

Optex Systems Holdings Inc
Form 10-K
December 20, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended October 1, 2017

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

For the transition period from ___ until ___

Commission File Number 000-54114

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.

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

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

Emerging growth company

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

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

The aggregate market value of the 4,535,870 shares of voting stock held by non-affiliates of the registrant based on the closing price on the OTC Markets on March 31, 2017 was \$3,220,468.

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 19, 2017 |
| Common Stock | 8,590,101 |

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 annual report. 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 Exploration, Inc. was a Delaware corporation formed on April 11, 2006 to search for available mining properties in North Central British Columbia. It entered into an option agreement in 2006 to purchase a mineral claim, and the option expired in May 2008 without any payment being made. Thus, as of May 2008, Sustut had no operating business.

As a result of the reorganization on March 30, 2009, which is described below, Optex Systems Holdings changed its name from Sustut Exploration Inc. to Optex Systems Holdings, Inc.

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 us as follows (all on a pre-split basis due to the historical context): (i) the outstanding 85,000,000 shares of Optex Systems, Inc. (Delaware) common stock were exchanged for 113,333,282 shares of our common stock, (ii) the outstanding 1,027 shares of Optex Systems, Inc. (Delaware) Series A preferred stock were exchanged for 1,027 shares of 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 (presplit) shares of us common stock. Optex Systems, Inc. (Delaware) has remained our wholly-owned subsidiary.

Current Line of Business

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

We continue to field new product opportunities from both domestic and international customers. Given continuing unrest in multiple global hot spots, the need for precision optics continues to increase. Most of these requirements are for observation and situational awareness applications; however, we continue to see requests for higher magnification and custom reticles in various product modifications. The basic need to protect the soldier while providing information about the mission environment continues to be the primary driver for these requirements.

We do not believe that the change in government administration will cause a major change in the direction of funding or product need for the U.S. military. Maintenance will still be required, and the opportunities for us to upgrade existing systems with higher performing systems will continue to present themselves. Spending levels may change, but given the mix between foreign spending, domestic/prime demand, and the more recent commercial opportunities, we do not expect any negative trends arising from political domestic changes into fiscal 2017.

Recent Events

Sileas Corp.

On June 9, 2017, Sileas Corp. ("Sileas"), a related party to us, entered into a transaction with The Longview Fund, L.P. ("Longview") to settle its February 20, 2009 note with Longview in the original principal amount of \$13,524,405 (the "Note"). The parties agreed to a conversion by Longview of \$3,358,538 of the amount due under the Note into 2,798,782 shares of Company common stock owned by Sileas and previously pledged to Longview as security with respect to the Note. Simultaneously therewith, Sileas made a \$250,000 cash payment to Longview, and Longview agreed to cancel the remaining debt of \$10,571,791 due under the Note. The remaining amount due under the Note is \$64,000 which shall be paid in cash by Sileas to Longview on a quarterly basis, upon the payment of quarterly dividends by us, over the next four calendar quarters commencing on or about June 30, 2017. In order to effect the

above, Longview also released the pledge on all of our shares owned by Sileas and previously pledged to Longview.

Simultaneously with the above, Sileas sold 800,000 shares of our common stock to Danny Schoening and Karen Hawkins at a price equal to \$314,000 (which is a discounted amount based upon recognition of years of administrative support by Mr. Schoening and Ms. Hawkins for the Company) as follows: (i) Danny Schoening: 640,000 Shares for \$200,000 plus a \$50,825 promissory note; and (ii) Karen Hawkins: 160,000 Shares for \$50,000 plus a \$12,706 promissory note. Each promissory note has a one year term, with interest at 1.18% per annum and shall be payable in four equal quarterly installments of \$12,800 for Danny Schoening and \$3,200 for Karen Hawkins, each installment payable within five business days after the payment of cash dividends by us to each of them. As a result, Sileas no longer owns any shares of our common stock.

After giving effect to the above transactions, the beneficial ownership of our equity securities by held by each of the Longview Fund, Danny Schoening and Karen Hawkins as of December 18, 2017 is follows:

The Longview Fund 2,800,132 shares or 31.1%

Danny Schoening 744,287 shares or 8.3%

Karen Hawkins shares 192,563 or 2.1%

Changes to the Board of Directors

Effective as of May 31, 2017, Charles Trego resigned as a director of us and from all appointments to Committees of our Board of Directors. On May 26, 2016, Kerry Craven resigned as one of our directors.

Effective as of June 9, 2017, Peter Benz resigned as Chairman of the Board and a Director of us. Effective as of that same date, our Board of Directors appointed Danny Schoening, its CEO and a director, as the Chairman of the Board of Directors and appointed Karen Hawkins, its CFO, and Bill Bates, the General Manager of its Applied Optics Center division, as directors. Stanley Hirschman retired as our President as of July 20, 2017.

Dividend

On July 12, 2017, we paid our holders (as of July 5, 2017) of common stock, Series C preferred stock and warrants (with the Series C preferred stock and warrants on an as converted/exercised basis) a dividend of \$.02 per share. On October 19, 2017, we paid our shareholders of record, as October 12, 2017, a cash dividend at the rate of \$0.02 per share for each share of our common stock, warrants and Series C preferred stock (on an as exercisable/convertible basis for the warrants and Series C preferred stock).

Compensation Changes

On January 21, 2016, our Board of Directors Compensation Committee held a meeting and approved the following compensation changes:

A base salary increase of 10% for Danny Schoening, CEO, and Karen Hawkins, CFO.

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A bonus payment of \$7.5 thousand awarded to Karen Hawkins for 2015 performance.

A \$10 thousand monthly director fee for Peter Benz, Chairman, effective for calendar 2016.

On November 4, 2016, our Board of Directors Compensation Committee held a meeting and approved the following compensation changes:

A bonus payment of \$48.9 thousand awarded to Danny Schoening for 2016 performance.

A bonus payment of \$35.7 thousand awarded to Karen Hawkins for 2016 performance.

On March 31, 2017, our Board of Directors Compensation Committee held a meeting and approved the following compensation changes:

A base salary increase of 4% for Danny Schoening, CEO, and Karen Hawkins, CFO.

On June 9, 2017, through Unanimous Written Consent, our Board of Directors approved the following compensation changes:

Danny Schoening's employment agreement shall be amended to increase his annual bonus from a maximum of 30% to 60% of his base salary.

A \$10 thousand monthly board advisory fee for Peter Benz (former board Chairman), through December 2017.

On June 14, 2017, through Unanimous Written Consent, our Board of Directors approved the following compensation changes for independent board members:

Increased the monthly fee paid to the remaining independent directors from \$1,000 to \$1,500 per month, effective immediately.

Credit Facility — Avidbank

On April 20, 2016, we amended our revolving credit facility with Avidbank. The new renewable revolving maturity date is January 22, 2018. The facility provides up to \$2 million in financing against eligible receivables and is subject to meeting certain covenants including an asset coverage ratio test for up to twenty months. The material terms of the amended revolving credit facility are as follows:

The interest rate for all advances shall be the then in effect prime rate plus 2.5% and is subject to a minimum interest payment requirement per six month period of \$10,000.

Interest shall be paid monthly in arrears.

A facility fee of (0.5%) of the revolving line (\$10,000) was due (and paid) on May 22, 2016 and each anniversary thereof for so long as the revolving credit facility is in effect.

The loan period is from April 20 through January 22, 2018 at which time any outstanding advances, and accrued and unpaid interest thereon, will be due and payable.

Our obligations to Avidbank are secured by a first lien on all of its assets (including intellectual property assets should it have any in the future) in favor of Avidbank.

The facility contains customary events of default. Upon the occurrence of an event of default that remains uncured after any applicable cure period, Avidbank's commitment to make further advances may terminate, and Avidbank would also be entitled to pursue other remedies against us and the pledged collateral.

Pursuant to a guaranty executed by Optex Systems Holdings in favor of Avidbank, Optex Systems Holdings has guaranteed all obligations of Optex Systems, Inc. to Avidbank.

On October 17, 2016, we further amended our revolving credit facility with Avidbank to increase the facility to \$2.2 million and to allow for a \$250 thousand letter of credit sublimit with an annual fee of 1.5% of the face amount of the letter of credit. On October 17, 2016, we secured a \$250 thousand irrevocable letter of credit from Avidbank with Cabot Industrial Value Fund II Operating Partnership, L.P. as the beneficiary. The letter of credit was issued as a condition of our facility lease, executed on October 21, 2016^t for the Applied Optics Center facility in Dallas, Texas.

2016 Restricted Stock Unit Plan

On June 14, 2016, our Compensation Committee approved our 2016 Restricted Stock Unit Plan. This plan provides for issuance of stock units (“RSUs”) for up to 1,000,000 shares of our common stock. Each RSU constitutes a right to receive one share of our common stock, subject to vesting, which unless otherwise stated in an RSU agreement, shall vest in equal amounts on the first, second and third anniversary of the grant date. Shares of our common stock underlying the number of vested RSUs will be delivered as soon as practicable after vesting. During the period between grant and vesting, the RSUs may not be transferred, and the grantee has no rights as a shareholder until vesting has occurred. If the grantee’s employment is terminated for any reason (other than following a change in control of us or a termination of an officer other than for cause), then any unvested RSUs under the award will automatically terminate and be forfeited. If an officer grantee’s employment is terminated by us without cause or by the grantee for good reason, then, provided that the RSUs have not been previously forfeited, the remaining unvested portion of the RSUs will immediately vest as of the officer grantee’s termination date. In the event of a change in control, our obligations regarding outstanding RSUs shall, on such terms as may be approved by the Committee prior to such event, immediately vest, be assumed by the surviving or continuing company or cancelled in exchange for property (including cash).

On June 15, 2016, we issued 150,000 RSUs to our Chief Executive Officer, Danny Schoening, and 50,000 RSUs to our Chief Financial Officer, Karen Hawkins. The RSUs issued to Mr. Schoening and Ms. Hawkins vest as follows: 34% on January 1, 2017, 33% on January 1, 2018 and 33% on January 1, 2019.

On June 14, 2017, we issued 50,000 RSUs to Bill Bates, General Manager of the Applied Optics Center and a newly appointed board member. The RSUs will vest over three years as follows: 34% on January 1, 2018, 33% on January 1, 2019 and 33% on January 1, 2020.

Public Offering

On August 26, 2016, we consummated a public offering of 2,291,000 Class A units consisting of common stock and warrants and 400 Class B units consisting of shares of Series C convertible stock and warrants for a total gross purchase price of \$4,750,280.

New Product Development

On November 10, 2015, we entered into a retail sales relationship with Cabela's Inc., to distribute our Red Tail Digital Spotting Scope, patented on July 11, 2017, as well as our new Stabilized Monocular. We are presently in negotiations to make these devices available via General Services Administration schedules for government personnel.

Products

Our 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 and armored security vehicles. We also manufacture and deliver numerous periscope configurations, rifle and surveillance sights and night vision optical assemblies. We deliver our products both directly to the federal government and to prime contractors.

We deliver high volume products, under multi-year contracts, to large defense contractors and government customers. Increased emphasis in the past two years has been on new opportunities to promote and deliver our 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 categories include:

Electronic sighting systems

Mechanical sighting systems

Laser protected plastic and glass periscopes

Non-laser protected plastic and glass periscopes

Howitzer sighting systems

M36 Thermal Day/Night Periscopes

M17 Day/Thermal Periscopes

Ship binoculars

Replacement optics (e.g. filters, mirrors)

Optical assemblies and laser filters

7

| Product Line | Product Category |
|-----------------------|--|
| Periscopes | Laser & Non Laser Protected Plastic & Glass Periscopes, Electronic M17 Day/Thermal Periscopes, Vision Blocks |
| Sighting Systems | Back Up Sights, Digital Day and Night Sighting Systems (DDAN), M36 Thermal Periscope, Unity Mirrors |
| Howitzers | M137 Telescope, M187 Mount, M119 Aiming Device |
| Other | Muzzle Reference Systems (MRS), Binoculars, Collimators, Optical Lenses & Elements, Windows |
| Applied Optics Center | ACOG Laser filter, Laser Filter Interface, Optical Assemblies |

Location and Facility

We are headquartered in Richardson, TX and lease approximately 93,967 combined square feet of facilities including Richardson, Texas and Dallas, Texas. As of December 5, 2017, we had 98 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 renewed the lease on our 49,100 square foot, Richardson, Texas facility, effective as of December 10, 2013, with a lease expiration of March 31, 2021. As of December 5, 2017, the Richardson facility operates with 61 full time equivalent employees in a single shift operation.

In November 2014, we also acquired a business unit from L-3 Communications, Inc., which is described herein below under “Recent Events — Acquisition”. The acquisition, Applied Optics Center, is located in Dallas, Texas with leased premises consisting of approximately 44,867 square feet of space. As of December 5, 2017, the Applied Optics Center operates with 37 full time equivalent employees in a single shift operation.

Contracts

Many of our contracts allow for government contract financing in the form of contract progress payments pursuant to Federal Acquisition Regulation 52.232-16, “Progress Payments”. As a small business, and subject to certain limitations, this clause provides for government payment of up to 90% of incurred program costs prior to product delivery. To the extent our contracts allow for progress payments, we intend to utilize this benefit, thereby minimizing the working capital impact on us for materials and labor required to complete the contracts.

Our contracts allow for Federal Acquisition Regulation 52.243-1 which entitles the contractor to an “equitable adjustment” to the contract if the contract changes result in a change in contract costs or time of performance. In essence, an equitable price adjustment request is a request for a contract price modification (generally an increase) that allows for the contractor to be “made whole” for additional costs incurred which were necessitated by some modification of the contract effort. This modification may come from an overt change in U.S. Government requirements or scope, or it may come from a change in the conditions surrounding the contract (e.g., differing site conditions or late delivery of U.S. Government-furnished property) which result in statement of work additions, deletions, part substitutions, schedule or other changes to the contract which impact the contractor’s overall cost to complete.

Each contract with our customers has specific quantities of material that need to be purchased, assembled, and then shipped. Prior to bidding a contract, we contact potential sources of material and receive qualified quotations for each 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 we would attempt to find an acceptable alternate supplier, and if successful, we would then renegotiate contractual deliverables (e.g., specifications, delivery, price). As of December 5, 2017, approximately 22% of our material requirements are single-sourced across 9 suppliers representing approximately 17% of our active supplier orders. 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. This 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 of \$750,000. 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. |

We are responsible for full compliance with the Federal Acquisition Regulation. Upon award, the contract may identify certain regulations that we need 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 we 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.

We are 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. We currently have 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 we currently use 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 5, 2017).

| DSP - 5 licenses | Issue Date | Expiration Date (48 months of issue) | Value (\$) |
|------------------|------------|---|------------|
| 050490628 | 1/3/2014 | 1/2/2018 | 45,928 |
| 050490371 | 1/14/2014 | 1/13/2018 | 14,290 |
| 050497324 | 2/1/2014 | 1/31/2018 | 15,384 |
| 050497307 | 2/12/2014 | 2/11/2018 | 11,881 |
| 050497162 | 2/20/2014 | 2/19/2018 | 2,122 |
| 050501481 | 2/26/2014 | 2/25/2018 | 255,700 |
| 050504795 | 3/27/2014 | 3/26/2018 | 26,794 |
| 050511388 | 4/21/2014 | 4/20/2018 | 30,086 |
| 050510061 | 5/19/2014 | 5/18/2018 | 10,564 |
| 050521562 | 6/27/2014 | 6/26/2018 | 3,108 |
| 050521680 | 7/7/2014 | 7/6/2018 | 10,572 |
| 050521706 | 7/15/2014 | 7/14/2018 | 7,441 |
| 050521673 | 7/15/2014 | 7/14/2018 | 1,236 |
| 050521555 | 7/17/2014 | 7/16/2018 | 18,970 |
| 050530555 | 9/22/2014 | 9/21/2018 | 4,930 |
| 050537697 | 11/4/2014 | 11/3/2018 | 6,028 |
| 050539610 | 11/14/2014 | 11/13/2018 | 7,746 |
| 050486913 | 11/20/2014 | 11/19/2018 | 79,882 |
| 050490381 | 12/11/2014 | 12/10/2018 | 36,250 |
| 050546222 | 1/9/2015 | 1/8/2019 | 2,950 |
| 050549789 | 2/18/2015 | 2/17/2019 | 53,720 |

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| | | | |
|-----------|-----------|-----------|---------|
| 050549846 | 2/23/2015 | 2/22/2019 | 165,372 |
| 050549534 | 2/25/2015 | 2/24/2019 | 88,555 |
| 050549933 | 2/27/2015 | 2/26/2019 | 34,888 |
| 050549843 | 3/23/2015 | 3/22/2019 | 1,213 |

| DSP - 5 licenses | Issue Date | Expiration Date (48 months of issue) | Value (\$) |
|------------------|------------|---|------------|
| 050553879 | 3/23/2015 | 3/22/2019 | 4,066 |
| 050553874 | 3/27/2015 | 3/26/2019 | 3,472 |
| 050553876 | 3/27/2015 | 3/26/2019 | 1,021 |
| 050560846 | 5/21/2015 | 5/20/2019 | 6,418 |
| 050560953 | 5/29/2015 | 5/28/2019 | 1,792 |
| 050561878 | 6/5/2015 | 6/4/2019 | 75,047 |
| 050562319 | 6/12/2015 | 6/11/2019 | 2,815 |
| 050560740 | 6/30/2015 | 6/29/2019 | 3,308 |
| 050565738 | 7/9/2015 | 7/8/2019 | 1,543 |
| 050566061 | 7/22/2015 | 7/21/2019 | 27,401 |
| 050561747 | 7/27/2015 | 7/26/2019 | 250 |
| 050565746 | 7/30/2015 | 7/29/2019 | 1,543 |
| 050568890 | 8/7/2015 | 8/6/2019 | 4,204 |
| 050570373 | 8/21/2015 | 8/20/2019 | 4,297 |
| 050571083 | 9/8/2015 | 9/7/2019 | 92,042 |
| 050574185 | 9/25/2015 | 9/24/2019 | 413,263 |
| 050581564 | 12/11/2015 | 12/10/2019 | 2 |
| 050581341 | 12/17/2015 | 12/16/2019 | 30,541 |
| 050582302 | 12/17/2015 | 12/16/2019 | 402 |
| 050581218 | 12/18/2015 | 12/17/2019 | 4,298 |
| 050573342 | 10/7/2015 | 10/6/2019 | 203,832 |
| 050581341 | 12/17/2015 | 12/16/2019 | 30,541 |
| 050573343 | 10/7/2015 | 10/6/2019 | 8,446 |
| 050582108 | 1/20/2016 | 1/19/2020 | 1,075 |
| 050586060 | 2/24/2016 | 2/23/2020 | 931 |
| 050598474 | 6/10/2016 | 6/9/2020 | 35,713 |
| 050596660 | 6/23/2016 | 6/22/2020 | 631 |
| 050598467 | 6/23/2016 | 6/22/2020 | 4,519 |
| 050601710 | 7/12/2016 | 7/11/2020 | 6,757 |
| 050596660 | 6/20/2016 | 6/19/2020 | 631 |
| 050607056 | 10/5/2016 | 10/4/2020 | 10,001 |
| 050587550 | 3/1/2016 | 2/29/2020 | 1 |
| 050602855 | 7/27/2016 | 7/26/2020 | 75,552 |
| 050603610 | 8/9/2016 | 8/8/2020 | 6,094 |
| 050596718 | 6/28/2016 | 6/27/2020 | 917 |
| 050612378 | 11/28/2016 | 11/27/2020 | 292,670 |
| 050612416 | 11/28/2016 | 11/27/2020 | 151,761 |
| 050612399 | 11/28/2016 | 11/27/2020 | 46,301 |
| 050612547 | 11/28/2016 | 11/27/2020 | 6,976 |
| 050612382 | 11/28/2016 | 11/27/2020 | 83,902 |
| 050612402 | 11/28/2016 | 11/27/2020 | 45,801 |
| 050615460 | 12/15/2016 | 12/14/2020 | 1,018,908 |

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| | | | |
|-----------|-----------|-----------|-----------|
| 050615456 | 1/11/2017 | 1/10/2021 | 463,140 |
| 050615457 | 1/11/2017 | 1/10/2021 | 61,472 |
| 050624356 | 3/22/2017 | 3/21/2021 | 1,033,093 |
| 050629385 | 6/12/2017 | 6/11/2021 | 9,240 |
| 050635531 | 7/12/2017 | 7/11/2021 | 24,449 |
| 050643341 | 10/4/2017 | 10/3/2021 | 94,609 |

| DSP - 6 Licenses | Issue Date | Expiration Date (48 months of issue) | Total Contract Value (\$) |
|-------------------------|-------------------|---|--------------------------------------|
| 060046631 | 10/22/2015 | 10/6/2019 | \$ — |
| 060046632 | 10/21/2015 | 10/6/2019 | — |

| DSP -73 Licenses | Issue Date | Expiration Date (48 months of issue) | Total Contract Value (\$) |
|-------------------------|-------------------|---|--------------------------------------|
| 730053549 | 7/29/2015 | 7/28/2019 | \$ 30,000 |

| BIS - 711 Licenses | Issue Date | Expiration Date (48 months of issue) | Total Contract Value (\$) |
|---------------------------|-------------------|---|--|
| D1083980 | 2/28/2017 | 2/27/2021 | \$4,744 |
| D1083993 | 2/28/2017 | 2/27/2021 | \$2,875 |
| D1083955 | 3/2/2017 | 3/1/2021 | \$1,176 |
| D1085182 | 3/20/2017 | 3/19/2021 | \$46,032 |
| D1085299 | 3/20/2017 | 3/19/2021 | \$45,800 |
| D1085522 | 3/20/2017 | 3/19/2021 | \$2,966 |
| D1085153 | 3/20/2017 | 3/19/2021 | \$1,614,572 |

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.

Our contracts may also be governed by the Truth in Negotiation Act requirements where certain of our contracts or proposals exceed the \$750,000 threshold and/or are deemed as sole source, or non-competitive awards, covered under this act. For these contracts, we 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, we could be subjected to a defective pricing claim adjustment with accrued interest. Currently, we do 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, we do 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 noncompliance.

The terms of our material contracts are as follows (updated as of October 30, 2017):

| Customer | Customer PO/Contract | Contract Type ⁽¹⁾ | Total Award Value ⁽²⁾ (millions) | Remaining Value ⁽³⁾ (millions) | Delivery Period |
|--|----------------------------|------------------------------|---|---|----------------------|
| GDLS – Canada ⁽⁴⁾ Sighting Systems | Subcontract PO 35334144 | FFPQ | \$ 8.7 | \$ 1.2 | Mid 2012 – May 2018 |
| GDLS – Canada ⁽⁵⁾ Sighting Systems | Subcontract PO 35419634 | FFPQ | \$ 1.0 | \$ 0.5 | June 2017- Mar 2018 |
| General Dynamics ⁽⁶⁾ Periscopes | Subcontract PO 40242047 | FFPQ | \$ 1.3 | \$ 0.3 | Aug 2016 – Apr 2018 |
| GDLS - Canada ⁽⁷⁾ Periscopes | Subcontract PO 35506523 | FFPQ | \$ 1.5 | \$ 1.5 | Dec 2017 – May 2020 |
| Harris Corp ⁽⁸⁾ Laser Filters | Subcontract PO 35506523 | FFPQ | \$ 1.7 | \$ 0.5 | June 2017 – Jan 2018 |
| DLA Land at Aberdeen ⁽⁹⁾ Laser Filter Assemblies | Prime SPRBL1-17-D-0008 | IDIQ | \$ 1.6 | \$ 1.6 | Jan 2018- Aug 2018 |
| GDLS – Canada ⁽¹⁰⁾ Sighting Systems | Subcontract PO 35515590 | FFPQ | \$ 1.4 | \$ 1.4 | Oct 2017- Sept 2020 |
| DLA Land and Maritime ⁽¹¹⁾ Periscopes | Prime SPE7LX17D0053 | IDIQ | \$ 1.5 | \$ 1.5 | Oct 2017- Sept 2020 |

(1) FFPQ – Firm fixed price and quantity, IDIQ – Indefinite delivery indefinite quantity, PP – Progress Billable. .
 (1) Payment terms on shipments are net 30 or net-45 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 us. The total award value represents already awarded delivery order contracts. Based on our 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 October 30, 2017. Only these undelivered values of the contracts may be subject to the contract termination clause. It has been our experience that these clauses are rarely invoked.*

(4) *Contract was awarded on October 24, 2011 but effective November 4, 2011 as the date on which approved for disclosure by contractor. Total award value includes all statement of work change orders through June 26, 2016.*

(5) *Contract award quantity added on December 3, 2013 as a follow on quantity to the original PO 35334144.*

(6) *Contract quantity awarded on January 24, 2016.*

(7) *Contract quantity awarded on December 14, 2016 for laser protected periscopes installed on Light Armored Vehicles in the Middle East.*

(8) *Contract quantity awarded on March 30, 2017.*

(9) *Five year IDIQ contract for Light Interference Filter Assemblies awarded on July 3, 2017. The contract calls for five one-year ordering periods running consecutively commencing on July 5, 2017. On July 12, 2017 the first task delivery order DO-0001 was awarded for \$1.6 million. The Company expects to generate between \$8.4 and \$12.4 million in revenue over the next five year period from this contract.*

(10) *Contract awarded on September 11, 2017 to provide LAV 6.0 optimized weapon system support for Optex’s Commander Sighting System. The in-service support will continue over the next three years for their existing fleet of Light Armored Vehicles.*

(11) *Three year IDIQ contract for periscopes awarded on September 18, 2017. The contract includes three base years and two option years. The based contract expires September 11, 2020. As of October 30, three task delivery orders have been awarded against the IDIQ for a total value of \$1.5 million. The company expects to generate between \$1.5 and \$2.4 million in revenue over the next five year period from this contract.*

Market Opportunity — U.S. Military

During the twelve months ending October 1, 2017, approximately 68% of our business was in support of U.S. military products. The chart below was derived from public government spending sources and depicts total U.S. military spending from 2007 through 2016 and estimated spending through 2022. The purpose of including this chart is to provide the reader with historical trend data and projected U.S. military defense and procurement spending over time. Military spending peaked at \$678.1 billion in 2011. As of fiscal year 2017 the total projected military spending is projected to decline by 15.5% to \$573.0 billion from the peak 2011 level. However, the military spending in the chart below depicts increased spending through 2022 of 11.8% with the largest increase of 8.5% occurring in the next fiscal year (2018). The projected increase of military procurement in fiscal 2018 represents an 8.1% increase over fiscal year 2017 levels. On November 16, 2017, the National Defense Authorization Act (NDAA) for fiscal year 2018 was sent to President Trump to sign into law after passing both the House of Representatives and the Senate. The NDAA authorizes total spending of \$700 billion which includes the authorization of \$65.8 billion in additional funding for the Overseas Contingency Operation (OCO) account.

Source: Government Publishing Office, U.S. Budget Historical Tables, FY 2018, Table 3.2 Outlays by function and subfunction, 1962-2022.

The table below depicts the U.S. Department of Defense budget request for fiscal year 2018 for major ground system programs. The total fiscal year 2018 budget request for major ground system programs is increased by 11.2% over the fiscal year 2017 levels and 16.7% over the fiscal year 2016 levels. Although it is difficult to directly tie the budget request to specific components provided by Optex Systems, we provide periscopes, collimator assemblies, vision blocks and laser interface filters to the U.S. armed forces on almost all of the ground system platforms categorized below.

| Major Weapon System Summary (\$ in Millions) | FY 2016 | FY 2017 | FY 2018 | | Total Request |
|---|-----------|-----------|----------------|---------------|------------------|
| | | | Base Budget | OCO Budget | |
| Ground Systems - Joint Service | | | | | |
| JLTV Joint Light Tactical Vehicle | \$366.2 | \$775.8 | \$1,141.6 | \$1.1 | \$1,142.7 |
| Ground Systems - USA | | | | | |
| AMPV Armored Multi-Purpose Vehicle | 213.0 | 184.2 | 393.5 | 253.9 | 647.4 |
| FHTV Family Of Heavy Tactical Vehicles | 30.8 | 57.1 | 92.1 | 25.9 | 118.0 |
| M-I Abrams Tank Modification/Upgrades | 504.7 | 898.7 | 632.4 | 581.5 | 1,213.9 |
| PIM Paladin Integrated Management | 410.3 | 636.0 | 652.5 | 125.7 | 778.2 |
| FMTV Family of Medium Tactical Vehicles | 334.0 | 352.8 | 84.7 | — | 84.7 |
| Stryker Stryker | 1,191.0 | 735.4 | 178.2 | — | 178.2 |
| Ground Systems - USMC | | | | | |
| ACV Amphibious Combat Vehicle | 197.0 | 158.7 | 340.5 | — | 340.5 |
| Total Ground Systems | \$2,880.8 | \$3,022.9 | \$2,373.9 | \$987.0 | \$3,360.9 |

Source: Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, "Program Acquisition Cost by Weapon System, United States Department of Defense, Fiscal Year 2018 Budget Request", May 2017

The U.S. government spending reductions in the last seven years have had a significant impact on our product lines as our products directly support various types of U.S. military land vehicle procurements. As a result of lower U.S. government spending from the peak 2011 levels, the Company has continued to explore other opportunities for manufacturing outside of our traditional product lines for products which could be manufactured using our existing lines in order to fully utilize our existing capacity.

We are cautiously optimistic that the new government administrations proposed boost in military spending will have a favorable impact in the direction of funding or product need for the U.S. military. We anticipate that absent any significant changes from the current defense spending levels, maintenance will still be required, and the opportunities for us to upgrade existing systems with higher performing systems will continue to present themselves. Spending levels may change, but given the mix between foreign spending, domestic/prime demand, and the more recent commercial opportunities, we do not expect any negative trends arising from political domestic changes over the next twelve months.

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

Product reliability — failure can cost lives

Speed to delivery and adherence to delivery 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.

We focus 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 — Foreign Military

Despite the downturn in U.S. military spending, foreign military funding for products built in the United States for selected foreign militaries has held to peak funding levels. Thus, we have increased efforts to promote our proven military products, as well as newly improved product solutions directly to foreign military representatives. In 2014, we completed the first shipments of M17 Day/Thermal Periscope (NSN 6650-01-619-6545) to a country in South America. During fiscal year 2016, Optex Systems completed its first order of its patented M17 Day / Thermal Periscope for \$0.6 million to Brazil. These direct sales transactions allow us to directly serve South American customers and affect influence into their future procurements. Additionally, shipment of the new M17 Day/Thermal Periscope validates our efforts to upgrade existing platforms with new technology. The M17 Day/Thermal Periscope is a cost effective upgrade to existing systems in that it provides both day and thermal views specifically designed for driving armored vehicles. It can be installed in vehicles which were originally designed without this technology and may be used as a backup to existing systems. We anticipate our efforts in South America will culminate in new orders for this technology in the near term. We will continue to pursue international opportunities through direct sales (e.g., General Dynamics Land Systems — Canada), International Parts Supply and through other 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.

Market Opportunity — Commercial

Our 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 four product areas.

Big Eye Binoculars — While the military application we produce is based on mature military designs, we own all castings, tooling and glass technology. These large fixed mount binoculars could be sold to cruise ships, personal yachts and cities/municipalities. The binoculars are also applicable to fixed, land based outposts for private commercial security as well as border patrols and regional law enforcement.

Night Vision Sight — We have 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 — We manufacture and assemble 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 selective suppliers. This combined equipment and technology has potential applications with the border patrol, police and governmental or commercial security agencies.

Thin Film Coatings — The acquisition of the Applied Optics Center (AOC) also creates a new sector of opportunity for commercial products for us. Globally, commercial optical products use thin film coatings to create product differentiation. These coatings can be used for redirecting light (mirrors), blocking light (laser protection), absorbing select light (desired wavelengths), and many other combinations. They are used in telescopes, rifle scopes, binoculars, microscopes, range finders, protective eyewear, photography, etc. Given this broad potential, the commercial applications are a key opportunity going forward.

Optical Assemblies – Through the Applied Optics Center, we are utilizing our experience in military sighting systems to pursue commercial opportunities associated with products that incorporate multi-lens optical cell assemblies, bonded optical elements and mechanical assemblies. There are a wide variety of products in the medical, machine vision, automotive and outdoor recreation fields that can benefit from our capabilities. Support to domestic customers for these type products has driven significant increases in overall sales during the last two years.

Customer Base

We serve customers in four primary categories: as prime defense contractor (Defense Logistics Agency (DLA) Land and Maritime, DLA Warren, DLA Aviation, U.S. Army, Navy and Marine Corps), as defense subcontractor (General Dynamics, L-3 Communications, Harris Corporations, BAE, and NorcaTec), as a military supplier to foreign governments (Israel, Australia, South America and NAMSA) and also as a commercial optical assembly supplier (Nightforce Optics, Cabela's). During the twelve months ended October 1, 2017, we derived approximately 86% of our gross business revenue from four major customers: U.S. government agencies (38%), Nightforce Optics, Inc. (22%), General Dynamics (19%), Harris Corporation (7%). We have approximately 100 discrete contracts for items that are utilized in vehicles, product lines and spare parts. Due to the high percentage of prime and subcontracted U.S. defense revenues, large customer size and 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 us. 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, we competed with two other companies in different spaces. First, we 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, we currently compete 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. During the last four years, overall plastic periscope demand quantities have declined, while competition on the lower level periscope products has significantly increased as new contractors aggressively compete for market share amongst the existing customer base and quantities.

Buyers — Medium Risk to us. 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 us. We have 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.

Suppliers — Low to Medium Risk to Optex Systems Holdings. 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.

Consistent with our marketing plan and business model, the AOC acquisition strengthened our overall position by decreasing the bargaining power of their suppliers through the backwards integration of a key supplier and created additional barriers of entry of potential competitors. Overall, the customer base and the competition have seen the acquisition as creating a stronger company.

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

| | Existing Customers | New Customers |
|--------------|--|---|
| New Products | <p><u>USACC</u> Binoculars</p> <p><u>GDLS</u> DDAN</p> <p><u>Commercial</u> Optical Lens</p> | <p><u>Chile</u> M17 Day/Thermal</p> <p><u>Brazil</u> M17 Day/Thermal</p> <p><u>Israel</u> M17 Day/Thermal</p> |

Commercial: Optical Lens, Spotting Scopes, Monocular Lens

Existing Products USACC Periscopes, Back Up Sights, Marines Sighting Systems

Binoculars, Vision Blocks,

ACOG Filter Units

GDLs Periscopes, Collimators

BAE Periscopes

L3- Laser Interface Filters

DLA Optical Elements

Commercial: Optical Lens, Spotting Scopes, Monocular Lens

This product/customer matrix sets forth our four basic approaches:

1) Sell existing products to existing customers.

- 2) Sell existing products to new customers.
- 3) Develop new products to meet the needs of our existing customers.
- 4) Develop new products to meet the needs of new customers.

The product categories described in the above matrix are associated with the product lines set forth below:

| Product Line | Product Category |
|-----------------------|--|
| Periscopes | Laser & Non Laser Protected Plastic & Glass Periscopes, Electronic M17 Day/Thermal Periscopes, Vision Blocks |
| Sighting Systems | Back Up Sights, Digital Day and Night Sighting Systems (DDAN) and Optimized Weapon System Support (OWSS), M36 Thermal Periscope, Unity Mirrors |
| Howitzers | M137 Telescope, M187 Mount, M119 Aiming Device |
| Other | Muzzle Reference Systems (MRS), Binoculars, Collimators, Optical Lenses & Elements, Windows |
| Applied Optics Center | ACOG Laser filter, Laser Filter Interface, Optical Assemblies |

Operations Plan

Our operations plan can be broken down into three distinct areas: material management, manufacturing space planning and efficiencies associated with economies of scale.

Materials Management

The largest portion of our costs is materials. We have completed the following activities in order to demonstrate continuous improvement:

-

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Successful completion of annual surveillance audit for ISO 9001:2008 certificate, with no major nonconformance issues

- Weekly cycle counts on inventory items
- Weekly material review board meeting on non-moving piece parts
- Kanban kitting on products with consistent ship weekly ship quantities
- Daily cross functional floor meetings focused on delivery, yields and labor savings
- Redesigned floor layout using tenant improvement funds
- Daily review of yields and product velocity
- Bill of material reviews prior to work order release

Future continuous improvement opportunities include installation and training of shop floor control module within the ERP system and organizational efficiencies of common procurement techniques among buyers.

Manufacturing Space Planning

We currently lease 93,967 square feet of manufacturing space (see “Location and Facility”), including the additional leased space in conjunction with our recent acquisition as described under “Recent Events”. Our current facilities are sufficient to meet our immediate production needs without excess capacity. As our processes are primarily labor driven, we are able to easily adapt to changes in customer demand by adjusting headcounts, overtime schedules and shifts in line with production needs. In the event additional floor space is required to accommodate new contracts, Optex has the option to lease adjacent floor space at the current negotiated lease cost per square foot. Consistent with the space planning, we will drive economies of scale to reduce support costs on a percentage of sales basis. These cost reductions can then be either passed through directly to the bottom line or used for business investment.

Our manufacturing process is driven by the use of six sigma techniques and process standardization. Initial activities in this area have been the successful six sigma projects in several production areas which have led to improved output and customer approval on the aesthetics of the work environment. In addition, we use many tools including 5S programs, six sigma processes, and define, measure, analyze, improve, control (DMAIC) problem solving techniques to identify bottlenecks within the process flow, reduce cost and improve product yields. Successful results can then be replicated across the production floor and drive operational improvements.

Economies of Scale

Plant efficiencies fluctuate as a function of program longevity, complexity and overall production volume. Our internal processes are primarily direct labor intensive and can be more easily adapted to meet fluctuations in customer demand; however, our material purchases, subcontracted operations and manufacturing support costs are extremely sensitive to changes in volume. As our volume increases, our support labor, material and scrap costs decline as a percentage of revenue as we are able to obtain better material pricing, and scrap, start up and support labor (fixed) costs and they are spread across a higher volume base. On the contrary, as production volumes decline, our labor and material costs per unit of production generally increase. Additional factors that contribute to economies of scale relate to the longevity of the program. Long running, less complex programs (e.g., periscopes) do not experience as significant of an impact on labor costs as production volumes change, as the associated workforce is generally less skilled and can be ramped quickly as headcounts shift. Our more complex thin laser filter coatings, Howitzer and thermal day/night programs are more significantly impacted by volume changes as they require a more highly-skilled workforce and ramp time is longer as the training is more complex. We continually monitor customer demand over a rolling twelve-month window and in order to anticipate any changes in necessary manpower and material which allows us to capitalize on any benefits associated with increased volume and minimize any negative impact associated with potential declines in product quantities.

Intellectual Property

We utilize several highly specialized and unique processes in the manufacture of our products. While we believe that these trade secrets have value, it is probable that our future success will depend primarily on the innovation, technical expertise, manufacturing and marketing abilities of our personnel. We cannot assure you that we will be able to maintain the confidentiality of our trade secrets or that our non-disclosure agreements will provide meaningful protection of our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or other disclosure. The confidentiality agreements that are designed to protect our trade secrets could be breached, and we might not have adequate remedies for the breach. Additionally, our trade secrets and proprietary know-how might otherwise become known or be independently discovered by others. We possess two utility patents.

Our competitors, many of which have substantially greater resources, may have applied for or obtained, or may in the future apply for and obtain, patents that will prevent, limit or interfere with our ability to make and sell some of our products. Although we believe that our products do not infringe on the patents or other proprietary rights of third parties, we cannot assure you that third parties will not assert infringement claims against us or that such claims will not be successful.

On July 11, 2017, we were issued U.S. Patent No. D791,852 S, for our Red Tail Digital Spotting Scope. We have a retail sales relationship with Cabela's Inc., to distribute these scopes. They are currently the only digital spotting scope offered by Cabela's. Our Red Tail Digital Spotting Scopes also received a favorable review from Trigger Magazine in 2017.

In May 2015, we announced the issuance to us of U.S. Patent No. 13,792,297 titled “ICWS Periscope”. This invention improves previously accepted levels of periscope performance that, in turn, improve soldier’s safety.

In December 2013, Optex Systems, Inc. was issued U.S. Patent No. 23,357,802 titled “Multiple Spectral Single Image Sighting System Using Single Objective Lens Set.” The technology platform, designed for our DDAN program, is applicable to all ground combat vehicles used by the US and foreign militaries. This invention presents a single image to both day and night sensors using precision optics, which in turn allows the user to individually observe day, night, or day and night simultaneously. In addition, it has proven to be especially useful in light transition points experienced at dusk and dawn. We are in production and currently delivering sighting systems with this advanced technology, a significant upgrade in the goal of supporting our customers as they modernize the worldwide inventory of aging armored vehicles. This technology is applicable to many sighting systems, and it has already been designed for implementation on the Light Armored Vehicles, the Armored Security Vehicle, the Amphibious Assault Vehicle, and the M60 Main Battle Tank. Digital Day and Night technology has advanced the capabilities of these installed weapon systems and is the first in a series of patents we have applied for to protect our Intellectual Property portfolio in support of the warfighters who use these systems.

In May 2012, we purchased a perpetual, non-exclusive license, with a single up front license fee of \$200,000 to use Patent 7,880,792 “Optical and Infrared Periscope with Display Monitor” owned by Synergy International Optronics, LLC. We believe the purchase of the license agreement may allow us to extend and expand our market potential for the M113APC vehicle type which has the highest number of commonly used armored vehicles in the world. The current estimated active M113 APC worldwide inventory is over 80,000 units. This licensing of this patent allows us to develop additional products for this vehicle type, including the M17 Day/Thermal and M17 Day/Night periscopes. We are actively marketing the new periscopes internationally and completed our first international shipment utilizing this technology in March 2014. We continue to prototype these products and demonstrate them to potential customers.

Competition

The markets for our products are competitive. We compete primarily on the basis of our ability to design and engineer products to meet performance specifications set by our customers. Our customers include military and government end users as well as prime contractors that purchase component parts or subassemblies, which they incorporate into their end products. Product pricing, quality, customer support, experience, reputation and financial stability are also important competitive factors.

There are a limited number of competitors in each of the markets for the various types of products that we design, manufacture and sell. At this time, we consider our primary competitors for the Optex, Richardson site to be Kent Periscopes and Synergy International Optronics, LLC. The Applied Optics Center thin film and laser coatings

products compete primarily with Materion-Barr, Artemis and Alluxa.

Our competitors are often well entrenched, particularly in the defense markets. Some of these competitors have substantially greater resources than we do. While we believe that the quality of our technologies and product offerings provides us with a competitive advantage over certain manufacturers, some of our competitors have significantly more financial and other resources than we do to spend on the research and development of their technologies and for funding the construction and operation of commercial scale plants.

We expect our competitors to continue to improve the design and performance of their products. We cannot assure investors that our competitors will not develop enhancements to, or future generations of, competitive products that will offer superior price or performance features, or that new technology or processes will not emerge that render our products less competitive or obsolete. Increased competitive pressure could lead to lower prices for our products, thereby adversely affecting our business, financial condition and results of operations. Also, competitive pressures may force us to implement new technologies at a substantial cost, and we may not be able to successfully develop or expend the financial resources necessary to acquire new technology. We cannot assure you that we will be able to compete successfully in the future.

Employees

We had 100 full time equivalent employees as of October 1, 2017 which includes small temporary work forces to handle peak loads as needed. To the best of our knowledge, we are compliant with local prevailing wage, contractor licensing and insurance regulations, and has good relations with its employees, who are not currently unionized.

Leases

We are headquartered in Richardson, TX and lease 93,967 combined square feet of facilities including Richardson, Texas and Dallas, Texas. 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 renewed the lease on our 49,100 square foot, Richardson, Texas facility, effective as of December 10, 2013, with a lease expiration of March 31, 2021. As of October 1, 2017, the Richardson facility operates with approximately 62 full time equivalent employees in a single shift operation.

Our Applied Optics Center, is located in Dallas, Texas with leased premises consisting of approximately 44,867 square feet of space. We executed a new lease for the Applied Optics Center location, effective as of October 1, 2016, which was countersigned by the landlord on October 21, 2016. The term of the lease expires October 31, 2021. There are two renewal options available to the tenant, and each renewal term is five years in duration. As of October 1, 2017, Applied Optics Center operates with approximately 38 full time equivalent employees in a single shift operation.

Item 1A Risk Factors

Investing in our common stock involves a high degree of risk. Prospective investors should carefully consider the risks described below, together with all of the other information included or referred to in this annual report, before purchasing shares of our common stock. There are numerous and varied risks, known and unknown, that may prevent us from achieving our goals. The risks described below are not the only risks we will face. If any of these risks actually occurs, our business, financial condition or results of operations may be materially adversely affected. In such case, the trading price of our common stock could decline and investors in our common stock could lose all or part of their investment. The risks and uncertainties described below are not exclusive and are intended to reflect the material

risks that are specific to us, material risks related to our industry and material risks related to companies that undertake a public offering or seek to maintain a class of securities that is registered or traded on any exchange or over-the-counter market.

Investing in our common stock involves a high degree of risk. Prospective investors should carefully consider the risks described below, together with all of the other information included or referred to in this annual report, before purchasing shares of our common stock. There are numerous and varied risks, known and unknown, that may prevent us from achieving our goals. The risks described below are not the only risks we will face. If any of these risks actually occurs, our business, financial condition or results of operations may be materially adversely affected. In such case, the trading price of our common stock could decline and investors in our common stock could lose all or part of their investment. The risks and uncertainties described below are not exclusive and are intended to reflect the material risks that are specific to us, material risks related to our industry and material risks related to companies that undertake a public offering or seek to maintain a class of securities that is registered or traded on any exchange or over-the-counter market.

Risks Related to our Business

We expect that we may need to raise additional capital in the future beyond any cash flow from our existing business; additional funds may not be available on terms that are acceptable to us, or at all.

We anticipate we may have to raise additional capital in the future to service our debt and to finance our future working capital needs. We cannot assure you that any additional capital will be available on a timely basis, on acceptable terms, or at all. Future equity or debt financings may be difficult to obtain. If we are not able to obtain additional capital as may be required, our business, financial condition and results of operations could be materially and adversely affected.

We anticipate that our capital requirements will depend on many factors, including:

our ability to fulfill backlog;

our ability to procure additional production contracts;

our ability to control costs;

the timing of payments and reimbursements from government and other contracts, including but not limited to changes in federal government military spending and the federal government procurement process;

increased sales and marketing expenses;

technological advancements and competitors' response to our products;

capital improvements to new and existing facilities;

our relationships with customers and suppliers; and

general economic conditions including the effects of future economic slowdowns, acts of war or terrorism and the current international conflicts.

Even if available, financings may involve significant costs and expenses, such as legal and accounting fees, diversion of management's time and efforts, and substantial transaction costs. If adequate funds are not available on acceptable terms, or at all, we may be unable to finance our operations, develop or enhance our products, expand our sales and marketing programs, take advantage of future opportunities or respond to competitive pressures.

Current economic conditions may adversely affect our ability to continue operations.

Current economic conditions may continue to cause a decline in business and consumer spending and capital market performance, which could adversely affect our business and financial performance. Our ability to raise funds, upon which we are fully dependent to continue to conduct and expand our operations, may be adversely affected by current and future economic conditions, such as a reduction in the availability of credit, financial market volatility and economic recession.

Our ability to fulfill our backlog may have an effect on our long term ability to procure contracts and fulfill current contracts.

Our ability to fulfill our backlog may be limited by our ability to devote sufficient financial and human capital resources and limited by available material supplies. If we do not fulfill our backlog in a timely manner, we may experience delays in product delivery which would postpone receipt of revenue from those delayed deliveries. Additionally, if we are consistently unable to fulfill our backlog, this may be a disincentive to customers to award large contracts to us in the future until they are comfortable that we can effectively manage our backlog.

Our historical operations depend on government contracts and subcontracts. We face risks related to contracting with the federal government, including federal budget issues and fixed price contracts.

Future general political and economic conditions, which cannot be accurately predicted, may directly and indirectly affect the quantity and allocation of expenditures by federal agencies. Even the timing of incremental funding commitments to existing, but partially funded, contracts can be affected by these factors. Therefore, cutbacks or re-allocations in the federal budget could have a material adverse impact on our results of operations. Given the continued adverse economic conditions, the federal government has slowed its pace with regard to the release of orders for the U.S. military. Since we depend on orders for equipment for the U.S. military for a significant portion of our revenues, this slower release of orders will continue to have a material adverse impact on our results of operations. Obtaining government contracts may also involve long purchase and payment cycles, competitive bidding, qualification requirements, delays or changes in funding, budgetary constraints, political agendas, extensive specification development, price negotiations and milestone requirements. In addition, our government contracts are primarily fixed price contracts, which may prevent us from recovering costs incurred in excess of budgeted costs. Fixed price contracts require us to estimate the total project cost based on preliminary projections of the project's requirements. The financial viability of any given project depends in large part on our ability to estimate such costs accurately and complete the project on a timely basis. Some of those contracts are for products that are new to our business and are thus subject to unanticipated impacts to manufacturing costs. Given the current economic conditions, it is also possible that even if our estimates are reasonable at the time made, that prices of materials are subject to unanticipated adverse fluctuation. In the event our actual costs exceed fixed contractual costs of our product contracts, we will not be able to recover the excess costs which could have a material adverse effect on our business and results of operations. We examine these contracts on a regular basis and accrue for anticipated losses on these contracts, if necessary. As of October 1, 2017, there was zero in accrued loss provisions for loss contracts or cost overruns.

Approximately 68% of our contracts contain termination clauses for convenience. In the event these clauses should be invoked by our customer, future revenues against these contracts could be affected, however these clauses allow for a full recovery of any incurred contract costs plus a reasonable fee up through and as a result of the contract termination. We are currently unaware of any pending terminations on our existing contracts.

In some cases, contract awards may be issued that are subject to renegotiation at a date (up to 180 days) subsequent to the initial award date. Generally, these subsequent negotiations have had an immaterial impact (zero to 5%) on the contract price of the affected contracts. Currently, none of our awarded contracts are subject to renegotiation.

We have sought to mitigate the adverse impact from the slower pace of U.S. military orders on our results of operations by seeking to obtain foreign military orders as well as new commercial business. We do not expect these markets to completely mitigate the negative impact of lower U.S. defense spending.

There is further uncertainty which arises from the sequestration in early 2013 which may continue to affect business opportunities at the federal government level.

Military spending has been negatively impacted by the Budget Control Act of 2011, which was passed in August 2011. The Budget Control Act mandated a \$917.0 billion reduction in discretionary spending over the next decade, and \$1.2 trillion in automatic spending cuts over a nine-year period to be split between defense and non-defense programs beginning in January 2013.

On November 2, 2015 Congress passed the Bipartisan Budget Act of 2015 which sets federal spending through the 2016 and 2017 fiscal years, and eases strict caps on spending set forth in the 2011 sequestration. The plan lifted caps on the appropriated spending each year by \$50 billion in 2016 and \$30 billion in 2017, evenly divided between defense and domestic programs with an additional \$16 billion added each year in the form of inflated war spending, evenly split between the Defense and State departments.

On November 16, 2017, the National Defense Authorization Act (NDAA) for fiscal year 2018 was sent to President Trump to sign into law after passing both the House of Representatives and the Senate. The 2018 NDAA authorizes total spending of \$700 billion which includes a base spending authorization of \$634 billion plus the authorization of \$65.8 billion in additional funding for the Overseas Contingency Operation (OCO) account. The bill authorizes a major hike in military spending over the 2017 NDAA authorization of \$619 billion and sets defense spending well above the \$549 billion base authorization cap under the 2011 Budget Control Act. There currently is no clear plan from Congress on how to provide additional money above the sequestration limit and changes in the sequestration law will require bipartisan support to reach a senate vote threshold of 60 to avoid a filibuster. Although it is difficult to directly tie the budget request to specific components provided by Optex Systems, we provide periscopes, collimator assemblies, vision blocks and laser interface filters to the U.S. armed forces on almost all of the ground system platforms categorized in the Department of Defense budget request for 2018.

If we fail to scale our operations appropriately in response to growth and changes in demand, we may be unable to meet competitive challenges or exploit potential market opportunities, and our business could be materially and adversely affected.

Our past growth has placed, and any future growth in our historical business is expected to continue to place, a significant strain on our management personnel, infrastructure and resources. To implement our current business and product plans, we will need to continue to expand, train, manage and motivate our workforce, and expand our operational and financial systems and our manufacturing and service capabilities. All of these endeavors will require substantial management effort and additional capital. If we are unable to effectively manage our expanding operations, we may be unable to scale our business quickly enough to meet competitive challenges or exploit potential market opportunities, and our current or future business could be materially and adversely affected.

We do not have employment agreements with our key personnel, other than our Chief Executive and Financial Officers, and our management has very minimal unencumbered equity ownership in us. If we are not able to retain our key personnel or attract additional key personnel as required, we may not be able to implement our business plan and our results of operations could be materially and adversely affected.

We depend to a large extent on the abilities and continued participation of our executive officers and other key employees. The loss of any key employee could have a material adverse effect on our business. We currently have only two employment agreements, with our Chief Executive Officer which renews on an annual basis and currently expires on December 1, 2018, and our Chief Financial Officer which expires on January 31, 2018, with renewable terms each 18 months thereafter. We do not presently maintain “key man” insurance on any other key employees. Our management also has minimal unencumbered ownership interest in us, thus limiting their direct stake in our outcome. We believe that as our activities increase and change in character, additional, experienced personnel will be required to implement our business plan. Competition for such personnel is intense, and we cannot assure you that they will be available when required, or that we will have the ability to attract and retain them. In addition, due to our small size, we do not presently have depth of staffing in our executive, operational and financial management areas in order to

have an effective succession plan should the need arise. Thus, in the event of the loss of one or more of our management employees, our results of operations could be vulnerable to challenges associated with recruiting additional key personnel, if such recruiting efforts are not successful in a timely manner.

Certain of our products are dependent on specialized sources of supply that are potentially subject to disruption which could have a material, adverse impact on our business.

We have selectively single-sourced some of our material components in order to mitigate excess procurement costs associated with significant tooling and startup costs. Furthermore, because of the nature of government contracts, we are often required to purchase selected items from U.S. government approved suppliers, which may further limit our ability to utilize multiple supply sources for these key components.

To the extent any of these single sourced or government approved suppliers may have disruptions in deliveries due to production, quality, or other issues, we may also experience related production delays or unfavorable cost increases associated with retooling and qualifying alternate suppliers. The impact of delays resulting from disruptions in supply for these items could negatively impact our revenue, our reputation with our customers, and our results of operations. In addition, significant price increases from single-source suppliers could have a negative impact on our profitability to the extent that we are unable to recover these cost increases on our fixed price contracts.

Each contract has a specific quantity of material which needs to be purchased, assembled, and shipped. Prior to bidding a contract, we contact potential sources of material and receive 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 we would find an alternate supplier and bring this information back to the final customer. Contractual deliverables would then be re-negotiated (e.g., specifications, delivery, price. As of December 5, 2017, approximately 22% of our material requirements are single-sourced across 9 suppliers representing approximately 17% of our active supplier orders. Single-sourced component requirements span across all of our major product lines. The vast majority of these single-sourced components could be provided by another supplier with minimal interruption in schedule (supply delay of 3 months or less) or minimally increased costs. We do not believe these single sourced materials to pose any significant risk to us as other suppliers are capable of satisfying the purchase requirements in a reasonable time period with minimal increases in cost. Of these single sourced components, we have contracts (purchase orders) with firm pricing and delivery schedules in place with each of the suppliers to supply parts in satisfaction of our current contractual needs.

We consider only those specialized single source suppliers where a disruption in the supply chain would result in a period of three months or longer for us to identify and qualify a suitable replacement to present a material financial or schedule risk. In the table below, we identify only those specialized single source suppliers and the product lines supported by those materials utilized by us as of December 5, 2017.

| Product Line | Supplier | Supply Item | Risk | Purchase Orders |
|---------------------------|-----------------------|-------------------------------------|---|---|
| Sighting Systems M36 DDAN | Libra Industries | Digital camera system | Alternative source would take in excess of six months to qualify | This supplier is the designated replacement for Raytheon for the video system boards. One P.O. is currently in place to drive the transfer from Raytheon. |
| Periscopes | Newport Corp. | Metal mirrors for Driver periscopes | Alternative source would take in excess of six months to qualify | Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule |
| Periscopes | Optical Security Inc. | Vision blocks for armored vehicles | Alternative source would take in excess of six months to qualify | Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule. |
| Periscopes | Brown Die Casting | Die-cast housings | Consolidated all die cast tooling at this supplier. Would take approximately six months to move tooling and re-qualify. | Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on |

schedule.

| | | | | |
|------------|-----------------|--|--|---|
| Periscopes | Harbor Castings | Steel castings | Alternative source would take six months to qualify | Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. |
| Periscopes | Lanzen | MIL Spec welded housings for vision blocks | Would take approximately 4-6 months to re-qualify a new supplier | Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule. |

| Product Line | Supplier | Supply Item | Risk | Purchase Orders |
|--|-------------------------------|---|---|---|
| Other Big Eye | Corbett-Steeves Pattern Works | Sand castings for big eye binocular parts | Would take approximately 4-6 months to re-qualify a new supplier | Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. |
| Applied Optics Center Coated Filters | Carter Glass Blowing | Quartz Blocks | Alternative source would take in excess of six months to develop and qualify | Current firm fixed price and quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule. |
| Applied Optics Center M22/M24 Binocular | FujiFilm North America | Spare Components | Only approved source due to proprietary rights. Alternate source cannot be developed. | Current firm fixed price and quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule. |

The defense technology supply industry is subject to technological change and if we are not able to keep up with our competitors and/or they develop advanced technology as response to our products, we may be at a competitive disadvantage.

The market for our products is generally characterized by technological developments, evolving industry standards, changes in customer requirements, frequent new product introductions and enhancements, short product life cycles and severe price competition. Our competitors could also develop new, more advanced technologies in reaction to our products. Currently accepted industry standards may change. Our success depends substantially on our ability, on a cost-effective and timely basis, to continue to enhance our existing products and to develop and introduce new products that take advantage of technological advances and adhere to evolving industry standards. An unexpected change in one or more of the technologies related to our products, in market demand for products based on a particular technology or of accepted industry standards could materially and adversely affect our business. We may or may not be able to develop new products in a timely and satisfactory manner to address new industry standards and technological changes, or to respond to new product announcements by others. In addition, new products may or may not achieve market acceptance.

Unexpected warranty and product liability claims could adversely affect our business and results of operations.

The possibility of future product failures could cause us to incur substantial expense to repair or replace defective products. We warrant the quality of our products to meet customer requirements and be free of defects for twelve months subsequent to delivery. We establish reserves for warranty claims based on our historical rate of returned shipments against these contracts. There can be no assurance that this reserve will be sufficient if we were to experience an unexpectedly high incidence of problems with our products. Significant increases in the incidence of such claims may adversely affect our sales and our reputation with consumers. Costs associated with warranty and product liability claims could materially affect our financial condition and results of operations.

We derive almost all of our revenue from four customers and the loss of any of these customers could have a material adverse effect on our revenues.

For the year ended October 1, 2017, we derived approximately 86% of our gross operating revenue from four customers: 38% from the U.S. Government (primarily Defense Logistics Agencies (DLA) and USACC-Warren), 22% from Nightforce Optics Inc., 19% from General Dynamics Land Systems Divisions, and 7% from Harris Corporation. Procuring new customers and contracts may partially mitigate this risk. In particular, a decision by General Dynamics Land System Divisions, USACC-Warren, DLA or Nightforce Optics Inc. to cease issuing contracts to us could have a significant material impact on our business and results of operations given that they represent over 79% of our gross business revenue. There can be no assurance that we could replace these customers on a timely basis or at all.

We have approximately 60 discrete contracts with General Dynamics Land System Division and the U.S. Government (primarily USACC-Warren and DLA), and other prime contractors. If they choose to terminate these contracts, we are entitled to fully recover all contractual costs and reasonable profits incurred up to or as a result of the terminated contract.

We only possess four patents and rely primarily on trade secrets to protect our intellectual property.

We utilize several highly specialized and unique processes in the manufacture of our products, for which we rely solely on trade secrets to protect our innovations. We cannot assure you that we will be able to maintain the confidentiality of our trade secrets or that our non-disclosure agreements will provide meaningful protection of our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or other disclosure. The non-disclosure agreements that are designed to protect our trade secrets could be breached, and we might not have adequate remedies for the breach.

It is also possible that our trade secrets will otherwise become known or independently developed by our competitors, many of which have substantially greater resources than us, and these competitors may have applied for or obtained, or may in the future apply for or obtain, patents that will prevent, limit or interfere with our ability to make and sell some of our products. Although based upon our general knowledge (and we have not conducted patent searches), we believe that our products do not infringe on the patents or other proprietary rights of third parties; however, we cannot assure you that third parties will not assert infringement claims against us or that such claims will not be successful.

In the future, we may look to acquire other businesses in our industry and the acquisitions will require us to use substantial resources.

In the future, we may decide to pursue acquisitions of other businesses in our industry. In order to successfully acquire other businesses, we would be forced to spend significant resources for both acquisition and transactional costs, which could divert substantial resources in terms of both financial and personnel capital from our current operations. Additionally, we might assume liabilities of the acquired business, and the repayment of those liabilities could have a material adverse impact on our cash flow. Furthermore, when a new business is integrated into our ongoing business, it is possible that there would be a period of integration and adjustment required which could divert resources from ongoing business operations.

The Financial Industry Regulatory Authority, or FINRA, has adopted sales practice requirements which may also limit a shareholder's ability to buy and sell our stock.

FINRA has adopted rules that require that in recommending an investment to a customer, a broker-dealer must have reasonable grounds for believing that the investment is suitable for that customer. Prior to recommending speculative low priced securities to their non-institutional customers, broker-dealers must make reasonable efforts to obtain information about the customer's financial status, tax status, investment objectives and other information. Under interpretations of these rules, FINRA believes that there is a high probability that speculative low priced securities will not be suitable for at least some customers. FINRA requirements make it more difficult for broker-dealers to recommend that their customers buy our common stock, which may limit your ability to buy and sell our stock and have an adverse effect on the market for our shares.

The elimination of monetary liability against our directors, officers and employees under Delaware law and the existence of indemnification rights to our directors, officers and employees may result in substantial expenditures by us and may discourage lawsuits against our directors, officers and employees.

We provide indemnification to our directors and officers to the extent provided by Delaware law. The foregoing indemnification obligation could result in our incurring substantial expenditures to cover the cost of settlement or damage awards against directors and officers, which we may be unable to recoup. These provisions and resultant costs may also discourage us from bringing a lawsuit against directors and officers for breaches of their fiduciary duties and may similarly discourage the filing of derivative litigation by our stockholders against our directors and officers even though such actions, if successful, might otherwise benefit us and our stockholders.

Risks Related to Our Stock

We have issued a large number of shares of preferred stock, warrants and options, which if converted or exercised would substantially increase the number of common shares outstanding.

On December 19, 2017, we had 8,590,101 shares of common stock outstanding, and (a) we have vested options outstanding to purchase common stock that, if fully exercised, would generate proceeds of \$600,100 and result in the issuance of an additional 60,010 shares of common stock, and (b) we have 78 shares of Series C preferred stock that, if fully converted into 4,167 common shares per preferred share, would result in the issuance of an additional 325,000 shares of common stock and (c) we have 4,125,200 warrants outstanding at an exercise price of \$1.50 per share and (d) we have 182,000 granted unvested restricted stock units outstanding. Future sales of our common stock, warrants, options and Series C preferred stock may also adversely affect our stock price and our ability to raise funds in new offerings.

As a key component of our growth strategy we have provided and intend to continue offering compensation packages to our management and employees that emphasize equity-based compensation and would thus cause further dilution.

The warrants and our Series C preferred stock are unlisted securities and there is no public market for them.

There is no established public trading market for the warrants or the Series C preferred stock, and we do not expect a market to develop. In addition, the warrants and Series C preferred stock are not listed, and we do not intend to apply for listing of the warrants or the Series C preferred stock on any securities exchange or trading system. Without an active market, the liquidity of the warrants and the Series C preferred stock is limited, and investors may be unable to

liquidate their investments in the warrants and Series C preferred stock.

Our stock price is speculative and there is a risk of litigation.

The trading price of our common stock has in the past and may in the future be subject to wide fluctuations in response to factors such as the following:

revenue or results of operations in any quarter failing to meet the expectations, published or otherwise, of the investment community;

speculation in the press or investment community;

wide fluctuations in stock prices, particularly with respect to the stock prices for other defense industry companies;

announcements of technological innovations by us or our competitors;

new products or the acquisition of significant customers by us or our competitors;

changes in investors' beliefs as to the appropriate price-earnings ratios for us and our competitors;

changes in management;

sales of common stock by directors and executive officers;

rumors or dissemination of false or misleading information, particularly through Internet chat rooms, instant messaging, and other rapid-dissemination methods;

conditions and trends in the defense industry generally;

the announcement of acquisitions or other significant transactions by us or our competitors;

adoption of new accounting standards affecting our industry;

general market conditions;

domestic or international terrorism and other factors; and

the other factors described in this section.

Fluctuations in the price of our common stock may expose us to the risk of securities class action lawsuits. Although no such lawsuits are currently pending against us and we are not aware that any such lawsuit is threatened to be filed in the future, there is no assurance that we will not be sued based on fluctuations in the price of our common stock. Defending against such suits could result in substantial cost and divert management's attention and resources. In addition, any settlement or adverse determination of such lawsuits could subject us to significant liability.

Future sales of our common stock could depress our stock price.

Sales of a large number of shares of our common stock, or the availability of a large number for sale, could materially adversely affect the per share market price of our common stock and could impair our ability to raise funds in addition offering of our debt or equity securities. In the event that we propose to register shares of common stock under the Securities Act for our own account, certain shareholders are entitled to include their shares in the registration, subject to limitations described in the agreements granting these rights.

Cautionary Note Regarding Forward-Looking Information

This prospectus, in particular the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” appearing herein, contains certain “forward-looking statements” within the meaning of Section 27A of the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended (“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 electrical storage device industry, all of which are subject to various risks and uncertainties.

When used in this prospectus as well as in reports, statements, and information we have filed with the Securities and Exchange Commission, 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 expressions and variations thereof are intended to identify such forward-looking statements. However, any statements contained in this prospectus 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.

Item 2 Properties

We are headquartered in Richardson, TX and lease 93,967 combined square feet of facilities including Richardson, Texas and Dallas, Texas. As of December 5, 2017, we had 98 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 renewed the lease on our 49,100 square foot, Richardson, Texas facility, effective as of December 10, 2013 with a lease expiration of March 31, 2021. As of December 5, 2017, the Richardson facility operates with 61 full time equivalent employees in a single shift operation.

In November 2014, we also acquired a new business unit from L-3 Communications, Inc., which is described herein below under “Recent Events — Acquisition”. The acquisition, the Applied Optics Center, is located in Dallas, Texas with leased premises consisting of approximately 44,867 square feet of space. We executed a new lease for the Applied Optics Center location, effective as of October 1, 2016, which was countersigned by the landlord on October 21, 2016. The term of the lease expires October 31, 2021. There are two renewal options available to the tenant, and each renewal term is five years in duration. As of December 5, 2017, Applied Optics Center operates with approximately 37 full time equivalent employees in a single shift operation.

Item 3 Legal Proceedings

From time to time, we are involved in lawsuits, claims, investigations and proceedings, including pending opposition proceedings involving patents that arise in the ordinary course of business. There are no matters pending that we expect to have a material adverse impact on our business, results of operations, financial condition or cash flows.

Item 4 Mine Safety Disclosures

None.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market information

Our common stock is currently quoted on the OTCQB Marketplace under the symbol “OPXS”. Trading in our common stock has historically lacked consistent volume, and the market price has been volatile.

The following table shows the range of high and low bid prices for our common stock as reported by the OTCQB Marketplace. The quotations reflect inter-dealer prices, without retail markup, markdown or commission and may not represent actual transactions.

| Period | High | Low |
|---------------------|---------|---------|
| First Quarter 2015 | \$10.00 | \$10.00 |
| Second Quarter 2015 | \$10.00 | \$8.00 |
| Third Quarter 2015 | \$7.00 | \$5.00 |
| Fourth Quarter 2015 | \$8.00 | \$8.00 |
| First Quarter 2016 | \$7.30 | \$2.60 |
| Second Quarter 2016 | \$3.50 | \$2.00 |
| Third Quarter 2016 | \$2.60 | \$1.75 |
| Four Quarter 2016 | \$2.75 | \$0.68 |
| First Quarter 2017 | \$1.02 | \$0.59 |
| Second Quarter 2017 | \$0.79 | \$0.59 |
| Third Quarter 2017 | \$1.05 | \$0.66 |
| Fourth Quarter 2017 | \$1.30 | \$0.90 |

On December 15, 2017, the closing price for our common stock as reported on the OTCQB was \$1.07 per share.

Securities outstanding and holders of record

On December 19, 2017, there were approximately 80 shareholders of record for our common stock and 8,590,101 shares of our common stock issued and outstanding.

Dividends

On June 26, 2017, the board of directors approved a resolution authorizing a \$0.02 per share (and per warrant) dividend payment on July 12, 2017, for common and preferred C shareholders and warrant holders of record as of July 5, 2017 and for three subsequent quarterly record dates thereafter. Quarterly dividends of \$261 thousand were paid out to share and warrant holders on July 12, 2017. Optex recorded an additional \$261 thousand in dividends payable as of October 1, 2017 for the fourth quarter declared dividends which were paid on October 19, 2017. The Company will review its working capital needs after the next two quarters dividend payments prior to determining any future dividends or amounts to be paid to our shareholders beyond April 2018.

Information respecting equity compensation plans

Summary Equity Compensation Plan Information

Optex Systems Holdings adopted its 2009 Stock Option Plan on March 26, 2009. On December 9, 2011, the Board of Directors of Optex Systems Holdings, Inc. authorized an amendment to its Stock Option Plan to increase the number of issuable shares from 6,000 to 50,000 and authorized the grant of 10,000 options to two board members and a total of 36,070 to Optex Systems Holdings employees including 20,000 options to executive officers. On December 19, 2013, the Board of Directors of Optex Systems Holdings, Inc. authorized an amendment to its Stock Option Plan to increase the number of issuable shares from 50,000 to 75,000 and authorized the grant of 20,000 options to three board members and a grant of 5,000 to an Optex Systems Holdings officer. The options granted in 2011 and 2013 were at exercise prices of \$10.00 per share with each grant to vest 25% per year over four years for each year with which the grantee is still employed by or serving as a director of Optex Systems Holdings, Inc. (with all unvested options automatically expiring on the date of termination of employment by or service as a director of Optex Systems Holdings, Inc.) and all unvested options immediately vesting upon a change of control due to a merger or acquisition of the Company. As of December 18, 2017, 71,070 options had been granted, 6,060 of these options had forfeited due to terminations or expiration, and 65,010 had vested of which 5,000 options were exercised. The outstanding vested and unvested options are 60,010 and zero, respectively.

2016 Restricted Stock Unit Plan

On June 14, 2016, our Compensation Committee approved our 2016 Restricted Stock Unit Plan. This plan provides for issuance of stock units (“RSUs”) for up to 1,000,000 shares of our common stock. Each RSU constitutes a right to receive one share of our common stock, subject to vesting, which unless otherwise stated in an RSU agreement, shall vest in equal amounts on the first, second and third anniversary of the grant date. Shares of our common stock underlying the number of vested RSUs will be delivered as soon as practicable after vesting. During the period between grant and vesting, the RSUs may not be transferred, and the grantee has no rights as a shareholder until vesting has occurred. If the grantee’s employment is terminated for any reason (other than following a change in control of us or a termination of an officer other than for cause), then any unvested RSUs under the award will automatically terminate and be forfeited. If an officer grantee’s employment is terminated by us without cause or by the grantee for good reason, then, provided that the RSUs have not been previously forfeited, the remaining unvested portion of the RSUs will immediately vest as of the officer grantee’s termination date. In the event of a change in control, our obligations regarding outstanding RSUs shall, on such terms as may be approved by the Committee prior to such event, immediately vest, be assumed by the surviving or continuing company or cancelled in exchange for property (including cash).

On June 15, 2016, we issued 150,000 RSUs to our Chief Executive Officer, Danny Schoening, and 50,000 RSUs to our Chief Financial Officer, Karen Hawkins. The RSUs issued to Mr. Schoening and Ms. Hawkins vest as follows: 34% on January 1, 2017, 33% on January 1, 2018 and 33% on January 1, 2019.

On January 5, 2017, Optex Systems Holdings issued 45,799 common shares related to the vesting of the 68,000 restricted stock units on January 1, 2017. The shares issued were net of 22,201 common shares withheld for employee federal income tax requirements.

On June 15, 2017, the Company issued 50,000 RSUs to its Applied Optics Center General Manager and new board member, Bill Bates. Pursuant to the RSU agreements the RSUs issued to Mr. Bates will vest as follows: 34% on January 1, 2018, 33% on January 1, 2019 and 33% on January 1, 2020. The total market value of the restricted stock units based on the shares price of \$0.95 as of June 15, 2016 is \$47.5 thousand. The cost of the shares is amortized on a straight line basis across the vesting periods.

As of December 18, 2017 there are 182,000 outstanding unvested restricted stock units remaining to vest of which 83,000 will vest on January 1, 2018.

Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the consolidated financial statements and the related notes that are set forth in our financial statements elsewhere in this annual report.

This management's discussion and analysis reflects information known to management as of our fiscal year end, October 1, 2017, and the date of filing. This MD&A is intended to supplement and complement our audited financial statements and notes thereto for the year ended October 1, 2017, prepared in accordance with U.S. generally accepted accounting principles (GAAP). You are encouraged to read our financial statements in conjunction with your reading of this MD&A. The financial information in this MD&A has been prepared in accordance with GAAP, unless otherwise indicated. In addition, we use non-GAAP financial measures as supplemental indicators of our operating performance and financial position. We use these non-GAAP financial measures internally for comparing actual results from one period to another, as well as for planning purposes. We will also report non-GAAP financial results as supplemental information, as we believe their use provides more insight into our performance. When a non-GAAP measure is used in this MD&A, it is clearly identified as a non-GAAP measure and reconciled to the most closely corresponding GAAP measure.

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

Background

On March 30, 2009, a reorganization was consummated pursuant to which the then existing shareholders of Optex Systems, Inc. (Delaware) exchanged their shares of common stock for 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 by Optex Systems Holdings 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 by Optex Systems Holdings 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 by Optex Systems Holdings 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. The common shares above are presented at their pre reverse split share quantities to preserve historical information. Optex Systems Holdings effected a 1000:1 reverse stock split on October 7, 2015. As a result of the reorganization, Optex Systems Holdings changed its name from Sustut Exploration Inc. to Optex Systems Holdings, Inc., and its year end from December 31 to a fiscal year ending on the Sunday nearest September 30.

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

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

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

conditions effecting contract awards and pricing solicitations.

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

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

In addition, some of our contracts allow for government contract financing in the form of contract progress payments pursuant to Federal Acquisition Regulation 52.232-16, "Progress Payments". As a small business, and subject to certain limitations, this clause provides for government payment of up to 90% of incurred program costs prior to product delivery. To the extent our contracts allow for progress payments, we intend to utilize this benefit, thereby minimizing the working capital impact on Optex Systems Holdings for materials and labor required to complete the contracts.

Recent Orders

In October 2016, we received a \$0.8 million order from L-3 Communications for night vision goggle laser interference filter assemblies deliverable through March 2017.

In October 2016, we were awarded a \$1.3 million portion of a commercial multi-year strategic supplier agreement with a domestic manufacturer of premium optical devices to supply its optical assemblies. The units will be delivered in fiscal year 2017.

In November 2016, we were awarded a \$1.5 million contract for laser protected periscopes from Defense Logistics Agency (DLA). The award is the first delivery order against a 5-year Indefinite Delivery, Indefinite Quantity (IDIQ) contract with DLA totaling \$5.99 million. Deliveries for the first order against this contract began in January 2017 and will continue through August 2017.

In December 2016, we were awarded a \$1.5 million purchase order from one of the world's largest defense companies for laser protected periscopes installed into Light Armored Vehicles in the Middle East. The periscopes will be delivered over three years, with the first delivery beginning in December 2017.

In February 2017, we were awarded a \$1.3 million award with a domestic manufacturer of premium optical devices for deliveries in fiscal year 2017.

In March 2017, we received a purchase order from a domestic defense contractor in the amount of \$1.7 million to supply Laser Interference Filter (LIF) Assemblies supporting the U.S. Government spares for fielded night vision goggles. Deliveries will begin in June 2017 and continue through January 2018.

On July 3, 2017, we were awarded a five year Indefinite-Delivery Indefinite-Quantity contract through DLA Land at Aberdeen for provision of night vision assemblies for the U.S. military. The Laser Interference Filter Assemblies will be manufactured at the Applied Optics Center (AOC) Division of Optex Systems, Inc. in Dallas, Texas. The contract

calls for five one-year ordering periods running consecutively commencing on July 5, 2017 at pricing set forth in the addenda to the contract. The contract calls for first article testing and has a guaranteed minimum of \$50,000. Given prior contracts awarded to the Company through DLA, the Company expects to generate between \$8.4 and \$12.4 million in revenue over the next five year period from this contract.

On September 11, 2017 we were awarded a \$1.35 million contract by defense industry leader General Dynamics Land Systems-Canada, to provide LAV 6.0 optimized weapon system support for Optex's Commander Sighting System. This in-service support will continue over the next three years for their existing fleet of Light Armored Vehicles.

On September 18, 2017 was awarded a five year Indefinite-Delivery Indefinite-Quantity (IDIQ) contract through Defense Logistics Association (DLA) in support of the Abrams Main Battle Tank platform. The contract is expected to generate between \$1.5M and \$2.4 million in revenue over the next five year period for Optex Systems. As of October 30, three task delivery orders have been awarded against the IDIQ for a total value of \$1.5 million.

New Product Development

We continue to field new product opportunities from both domestic and international customers. Given continuing unrest in multiple global hot spots, the need for precision optics continues to increase. Most of these requirements are for observation and situational awareness applications; however, we continue to see requests for higher magnification and custom reticles in various product modifications. The basic need to protect the soldier while providing information about the mission environment continues to be the primary driver for these requirements.

We are cautiously optimistic that the new government administrations proposed boost in military spending will have a favorable impact in the direction of funding or product need for the U.S. military. We anticipate that absent any significant changes from the current defense spending levels, maintenance will still be required, and the opportunities for us to upgrade existing systems with higher performing systems will continue to present themselves. Spending levels may change, but given the mix between foreign spending, domestic/prime demand, and the more recent commercial opportunities, we do not expect any negative trends arising from political domestic changes over the next twelve months.

In July 2017, Optex Systems was awarded a design patent on our “Red Tail” digital spotting scope. This device is targeted towards long range observation and image recording used by military, border patrol, and select consumer/commercial applications. The device is designed to deliver high definition images with military grade resolution, but at commercial “off the shelf” pricing. Using high grade optics to deliver a 45X magnified image onto a 5 megapixel CMOS sensor, the Red Tail device then transmits this image via Wi-Fi to the user’s smartphone or tablet. Digital still images or videos can then be captured and/or emailed using a custom Red Tail app available for either iOS or Android devices.

Recent Events

Stock Repurchase

On April 27, 2017, the Board of Directors of Optex Systems Holdings approved a purchase of 700,000 shares of its common stock in a private transaction from The Longview Fund, L.P. The transaction was priced at the closing sale price on April 28, 2017 of \$0.74 per share for a total transaction amount of \$518,000. Upon repurchase on May 1, 2017, the shares were cancelled thereby reducing the total shares outstanding of its common stock.

Sileas Corp.

On June 9, 2017, Sileas Corp. (“Sileas”), a related party to us, entered into a transaction with The Longview Fund, L.P. (“Longview”) to settle its February 20, 2009 note with Longview in the original principal amount of \$13,524,405 (the “Note”). The parties agreed to a conversion by Longview of \$3,358,538 of the amount due under the Note into 2,798,782 shares of Company common stock owned by Sileas and previously pledged to Longview as security with respect to the Note. Simultaneously therewith, Sileas made a \$250,000 cash payment to Longview, and Longview agreed to cancel the remaining debt of \$10,571,791 due under the Note. The remaining amount due under the Note is \$64,000 which shall be paid in cash by Sileas to Longview on a quarterly basis, upon the payment of quarterly dividends by us, over the next four calendar quarters commencing on or about June 30, 2017. In order to effect the above, Longview also released the pledge on all of our shares owned by Sileas and previously pledged to Longview.

Simultaneously with the above, Sileas sold 800,000 shares of our common stock to Danny Schoening and Karen Hawkins at a price equal to \$314,000 (which is a discounted amount based upon recognition of years of administrative support by Mr. Schoening and Ms. Hawkins for the Company) as follows: (i) Danny Schoening: 640,000 Shares for \$200,000 plus a \$50,825 promissory note; and (ii) Karen Hawkins: 160,000 Shares for \$50,000 plus a \$12,706 promissory note. Each promissory note has a one year term, with interest at 1.18% per annum and shall be payable in four equal quarterly installments of \$12,800 for Danny Schoening and \$3,200 for Karen Hawkins, each installment payable within five business days after the payment of cash dividends by us to each of them. As a result, Sileas no longer owns any shares of our common stock.

Changes to the Board of Directors

Effective as of May 31, 2017, Charles Trego resigned as a director of us and from all appointments to Committees of our Board of Directors.

Effective as of June 9, 2017, Peter Benz resigned as Chairman of the Board and a Director of us. Effective as of that same date, our Board of Directors appointed Danny Schoening, its CEO and a director, as the Chairman of the Board of Directors and appointed Karen Hawkins, its CFO, and Bill Bates, the General Manager of its Applied Optics Center division, as directors. The board further resolved that Owen Naccarato would replace Charles Trego as the new Audit Committee chair.

Executive and Board Compensation

On June 9, 2017, through Unanimous Written Consent, the Board of Directors amended Danny Schoening's employment agreement to increase his annual bonus from a maximum of 30% to 60% of his base salary and entered into a consulting agreement with Peter Benz to provide advisory services at the rate of \$10,000 per month through December 2017.

On June 14, 2017, through Unanimous Written Consent, the Board of Directors increased the monthly fee paid to the remaining independent directors from \$1,000 to \$1,500 per month, effective immediately, and granted Bill Bates, the Applied Optics Center General Manager and new board member 50,000 Restricted Stock Units (RSU's). Pursuant to the RSU agreements the RSUs issued to Mr. Bates will vest as follows: 34% on January 1, 2018, 33% on January 1, 2019 and 33% on January 1, 2020. The total market value of the restricted stock units based on the shares price of \$0.95 as of June 15, 2016 is \$47.5 thousand.

Dividends

On June 26, 2017, the board of directors approved a resolution authorizing a \$0.02 per share (and per warrant) dividend payment on July 12, 2017, for common and preferred C shareholders and warrant holders of record as of July 5, 2017 and for three subsequent quarterly record dates thereafter. On October 19, 2017, we paid a second \$0.02 per share dividend to holders of record as of October 12, 2017.

Results of Operations

Segment Information

We have presented the operating results by segment to provide investors with an additional tool to evaluate our operating results and to have a better understanding of the overall performance of each business segment and its ability to perform in subsequent periods. Management of Optex Systems Holdings uses the selected financial measures by segment internally to evaluate its ongoing segment operations and to allocate resources within the organization accordingly. Segments are determined based on differences in products, location, internal reporting and how operational decisions are made. Management has determined that the Optex Systems, Richardson plant, and the Applied Optics Center, Dallas plant, which was acquired on November 3, 2014, are separately managed, organized, and internally reported as separate business segments. The table below provides a summary of selective statement of operations data by operating segment for the years ended October 1, 2017 and October 2, 2016 reconciled to the Audited Consolidated Results of Operations as presented in Item 8, “Financial Statements and Supplementary Data”.

Results of Operations Selected Financial
 Info by Segment

(Thousands)

Twelve months ending

| | October 1, 2017 | | | | October 2, 2016 | | | |
|---|---------------------|---------------------------------------|---|--------------|---------------------|---------------------------------------|--|--------------|
| | Optex Richardson | Applied Optics Center Dallas | Other (non allocated costs and eliminations) | Consolidated | Optex Richardson | Applied Optics Center Dallas | Other (non allocated costs and eliminations) | Consolidated |
| Revenue from External Customers | \$ 11,256 | \$ 7,291 | \$ — | \$ 18,547 | \$ 11,052 | \$ 6,227 | \$ — | \$ 17,279 |
| Intersegment Revenues | — | 1,694 | (1,694) | — | — | 1,892 | (1,892) | — |
| Total Segment Revenue | 11,256 | 8,985 | (1,694) | 18,547 | 11,052 | 8,119 | (1,892) | 17,279 |
| Total Cost of Sales | 9,099 | 7,728 | (1,694) | 15,133 | 8,891 | 7,229 | (1,892) | 14,228 |
| Gross Margin | 2,157 | 1,257 | — | 3,414 | 2,161 | 890 | — | 3,051 |
| Gross Margin % | 19.2 % | 14.0 % | 0.0 % | 18.4 % | 19.6 % | 11.0 % | 0.0 % | 17.7 % |
| General and Administrative Expense ⁽¹⁾ | 2,595 | 435 | 180 | 3,210 | 2,604 | 507 | 851 | 3,962 |
| Segment Allocated G&A Expense | (776) | 776 | — | — | (728) | 728 | — | — |
| Net General & Administrative Expense | 1,819 | 1,211 | 180 | 3,210 | 1,876 | 1,235 | 851 | 3,962 |
| Operating Income (Loss) | 338 | 46 | (180) | 204 | 285 | (345) | (851) | (911) |
| Operating (Loss) % | 3.0 % | 0.5 % | 10.6 % | 1.1 % | 2.6 % | (4.2 %) | 0.0 % | (5.3 %) |
| (Loss) Gain on Change in Fair Value of Warrants | — | — | (489) | (489) | — | — | 739 | 739 |
| Interest Expense | — | — | (19) | (19) | — | — | (36) | (36) |

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| | | | | | | | | | | | |
|--------------------------------|-------|---|------|---|----------|----------|-------|---|----------|----------|----------|
| Net Income (Loss) before taxes | \$338 | | \$46 | | \$(688) | \$(304) | \$285 | | \$(345) | \$(148) | \$(208) |
| Net Income (Loss) % | 3.0 | % | 0.5 | % | — | (1.6 %) | 2.6 | % | (4.2 %) | — | (1.2 %) |

(1) General and administrative expenses for the twelve months ending October 2, 2016 of \$140 thousand associated with amortized stock compensation attributable to executive/director restricted stock units has been restated from Optex Richardson to Other (non allocated costs and eliminations). Operating income (loss) for Optex Richardson and Other (non allocated costs and eliminations) as been restated to reflect the change. Other (non allocated costs and eliminations) includes \$711 thousand in expenses attributable to warrants issued in the August 2016 public offering.

Our total external sales revenues increased by \$1.2 million, or 6.9%, in 2017 over the 2016 revenue levels. The Optex Systems Richardson segment realized a \$0.1 million, or 0.9%, increase in external revenue and the Applied Optics Center segment realized an increase of \$1.1 million, or 17.7%, in external revenue over the prior year period. Intersegment revenues decreased by (\$0.2) million during the 2017 year, from \$1.9 million to \$1.7 million.

Intersegment revenues relate primarily to coated filters provided by the Applied Optics Center to Optex Systems in support of the Optex Systems periscope line.

Gross margin increased \$0.4 million and the gross margin percentage increased by 1% point from 17.7% in 2016 to 18.4% in 2017. The gross margin and the gross margin percentages increased significantly in 2017 for the Applied Optics Center segments over 2016. The Applied Optics Center gross margin increased by \$0.4 million and the gross margin percent increased by 3.1% points from 11.0% in 2016 to 14.1% in 2017 over the 2016 gross margin. U.S. government military spending has a significant impact on our product lines as our products directly support various types of U.S. military land vehicle procurements. During 2017, the Optex Systems gross margin percentage declined slightly to 19.2% in 2017 as compared to a gross margin percentage of 19.6% in 2016 primarily driven by changes in product mix between the years.

During the year ending 2017, the Applied Optics Center absorbed (\$0.8) million of fixed general and administrative costs incurred by Optex Systems for support services, as compared to (\$0.7) million in the prior year period. These expenses cover accounting, executive, human resources, information technology, board fees and other corporate expenses paid by Optex Systems and shared across both operating segments.

Operating income increased significantly, by \$1.1 million, in 2017, to \$0.2 million, as compared to the prior year operating loss of (\$0.9) million. The Applied Optics Center operating profit increased by \$0.4 million, from a prior year operating loss of (\$0.3) million to a 2017 operation income of \$0.1 million. Optex Systems operating profit increased slightly, \$0.04 million, in 2017 as compared to 2016 on higher revenue. The Other (non allocated costs and eliminations) operating loss in 2016 included (\$0.7) million in non-recurring warrant expenses associated with the public offering in August 2016.

The net loss before taxes increased from the prior year by (\$0.1) million, from a prior year net loss before taxes of (\$0.2) million to a current year net loss before taxes of (\$0.3) million. The increase in net loss year over year is primarily due increased operating profit of \$1.1 million, offset by non cash related changes to the fair value of warrants of (\$1.2) million from a gain of \$0.7 million 2016 to a loss of (\$0.5) million 2017.

Backlog

Backlog as of October 1, 2017 was \$15.7 million as compared to a backlog of \$12.0 million as of October 2, 2016, representing an increase of 30.8%. The following table depicts the current expected delivery by quarter of all contracts awarded as of October 1, 2017.

| Product Line | (Millions) | | | | 2018 Delivery | 2019+ Delivery | Total Backlog 10/1/2017 | Total Backlog 10/2/2016 | Variance | % Chg |
|-----------------------------------|------------|------------|------------|------------|------------------|-------------------|-------------------------------|-------------------------------|----------|----------|
| | Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 | | | | | | |
| Periscopes | 2.0 | 1.2 | 0.5 | — | 3.7 | 1.2 | 4.9 | 3.4 | 1.5 | 44.1 % |
| Sighting Systems | 0.5 | 1.0 | 0.8 | 0.1 | 2.4 | 1.7 | 4.1 | 3.2 | 0.9 | 28.1 % |
| Other | 0.2 | 0.3 | 0.1 | — | 0.6 | — | 0.6 | 2.3 | (1.7) | (73.9%) |
| Optex Systems - Richardson | 2.7 | 2.5 | 1.4 | 0.1 | 6.7 | 2.9 | 9.6 | 8.9 | 0.7 | 7.9 % |
| Applied Optics Center - Dallas | 1.8 | 1.8 | 1.5 | 0.9 | 6.0 | 0.1 | 6.1 | 3.1 | 3.0 | 96.8 % |
| Total Backlog | 4.5 | 4.3 | 2.9 | 1.0 | 12.7 | 3.0 | 15.7 | 12.0 | 3.7 | 30.8 % |

During 2017, Optex Systems Holdings received new orders totaling \$22.3 million, a 26.7% increase, as compared to new orders of \$17.6 million during the prior year. The 2017 orders consist of \$8.6 million in support of our periscope product line, \$10.3 million attributable to the Applied Optics Center and \$2.1 million attributable to sighting systems and support, and \$1.3 million in other products. Approximately 39.1% or \$8.7 million of the orders received in fiscal year 2017 were delivered within the year, with \$10.6 million deliverable in 2018 and the remaining \$3.0 million balance to be delivered in fiscal year 2019 and beyond. As of October 1, 2017 our shippable backlog for fiscal year 2018 is \$15.7 million. As of December 5, 2017, Optex Systems Holdings, Inc. has received additional new orders of \$2.5 million, which includes \$1.3 million in periscopes, \$0.7 million in sighting systems, \$0.3 million in Optex other and \$0.2 million of Applied Optics Center products for deliveries in fiscal year 2018. We expect our orders during fiscal year 2018 to meet or exceed the fiscal year 2017 orders, with a substantial portion, approximately 35-40%, to be deliverable within the fiscal year 2018 period.

Military spending has been negatively impacted by the Budget Control Act of 2011, which was passed in August 2011. The Budget Control Act mandated a \$917.0 billion reduction in discretionary spending over the next decade, and \$1.2 trillion in automatic spending cuts over a nine-year period to be split between defense and non-defense programs beginning in January 2013. The sequestration caps were eased during the 2016 and 2017 fiscal years as Congress passed the Bipartisan Budget Act of 2015.

We believe that the defense industry effects of the sequestration from 2011 have reached a plateau and we will begin to see small but steady increases in defense military procurement orders in the coming years. On November 16, 2017, the National Defense Authorization Act (NDAA) for fiscal year 2018 was sent to President Trump to sign into law after passing both the House of Representatives and the Senate. The 2018 NDAA authorizes total spending of \$700 billion which includes a base spending authorization of \$634 billion plus the authorization of \$65.8 billion in additional funding for the Overseas Contingency Operation (OCO) account. The bill authorizes a major hike in military spending over the 2017 NDAA authorization of \$619 billion and sets defense spending well above the \$549 billion base authorization cap under the 2011 Budget Control Act. There currently is no clear plan from Congress on how to provide additional money above the sequestration limit and changes in the sequestration law will require bipartisan support to reach a senate vote threshold of 60 to avoid a filibuster. Although it is difficult to directly tie the budget request to specific components provided by Optex Systems, we provide periscopes, collimator assemblies, vision blocks and laser interface filters to the U.S. armed forces on almost all of the ground system platforms categorized in the Department of Defense budget request for 2018.

The U.S. military supply industry has become highly competitive as suppliers fight for increased market share to offset the impacts of the reduced government spending. We compete with other suppliers on the basis of quality, delivery, price, and overall customer service, among other things. Our competitors include a number of suppliers, some of which have established strong relationships with the defense contracting agencies. Competition can lead to price reductions, reduced margins and an inability to gain or hold market share. We are aggressively pursuing additional periscope market share in both foreign and domestic defense contractor markets in order to mitigate the effect the reduced U.S. military orders has on our operations.

Optex Systems - Richardson:

Backlog for our periscope product line has increased 44.1% or \$1.5 million to \$4.9 million, from our ending 2016 fiscal year level of \$3.4 million. We attribute the increased backlog in 2017 to delayed timing of U.S. government contract awards during the fourth quarter of 2016 combined with increased orders in the current fiscal year. Our total periscope contract awards for fiscal 2017 totaled \$8.6 million as compared to \$7.8 million in the fiscal year 2016. Optex Systems, Inc. has experienced an increase in US government demand for laser protected periscopes in support of ongoing maintenance of US combat vehicles in addition to increased orders for foreign markets in support of Saudi Arabia's Light Armored Vehicle, Morocco's conversion of M1A1 vehicles to the situational awareness configuration and US Department of State Foreign Military Sales (FMS) in support of the M113 Periscope Upgrade program for Brazil. During fiscal year 2017 we received a large award consisting of a \$1.5 million contract for laser protected periscopes from Defense Logistics Agency (DLA). The award is the first delivery order against a 5-year Indefinite Delivery, Indefinite Quantity (IDIQ) contract with DLA totaling \$5.99 million. In addition, Optex was awarded a \$1.5 million purchase order from one of the world's largest defense companies for laser protected periscopes. These periscopes are installed into Light Armored Vehicles in the Middle East and will be delivered over the next three years beginning in December 2017. During the last quarter of fiscal year 2017 Optex was awarded an additional 5-year Indefinite Delivery, Indefinite Quantity (IDIQ) contract with DLA in support of the Abrams Main Battle Tank platform. The total contract is expected to generate between \$1.5 million and \$2.4 million in revenue over the next five year period for Optex Systems. On September 29, 2017 we received our first task order delivery award of \$0.5 million, with an additional \$1.0 million awarded in two separate task orders on October 23, 2017 subsequent to the fiscal 2017 year end.

Sighting Systems backlog increased by \$0.9 million or 28.1% in the last twelve months. In September 2017, we received a substantial contract award of from General Dynamics Land Systems- Canada of \$1.35 million to provide LAV 6.0 optimized weapon system support for Optex's Commander Sighting System. This in-service support will continue over the next three years for their existing fleet of Light Armored Vehicles. We continued to deliver against our existing M36 DDAN sighting systems contract. We anticipate the possibility of new sighting systems orders for DDANs as well as similar sighting systems for delivery beyond 2018. Our current sighting system backlog deliveries have been scheduled through the third quarter of fiscal 2018.

Our backlog in other product groups decreased by (\$1.7) million or 73.9% from \$2.3 million in 2016 to \$0.6 million in 2017. The decrease is driven by lower orders for collimator assemblies and cable periscope assemblies. In 2016 we books two large orders which were shipped during 2017. We continue to bid on new orders within these product groups and anticipate new orders on these products throughout 2018.

Applied Optics Center – Dallas

The Applied Optics Center backlog increased by \$3.0 million, or 98.6%, for the year ending 2017 from \$3.0 million in 2016 to \$6.1 million in 2017. Significant new orders booked during the year consisted of a \$0.8 million order from L-3 Communications, a \$1.7 million order from a domestic defense contractor to supply night vision goggle laser interference filter assemblies and commercial purchase orders totaling \$4.9 million against a multi-year strategic supplier agreement for optical assemblies and \$1.6 million in task orders for night vision assemblies for the U.S. military against a five year Indefinite-Delivery Indefinite-Quantity contract through DLA Land at Aberdeen The total expected value of the IDIQ contract is between \$8.4 and \$12.4 million in revenue over the next five year period.

The Applied Optics Center also serves as a primary filter supplier to the Optex Systems – Richardson plant. During the fiscal year 2017, the Applied Optex Center received intracompany orders for laser coated filters in support of Optex periscopes of \$1.7 million, as compared to \$1.9 million in the prior year.

We are cautiously optimistic that recent proposed boosts in military spending by the government administration will have a favorable impact in the direction of funding or product need for the U.S. military. Optex Systems Holdings continues to pursue new international and commercial opportunities in addition to maintaining its current footprint with U.S. military vehicle manufactures, with existing as well as new product lines. We continue exploring new market opportunities for our M17 day/thermal periscopes and digital optics for commercial applications. We are also reviewing potential products, outside our traditional product lines, which could be manufactured using our current production facilities in order to capitalize on our existing capacity. Further, we continue to look for strategic businesses to acquire that will strengthen our existing product line, expand our operations, and enter new markets.

Twelve month period ended October 1, 2017 compared to the twelve month period ended October 2, 2016

Revenues:

The table below details the revenue changes by segment and product line for the year ended October 1, 2017 as compared to the year ended October 2, 2016.

| Product Line | Twelve months ended (Millions) | | | |
|--------------------------------|-----------------------------------|-----------------|----------|---------|
| | October 1, 2017 | October 2, 2016 | Variance | % Chg |
| Periscopes | \$7.1 | \$8.1 | \$(1.0) | (12.3) |
| Sighting Systems | 1.1 | 1.8 | (0.7) | (38.9) |
| Other | 3.0 | 1.2 | 1.8 | 150.0 |
| Optical Systems – Richardson | 11.2 | 11.1 | 0.1 | 0.9 |
| Applied Optics Center – Dallas | 7.3 | 6.2 | 1.1 | 17.7 |
| Total Revenue | \$18.5 | \$17.3 | \$1.2 | 6.9 |

Our total revenues increased by \$1.2 million, or 6.9%, in 2017 over the 2016 revenue levels. The Optex Systems Richardson segment realized a \$0.1 million, or 0.9%, increase in revenue and the Applied Optics Center segment realized an increase of \$1.1 million, or 17.7%, in revenue over the prior year period. Approximately 39.1% of our total revenue recognized during the fiscal year was from new orders booked during the twelve months ending October 1, 2017.

Revenues decreased by (\$1.0) million or (12.3%) on our periscope line during the twelve months ended October 1, 2017 as compared to the twelve months ended October 2, 2016. Revenue decreased during the current year from the prior year primarily due to lower revenue on glass periscopes of (\$0.5) million for the US government and lower

revenue of (\$0.5) million on foreign M17 day thermal periscopes for contracts which were completed in 2016. Based on our strong ending September backlog of \$4.9 million and new orders of \$1.3 million received in the first quarter of fiscal 2018, we expect our 2018 periscope revenues to meet or exceed the 2017 levels with a strong first quarter backlog schedule.

Revenues on sighting systems declined by (\$0.7) million, or (38.9%) from the prior year period . Deliveries on our backlog for DDAN sighting systems which were previously pending qualification testing, receipt of long lead materials and export licensing were delayed throughout the first half of 2017. We resumed production on these units in June and are anticipated higher production levels through the third quarter of 2018.

Revenue on other product lines increased by \$1.8 million, or 150%, compared to revenues in the prior year as we completed first article testing and shipped \$1.6 million in collimator assembly units against orders received from two U.S. military customers in 2016. In addition, we increased shipments by an additional \$0.3 million in cable periscope assemblies against an U.S military order booked in 2016, the increases were offset by lower revenue of (\$0.1) million on other smaller orders. We continue to bid on smaller miscellaneous spare orders on an ongoing basis.

The Applied Optics Center external revenue increased by \$1.1 million, or 17.7%, during the 2017 fiscal year as compared to the prior year period due to increased deliveries on commercial optical assemblies of \$1.4 million and increased revenue in laser coated filters \$0.6 million and other AOC products of \$0.4 million which was offset by reductions in ACOG 36MM filters of (\$1.3) for a contract shipped complete in fiscal year 2016. As are entering fiscal 2018 with a very strong backlog of \$6.1 million, a 96.8% increase over the prior year ending backlog, we expect the Applied Optics Center revenue to remain strong through the second quarter with additional orders anticipated for delivery the second half of the year.

Gross Margin. The gross margin during the period ending October 1, 2017 was 18.4% of revenue as compared to a gross margin of 17.7% of revenue for the period ending October 2, 2016. Cost of sales increased by \$0.9 million to \$15.1 million for the fiscal year ending 2017 compared to \$14.2 million for the fiscal year ending 2016. The increased cost of sales was primarily driven by higher revenues. The gross margin increased by \$0.3 million to \$3.4 million in 2017 as compared to \$3.1 million in 2016. We attribute the improvement in gross margin to higher revenue combined with cost efficiency improvements at the Applied Optics Center combined with changes in product mix between the respective years.

G&A Expenses. During the fiscal year ended October 1, 2017, we recorded operating expenses of \$3.2 million as opposed to \$4.0 million during the period ending October 2, 2016, a decrease of (\$0.8) million or (17.5%). The decrease in general and administrative expenses in the year ending 2017 as compared to the year ending 2016 is primarily attributable to (\$0.9) million non-recurring expenses incurred in 2016 attributable to the August 2016 public offering offset by increased spending of \$0.1 million in 2017 for the executive and management incentive plans.

Operating Income (Loss). During the period ending October 1, 2017, we recorded operating income of \$0.2 million as compared to an operating loss of (\$0.9) million during the period ending October 2, 2016. The \$1.1 million increase in operating income in the current year over the prior year is primarily due to the increased gross margin of \$0.3 million on higher revenue and reduced general and administrative costs of \$0.8 million in 2017 as compared to 2016.

Net loss applicable to common shareholders. During the year ended October 1, 2017, we recorded a net loss applicable to common shareholders of (\$0.3) million as compared to net loss applicable to common shareholders of (\$1.4) million during the year ended October 2, 2016. The decreased loss of \$1.1 million is primarily attributable to a decrease in operating losses of \$1.1 million. In addition during 2016 we realized a (\$0.7) million gain the the change in fair value of warrants, as compared to a loss on the change in fair value of warrants of (\$0.5) million in 2017 which was offset by \$1.2 million in premiums on preferred stock for the beneficial conversion features recognized on Series A and Series B preferred incurred during 2016. The Series A and Series B preferred shares were converted or redeemed in full during 2016, thus there is no remaining premiums related to a beneficial conversion feature on those shares.

Liquidity and Capital Resources

As of October 1, 2017, Optex Systems Holdings had working capital of \$8.0 million, as compared to \$8.6 million as of October 2, 2016. During the year ended October 1, 2017, the Company experienced a net loss of (\$0.3) million as compared to a net loss of \$(1.4) million, and an increase in revenues of \$1.2 million, or 6.9%, up to \$18.5 million, from \$17.3 million, as compared to the prior year ended October 2, 2016. New orders increased 26.7% to \$22.3 million, as compared to new orders of \$17.6 million during the prior year. Backlog has increased by \$3.7 million, or 30.8% to 15.7 million over the prior year backlog of 12.0 million. Approximately 39.1% of annual revenue is derived from new orders booked during the fiscal year.

U.S. military spending has been significantly reduced from the 2011 peak spending levels as a result of a decrease in military operations in Iraq and Afghanistan and due to Congressional sequestration cuts to defense spending created by the Budget Control Act of 2011, which began in fiscal year 2013. As a result of lower U.S. government defense spending, the Company has continued to explore other opportunities for manufacturing outside of our traditional product lines for products which could be manufactured using our existing lines in order to fully utilize our existing capacity. On November 16, 2017, the National Defense Authorization Act (NDAA) for fiscal year 2018 was sent to President Trump to sign into law after passing both the House of Representatives and the Senate. The 2018 NDAA authorizes total spending of \$700 billion which includes a base spending authorization of \$634 billion plus the authorization of \$65.8 billion in additional funding for the Overseas Contingency Operation (OCO) account. The bill authorizes a major hike in military spending over the 2017 NDAA authorization amount of \$619 billion and sets defense spending well above the \$549 billion base authorization cap under the 2011 Budget Control Act. Currently, there is no clear plan from Congress on how to provide the additional money above the sequestration limit as changes in the sequestration law will require bipartisan support to reach a vote threshold of 60 senators to avoid a filibuster. We are cautiously optimistic that the defense industry effects of the sequestration from 2011 have reached a plateau and we will begin to see small but steady increases in defense military procurement orders in fiscal year 2018 and upcoming fiscal years. Further, we continue to look for additional strategic businesses to acquire that will strengthen our existing product line, expand our operations, and enter new markets.

The Company has historically funded its operations through operations, convertible notes, common and preferred stock offerings and bank debt. The Company's ability to generate positive cash flows depends on a variety of factors, including the continued development and successful marketing of the Company's products. At October 1, 2017, the Company had approximately \$1.7 million in cash and an outstanding payable balance of \$0.3 million against our working line of credit. The line of credit allows for borrowing up to a maximum of \$2.2 million, which fluctuates based on our open accounts receivable balance. As of October 1, 2017, our outstanding accounts receivable was \$3.1 million. We expect the accounts to be collected during the first quarter of fiscal 2017. The Company expects to incur net income and positive cash flow from operating activities throughout 2018 on higher projected revenue growth combined with increased gross margin related to existing and planned productivity and cost efficiency improvements. Although our 2017 year end net loss was (\$0.3) million; it marked a significant improvement of \$1.1 million from the prior year net loss of (\$1.4) million. Our net income during the final quarter of 2017 was \$0.5 million, a significant increase in profitability, offsetting much the (\$0.8) million in losses incurred during the first three quarters of the fiscal year. Successful transition to attaining and maintaining profitable operations is dependent

upon maintaining a level of revenue adequate to support the Company's cost structure. We are entering 2018 with a strong \$15.7 million backlog, 30.8% higher than the prior year end with increased orders booked during 2017 fiscal year. Management intends to manage operations commensurate with its level of working capital and facilities line of credit during the next twelve months; however, uneven revenue levels driven by changes in customer delivery demands, first article inspection requirements or other program delays combined with increasing inventory and production costs required to support the increases in backlog could create a working capital shortfall. In the event the Company does not successfully implement its ultimate business plan, certain assets may not be recoverable.

On August 26, 2016, we consummated a public offering of 2,291,000 Class A units consisting of common stock and warrants and 400 Class B units consisting of shares of Series C convertible stock and warrants for a total gross purchase price of \$4.8 million. The net proceeds of the offering were \$4.2 million after underwriter expenses. We used \$0.3 million of the proceeds for offering expenses paid by Optex Systems Holdings and \$1.7 million of the proceeds for the redemption of Series A and Series B preferred shares which were a condition of the offering. The remaining \$2.2 million of funds will be used to fund working capital needs to support revenue growth and acquisitions.

On April 27, 2017, the Board of Directors of Optex Systems Holdings approved a purchase of 700,000 shares of its common stock in a private transaction from The Longview Fund, L.P. The transaction was priced at the closing sale price on April 28, 2017 of \$0.74 per share for a total transaction amount of \$518,000. Upon repurchase on May 1, 2017, the shares were cancelled thereby reducing the total shares outstanding of its common stock.

On June 26, 2017, the board of directors approved a resolution authorizing a \$0.02 per share (and per warrant) dividend payment on July 12, 2017, for common and preferred C shareholders and warrant holders of record as of July 5, 2017 and for three subsequent quarterly record dates thereafter. Quarterly dividends of \$261 thousand were paid out to share and warrant holders on July 12, 2017. Optex recorded an additional \$261 thousand in dividends payable as of October 1, 2017 for the fourth quarter declared dividends which were in paid on October 19, 2017, in the first quarter of 2018. The Company expects to pay additional dividends totaling \$522 thousand through April 2018, \$261 thousand per quarter, covering the first two quarters of 2018 ending in March. The Company will review its working capital needs after the second fiscal quarter prior to determining any future dividends or amounts to be paid to our shareholders beyond April 2018.

Period from October 2, 2016 through October 1, 2017

Cash and Cash Equivalents. As of October 1, 2017, we had cash and cash equivalents of \$1.7 million as compared to \$2.6 million as of October 2, 2016, a decrease in cash and cash equivalents of (\$0.9) million.

Net Cash (Used by) Provided by Operating Activities. Net cash provided by operating activities during the period beginning October 2, 2016 and ending October 1, 2017 was zero. The primary use of cash provided by operations was driven by increased inventory of (\$1.4) million in support of higher revenue levels projected for 2018, increased accounts receivable of (\$1.2) million due to substantially higher shipments during the fourth quarter which will be paid during the first quarter of 2018 and an operating loss of (\$0.3) million. These were offset by increased accounts payable and accrued expenses of \$1.3 related to inventory purchases and increased operating costs driven by production increases, increased customer deposits on new orders of \$0.4, non-cash expenses included in net loss of \$1.1 million and other working capital changes of \$0.1 million

Net Cash (Used) by Investing Activities. In the twelve months ended October 1, 2017, cash used by investing activities was (\$0.1) million for new asset purchases used in support of production.

Net Cash (Used) by Financing Activities. Net cash used in financing activities was (\$0.8) million during the twelve months ended October 1, 2017 due to the repurchase of outstanding common stock of (\$0.5) million in May 2017 and dividend payments in July 2017 of (\$0.3) million. As of October 1, 2017, the outstanding line of credit balance was

\$0.3 million

Critical Accounting Policies

Revenue Recognition: Optex Systems Holdings recognizes revenue based on the modified percentage of completion method utilizing the units-of-delivery method, in accordance with FASB ASC 605-35:

The units-of-delivery method recognizes as revenue the contract price of units of a basic production product delivered during a period and as the cost of earned revenue the costs allocable to the delivered units. Costs allocable to undelivered units are reported in the balance sheet as inventory or work in progress. The method is used in circumstances in which an entity produces units of a basic product under production-type contracts in a continuous or sequential production process to buyers' specifications.

Optex Systems Holdings contracts are fixed price production type contracts whereby a defined order quantity is delivered to the customer during a continuous or sequential production process tailored to the buyer's specifications (build to print). Optex Systems Holdings' deliveries against these contracts generally occur in monthly increments across fixed delivery periods spanning from 3 to 36 months.

Estimated Costs at Completion and Accrued Loss on Contracts: Optex Systems Holdings reviews and reports on the performance of its long term contracts and production orders against the respective resource plans for such contracts/orders. These reviews are summarized in the form of estimates at completion. Estimates at completion include Optex Systems Holdings' incurred costs to date against the contract/order plus management's current estimates of remaining amounts for direct labor, material, other direct costs and subcontract support and indirect overhead costs based on the completion status and future contractual requirements for each order.

If an estimate at completion indicates a potential overrun against budgeted resources for a fixed price contract/order, management first attempts to implement lower cost solutions that will profitably meet the requirements of the fixed price contract. If such solutions do not appear practicable, management makes a determination whether to seek renegotiation of contract or order requirements from the customer. If neither cost reduction nor renegotiation appears probable, an accrual for the contract loss/overrun is recorded against earnings and the loss is recognized in the first period the loss is identified based on the most recent estimates at completion of the particular contract or product order. As of October 1, 2017 there was \$0 in contract loss reserves. As of October 2, 2016 the contract loss reserves were \$0 thousand.

Stock-Based Compensation: FASB ASC 718 establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services, but primarily focuses on transactions whereby an entity obtains employee services for share-based payments. FASB ASC 718 requires that the compensation cost relating to share-based payment transactions be recognized in the financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments.

Optex Systems Holdings' accounting policy for equity instruments issued to consultants and vendors in exchange for goods and services follows the provisions of FASB ASC 505-50. The measurement date for the fair value of the equity instruments issued is determined at the earlier of (i) the date at which a commitment for performance by the consultant or vendor is reached or (ii) the date at which the consultant or vendor's performance is complete. In the case of equity instruments issued to consultants, the fair value of the equity instrument is recognized over the term of the consulting agreement. Stock-based compensation related to non-employees is accounted for based on the fair value of the related stock or options or the fair value of the services, whichever is more readily determinable in accordance with FASB ASC 718.

Beneficial Conversion Features of Convertible Securities: Conversion options that are not bifurcated as a derivative pursuant to ASC 815 and not accounted for as a separate equity component under the cash conversion guidance are evaluated to determine whether they are beneficial to the investor at inception (a beneficial conversion feature) or may become beneficial in the future due to potential adjustments. The beneficial conversion feature guidance in ASC 470-20 applies to convertible stock as well as convertible debt which are outside the scope of ASC 815. A beneficial conversion feature is defined as a nondetachable conversion feature that is in the money at the commitment date. In

addition, our preferred stock issues contain conversion terms that may change upon the occurrence of a future event, such as antidilution adjustment provisions. The beneficial conversion feature guidance requires recognition of the conversion option's in-the-money portion, the intrinsic value of the option, in equity, with an offsetting reduction to the carrying amount of the instrument. The resulting discount is amortized as a dividend over either the life of the instrument, if a stated maturity date exists, or to the earliest conversion date, if there is no stated maturity date. If the earliest conversion date is immediately upon issuance, the dividend must be recognized at inception. When there is a subsequent change to the conversion ratio based on a future occurrence, the new conversion price may trigger the recognition of an additional beneficial conversion feature on occurrence.

During the twelve months ending October 2, 2016, Optex Systems Holdings had preferred stock outstanding, convertible into common shares, containing beneficial conversion features at inception as well as potential beneficial conversion features that could be triggered by future adjustments to the conversion price. Because our preferred stock was perpetual, with no stated maturity date, and the conversions could occur any time from inception, the dividend is recognized immediately when a beneficial conversion exists at issuance. The August 26, 2016 public offering triggered a reset of the preferred stock conversion rate from \$2.50 per common share to \$1.20 per common share on our Series A and Series B preferred shares and resulted in a \$0.8 million beneficial conversion feature. The public offering also included a beneficial conversion feature of \$0.4 million at the August 26, 2016 commitment date of the 400 shares of Series C preferred stock issued in the offering, based on the effective conversion price of the shares, net of the allocated warrant proceeds. During the twelve months ending October 2, 2016, Optex Systems Holdings recognized a total preferred stock dividend of \$1.2 million as a result of the beneficial conversion features triggered on the existing and new issues of preferred shares. There were no preferred shares outstanding during the twelve months ending October 1, 2017 subject to subsequent beneficial conversion features, thus there was zero preferred stock dividends recognized during the period.

Income Tax/Deferred Tax: FASB ASC 740 requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on differing treatment of items for financial reporting and income tax reporting purposes. The deferred tax balances are adjusted to reflect tax rates by tax jurisdiction, based on currently enacted tax laws, which will be in effect in the years in which the temporary differences are expected to reverse. Under FASB ASC 740, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided for certain deferred tax assets if it is more likely than not that Optex Systems Holdings will not realize tax assets through future operations. When assessing the recoverability of deferred tax assets, management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies. Based on those estimates, management has determined that the deferred tax assets may not be realized and has established a valuation allowance against the deferred tax asset balance. As of October 1, 2017 Optex Systems Inc. has a deferred tax asset valuation allowance of (\$4.6) million against deferred tax assets of \$4.6 million.

Recent Accounting Pronouncements

Recent Accounting Pronouncements are detailed under Note 3 of Item 8 “Financial Statements and Supplementary Data” of this report.

Cautionary Factors That May Affect Future Results

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

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 annual report. In this annual report Optex Systems Holdings has identified important factors that could cause actual results to differ from expected or historic results. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider any such list to be a complete list of all potential risks or uncertainties.

Item 8 Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and

Stockholders of Optex Systems Holdings, Inc.

We have audited the accompanying consolidated balance sheet of Optex Systems Holdings, Inc. (the Company) as of October 1, 2017, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended. The Company's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Optex Systems Holdings, Inc. as of October 1, 2017, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/Whitley Penn LLP

December 20, 2017

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Stockholders of Optex Systems Holdings, Inc.

Richardson, Texas

We have audited the accompanying consolidated balance sheets of Optex Systems Holdings, Inc. (the Company) as of October 2, 2016, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended. The Company's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Optex Systems Holdings, Inc. as of October 2, 2016, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/PMB Helin Donovan, LLP

PMB Helin Donovan, LLP

December 22, 2016 (February 21, 2017 as to Note 13)

Austin, Texas

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Optex Systems Holdings, Inc.**Consolidated Balance Sheets**

| | (Thousands, except share and per share data) | |
|---|--|--------------------|
| | October 1, 2017 | October 2, 2016 |
| ASSETS | | |
| Cash and Cash Equivalents | \$1,682 | \$2,568 |
| Accounts Receivable, Net | 3,125 | 2,095 |
| Net Inventory | 7,614 | 6,214 |
| Prepaid Expenses | 63 | 120 |
| Current Assets | 12,484 | 10,997 |
| Property and Equipment, Net | 1,460 | 1,651 |
| Other Assets | | |
| Prepaid Royalties - Long Term | 60 | 90 |
| Security Deposits | 23 | 23 |
| Other Assets | 83 | 113 |
| Total Assets | \$14,027 | \$12,761 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Accounts Payable | \$1,362 | \$706 |
| Dividends Payable | 261 | — |
| Accrued Expenses | 1,450 | 810 |
| Accrued Warranties | 174 | 28 |
| Customer Advance Deposits | 927 | 559 |
| Credit Facility | 300 | 300 |
| Current Liabilities | 4,474 | 2,403 |
| Warrant Liability | 3,607 | 3,118 |
| Total Liabilities | 8,081 | 5,521 |
| Stockholders' Equity | | |
| Preferred Stock Series C (\$0.001 par 400 authorized, 174 and 360 issued and outstanding, respectively) | — | — |

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| | | |
|---|----------|----------|
| Common Stock – (\$0.001 par, 2,000,000,000 authorized, 8,190,101 and 8,266,601 shares issued and outstanding, respectively) | 8 | 8 |
| Additional Paid-in-capital | 26,411 | 26,879 |
| Accumulated Deficit | (20,473) | (19,647) |
| Stockholders' Equity | 5,946 | 7,240 |
| Total Liabilities and Stockholders' Equity | \$14,027 | \$12,761 |

The accompanying notes are an integral part of these financial statements

Optex Systems Holdings, Inc.**Consolidated Statements of Operations**

| | (Thousands, except share and per share data) | |
|--|---|--------------------|
| | Twelve months ended | |
| | October 1, 2017 | October 2, 2016 |
| Revenue | \$ 18,547 | \$ 17,279 |
| Cost of Sales | 15,133 | 14,228 |
| Gross Margin | 3,414 | 3,051 |
| General and Administrative Expense | 3,210 | 3,962 |
| Operating Income (Loss) | 204 | (911) |
| (Loss) Gain on Change in Fair Value of Warrants | (489) | 739 |
| Interest Expense | (19) | (36) |
| Other Expense | (508) | 703 |
| Loss Before Taxes | (304) | (208) |
| Current Income Taxes (Benefit) | — | — |
| Deferred Income Taxes (Benefit) | — | — |
| Net Loss After Taxes | (304) | (208) |
| Preferred stock dividend/premium | — | (1,203) |
| Net (loss) applicable to common shareholders | \$(304) | \$(1,411) |
| Basic and diluted (loss) per share | \$(0.04) | \$(0.91) |
| Weighted Average Common Shares Outstanding - basic and fully diluted | 7,995,092 | 1,546,774 |

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

Optex Systems Holdings, Inc.**Consolidated Statements of Cash Flows**

| | (Thousands) | |
|---|---------------------|-----------------|
| | Twelve months ended | |
| | October 1, 2017 | October 2, 2016 |
| Cash flows from operating activities: | | |
| Net loss | \$(304) | \$(208) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 337 | 345 |
| Loss (gain) on change in fair value of warrants | 489 | (739) |
| Noncash interest expense | — | (17) |
| Stock compensation expense | 220 | 192 |
| (Use of) provision for inventory valuation | (34) | 60 |
| (Gain) loss on sale of fixed assets | (38) | 5 |
| (Increase) decrease in accounts receivable | (1,185) | 771 |
| Increase in inventory (net of progress billed) | (1,366) | (562) |
| Decrease in prepaid expenses | 57 | 51 |
| Increase in accounts payable and accrued expenses | 1,296 | 130 |
| Increase in accrued warranty costs | 146 | — |
| Decrease in prepaid royalties - long term | 30 | 30 |
| Increase (decrease) in customer advance deposits | 368 | (597) |
| Total adjustments | 320 | (331) |
| Net cash provided by (used in) operating activities | 16 | (539) |
| Cash flows (to) from investing activities | | |
| Purchases of property and equipment | (149) | (34) |
| Proceeds from sale of fixed assets | 41 | 4 |
| Net cash used in investing activities | (108) | (30) |
| Cash flows from (to) financing activities | | |
| Dividends paid | (261) | — |
| Net proceeds from sale of common stock | — | 4,750 |
| Redemption of preferred stock | — | (1,751) |
| Deferred public offering costs | — | (45) |
| Cash paid for taxes withheld on net settled restricted stock unit share issue | (15) | — |
| Proceeds (to) credit facility (net) | — | (500) |
| Proceeds (to) stock repurchase | (518) | — |
| Net cash (used in) provided by financing activities | (794) | 2,454 |
| Net (decrease) increase in cash and cash equivalents | (886) | 1,885 |

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| | | |
|---|---------|---------|
| Cash and cash equivalents at beginning of period | 2,568 | 683 |
| Cash and cash equivalents at end of period | \$1,682 | \$2,568 |
| Supplemental cash flow information: | | |
| Exchange of common stock for non-trade accounts receivable | \$155 | \$— |
| Exchange of preferred stock for common stock | 930 | 6,939 |
| Beneficial conversion features on preferred stock | — | 1,203 |
| Fair value of warrants issued for underwriter expenses in public offering | — | 156 |
| Dividends declared and unpaid | 261 | — |
| Cash paid for interest | 19 | 53 |

The accompanying notes are an integral part of these financial statements

Optex Systems Holdings, Inc.
Consolidated Statement of Stockholders' Equity

(Thousands, except share data)

| | Common Shares Outstanding | Series A Preferred Shares | Series B Preferred Shares | Series C Preferred Shares | Common Stock | Additional Paid in Capital | Retained Earnings | Total Stockholders Equity |
|--|---------------------------------|------------------------------------|------------------------------------|------------------------------------|-----------------|----------------------------------|----------------------|---------------------------------|
| Balance at September 27, 2015 | 314,867 | 1,001 | 994 | — | \$ — | \$ 26,394 | \$(18,236) | \$ 8,158 |
| Stock Compensation Expense | — | — | — | — | — | 192 | — | 192 |
| Issue of Shares - DTC/CEDE fractional roundup correction for reverse split 12/8/15 | 247 | — | — | — | — | — | — | — |
| Conversion of Preferred Series B (10/23/15) | 16,031 | — | (25) | — | — | — | — | — |
| Conversion of Preferred Series A (3/27/16) | 1,250,000 | (456) | — | — | 2 | (2) | — | — |
| Conversion of Preferred Series B (7/6/16) | 109,291 | — | (167) | — | — | — | — | — |
| Conversion of Preferred Series A (8/10/16) | 25,000 | (9) | — | — | — | — | — | — |
| Issue of Common Shares for Investor Relations (IRTH) | 40,000 | — | — | — | — | — | — | — |
| Issuance of Common Stock 8/26/2016 | 2,291,900 | — | — | 400 | 2 | 4,748 | — | 4,750 |
| Fees on Share Offering paid by Optex | — | — | — | — | — | (45) | — | (45) |
| Redemption of Series A & Series B Preferred Shares 8/26/2016 | — | (66) | (796) | — | — | (1,751) | — | (1,751) |

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| | | | | | | | | |
|---|------------|--------|------|--------|------|-----------|------------|----------|
| Conversion of Series A & Series B Preferred Shares 8/26/2016 | 2,698,431 | (470) | (6) | — | 3 | (3) | — | — |
| Fair Value of Warrants Issued in Offering 8/26/2016 | — | — | — | — | — | (3,856) | — | (3,856) |
| Conversions of Series C Preferred Shares | 166,667 | — | — | (40) | — | — | — | — |
| Ratchet on Preferred Series A 3/27/16 Conversion (10/18/16) | 1,354,167 | — | — | — | 1 | (1) | — | — |
| Beneficial Conversion Feature on Preferred Stock -Dividend/Premium | — | — | — | — | — | 1,203 | (1,203) | — |
| Net (loss) | — | — | — | — | — | — | (208) | (208) |
| Balance at October 2, 2016 | 8,266,601 | — | — | 360 | \$ 8 | \$ 26,879 | \$(19,647) | \$ 7,240 |
| Stock Compensation Expense | — | — | — | — | — | 220 | — | 220 |
| Shares issued in settlement of 68,000 vested restricted stock units on 1/4/17, net of tax withheld shares of 22,201 | 45,799 | — | — | — | — | (15) | — | (15) |
| Return and cancellation of Sileas held Common Shares in exchange for Accounts Recievables due from Sileas | (197,299) | — | — | — | — | (155) | — | (155) |
| Conversions of Series C Preferred Shares | 775,000 | — | — | (186) | 1 | (1) | — | — |
| Stock Buyback and Cancellation | (700,000) | — | — | — | (1) | (517) | — | (518) |
| Declared Dividends | — | — | — | — | — | — | (522) | (522) |
| Net (loss) | — | — | — | — | — | — | (304) | (304) |
| Balance at October 1, 2017 | 8,190,101 | — | — | 174 | \$ 8 | \$ 26,411 | \$(20,473) | \$ 5,946 |

The accompanying notes are an integral part of these financial statements

Note 1 — Organization and Operations

On March 30, 2009, Optex Systems Holdings, Inc. (formerly known as Sustut Exploration, Inc.), a Delaware corporation (“Optex Systems Holdings”), along with Optex Systems, Inc., a privately held Delaware corporation (“Optex Systems, Inc.”), which is a wholly-owned subsidiary of Optex Systems Holdings, entered into a reorganization agreement, pursuant to which Optex Systems, Inc. was acquired by Optex Systems Holdings in a share exchange transaction. Optex Systems Holdings became the surviving corporation. At the closing, there was a name change from Sustut Exploration, Inc. to Optex Systems Holdings, Inc., and its year end changed from December 31 to a fiscal year ending on the Sunday nearest September 30.

On October 14, 2008, certain senior secured creditors of Irvine Sensors Corporation, Longview Fund, L.P. (Longview) and Alpha Capital Anstalt formed Optex Systems, Inc., which acquired all of the assets and assumed certain liabilities of Optex Systems, Inc., a Texas corporation (“Optex Systems, Inc. (Texas)”), and a wholly-owned subsidiary of Irvine Sensors Corporation, in a transaction that was consummated via purchase at a public auction. Following this asset purchase, Optex Systems, Inc. (Texas) remained a wholly-owned subsidiary of Irvine Sensors Corporation.

On February 20, 2009, Sileas Corporation (Sileas), a newly-formed Delaware corporation, owned by present members of Optex Systems Holdings’ management, purchased 100% of Longview’s equity and debt interest in Optex Systems, Inc. (Longview’s interest in Optex Systems, Inc. then representing 90% of the issued and outstanding common equity interests in Optex Systems, Inc.), in a private transaction.

Optex Systems, Inc. operated as a privately-held Delaware corporation until March 30, 2009, when, as a result of a reverse merger transaction consummated pursuant to a reorganization agreement dated March 30, 2009, it became a wholly-owned subsidiary of Optex Systems Holdings. Sileas was the majority owner (parent) of Optex Systems Holdings, until June 9, 2017. On June 9, 2017, Sileas entered into a transaction with Longview to settle its original February 20, 2009 Note with Longview in exchange for 2,798,782 common shares of Optex Systems Holdings common stock owned by Sileas, a \$250,000 cash payment and a Note to Longview of \$64,000 which shall be paid in cash by Sileas to Longview on a quarterly basis. See Note 9. As a result of the transaction, Longview owns 34.2% of the issued and outstanding equity interests in Optex Systems. The financial statements of Optex Systems Holdings represent subsidiary statements and do not include the accounts of its majority owner.

Optex Systems Holdings’ operations are based in Dallas and Richardson, Texas in leased facilities comprising 93,967 square feet. As of October 1, 2017, Optex Systems Holdings operated with 100 full-time equivalent employees.

Optex Systems Holdings manufactures optical sighting systems and assemblies, for the U.S. Department of Defense, foreign military applications and commercial markets. Its products are installed on a variety of U.S. military land vehicles, such as the Abrams and Bradley fighting vehicles, light armored and advanced security vehicles, and have been selected for installation on the Stryker family of vehicles. Optex Systems Holdings also manufactures and delivers numerous periscope configurations, rifle and surveillance sights and night vision optical assemblies. Optex Systems Holdings' products consist primarily of build to customer print products that are delivered both directly to the military and to other defense prime contractors or commercial customers.

In February 2009, Optex Systems Holdings' ISO certification status was upgraded from 9001:2000 to 9001:2008, bringing Optex Systems Holdings into compliance with the new ISO standards rewritten to align with ISO 14001.

On November 3, 2014, Optex Systems, Inc. entered into a Purchase Agreement with L-3 Communications, Inc. ("L-3") pursuant to which Optex purchased from L-3 the assets comprising L-3's Applied Optics Center (AOC) Products Line ("Purchased Assets"), which is engaged in the production and marketing and sales of precision optical assemblies utilizing thin film coating capabilities for optical systems and components primarily used for military purposes.

U.S. military spending has been significantly reduced as a result of the Congressional sequestration cuts to defense spending, which began in fiscal year 2013. As a result of lower U.S. government spending, the Company has continued to explore other opportunities for manufacturing outside of our traditional product lines for products which could be manufactured using our existing lines in order to fully utilize our existing capacity. Further, we continue to look for additional strategic businesses to acquire that will strengthen our existing product line, expand our operations, and enter new markets.

We are cautiously optimistic that the new government administrations proposed boost in military spending will have a favorable impact in the direction of funding or product need for the U.S. military. We anticipate that absent any significant changes from the current defense spending levels, maintenance will still be required, and the opportunities for us to upgrade existing systems with higher performing systems will continue to present themselves. Spending levels may change, but given the mix between foreign spending, domestic/prime demand, and the more recent commercial opportunities, we do not expect any negative trends arising from political domestic changes over the next twelve months.

Note 2 — Accounting Policies

Basis of Presentation

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

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statement and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from the estimates.

Segment Reporting: FASB ASC 280 requires that a public business enterprise report financial and descriptive information about its reportable operating segments. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and assess performance. Generally, financial information is required to be reported on the basis that it is used internally for evaluating segment performance and deciding how to allocate resources to segments. Segments are determined based on differences in products, internal reporting and how operational decisions are made. Management has determined that the Optex Systems, Richardson plant, and the Applied Optics Center, Dallas plant, which was acquired on November 3, 2014, are separately managed, organized, and internally reported as separate business segments. The FASB ASC 280 requires that a public business enterprise report a measure of segment profit or loss, certain specific revenue and expense items, and segment assets. It requires reconciliations of total segment revenues, total segment profit or loss, total segment assets, and other amounts disclosed for segments to corresponding amounts in the enterprise's general-purpose financial statements.

Fiscal Year: Optex System Holdings' fiscal year ends on the Sunday nearest September 30. Fiscal year 2016 ended on October 1, 2017 and included 53 weeks. Fiscal year 2016 ended on October 2, 2016 and included 53 weeks.

Fair Value of Financial Instruments: FASB ASC 825-10 requires disclosure of fair value information about certain financial instruments, including, but not limited to, cash and cash equivalents, accounts receivable, prepaid expenses, accounts payable, accrued expenses credit facilities and warrant liabilities. Fair value estimates discussed herein are based upon certain market assumptions and pertinent information available to management as of fiscal years ended October 1, 2017 and October 2, 2016. The carrying value of the balance sheet financial instruments included in Optex Systems Holdings' consolidated financial statements approximated their fair values.

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

The accounting guidance FASB ASC 820-10, “*Fair Value Measurements and Disclosures*” establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value and requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs reflecting the reporting entity’s own assumptions.

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

The methods, significant inputs and assumptions utilized in estimating the fair value of the warrant liabilities are discussed further in Note 13 “Warrant Liabilities”. Each of the measurements is considered a Level 3 measurement as a result of at least one unobservable input.

Cash and Cash Equivalents: For financial statement presentation purposes, Optex Systems Holdings considers those short-term, highly liquid investments with original maturities of three months or less to be cash or cash equivalents. Optex Systems Holdings has \$1,682 thousand in cash on deposit with our bank. Only a portion of the cash, currently \$250 thousand, would be covered by federal deposit insurance and the uninsured balances are substantially greater than the insured amounts. We are exploring options to invest a portion of the excess cash into short term treasuries covered by federal deposit insurance in the near term.

Concentration of Credit Risk: Optex Systems Holdings’ revenues and accounts receivables for fiscal year ended October 1, 2017 are derived from sales to U.S. government agencies (38%), General Dynamics (19%), Nightforce Optics, Inc. (22%) and all other contractors (21%). Optex Systems Holdings does not believe that this concentration results in undue credit risk because of the financial strength of the obligees.

Accounts Receivable: Optex Systems Holdings records its accounts receivable at the original sales invoice amount less liquidations for previously collected advance/progress bills and an allowance for doubtful accounts. An account

receivable is considered to be past due if any portion of the receivable balance is outstanding beyond its scheduled due date. On a quarterly basis, Optex Systems Holdings evaluates its accounts receivable and establishes an allowance for doubtful accounts, based on its history of past write-offs and collections, and current credit conditions. No interest is accrued on past due accounts receivable. As of October 1, 2017 and October 2, 2016, Optex Systems Holdings had an allowance for doubtful accounts of \$2 thousand and \$42 thousand, for non U.S. government account balances greater than 120 days. As the customer base is primarily U.S. government and government prime contractors, Optex Systems Holdings allowance for doubtful accounts is minimal. Optex Systems Holdings charges uncollectible accounts to bad debt expense in the period as they are first deemed uncollectible. In the fiscal year 2017 we recognized income of (\$12) thousand related to bad debt expense deemed as uncollectible in 2016 which was subsequently paid in 2017. In the fiscal year 2016 there was \$36 thousand in bad debt expenses associated with uncollectable accounts.

Inventory: Inventory is recorded at the lower of cost or market, and adjusted as appropriate for decreases in valuation and obsolescence. Adjustments to the valuation and obsolescence reserves are made after analyzing market conditions, current and projected sales activity, inventory costs and inventory balances to determine appropriate reserve levels. Cost is determined using the first-in first-out method. Under arrangements by which progress payments are received against certain contracts, the customer retains a security interest in the undelivered inventory identified with these contracts. Payments received for such undelivered inventory are classified as unliquidated progress payments and deducted from the gross inventory balance. As of October 1, 2017 and October 2, 2016 inventory included:

| | (Thousands) | |
|--------------------------|-------------|---------|
| | As of | As of |
| | October | October |
| | 1, 2017 | 2, 2016 |
| Raw Materials | \$5,931 | \$4,655 |
| Work in Process | 2,859 | 2,830 |
| Finished Goods | 441 | 380 |
| Gross Inventory | 9,231 | 7,865 |
| Less: Inventory Reserves | (1,617) | (1,651) |
| Net Inventory | \$7,614 | \$6,214 |

Warranty Costs: Some of Optex Systems Holdings' customers require that the Company warrant the quality of its products to meet customer requirements and be free of defects for up to twelve months subsequent to delivery. Future warranty costs are based on the estimated cost of replacement for expected returns based upon our most recent experience rate of defects as a percentage of warranty covered sales. Throughout the year, warranty costs are expensed as incurred, and as of each year end, Optex Systems Holdings reviews the prior 12 month warranty experience rate and may adjust the warranty accrual as required to cover any additional anticipated warranty costs related to prior shipments. As of October 1, 2017 and October 2, 2016, the existing warranty reserve balances of \$174 thousand and \$28 thousand, respectively, were reviewed and determined to be adequate to satisfy any future warranty claims that may have existed as of the end of each fiscal year for shipments occurring in the prior 12 months. The increase in warranty reserves of \$146 thousand during the twelve months ending October 1, 2017 from the prior year balance represents additional expenses recognized during 2017 related to quality issues encountered on our Applied Optics Center optical assemblies during the year for returned products requiring repairs or replacements. We believe we have made sufficient improvements to the production process to reduce the return rate on any future shipments but we will continue to review and monitor the reserve balances related to this product line against any existing warranty backlog and current trend data until the current warranty backlog is depleted.

Property and Equipment: Property and equipment are recorded at cost. Depreciation is computed using the straight line method over the estimated useful lives of the assets, ranging from three to seven years. Expenditures for renewals and betterments are capitalized. Expenditures for minor items, repairs and maintenance are charged to operations as incurred. Gain or loss upon sale or retirement due to obsolescence is reflected in the operating results in the period the event takes place.

Revenue Recognition: Optex Systems Holdings recognizes revenue based on the modified percentage of completion method utilizing the units-of-delivery method, in accordance with FASB ASC 605-35:

The units-of-delivery method recognizes as revenue the contract price of units of a basic production product delivered during a period and as the cost of earned revenue the costs allocable to the delivered units. Costs allocable to undelivered units are reported in the balance sheet as inventory or work in progress. The method is used in circumstances in which an entity produces units of a basic product under production-type contracts in a continuous or sequential production process to buyers' specifications.

Optex Systems Holdings contracts are fixed price production type contracts whereby a defined order quantity is delivered to the customer during a continuous or sequential production process tailored to the buyer's specifications (build to print). Optex Systems Holdings' deliveries against these contracts generally occur in monthly increments across fixed delivery periods spanning from 3 to 36 months.

Customer Advance Deposits: Customer advance deposits represent amounts collected from customers in advance of shipment or revenue recognition which relate to undelivered product due to non-substantive milestone payments or other cash in advance payment terms. As of October 1, 2017, Optex Systems, Inc. had a balance of \$927 thousand in customer advance deposits related to multiple contracts for our sighting system product line. The products associated with the sighting systems customer deposits generally have a high material content with long lead items which require purchase well in advance of final product delivery. We expect the deliveries against these contracts extend into the fourth quarter of fiscal year 2018. Of the total collected customer advance deposits, \$927 thousand relate to short term customer advance deposits for deliveries to occur within the next twelve months.

Estimated Costs at Completion and Accrued Loss on Contracts: Optex Systems Holdings reviews and reports on the performance of its contracts and production orders against the respective resource plans for such contracts/orders. These reviews are summarized in the form of estimates at completion. Estimates at completion include Optex Systems Holdings' incurred costs to date against the contract/order plus management's current estimates of remaining amounts for direct labor, material, other direct costs and subcontract support and indirect overhead costs based on the completion status and future contractual requirements for each order.

If an estimate at completion indicates a potential overrun against budgeted resources for a fixed price contract/order, management first attempts to implement lower cost solutions that will profitably meet the requirements of the fixed price contract. If such solutions do not appear practicable, management makes a determination whether to seek renegotiation of contract or order requirements from the customer. If neither cost reduction nor renegotiation appears probable, an accrual for the contract loss/overrun is recorded against earnings and the loss is recognized in the first period the loss is identified based on the most recent estimates at completion of the particular contract or product order. As of October 1, 2017 and October 2, 2016 the contract loss reserves were \$0 thousand.

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

In the event a termination for convenience were to occur, these Federal Acquisition Regulation clause 52.249-2 provides for full recovery of all contractual costs and profits reasonably incurred up to and as a result of the terminated contract. In the event a termination for default were to occur, Optex Systems Holdings could be liable for any excess cost incurred by the government to acquire supplies from another supplier similar to those terminated from Optex Systems Holdings. Optex Systems Holdings would not be liable for any excess costs if the failure to perform the contract arises from causes beyond its control and without its fault or negligence as defined by Federal Acquisition Regulation clause 52.249-8. In addition, the government may require Optex Systems Holdings to transfer title and deliver to the government any completed supplies, partially completed supplies and materials, parts, tools, dies, jigs, fixtures, plans, drawings, information, and contract rights that Optex Systems Holdings has specifically produced or acquired for the terminated portion of this contract. The government shall pay contract price for completed supplies delivered and accepted, and Optex Systems Holdings and the government would negotiate an agreed upon amount of payment for manufacturing materials delivered and accepted and for the protection and preservation of the property. Failure to agree on an amount for manufacturing materials is subject to the Federal Acquisition Regulation Disputes clause 52.233-1.

In some cases, Optex Systems Holdings may receive orders subject to subsequent price negotiation on contracts exceeding the federal government simplified acquisition threshold of \$750,000. These “undefinitized” contracts are considered firm contracts but as Cost Accounting Standards Board covered contracts, they are subject to the Truth in Negotiations Act disclosure requirements and downward only price negotiation. As of October 1, 2017 and October 2, 2016, Optex Systems had no booked orders that fell under this criterion.

Impairment or Disposal of Long-Lived Assets: Optex Systems Holdings follows the provisions of FASB ASC 360-10, “*Accounting for the Impairment or Disposal of Long-lived Assets*”. This standard requires, among other things, that long-lived assets be reviewed for potential impairment whenever events or circumstances indicate that the carrying amounts may not be recoverable. The assessment of possible impairment is based on the ability to recover the carrying value of the asset from the expected future pre-tax cash flows (undiscounted and without interest charges) of the related operations. If these cash flows are less than the carrying value of such assets, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires management to estimate future cash flows and the fair value of long-lived assets. No impairment of long-lived assets was recorded for the periods presented.

Stock-Based Compensation: FASB ASC 718 establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services, but primarily focuses on transactions whereby an entity obtains employee services for share-based payments. FASB ASC 718 requires that the compensation cost relating to share-based payment transactions be recognized in the financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments.

Optex Systems Holdings' accounting policy for equity instruments issued to consultants and vendors in exchange for goods and services follows the provisions of FASB ASC 505-50. The measurement date for the fair value of the equity instruments issued is determined at the earlier of (i) the date at which a commitment for performance by the consultant or vendor is reached or (ii) the date at which the consultant or vendor's performance is complete. In the case of equity instruments issued to consultants, the fair value of the equity instrument is recognized over the term of the consulting agreement. Stock-based compensation related to non-employees is accounted for based on the fair value of the related stock or options or the fair value of the services, whichever is more readily determinable in accordance with FASB ASC 718.

Beneficial Conversion Features of Convertible Securities: Conversion options that are not bifurcated as a derivative pursuant to ASC 815 and not accounted for as a separate equity component under the cash conversion guidance are evaluated to determine whether they are beneficial to the investor at inception (a beneficial conversion feature) or may become beneficial in the future due to potential adjustments. The beneficial conversion feature guidance in ASC 470-20 applies to convertible stock as well as convertible debt which are outside the scope of ASC 815. A beneficial conversion feature is defined as a nondetachable conversion feature that is in the money at the commitment date. In addition, our preferred stock issues contain conversion terms that may change upon the occurrence of a future event, such as antidilution adjustment provisions. The beneficial conversion feature guidance requires recognition of the conversion option's in-the-money portion, the intrinsic value of the option, in equity, with an offsetting reduction to the carrying amount of the instrument. The resulting discount is amortized as a dividend over either the life of the instrument, if a stated maturity date exists, or to the earliest conversion date, if there is no stated maturity date. If the earliest conversion date is immediately upon issuance, the dividend must be recognized at inception. When there is a subsequent change to the conversion ratio based on a future occurrence, the new conversion price may trigger the recognition of an additional beneficial conversion feature on occurrence.

During the twelve months ending October 2, 2016, Optex Systems Holdings had preferred stock outstanding, convertible into common shares, containing beneficial conversion features at inception as well as potential beneficial conversion features that could be triggered by future adjustments to the conversion price. Because our preferred stock was perpetual, with no stated maturity date, and the conversions could occur any time from inception, the dividend is recognized immediately when a beneficial conversion exists at issuance. The August 26, 2016 public offering triggered a reset of the preferred stock conversion rate from \$2.50 per common share to \$1.20 per common share on our Series A and Series B preferred shares and resulted in a \$0.8 million beneficial conversion feature. The public offering also included a beneficial conversion feature of \$0.4 million at the August 26, 2016 commitment date of the 400 shares of Series C preferred stock issued in the offering, based on the effective conversion price of the shares, net

of the allocated warrant proceeds. During the twelve months ending October 2, 2016, Optex Systems Holdings recognized a total preferred stock dividend of \$1.2 million as a result of the beneficial conversion features triggered on the existing and new issues of preferred shares. There were no preferred shares outstanding during the twelve months ending October 1, 2017 subject to subsequent beneficial conversion features, thus there was zero preferred stock dividends recognized during the period.

Income Tax/Deferred Tax: FASB ASC 740 requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on differing treatment of items for financial reporting and income tax reporting purposes. The deferred tax balances are adjusted to reflect tax rates by tax jurisdiction, based on currently enacted tax laws, which will be in effect in the years in which the temporary differences are expected to reverse. Under FASB ASC 740, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided for certain deferred tax assets if it is more likely than not that Optex Systems Holdings will not realize tax assets through future operations. When assessing the recoverability of deferred tax assets, management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies and results of recent operations. Based on those estimates, management has determined that the deferred tax assets may not be realized and has established a valuation allowance against the deferred tax asset balance. We record uncertain tax positions in accordance with ASC 740 on the basis of a two-step process in which (1) we determine whether it is more likely than not that the tax positions will be sustained on the basis of the technical merits of the position and (2) for those tax positions that meet the more-likely-than-not recognition threshold, we recognize the largest amount of tax benefit that is more than 50 percent likely to be realized upon ultimate settlement with the related tax authority.

As of October 1, 2017 Optex Systems Inc. has a deferred tax asset valuation allowance of (\$4.6) million against deferred tax assets of \$4.6 million due to historical losses resulting in a Net Operating Loss Carryforward for each of the fiscal years 2010 through 2016. We intend to continue maintaining a full valuation allowance on our deferred tax assets until there is sufficient evidence to support the reversal of all or some portion of these allowances. However, given our improved earnings performance during the final quarter of fiscal year ending October 1, 2017, and anticipated future earnings, we believe that there is a reasonable possibility that within the next 12 months, sufficient positive evidence may become available to allow us to reach a conclusion that a significant portion of the valuation allowance will no longer be needed. Release of the valuation allowance would result in the recognition of certain deferred tax assets and a decrease to income tax expense for the period the release is recorded. We believe the change in the valuation allowance could approximate \$2.0 million, assuming a change in tax rate from 34% to 21%. However, the exact timing and amount of the valuation allowance release are subject to change on the basis of the level of profitability that we are able to actually achieve and the corporate tax rate in effect at that time.

Earnings per Share: Basic earnings per share is computed by dividing income available for common shareholders (the numerator) by the weighted average number of common shares outstanding (the denominator) for the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

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

For the twelve months ended October 1, 2017, 4,125,200 warrants, 174 Series C preferred stock (convertible into 725,000 common shares) and 56,260 stock options and 182,000 unvested restricted stock units were excluded as anti-dilutive due to the net loss attributable to common shareholders during the years. For the twelve months ended October 2, 2016, 4,125,200 warrants, 360 Series C preferred stock (convertible into 1,500,000 common shares) and 52,840 stock options and 200,000 unvested restricted stock units were excluded as anti-dilutive due to the net loss attributable to common shareholders during the years.

Note 3 — Recent Accounting Pronouncements

In May 2017, the FASB issued ASU 2017-09, Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting (“ASU 2017-09). ASU 2017-09 provides clarity and reduce both (1) diversity in practice and (2) cost and complexity when applying the guidance in Topic 718, Compensation—Stock Compensation, to a change to

the terms or conditions of a share-based payment award. The amendments in this update provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. The amendments in this update are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted. As such, Optex Systems Holdings is required to adopt these provisions as of the fiscal year beginning on October 1, 2018. The amendments in this update should be applied prospectively to an award modified on or after the adoption date. We are currently assessing the potential impact of ASU 2017-09 on our consolidated financial statements and results of operations.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). ASU 2016-15 reduces diversity in practice in how certain transactions are classified in the statement of cash flows. The amendments in ASU 2016-15 provide guidance on specific cash flow issues including debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, and distributions received from equity method investees. ASU 2016-15 is effective for annual and interim periods beginning after December 15, 2017. As such, Optex Systems Holdings is required to adopt these provisions as of the fiscal year beginning on October 1, 2018. We are currently assessing the potential impact of ASU 2016-15 on our consolidated financial statements and results of operations.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (“ASU 2016-13”). ASU 2016-13 changes the impairment model for most financial assets and certain other instruments, including trade and other receivables, held-to-maturity debt securities and loans, and requires entities to use a new forward-looking expected loss model that will result in the earlier recognition of allowance for losses. This update is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for a fiscal year beginning after December 15, 2018, including interim periods within that fiscal year. Entities will apply the standard’s provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. As such, Optex Systems Holdings is required to adopt these provisions as of the fiscal year beginning on September 30, 2019. We are currently assessing the potential impact of ASU 2016-13 on our consolidated financial statements and results of operations.

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-09 amending several aspects of share-based payment accounting. This guidance requires all excess tax benefits and tax deficiencies to be recorded in the income statement when the awards vest or are settled, with prospective application required. The guidance also changes the classification of such tax benefits or tax deficiencies on the statement of cash flows from a financing activity to an operating activity, with retrospective or prospective application allowed. Additionally, the guidance requires the classification of employee taxes paid when an employer withholds shares for tax-withholding purposes as a financing activity on the statement of cash flows, with retrospective application required. This ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. As such, Optex Systems Holdings adopted these provisions as of the fiscal year beginning October 2, 2017. There was no material effect of the new provisions on our consolidated financial statements and related disclosures.

In February 2016, FASB issued ASU 2016-02—*Leases (Topic 842)*. The update is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application of the amendments in this update is permitted. As such, Optex Systems Holdings is required to adopt these provisions as of the fiscal year beginning on September 30, 2019. Optex Systems Holdings is currently evaluating the impact of FASB ASU 2016-02

and expects the adoption thereof will have a material effect on Optex Systems Holdings' presentation of balance sheet assets and liabilities based on the present value of future lease payments, but does not expect a material effect on the presentation of expenses and cash flows

In July 2015, FASB issued ASU 2015-11—*Inventory (Topic 330): "Simplifying the Measurement of Inventory"*. The update is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. As such, Optex Systems Holdings is required to adopt these provisions as of the fiscal year beginning on October 2, 2017. The amendments in this Update should be applied prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. The update is part of FASB's Simplification Initiative, the objective of which is to identify, evaluate, and improve areas of generally accepted accounting principles (GAAP) for which cost and complexity can be reduced. Pursuant to the update, an entity should measure inventory at the lower of cost and net realizable value. The amendments in the update more closely align the measurement of inventory in GAAP with the measurement of inventory in International Financial Reporting Standards (IFRS). Optex Systems Holdings is currently evaluating the impact of FASB ASU 2015-11 but does not expect the adoption thereof to have a material effect on Optex Systems Holdings' financial statements.

In August 2014, FASB issued ASU 2014-15—Presentation of Financial Statements—Going Concern (ASC Subtopic 205-40): “*Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern*”. The update requires management to assess a company’s ability to continue as a going concern and to provide related footnote disclosures in certain circumstances. All entities are required to apply the new requirements in annual periods ending after December 15, 2016, and interim periods thereafter. As such, Optex Systems Holdings adopted these provisions for the annual period ending October 1, 2017. There was no material effect on Optex Systems Holdings’ financial statements of as a result of adoption of FASB ASU 2014-15.

In May 2014, FASB issued ASU 2014-09—Revenue from Contracts with Customers (Topic 606): “*Section A—Summary and Amendments That Create Revenue from Contracts with Customers, (Topic 606) and Other Assets and Deferred Costs—Contracts with Customers (Subtopic 340-40), Section B—Conforming Amendments to Other Topics and Subtopics in the Codification and Status Tables, Section C—Background Information and Basis for Conclusions*”. The guidance in this update affects any entity that enters into contracts with customers to transfer goods or services and supersedes the revenue recognition requirements in Topic 605, Revenue Recognition. FASB deferred the effective date of ASU 2014-09 in August 2015, with ASU 2015-14—“Revenue from Contracts with Customers (Topic 606): *Deferral of the Effective Date*” The amendments in this update defer the effective date of ASU 2014-09 for all entities by one year. Public business entities should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net) (“ASU 2016-08”). ASU 2016-08 does not change the core principle of Topic 606 but clarifies the implementation guidance on principal versus agent considerations. ASU 2016-08 is effective for the annual and interim periods beginning after December 15, 2017. As such, Optex Systems Holdings is required to adopt these provisions as of the fiscal year beginning on October 1, 2018. Optex Systems Holdings is currently evaluating the impact of FASB ASU 2014-09 and subsequent amendments but does not expect the adoption thereof to have a material effect on Optex Systems Holdings’ financial statements.

Note 4 Segment Reporting

Optex Systems Holdings, Inc. has two reportable segments which include Optex Systems (OPX)-Richardson, and Applied Optics Center (AOC) – Dallas. The accounting policies for each segment are the same as those described in the summary of significant accounting policies. Optex Systems Holdings, Inc. evaluates performance based on profit and loss from operations before income taxes excluding nonrecurring gains and losses.

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

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

Optex Systems – Dallas, serves as the home office for both segments and shared general and administrative costs attributable to both segments are allocated directly to the segments based on the government costs accounting standard, CAS 403 – “Allocation of Home Office Expenses to Segments”. The purpose of CAS 403 is to provide criteria for allocating home office expenses to the segments of an organization based on the beneficial or causal relationships between the expenses and the receiving segments. Based on CAS 403, Optex Systems Holdings allocates home office expenses based on a three factor formula which is the average of the following three percentages for the each segments fiscal year:

- (1) The percentage of segment payroll dollars to total payroll dollars of all segments;
- (2) The percentage of the segment’s operating revenue to the total operating revenue of all segments
- (3) The percentage of the average net book value of the sum of the segment’s tangible capital assets plus inventories to the total average net book value of such assets of all segments.

Optex Systems (OPX) – Richardson, Texas

Optex Systems, Inc. manufactures optical sighting systems and assemblies, primarily for Department of Defense applications. Its products are installed on various types of U.S. military land vehicles, such as the Abrams and Bradley fighting vehicles, light armored and armored security vehicles and have been selected for installation on the Stryker family of vehicles. Optex Systems, Inc. also manufactures and delivers numerous periscope configurations, rifle and surveillance sights and night vision optical assemblies. We have capabilities which include machining, bonding, painting engraving and assembly and can perform both optical and environmental testing in-house. Optex Systems, Inc. products consist primarily of build-to-customer print products that are delivered both directly to the armed services and to other defense prime contractors. Optex Systems in Richardson is both a prime and sub-prime contractor to the Department of Defense. Sub-prime contracts are typically issued through major defense contractors such as General Dynamics Land Systems, Raytheon Corp., BAE, NorcaTec and others. Optex Systems is also a military supplier to foreign governments such as Israel, Australia and NAMSA and South American countries and as a subcontractor for several large U.S. defense companies serving foreign governments.

During the year ended October 1, 2017, approximately 100% of Optex Systems – Richardson revenues were in support of prime and subcontracted military customers. The Optex Systems segment serves domestic military customers, 87%, and foreign military customers, 13%. The Optex Systems segment revenue for the year ending October 1, 2017 was derived from external customers consisting of the U.S. government, 60%, General Dynamics, 29%, and other external customers, 11%.

Optex Systems is located in Richardson Texas, with leased premises consisting of approximately 49,100 square feet. As of October 1, 2017, the Richardson facility operated with 62 full time equivalent employees in a single shift operation. Optex Systems in Richardson serves as the home office for both the Optex Systems (OPX) and Applied

Optics Center (AOC) segments.

Applied Optics Center (AOC) – Dallas

On November 3, 2014, Optex Systems, Inc. entered into a Purchase Agreement with L-3 pursuant to which Optex Systems, Inc. purchased from L-3 the assets comprising L-3's Applied Optics Center Products Line (see note 4).

Applied Optics Center is engaged in the production, marketing and sales of precision optical assemblies and components which utilize thin film coating technologies. Most of the AOC products and services are directly related to the deposition of thin-film coatings. AOC is both a prime and sub-prime contractor to the Department of Defense.

Sub-prime contracts are typically issued through major defense contractors such as General Dynamics Land Systems, Raytheon Corp., L-3 Communications, Harris Corp and others. AOC also creates a new sector of opportunity for commercial products. Globally, commercial optical products use thin film coatings to create product differentiation and performance levels. These coatings can be used for redirecting light (mirrors), blocking light (laser protection), absorbing select light (desired wavelengths), and many other combinations. They are used in telescopes, rifle scopes, binoculars, microscopes, range finders, protective eyewear, photography, etc. The Applied Optics Center is a key supplier to Nightforce Optics, Inc. and provides optical assembly components to their markets of interest in commercial sporting optics and select military optics. Given this broad potential, the commercial applications are a key opportunity going forward. The Applied Optics Center segment also serves as the key supplier of the laser coated filters used in the production of periscope assemblies at the Optex Systems Richardson segment.

The Applied Optics Center serves primarily domestic U.S. customers. Approximately 81% of the Applied Optics Center revenue for the year ending October 1, 2017 was derived from external customers consisting of Nightforce Optics, Inc., 56%, Harris Corp., 17%, L3 Communications, 11%, the U.S. government, 5%, and other external customers, 11%. Sales to commercial customers represent 60% and military sales to prime and subcontracted customers represent 40% of the total segment revenue. Intersegment sales to Optex Systems – Richardson during the year ended October 1, 2017, comprised 19% of the total segments revenue and was primarily in support of military contracts.

The Applied Optics Center (AOC), is located in Dallas, Texas with leased premises consisting of approximately 44,867 square feet of space. As of October 1, 2017, AOC operated with 38 full time equivalent employees in a single shift operation.

The financial table below presents the information for each of the reportable segments profit or loss as well as segment assets for each year. Optex Systems Holdings, Inc. does not allocate interest expense, income taxes, stock compensation associated with restricted stock units, or unusual items to segments.

Reportable Segment Financial Information
(thousands)

Twelve months ending October 1, 2017

| | Optex Systems Richardson | Applied Optics Center Dallas | Other (non allocated costs and intersegment eliminations) | Consolidated Total |
|--|---|---|--|-------------------------------|
| Revenues from external customers | \$11,256 | \$ 7,291 | \$ — | \$ 18,547 |
| Intersegment revenues | — | 1,694 | (1,694) | — |
| Total Revenue | \$11,256 | \$ 8,985 | \$ (1,694) | \$ 18,547 |
| Interest expense | \$— | \$ — | \$ 19 | \$ 19 |
| Depreciation and Amortization | \$56 | \$ 281 | \$ — | \$ 337 |
| Income (Loss) before taxes | \$338 | \$ 46 | \$ (688) | \$ (304) |
| Other significant noncash items: | | | | |
| Allocated home office expense | \$(776) | \$ 776 | \$ — | \$ — |
| Loss on change in fair value of warrants | \$— | \$ — | \$ 489 | \$ 489 |
| Stock compensation expense (1) | \$40 | \$ — | \$ 180 | \$ 220 |
| Royalty expense amortization | \$30 | \$ — | \$ — | \$ 30 |
| Segment Assets | \$8,663 | \$ 5,364 | \$ — | \$ 14,027 |
| Expenditures for segment assets | \$(23) | \$(126) | \$ — | \$ (149) |

(1) General and administrative expenses for the twelve months ending October 1, 2017 of \$180 thousand, associated with amortized stock compensation attributable to executive/director restricted stock units has been restated from Optex Richardson to Other non allocated costs. Operating income (loss) for Optex Richardson and Other non allocated has been restated to reflect the change.

Reportable Segment Financial Information
(thousands)

Twelve months ending October 2, 2016

| | Optex Systems Richardson | Applied Optics Center Dallas | Other (non allocated costs and intersegment eliminations) | Consolidated Total |
|--|---|---|--|-------------------------------|
| Revenues from external customers | \$ 11,052 | \$ 6,227 | \$ — | \$ 17,279 |
| Intersegment revenues | — | 1,892 | (1,892) | — |
| Total Revenue | \$ 11,052 | \$ 8,119 | \$ (1,892) | \$ 17,279 |
| Interest expense | \$— | \$— | \$ 36 | \$ 36 |
| Depreciation and Amortization | \$ 73 | \$ 272 | \$ — | \$ 345 |
| Income (Loss) before taxes(1) | \$ 285 | \$ (345) | \$ (148) | \$ (208) |
| Other significant noncash items: | | | | |
| Allocated home office expense | \$(728) | \$ 728 | \$ — | \$ — |
| (Gain) on change in fair value of warrants | \$— | \$— | \$ (739) | \$ (739) |
| Stock option compensation expense(1) | \$ 52 | \$— | \$ 140 | \$ 192 |
| Royalty expense amortization | \$ 30 | \$— | \$ — | \$ 30 |
| Use of contract loss reserves | \$— | \$ (54) | \$ — | \$ (54) |
| Warrants issued for underwriter expenses | \$— | \$— | \$ 156 | \$ 156 |
| Segment Assets | \$ 8,861 | \$ 3,900 | \$ — | \$ 12,761 |
| Expenditures for segment assets | \$(16) | \$(18) | \$ — | \$ (34) |

(1) General and administrative expenses for the twelve months ending October 2, 2016 of \$140 thousand, associated with amortized stock compensation attributable to executive/director restricted stock units has been restated from Optex Richardson to Other non allocated costs. Operating income (loss) for Optex Richardson and Other non allocated has been restated to reflect the change.

Note 5 — Property and Equipment

A summary of property and equipment at October 1, 2017 and October 2, 2016 is as follows:

| | | (Thousands) | |
|--------------------------------|-----------------------|----------------------------------|----------------------------------|
| | Estimated Useful Life | Year Ended October 1, 2017 | Year Ended October 2, 2016 |
| Property and Equipment | | | |
| Furniture and Fixtures | 3-5yrs | \$368 | \$ 356 |
| Machinery and Equipment | 5 yrs | 3,364 | 3,233 |
| Leasehold Improvements | 7 yrs | 276 | 276 |
| Less: Accumulated Depreciation | | (2,548) | (2,214) |
| Net Property & Equipment | | \$1,460 | \$ 1,651 |
| Depreciation Expense | | \$337 | \$ 345 |

During the twelve months ending October 1, 2017, Optex Systems Holdings' purchased \$12 thousand and \$137 thousand in new furniture and fixtures and new machinery and equipment, respectively, and sold machinery and equipment with a net book value of \$3 thousand for \$41 thousand in proceeds resulting in a gain on asset sales of \$38 thousand.

Note 6 — Accrued Expenses

The components of accrued liabilities for the years ended October 1, 2017 and October 2, 2016 are summarized below:

| | (Thousands) | |
|-----------------------|-------------------------------------|----------------------------------|
| | Year Ended October 1, 2017 | Year Ended October 2, 2016 |
| Deferred Rent Expense | \$123 | \$ 108 |
| Accrued Vacation | 328 | 330 |
| Property Taxes | 105 | 101 |

| | | |
|---------------------------|---------|--------|
| Operating Expenses | 778 | 144 |
| Payroll & Payroll Related | 116 | 127 |
| Total Accrued Expenses | \$1,450 | \$ 810 |

Note 7 — Commitments and Contingencies

Rental Payments under Non-cancelable Operating Leases

Optex Systems Holdings leases its office and manufacturing facilities for the Optex Systems, Inc., Richardson address and the Applied Optics Center Dallas address, under non-cancellable operating leases.

The leased facility under Optex Systems Inc. at 1420 Presidential Drive, Richardson, Texas consists of 49,100 square feet of space and expires March 31, 2021. Pursuant to the terms of the most recent amendment to the Richardson site facilities lease, there was no base rent payment due from January 1, 2014 through March 31, 2014, with payments beginning April 2014, and annual rental payment inflationary increases between 3.4% and 4.8% occurring each year beginning in 2016.

The leased facility under the Applied Optics Center at 9839 and 9827 Chartwell Drive, Dallas, Texas, consists of 44,867 square feet of space at the premises. On November 17, 2016, we received a countersigned new lease for the Applied Optics Center from the landlord, dated October 21, 2016, and which commenced retroactive to October 1, 2016. The new lease term will expire on October 31, 2021, with two renewal options available to the tenant, each with a renewal term duration of five years. The monthly base rent is \$19.4 thousand through September 30, 2017 and escalates approximately 3% October 1, each year thereafter through 2021. The lease includes a one month base rent abatement for October 1 through October 31, 2016 for \$19.4 thousand. The monthly rent includes approximately \$4.9 thousand for additional Common Area Maintenance fees and taxes (CAM), to be adjusted annually based on actual expenses incurred by the landlord. The total monthly rent including CAM is \$24.3 thousand beginning November 1, 2016. Our obligations to make payments under the lease are secured by a \$250,000 standby letter of credit which we may be reduced to \$125,000 on October 31, 2019.

As of October 1, 2017 the unamortized deferred rent was \$123 thousand as compared to \$108 thousand as of October 2, 2016. Deferred rent expense is amortized monthly over the life of the leases.

As of October 1, 2017, the remaining minimum base lease and estimated common area maintenance (CAM) payments under the non-cancelable office and facility space leases are as follows:

Non-cancellable Operating Leases Minimum Payments

| Fiscal Year | (Thousands) | | | | Total |
|-------------------------------------|-----------------------------|-----------------|------------------------------|-----------------|-----------------|
| | Optex Systems Richardson | | Applied Optics Center Dallas | | |
| | Lease Payments | CAM Estimate | Lease Payments | CAM Estimate | Payments |
| 2018 | \$ 271 | \$ 108 | \$ 240 | \$ 60 | \$ 679 |
| 2019 | 281 | 110 | 248 | 61 | 700 |
| 2020 | 291 | 112 | 255 | 62 | 720 |
| 2021 | 147 | 57 | 262 | 63 | 529 |
| 2022 | — | — | 22 | 5 | 27 |
| Total minimum lease payments | \$ 990 | \$ 387 | \$ 1,027 | \$ 251 | \$ 2,655 |

Total expense under both facility lease agreements as of the twelve months ended October 1, 2017 was \$655 thousand. Total expense under both facility lease agreements as of the twelve months ended October 2, 2016 was \$627 thousand.

Note 8 — Transactions with a Related Party

In the twelve months ending October 2, 2016, Sileas Corporation converted 926 shares of Optex Systems Series A preferred stock at a total stated value of \$6.4 million for 5,293,896 common shares.

On October 31, 2016, Longview Fund L.P. authorized the return to Optex Systems Holdings' treasury of 197,299 common shares, held by Sileas Corporation in settlement of \$155 thousand of accounts receivable due for expenses paid by Optex Systems Inc. on behalf of the Sileas Corporation. The shares were subsequently cancelled in

satisfaction of the outstanding accounts receivable balance as of October 31, 2016. As of October 1, 2017, and October 2, 2016, accounts receivable included \$0 and \$132 thousand, respectively of non-trade receivables due from Sileas Corporation, a related party, for operating expenses paid by Optex Systems on their behalf.

On April 27, 2017, the Board of Directors of Optex Systems Holdings approved a purchase of 700,000 shares of its common stock in a private transaction from The Longview Fund, L.P. The transaction was priced at the closing sale price on April 28, 2017 of \$0.74 per share for a total transaction amount of \$518,000. Upon repurchase on May 1, 2017, the shares were cancelled thereby reducing the total shares outstanding of its common stock.

There were no other transactions with Related Parties during fiscal years 2017 or 2016 except as described below in Note 9 Debt Financing.

Note 9 — Debt Financing

Related Parties

Acquisition by Sileas Corporation on February 20, 2009

On February 20, 2009, Sileas purchased 100% of the equity and debt interest held by Longview, which represented 90% of the Optex Systems, Inc. (Delaware) outstanding equity on that date.

Sileas Secured Promissory Note Due on May 29, 2021 to Longview Fund, LP

As a result of the transaction described above between Sileas and Longview on February 20, 2009, Sileas, the then new majority owner of Optex Systems, Inc. (Delaware), executed and delivered to Longview, a Secured Promissory Note due February 20, 2012 in the original principal amount of \$13,524,405. The original Note bears simple interest at the rate of 4% per annum, and the interest rate upon an event of default increases to 10% per annum. The maturity date of the Note was extended on November 22, 2011 and again on November 27, 2013. In exchange for the extensions, Sileas Corp. agreed to pay the Longview Fund an extension fee equal to 2% of the principal amount of this Secured Note as of each amendment date.

On June 5, 2015, Sileas Corp. amended its Secured Note, with Longview Fund, L.P., as lender, as follows:

The principal amount was increased to \$18,022,329 to reflect the original principal amount plus all accrued and unpaid interest to date, and the Secured Note ceased to bear interest as of that date;

The maturity date of the note was extended to May 29, 2021; and

A conversion feature was added to the Secured Note by which the principal amount of the Secured Note can be converted into our Series A preferred stock, which is owned by Sileas, at the stated value of our Series A preferred stock.

On August 4, 2016, Longview Fund, L.P. converted \$250 thousand of the note principal for 100,000 shares of Optex Systems Holdings common stock pursuant to the note conversion terms. The Sileas note balance to the Longview Fund, LP as of October 2, 2016 is \$17.8 million.

In the twelve months ending October 2, 2016, Sileas Corporation converted all their Optex Systems Holdings, Inc. Series A preferred stock, 926 shares, at a total stated value of \$6.4 million for 5,293,896 common shares. The total common shares held by Sileas as of October 2, 2016 is 5,296,081. These additional shares have been retroactively reflected in the ending common shares outstanding as of October 2, 2016.

On May 1, 2017, The Longview Fund, L.P. converted \$0.8 million of the Sileas Corp.(a related party) note principal in exchange for 700,000 shares of Optex Systems Holdings common stock. The Sileas Corp. note balance to The Longview Fund, L.P. as of May 1, 2017, after conversion, is \$14.2 million.

On June 9, 2017, Sileas Corp. (“Sileas”), a related party to the Company, entered into a transaction with The Longview Fund, L.P.(“Longview”) to settle its February 20, 2009 note with Longview in the original principal amount of \$13,524,405 (the “Note”). The parties agreed to a conversion by Longview of \$3,358,538 of the amount due under the Note into 2,798,782 shares of Company common stock owned by Sileas and previously pledged to Longview as security with respect to the Note. Simultaneously therewith, Sileas made a \$250,000 cash payment to Longview, and Longview agreed to satisfy \$10,571,791 of the amount due under the Note. The remaining amount due under the Note is \$64,000 which shall be paid in cash by Sileas to Longview on a quarterly basis, upon the payment of quarterly dividends by the Company, over the next four calendar quarters commencing on or about June 30, 2017. In order to effect the above, Longview also released the pledge on all Company shares owned by Sileas and previously pledged to Longview. The Sileas Corp. note balance to The Longview Fund, L.P. as of October 1, 2017 is \$48 thousand.

Simultaneously with the above on June 9, 2017, Sileas sold 800,000 shares of Company common stock to Danny Schoening and Karen Hawkins at a price equal to \$314,000 (which is a discounted amount based upon recognition of years of administrative support by Mr. Schoening and Ms. Hawkins for the Company) as follows: (i) Danny Schoening: 640,000 Shares for \$200,000 plus a \$50,825 promissory note; and (ii) Karen Hawkins: 160,000 Shares for \$50,000 plus a \$12,706 promissory note. Each promissory note has a one year term, with interest at 1.18% per annum and shall be payable in four equal quarterly installments of \$12,800 for Danny Schoening and \$3,200 for Karen Hawkins, each installment payable within five business days after the payment of cash dividends by the Company to each of them. As a result, Sileas no longer owns any shares of Company common stock.

Credit Facility — Avidbank

On April 20, 2016, the Company amended its revolving credit facility with Avidbank. The new renewable revolving maturity date is January 22, 2018. The facility provides up to \$2 million in financing against eligible receivables and is subject to meeting certain covenants including an asset coverage ratio test for up to twenty months. The material terms of the amended revolving credit facility are as follows:

The interest rate for all advances shall be the then in effect prime rate plus 2.5% and is subject to a minimum interest payment requirement per six month period of \$10,000.

Interest shall be paid monthly in arrears.

A facility fee of (0.5%) of the revolving line (\$10,000) is due on May 22, 2016 and each anniversary thereof for so long as the revolving credit facility is in effect.

The loan period is from April 20 through January 22, 2018 at which time any outstanding advances, and accrued and unpaid interest thereon, will be due and payable.

The obligations of Optex Systems, Inc. to Avidbank are secured by a first lien on all of its assets (including intellectual property assets should it have any in the future) in favor of Avidbank.

The facility contains customary events of default. Upon the occurrence of an event of default that remains uncured after any applicable cure period, Avidbank's commitment to make further advances may terminate, and Avidbank would also be entitled to pursue other remedies against Optex Systems, Inc. and the pledged collateral.

Pursuant to a guaranty executed by Optex Systems Holdings in favor of Avidbank, Optex Systems Holdings has guaranteed all obligations of Optex Systems, Inc. to Avidbank.

The Company amended its revolving credit facility with Avidbank on October 17, 2016 from \$2 million to \$2.2 million. The interest rate for all advances against the line of credit shall be the then in effect prime rate plus 2.5% and is subject to a minimum interest payment requirement per nine month period of \$10,000. The renewable revolving maturity date is January 22, 2018 and is secured by a first lien on all of its assets in favor of Avidbank. In order to meet the security requirement under the lease, we entered into a letter of credit with Avidbank on October 17, 2016 in the amount of \$250,000, which expires on October 17, 2017 and is renewable by us for successive one year periods unless the bank notifies us no later than 60 days prior to the end of the initial or any extended term that it shall not renew the letter of credit.

As of October 1, 2017 and October 2, 2016, the outstanding principal balance on the line of credit was \$300 thousand. For the years ended October 1, 2017 and October 2, 2016, the total interest expense against the outstanding line of credit balance was \$20 thousand and \$36 thousand.

Note 10 — Stock Based Compensation

The Optex Systems Holdings 2009 Stock Option Plan provides for the issuance of up to 75,000 shares to Optex Systems Holdings officers, directors, employees and to independent contractors who provide services to Optex Systems Holdings as either incentive or nonstatutory stock options determined at the time of grant. As of October 1, 2017, Optex Systems Holdings has granted stock options to officers and employees as follows (as adjusted for the 1000:1 reverse stock split on common shares effective October 7, 2015):

| Date of Grant | Options Granted | Exercise Price | Options Outstanding As of 10/01/17 | Expiration Date | Vesting Period |
|----------------------|------------------------|-----------------------|---|------------------------|-----------------------|
| 12/09/11 | 46,070 | \$ 10.00 | 35,010 | 12/08/2018 | 4 years |
| 12/19/13 | 25,000 | \$ 10.00 | 25,000 | 12/18/2020 | 4 years |
| Total | 71,070 | | 60,010 | | |

The following table summarizes the status of Optex Systems Holdings' aggregate stock options granted under the incentive stock option plan (as adjusted for the 1000:1 reverse stock split on common shares effective October 7, 2015):

| Subject to Exercise | Number of Remaining Options | Weighted | | Aggregate Value (Thousands) |
|---|-----------------------------|--------------------|-------------------------------|-----------------------------|
| | | Average Fair Value | Weighted Average Life (Years) | |
| Outstanding as of September 27, 2015 | 62,858 | \$ — | 2.32 | \$ — |
| Granted – 2016 | — | | | |
| Forfeited – 2016 | (2,518) | | | — |
| Exercised – 2016 | — | | | — |
| Outstanding as of October 2, 2016 | 60,340 | \$ — | 1.40 | \$ — |
| Granted – 2017 | — | | | |
| Forfeited – 2017 | (330) | | | — |
| Exercised – 2017 | — | | | — |
| Outstanding as of October 1, 2017 | 60,010 | \$ — | 0.76 | \$ — |
| Exercisable as of October 2, 2016 | 52,840 | \$ — | 1.07 | \$ — |
| Exercisable as of October 1, 2017 | 56,260 | \$ — | .60 | \$ — |

There were no options granted in the twelve months ended October 1, 2017 and October 2, 2016.

The following table summarizes the status of Optex Systems Holdings' aggregate non-vested shares granted under the 2009 Stock Option Plan:

| | Number of Non-vested Options | Weighted-Average Grant Date Fair Value |
|---|------------------------------|--|
| Non-vested as of September 27, 2015 | 22,592 | \$ 7.66 |
| Non-vested granted — year ended October 2, 2016 | — | — |
| Vested — year ended October 2, 2016 | (12,574) | 7.33 |
| Forfeited — year ended October 2, 2016 | (2,518) | — |
| Non-vested as of October 2, 2016 | 7,500 | \$ 8.00 |
| Non-vested granted — year ended October 1, 2017 | — | — |
| Vested — year ended October 1, 2017 | (3,750) | 8.00 |

| | | |
|---|--------------|----------------|
| Forfeited — year ended October 1, 2017 | — | — |
| Non-vested as of October 1, 2017 | 3,750 | \$ 8.00 |

Restricted Stock Units issued to Officers and Employees

On June 14, 2016, the Compensation Committee (“Committee”) of the Board of Directors of Optex Systems Holdings, Inc. approved the Company’s 2016 Restricted Stock Unit Plan (the “Plan”). The Plan provides for the issuance of stock units (“RSU”) for up to 1,000,000 shares of the Company’s common stock to Optex Systems Holdings officers and employees. Each RSU constitutes a right to receive one share of the Company’s common stock, subject to vesting, which unless otherwise stated in an RSU agreement, shall vest in equal amounts on the first, second and third anniversary of the grant date. Shares of the Company’s common stock underlying the number of vested RSUs will be delivered as soon as practicable after vesting. During the period between grant and vesting, the RSUs may not be transferred, and the grantee has no rights as a shareholder until vesting has occurred. If the grantee’s employment is terminated for any reason (other than following a change in control of the Company or a termination of an officer other than for cause), then any unvested RSUs under the award will automatically terminate and be forfeited. If an officer grantee’s employment is terminated by the Company without cause or by the grantee for good reason, then, provided that the RSUs have not been previously forfeited, the remaining unvested portion of the RSUs will immediately vest as of the officer grantee’s termination date. In the event of a change in control, the Company’s obligations regarding outstanding RSUs shall, on such terms as may be approved by the Committee prior to such event, immediately vest, be assumed by the surviving or continuing company or cancelled in exchange for property (including cash).

On June 15, 2016, the Company issued 150,000 RSUs to its Chief Executive Officer, Danny Schoening, and 50,000 RSUs to its Chief Financial Officer, Karen Hawkins. The RSUs issued to Mr. Schoening and Ms. Hawkins vest as follows: 34% on January 1, 2017, 33% on January 1, 2018 and 33% on January 1, 2019. The total market value of the restricted stock units based on the shares price of \$1.85 as of June 15, 2016 is \$372 thousand. The cost of the shares is amortized on a straight line basis across the vesting periods.

On June 15, 2017, the Company issued 50,000 RSUs to its Applied Optics Center General Manager and new board member, Bill Bates. Pursuant to the RSU agreements the RSUs issued to Mr. Bates will vest as follows: 34% on January 1, 2018, 33% on January 1, 2019 and 33% on January 1, 2020. The total market value of the restricted stock units based on the shares price of \$0.95 as of June 15, 2016 is \$47.5 thousand. The cost of the shares is amortized on a straight line basis across the vesting periods.

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

Outstanding
Unvested
RSU’s

| | |
|---------------------------------------|----------------|
| Granted - year ended 2016 | 200,000 |
| Vested 2016 - year ended 2016 | — |
| Unvested as of October 2, 2016 | 200,000 |
| Granted - year ended 2017 | 50,000 |
| Vested - year ended 2017 | (68,000) |
| Unvested as of October 1, 2017 | 182,000 |

On January 4, 2017, Optex Systems Holdings issued 45,799 common shares related to the vesting of the 68,000 restricted stock units on January 1, 2017. The shares issued were net of 22,201 common shares withheld for employee federal income tax requirements.

Consulting and Vendor Equity Issues

On April 29, 2016, Optex Systems Holdings, Inc. issued 40,000 common “restricted” shares at a market price of \$2.35 per share (\$94,000) in support of the IRTH Communications agreement. The cost of the shares is amortized on a straight line basis through April 2017. There were no other equity instruments issued to consultants and vendors during the twelve months ended October 1, 2017.

Stock Based Compensation Expense

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

| | Stock Compensation (thousands) | | | |
|--------------------------|--|-----------------------|--|--------------------|
| | Recognized Compensation Expense Twelve months ended October 1, 2017 | | Unrecognized Compensation Expense As of period ending October 1, 2017 | |
| | October 2, 2016 | October 1, 2016 | October 1, 2017 | October 2, 2016 |
| Stock Options | \$40 | \$ 52 | \$ 8 | \$ 48 |
| Restricted Stock Units | 133 | 93 | 194 | 279 |
| Consultant Shares (IRTH) | 47 | 47 | — | 47 |
| Total Stock Compensation | \$220 | \$ 192 | \$ 202 | \$ 374 |

Note 11 — Defined Contribution Plan

The Company sponsors a defined contribution pension plan under Section 401(k) of the Internal Revenue Code for all employees. Company contributions are voluntary and are determined annually at the discretion of the Board of Directors at the beginning of each fiscal year. For the fiscal years ending October 1, 2017 and October 2, 2016, the Company offered a qualified automatic contribution arrangement (QACA) with a 100% match of the first 1% and 50% matching of the next 5% and a 2 year vesting requirement. The Company's contribution expense for the fiscal years ended October 1, 2017 and October 2, 2016 were \$130 thousand and \$133 thousand, respectively.

Note 12 — Stockholders Equity

The table below depicts the Optex Systems Holdings stock equity transactions and ending share balances by equity class for the twelve months ending October 2, 2016 and October 1, 2017, respectively.

Optex Systems Holdings Inc.
Stockholder Equity Shares Outstanding

| | Common | Series A | Series B | Series C | Warrants |
|---|------------|-------------|-------------|-------------|-----------|
| Shares outstanding as of September 27, 2015 | 314,867 | 1,001 | 994 | — | |
| Preferred share conversions to common shares | 5,619,587 | (935) | (198) | (40) | |
| DTC roundup correction | 247 | | | | |
| Issuance of common shares for IRTH consulting | 40,000 | | | — | |
| Public offering issuances of common and Preferred C shares ⁽¹⁾ | 2,291,900 | | | 400 | 3,958,700 |
| Underwriter warrants issued with public offering ⁽¹⁾ | | | | | 166,500 |
| Preferred share redemptions for cash ⁽²⁾ | — | (66) | (796) | | |
| Shares outstanding as of October 2, 2016 | 8,266,601 | — | — | 360 | 4,125,200 |
| Preferred share conversions to common shares | 775,000 | | | (186) | |
| Common shares issued for vested restricted stock units, net of tax withheld | 45,799 | — | — | — | |
| Common stock repurchase | (700,000) | — | — | — | |
| Common stock received and cancelled in settlement accounts receivable | (197,299) | — | — | — | |
| Shares outstanding as of October 1, 2017 | 8,190,101 | — | — | 174 | 4,125,200 |

(1) On August 26, 2016, we consummated a public offering of 2,291,000 Class A units consisting of common stock and warrants and 400 Class B units consisting of shares of Series C convertible stock and warrants for a total gross purchase price of \$4,750,280. The offering is comprised of Class A Units, priced at a public offering price of \$1.20 per unit, with each unit consisting of one share of common stock and one five-year warrant to purchase one share of common stock with an exercise price of \$1.50 per share (each, a “warrant”), and Class B Units, priced at a public offering price of \$5,000 per unit, with each unit comprised of one share of preferred stock with a conversion price of \$1.20 which is convertible into 4,167 shares of common stock and warrants to purchase 4,167 shares of common stock. The securities comprising the units are immediately separable and will be issued separately. In connection with the offering, 166,500 five-year warrants to purchase one share of common stock with an exercise price of \$1.50 per share were issued to the underwriter.

(2) On August 26, 2016, 66 Series A and 796 Series B preferred shares were redeemed for \$1.75 million, as a condition of the public offering

Dividends

On June 26, 2017, the board of directors approved a resolution authorizing a \$0.02 per share (and per warrant) dividend payment on July 12, 2017, for common and preferred series C shareholders and warrant holders of record as of July 5, 2017 and for three subsequent quarterly record dates thereafter. Quarterly dividends of \$261 thousand were paid out to share and warrant holders on July 12, 2017. Optex recorded an additional \$261 thousand in dividends payable as of October 1, 2017 for the fourth quarter declared dividends which were paid on October 19, 2017. There were no dividends declared or paid for year ending October 2, 2016.

Common stock

As of October 2, 2016, Optex Systems had 314,867 common shares outstanding.

On August 26, 2016, 2,291,900 Class A units consisting of common stock and warrants and 400 Class B units consisting of shares of Series C convertible stock and warrants were issued pursuant to a public offering. The offering is comprised of Class A Units, priced at a public offering price of \$1.20 per unit, with each unit consisting of one share of common stock and one five-year warrant to purchase one share of common stock with an exercise price of \$1.50 per share (each, a “warrant”), and Class B Units, priced at a public offering price of \$5,000 per unit, with each unit comprised of one share of preferred stock with a conversion price of \$1.20 which is convertible into 4,167 shares of common stock and warrants to purchase 4,167 shares of common stock. The net proceeds from the offering were \$4,247 thousand (Gross proceeds of \$4,752 thousand less underwriter expenses of \$505 thousand). Deferred public offering costs incurred by Optex in connection with the offering was \$252 thousand.

During the twelve months ending October 2, 2016, Optex Systems Holdings issued 5,619,587 common shares due to conversions of Series A, Series B and Series C preferred stock, 2,291,900 shares were issued in connection with the public offering, 247 common shares were issued to correct Depository Trust and Clearing Corporation (DTC) rounding errors occurring from the October 7, 2015 reverse split and 40,000 common shares were issued to a vendor (See note 10). As of October 2, 2016, the outstanding common shares are 8,266,601.

On October 31, 2016, Longview Fund L.P. authorized the return to Optex Systems Holdings’ treasury of 197,299 common shares, held by Sileas Corporation in settlement of \$155 thousand of accounts receivable due for expenses paid by Optex Systems Inc. on behalf of the Sileas Corporation. The shares were subsequently cancelled in satisfaction of the outstanding accounts receivable balance as of October 31, 2016.

On April 27, 2017, the Board of Directors of Optex Systems Holdings approved a purchase of 700,000 shares of its common stock in a private transaction from The Longview Fund, L.P. The transaction was priced at the closing sale price on April 28, 2017 of \$0.74 per share for a total transaction amount of \$518,000. Upon repurchase on May 1, 2017, the shares were cancelled thereby reducing the total shares outstanding of its common stock.

During the twelve months ending October 1, 2017, Optex Systems Holdings issued 775,000 common shares due to conversions of Series C preferred stock, and 45,799 common shares were issued related to the vesting of restricted stock units. There were no other issuances of common or preferred stock during the twelve months ended October 1, 2017. As of October 1, 2017, the outstanding common shares were 8,190,101.

Series A preferred stock

Optex Systems Holdings has filed a Certificate of Designation with the Secretary of State of the State of Delaware authorizing a series of preferred stock, under its articles of incorporation, known as "Series A preferred stock". The Certificate of Designation currently sets forth the following terms for the Series A preferred stock: (i) number of authorized shares: 1,027; (ii) per share stated value: \$6,860; (iii) liquidation preference per share: stated value; (iv) conversion price: \$1.20 per share, as adjusted from time to time; and (v) voting rights: votes along with the common stock on an as converted basis with one vote per share (vi) par value \$0.001 per share. Holders of preferred shares receive preferential rights in the event of liquidation. Additionally the preferred stock shareholders are entitled to vote together with the common stock on an "as-converted" basis.

Each share of preferred stock is immediately convertible into common shares at the option of the holder which entitles the holder to receive the equivalent number of common shares equal to the stated value of the preferred shares divided by the conversion price in effect as of the conversion date. Effective as of October 7, 2015, the conversion price has been reset to \$2.50 per share pursuant to the 1000:1 reverse stock split on common shares and effective on August 22, 2016, the conversion price has been reset to \$1.20 pursuant to a public offering of common shares at \$1.20 per share.

Optex Systems Holdings had 1,001 of preferred shares outstanding as of September 28, 2015. During the twelve months ending October 2, 2016 there were conversions of 935 preferred Series A shares, or \$6.4 million, into 5,318,896 common shares, and cash redemptions for \$0.5 million of 66 Series A preferred shares. During the twelve months ending October 2, 2016, Optex System Holdings recognized a \$0.8 million adjustment to retained earnings for dividends due to a beneficial conversion feature on 926 Series A preferred shares, whereas the conversion price reset from \$2.50 per common share to \$1.20 per common share as a result of the public offering price on August 26, 2016.

During the twelve months ending October 1, 2017 there were no conversions and no new issues of Series A preferred shares. Optex Systems Holdings had zero preferred shares outstanding as of October 1, 2017.

Series B Preferred Stock

On March 26, 2015, Optex Systems Holdings filed a Certificate of Designation with the Secretary of State of the State of Delaware authorizing a series of preferred stock, under its articles of incorporation, known as “Series B preferred stock”. The Certificate of Designation currently sets forth the following terms for the Series B preferred stock: (i) number of authorized shares: 1,010; (ii) per share stated value: \$1,629 (iii) liquidation preference per share, other than Series A preferred stock: stated value; (iv) conversion price: \$1.20 per share, as adjusted from time to time; (v) voting rights: votes along with the common stock on an as converted basis with one vote per share; and (vi) par value of \$0.001 per share.

Each share of preferred stock is immediately convertible into common shares at the option of the holder which entitles the holder to receive the equivalent number of common shares equal to the stated value of the preferred shares divided by the conversion price in effect as of the conversion date. Effective as of October 7, 2015, the conversion price has been reset to \$2.50 per share pursuant to the 1000:1 reverse stock split on common shares and effective on August 22, 2016, the conversion price has been reset to \$1.20 pursuant to a public offering of common shares at \$1.20 per share.

During the twelve months ending October 2, 2016 there were no dividends booked to retained earnings related to the beneficial conversion feature on Series B preferred shares as the conversion price remained at or above the market price.

As of September 27, 2015, there were 994 shares of Series B preferred shares outstanding. During the twelve months ending October 2, 2016 there were conversions of 198 preferred Series B shares, or \$324 thousand, into 134,024 common shares, and cash redemptions of 796 Series B preferred shares for \$1.3 million. As of October 2, 2016 and October 1, 2017 there were zero preferred Series B shares outstanding.

Series C Preferred Stock

Our board of directors designated 400 shares of our preferred stock as Series C convertible preferred stock (“Series C preferred stock”). The preferences and rights of the Series C preferred stock are set forth in a Certificate of Designation (the “Series C Certificate of Designation”).

Pursuant to a transfer agency agreement between us and Equity Stock Transfer, as transfer agent, the Series C preferred stock will be issued in book-entry form and shall initially be represented only by one or more global certificates deposited with The Depository Trust Company, or DTC, and registered in the name of Cede & Co., a nominee of DTC, or as otherwise directed by DTC.

In the event of a liquidation, the holders of Series C preferred stock are entitled to participate on an as-converted-to-Common Stock basis with holders of the Common Stock in any distribution of assets of the Company to the holders of the Common Stock. The Series C Certificate of Designation provides, among other things, that we shall not pay any dividends on shares of Common Stock (other than dividends in the form of Common Stock) unless and until such time as we pay dividends on each Series C preferred share on an as-converted basis. Other than as set forth in the previous sentence, the Series C Certificate of Designation provides that no other dividends shall be paid on Series C preferred stock.

With certain exceptions, as described in the Series C Certificate of Designation, the Series C preferred stock have no voting rights. However, as long as any shares of Series C preferred stock remain outstanding, the Series C Certificate of Designation provides that we shall not, without the affirmative vote of holders of a majority of the then-outstanding Series C preferred stock, (a) alter or change adversely the powers, preferences or rights given to the Series C preferred stock or alter or amend the Series C Certificate of Designation, (b) increase the number of authorized shares of Series C preferred stock or (c) amend our certificate of incorporation in any manner that adversely affects the rights of holders of Series C preferred stock.

Each Series C preferred share is convertible at any time at the holder's option into a number of shares of common stock equal to \$5,000 divided by the Series C Conversion Price. The "Series C Conversion Price" is initially \$1.20 and is subject to adjustment for stock splits, stock dividends, distributions, subdivisions and combinations. Notwithstanding the foregoing, the Series C Certificate of Designation further provides that we shall not effect any conversion of Series C preferred stock, with certain exceptions, to the extent that, after giving effect to an attempted conversion, the holder of Series C preferred stock (together with such holder's affiliates, and any persons acting as a group together with such holder or any of such holder's affiliates) would beneficially own a number of shares of Common Stock in excess of 4.99% of the shares of our Common Stock then outstanding after giving effect to such exercise (the "preferred stock Beneficial Ownership Limitation"); provided, however, that upon notice to the Company, the holder may increase or decrease the preferred stock Beneficial Ownership Limitation, provided that in no event shall the preferred stock Beneficial Ownership Limitation exceed 9.99% and any increase in the preferred stock Beneficial Ownership Limitation will not be effective until 61 days following notice of such increase from the holder to us.

We do not intend to apply for listing of the Series C preferred stock on any securities exchange or other trading system.

During the twelve months ending October 2, 2016 there were 400 preferred Series C shares issued, at a total stated value of \$2 million, pursuant to the public offering on August 26, 2016, and conversions of 40 preferred Series C shares, or \$200 thousand, into 166,667 common shares. As of October 2, 2016 there were 360 preferred Series C shares outstanding.

During the twelve months ending October 2, 2016, Optex System Holdings recognized an additional \$0.4 million adjustment to retained earnings for dividends due to a beneficial conversion feature on 400 Series C preferred shares, whereas the effective accounting conversion price at inception, after allocation of warrant proceeds was \$0.27 and was "in the money" as it was significantly below the then current market price of \$0.94 per common share as of the public offering on August 26, 2016.

During the twelve months ending October 12, 2017, there were no new issues of preferred Series C shares, and conversions of 186 preferred Series C shares, or \$0.9 million, into 775,000 common shares. As of October 1, 2017

there were 174 preferred Series C shares outstanding.

Warrants

On August 26, 2016, Optex Systems Holdings Inc. issued 4,125,200 warrants to new shareholders and the underwriter, in connection with a public share offering. The warrants entitle the holder to purchase one share of our common stock at an exercise price equal to \$1.50 per share at any time on or after August 26, 2016 (the “Initial Exercise Date”) and on or prior to the close of business on August 26, 2021 (the “Termination Date”).

Pursuant to a warrant agreement between Optex Systems Inc. and Equity Stock Transfer, LLC, as warrant agent, the warrants will be issued in book-entry form and shall initially be represented only by one or more global warrants deposited with the warrant agent, as custodian on behalf of The Depository Trust Company, or DTC, and registered in the name of Cede & Co., a nominee of DTC, or as otherwise directed by DTC.

The exercise price and number of shares of common stock issuable upon exercise of the warrants may be adjusted in certain circumstances, including in the event of a stock splits, stock dividend, extraordinary dividend on or recapitalization, reorganization, merger or consolidation. For one year following the issuance date of the warrants, the exercise price of the warrants will also be adjusted for issuances of common stock at a price below their exercise price, on the date of issuance of any option to purchase, or sell or grant any right to reprice, or otherwise dispose of or issue (or announce any offer, sale, grant or any option to purchase or other disposition) any common stock or common stock equivalents, at an effective price per share less than the exercise price then in effect. Under such adjustment, the exercise price of the warrants shall be reduced to that lower issuance price per share. Under the terms of the Warrants, there can only be one such price reset during the term of the warrant.

Under the terms of the warrant agreement, Optex Systems Holdings Inc. has agreed to use their best efforts to maintain the effectiveness of the registration statement and current prospectus relating to common stock issuable upon exercise of the warrants until the expiration of the warrants. During any period Optex fails to have maintained an effective registration statement covering the shares underlying the warrants, the warrant holder may exercise the warrants on a cashless basis. The warrant holders do not have the rights or privileges of holders of common stock and any voting rights until they exercise their warrants and receive shares of common stock, except as set forth in the warrants. After the issuance of shares of common stock upon exercise of the warrants, each holder will be entitled to one vote for each share held of record on all matters to be voted on by stockholders.

Subject to limited exceptions, a holder of warrants will not have the right to exercise any portion of its warrants if the holder (together with such holder's affiliates, and any persons acting as a group together with such holder or any of such holder's affiliates) would beneficially own a number of shares of common stock in excess of 4.99% of the shares of our common stock then outstanding after giving effect to such exercise (the "Beneficial Ownership Limitation"); provided, however, that, upon notice to the Company, the holder may increase or decrease the Beneficial Ownership Limitation, provided that in no event shall the Beneficial Ownership Limitation exceed 9.99% and any increase in the Beneficial Ownership Limitation will not be effective until 61 days following notice of such increase from the holder to us.

No fractional shares of common stock will be issued upon exercise of the warrants. If, upon exercise of the warrants, a holder would be entitled to receive a fractional interest in a share, Optex Systems Holdings Inc. will, upon exercise, round up to the nearest whole number of shares of common stock to be issued to the warrant holder. If multiple warrants are exercised by the holder at the same time, Optex Systems Holdings Inc. will aggregate the number of whole shares issuable upon exercise of all the warrants. There is no established trading market for the warrants. The warrants have been approved for quotation on the OTCQB.

In the event of a fundamental transaction (as defined in warrant), then the Company or any successor entity will pay at the holder's option, exercisable at any time concurrently with or within 30 days after the consummation of the fundamental transaction, an amount of cash equal to the value of the remaining unexercised portion of the warrants on the date of consummation of the fundamental transaction as determined in accordance with the Black Scholes option pricing model.

During the twelve months ending October 1, 2017, zero warrants had been exercised. As of October 1, 2017 the outstanding warrants were 4,125,200.

Note 13 — Warrant Liabilities

On August 26, 2016, Optex Systems Holdings Inc. issued 4,125,200 warrants to new shareholders and the underwriter, in connection with a public share offering. The warrants entitle the holder to purchase one share of our common stock at an exercise price equal to \$1.50 per share at any time on or after August 26, 2016 (the “Initial Exercise Date”) and on or prior to the close of business on August 26, 2021 (the “Termination Date”). The Company determined that these warrants are free standing financial instruments that are legally detachable and separately exercisable from the common stock included in the public share offering. Management also determined that the warrants are puttable for cash upon a fundamental transaction at the option of the holder and as such required classification as a liability pursuant to ASC 480 “*Distinguishing Liabilities from Equity*”. In accordance with the accounting guidance, the outstanding warrants are recognized as a warrant liability on the balance sheet and are measured at their inception date fair value and subsequently re-measured at each reporting period with changes being recorded as a component of other income in the statement of operations.

The proceeds of the offering are allocated between the common stock, Series C preferred shares and warrant liability as of the initial measurement as follows:

(Thousands, except share and per share data)

| As of August 26, 2016 | Common Shares | Series C Preferred Shares | Total | Underwriter Warrants* | Warrant Liability* |
|---------------------------------------|---------------|---------------------------|----------|-----------------------|--------------------|
| Shares | 2,291,900 | 400 | | 166,500 | 4,125,200 |
| Price per share | \$ 1.20 | \$ 5,000 | | \$ 0.9349 | \$ 0.9349 |
| Proceeds received | \$ 2,750 | \$ 2,000 | \$ 4,750 | | |
| Less: Warrant liability at fair value | (2,142) | (1,558) | (3,700) | \$ (156) | \$ (3,856) |
| Residual proceeds to shares | \$ 608 | \$ 442 | \$ 1,050 | | |

The fair value of the warrant liabilities was measured using a binomial lattice model. Significant inputs into the model at the inception and reporting period measurement dates are as follows:

| Binomial Assumptions | Issuance date ⁽¹⁾ August 26, 2016 | Period ending October 2, 2016 | Period ending October 1, 2017 |
|---|--|----------------------------------|----------------------------------|
| Exercise Price ⁽¹⁾ | \$ 1.50 | \$ 1.50 | \$ 1.50 |
| Warrant Expiration Date ⁽¹⁾ | August 26, 2021 | August 26, 2021 | August 26, 2021 |
| Stock Price ⁽²⁾ | \$ 0.95 | \$ 0.77 | \$ 0.98 |
| Interest Rate (annual) ⁽³⁾ | 1.23 | % 1.14 | % 1.62 |
| Volatility (annual) ⁽⁴⁾ | 246.44 | % 242.17 | % 179.36 |
| Time to Maturity (Years) | 5.0 | 4.9 | 3.9 |
| Number of Steps (Quarters) | 20 | 20 | 16 |
| Calculated fair value per share | \$ 0.93 | \$ 0.76 | \$ 0.87 |
| Quarterly Dividend per share for Next Three Quarters ⁽⁵⁾ | \$— | \$— | \$ 0.02 |
| Future Estimated Quarterly Dividend per share ⁽⁶⁾ | \$— | \$— | \$ 0.01 |

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

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

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

(4) Based on the historical daily volatility of Optex Systems Holdings, Inc. as of August 26, 2016 and each presented period ending date.

(5) Pursuant to June 12, 2017 Board of Directors authorization of a \$0.02 per share (and per warrant) dividend payment in July for shareholders and warrant holders of record on July 5, 2017 and for three subsequent quarterly record dates thereafter.

(6) Current estimated dividend payments beyond initial four quarters. At a future date, the company will review the working capital needs and make a final determination of any future dividend payments and amounts beyond the initial four quarter payments.

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

| Warrant Liability | Warrants Outstanding | Fair Value per Share | Fair Value (000's) |
|---|----------------------|----------------------|--------------------|
| Fair Value at initial measurement date of 8/26/2016 | 4,125,200 | \$ 0.93 | \$ 3,857 |
| (Gain) on Change in Fair Value of Warrant Liability | | | (739) |
| Fair Value as of period ending 10/2/2016 | 4,125,200 | \$ 0.76 | \$ 3,118 |
| Loss on Change in Fair Value of Warrant Liability | | | 489 |
| Fair Value as of period ending 10/1/2017 | 4,125,200 | \$ 0.87 | \$ 3,607 |

During the twelve months ending October 1, 2017 Optex Systems Holdings recorded a loss on changes in fair value of warrant liability of \$489 thousand. During the twelve months ending October 2, 2016, Optex Systems Holdings recognized a gain on change in fair value of warranty liabilities of (\$739) thousand. During the twelve months ending October 1, 2017 and October 2, 2016 none of the warrants have been exercised.

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

Note 14 — Income Taxes

The income tax provisions as of October 1, 2017 and October 2, 2016 include the following:

| | (Thousands) | |
|--|-------------|-------|
| | 2017 | 2016 |
| Current income tax expense: | | |
| Federal | \$— | \$— |
| State | — | — |
| Deferred income tax provision (benefit): | | |
| Federal | 76 | (65) |
| State | — | — |
| Change in valuation allowance | (76) | 65 |
| Provision for (Benefit from) income taxes, net | \$-0- | \$-0- |

The income tax provision for Optex Systems as of October 1, 2017 differs from those computed using the statutory federal tax rate of 34%, due to the following permanent differences:

| | 2017 | % | 2016 | % |
|---|-------|------|--------|------|
| Tax provision (benefit) at statutory federal rate | \$63 | 34 | \$(80) | 34 |
| Nondeductible expenses | 13 | 7 | 15 | 25 |
| Change in valuation and other | (76) | (41) | 65 | (59) |
| Provision for (Benefit from) income taxes, net | \$-0- | -0- | \$-0- | -0- |

Deferred income taxes recorded in the balance sheets results from differences between financial statement and tax reporting of income and deductions. A summary of the composition of the deferred income tax assets (liabilities) follows:

| | (Thousands) | |
|--|---------------------|----------------|
| | Deferred Tax | |
| | Asset — Long | |
| | Term | |
| | As of | As of |
| | October | October |
| | 1, | 2, |
| | 2017 | 2016 |
| Stock Options | \$382 | \$308 |
| Inventory Reserve | 321 | 332 |
| Uicap | 50 | 41 |
| Deferred Compensation | 55 | — |
| Contract Loss Reserve | (279) | (279) |
| Fixed assets | 130 | 89 |
| Goodwill Amortization | 1,128 | 1,289 |
| Intangible Asset Amortization | 549 | 641 |
| Net Operating Losses | 2,210 | 2,244 |
| Other | 30 | (14) |
| Subtotal | \$4,576 | \$4,651 |
| Valuation allowance | (4,576) | (4,651) |
| Net deferred asset (liability)-long term | \$-0- | \$-0- |

As of October 1, 2017, the Company has a net operating loss carryforward of \$6,503 thousand as compared to net loss carryforwards of \$6,601 thousand available as of October 2, 2016.

As of October 1, 2017 management assessed the recoverability of deferred tax assets and determined due to historical loss conditions and the downturn in the defense budget spending, that the balance of deferred tax assets may not be realized. The valuation allowance reserve was decreased by \$75 thousand during the twelve months ended October 1, 2017, consistent with the 2017 change in deferred tax assets. As of October 1, 2017 Optex Systems Inc. has a deferred tax asset valuation allowance of (\$4.6) million against a deferred tax asset of \$4.6 million.

As the result of the application of the FASB ASC 740-10, Optex Systems Holdings has no unrecognized tax benefits. By statute, the tax years ending in October 1, 2017, October 2, 2016 and September 27, 2015 are open to examination by the major taxing jurisdictions to which the Optex Systems Holdings is subject.

There were no income taxes paid during the fiscal years ended October 1, 2017 or October 2, 2016.

Note 15 — Subsequent Events

On November 15, 2017 there were 48 Series C preferred shares converted into 200,000 shares of common stock at the Conversion price of \$1.20, or \$240 thousand. On December 18, 2017 there were 48 Series C preferred shares converted into 200,000 shares of common stock at the conversion price of \$1.20, or \$240 thousand. After the conversions, there are 78 Series C preferred shares and 8,590,101 common shares outstanding.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

Dismissal of Current Independent Registered Public Accounting Firm

On January 13, 2017, Optex Systems Holdings, Inc., a Delaware corporation (“Company”) dismissed PMB Helin Donovan, LLP (“PMB”) as its independent registered public accounting firm. The decision to dismiss PMB was made by the Company’s Board of Directors at the recommendation of its Audit Committee on January 9, 2017.

PMB's reports on our financial statements for the years ended October 2, 2016 and September 27, 2015 did not contain an adverse opinion or a disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope, or accounting principles. During the two fiscal years ended October 2, 2016 and September 27, 2015 and through January 13, 2017, the date of PMB's dismissal, we had no disagreements (as defined in Item 304 of Regulation S-K) with PMB on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to PMB's satisfaction, would have caused it to make reference to the subject matter of the disagreements in connection any opinion to the subject matter of the disagreement. Furthermore, during the period of PMB's retention, there were no reportable events of the type described in Item 304(a)(1)(v) of Regulation S-K.

Engagement of Whitley Penn LLP

On January 16, 2017, our Board of Directors engaged Whitley Penn LLP ("WP"), which is an independent registered public accounting firm registered with, and governed by the rules of, the Public Company Accounting Oversight Board, as our independent registered public accounting firm. During the two fiscal years ended October 2, 2016 and September 27, 2015 and through January 13, 2017, the date of PMB's dismissal, neither the Company nor anyone on our behalf consulted WP regarding either (i) the application of accounting principles to a specified transaction regarding the Company, either proposed or completed, or the type of audit opinion that might be rendered on the Company's financial statements, and neither a written report nor oral advice was provided to the Company that was an important factor considered by the Company in reaching a decision as to the accounting, auditing or financial reporting issue; or (ii) any matter that was the subject of a disagreement (as that term is defined in Item 304(a)(1)(iv) of Regulation S-K and the related instructions) or a "reportable event" (as that term is defined in Item 304(a)(1)(v) of Regulation S-K).

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of October 1, 2017, management performed, with the participation of our Principal Executive Officer and Principal Financial Officer, an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Our disclosure controls and procedures are designed to ensure that information required to be disclosed in the report we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's forms, and that such information is accumulated and communicated to our management including our Principal Executive Officer and our Principal Financial Officer, to allow timely decisions regarding required disclosures. Based on the evaluation, our Principal Executive Officer and our Principal Financial Officer concluded that, as of October 1, 2017, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

During the year ended October 1, 2017, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. In response to restatement corrections for our initial accounting treatment of warrants issued in a public offering that resulted in an amendment to the Annual Report Form 10-K for fiscal year ending October 2, 2016, as filed on December 23, 2016, we have expanded our policies and procedures to address the initial review of, and subsequent accounting treatment for our existing outstanding warrants and any future issues of complex financial instruments in accordance with the appropriate GAAP accounting guidance for complex equity and debt transactions.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projection of any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has conducted, with the participation of our Principal Executive Officer and our Principal Financial Officer, an assessment, including testing of the effectiveness, of our internal control over financial reporting as of October 1, 2017. Management's assessment of internal control over financial reporting was conducted using the criteria in *Internal Control over Financial Reporting - Guidance for Smaller Public Companies* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. In connection with our management's assessment of our internal control over financial reporting as required under Section 404 of the Sarbanes-Oxley Act of 2002, we have not identified any material weaknesses in our internal control over financial reporting as of October 1, 2017. We have thus concluded that our internal control over financial reporting was effective as of October 1, 2017.

In response to restatement corrections made for the company's initial accounting treatment of warrants issued in a public offering that resulted in an amendment to the Annual Report Form 10-K for fiscal year ending October 2, 2016, as filed on December 23, 2016, management has expanded the company's policies and procedures to address the initial review of, and subsequent accounting treatment for the existing outstanding warrants and any future issues of complex financial instruments in accordance with the appropriate accounting guidance included in ASC 480 "Distinguishing Liabilities from Equity" and ASC 815 "Derivatives and Hedging".

PART III

Item 10 Directors, Executive Officers and Corporate Governance

Our board of directors directs the management of the business and affairs of our company as provided in our certificate of incorporation, our by-laws and the General Corporation Law of Delaware. Members of our board of directors keep informed about our business through discussions with senior management, by reviewing analyses and reports sent to them, and by participating in board and committee meetings.

Our company is led by Danny Schoening, who has served as COO since 2009 and was appointed CEO in 2013, and became Chairman in 2017.

As of December 5, 2017, our board of directors consists of five directors which includes two independent directors and three non-independent directors as discussed below.

Our board leadership structure is used by other smaller public companies in the United States, and we believe that this leadership structure is effective for us. We believe that our directors provide effective oversight of the risk management function, especially through dialogue between the full board and our management. Our directors serve for a one year term and if there is no election until their successors are elected and duly qualify. We intend to have our majority holders re-elect the Board in fiscal 2018 as a formality.

We do not currently consider diversity in identifying nominees for director. Due to our small size, the priority has been in attracting qualified directors, and issues such as diversity have not yet been considered.

Directors and Executive Officers

The following table sets forth information regarding the members of our board of directors and our executive officers and other significant employees. All of our current officers and directors were appointed on March 30, 2009, the closing date of the reorganization, except as otherwise noted.

The following table sets forth certain information with respect to our directors and executive officers:

| Name | Age | Position |
|---------------------------------|------------|---|
| David Kittay ⁽³⁾ | 54 | Director |
| Owen Naccarato ⁽³⁾ | 68 | Director |
| Billy Bates ⁽²⁾ | 54 | General Manager, Applied Optics Center, Director |
| Danny Schoening | 53 | Chief Executive Officer, Chief Operating Officer, Chairman and Director |
| Karen L. Hawkins ⁽¹⁾ | 52 | Chief Financial Officer and Director |

(1) *Effective November 19, 2014, Karen Hawkins, formerly our Vice President of Finance and Controller, was appointed as our Chief Financial Officer and was appointed as a Director on June 9, 2017.*

(2) *Billy Bates was appointed as a Director on June 9, 2017.*

(3) *Elected as a director effective as of May 27, 2015 and is an independent director as such term is defined under NASDAQ Listing Rule 5605(b)(2) and Exchange Act Rule 10A-3.*

David Kittay, is an experienced investment banker and asset manager. Mr. Kittay is Senior Vice President of North View Investment Banking Group responsible for facilitating the investment banking activities of the firm including relationship cultivation, mergers and acquisitions, capital formation, financial structuring and solutions. In October 2008 he co-founded Summerline Asset Management, a specialty investment firm, with which he has been involved on a continuous basis since 2008, which works with non-investment grade public and private companies requiring financing ranging from \$5 to \$100 million. Mr. Kittay holds a Bachelors of Arts from Ithaca College, Ithaca, New York and is a graduate of New York Law School holding his Juris Doctorate degree. Our board of directors has determined that Mr. Kittay is suited to sit on our Board because of his long term experience with the capital markets.

Owen Naccarato, Esq., CPA and MBA, has for the last sixteen years been a practicing attorney, with his own firm, specializing in corporate and securities law. Mr. Naccarato specializes in SEC matters. Prior to practicing law, Mr. Naccarato has over twenty years of experience holding various high level financial and accounting positions with Fortune 500 and smaller firms in the manufacturing, leasing, consumer/commercial financing and real estate industries. Mr. Naccarato is a member of the ABA, the California State Bar, the Los Angeles County Bar and the Orange County Bar. Mr. Naccarato also earned a BS in Accounting from Northern Illinois University, an MBA from DePaul University and was a certified public accountant, having articulated in the State of Illinois. Our board of directors has determined that Mr. Naccarato is suited to sit on our Board because of his long standing capital markets experience.

Danny Schoening. Mr. Schoening joined Optex Systems, Inc. (Texas) in January 2008. Upon the acquisition of the assets of Optex Systems, Inc. (Texas) by Optex Systems, Inc. (Delaware), Mr. Schoening became the COO of Optex Systems, Inc. (Delaware) (as of September 28, 2008) and he commenced service with Optex Systems Holdings as its Chief Operating Officer as of the date of the reorganization, March 30, 2009 and was appointed Chief Executive Officer and as a Director in 2013. He has been instrumental in establishing the systems and infrastructure required to continue Optex System's rapid growth. This activity was rewarded with Optex System's recent ISO 9001:2000 Certification. From February 2004 to January 2008, Danny was the Vice President of Operations for The Finisar Corporation AOC Division for 4 years where he led a team of up to 200 employees to produce vertical cavity lasers for the data communications industry at production rates of hundreds of thousands of units per week. Prior to Finisar, Danny was the Director of Operations for multiple divisions of Honeywell International. Serving the Automotive, Medical, Aerospace, and Consumer Commercial Markets. During this 17-year period, Danny was recognized with Honeywell's Lund Award, their highest award for developing employee resources. Danny has a broad experience level in the following technologies: Mechanical Assembly Processes, Micro-Electronic Assembly Processes, Laser Manufacturing, Plastic Molding, Metal Machining, Plating, Thick Film Printing, Surface Mount Technology, Hall Effect Technology and MEMS based Pressure Devices. Danny received a Bachelor's of Science in Manufacturing Engineering Technology from the University of Nebraska, an MBA from Southern Methodist University, and holds three U.S. patents. The Board of Directors has determined that Mr. Schoening is suited to sit on our Board because of his industry experience and as he is the CEO.

Karen L. Hawkins. On November 19, 2014, Karen Hawkins was appointed as our Chief Financial Officer. Ms. Hawkins had previously served as our Vice President, Finance and Controller, since the date of the reorganization, March 30, 2009 and was the controller of Optex Systems, Inc. (Delaware), effective September 28, 2009. She began

her employment with Optex Systems, Inc. (Texas) in April 2007. Ms. Hawkins has over 25 years' experience in Financial Accounting and Management, primarily focused in the Defense and Transportation Industries. She has a strong background in both Financial & Cost Accounting, with extensive Government Pricing, Financial Analysis, and Internal Auditing experience. Her past history also includes Program Management, Materials Management and Business Development. She brings over 18 years' direct experience in Government Contracting with a strong knowledge of Cost Accounting Standards Board and Federal Acquisition Regulation. Her previous employment includes General Dynamics — Ordnance and Tactical Division, Garland (formerly known as Intercontinental Manufacturing) for over 13 years from November, 1994 through March, 2007. During her tenure there she served in the roles of Controller (Accounting & IT), Program Manager over a \$250M 3-year Army Indefinite Delivery/Indefinite Quantity (Indefinite Delivery/Indefinite Quantity) type contract, as well as Materials Manager with oversight of Purchasing, Production Control & Warehousing functions. Prior to her employment at General Dynamics, Ms. Hawkins served in various finance and accounting positions at Luminator, a Mark IV Industries Co, and Johnson Controls, Battery Division - Garland. Karen received her Bachelor's Degree in Business Administration in Accounting from Stephen F. Austin State University in Texas in 1986 and became a Certified Public Accountant in 1992.

Bill Bates. Mr. Bates has thirty-five years experience related to optical component and system manufacturing. He is currently the General Manager of the Applied Optics Center in Dallas, Texas where he oversees the Thin-film Coating and Optical Assembly Operations. He has held various positions throughout his thirty-five years experience within Litton Industries, Northrop Grumman Corporation, and L-3 Communications. He previously served as Vice President and General Manager within the Warrior Systems Division of L-3 Communications. Mr. Bates received a Bachelor of Science of Business Administration from DeVry University and an MBA from the University of Texas at Dallas.

Family Relationships

There are no family relationships among the officers and directors.

Presiding Director

Our Chairman, Danny Schoening, is the presiding director at meetings. In the event that the Chairman is unavailable to serve at a particular meeting, responsibility for the presiding director function will rotate among the directors in attendance.

Corporate Governance

Our board of directors believes that sound governance practices and policies provide an important framework to assist them in fulfilling their duty to stockholders. Our board of directors actively supports management's adoption and implementation of many "best practices" in the area of corporate governance, including annual review of internal control changes, compensation practices, executive management and auditor retention. In 2017 and 2016, all directors attended a minimum of 75% of the meetings of the board of directors.

Code of Ethics

Our board of directors has adopted a Code of Ethics which has been distributed to all directors, and executive officers, and will be distributed to employees and will be given to new employees at the time of hire. The Financial Code of Ethics contains a number of provisions that apply principally to our Principal Executive Officer, Principal Financial Officer and other key accounting and financial personnel. A copy of our Code of Business Conduct and Ethics can be

found under the “Investor Relations” section of our website (www.optexsys.com) under the section for corporate governance. We also intend to disclose any amendments or waivers of our Code on our website.

Board Meetings

We are incorporated under the laws of the State of Delaware. The interests of our stockholders are represented by the board of directors, which oversees our business and management.

The board of directors meets regularly during the year and holds special meetings and acts by unanimous written consent whenever circumstances require. The board held three meetings (including special meetings) and took action by unanimous written consent seven times during our fiscal year ended October 1, 2017.

Board Committees

Messrs. Naccarato and Kittay serve on our Audit Committee and Compensation Committee with Mr. Naccarato as chair of the Audit Committee and Mr. Kittay as chair of the Compensation Committee.

Board nominations

Stockholders wishing to bring a nomination for a director candidate before a stockholders meeting must give written notice to our Corporate Secretary, either by personal delivery or by United States mail, postage prepaid. The stockholder's notice must be received by the Corporate Secretary not later than (a) with respect to an Annual Meeting of Stockholders, 90 days prior to the anniversary date of the immediately preceding annual meeting, and (b) with respect to a special meeting of stockholders for the election of directors, the close of business on the tenth day following the date on which notice of the meeting is first given to stockholders. The stockholder's notice must set forth all information relating to each person whom the stockholder proposes to nominate that is required to be disclosed under applicable rules and regulations of the SEC, including the written consent of the person proposed to be nominated to being named in the proxy statement as a nominee and to serving as a director if elected. The stockholder's notice must also set forth as to the stockholder making the nomination (i) the name and address of the stockholder, (ii) the number of shares held by the stockholder, (iii) a representation that the stockholder is a holder of record of stock of the Optex Systems Holdings, entitled to vote at the meeting and intends to appear in person or by proxy at the meeting to nominate the person named in the notice, and (iv) a description of all arrangements or understandings between the stockholder and each nominee.

Stockholder Communications with the Board of Directors

Stockholders may communicate directly with the board of directors or any board member by writing to them at Optex Systems Holdings, Inc., 1420 Presidential Drive, Richardson, TX 75081. The outside of the envelope should prominently indicate that the correspondence is intended for the board of directors or for a specific director. The secretary will forward all such written communications to the director to whom it is addressed or, if no director is specified, to the entire board of directors.

Director Attendance at Annual Meetings of Stockholders

Directors are encouraged to attend annual meetings, although such attendance is not required.

Board Independence

Our board of directors has determined that two of our directors would meet the independence requirements of the Nasdaq Capital Market, if such standards applied to the Company. In reaching its conclusions, the board of directors

considered all relevant facts and circumstances with respect to any direct or indirect relationships between the Company and each of the directors, including those discussed under the caption “Certain Relationships and Related Transactions” below. Our board of directors determined that any relationships that exist or existed in the past between the Company and each of the independent directors were immaterial on the basis of the information set forth in the above-referenced sections.

Director Compensation

See table below under “Executive Compensation — Director Compensation.”

Item 11 Executive Compensation

The board of directors administers our option compensation plan. Our Principal Executive Officer and other members of management regularly discuss our compensation issues with the Board of Directors. Subject to Board review, modification and approval, Mr. Hirschman typically makes recommendations respecting bonuses and equity incentive awards for the other members of the executive management team. The Board establishes all bonus and equity incentive awards for Mr. Hirschman in consultation with other members of the management team.

Summary Compensation Table

The following table sets forth, for the years indicated, all compensation paid, distributed or accrued for services, including salary and bonus amounts, rendered in all capacities by our principal executive officer, principal financial officer and all other executive officers who received or are entitled to receive remuneration in excess of \$100,000 during the stated periods. These officers are referred to herein as the “named executive officers.” Except as provided below, none of our executive officers received annual compensation in excess of \$100,000 during the last two fiscal years.

| Name and Position | Year | Salary | Bonus | Stock Awards (\$) | Option Awards (\$) | All Other Compensation | Total |
|---|------|-----------|----------|-------------------|--------------------|------------------------|-----------|
| | | (\$) | (\$) | (2) | (1) | (\$) | (\$) |
| Stanley A. Hirschman, President (resigned) | 2017 | \$— | \$— | \$ — | \$ 9,971 | \$ — | \$9,971 |
| | 2016 | 33,231 | — | — | 11,729 | — | 44,960 |
| | 2015 | 61,084 | — | — | 14,971 | — | 76,055 |
| Danny Schoening, CEO & Board Chairman | 2017 | \$256,416 | \$48,856 | \$ 93,000 | \$ 19,943 | \$ — | \$418,215 |
| | 2016 | 254,066 | 14,872 | 69,750 | 23,457 | — | 362,145 |
| | 2015 | 213,754 | — | — | 29,941 | — | 243,695 |
| Karen Hawkins CFO & Board Director | 2017 | \$184,124 | \$35,699 | \$ 31,000 | \$ 9,971 | \$ — | \$260,794 |
| | 2016 | 182,755 | 7,500 | 23,250 | 11,729 | — | 225,234 |
| | 2015 | 162,571 | — | — | 14,971 | — | 177,542 |
| Bill Bates AOC GM & Board Director | 2017 | \$135,631 | \$6,681 | \$ 8,696 | \$ — | \$ — | \$151,008 |

The amounts in the “Option awards” column reflect the dollar amounts recognized as the executive portion of compensation expense for financial statement reporting purposes for each named executive officer during fiscal (1)2014 through fiscal 2016, as required by FASB ASC 718, disregarding any estimates for forfeitures relating to service-based vesting conditions. For the assumptions relating to these valuations, see note 10 to our fiscal 2014 audited financial statements.

On June 15, 2016, the Company issued 150,000 RSUs to its Chief Executive Officer, Danny Schoening, and 50,000 RSUs to its Chief Financial Officer, Karen Hawkins. The RSUs issued to Mr. Schoening and Ms. Hawkins vest as follows: 34% on January 1, 2017, 33% on January 1, 2018 and 33% on January 1, 2019. The total market value of the restricted stock units based on the shares price of \$1.85 as of June 15, 2016 is \$372 thousand. On June 15, 2017, the Company issued 50,000 RSUs to its General Manager (Applied Optical Products). The RSUs (2) issued to Mr. Bates vest as follows: 34% on January 1, 2018, 33% on January 1, 2019 and 33% on January 1, 2020. The total market value of the restricted stock units granted to Mr. Bates based on the shares price of \$0.95 as of June 15, 2017 is \$47.5 thousand. The cost of the shares is amortized on a straight line basis across the vesting periods. The amounts in the “Stock awards” column reflect the dollar amounts recognized as the executive portion of compensation expense for financial statement reporting purposes for each named executive officer during the fiscal years, as required by FASB ASC 718 (prior authoritative literature SFAS 123(R), disregarding any estimates for forfeitures relating to service-based vesting conditions. .

Option Grants in Last Fiscal Year

On December 19, 2013, our Board of Directors authorized an amendment to our Stock Option Plan to increase the number of issuable shares from 50,000 to 75,000 and authorized the grant of 20,000 options to three board members

and a grant of 5,000 to an officer. The options are exercise prices of \$10 per share with each grant to vest 25% per year over four years for each year with which the grantee is still employed by or serving as a director of us, Inc. (with all unvested options automatically expiring on the date of termination of employment by or service as a director of us, Inc.) and all unvested options immediately vesting upon a change of control due to a merger or acquisition of us. There were no other plan based awards made to our named executive officers during the fiscal year ended October 1, 2017 or for the fiscal year ended October 2, 2016.

Employment Agreements - Danny Schoening

We entered into an employment agreement with Danny Schoening dated December 1, 2008. The term of the agreement commenced as of December 1, 2008 and the current term has automatically renewed through December 1, 2018. The term of the agreement shall be automatically extended for successive 18 month periods, unless we shall provide a written notice of termination at least ninety (90) days, or Mr. Schoening shall provide a written notice of termination at least 90 days, prior to the end of the initial term or any extended term, as applicable. During the first eighteen months of the term of the agreement, we paid to Schoening a base salary at the annual rate of \$190,000, and his base salary for the first renewal term has continued at the same rate. On December 9, 2011, the Board of Directors authorized a six percent increase in Schoening's base salary effective January 1, 2012. On December 19, 2013, the Board of Directors of us authorized a five percent increase in Schoening's base salary effective January 1, 2014. Schoening was paid a one-time bonus of \$10,000 at the commencement of the employment agreement in December 2008 and was granted 1,415 options to purchase common stock at an exercise price of \$150 per share at the time of the closing of the reorganization.

On each subsequent renewal date of the commencement of employment, Schoening's base salary shall be reviewed by the Board and may be increased to such rate as the Board, in its sole discretion, may hereafter from time to time determine. During the term of the agreement, Schoening shall be entitled to receive bonuses of up to 30% of his base salary per year at the discretion of our Board of Directors pursuant to performance objectives to be determined by the Board of Directors. Any bonuses shall be payable in cash and shall be paid within ninety (90) days of any year anniversary of the date of the agreement. Upon closing of the reorganization, we granted Schoening stock options equal to 1% of the issued and outstanding shares immediately after giving effect to the reorganization, with 34% of the options having vested on March 30, 2010, and 33% of the options having vested on March 31, 2011 and 33% of the options having vested on March 31, 2012.

The employment agreement events of termination consist of: (i) death of Mr. Schoening; (ii) termination by us for cause (including conviction of a felony, commission of fraudulent acts, willful misconduct by Mr. Schoening, continued failure to perform duties after written notice, violation of securities laws and breach of the employment agreement), (iii) termination without cause by us and (iv) termination by Mr. Schoening for good reason (including breach by us of its obligations under the agreement, the requirement for Mr. Schoening to move more than 100 miles away for his employment without consent, and merger or consolidation that results in more than 66% of the combined voting power of the then outstanding securities of us or our successor changing ownership or a sale of all or substantially all of our assets, without the surviving entity assuming the obligations under the agreement). For a termination by us for cause or upon death of Mr. Schoening, Mr. Schoening shall be paid salary and bonus earned through the date of termination. For a termination by us without cause or by Mr. Schoening with good reason, Mr. Schoening shall also be paid six months' base salary in effect and all granted stock options shall remain exercisable for a period of two years after such termination, with all unvested stock options immediately vesting. The agreement contains a standard non-solicitation and non-compete agreement that extends for one year subsequent to termination thereof.

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On January 21, 2016, our Board of Directors Compensation Committee held a meeting and approved a base salary increase of 10% for Danny Schoening, CEO.

On November 4, 2016, our Board of Directors Compensation Committee held a meeting and approved a bonus payment of \$48.9 thousand awarded to Danny Schoening for 2016 performance.

On March 31, 2017, our Board of Directors Compensation Committee held a meeting and approved a base salary increase of 4% for Danny Schoening, CEO.

On June 9, 2017, through Unanimous Written Consent, our Board of Directors approved an amendment to Danny Schoening's employment agreement to increase his annual bonus from a maximum of 30% to 60% of his base salary.

Karen Hawkins

On August 4, 2016, our Board of Directors approved an employment agreement for Karen Hawkins, Chief Financial Officer, dated as of August 1, 2016. This agreement has the following salient terms:

The term of the agreement commenced on August 1, 2016 and expires on January 31, 2018 and automatically renews for subsequent 18 month periods unless Ms. Hawkins or we give notice of termination at least 90 days before the end of the term then in effect.

The base salary thereunder is \$178,496, and Ms. Hawkins is entitled to annual bonuses of up to 30% of her base salary as approved by the Board.

Ms. Hawkins is entitled to 15 days' vacation and all other benefits accorded to our other senior executives.

The employment agreement events of termination consist of: (i) death of Ms. Hawkins; (ii) termination by us for cause (including conviction of a felony, commission of fraudulent acts, willful misconduct by Ms. Hawkins, continued failure to perform duties after written notice, violation of securities laws and breach of the employment agreement), (iii) termination without cause by us and (iv) termination by Ms. Hawkins for good reason (including breach by us of its obligations under the agreement, the requirement for Ms. Hawkins to move more than 100 miles away for her employment without consent, and merger or consolidation that results in more than 66% of the combined voting power of the then outstanding securities of us or our successor changing ownership or a sale of all or substantially all of our assets, without the surviving entity assuming the obligations under the agreement). For a termination by us for cause or upon death of Ms. Hawkins, Ms. Hawkins shall be paid salary and bonus earned through the date of termination. For a termination by us without cause or by Ms. Hawkins with good reason, Ms. Hawkins shall also be paid six months' base salary in effect and all granted stock options shall remain exercisable for a period of two years after such termination, with all unvested stock options immediately vesting. The agreement contains a standard non-solicitation and non-compete agreement that extends for one year subsequent to termination thereof.

On January 21, 2016, our Board of Directors Compensation Committee held a meeting and approved a bonus payment of \$7.5 thousand awarded to Karen Hawkins for 2015 performance.

On November 4, 2016, our Board of Directors Compensation Committee held a meeting and approved a bonus payment of \$35.7 thousand awarded to Karen Hawkins for 2016 performance.

On March 31, 2017, our Board of Directors Compensation Committee held a meeting and approved a base salary increase of 4% for Karen Hawkins, CFO.

We do not have any other employment agreements with our executive officers and directors.

Equity Compensation Plan Information

We currently have an option compensation plan covering the issuance of both incentive and nonstatutory options, determined at the time of grant, for the purchase of up to 75,000 shares, which was increased from 50,000 shares on December 19, 2013. The purpose of the Plan is to assist us in attracting and retaining highly competent employees and to act as an incentive in motivating selected officers and other employees of us and our subsidiaries, and directors and consultants of us and our subsidiaries, to achieve long-term corporate objectives. On December 19, 2013, the Board of Directors authorized the grant of 20,000 options to three board members and a grant of 5,000 to an officer. There are 75,000 shares of common stock reserved for issuance under this Plan. As of October 1, 2017, we had issued 71,070 share options under this Plan of which 6,060 shares had forfeited and 65,010 shares had vested, and 5,000 shares had been exercised as of October 1, 2017.

The outstanding options include 56,260 options that are currently vested and exercisable as of October 1, 2017, and 3,750 options vested on December 18, 2017. The vested options represent potential future cash proceeds to our company of \$600,100. There are no additional options that will become vested and exercisable within 60 days. The following table provides summary information on our outstanding options as of December 18, 2017.

| | Vested Option Grants | | | Unvested Option Grants | | |
|---|----------------------|---------|-----------|------------------------|---------|----------|
| | Shares | Price | Proceeds | Shares | Price | Proceeds |
| FY2012 Employee & officer plan options | 10,010 | 10.00 | 100,100 | — | 10.00 | \$— |
| FY2012 Directors plan options | 25,000 | 10.00 | 250,000 | — | 10.00 | — |
| FY2014 Directors plan options | 25,000 | 10.00 | 250,000 | — | 10.00 | — |
| Non-plan options to consultants and employees | — | — | — | — | — | — |
| Total | 60,010 | \$10.00 | \$600,100 | — | \$10.00 | \$— |

The holders of options are not required to exercise their rights at any time and we are unable to predict the amount and timing of any future option exercises. We reserve the right to temporarily reduce the exercise prices of our options from time to time in order to encourage the early exercise of the options.

Outstanding Director and Officer Equity Awards as of December 18, 2017

| Name | Option Awards Number of shares underlying unexercised options | | Equity Incentive Plan Awards Total Granted | Exercise Price | Expiration Date | Footnotes |
|-----------------|--|-------------------------|---|-------------------|-----------------|-----------|
| | Non-Plan Number Exercisable | Number Unexercisable | | | | |
| Danny Schoening | 10,000 | — | 10,000 | 10.00 | 12/8/2018 | (1)) |
| | 10,000 | — | 10,000 | 10.00 | 12/18/2020 | (2)) |
| Karen Hawkins | 5,000 | — | 5,000 | 10.00 | 12/8/2018 | (1)) |
| | 5,000 | — | 5,000 | 10.00 | 12/18/2020 | (2)) |
| Stan Hirschman | 5,000 | — | 5,000 | 10.00 | 12/8/2018 | (1)) |
| | 5,000 | — | 5,000 | 10.00 | 12/18/2020 | (2))(3) |
| Merrick Okamoto | 5,000 | — | 5,000 | 10.00 | 12/8/2018 | (1)) |
| | 5,000 | — | 5,000 | 10.00 | 12/18/2020 | (2))(3) |

Options granted on December 9, 2011 pursuant to employee stock option compensation plan. Shares vest over 4 (1) years at a rate of 25% per year each respective anniversary date subsequent to 2011 and expire after seven years. As of December 9, 2015 100% of the options had vested and become exercisable.

Options granted on December 19, 2013 pursuant to employee stock option compensation plan. Shares vest over 4 (2) years at a rate of 25% per year each respective anniversary date subsequent to 2013 and expire after seven years. As of October 1, 2017 75% of the options had vested and an additional 25%, 3,750 of the total granted options had vested and become exercisable on December 18, 2017.

(3) Merrick Okamoto resigned as an officer on November 19, 2014, upon resignation, the board approved vesting of 100% of his outstanding unvested options. Stan Hirschman resigned as a director effective on November 4, 2015,

On December 8, 2015, the board of directors approved vesting of 100% of his outstanding unvested options effective on his resignation.

Restricted Stock Units issued to Officers and Employees

On June 14, 2016, the Compensation Committee (“Committee”) of the Board of Directors of Optex Systems Holdings, Inc. approved the Company’s 2016 Restricted Stock Unit Plan (the “Plan”). The Plan provides for the issuance of stock units (“RSU”) for up to 1,000,000 shares of the Company’s common stock to Optex Systems Holdings officers and employees. Each RSU constitutes a right to receive one share of the Company’s common stock, subject to vesting, which unless otherwise stated in an RSU agreement, shall vest in equal amounts on the first, second and third anniversary of the grant date. Shares of the Company’s common stock underlying the number of vested RSUs will be delivered as soon as practicable after vesting. During the period between grant and vesting, the RSUs may not be transferred, and the grantee has no rights as a shareholder until vesting has occurred. If the grantee’s employment is terminated for any reason (other than following a change in control of the Company or a termination of an officer other than for cause), then any unvested RSUs under the award will automatically terminate and be forfeited. If an officer grantee’s employment is terminated by the Company without cause or by the grantee for good reason, then, provided that the RSUs have not been previously forfeited, the remaining unvested portion of the RSUs will immediately vest as of the officer grantee’s termination date. In the event of a change in control, the Company’s obligations regarding outstanding RSUs shall, on such terms as may be approved by the Committee prior to such event, immediately vest, be assumed by the surviving or continuing company or cancelled in exchange for property (including cash).

On June 15, 2016, the Company issued 150,000 RSUs to its Chief Executive Officer, Danny Schoening, and 50,000 RSUs to its Chief Financial Officer, Karen Hawkins. The RSUs issued to Mr. Schoening and Ms. Hawkins vest as follows: 34% on January 1, 2017, 33% on January 1, 2018 and 33% on January 1, 2019. The total market value of the restricted stock units based on the shares price of \$1.85 as of June 15, 2016 is \$372 thousand. The cost of the shares is amortized on a straight line basis across the vesting periods.

On January 5, 2017, Optex Systems Holdings issued 45,799 common shares related to the vesting of the 68,000 restricted stock units on January 1, 2017. The shares issued were net of 22,201 common shares withheld for employee federal income tax requirements.

On June 15, 2017, the Company issued 50,000 RSUs to its Applied Optics Center General Manager and new board member, Bill Bates. Pursuant to the RSU agreements the RSUs issued to Mr. Bates will vest as follows: 34% on January 1, 2018, 33% on January 1, 2019 and 33% on January 1, 2020. The total market value of the restricted stock units based on the shares price of \$0.95 as of June 15, 2016 is \$47.5 thousand. The cost of the shares is amortized on a straight line basis across the vesting periods.

As of October 2, 2017 there are 182,000 outstanding unvested restricted stock units remaining to vest.

Consulting and Vendor Equity Compensation

On April 29, 2016, Optex Systems Holdings, Inc. issued 40,000 common “restricted” shares at a market price of \$2.35 per share (\$94,000) in support of the IRTM Communications agreement. The cost of the shares is amortized on a straight line basis through April 2017. There were no other equity instruments issued to consultants and vendors during the twelve months ended October 1, 2017. During the twelve months ending October 1, 2017 and October 2, 2016, \$47 thousand was expensed to stock compensation, and there is zero unamortized stock option compensation related to these shares.

Nonqualified deferred compensation

We had no non-qualified deferred compensation plans during year ended October 1, 2017.

Post-Termination Compensation

We have not entered into change in control agreements with any of our named executive officers or other members of the executive management team other than the provision with respect to Mr. Schoening and Ms. Hawkins described above. No awards of equity incentives under our 2009 Stock Option Plan provide for immediate vesting upon a change in control. However, our Board of Directors has the full and exclusive power to interpret the plans, including the power to accelerate the vesting of outstanding, unvested awards. A “change in control” is generally defined as (1) the acquisition by any person of 66% or more of the combined voting power of our outstanding securities or (2) the occurrence of a transaction requiring stockholder approval and involving the sale of all or substantially all of our assets or the merger of us with or into another corporation.

Director Compensation

The following table provides information regarding compensation paid to directors for services rendered during the year ended October 1, 2017.

| Name | Fees Earned or Paid in Cash (\$) | Stock Awards (\$) | Option Awards (\$) ⁽¹⁾ | Non-Equity Incentive Plan Compensation (\$) | Nonqualified Deferred Compensation Earnings (\$) | All Other Compensation (\$) | Total (\$) |
|--------------------------------|----------------------------------|-------------------|-----------------------------------|---|--|-----------------------------|------------|
| Chuck Trego ⁽²⁾ | 12,000 | — | — | — | — | — | 12,000 |
| David Kittay ⁽²⁾ | 16,500 | — | — | — | — | — | 16,500 |
| Owen Naccarato ⁽²⁾ | 12,000 | — | — | — | — | — | 12,000 |
| Peter Benz ⁽³⁾ | 110,000 | — | — | — | — | — | 110,000 |
| Danny Schoening ⁽³⁾ | — | — | — | — | — | — | — |
| Karen Hawkins ⁽³⁾ | — | — | — | — | — | — | — |
| Bill Bates ⁽³⁾ | — | — | — | — | — | — | — |

The amounts in the “Option awards” column reflect the dollar amounts recognized as the director fee portion of compensation expense for financial statement reporting purposes for each named director executive officer during (1) fiscal 2015, as required by FASB ASC 718, disregarding any estimates for forfeitures relating to service-based vesting conditions. Danny Schoening, Karen Hawkins and Bill Bates option awards have been separately reported as Executive Compensation on the summary compensation table.

Director and meeting fees paid quarterly from October 2016 through September 2017. Each independent director receives \$1,000 for each month served from October 2017 through May 2017 and \$1,500 for each month from (2) July 2017 through September 2017, paid quarterly, and \$500 for each meeting attended. From October through September 2016, there were three board meetings, four audit committee meetings, and two compensation committee meeting held. Chuck Trego resigned as a director as of May 31, 2017.

Peter Benz is served as a non-independent director and received \$10,000 for his services for each month served.

(3) Peter Benz resigned as a director effective June 9, 2017, pursuant to a separation agreement, he serves as a board advisor and will receive \$10,000 for services until December 31, 2017. Danny Schoening, Karen Hawkins and Bill Bates are serving as a non-independent director and as such received no board fees in 2017.

The members of our board of directors are actively involved in various aspects of our business ranging from relatively narrow board oversight functions to providing hands-on guidance to our executives and scientific staff with respect to matters within their personal experience and expertise. We believe that the active involvement of all directors in our principal business and policy decisions increases our board of directors’ understanding of our needs and improves the overall quality of our management decisions.

With the exception of Danny Schoening, Karen Hawkins and Bill Bates, our directors are compensated separately for service as independent members of our board of directors.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

On December 19, 2017, we had 8,590,101 shares of common stock, 78 shares of Series C preferred shares (convertible into 325,000 shares of common stock), 4,125,200 warrants, 182,000 granted and unvested restricted stock units and 60,010 vested and exercisable stock options. The following table sets forth certain information with respect to the beneficial ownership of our securities as of December 18, 2017, for (i) each of our directors and executive officers; (ii) all of our directors and executive officers as a group (not noting our four new directors who have not yet been issued any stock or options which have vested); and (iii) each person who we know beneficially owns more than 5% of our common stock.

Beneficial ownership data in the table has been calculated based on Commission rules that require us to identify all securities that are exercisable or convertible into shares of our common stock within 60 days of July 19, 2017 and treat the underlying stock as outstanding for the purpose of computing the percentage of ownership of the holder.

Except as indicated by the footnotes following the table, and subject to applicable community property laws, each person identified in the table possesses sole voting and investment power with respect to all capital stock held by that person. The address of each named executive officer and director, unless indicated otherwise by footnote, is c/o our corporate headquarters.

Except as otherwise set forth below, the address of each of the persons listed below is our address.

| Title of Class | Name of Beneficial Owner | Number of Shares | Percentage of Outstanding Shares | |
|--|-----------------------------------|-------------------------|---|---|
| 5% Holders | Longview Fund L.P. ⁽¹⁾ | 2,800,132 | 31.1 | % |
| | Alpha Capital ⁽²⁾ | 734,959 | 8.3 | % |
| | Gate City Capital ⁽³⁾ | 410,410 | 4.6 | % |
| Directors and Officers: | Danny Schoening ⁽⁴⁾ | 744,287 | 8.2 | % |
| | Karen Hawkins ⁽⁵⁾ | 192,563 | 2.1 | % |
| Directors and officers as a group (3 Individuals) ⁽⁶⁾ | | 948,300 | 10.5 | % |

Viking Asset Management, the authorized agent of the Longview Fund, L.P. (“Longview”), has discretionary authority to vote and dispose of the shares held by Longview and may be deemed to be the beneficial owner of these shares. Merrick Okamoto, in his capacity as Manager of Viking Asset Management, may also be deemed to have investment discretion and voting power over the shares held by Longview. Mr. Okamoto disclaims any such beneficial ownership of the shares. Viking Asset Management is not affiliated with any FINRA members. This selling stockholder acquired the securities in the ordinary course of business, and at the time of the purchase of the securities to be resold, the seller had no agreements or understandings, directly or indirectly, with any person to distribute the securities.

Represents shares held by Alpha Capital Anstalt, which is located at Pradafant 7, 9490 Furstentums, Vaduz, 2Lichtenstein. Includes common shares held of 409,959, and 78 shares of Series C preferred stock convertible into 325,000 common shares.

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Represents 410,410 common shares reported as held by Gate City Capital Management LLC, 70 West Madison Street, Suite 1400 Chicago, IL 60602 on SEC schedule 13G (filed on May 1, 2017).

Includes common shares held of 674,349, restricted stock units of 33,338 expected to vest on January 1, 2018 and 4 settle net of taxes withheld on January 3, 2018 and options to purchase 20,000 shares of our common stock which have vested and are currently exercisable, and 8,300 warrants.

Represents common shares held of 171,450, restricted stock units of 11,113 expected to vest on January 1, 2018 and 5 settle net of taxes withheld on January 3, 2018 and options to purchase 10,000 shares of our common stock which have vested and are currently exercisable.

Represents common shares, options, and warrants held by Danny Schoening, Karen Hawkins, and Bill Bates. Bill 6 Bates has 11,450 restricted stock units expected to vest on January 1, 2018 and settle net of taxes withheld on January 3, 2018

Item 13 Certain Relationships and Related Transactions, and Director Independence

Relationship between Optex Systems, Inc. (Texas), Irvine Sensors Corporation and Longview and Alpha

Longview and Alpha were owed certain debt by Irvine Sensors Corporation including debt evidenced by (i) a December 29, 2006 Term Loan and Security Agreement executed by Irvine Sensors Corporation and Longview and Alpha, and (ii) a series of secured promissory notes purchased by them and issued to them on December 29, 2006, July 19, 2007 and November 28, 2007. As of August 24, 2008, the total amount due under all of the described notes was approximately \$18.4 million. Optex Systems, Inc. (Texas), which was and is a wholly owned subsidiary of Irvine Sensors Corporation, was a guarantor of all of those notes, and pursuant to related security agreements Longview and Alpha had a validly perfected, fully enforceable security interest in all personal property of Optex Systems, Inc. (Texas). On September 19, 2008, pursuant to an Assignment and Stock/Note Issuance Agreement, Alpha and Longview transferred and assigned to Optex Systems, Inc. (Delaware) which assumed, \$15 million of their respective interests and rights in the aforesaid notes and obligations to Optex Systems, Inc. (Delaware) in exchange for \$9 million of equity and \$6 million of debt.

Acquisition of Assets of Optex Systems, Inc. (Texas) by Optex Systems, Inc. (Delaware) on October 14, 2008

On October 14, 2008, in a purchase 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 owned by it and the assumption of approximately \$3.8 million of certain Optex Systems, Inc. (Texas) liabilities. The \$15 million of Irvine Sensors Corporation debt was contributed by Longview and Alpha to Optex Systems, Inc. (Delaware) in exchange for a \$6 million note payable from Optex Systems, Inc. (Delaware) and a \$9 million equity interest in Optex Systems, Inc. (Delaware). Longview and Alpha owned Optex Systems, Inc. (Delaware) until February 20, 2009, when Longview sold 100% of its interests in Optex Systems, Inc. (Delaware) to Sileas, as discussed below. In referring to these transactions, Optex Systems, Inc. (Delaware) is considered to be the successor entity to Optex Systems, Inc. (Texas), the predecessor entity.

Secured Promissory Notes and Common Shares Issued in connection with Purchase by Optex Systems, Inc. (Delaware)

In connection with the public sale of the Optex Systems, Inc. (Texas) assets to Optex Systems, Inc. (Delaware), Optex Systems, Inc. (Delaware) delivered to each of Longview and Alpha a Secured Promissory Note due September 19, 2011 in the principal amounts of \$5,409,762 and \$540,976, respectively. Each Note bears simple interest at the rate of 6% per annum, and the interest rate upon an event of default increases to 8% per annum. After 180 days from the issue

date, the principal amount of the Notes and accrued and unpaid interest thereon may be converted into Optex Systems, Inc. (Delaware) common stock at a conversion price of \$1.80 per share (pre-split and pre-reorganization price). The Notes may be redeemed prior to maturity at a price of 120% of the then outstanding principal amount plus all accrued and unpaid interest thereon. The obligations of Optex Systems, Inc. (Delaware) under the Notes are secured by a lien against all of the assets of Optex Systems, Inc. (Delaware) in favor of Longview and Alpha. In addition, Optex Systems, Inc. (Delaware) issued common stock to each of Longview and Alpha in the quantities of 45,081,350 and 4,918,650, respectively (pre reverse split numbers as historical). On October 30, 2008, Alpha sold its Optex Systems, Inc. (Delaware) common stock to Arland Holding, Ltd. On February 20, 2009, Longview sold its Note to Sileas (see below).

Acquisition by Sileas of Longview's Interests in Optex Systems, Inc. (Delaware) on February 20, 2009

On February 20, 2009, Sileas purchased 100% of the equity and debt interest held by Longview, representing 90% of Optex Systems, Inc. (Delaware), in a private transaction. The primary reason for the acquisition was to eliminate shareholder control of us by Longview and to limit any perception of control over the day-to-day operations of us, whether or not such control actually existed. While Longview makes investments in a variety of companies, it strives to invest passively and leave the day-to-day operations of the companies in its investment portfolio to the management teams of those companies. In addition, the acquisition allowed Optex Systems Holdings to avoid potential conflicts of interest or other related business issues that might have adversely affected our operations as a result of Longview's investments in other companies.

The purchase price for the acquisition was \$13,524,405. Sileas issued a purchase money note to Longview for the full amount of the purchase price in exchange for 45,081,350 (pre-split as historical) shares of common stock of us (representing 90% of the outstanding shares) and transfer to Sileas of a note dated December 2, 2008, issued by us to Longview in the principal amount of \$5,409,762. No contingent consideration is due the seller in the transaction. The obligations of Sileas under the Note are secured by a security interest in our common and preferred stock owned by Sileas that was granted to Longview pursuant to a Stock Pledge Agreement delivered by Sileas to Longview and also by a lien on all of the assets of Sileas. On March 27, 2009, Sileas and Alpha (which owned the balance of the \$6,000,000 of the notes) exchanged the \$6,000,000 aggregate principal number of notes, plus accrued and unpaid interest thereon, for 1,027 shares of Optex Systems, Inc. (Delaware) Series A preferred stock.

Sileas has no operations or business activities other than holding the stock and notes described above and has no revenues, and it holds no assets other than the stock and notes described above. The management of Sileas believes that the value of its common stock and preferred stock holdings in Optex Systems Holdings will increase over time. Sileas plans to repay Longview, no later than the maturity date, through some combination of a recapitalization of Sileas equity and debt and partial or full liquidation of its interests in Optex Systems Holdings. Sileas will be limited by the extent of our stock price and limitations on ability to resell the stock it owns in Optex Systems Holdings.

Secured Promissory Note Due February 20, 2016/Longview Fund, LP

As a result of the transaction described above between Sileas and Longview on February 20, 2009, Sileas, the new majority owner of Optex Systems, Inc. (Delaware), executed and delivered to Longview, a Secured Promissory Note due February 20, 2012 in the principal amount of \$13,524,405. The Note bears simple interest at the rate of 4% per annum, and the interest rate upon an event of default increases to 10% per annum. In the event that a Major Transaction occurs prior to the maturity date resulting in the Borrower receiving Net Consideration with a fair market value in excess of the principal and interest due under the terms of this Secured Note, then in addition to paying the principal and interest due, Sileas shall also pay an amount equal to 90% of the consideration. "Major Transaction" refers to a transaction whereby Optex Systems, Inc. (Delaware) would consolidate or merge into or sell or convey all or substantially all of its assets to a third party entity for more than nominal consideration, and "Net Consideration" refers to the fair market value of the consideration received in connection with a Major Transaction less all outstanding liabilities of Optex Systems, Inc. (Delaware).

On November 22, 2011 Sileas Corp and Longview Fund, LP entered into an amendment to the Secured Promissory Note that extended the maturity date for an additional two-year period ending on February 20, 2014. In exchange for the extension, Sileas Corp agreed to pay Longview Fund an extension fee equal to 2% of the principal amount of this Secured Note. As a result of the agreement, the principal amount of the Note was increased \$270 thousand to \$13.8 million as of November 22, 2011.

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On November 27, 2013 Sileas Corp. and the Longview Fund, LP entered into an amendment to the Secured Promissory Note that extended the maturity date for an additional two-year period ending on February 20, 2016. In exchange for the extension, Sileas Corp. agreed to pay the Longview Fund an extension fee equal to 2% of the principal amount of this Secured Note. As a result of the amendment, the principal amount of the Note was increased by \$275 thousand to \$14.1 million as of November 27, 2013, 2013.

On June 5, 2015, Sileas Corp. amended its Secured Note, with Longview Fund, L.P., as lender, as follows:

The principal amount was increased to \$18,022,329 to reflect the original principal amount plus all accrued and unpaid interest to date, and the Secured Note ceased to bear interest as of that date;

The maturity date of the note was extended to May 29, 2021; and

A conversion feature was added to the Secured Note by which the principal amount of the Secured Note can be converted into our Series A preferred stock, which is owned by Sileas, at the stated value of our Series A preferred stock.

On August 4, 2016, Longview Fund, L.P. converted \$250 thousand of the note principal for 100,000 shares of Optex Systems Holdings common stock pursuant to the note conversion terms. The Sileas note balance to the Longview Fund, LP as of October 1, 2017 is \$17.8 million.

On October 31, 2016, Longview Fund, L.P. converted \$2.7 million of the Sileas note principal in exchange for 800,000 shares of Optex Systems Holdings common stock. The Sileas note balance to the Longview Fund, LP as of December 7, 2016 is \$15.1 million.

On May 1, 2017, The Longview Fund, L.P. converted \$0.8 million of the Sileas Corp.(a related party) note principal in exchange for 700,000 shares of Optex Systems Holdings common stock. The Sileas Corp. note balance to The Longview Fund, L.P. as of May 1, 2017, after conversion, is \$14.2 million.

On June 9, 2017, Sileas Corp. (“Sileas”), a related party to the Company, entered into a transaction with The Longview Fund, L.P.(“Longview”) to settle its February 20, 2009 note with Longview in the original principal amount of \$13,524,405 (the “Note”). The parties agreed to a conversion by Longview of \$3,358,538 of the amount due under the Note into 2,798,782 shares of Company common stock owned by Sileas and previously pledged to Longview as security with respect to the Note. Simultaneously therewith, Sileas made a \$250,000 cash payment to Longview, and Longview agreed to satisfy \$10,571,791 of the amount due under the Note. The remaining amount due under the Note is \$64,000 which shall be paid in cash by Sileas to Longview on a quarterly basis, upon the payment of quarterly dividends by the Company, over the next four calendar quarters commencing on or about June 30, 2017. In order to effect the above, Longview also released the pledge on all Company shares owned by Sileas and previously pledged to Longview. The Sileas Corp. note balance to The Longview Fund, L.P. as of October 1, 2017 is \$48 thousand.

Alpha Capital Anstalt Stock Purchase and Preferred Shares Conversions

On February 22, 2012, Alpha Capital Anstalt bought 5,000 shares of our restricted common stock at a purchase price of \$10.00 per share for a total purchase price of \$50,000. As of August 26, 2016 Alpha Capital Anstalt had converted a total 34.6 Series A preferred shares at a stated value of \$6,860 into 42,500 shares of its Common Stock for a total converted value of \$237,497. The Common Stock was purchased or converted by Alpha in private transactions exempt from registration under Section 4(2) of the Securities Act of 1934 and is restricted from resale and the stock certificate issued bears the appropriate restrictive legend. On August 26, 2016 Alpha Capital Anstalt redeemed 66.4 Series A preferred shares for \$455,397. There were no remaining Series A preferred shares after the August 26, 2016 conversion.

Reorganization/Share Exchange

On March 30, 2009, a reorganization occurred whereby the then existing shareholders of Optex Systems, Inc. (Delaware) exchanged their shares of common stock with the shares of common stock of us as follows: (i) the outstanding 85,000,000 shares of Optex Systems, Inc. (Delaware) common stock were exchanged by Optex Systems Holdings for 113,333,282 shares (pre-split as historical) of us common stock, (ii) the outstanding 1,027 shares of Optex Systems, Inc. (Delaware) Series A preferred stock were exchanged by Optex Systems Holdings for 1,027 shares of our Series A preferred stock and (iii) the 8,131,667 shares (pre-split as historical) of Optex Systems, Inc. (Delaware) common stock purchased in the private placement, which also occurred on March 30, 2009, were exchanged by Optex Systems Holdings for 8,131,667 shares of the Company's common stock. The per share price in the private placement was \$0.15 per share of common stock, and the closing date was March 30, 2009. Optex Systems, Inc. (Delaware) remains a wholly-owned subsidiary of us.

At the time of the reorganization (all numbers are pre-split due to historical context), 25,000,000 shares owned by Andrey Oks, the former CEO, were cancelled. Immediately prior to the closing, 17,449,991 shares of our common stock were outstanding. The 17,449,991 shares derives from the 17,999,995 shares outstanding as of December 31, 2008 plus the 26,999,996 shares issued in conjunction with the 2.5:1 forward stock split authorized by the Sustut Board and shareholders and effected on February 27, 2009 less retirement of Andrey Oks' 25,000,000 shares and cancellation of 3,800,000 shares previously issued to Newbridge Securities Corporation, shares plus issuance of 1,250,000 shares in payment for two investor relations agreements. The total outstanding common shares of us subsequent to the closing of the reorganization is as follows (1):

| | |
|---|-------------|
| Existing Sustut Shareholders | 17,449,991 |
| Optex Systems, Inc. (Delaware) shares exchanged | 113,333,282 |
| Optex Systems, Inc. (Delaware) Private Placement shares exchanged | 8,131,667 |
| Total Shares after reorganization | 138,914,940 |
| | |
| Cancellation of shares – American Capital Ventures | (700,000) |
| Private placement – June 29, 2009 | 750,000 |
| Issuance of shares as consideration – ZA Consulting | 480,000 |
| Shares Outstanding on September 27, 2009 | 139,444,940 |

Rule 409(b) states: “(b) The registrant shall include a statement either showing that unreasonable effort or expense would be involved or indicating the absence of any affiliation with the person within whose knowledge the information rests and stating the result of a request made to such person for the information.”

We made requests of counsel representing Sustut’s directors and officers to obtain additional information into the principles behind their determination that the securities of the registrant issued in the March 30, 2009 share exchange represented “fair market value” to acquire the business operations of Optex Systems, Inc. (Delaware), and they were not able to provide any information. We confirm that we have no affiliation with Sustut’s former counsel, Anslow & Jacklin, who was our only source of information regarding the prior history of Sustut and that the result of our request was that they stated they had no information and were not able to obtain further information on this issue.

We have not been able to provide further background as to how the merger consideration was determined beyond the fact that it was determined by negotiation between Sustut and Optex Systems, Inc. (Delaware). Thus, we have invoked Rule 409(b) which states: “(b) The registrant shall include a statement either showing that unreasonable effort or expense would be involved or indicating the absence of any affiliation with the person within whose knowledge the information rests and stating the result of a request made to such person for the information.”

Transactions with Executive Management

See the “Executive Compensation” section for a discussion of the material elements of compensation awarded to, earned by or paid to our named executive officers. Other than as stated in the “Executive Compensation” section, we have not entered into any transactions with executive management.

Item 14 Principal Accounting Fees and Services

The following table sets forth the fees paid to date for audit services rendered during fiscal years ended October 1, 2017 and October 2, 2016, respectively.

| Fee Category | 2017 | 2016 |
|---|-------------|-------------|
| Audit Fees ⁽¹⁾ | \$ 103,785 | 76,696 |
| Audit-Related Fees-registration statement consents ⁽²⁾ | \$5,000 | 34,409 |

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| | | |
|----------|----------|--------|
| Tax Fees | \$13,575 | 10,500 |
|----------|----------|--------|

Audit Fees are fees for professional services performed for the audit of our annual consolidated financial (1) statements and review of consolidated financial statements included in our 10-Q filings for the fiscal years ended October 1, 2017 and October 2, 2016, respectively.

(2) Fees paid in related to consent for S-1 registration statement and procedures associated with SEC comment letter for S-1 registration statement.

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Item 15 Exhibits

Exhibits

Exhibit No. Description

- 1.1 Form of Underwriting Agreement⁽²⁸⁾
- 2.1 Agreement and Plan of Reorganization, dated as of the March 30, 2009, by and between registrant, a Delaware corporation and Optex Systems, Inc., a Delaware corporation⁽¹⁾.
- 3.1 Certificate of Incorporation, as amended, of Optex Systems Holdings, Inc⁽²⁾.
- 3.2 Bylaws of Optex Systems Holdings⁽¹⁾.
- 3.3 Charters of the Audit Committee, Compensation Committee and Nominating Committee⁽²⁶⁾.
- 4.1 Certificate of Powers, Designations, Preferences and Rights of the Series B Preferred Stock of Optex Systems Holdings, Inc. dated March 26, 2015⁽²³⁾.
- 4.2 Form of Warrant for Offering⁽²⁵⁾
- 4.3 Form of Underwriter Warrant for Offering⁽²⁵⁾
- 4.4 Certificate of Designation of Series C Convertible Preferred Stock⁽²⁹⁾
- 10.1 2009 Stock Option Plan⁽¹⁾.
- 10.2 Employment Agreement with Danny Schoening⁽¹⁾.
- 10.3 Lease for 1420 Presidential Blvd., Richardson, TX⁽¹⁾.
- 10.4 Form of Warrant⁽³⁾
- 10.5 Specimen Stock Certificate⁽³⁾
- 10.6 Contract W52H0905D0248 with Tank-automotive and Armaments Command, dated August 19, 2005⁽⁵⁾⁽⁶⁾
- 10.7 Contract W52H0909D0128 with Tank-automotive and Armaments Command, dated March 24, 2009⁽⁵⁾
- 10.8 Contract W52H0905D0260 with Tank-automotive and Armaments Command, dated August 3, 2005⁽⁵⁾⁽⁶⁾

10.9 PO# 40050551 with General Dynamics, dated June 8, 2009⁽⁵⁾⁽⁶⁾

10.10 Contract 9726800650 with General Dynamics, dated April 9, 2007⁽⁵⁾⁽⁶⁾

10.11 Form of Subscription Agreement⁽⁴⁾

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| Exhibit No. | Description |
|--------------------|--|
| <u>10.12</u> | <u>Single Source Supplier Purchase Orders with TSP Inc.⁽⁵⁾</u> |
| <u>10.13</u> | <u>Single Source Supplier Purchase Orders with SWS Trimac⁽⁵⁾</u> |
| <u>10.14</u> | <u>Single Source Supplier Purchase Orders with Danaher Controls⁽⁵⁾</u> |
| <u>10.15</u> | <u>Single Source Supplier Purchase Orders with Spartech Polycast⁽⁵⁾</u> |
| <u>10.16</u> | <u>Third Amendment to Lease, between Aquiport DFWIP and Optex Systems, Inc., dated January 7, 2010.⁽⁵⁾</u> |
| <u>10.17</u> | <u>\$250,000 principal amount Note in favor of the Longview Fund, L.P., dated October 27, 2009⁽⁹⁾</u> |
| <u>10.18</u> | <u>Investor Relations Agreement, dated April 1, 2009 between Optex Systems and American Capital Ventures, Inc.⁽⁹⁾</u> |
| <u>10.19</u> | <u>Form of Loan and Security Agreement between Optex Systems, Inc. and Peninsula Bank Business Funding, dated March 4, 2010⁽⁵⁾</u> |
| <u>10.20</u> | <u>Form of Unconditional Guaranty executed by Optex Systems Holdings, Inc. in favor of Peninsula Bank Business Funding, dated March 4, 2010⁽⁵⁾</u> |
| <u>10.21</u> | <u>Form of Warrant issued by Optex Systems Holdings, Inc. to Peninsula Bank Business Funding, dated March 4, 2010⁽⁵⁾</u> |
| <u>10.22</u> | <u>Allonge to Promissory Note, dated January 5, 2010⁽⁹⁾</u> |
| <u>10.23</u> | <u>Showcase Agreement between Optex Systems, Inc. and ECON Corporate Services, Inc., dated April 1, 2009⁽⁹⁾</u> |
| <u>10.24</u> | <u>Consulting Agreement dated June 29, 2009, between ZA Consulting, Inc. and Optex Systems, Inc.⁽⁹⁾</u> |
| <u>10.25</u> | <u>Purchase Order dated June 28, 2010 with TACOM-Warren⁽⁷⁾</u> |
| <u>10.26</u> | <u>First Amendment to Loan and Security Agreement, dated August 3, 2010, by and between Peninsula Bank Business Funding and Optex Systems, Inc.⁽⁸⁾</u> |
| <u>10.27</u> | <u>Waiver by Peninsula Bank Business Funding to Optex Systems, Inc., dated November 24, 2010⁽¹⁰⁾</u> |
| <u>10.28</u> | <u>Second Amendment to Loan and Security Agreement, dated November 29, 2010, by and between Peninsula Bank Business Funding and Optex Systems, Inc.⁽¹⁰⁾</u> |
| <u>10.29</u> | <u>Third Amendment to Loan and Security Agreement, dated February 15, 2011, by and between Peninsula Bank Business Funding and Optex Systems, Inc.⁽¹¹⁾</u> |
| <u>10.30</u> | <u>Fourth Amendment to Loan and Security Agreement, dated March 22, 2011, by and between Peninsula Bank Business Funding and Optex Systems, Inc.⁽¹²⁾</u> |

10.31 Waiver of Series A preferred shareholders⁽¹⁴⁾

10.32 Form of Subscription Agreement⁽¹⁵⁾

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Exhibit No. Description

| | |
|--------------|---|
| <u>10.33</u> | <u>PO# SPRDL1-12-C-0023 with DLA Land-Warren, dated October 24, 2011⁽¹⁶⁾</u> |
| <u>10.34</u> | <u>Agreement with GDLS-Canada, dated as of November 3, 2011⁽¹⁹⁾</u> |
| <u>10.35</u> | <u>Amendment to 2009 Stock Option Plan⁽¹⁷⁾</u> |
| <u>10.36</u> | <u>Amendment to the Articles of Incorporation⁽¹⁸⁾</u> |
| <u>10.37</u> | <u>Amendment to Credit Facility with Avidbank⁽²⁰⁾</u> |
| <u>10.38</u> | <u>Purchase Agreement dated November 3, 2014⁽²¹⁾</u> |
| <u>10.39</u> | <u>Assignment of Lease dated October 30, 2014⁽²¹⁾</u> |
| <u>10.40</u> | <u>Form of Subscription Agreement⁽²²⁾</u> |
| <u>10.41</u> | <u>Form of Convertible Note⁽²²⁾</u> |
| <u>10.42</u> | <u>Form of Registration Rights Agreement⁽²²⁾</u> |
| <u>10.43</u> | <u>Form of Make Whole Agreement⁽²²⁾</u> |
| <u>10.44</u> | <u>Supply Agreement, dated May 26, 2015, between Optex Systems Holding, Inc. and Nightforce Optics, Inc.⁽²⁴⁾</u> |
| <u>10.45</u> | <u>First Amendment to Amended and Restated Loan Agreement with Avidbank⁽²⁶⁾</u> |
| <u>10.46</u> | <u>Restricted Stock Unit Plan⁽²⁷⁾</u> |
| <u>10.47</u> | <u>Form of RSU Agreement⁽²⁷⁾</u> |
| <u>10.48</u> | <u>Employment Agreement with Karen Hawkins, dated as of August 1, 2016⁽²⁵⁾</u> |
| <u>10.49</u> | <u>Form of Lease⁽³⁰⁾</u> |
| <u>10.50</u> | <u>Form of Letter of Credit⁽³⁰⁾</u> |
| <u>10.51</u> | <u>Form of Second Amendment to Loan Agreement⁽³⁰⁾</u> |
| <u>10.52</u> | <u>Form of Stock Repurchase Agreement⁽³¹⁾</u> |
| <u>10.53</u> | <u>Form of Note Satisfaction Agreement⁽³²⁾</u> |
| <u>10.54</u> | <u>Form of Stock Purchase Agreement⁽³²⁾</u> |
| <u>10.55</u> | <u>Form of Award/Contract between the Company and US DLA, dated July 3, 2017⁽³³⁾</u> |

14.1 Code of Ethics⁽³⁾

21.1 List of Subsidiaries — Optex Systems, Inc.

31.1 Certifications pursuant to Section 302 of Sarbanes Oxley Act of 2002

31.2 Certifications pursuant to Section 302 of Sarbanes Oxley Act of 2002

32.1 Certifications pursuant to Section 906 of Sarbanes Oxley Act of 2002

32.2 Certifications pursuant to Section 906 of Sarbanes Oxley Act of 2002

EX-101.INS XBRL Instance Document

EX-101.SCHXBRL Taxonomy Extension Schema Document

EX-101.CALXBRL Taxonomy Extension Calculation Linkbase Document

EX-101.DEF XBRL Taxonomy Extension Definition Linkbase Document

EX-101.LABXBRL Taxonomy Extension Label Linkbase Document

EX-101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

(1) Incorporated by reference from our Current Report on Form 8-K dated April 3, 2009.

- (2) Incorporated by reference from our Amendment No. 4 to Registration Statement on Form S-1 filed on September 28, 2009
- (3) Incorporated by reference from our Registration Statement on Form S-1 filed on May 19, 2009
- (4) Incorporated by reference from our Form 10-K for the fiscal year ended September 27, 2009, filed on January 11, 2010
- (5) Incorporated by reference from our Amendment No. 4 to Registration Statement on Form S-1 filed on June 14, 2010
- (6) This exhibit is missing part of the original bid/solicitation package as such information can only be obtained from third parties with which the registrant has no affiliation, and registrant has made requests from such third parties for such information, and such parties have not been able to provide such information.
- (7) Incorporated by reference from our Current Report on Form 8-K dated July 2, 2010
- (8) Incorporated by reference from our Form 10-Q for the quarter ended on June 27, 2010, filed on September 11, 2010
- (9) Incorporated by reference from our Amendment No. 5 to Registration Statement on Form S-1 filed on September 3, 2010
- (10) Incorporated by reference from our Amendment No. 20 to Registration Statement on Form S-1 filed on January 13, 2011
- (11) Incorporated by reference from our Form 10-Q for the quarter ended on January 2, 2011, filed on February 16, 2011
- (12) Incorporated by reference from our Current Report on Form 8-K filed on March 28, 2011
- (13) Intentionally left blank
- (14) Incorporated by reference from our Form S-1 filed on August 1, 2011
- (15) Incorporated by reference from our Form S-1 filed on September 2, 2011
- (16) Incorporated by reference from our Current Report on Form 8-K filed on November 7, 2011
- (17) Incorporated by reference from our Form 10-K filed on December 27, 2011
- (18) Incorporated by reference from our Amendment No. 5 to Registration Statement on Form S-1 filed on January 27, 2012
- (19) Incorporated by reference from our Form 10-K/A for the year ended October 2, 2016, filed on March 27, 2012
- (20) Incorporated by reference from our Form 10-Q for the quarter ended on April 1, 2012, filed on May 15, 2012
- (21) Incorporated by reference from our Current Report on Form 8-K, dated November 7, 2014
- (22) Incorporated by reference from our Current Report on Form 8-K, dated November 18, 2014
- (23) Incorporated by reference from our Current Report on Form 8-K, dated April 1, 2015
- (24) Incorporated by reference from our Current Report on Form 8-K, dated July 13, 2015
- (25) Incorporated by reference from our Current Report on Form 8-K, filed on August 10, 2016
- (26) Incorporated by reference from our Current Report on Form 8-K, filed on April 28, 2016
- (27) Incorporated by reference from our Current Report on Form 8-K, filed on June 17, 2016
- (28) Incorporated by reference from our Amendment No. 2 to Form S-1, filed on August 12, 2016
- (29) Incorporated by reference from our Amendment No. 5 to Form S-1, filed on August 22, 2016
- (30) Incorporated by reference from our Current Report on Form 8-K, filed on November 23, 2016
- (31) Incorporated by reference from our Current Report on Form 8-K, filed on May 1, 2017
- (32) Incorporated by reference from our Current Report on Form 8-K, filed on June 15, 2017
- (33) Incorporated by reference from our Current Report on Form 8-K, filed on July 10, 2017

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

OPTEX SYSTEMS HOLDINGS, INC.

By: /s/ Danny Schoening
Danny Schoening, Principal Executive Officer and Director

Date: December 20, 2017

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

Date: December 20, 2017

Pursuant to the requirements of the Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|--|---|-------------------|
| /s/ Peter Benz Peter Benz | Chairman and Director | December 20, 2017 |
| /s/ Danny Schoening Danny Schoening | Principal Executive Officer and Director | December 20, 2017 |
| /s/ Karen Hawkins Karen Hawkins | Principal Financial Officer and Principal Accounting Officer and Director | December 20, 2017 |
| /s/ David Kittay David Kittay | Director | December 20, 2017 |
| /s/ Owen Naccarato Owen Naccarato | Director | December 20, 2017 |
| /s/ Billy Bates Billy Bates | Director | December 20, 2017 |

