

Optex Systems Holdings Inc
Form 10-K
December 19, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended September 30, 2012

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

For the transition period from ___ until ___

Commission File Number 000-22573

OPTEX SYSTEMS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation organization)

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

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

75081-2439
(Zip Code)

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

Securities Registered under Section 12(b) of the Act

None

Securities Registered under Section 12(g) of the Act

Common Stock, par value \$.001 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files).

Yes No

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes " No x

The aggregate market value of the 31,513,325 shares of voting stock held by non-affiliates of the registrant based on the closing price on the OTC Markets on April 2, 2012 was \$315,133.

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

	Shares Outstanding
Title of Class	December 17, 2012
Common Stock	152,346,607

DOCUMENTS INCORPORATED BY REFERENCE

None.

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Cautionary Note Regarding Forward-Looking Information

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

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

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

PART I

Item 1 Description of Business

Background

Prior History - Sustut Exploration, Inc.

Sustut was a Delaware corporation formed on April 11, 2006 to search for available properties in North Central British Columbia. In May 2006, Sustut entered into an agreement, which was negotiated at arms-length with Richard Simpson, to acquire a 100% interest in the WILLOW claim purported to be located in the Omineca Mining Division, NTS map sheet 94D/10E. The property could have been acquired from Simpson by paying a total of \$75,000 in two option payments with the last option payment being due on May 15, 2008; however, Sustut did not make the required payments and did not acquire title to those property rights.

The mineral claim, which was to be Sustut's primary business, expired on May 15, 2008 leaving Sustut with no operating business of which to dispose. Optex Systems Holdings does not believe it presently maintains any rights related to the Willowvale project and does not intend to pursue a mining or mineral business. Optex Systems Holdings does not intend to make any payment to exercise any option or extend the term of the rights, if any continue to exist.

Reorganization

On March 30, 2009, a reorganization occurred whereby the then existing shareholders of Optex Systems, Inc., a private Delaware corporation ("Optex Systems, Inc. (Delaware)"), exchanged their shares of Optex Systems, Inc. (Delaware) common stock with the shares of common stock of Optex Systems Holdings as follows: (i) the outstanding 85,000,000 shares of Optex Systems, Inc. (Delaware) common stock were exchanged for 113,333,282 shares of Optex Systems Holdings common stock, (ii) the outstanding 1,027 shares of Optex Systems, Inc. (Delaware) Series A preferred stock were exchanged for 1,027 shares of Optex Systems Holdings Series A preferred stock and (iii) the 8,131,667 shares of Optex Systems, Inc. (Delaware) common stock purchased in the private placement were exchanged for 8,131,667 shares of Optex Systems Holdings common stock. Optex Systems, Inc. (Delaware) has remained a wholly-owned subsidiary of Optex Systems Holdings, and the Optex Systems, Inc. (Delaware) shareholders are now shareholders of Optex Systems Holdings. As a result of the reorganization, Sileas Corporation, a former shareholder of Optex Systems, Inc. (Delaware), beneficially owns approximately 84.95% of the issued and

outstanding common stock of Optex Systems Holdings and Alpha Capital Anstalt, a former shareholder of Optex Systems, Inc. (Delaware) owns 8.56% of the issued and outstanding common stock of Optex Systems Holdings. Furthermore, at the time of the reorganization, Andrey Oks resigned as the sole officer and director of Optex Systems Holdings. Additionally, Stanley Hirschman, Ronald Richards and Merrick Okamoto were appointed as its directors, and Stanley Hirschman, Danny Schoening and Karen Hawkins were appointed as its President, COO and V.P. of Finance/Controller, respectively.

Prior to the closing under the reorganization agreement, Optex Systems, Inc. (Delaware) accepted subscriptions from accredited investors for a total 27.1 units, for \$45,000 per unit, with each unit consisting of 300,000 shares of common stock of Optex Systems, Inc. (Delaware) and warrants to purchase 300,000 shares of common Stock for \$0.45 per share for a period of five years from the initial closing, which were issued by Optex Systems, Inc. (Delaware) after the closing referenced above. Gross proceeds to Optex Systems, Inc. (Delaware) were \$1,219,750, and after deducting (i) a cash finder's fee of \$139,555, (ii) non-cash consideration of indebtedness owed to an investor of \$146,250, and (iii) stock issuance costs of \$59,416, the net proceeds were \$874,529. The finder also received five year warrants to purchase 2.39 units, at an exercise price of \$49,500 per unit.

Contracts

Each contract with Optex Systems Holdings' customers has specific quantities of material that need to be purchased, assembled, and then shipped. Prior to bidding a contract, Optex Systems Holdings contacts potential sources of material and receives qualified quotations for this material. In some cases, the entire volume is given to a single supplier and in other cases, the volume might be split between several suppliers. If a contract has a single source supplier and that supplier fails to meet their obligations (e.g., quality, delivery), then Optex Systems Holdings would attempt to find an acceptable alternate supplier, and if successful, it would then renegotiate contractual deliverables (e.g., specifications, delivery, price). As of December 7, 2012, approximately 34% of our material requirements are single-sourced across 6 suppliers representing approximately 6% of our active supplier base. Single-sourced component requirements span across all of our major product lines. Of these single sourced components, we have material contracts (purchase orders) with firm pricing and delivery schedules in place with each of the suppliers to supply the parts necessary to satisfy our current contractual needs.

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

Regulation	Summary
Federal Acquisition Regulation	The principal set of rules in the Federal Acquisition Regulation System. This system consists of sets of regulations issued by agencies of the federal government of the United States to govern what is called the "acquisition process," which is the process through which the government acquires goods and services. That process consists of three phases: (1) need recognition and acquisition planning, (2) contract formation, and (3) contract administration. The FAR System regulates the activities of government personnel in carrying out that process. It does not regulate the purchasing activities of private sector firms, except to the extent that those activities involve government solicitations and contracts by reference.
International Traffic in Arms Regulations	United States government regulations that control the export and import of defense-related articles and services on the United States Munitions List. These regulations implement the provisions of the Arms Export Control Act.
Truth in Negotiations Act	A public law enacted for the purpose of providing for full and fair disclosure by contractors in the conduct of negotiations with the government. The most significant provision included is the requirement that contractors submit certified cost and pricing data for negotiated procurements above a defined threshold, which was increased from \$650,000 to \$700,000 on October 1, 2010. It requires contractors to provide the government with an extremely broad range of cost or pricing information relevant to the expected costs of contract performance, and it requires contractors and subcontractors to submit cost or pricing data to the government and to certify that, to the best of their knowledge and belief, the data are current, accurate, and complete.

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

First Article Testing and Acceptance requirements consist of specific steps. For example, the first article testing associated with Howitzer-type product is comprehensive and time consuming. The dimensions and material

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

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

The aforementioned licenses are valid for 48 months from date that each such license is issued as set forth on the table below (updated as of December 7, 2012).

DSP - 5 Licenses	Issue Date	Expiration Date (48 months of issue)
50137740	1/5/2009	1/5/2013
50146207	3/13/2009	3/13/2013
50137823	1/5/2009	1/5/2013
50169739	6/4/2009	6/4/2013
50184920	8/19/2009	8/19/2013
50185923	8/28/2009	8/28/2013
50187735	3/19/2010	3/19/2014
50230854	3/30/2010	3/30/2014
50187735	10/1/2009	10/1/2013
50220671	10/1/2009	10/1/2013
50221743	4/1/2010	4/1/2014
50209709	2/23/2010	2/23/2014
50233257	6/10/2010	6/10/2014
50269333	1/7/2011	1/7/2015
50274142	1/5/2011	1/5/2015
50275888	2/28/2011	2/28/2015
50284334	3/1/2011	3/1/2015
50290287	4/13/2011	4/13/2015
50290963	5/2/2011	5/2/2015
50302078	5/27/2011	5/27/2015

(DSP-6)60023740/50302078	6/22/2011	6/22/2015
50303894	6/1/2011	6/1/2015
(DSP-6)60026734/50303894	12/1/2011	12/1/2015
50298020	6/6/2011	6/6/2015
50310470	7/7/2011	7/7/2015
50309527	7/12/2011	7/12/2015
50313126	7/14/2011	7/14/2015
50314547	8/11/2011	8/11/2015
50324632	9/8/2011	9/8/2015
50323843	9/23/2011	9/23/2015
50343236	12/7/2011	12/7/2015
50343846	12/5/2011	12/5/2015
50343382	12/21/2011	12/21/2015
50343483	12/28/2011	12/28/2015
50355614	2/1/2012	2/1/2016
50355650	1/31/2012	1/31/2016
50346638	2/13/2012	2/13/2016
50362079	2/29/2012	2/29/2016
50362307	3/19/2012	3/19/2016
50362221	3/19/2012	3/19/2016
50360195	3/23/2012	3/23/2016
(TA-0018-12B) 50374118	4/18/2012	4/18/2016
50381011	5/24/2012	5/24/2016
50382421	5/31/2012	5/31/2016
50386018	7/12/2012	7/12/2016
50397890	8/8/2012	8/8/2016
50398181	8/10/2012	8/10/2016
50398178	8/10/2012	8/10/2016
50402338	8/29/2012	8/29/2016
50403055	9/6/2012	9/6/2016
50399603	9/18/2012	9/18/2016

DSP - 73 Licenses	Date Issued	Expiration Date (48 months of issue)
730010051	2/27/2009	2/27/2013
730024737	2/16/2010	2/16/2014
730026913	6/15/2010	6/15/2014
730030429	2/22/2011	2/22/2015
730031574	6/15/2011	6/15/2015
730033471	9/16/2011	9/16/2015
730033903	9/23/2011	9/23/2015
730038566	6/26/2012	6/26/2016
730038918	8/13/2012	8/13/2016

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

Optex Systems Holdings' contracts may also be governed by the Truth in Negotiation Act requirements where certain of our contracts or proposals exceed the \$700,000 threshold and/or are deemed as sole source, or non competitive awards, covered under this act. For these contracts, Optex Systems Holdings must provide a vast array of cost and pricing data in addition to certification that our pricing data and disclosure materials are current, accurate and complete upon conclusion of the negotiation. Due to the additional disclosure and certification requirements, if a post contract award audit were to uncover that the pricing data provided was in any way not current, accurate or complete as of the certification date, Optex Systems Holdings could be subjected to a defective pricing claim adjustment with accrued interest. Currently, Optex Systems Holdings does not have any pending defective pricing claim adjustments. Additionally, as a result of this requirement, contract price negotiations may span from two to six months and can result in undefinitized or not to exceed ceiling priced contracts subject to future downward negotiations and price adjustments. Currently, Optex Systems Holdings does not have any undefinitized contracts subject to further price negotiation.

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

The material terms of our material contracts are as follows (updated as of December 7, 2012):

Customer	Customer PO/Contract	Contract Type	Contract Min Qty	Contract Max Qty	Total Award Value (2)	Progress Billable (1)	Order Milestone Expiration	Remaining Value	Delivery Period
General Dynamics Land Systems	40156697/W56HZV-06-G-0006	Firm Fixed Price and Fixed Quantity Purchase Order	N/A	N/A	\$1,148,591	Yes	N/A	\$ 1,148,591	Jan 2013 Sep 2014
DLA Land – Warren (4)	SPRDL1-12-C-0023	Firm Fixed Price and Fixed	N/A	N/A	\$1,131,936	No	N/A	\$ 1,131,936	2011 -

		Quantity Purchase Order						Jun 2013
		Firm Fixed Price and Fixed Quantity Purchase Order	N/A	N/A	\$8,018,364	Yes	N/A	\$ 7,362,609
GDLS - Canada (5)	Subcontract PO 35334144							Mid 2012 Oct 2017

(1) *Payment terms on shipments are net 30 days.*

(2) *“Total Award Value” as included in the table represents the total value of all delivery orders against the prime contract that have already been awarded to Optex. The total award value represents already awarded delivery order contracts. Based on Optex’s historical experience with these contracts and other similar contracts, the amount awarded has directly correlated to the amount received.*

(3) *The “Remaining Value” depicts the open undelivered values remaining to be delivered against the contract awards as of September 30, 2012. Only these undelivered values of the contracts may be subject to the contract termination clause. It has been the experience of Optex Systems that these clauses are rarely invoked.*

(4) *Contract was awarded on October 24, 2011.*

(5) *Contract was awarded on October 24, 2011 but effective November 3, 2011 as the date on which approved for disclosure by contractor. This contract provides for milestone billing, in part.*

Organizational History

On October 14, 2008, in a transaction that was consummated via public auction, Optex Systems, Inc. (Delaware) purchased all of the assets of Optex Systems, Inc. (Texas) in exchange for \$15 million of Irvine Sensors Corporation debt and the assumption of approximately \$3.8 million of certain liabilities of Optex Systems, Inc. (Texas). Optex Systems, Inc. (Delaware) was formed by the Longview Fund, LP and Alpha Capital Antstalt, former secured creditors of Irvine Sensors Corporation, to consummate the transaction with Optex Systems Holdings, and subsequently, on February 20, 2009, Longview Fund conveyed its ownership interest in Optex Systems Holdings to Sileas Corporation, an entity owned by three of Optex Systems Holdings' officers (one of whom is also one of Optex Systems Holdings' three directors). On March 30, 2009, a reorganization occurred whereby Optex Systems, Inc. (Delaware) became a wholly-owned subsidiary of Optex Systems Holdings.

Products

Optex Systems Holdings' products are installed on various types of U.S. military land vehicles, such as the Abrams and Bradley, and Stryker families of fighting vehicles, as well as light armored (LAV) and armored security (ASV) vehicles. Optex Systems Holdings also manufactures and delivers numerous periscope configurations, rifle and surveillance sights and night vision optical assemblies. Optex Systems Holdings delivers its products both directly to the federal government and to prime contractors.

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

Specific product lines include:

- Electronic sighting systems

- Mechanical sighting systems

- Laser protected glass periscopes

- Laser protected plastic periscopes
- Non-laser protected plastic periscopes
- Howitzer sighting systems
- M36 Thermal Day / Night Periscopes
- M17 Day / Thermal Periscopes
- Ship binoculars
- Replacement optics (e.g. filters, mirrors)

Location and Facility

We are located in Richardson, TX in an approximately 49,000 square foot facility, and as of December 7, 2012, we had 74 full time equivalent employees. We operate with a single shift, and capacity could be expanded by adding a second shift. Our proprietary processes and methodologies provide barriers to entry for other competing suppliers. In many cases, we are the sole source provider or one of only two providers of a product. We have capabilities which include machining, bonding, painting, tracking, engraving and assembly and can perform both optical and environmental testing in-house.

We lease our facility. Effective as of January 4, 2010, Optex Systems Holdings, Inc. renewed its Richardson, TX lease. Under the terms of the amendment:

- The lease term is extended until July 31, 2015.
- The annual base rent rate is as follows: until 7/31/2010, \$0.00 per square foot; from 8/1/2010 – 7/31/2013, \$4.70 per square foot; and from 8/1/2013 – 7/31/2015, \$4.95 per square foot.
- A \$0.2 million improvement allowance is included.
- For the first two years of the extended term, the landlord has granted the option to take over additional space at similar terms as in the amendment.

Market Opportunity – U.S. Military

Optex Systems Holdings believes the U.S. government's commitment to military defense spending in the coming years will remain strong; however, in light of recent government uncertainties related to the congressional budget and current deficit spending, we cannot anticipate whether the historical trends in military spending will continue at the same pace as in prior years. The chart below was derived from public government spending sources and depicts total U.S. military spending from 2001 through 2011 and forecasted spending through 2017. It is difficult to directly tie this spending to any specific military vehicles; (with the extraordinary exception of the Mine Resistant Ambush Protected \$22 billion program funded in FY2007-2008); however, Optex Systems Holdings serves the U.S. armed forces, active duty and reserves, plus various state national guards. The purpose of including this chart is to provide the reader with actual trend data showing military spending by the government from 2001 through 2011. The total military spending increased from \$290.2 billion in 2001 to \$678.1 billion in 2011 representing a total increase in military spending of 233.7% in the last 11 years. However, unlike the trend previously depicted in this chart, we have experienced reduced spending in 2012 and given anticipated reductions in spending by the U.S. military in the coming years, Optex Systems Holdings continues to aggressively pursue international opportunities in addition to maintaining its current footprint with U.S. vehicle manufactures. We are now bidding on several substantial government contracts to expand sales and production beyond the current production and backlog. For example, Optex Systems Holdings is supporting General Dynamics Land Systems in their efforts related to the production of the Israeli Namer Armored Personnel Carrier (aka Merkava APC). In this opportunity, General Dynamics Land Systems is contracting for the production of 386 vehicles which contain a "Periscope Kit" which could be supplied by Optex Systems Holdings. This kit would contain seven periscopes and sixteen additional supporting part numbers. Optex Systems Holdings will continue to pursue international opportunities through direct sales (e.g., General Dynamics Land Systems – Canada) and through existing customers (e.g., General Dynamics Land Systems – Israeli Namer Project). We are also exploring possibilities to adapt some of our products for commercial use in those markets that demonstrate potential for solid revenue growth, both domestically and internationally.

Source: Government Printing Office, U.S. Budget Historical Tables, FY 2011, Table 3.2 Outlays by function and subfunction, 1962-2017

The following factors are important to the U.S. military:

- Reliability – failure can cost lives

- Time delivery to schedule

- System life cycle extension

- Low cost/best value

- Visual aids for successful execution of mission objectives

- Mission critical products specifically related to soldier safety.

Optex Systems Holdings focuses on delivering products that satisfy these factors and believes it is well positioned to continue to service U.S. and foreign military needs.

Market Opportunity – Commercial

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

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Big Eye Binoculars – While the military application we produce is based on mature military designs, Optex Systems Holdings owns all castings, tooling and glass technology. These large fixed mount binoculars could be sold to cruise ships, personal yachts and cities/municipalities.

Night Vision Sight – Optex Systems Holdings has manufactured the optical system for the NL-61 Night Vision Sight for the Ministry of Defense of Israel. This technology could be implemented for commercial applications.

Infrared Imaging Equipment – Optex Systems Holdings manufactures and assembles infrared imaging equipment and components for Raytheon’s Thermal Imaging M36 Mount product and has recently added a low-cost, uncooled, thin film, thermal imager through its partnership with Bridge Semiconductor (Pittsburgh, PA). This combined equipment and technology has potential applications with the border patrol, police and governmental or commercial security agencies.

Customer Base

Optex Systems Holdings serves customers in three primary categories: as prime contractor (TACOM Life Cycle Command, DLA (Defense Logistics Agency) Warren, U.S. Army, Navy and Marine Corps), as subcontractor (General Dynamics, BAE, and NorcaTec) and also as a supplier to foreign governments (Israel, Australia and NAMSA). Although we do serve all three of these categories, for the twelve months ended September 30, 2012, we derived approximately 97% of our gross business revenue from three customers: 83% from General Dynamics Land Systems Divisions, 10% from the U.S. Government (primarily DLA), and 4% from BAE Systems (with which we have approximately 80 discrete contracts for items that are utilized in vehicles, product lines and spare parts). Given the size of General Dynamics Land System Division, DLA and BAE as well as the fact that there are multiple contracts with each entity, which are not interdependent, we are of the opinion that this provides us with a fairly well diversified revenue pool.

Marketing Plan

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

Historically, Optex Systems Holdings competed with two other companies in different spaces. First, Optex Systems Holdings previously competed with Miller-Holzwarth in the plastic periscope business. In July 2012, Miller-Holzwarth, Inc. ceased operations apparently as a result of an inability to meet its financial obligations combined with a decline in defense market conditions. Second, Optex Systems Holdings currently competes with Seiler Instruments for fire control products. These contracts are higher value products, but lower quantities. Given the expense of development and qualification testing, the barrier to entry is high for new competitors. Currently, the business is in receivership and the ultimate business and contract disposition is yet to be determined. However, overall

plastic periscope demand quantities have declined in the last twelve months, while competition on the lower level periscope products has significantly increased as Optex Systems Holdings and a few new foreign contractors have aggressively competed for market share amongst the existing customer base and quantities.

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

Substitutes – Low Risk to Optex Systems Holdings. Optex Systems Holdings has both new vehicle contracts and replacement part contracts for the exact same product. The U.S. government has declared that the Abrams/Bradley base vehicles will be the ground vehicle of choice through 2040. The Bradley vehicle has been in service for 28 years, the Abrams for 27 years. . In February 2008, the U.S. Army signed a multiyear third party contract for the delivery of improved Abrams and Bradleys. The contract is for up to 435 tanks and 540 Bradley vehicles. These are the only production tanks currently in production by the government. This, in conjunction with the 30 year life span, supports their continued use through 2040. The Abrams is the principal battle tank of the United States Army and Marine Corps, and the armies of Egypt, Kuwait, Saudi Arabia, and since 2007, Australia. The new contract terms allow efficiencies within the supply chain and a very long return on investment on new vehicle proposals. There is a new Ground Combat Vehicle in development that will ultimately supplement or replace the Bradley vehicles. The U.S. Army is waiting to receive prototype vehicles from different bidders to begin testing. The U.S. Army intends to replace about 40 percent of the Bradleys in its heavy combat brigades with new Ground Combat Vehicles and has an initial acquisition goal of 1,874 vehicles with the production of the vehicle anticipated to start in 2018.

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

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