

Inrad Optics, Inc.
Form 10-Q
November 14, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended **SEPTEMBER 30, 2018**

OR

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

For the transition period from _____ to _____

Commission file number **0-11668**

INRAD OPTICS, INC.

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(Exact name of registrant as specified in its charter)

| | |
|---|--|
| <u>New Jersey</u> | <u>22-2003247</u> |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |

181 Legrand Avenue, Northvale, NJ 07647
(Address of principal executive offices)
(Zip Code)

(201) 767-1910
(Registrant's telephone number, including area code)

(Former name, former address and formal fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the 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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

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

Yes No

The number of shares of the registrant's common stock outstanding, \$0.01 par value, as of November 14, 2018 was 13,627,888

INRAD OPTICS, INC AND SUBSIDIARIES

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INRAD OPTICS, INC AND SUBSIDIARIES**CONDENSED CONSOLIDATED BALANCE SHEETS**

| | September 30, 2018 (Unaudited) | December 31, 2017 |
|---|--------------------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 890,409 | \$ 799,953 |
| Accounts receivable (net of allowance for doubtful accounts of \$15,000 in 2018 and 2017) | 1,532,296 | 1,034,398 |
| Inventories, net | 2,873,288 | 3,196,001 |
| Other current assets | 126,699 | 127,900 |
| Total current assets | 5,422,692 | 5,158,252 |
| Plant and equipment: | | |
| Plant and equipment, at cost | 14,672,634 | 14,726,638 |
| Less: Accumulated depreciation and amortization | (14,010,669) | (14,013,850) |
| Total plant and equipment | 661,965 | 712,788 |
| Precious Metals | 562,347 | 563,760 |
| Intangible Assets, net | 40,615 | 70,219 |
| Other Assets | 24,240 | 37,486 |
| Total Assets | \$ 6,711,859 | \$ 6,542,505 |
| Liabilities and Shareholders' Equity | | |
| Current Liabilities: | | |
| Current portion of other long term notes | \$ 12,486 | \$ 12,486 |
| Accounts payable and accrued liabilities | 734,090 | 1,217,157 |
| Contract liabilities | 800,452 | 869,677 |
| Total current liabilities | 1,547,028 | 2,099,320 |
| Related Party Convertible Notes Payable | 2,500,000 | 2,500,000 |
| Other Long Term Notes, net of current portion | 248,430 | 257,738 |
| Total liabilities | 4,295,458 | 4,857,058 |
| Commitments | | |
| Shareholders' Equity: | | |
| Common stock: \$.01 par value; 60,000,000 authorized shares; 13,632,488 shares issued at September 30, 2018 and 13,521,200 shares issued at December 31, 2017 | 136,326 | 135,213 |
| Capital in excess of par value | 19,026,945 | 18,882,086 |

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| | | |
|---|---------------|---------------|
| Accumulated deficit | (16,731,920) | (17,316,902) |
| | 2,431,351 | 1,700,397 |
| Less - Common stock in treasury, at cost (4,600 shares) | (14,950) | (14,950) |
| Total shareholders' equity | 2,416,401 | 1,685,447 |
| Total Liabilities and Shareholders' Equity | \$ 6,711,859 | \$ 6,542,505 |

See Notes to Condensed Consolidated Financial Statements (Unaudited)

INRAD OPTICS, INC AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|---|---|--------------|--|---------------|
| | | 2017 | | |
| Total revenue | \$ 2,788,863 | \$ 2,529,623 | \$ 8,814,767 | \$ 7,300,874 |
| Cost and expenses: | | | | |
| Cost of goods sold | 1,862,879 | 1,891,036 | 6,459,987 | 5,926,224 |
| Selling, general and administrative expenses | 579,254 | 638,590 | 1,648,325 | 1,821,219 |
| | 2,442,133 | 2,529,626 | 8,108,312 | 7,747,443 |
| Income (loss) from operations | 346,730 | (3) | 706,455 | (446,569) |
| Other expense: | | | | |
| Interest expense—net | (40,015) | (39,860) | (119,185) | (120,819) |
| Loss on exchange of precious metals | — | — | (2,288) | — |
| | (40,015) | (39,860) | (121,473) | (120,819) |
| Income (loss) before income taxes | 306,715 | (39,863) | 584,982 | (567,388) |
| Income tax (provision) benefit | — | — | — | — |
| Net income (loss) | \$ 306,715 | \$ (39,863) | \$ 584,982 | \$ (567,388) |
| Net income (loss) per common share — basic | \$ 0.02 | \$ (0.00) | \$ 0.04 | \$ (0.04) |
| Net income (loss) per common share — diluted | \$ 0.02 | \$ (0.00) | \$ 0.04 | \$ (0.04) |
| Weighted average shares outstanding— basic | 13,627,888 | 13,508,267 | 13,541,331 | 13,318,228 |
| Weighted average shares outstanding— diluted | 13,992,925 | 13,508,267 | 13,921,616 | 13,318,228 |

See Notes to Condensed Consolidated Financial Statements (Unaudited)

INRAD OPTICS, INC AND SUBSIDIARIES**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

| | Nine Months Ended September 30, | |
|---|------------------------------------|-------------|
| | 2018 | 2017 |
| Cash flows from operating activities: | | |
| Net income (loss) | \$584,982 | \$(567,388) |
| Adjustments to reconcile net income (loss) to net cash provided (used in) operating activities: | | |
| Depreciation and amortization | 210,502 | 282,046 |
| Loss on exchange of precious metals | 2,288 | — |
| 401K common stock contribution - non cash item | 92,780 | 124,289 |
| Stock based compensation | 53,192 | 44,547 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (497,898) | (75,137) |
| Inventories, net | 322,713 | (410,966) |
| Other current assets | 1,201 | 53,458 |
| Other assets | 13,246 | (7,960) |
| Accounts payable and accrued liabilities | (483,067) | 172,817 |
| Contract Liabilities | (69,225) | 178,239 |
| Total adjustments and changes | (354,268) | 361,333 |
| Net cash provided (used in) operating activities | 230,714 | (206,055) |
| Cash flows from investing activities: | | |
| Capital expenditures | (130,075) | (94,804) |
| Purchase of precious metals | (875) | — |
| Net cash (used in) investing activities | (130,950) | (94,804) |
| Cash flows from financing activities: | | |
| Principal payments on notes payable-other | (9,308) | (105,243) |
| Net cash (used in) financing activities | (9,308) | (105,243) |
| Net increase (decrease) in cash and cash equivalents | 90,456 | (406,102) |
| Cash and cash equivalents at beginning of period | 799,953 | 973,333 |
| Cash and cash equivalents at end of period | \$890,409 | \$567,231 |
| Supplemental Disclosure of Cash Flow Information: | | |
| Interest paid | \$105,490 | \$122,278 |
| Income taxes paid | \$— | \$1,050 |

See Notes to Condensed Consolidated Financial Statements (Unaudited)

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INRAD OPTICS, INC AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Inrad Optics, Inc. and its subsidiaries (collectively, the “Company”). All significant intercompany balances and transactions have been eliminated.

The condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments of a normal recurring nature considered necessary for a fair presentation have been included. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for the full fiscal year. For further information, refer to the consolidated financial statements and accompanying footnotes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

In preparing these consolidated financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through the date the consolidated financial statements were issued.

Management Estimates

These unaudited condensed consolidated financial statements and related disclosures have been prepared in conformity with U.S. GAAP which requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses reported in those financial statements. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including

the current economic environment, and makes adjustments when facts and circumstances dictate. As future events and their effects cannot be determined with precision, actual results could differ significantly from those estimates and assumptions. Significant changes, if any, in those estimates resulting from continuing changes in the economic environment will be reflected in the consolidated financial statements in future periods.

Accounts Receivable

Accounts receivable are carried at net realizable value, net of write-offs and allowances. The Company establishes an allowance for doubtful accounts based on estimates as to the collectability of accounts receivable. Management specifically analyzes past-due accounts receivable balances and, additionally, considers bad debt history, customer credit-worthiness, current economic trends and changes in customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Uncollectible accounts receivable are written-off when it is determined that the balance will not be collected. Reserves for uncollectible accounts receivable are recorded as part of selling, general and administrative expenses in the Consolidated Statements of Operations, and were approximately \$15,000 at September 30, 2018.

Inventories

Inventories are stated at the lower of cost (first-in-first-out basis) and net realizable value. The Company records a reserve for slow moving inventory as a charge against earnings for all products identified as surplus, slow-moving or discontinued. Excess work-in-process costs are charged against earnings whenever estimated costs-of-completion exceed unbilled revenues.

Inventories are comprised of the following and are shown net of inventory reserves, in thousands:

| | September 30, 2018 (Unaudited) | December 31, 2017 |
|--|--------------------------------------|----------------------|
| Raw materials | \$ 1,000 | \$ 1,174 |
| Work in process, including manufactured parts and components | 1,398 | 1,462 |
| Finished goods | 475 | 560 |
| | \$ 2,873 | \$ 3,196 |

Income Taxes

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Deferred tax assets and liabilities are determined based on the difference between the financial statements carrying amounts and the tax basis of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse.

In evaluating the Company's ability to recover deferred tax assets in future periods, management considers the available positive and negative factors, including the Company's recent operating results, the existence of cumulative losses and near term forecasts of future taxable income consistent with the plans and estimates that management uses to manage the underlying business. A significant piece of objective negative evidence evaluated was the cumulative loss incurred by the Company over the three year period ended December 31, 2017. Such objective evidence limits the ability to consider other subjective evidence such as our projections for future growth.

On the basis of this evaluation as of September 30, 2018, the Company's management concluded that it is more likely than not that the Company will not be able to realize any portion of the benefit on the net deferred tax balance of \$3,380,000 and therefore the Company continues to maintain a valuation allowance for the full amount of the net deferred tax balance. When sufficient positive evidence exists, the Company's income tax expense will be charged with the increase or decrease in its valuation allowance. An increase or reversal of the Company's valuation allowance could have a significant negative or positive impact on the Company's future earnings.

For the three and nine months ended September 30, 2018, the Company did not record a current provision for income taxes due to the availability of net operating loss carryforwards to offset taxable income for both federal and state tax purposes.

The Tax Cuts and Jobs Act was enacted on December 22, 2017. The Tax Act eliminates alternative minimum taxes and lowers the U.S. federal corporate income tax from 34% to 21% effective January 1, 2018. At December 31, 2017, the Company re-measured its net deferred tax assets using the new Federal Tax Rate and posted a one-time reduction of \$1,765,000 in deferred tax assets and \$1,765,000 to the valuation allowance to reflect the lower realization rate to be applied commencing in 2018.

Net Income (Loss) per Common Share

Basic net income (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares and common stock equivalents outstanding, calculated on the treasury stock method for options, stock grants and warrants using the average market prices during the period, including potential common shares issuable upon conversion of outstanding convertible notes, except if the effect on the per share amounts is anti-dilutive.

For the three and nine months ended September 30, 2018, a total of 2,500,000 common shares and 1,875,000 common shares from warrants issuable upon conversion of outstanding convertible notes were excluded from the computation of diluted net income per common share because their effect is anti-dilutive.

For the three and nine months ended September 30, 2017, all common stock equivalents were excluded from the computation of diluted net loss per share because their effect is anti-dilutive. This included 2,500,000 common shares and 1,875,000 common shares from warrants issuable upon conversion of outstanding convertible notes, in addition to 911,341 common stock options, in each respective period.

A reconciliation of the shares used in the calculation of basic and diluted earnings (loss) per common share is as follows:

| | Three Months Ended September 30, 2018 | | | Three Months Ended September 30, 2017 | | |
|---|--|-------------------------|---------------------|--|-------------------------|---------------------|
| | Income(Loss) (Numerator) | Shares (Denominator) | Per Share Amount | Income(Loss) (Numerator) | Shares (Denominator) | Per Share Amount |
| Basic Income (Loss) Per Share: | | | | | | |
| Net Income (Loss) | \$306,715 | 13,627,888 | \$ 0.02 | \$(39,863) | 13,508,267 | \$ (0.00) |
| Effect of dilutive securities: | | | | | | |
| Convertible Notes | — | — | | — | — | |
| Accrued Interest on Convertible Notes | — | — | | — | — | |
| Warrants | — | — | | — | — | |
| Stock Options | — | 365,037 | | — | — | |
| Diluted Income (Loss) Per Share: | \$306,715 | 13,992,925 | \$ 0.02 | \$(39,863) | 13,508,267 | \$ (0.00) |
| | | | | | | |
| | Nine Months Ended September 30, 2018 | | | Nine Months Ended September 30, 2017 | | |
| | Income(Loss) (Numerator) | Shares (Denominator) | Per Share Amount | Income(Loss) (Numerator) | Shares (Denominator) | Per Share Amount |
| Basic Income (Loss) Per Share: | | | | | | |
| Net Income (Loss) | \$584,981 | 13,541,331 | \$ 0.04 | \$(567,387) | 13,318,228 | \$ (0.04) |
| Effect of dilutive securities: | | | | | | |
| Convertible Notes | — | — | | — | — | |
| Accrued Interest on Convertible Notes | — | — | | — | — | |
| Warrants | — | — | | — | — | |
| Stock Options | — | 380,285 | | — | — | |
| Diluted Income (Loss) Per Share: | \$584,981 | 13,921,616 | \$ 0.04 | \$(567,387) | 13,318,228 | \$ (0.04) |

Stock-Based Compensation

Stock-based compensation expense is estimated at the grant date based on the fair value of the award. The Company estimates the fair value of stock options granted using the Black-Scholes option pricing model. The fair value of restricted stock units granted is based on the closing market price of the Company's common stock on the date of the grant. The fair value of these awards, adjusted for estimated forfeitures, is amortized over the requisite service period

of the award, which is generally the vesting period.

Recently Adopted Accounting Standards

In May 2014, the FASB issued Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”), which supersedes the revenue recognition requirements in ASC 605, “Revenue Recognition.” ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. It also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue, cash flows arising from customer contracts, including significant judgments and changes in judgments, and assets recognized from costs incurred to obtain or fulfill a contract. ASU 2014-09 is effective for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. The Company adopted the provisions of ASU 2014-09 on January 1, 2018, using the modified retrospective approach. Revenue from the Company’s sales continue to generally be recognized either when products are shipped (i.e. point in time) or under certain long-term government contracts, as the Company transfers control of the product or service to its customers (i.e. over time), which approximates the previously used percentage-of-completion method of accounting. As such, the adoption of ASU 2014-09 had no material impact to the Company’s financial position or results of operations; however, the Company has now presented the disclosures required by this new standard, refer to Note 2.

In February 2016, the FASB created Topic 842 and issued ASU 2016-02, Leases. The guidance in this update supersedes Topic 840, Leases. This ASU requires lessees to recognize a right-of-use assets and a lease liability, initially measured at the present value of the lease payments on the balance sheet. For public companies, the amendments will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Earlier application is permitted. The Company is currently evaluating the impact of the adoption of ASU 2016-02 on its financial statements and disclosure.

In June 2018, the FASB issued ASU No. 2018-07, Compensation-Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, which largely aligns the measurement and classification guidance for share-based payments to nonemployees with the guidance for share-based payments to employees. The ASU also clarifies that any share-based payment issued to a customer should be evaluated under ASC 606, Revenue from Contracts with Customers. The ASU requires a modified retrospective transition approach. This new guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. We do not expect the adoption of this accounting standard update to have a material impact on our consolidated financial statements.

NOTE 2 – REVENUE

The Company’s revenues are comprised of product sales as well as products and services provided under long-term government contracts with its customers. All revenue is recognized when the Company satisfies its performance

obligation(s) under the contract (either implicit or explicit) by transferring the promised product or service to its customer either when (or as) its customer obtains control of the product or service. A performance obligation is a promise in a contract to transfer a distinct product or service to a customer. A contract's transaction price is allocated to each distinct performance obligation. The majority of the Company's contracts have a single performance obligation, as the promise to transfer products or services is not separately identifiable from other promises in the contract and, therefore, not distinct. For contracts with multiple performance obligations, the Company allocates the contract's transaction price to each performance obligation using the Company's best estimate of standalone selling price for each distinct product or service in the contract, which is generally based on an observable price.

Revenue is measured as the amount of consideration the Company expects to receive in exchange for transferring products or providing services. As such, revenue is recorded net of returns, allowances, customer discounts, and incentives. Sales, value added, and other taxes collected from customers and remitted to governmental authorities are accounted for on a net (excluded from revenues) basis. Shipping and handling costs are included in cost of goods sold.

The Company's performance obligations under long-term government contracts are generally satisfied over time. Revenue from products or services transferred to customers over time accounted for approximately 5.27% and 1.31% of revenue for the nine months ended September 30, 2018 and 2017, respectively. Revenue under these long-term government contracts are generally recognized over time using an input measure based upon the proportion of actual costs incurred to estimated total project costs, which is a method used to best depict the Company's performance to date under the terms of the contract.

Accounting for these long-term government contracts involves the use of various techniques to estimate total revenue and costs. The Company estimates profit on these long-term government contracts as the difference between total estimated revenue and expected costs to complete a contract and recognizes that profit over the life of the contract. Contract estimates are based on various assumptions to project the outcome of future events that may span several years. These assumptions include, among other things, labor productivity, costs and availability of materials, and timing of funding by the U.S. government. The nature of these long-term agreements may give rise to several types of variable consideration, such as claims, awards and incentive fees. Historically, these amounts of variable consideration are not considered significant. Additionally, contract estimates may include additional revenue for submitted contract modifications if there exists an enforceable right to the modification, the amount can be reasonably estimated and its realization is probable. These estimates are based on historical collection experience, anticipated performance, and the Company's best judgement at the time. These amounts are generally included in the contract's transaction price and are allocated over the remaining performance obligations. Changes in judgments on these above estimates could impact the timing and amount of revenue recognized with a resulting impact on the timing and amount of associated income. Under these long-term government contracts, the Company may receive payments from customers based upon contractual billing schedules; accounts receivable are recorded when the right to consideration becomes unconditional. In the event a contract loss becomes known, the entire amount of the estimated loss is recognized in the Consolidated Statements of Operations.

The majority of the Company's revenue is from products and services transferred to customers at a point in time and were approximately 94.73% and 98.69% of revenue for the nine months ended September 30, 2018 and 2017, respectively. The Company recognizes revenue at the point in time in which the customer obtains control of the product or service, which is generally when product title passes to the customer upon shipment. In limited cases, title does not transfer and revenue is not recognized until the customer has received the products at its physical location.

As part of the adoption of Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers (Topic 606)", the Company reviewed its sales by market area and reassigned certain customers within the existing markets. In addition, the Universities and National Lab market was renamed to Scientific/R&D. Sales by market area, as previously presented for the nine months ended September 30, 2017, were reclassified accordingly.

The following table summarizes the Company's sales by market area:

| | Nine Months Ended | |
|-----------------------------|-------------------|-------------|
| | September 30, | |
| | 2018 | 2017 |
| Aerospace & Defense | \$1,947,759 | \$2,398,218 |
| Process Control & Metrology | 4,463,700 | 2,947,569 |
| Laser Systems | 1,202,034 | 802,460 |
| Scientific / R&D | 1,201,274 | 1,152,627 |
| Total | \$8,814,767 | \$7,300,874 |

Net sales by timing to transfers of goods and services is as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------|----------------------------------|--------------|---------------------------------|--------------|
| | 2018 | 2017 | 2018 | 2017 |
| Transfer at point in time | \$ 2,630,851 | \$ 2,522,890 | \$ 8,350,606 | \$ 7,205,072 |
| Transfer over time | 158,013 | 6,733 | 464,161 | 95,802 |
| Total net sales | \$ 2,788,863 | \$ 2,529,623 | \$ 8,814,767 | \$ 7,300,874 |

The timing of revenue recognition, billings and cash collections results in billed receivables, costs in excess of billings (contract assets), and billings in excess of costs (contract liabilities, previously deferred revenue) on the Consolidated Balance Sheet. Contract liabilities additionally include customer advances or prepayments. Costs in excess of billings and billings in excess of costs associated with long-term government contracts were not significant at September 30, 2018 or 2017. Revenue recognized during the nine months ended September 30, 2018 and 2017 that was included in contract liabilities at the beginning of the period was approximately \$386,000 and \$86,000, respectively.

On September 30, 2018, the Company has approximately \$6,251,000 of remaining performance obligations, which is also referred to as backlog. Approximately 1% of the September 30, 2018 backlog is related to projects that will extend beyond September 30, 2019.

NOTE 3- EQUITY COMPENSATION PROGRAM AND STOCK BASED COMPENSATION

a) Stock Option Expense

The Company's results of operations for the three months ended September 30, 2018 and 2017 include stock-based compensation expense for stock option grants totaling \$27,191 and \$14,975, respectively. Such amounts have been included in the accompanying Condensed Consolidated Statements of Operations within cost of goods sold in the amount of \$7,598 (\$4,027 for 2017), and selling, general and administrative expenses in the amount of \$19,593 (\$10,948 for 2017).

The Company's results of operations for the nine months ended September 30, 2018 and 2017 include stock-based compensation expense for stock option grants totaling \$53,192 and \$44,547, respectively. Such amounts have been included in the accompanying Condensed Consolidated Statements of Operations within cost of goods sold in the amount of \$14,695 (\$12,274 for 2017) and selling, general and administrative expenses in the amount of \$38,497

(\$32,273 for 2017).

As of September 30, 2018 and 2017, there were \$207,725 and \$104,467 of unrecognized compensation cost, net of estimated forfeitures, related to non-vested stock options, which are expected to be recognized over a weighted average period of approximately 1.7 years and 1.5 years, respectively.

There were 175,000 and 180,000 stock options granted during the nine months ended September 30, 2018 and 2017 respectively. The following range of weighted-average assumptions were used to determine the fair value of stock option grants during the nine months ended September 30, 2018 and 2017:

| | Nine Months Ended | | | |
|-------------------------|-------------------|------|----------|---|
| | September 30, | | | |
| | 2018 | 2017 | | |
| Expected Dividend yield | — | % | — | % |
| Expected Volatility | 140 | % | 133-134 | % |
| Risk-free interest rate | 2.6 | % | 2.2-2.3 | % |
| Expected term | 10 years | | 10 years | |

b) Stock Option Activity

The following table represents stock options granted, exercised and forfeited during the nine months ended September 30, 2018:

| Stock Options | Number of Options | Weighted Average Exercise Price per Option | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value |
|-----------------------------------|--------------------------|---|--|----------------------------------|
| Outstanding at January 1, 2018 | 903,008 | \$.58 | 5.2 | \$ 648,410 |
| Granted | 175,000 | 1.00 | | |
| Exercised | — | — | | |
| Expired/Forfeited | (9,000) | .98 | | |
| Outstanding at September 30, 2018 | 1,069,008 | \$.65 | 5.8 | \$ 322,144 |
| Exercisable at September 30, 2018 | 719,517 | \$.59 | 3.7 | \$ 281,748 |

The following table represents non-vested stock options granted, vested and forfeited for the nine months ended September 30, 2018.

| | Options | Weighted-Average Grant-Date Fair Value (\$) |
|---------------------------------|----------------|--|
| Non-vested - January 1, 2018 | 330,495 | .44 |
| Granted | 175,000 | .98 |
| Vested | (156,004) | .38 |
| Forfeited | — | — |
| Non-vested – September 30, 2018 | 349,491 | .74 |

NOTE 4- STOCKHOLDERS' EQUITY

The Company approved a matching contribution to participants in the Inrad Optics 401k Plan (the "Plan") for the year ended December 31, 2017. In total, cash in the amount of \$30,926 and 111,288 common shares of Inrad Optics, Inc. with an equivalent value of \$92,779 was contributed to the Plan in June 2018.

NOTE 5 – RELATED PARTY TRANSACTIONS

On April 12, 2018, the maturity dates of a \$1,500,000 Subordinated Convertible Promissory Note to Clarex Limited (“Clarex”) and a \$1,000,000 Subordinated Convertible Promissory Note to an affiliate of Clarex were each extended to April 1, 2021 from April 1, 2019. The notes bear interest at 6%. Interest accrues yearly and is payable on maturity. Unpaid interest, along with principal, may be converted into securities of the Company as follows: the notes are convertible in the aggregate into 1,500,000 units and 1,000,000 units, respectively, with each unit consisting of one share of common stock and one warrant. Each warrant allows the holder to acquire 0.75 shares of common stock at a price of \$1.35 per share. As part of the agreement, the expiration dates of the warrants were extended from April 1, 2022 to April 1, 2024. As of September 30, 2018, the Company had accrued interest in the amount of \$75,500 associated with these notes.

NOTE 6 – OTHER LONG TERM NOTES

Other Long Term Notes consist of the following:

| | September 30, 2018 | December 31, 2017 |
|--|--------------------------|-------------------------|
| | (in thousands) | |
| U.S. Small Business Administration term note payable in equal monthly installments of \$1,922 and bearing an interest rate of 4.0% and expiring in April 2032. | 260 | 270 |
| Less current portion | (12) | (12) |
| Long-term debt, excluding current portion | \$ 248 | \$ 258 |

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

Caution Regarding Forward Looking Statements

This Quarterly Report contains forward-looking statements as that term is defined in the federal securities laws. The Company wishes to insure that any forward-looking statements are accompanied by meaningful cautionary statements in order to comply with the terms of the safe harbor provided by the Private Securities Litigation Reform Act of 1995. The events described in the forward-looking statements contained in this Quarterly Report may not occur. Generally, these statements relate to business plans or strategies, projected or anticipated benefits or other consequences of the Company's plans or strategies, projected or anticipated benefits of acquisitions made by the Company, projections involving anticipated revenues, earnings, or other aspects of the Company's operating results. The words "may", "will", "expect", "believe", "anticipate", "project", "plan", "intend", "estimate", and "continue", and their opposites and similar expressions are intended to identify forward-looking statements. The Company cautions you that these statements are not guarantees of future performance or events and are subject to a number of uncertainties, risks, and other influences, many of which are beyond the Company's control, that may influence the accuracy of the statements and the projections upon which the statements are based. Factors which may affect the Company's results include, but are not limited to, the risks and uncertainties discussed in Items 1A, 7 and 7A of the Company's most recent Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the Securities and Exchange Commission on April 2, 2018. Any one or more of these uncertainties, risks, and other influences could materially affect the Company's results of operations and whether forward-looking statements made by the Company ultimately prove to be accurate. Readers are further cautioned that the Company's financial results can vary from quarter to quarter, and the financial results for any period may not necessarily be indicative of future results. The foregoing is not intended to be an exhaustive list of all factors that could cause actual results to differ materially from those expressed in forward-looking statements made by the Company. The Company's actual results, performance and achievements could differ materially from those expressed or implied in these forward-looking statements. The Company undertakes no obligation to publicly update

or revise any forward looking statements, whether from new information, future events, or otherwise.

Critical Accounting Policies and Estimates

Our significant accounting policies are described in Note 1 of the accompanying consolidated financial statements and further discussed in our annual financial statements included in our annual report on Form 10-K for the year ended December 31, 2017. In preparing our condensed consolidated financial statements, we made estimates and judgments that affect the results of our operations and the value of assets and liabilities we report. These include estimates used in evaluating intangibles for impairment such as market multiples used in determining the fair value of reporting units, discount rates applicable in determining net present values of future cash flows, projections of future sales, earnings and cash flow and capital expenditures. It also includes estimates about the amount and timing of future taxable income in determining the Company's valuation allowance for deferred income tax assets. Our actual results may differ from these estimates under different assumptions or conditions.

For additional information regarding our critical accounting policies and estimates, see the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our annual report filed with the Securities and Exchange Commission on Form 10-K for the year ended December 31, 2017.

Results of Operations

Inrad Optics, Inc.’s business falls into two main categories: Optical Components and Laser Devices/Instrumentation.

The Optical Components category is focused on custom optics manufacturing. The Company specializes in high-end precision components. It develops, manufactures and delivers precision custom optics and thin film optical coating services through its Custom and Metal Optics operations. Glass, metal, and crystal substrates are processed using modern manufacturing equipment, complex processes and techniques to manufacture components, deposit optical thin films, and assemble sub-components used in advanced photonic systems. The majority of custom optical components and optical coating services supplied are used in inspection, process control systems, defense and aerospace electro-optical systems, laser system applications, industrial scanners, and medical system applications.

The Laser Devices/Instrumentation category includes the growth and fabrication of crystalline materials with electro-optic (EO) and non-linear optical properties for use in both standard and custom products. This category also includes the manufactured crystal based devices and associated instrumentation. The majority of crystals, crystal components and laser devices manufactured are used in laser systems, defense EO systems, medical lasers and R&D applications by engineers within corporations, universities and national laboratories.

The Company operates a manufacturing facility in Northvale, New Jersey and has its corporate offices in the same location.

Revenue

Sales for the three months ended September 30, 2018 increased by 10.2% to \$ 2,789,000 from \$2,530,000 for the comparable period last year. For the nine months ended September 30, 2018, sales were \$ 8,815,000, an increase of 20.7%, compared to \$7,301,000 for the nine months ended September 30, 2017.

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Sales to the defense/aerospace market decreased by \$422,000 or 44.7% to \$522,000 in the three months ended September 30, 2018 compared to \$944,000 in the comparable period last year. For the nine months ended September 30, 2018, sales were \$1,948,000, a decrease of 18.8%, compared to \$2,398,000 for the nine months ended September 30, 2017. The decrease in defense/aerospace market due to decrease in sales to multiple customers.

Process control and metrology (“PC&M”) sales were \$1,350,000, up \$307,000, or 29.5%, for the three months ended September 30, 2018 from the comparable period last year. For the nine months ended September 30, 2018, PC&M sales were \$4,464,000, up 51.4%, compared to \$2,948,000 for the nine months ended September 30, 2017. Higher overall demand in the PC&M market resulted in sales increases to several large existing accounts in the three and nine months ended September 30, 2018, compared to the same period last year.

For the three months ended September 30, 2018, sales to customers in the laser systems market were \$324,000, up \$87,000 or 37% from \$237,000 in the comparable period in 2017. For nine months ended September 30, 2018, sales in the laser systems market were \$1,202,000 an increase by 49.8% compared to \$802,000 in the same period in 2017. Shipments to one new customer in the second quarter of 2018 contributed to the overall increase.

Sales to customers in the Scientific/R&D market (formerly Universities & National Labs) were \$593,000 up \$286,000 or 93.5% for the three months ended September 30, 2018 from the comparable period last year. For the nine months ended September 30, 2018, sales were \$1,201,000 an increase of \$48,000 or 4.2% compared to \$1,153,000 for the nine months ended September 30, 2017. This resulted from an increase of shipments to National Laboratories.

For the nine months ended September 30, 2018, two customers in the process control and metrology market represented 10% or more of total sales. For the nine months ended September 30, 2017, two customers each represented 10% or more of total sales. One customer was in the process control and metrology market and the other customer was in the defense/aerospace market.

The Company's top five customers represented 54.5% of sales in the three month period ended September 30, 2018, compared to 46.1% in the same period in 2017. For the nine months ended September 30, 2018 the top five customers represented 53.3% of sales compared to 45.3% for the same period in 2017.

Orders booked during the first nine months of 2018 totaled \$8.6 million compared with \$8.3 million in the same period last year.

Order backlog was \$6.3 million at September 30, 2018, compared to \$7.3 million at September 30, 2017.

Cost of Goods Sold

For the three months ended September 30, 2018 and 2017, cost of goods sold was \$1,863,000 and \$1,891,000 respectively, a decrease of \$28,000 or approximately 1.47%. This represented 66.8% and 74.8% of sales, respectively.

For the nine months ended September 30, 2018, cost of goods sold were \$6,460,000, an increase of \$534,000 or 9.1% compared to \$5,926,000 in the same period in 2017. The increase was mainly attributable to higher sales in the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. Cost of goods sold decreased, as a percentage of sales for the nine months ended September 30, 2018 compared to 2017, representing 73.3% and 81.2%, respectively. The decrease is primarily due to products mix.

Material costs increased by \$65,000 or 15% in the three months ended September 30, 2018 compared to the same period last year. For the nine months ended September 30, 2018 and 2017, material costs were \$1,815,000 or 21% of sales and \$1,464,000, or 20% of sales respectively, primarily due to increase in sales and product mix.

For the three months ended September 30, 2018, manufacturing salaries and wages and related fringe benefits increased by approximately 2.7% or \$28,000 from the comparable period in 2017. For the nine months ended September 30, 2018, manufacturing salaries and wages and related fringe benefits increased by approximately 1.3% or \$40,000 from the nine months ended September 30, 2017.

Manufacturing expenses decreased by 1.9% for the three months ended September 30, 2018 compared to the same period in 2017 and decreased by 0.2% in the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017.

Gross profit for the three months ended September 30, 2018 was \$926,000 or 33.2% of sales compared to \$639,000 or 25.2% of sales in the same quarter last year. Gross profit for the nine months ended September 30, 2018 and 2017 was \$2,355,000 or 26.7% and \$1,375,000 or 18.8% of sales, respectively.

Selling, General and Administrative Expenses

Selling, general and administrative expenses (“SG&A” expenses) in the three and nine months ended September 30, 2018 amounted to \$579,000 or 20.8% of sales and \$1,648,000 or 18.7% of sales respectively. This compared to \$639,000 or 25.2% of sales and \$1,821,000 or 24.9% of sales, respectively, for the same periods in 2017.

This represented a decrease of approximately \$59,000 or 9.3% and \$173,000 or 9.5% in the three and nine months ended September 30, 2018 from the comparable period last year. The decrease is mainly attributable to lower sales salaries and legal and accounting expenses. In addition, amortization of intangible assets was lower as the asset was fully amortized in 2018.

Income (Loss) from Operations

The Company had income from operations of \$347,000 in the three months ended September 30, 2018 compared with a loss from operations \$0 in the three months ended September 30, 2017. For the nine months ended September 30, 2018, the Company's operating profit was \$706,000 compared with an operating loss of \$447,000 in the same period last year.

Other Income and Expense

Net interest expense for the third quarter of 2018 and 2017 was \$40,000 and \$40,000. Net interest expense for the nine months ended September 30, 2018 was \$119,000 compared to \$121,000 in the same period in 2017.

Income Taxes

For the three and nine months ended September 30, 2018, the Company did not record a current provision for income taxes due to the availability of net operating loss carryforwards to offset taxable income for both federal and state tax purposes.

For the three months ended September 30, 2017, the Company did not record a current provision for either state tax or federal alternative minimum tax due to the losses incurred for both income tax and financial reporting purposes.

Net Income (Loss)

The Company had a net income of \$307,000 compared to a net loss of \$40,000 in the three months ended September 30, 2018 and 2017, respectively. For the nine months ended September 30, 2018, the Company had net income of \$585,000 compared with a net loss of \$567,000 for the nine months ended September 30, 2017. Higher sales and a more profitable product mix, in the three and nine months ended September 30, 2018, combined with lower SG&A expenses were the primary factors in the increase in net income compared with the corresponding periods in the previous year.

Liquidity and Capital Resources

The Company's primary source of liquidity is cash and cash equivalents and on-going collection of accounts receivable. The Company's major use of cash in recent years has been for financing operations, for payment of accrued and current interest on convertible debt, for servicing of long term debt and for capital expenditures.

As of September 30, 2018 and December 31, 2017, the Company had cash and cash equivalents of \$890,000 and \$800,000, respectively.

On April 12, 2018, the maturity dates of a \$1,500,000 Subordinated Convertible Promissory Note to Clarex Limited ("Clarex") and a \$1,000,000 Subordinated Convertible Promissory Note to an affiliate of Clarex were each extended to April 1, 2021 from April 1, 2019. The notes bear interest at 6%. Interest accrues yearly and is payable on maturity. Unpaid interest, along with principal, may be converted into securities of the Company as follows: the notes are convertible in the aggregate into 1,500,000 units and 1,000,000 units, respectively, with each unit consisting of one share of common stock and one warrant. Each warrant allows the holder to acquire 0.75 shares of common stock at a price of \$1.35 per share. As part of the agreement, the expiration dates of the warrants were extended from April 1, 2022 to April 1, 2024. As of September 30, 2018, the Company had accrued interest in the amount of \$75,000 associated with these notes.

The following table summarizes net cash provided (used in) operating, investing and financing activities for the nine months ended September 30, 2018 and 2017:

| | Nine Months Ended | |
|--|--------------------------|-------------|
| | September 30, | |
| | 2018 | 2017 |
| | (In thousands) | |
| Net cash provided by (used in) operating activities | \$ 230 | \$ (206) |
| Net cash used in investing activities | (131) | (95) |
| Net cash used in financing activities | (9) | (105) |
| Net increase (decrease) in cash and cash equivalents | \$ 90 | \$ (406) |

Net cash provided by (used in) operating activities was \$230,000 for the nine months ended September 30, 2018 compared to net cash used in operations of (\$206,000) in the same period last year.

Net cash provided by operating activities in the nine months ended September 30, 2018 resulted primarily from reductions in accounts receivable, reductions in account payable and accrued liabilities, and lower contract liabilities.

Net cash used in investing activities was (\$131,000) during the nine months ended September 30, 2018 compared to (\$95,000) used in the same period last year mainly due to purchase of fixed assets. Net cash used in financing activities was (\$9,000) and (\$105,000) during the nine months ended September 30, 2018 and 2017, respectively, related to required principal payments on other long term notes and reflecting the maturity of a term note payable to Valley National Bank in July 2017.

Overall, cash and cash equivalents increased by \$90,000 and decreased by (\$406,000) for the nine months ended September 30, 2018 and 2017, respectively.

Management believes based on the Company's operations and its existing working capital resources together with existing cash flows, the Company has sufficient cash flows to fund operations through the next 12 months.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is a smaller reporting company and not required to provide the information required under this item.

ITEM 4. CONTROLS AND PROCEDURES

a. Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of September 30, 2018 (the “Evaluation Date”), have concluded that as of the Evaluation Date, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports we file or submit under the Exchange Act (1) is recorded, processed, summarized and reported, within the time periods specified in the Commission’s rules and forms, and (2) is accumulated and communicated to our management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow for timely decisions regarding required disclosure.

b. Changes in Internal Controls over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter 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

None.

ITEM 1A. RISK FACTORS

Not applicable

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3.

DEFAULTS UNDER SENIOR SECURITIES

None.

ITEM 4.

MINE SAFETY DISCLOSURES

Not applicable

ITEM 5. OTHER INFORMATION

None

ITEM 6.

EXHIBITS

11. An exhibit showing the computation of per-share earnings is omitted because the computation can be clearly determined from the material contained in this Quarterly Report on Form 10-Q.

31.1 Certificate of the Registrant's Chief Executive Officer, Amy Eskilson, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*

31.2 Certificate of the Registrant's Chief Financial Officer, Elias T. Kabous, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*

32.1 Certificate of the Registrant's Chief Executive Officer, Amy Eskilson, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

32.2 Certificate of the Registrant's Chief Financial Officer, Elias T. Kabous, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

101.INS XBRL Instance Document*

101.SCH XBRL Taxonomy Extension Schema*

101.CAL XBRL Taxonomy Extension Calculation Linkbase*

101.DEF XBRL Taxonomy Extension Definition Linkbase*

101.LAB XBRL Taxonomy Extension Label Linkbase*

101.PRE XBRL Taxonomy Extension Presentation Linkbase*

*Filed herewith

**Furnished herewith

SIGNATURES

Pursuant to 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.

Inrad Optics, Inc.

By: /s/ Amy Eskilson
Amy Eskilson
President and Chief Executive Officer

By: /s/ Elias T. Kabous
Elias T. Kabous
Chief Financial Officer,
Secretary and Treasurer

Date: November 14, 2018