	2004	2003
Customer A	37	14
Customer B	11	5
Customer C	-	49
All Others	52	32
	100%	100%

No other customer accounted for more than 10% of the Company s revenues during those periods.

At September 30, 2004, receivables from the Company s two largest customers were approximately 33% and 16%, respectively, of the total net accounts receivable. At June 30, 2004, receivables from the Company s largest customers were approximately 47%, 18%, 13%, and 12%, respectively of the total net accounts receivable. No other customer accounted for more than 10% of the Company s receivables as of September 30, 2004 and June 30, 2004.

Gross profit (loss) for the quarter ended September 30, 2004 as a percentage of revenues decreased from 8.2% for the quarter ended September 30,2003 to a negative 35.0% in the current quarter. The unfavorable change in gross profit was due primarily to lower sales volume, partially offset by a lower manufacturing cost structure resulting from restructuring measures implemented in fiscal year 2004.

Research and development expenses increased by approximately $89,000, or 33.4%, for the quarter ended September 30, 2004, compared to the same period last year. The increase was due to a higher level of resources being devoted to product development activities.

Selling, general and administrative expenses increased by approximately $68,000, or 15.9% for the quarter ended September 30, 2004 compared to the same period last year. The increase was due primarily to higher professional services expense and higher selling expense as a result of increased bid and proposal activities.

Interest income increased by approximately $5,100, or 68.9% for the quarter ended September 30, 2004 compared to the previous year. The increase was due to the higher base of cash and cash equivalents because of proceeds received from the rights offering in July 2004.

No income tax provision was recorded in the first quarter of fiscal year 2005 or 2004 because of the losses generated in those periods.

Liquidity and Capital Resources

For the three months ended September 30, 2004, the Company s cash and cash equivalents increased by approximately $4,390,000 to $4,733,000. The increase in cash and cash equivalents was due to receipt of gross proceeds from the rights offering of approximately $5,256,000 less payment of offering costs of $104,000, partially offset by cash used by operating activities of approximately $754,000, capital expenditures of approximately $1,000, and an increase in patent costs of approximately $7,000. The Company believes, based on its operating and strategic plans and the net proceeds received in July 2004 from its rights offering to stockholders, that it will have sufficient funds to conduct operations through at least the next twelve months.

Contractual cash commitments for the fiscal years subsequent to September 30, 2004 are summarized as follows:

	2005	2006	Thereafter	Total
Operating leases	$ 18,088	$ 741	$ 1,853	$ 20,682
Total	$ 18,088	$ 741	$ 1,853	$ 20,682

The Company provides a standard one-year warranty on materials and workmanship to its customers. The Company provides for estimated warranty costs at the time product revenue is recognized. Warranty costs are included as a component of cost of goods sold in the accompanying consolidated statements of operations. For the three month periods ended September 30, 2004 and 2003, warranty costs were not significant.

Trends and Uncertainties That May Affect Future Results

For the quarter ended September 30, 2004, the Company s cash used in operating activities was approximately $754,000, compared to approximately $592,000 for the previous quarter ended June 30, 2004. The increased cash usage is attributable primarily to (1) lower cash collections in the quarter ended September 30, 2004, resulting from lower sales in that quarter and preceding quarters, and the timing of cash receipts from customers, and (2) the timing of payments to certain vendors, including approximately $104,000 paid for expenses associated with the rights offering.

Capital equipment expenditures during the quarter ended September 30, 2004 were approximately $1,000, down 95% from the same period in 2003. Future capital expenditures will depend on future sales and the success of ongoing research and development efforts.

For the quarter ended September 30, 2004, research and development expenses were approximately $356,000, up 33% from $267,000 a year earlier. The level of future quarterly R&D expenses will ultimately depend on the Company s assessment of new product opportunities.

The Company expects its recent pattern of quarter-to-quarter revenue fluctuations to continue, due to the uncertain timing or orders from customers and their size in relation to total revenues. The Company continues to move forward with new products and technical innovations, in particular, the development of a new prototype 2.7 mm endoscope, and new instruments utilizing the Company s new micro-precisionTM lens technology (patent pending) for endoscopes under 1 mm. The Company continues to explore potential applications of single-molecule technology and nanotechnology, as well as potential near-term applications of the Company s existing technologies in non-medical markets.

The Company believes that the recent introduction of several new products, along with new and ongoing customer relationships, will generate additional revenues, which are required in order for the Company to achieve profitability. If these additional revenues are not achieved on a timely basis, the Company will be required and is prepared to implement further cost reduction measures, as necessary.

Item 3 Controls and Procedures

(a) As of the end of the period covered by this quarterly report, the Company s Chief Executive Officer and Principal Financial Officer have conducted an evaluation of the Company s disclosure controls and procedures. Based on their evaluation, the Company s Chief Executive Officer and Principal Financial Officer have concluded that the Company s disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the applicable Securities and Exchange Commission rules and forms.

(b) There was no change in the Company s internal control over financial reporting during the Company s most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Items 1-5   Not Applicable.

Item 6   Exhibits

Exhibit 31.1 - Certifications of the Company s Chief Executive Officer required by Rule 13a-14(a)/15d-14(a)

Exhibit 31.2 - Certification of the Company s Chief Financial Officer required by Rule 13a-14(a)/15d-14(a)

Exhibit 32.1 - Certifications of the Company s Chief Executive Officer and Chief Financial Officer required by Rule 13a-14(b) and 18 U.S. C. 1350.

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PRECISION OPTICS CORPORATION, INC.

DATE: November 12, 2004 BY: /s/ JACK P. DREIMILLER

Jack P. Dreimiller
Senior Vice President, Finance,
Chief Financial Officer and Clerk

EXHIBIT INDEX

Exhibit 31.1 - Certifications of the Company s Chief Executive Officer required by Rule 13a-14(a)/15d-14(a)

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