AVALONBAY COMMUNITIES INC
Form S-3ASR
June 22, 2006

As filed with the Securities and Exchange Commission on June 22, 2006

Registration Statement No. 333-

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-3

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

AVALONBAY COMMUNITIES, INC.

(Exact Name of Registrant as specified in its charter)

Maryland *(State or other jurisdiction of incorporation or organization)*	**77-0404318** *(I.R.S. Employer Identification Number)*

2900 Eisenhower Avenue, Suite 300

Alexandria, Virginia 22314

(703) 329-6300

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Bryce Blair

Chairman of the Board and Chief Executive Officer

AvalonBay Communities, Inc.

2900 Eisenhower Avenue, Suite 300

Alexandria, Virginia 22314

(703) 329-6300

(Name, address, including zip code, and telephone number, including area code, of agent for service)

With copies to:
John J. Huber, Esq.

William P. O Neill, Esq.

Latham & Watkins LLP

555 Eleventh Street, N.W., Suite 1000

Washington, D.C. 20004-1304

(202) 637-2200

Approximate date of commencement of proposed sale to the public:

At any time and from time to time after the effective date of this Registration Statement.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. o

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a registration statement pursuant to General Instruction I.D. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, check the following box. x

If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.D. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, check the following box. o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered (1)	Proposed Maximum Offering Price Per Share (2)	Proposed Maximum Aggregate Offering Price (3)	Amount of Registration Fee (4)
Common Stock, $0.01 par value per share	79,091	$ 40.50	$ 3,203,186	$ 342.74
	45,339	50.60	2,294,153	245.47
	34,877	69.95	2,439,646	261.04
	21,170	91.71	1,941,501	207.74
	54,880	102.88	5,646,054	604.13
	739	109.10	80,625	8.63
Total	236,096		$ 15,605,165	$ 1,669.75

(1) Consists of shares of common stock issued pursuant to the Registrant s 1994 Stock Incentive Plan, as amended and restated.

(2) Highest price, excluding interest, to be payable per share in connection with the rescission offer covered by this registration statement. The base purchase price per share will be equal to either (a) the exercise price of the related option, (b) the fair market value of the share received upon conversion of the related restricted stock unit on the date of conversion or (c) the fair market value of the restricted share on the date of vesting, as applicable. In each case, the actual purchase price will equal the base purchase price less dividends received to the Expiration Date and plus interest from the date of receipt of the shares through the Expiration Date as described herein. The base purchase price will be up to $40.50 for 79,091 shares; between $40.50 and $50.60 for 45,339 shares; between $50.60 and $69.95 for 34,877 shares; between $69.95 and $91.71 for 21,170 shares; between $91.71 and $102.88 for 54,880 shares; and $109.10 for 739 shares.

(3) Aggregate purchase price, excluding interest, estimated to be payable (based on the highest per share price) if the rescission offer covered by this registration statement is accepted in full with respect to the shares of common stock. Pursuant to Rule 457(j), this is the aggregate purchase price paid for all shares covered by this rescission offer.

(4) Calculated pursuant to Rule 457(j).

PROSPECTUS

AVALONBAY COMMUNITIES, INC.

RESCISSION OFFER

Up to 236,096 Shares of Common Stock

We are offering to repurchase up to 236,096 shares of our common stock (the Rescission Offer) from the persons who received such shares from us (a) upon the exercise of stock options, (b) upon the conversion of restricted stock units or (c) upon the vesting of restricted stock grants (persons in categories (a), (b) and (c) collectively, the Eligible Offerees, and each, an Eligible Offeree), in each case pursuant to awards made under our 1994 Stock Incentive Plan, as amended and restated (the Stock Incentive Plan), during the period from May 24, 2004 through June 12, 2006 (the Offering Period).

We are making this offer because the shares of our common stock subject to the Rescission Offer have not been properly registered under the Securities Act of 1933, as amended (the Securities Act), because our issuances of shares under the Stock Incentive Plan inadvertently exceeded the number of shares of our common stock registered with the United States Securities and Exchange Commission (the Commission) for issuance under the Stock Incentive Plan. These shares are now being registered by means of a Registration Statement on Form S-3, of which this prospectus forms a part. Accordingly, if you reject the Rescission Offer, the shares of our common stock subject to the Rescission Offer will be properly registered under the Securities Act.

The base repurchase price for each share of our common stock subject to the Rescission Offer will range from $25.375 (for 1,000 shares issued to an Eligible Offeree upon a stock option exercise) to $109.10 (for the vesting of 739 restricted shares awarded to an Eligible Offeree), and will be equal to either (a) the exercise price of the related option, (b) the fair market value of the share received upon conversion of the related restricted stock unit on the date of conversion or (c) the fair market value of the restricted share on the date of vesting, as applicable. If our offer to repurchase up to 236,096 shares is accepted in full, the average base repurchase price for the 236,096 shares will equal $63.20 per share and the median base repurchase price will equal $50.60 per share. In each case, the actual repurchase price that we will pay per share is the base repurchase price for that share less dividends paid on that share through the Expiration Date and plus interest from the date of receipt of that share through the Expiration Date as described in this prospectus.

The Rescission Offer will expire at 5:00 p.m., Eastern Daylight Time, on July 31, 2006 (the Expiration Date), which is at least thirty (30) days from the date the Rescission Offer will commence. Our common stock is listed on the New York Stock Exchange, which we refer to as the NYSE, under the symbol AVB. On June 21, 2006, the last reported sale price for our common stock on the NYSE was $106.12 per share. Our principal executive offices are located at 2900 Eisenhower Avenue, Suite 300, Alexandria, Virginia 22314. Our telephone number is (703) 329-6300.

ELIGIBLE OFFEREES MAY ELECT TO ACCEPT OR REJECT THE RESCISSION OFFER BY SUBMITTING A RESCISSION ELECTION FORM TO US ON OR BEFORE THE EXPIRATION DATE AS SET FORTH UNDER THE TERMS OF THIS PROSPECTUS. ELIGIBLE OFFEREES WHO FAIL TO RESPOND TO THE RESCISSION OFFER ON OR BEFORE THE EXPIRATION DATE WILL BE DEEMED BY US TO HAVE REJECTED THE RESCISSION OFFER. ACCEPTANCE OR REJECTION OF THE RESCISSION OFFER MAY PREVENT AN ELIGIBLE OFFEREE FROM MAINTAINING AN ACTION AGAINST US IN CONNECTION WITH THE SHARES OF COMMON STOCK ACQUIRED BY SUCH ELIGIBLE OFFEREE PURSUANT TO THE STOCK INCENTIVE PLAN DURING THE OFFERING PERIOD.

Investing in our securities involves various risks. Beginning on page 8, we discuss several Risk Factors that you should consider before investing in our securities.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this prospectus is June 22, 2006.

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ABOUT THIS PROSPECTUS

You should rely only on the information contained in this prospectus and the documents incorporated by reference. We have not authorized anyone to provide you with information different from that contained in this prospectus. The information in this document may only be accurate on the date of this document and you should assume that the information appearing in this prospectus is accurate only as of the date on the front cover of this prospectus. Our business, financial condition, results of operations and prospects may have changed since that date.

You should not consider any information in this prospectus or in the documents incorporated by reference herein to be investment, legal or tax advice. You should consult your own counsel, accountant and other advisors for legal, tax, business, financial and related advice regarding the repurchase of our common stock.

You should read both this prospectus and any applicable prospectus supplement together with additional information described below under the heading Where You Can Find More Information.

Unless the context otherwise requires, all references to we, us, our, our company, AvalonBay, or similar expressions in this prospectus refer collectively to AvalonBay Communities, Inc., a Maryland corporation, and its subsidiaries, and their respective predecessor entities for the applicable periods, considered as a single enterprise.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus, including the information incorporated by reference into this prospectus, contains statements that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. You can identify forward-looking statements by the use of the words believe, expect, anticipate, intend, estimate, assume, plan, project, ma and other similar expressions that predict or indicate future events and trends and which do not relate to historical matters. These statements include, among other things, statements regarding our intent, belief or expectations with respect to:

- our potential development, redevelopment, acquisition or disposition of communities;
- the timing and cost of completion of apartment communities under construction, reconstruction, development or redevelopment;
- the timing of lease-up, occupancy and stabilization of apartment communities;
- the pursuit of land on which we are considering future development;

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- the anticipated operating performance of our communities;
- cost, yield and earnings estimates;
- our declaration or payment of distributions;
- our joint venture and discretionary fund activities;
- our policies regarding investments, indebtedness, acquisitions, dispositions, financings and other matters;
- our qualification as a REIT under the Internal Revenue Code;
- the real estate markets in Northern and Southern California and markets in selected states in the Mid-Atlantic, Northeast, Midwest and Pacific Northwest regions of the United States and in general;
- the availability of debt and equity financing;
- interest rates;
- general economic conditions; and
- trends affecting our financial condition or results of operations.

We cannot assure the future results or outcome of the matters described in these statements; rather, these statements merely reflect our current expectations of the approximate outcomes of the matters discussed. You should not rely on forward-looking statements because they involve known and unknown risks, uncertainties and other factors, some of which are beyond our control. These risks, uncertainties and other factors, which we describe in Risk Factors elsewhere in this prospectus and from time to time in our filings with the Commission including in our Annual Report on Form 10-K for the year ended December 31, 2005, under the caption Risk Factors, may cause our actual results, performance or achievements to differ materially from the anticipated future results, performance or achievements expressed or implied by these forward-looking statements.

In addition, these forward-looking statements represent our estimates and assumptions only as of the date of this prospectus. We do not undertake to update these forward-looking statements, and therefore they may not represent our estimates and assumptions after the date of this prospectus.

SUMMARY

The following summary is qualified in its entirety by the more detailed information and historical consolidated financial statements, including the notes to those financial statements, appearing elsewhere or incorporated by reference in this prospectus. You should carefully consider the information set forth under Risk Factors beginning on page 8 of this prospectus and the risks identified in our Annual Report on Form 10-K for the year ended December 31, 2005, including those risks identified under the caption Risk Factors in that document.

The Company

AvalonBay Communities, Inc. is a Maryland corporation that has elected to be treated as a real estate investment trust, or REIT, for federal income tax purposes. We engage in the development, redevelopment, acquisition, ownership and operation of multifamily communities in high barrier-to-entry markets of the United States. These barriers-to-entry generally include a difficult and lengthy entitlement process with local jurisdictions and dense urban or suburban areas where zoned and entitled land is in limited supply. Our markets are located in the Northeast, Mid-Atlantic, Midwest, Pacific Northwest, and Northern and Southern California regions of the United States. We focus on these markets because we believe that, long term, the limited new supply of apartment homes and lower housing affordability in these markets will result in larger increases in cash flows relative to other markets over an entire business cycle. In addition to increasing the rental revenues of our operating assets, we believe these market attributes will increase the value of our operating assets and enable us to create additional value through the development and selective acquisition of multifamily housing.

At March 31, 2006, we owned or held a direct or indirect ownership interest in:

- 142 operating apartment communities containing 41,238 apartment homes in ten states and the District of Columbia, of which four communities containing 1,679 apartment homes were under reconstruction;

- 16 communities under construction that are expected to contain an aggregate of 4,879 apartment homes when completed; and

- rights to develop an additional 48 communities that, if developed in the manner expected, will contain an estimated 12,117 apartment homes.

AvalonBay is the surviving entity from the merger of Avalon Properties, Inc. with and into Bay Apartment Communities, Inc. on June 4, 1998. In October 1998, we changed our name to AvalonBay Communities, Inc. Our common stock is listed on the NYSE under the symbol AVB.

AvalonBay elected to qualify as a REIT for federal income tax purposes for the taxable year ended December 31, 1994 and has not terminated or revoked such election. As a REIT, with limited exceptions, we will not be taxed under federal and certain state income tax laws at the corporate level on our net income to the extent net income is distributed to our stockholders. We have historically made sufficient distributions to avoid tax on retained income, and we intend to make sufficient distributions to avoid income tax at the corporate level. While we believe that we are organized and qualified as a REIT and we intend to operate in a manner that will allow us to continue to qualify as a REIT, there can be no assurance that we will be successful in this regard. Qualification as a REIT involves the application of highly technical and complex provisions of the Internal Revenue Code for which there are limited judicial and administrative interpretations and involves the determination of a variety of factual matters and circumstances not entirely within our control.

The Rescission Offer

Overview

We are offering to repurchase up to 236,096 shares of our common stock from the persons who received such shares from us (a) upon the exercise of stock options, (b) upon the conversion of restricted stock units or (c) upon the vesting of restricted stock grants, in each case pursuant to awards made under the Stock Incentive Plan during the Offering Period. The shares subject to the Rescission Offer were issued in excess of the number of shares registered under the Securities Act for issuance under the Stock Incentive Plan.

The base repurchase price for each share of our common stock subject to the Rescission Offer will range from $25.375 (for 1,000 shares issued to an Eligible Offeree upon a stock option exercise) to $109.10 (for the vesting of 739 restricted shares awarded to an Eligible Offeree) and will be equal to either (a) the exercise price of the related option, (b) the fair market value of the share received upon conversion of the related restricted stock unit on the date of conversion or (c) the fair market value of the restricted share on the date of vesting, as applicable. If our offer to repurchase up to 236,096 shares is accepted in full, the average base repurchase price for the 236,096 shares will equal $63.20 per share and the median base repurchase price will equal $50.60 per share. In each case, the actual repurchase price that we will pay per share is the base repurchase price for that share less dividends paid on that share through the Expiration Date and plus interest at a rate of 4.04% per annum from the date of receipt of the share through the Expiration Date as described in this prospectus.

Our directors and executive officers acquired 83,201 of the shares of common stock that are subject to the Rescission Offer and other officers acquired an additional 76,454 of the shares that are subject to the Rescission Offer.

Our Board of Directors has approved the Rescission Offer in order to address applicable federal registration requirements in connection with the issuance of our common stock pursuant to the Stock Incentive Plan and to limit any contingent liability we may have as a result of noncompliance with such requirements.

Questions and Answers About the Rescission Offer

Q: Why are we making the Rescission Offer?

A: We are offering to repurchase up to 236,096 shares of our common stock from Eligible Offerees who received those shares pursuant to the Stock Incentive Plan during the Offering Period because we inadvertently issued shares pursuant to the Stock Incentive Plan in excess of the number of shares of our common that were registered with the Commission for issuance pursuant to the Stock Incentive Plan. We are making the Rescission Offer to address federal securities law compliance issues and to limit any contingent liability we may have as a result of noncompliance with applicable federal registration requirements in connection with the issuance of such shares of our common stock pursuant to the Stock Incentive Plan.

Q: Does the Rescission Offer apply to all shares I have received from AvalonBay?

A: No. The Rescission Offer only applies to shares you received when (a) you exercised an employee stock option during the Offering Period, (b) a deferred stock unit owned by you converted into common stock during the Offering Period, or (c) a restricted stock award owned by you vested during the Offering Period.

Q: What will I receive if I accept the Rescission Offer?

A: If you accept our Rescission Offer with respect to the common stock you acquired pursuant to the Stock Incentive Plan, we will repurchase the shares you hold that are subject to the Rescission Offer at a price per share equal to:

- if you acquired shares of our common stock by exercising options, the exercise price of the related option,

- if you acquired shares of our common stock through the conversion of restricted stock units, the fair market value of the share received upon conversion of the related restricted stock unit on the date of conversion, or

- if you acquired shares through the vesting of restricted stock, the fair market value of the restricted share on the date of vesting,

in each case, less dividends received to the Expiration Date and plus interest from the date of receipt of the shares through the Expiration Date at an interest rate as described in this prospectus.

If you accept the Rescission Offer, you will not have any right, title or interest to the shares of common stock you will be surrendering upon the closing of the Rescission Offer, and you will only be entitled to receive the proceeds from our repurchase of your common stock.

Q: Should I accept the Rescission Offer?

A: Every individual must make his or her own decision. You should be aware that you may receive less cash if you accept the Rescission Offer than if you reject the Rescission Offer and sell your shares on the open market. This will occur if the base repurchase price (i.e., the option exercise price or fair market value on the applicable restricted stock vesting date or restricted unit conversion date), as adjusted for dividends and interest, is less than the price at which our shares are trading on the open market.

Q: Can you give me an example of what I would receive if I participated in the Rescission Offer?

The calculation of the payment you would receive if we repurchase a share from you varies depending on how and when you acquired the shares.

- *Exercise of Options*: if you exercised an option on July 14, 2004 to purchase common stock at an exercise price of $50.60 per share and you accept the Rescission Offer, you would receive:

- The exercise price of your option = $50.60

- Less dividends we will have paid on that share through the Expiration Date = $5.80

- Plus simple interest at 4.04% per year = $4.18

- For a total of $50.60 $5.80 + $4.18 = $48.98

- *Conversion of Restricted Stock Units*: if you acquired a share through the conversion of a restricted stock unit on September 1, 2005 , with a value on such date of $84.27 per share and you accept the Rescission Offer, you would receive:

- The fair market value of the share received upon conversion of the related restricted stock unit on September 1, 2005 = $84.27

- Less dividends we will have paid on that share through the Expiration Date = $2.98
- Plus simple interest at 4.04% per year = $3.10
- For a total of $84.27 $2.98 + $3.10 = $84.39

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- *Vesting of Restricted Stock*: if you acquired a share pursuant to the vesting of restricted stock on November 22, 2005, with a value on such date of $91.71 (which was the closing price of our common stock on the NYSE on such date), and you accept the Rescission Offer, you would receive:

- The fair market value of the restricted share on November 22, 2005 = $91.71
- Less dividends we will have paid on that share through the Expiration Date =$2.27
- Plus simple interest at 4.04% per year = $2.55
- For a total of $91.71 $2.27 + $2.55 = $91.99

For shares issued on or prior to the record dates indicated below during the Offering Period, we paid or, in the case of the June 30, 2006 record date, will pay, prior to the Expiration Date the following dividends:

Dividend Payments

l Date	Payment Date	Amount Per Share
, 2004	July 15, 2004	$0.70
er 1,	October 15, 2004	0.70
y 3,	January 18, 2005	0.70
l, 2005	April 15, 2005	0.71
0,	July 15, 2005	0.71
er 3,	October 17, 2005	0.71
nber 30,	January 17, 2006	0.71
31,	April 17, 2006	0.78

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

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

The accompanying unaudited interim consolidated financial statements reflect all adjustments of a normal ar recurring nature which are, in the opinion of management, necessary to present fairly the financial position, results of operations and cash flows of Optex Systems Holdings for the interim periods presented. The result operations for these periods are not necessarily comparable to, or indicative of, results of any other interim p or for the fiscal year taken as a whole. Certain information that is not required for interim financial reporting purposes has been omitted.

Inventory: As of December 30, 2018 and September 30, 2018, inventory included:

	(Thousands)	
	December 30, 2018	September 30, 2018
Raw Material	$5,703	$ 5,580
Work in Process	4,147	3,478
Finished Goods	344	254
Gross Inventory	$10,194	$ 9,312
Less: Inventory Reserves	(1,673)	(1,673)
Net Inventory	$8,521	$ 7,639

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Concentration of Credit Risk: Optex Systems Holdings' accounts receivables for the period ended Decembe 2018 are derived from revenues to one major U.S. defense contractor, 69%, U.S. government agencies, 11% large commercial customer, 7%, and all other customers, 13%. The Company does not believe that this concentration results in undue credit risk because of the financial strength of the obligees.

Warranty Costs: As of December 30, 2018 and September 30, 2018, the Company had warranty reserve bala of $73 thousand and $101 thousand, respectively. During the three months ended December 30, 2018 the Company recognized a net gain in warranty expenses of ($21) thousand due to lower than estimated warrant repair and replacement costs for customer warranty units in backlog as of September 30, 2018 and returned t customer during the current period. During the three months ended December 31, 2017 the Company recogn warranty expenses of $77 thousand for warranties reserved on optical assembly shipments during the period increased estimated costs of warranty liabilities for warranty backlog units in-house as of the period end. We believe we have made sufficient improvements to the production process to minimize the return rate on futur shipments but we will continue to review and monitor the reserve balances related to this product line agains existing warranty backlog and current trend data on an interim basis until the current warranty backlog is depleted.

	Three months ended December 30, 2018	December 31, 2017
Beginning balance	$ 101	$ 174
Incurred costs for warranties during the three month period	(7)	—
Warranties reserved for new product shipped during the three month period(1)	29	62
Change in estimate for pre-existing warranty liabilities as of prior period end(2)	(50)	15
Ending balance	$ 73	$ 251

(1) Warranty expenses accrued to cost of sales (based on current period shipments and historical warranty return rate).

(2) Changes in estimated warranty liabilities recognized in cost of sales associated with: the period end cust returned warranty backlog, or the actual costs of repaired/replaced warranty units which were shipped to th customer during the current period.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affec 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 re could differ from the estimates.

Fair Value of Financial Instruments: Fair value estimates discussed herein are based upon certain market assumptions and pertinent information available to management as of the financial statement presentation da

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

The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value and requires 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 mar prices and minimize the use of unobservable inputs. An asset or liability's level is based on the lowest level input that is significant to the fair value measurement. Fair value estimates are reviewed at the origination da and again at each applicable measurement date and interim or annual financial reporting dates, as applicable the financial instrument, and are based upon certain market assumptions and pertinent information available management at those times.

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

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

For the three months ended December 30, 2018 and December 31, 2017, the adoption of the ASC 606 reven standard had no material effect on the financial statement presentation. Optex Systems Holdings does not ex the adoption of the new revenue recognition standard to have a material effect on the financial statement presentation on a retrospective or prospective basis for the upcoming interim, annual and comparative period covered through the current year end date September 29, 2019. The Company believes it's previous recognit policy as related to the production contracts ("units of delivery"), and maintenance contract ("passage of tim consistent with the new revenue recognition standard defined within FASB ASC 606 which requires unique performance obligations be recognized upon satisfaction of the customers' own performance obligation at th

point in time when the control of goods is transferred to the customer, or over time as the customer benefits f
provided maintenance and support services. The Company has on occasion, outside of the presented periods,
received selective contract awards and modifications which included substantive milestone performance
obligations, contract modifications, negotiated settlements and financing arrangements which could fall with
the scope of the new revenue recognition guidance on reoccurrence, and as such, the Company has expanded
their contract review process to ensure any new contract awards, changes, modifications, financing arrangem
or potential negotiated settlements are recorded in compliance to the new standard guidance.

During the three months ended December 30, 2018 there was $289 of revenue recognized during the period f
customer deposit liabilities (deferred contract revenue), and $19 of customer deposits refunded to the custom
on order cancellation. As of December 30, 2018 there is $5 thousand in customer deposit liabilities for advan
credit card payments received during the period for contracts expected to ship in January 2019. As of the per
ended September 30, and the three months ended December 30, 2018, there are no significant contract costs
as sales commissions or costs deferred.

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

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

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

For the three months ended December 30, 2018, 4,260,785 warrants and 99,000 unvested restricted stock un were included in the diluted earnings per share calculation as dilutive, and 25,000 stock options were exclud from the earnings per share calculation as antidilutive as they were "out of the money" and not exercisable d the period. For the three months ended December 31, 2017, 78 preferred Series C shares (which converts to 325,000 common shares), 182,000 unvested restricted stock units, 60,000 stock options and 4,323,135 warra were excluded from the diluted earnings per share calculations as antidilutive.

A significant number of our outstanding warrants and series C preferred shares are participating securities w share dividend distributions and the allocation of any undistributed earnings (deemed dividends) with our common shareholders. During the three months ended December 30, 2018, we had zero declared dividends a allocated undistributed earnings of $671 thousand attributable to the participating warrants. During the three months ended December 31, 2017, declared dividends of $90 thousand was attributable to participating warr and series C shareholders, and there was zero in undistributed earnings attributable to participating securities result of the net loss condition during the period.

The net loss applicable to common shareholders for the period ended December 31, 2017, previously reflecte ($0.01) per share has been corrected to ($0.02) per common share to include the effect of the prior year perio dividends distributed to participating securities on the earnings per common share.

Note 3 - Segment Reporting

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

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

Optex Systems (OPX) – Richardson, Texas

Optex Systems revenues are primarily in support of prime and subcontracted military customers. Approxima 81% of the Optex Systems segment revenue is comprised of domestic military customers and 19% is compri of foreign military customers. The Optex Systems segment revenue from the U.S. government and one other major U.S. defense contractor represent approximately 27% and 34% of the Company's consolidated revenu respectively.

Optex Systems is located in Richardson Texas, with leased premises consisting of approximately 49,100 squ feet. As of December 30, 2018, the Richardson facility operated with 67 full time equivalent employees in a single shift operation. Optex Systems, Richardson serves as the home office for both the Optex Systems and Applied Optics Center segments.

Applied Optics Center (AOC) – Dallas, Texas

The Applied Optics Center serves primarily domestic U.S. customers. Sales to commercial customers repres 45% and military sales to prime and subcontracted customers represent 30% of the total segment revenue. Approximately 83% of the AOC revenue is derived from external customers and approximately 17% is relat intersegment sales to Optex Systems in support of military contracts. The AOC segment revenue from the U government and one major commercial customer represents approximately 11% and 13% of the Company's consolidated revenue, respectively.

The Applied Optics Center is located in Dallas, Texas with leased premises consisting of approximately 44,8 square feet of space. As of December 30, 2018, AOC operated with 33 full time equivalent employees in a si shift operation.

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

Reportable Segment Financial Information (thousands)

Three months ended December 30, 2018

	Optex Systems Richardson	**Applied Optics Center Dallas**	**Other (non-allocated costs and intersegment eliminations)**	**Consolidated Total**
Revenues from external customers	$3,830	$ 2,061	$ —	$ 5,891
Intersegment revenues	—	415	(415)	—
Total Revenue	$3,830	$ 2,476	$ (415)	$ 5,891
Interest expense	$—	$ —	$ 6	$ 6
Depreciation and Amortization	$9	$ 76	$ —	$ 85
Income before taxes	$406	$ 330	$ 1,343	$ 2,079
Other significant noncash items:				
Allocated home office expense	$(170)	$ 170	$ —	$ —
Gain on change in fair value of warrants	$—	$ —	$ (1,385)	$ (1,385)
Stock compensation expense	$—	$ —	$ 36	$ 36
Royalty expense amortization	$8	$ —	$ —	$ 8
Warranty Expense	$—	$ (21)	$ —	$ (21)
Segment Assets	$9,448	$ 4,330	$ —	$ 13,778
Expenditures for segment assets	$4	$ 14	$ —	$ 18

Reportable Segment Financial Information (thousands)

Three months ended December 31, 2017

Optex Systems Richardson	**Applied Optics Center Dallas**	**Other (non-allocated costs and intersegment eliminations)**	**Consolida Total**
$2,665	$2,112	$—	$4,777

Revenues from external customers				
Intersegment revenues	—	371	(371	) —
Total Revenue	$2,665	$2,483	$(371	) $4,777
Interest expense	$—	$—	$3	$3
Depreciation and Amortization	$10	$71	$—	$81
Income (Loss) before taxes(1)	$138	$249	$(391	) $(4
Other significant noncash items:				
Allocated home office expense	$(156	) $156	$—	$—
Loss on Change in Fair Value of Warrants	$—	$—	$344	$344
Stock option compensation expense(1)	$—	$—	$44	$44
Royalty expense amortization	$7	$—	$—	$7
Warranty Expense	$—	$77	$—	$77
Segment Assets	$8,477	$4,708	$—	$13,185
Expenditures for segment assets	$—	$—	$—	$—

Note 4 - Commitments and Contingencies

Rental Payments under Non-cancellable Operating Leases

As of December 30, 2018, the remaining minimum lease and estimated adjusted common area maintenance (CAM) payments under the non-cancelable office and facility space leases are as follows:

Non-cancellable Operating Leases Minimum Payments

(Thousands) Optex Systems Richardson	Applied Optics Center Dallas

Fiscal Year	Lease Payments	CAM Estimate	Lease Payments	CAM Estimate	Total Payments
2019	$ 212	$ 83	$ 186	$ 51	$ 532
2020	291	112	255	62	720
2021	147	57	262	63	529
2022	—	—	22	5	27
Total minimum lease payments	**$** 650	**$** 252	**$** 725	**$** 181	**$** 1,808

Total facilities rental and CAM expense for both facility lease agreements as of the three months ended December 30, 2018 was $172 thousand. Total expense under facility lease agreements as of the three months ended December 31, 2017 was $168 thousand.

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As of December 30, 2018, the unamortized deferred rent was $106 thousand as compared to $111 thousand a
September 30, 2018. Deferred rent expense is amortized monthly over the life of the lease.

Note 5 - Debt Financing

Credit Facility — Avidbank

As of December 30, 2018 and September 30, 2018, the outstanding principal balance on the line of credit wa
$500 thousand and $300 thousand, respectively. For the three months ended December 30, 2018 and Decemb
31, 2017, the total interest expense against the outstanding line of credit balance was $6 thousand and $3
thousand.

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

The new revolving maturity date is April 21, 2020.

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

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

Note 6-Warrant Liabilities

On August 26, 2016, Optex Systems Holdings, Inc. issued 4,323,135 warrants to new shareholders and the
underwriter, in connection with a public share offering. The warrants entitle the holder to purchase one share
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")
Company determined that these warrants are free standing financial instruments that are legally detachable a
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
as such required classification as a liability pursuant to ASC 480 *"Distinguishing Liabilities from Equity"*. T
Company has no plans to consummate a fundamental transaction and does not believe a fundamental transac
is likely to occur during the remaining term of the outstanding warrants. In accordance with the accounting
guidance, the outstanding warrants are recognized as a warrant liability on the balance sheet and are measure
their inception date fair value and subsequently re-measured at each reporting period with changes being
recorded as a component of other income in the statements of operations.

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

Further, the Company reviewed the model volatility rate input by comparing the historical volatility of the tr common stock (OPXS) against similarly traded equities over the same time period, the historical volatility of Optex common stock subsequent to the August 26, 2016 public offering as compared to the volatility rate du the period which preceded the public offering, and the implied volatility based on the Optex warrant shares traded on the over-the-counter market ("OTC") under ticker OPXXW. Based on the review, the Company be the historical 2.7 year volatility rate on the common shares, based on the remaining term of the warrants, incl periods of significantly lower trading volume that precedes the public offering and which is not representativ the expected volatility over their remaining life. Recent trend information indicates the increase in common s float subsequent to the public offering combined with the concurrent preferred share conversions have significantly increased the frequency of trades and the average daily volume levels minimizing the volatility fluctuations which had previously existed on the common shares prior to the capitalization change. In additio substantially lower implied volatility on the warrants based on the available OTC market data, indicate that current market participants have assumed a future volatility comparable to the most recent experience rate. Accordingly, the current period BSM model fair value measurement assumes the adjusted 2.4 year historical volatility input rate of 62.95% and values the warrants within the range of trading prices during the most rec quarter end date.

The fair value of the warrant liabilities presented below were measured using either a BSM (subsequent to December 31, 2017) Binomial (through December 31, 2017) or valuation model. Significant inputs into the respective model at the inception and reporting period measurement dates are as follows:

Valuation Assumptions	**Issuance date*(1)* August 26, 2016*(4)***		**Period ended October 1, 2017(4)**		**Period ended December 31, 2017(4)**		**Period ended September 30, 2018(5)**		**Period end December 30, 2018(5)**
Exercise Price(1)	$ 1.50		$1.50		$1.50		$1.50		$ 1.50
Warrant Expiration Date (1)	8/26/2021		8/26/2021		8/26/2021		8/26/2021		8/26/2021
Stock Price (2)	$ 0.95		$0.98		$1.10		$1.71		$ 1.32
Interest Rate (annual) (3)	1.23	%	1.62	%	1.98	%	2.88	%	2.49
Volatility (annual) (4)(5)	246.44	%	179.36	%	171.04	%	64.05	%	62.95
Time to Maturity (Years)	5		3.9		3.7		2.9		2.7
Calculated fair value per share	$ 0.93		$0.87		$0.96		$0.82		$ 0.50

(1) Based on the terms provided in the warrant agreement to purchase common stock of Optex Systems Hold 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 e presented period ended date.

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

(4) Based on the historical daily volatility of Optex Systems Holdings, Inc. for the term of the warrants as of August 26, 2016 and each presented period ended date through April 1, 2018. The original fair value calculations were derived using the Binomial model, however, the yielded results were consistent with fair market valuation using the Black Scholes Merton Option Pricing model for each of the respective periods.

(5) Based on the historical daily volatility of Optex Systems Holdings, Inc. from the consummation of the pul raise on August 26, 2016 through the current presented measurement date. The company determined that the historical volatility prior to the August 26, 2016 public offering was not representative of the current market expectations due to the significant change in company capital structure and increase in public float shares (liquidity) arising from the common stock issued during the public offering and concurrent conversions of outstanding preferred shares into common stock. The fair value calculation was derived using the Black Sch Merton Option Pricing model.

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

Warrant Liability	**Warrants Outstanding**	**Fair Value per Share**	**Fair Value (000's)**
Fair Value as of period ended 10/01/2017	4,323,135	$ 0.87	**$3,607**
Loss on Change in Fair Value of Warrant Liability			344
Fair Value as of period ended 12/31/2017	4,323,135	$ 0.96	**3,951**
Fair Value as of period ended 09/30/2018	4,260,785	$ 0.82	**$3,500**
(Gain) on Change in Fair Value of Warrant Liability			(1,385)
Fair Value as of period ended 12/30/2018	4,260,785	$ 0.50	**2,115**

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During the three months ended December 30, 2018 or December 31, 2017, none of the warrants were exercis
During the three months ended December 30, 2018 and December 31, 2017, the Company recognized a ($1.4
million gain and a $344 thousand loss on the change in fair value of warrants, respectively.

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

Note 7-Stock Based Compensation

Stock Options issued to Employees, Officers and Directors

The Optex Systems Holdings 2009 Stock Option Plan provides for the issuance of up to 75,000 shares to the
Company's officers, directors, employees and to independent contractors who provide services to Optex Sys
Holdings as either incentive or non-statutory stock options determined at the time of grant. As of December
2018, there were 25,000 fully vested stock options outstanding at an exercise price of $10 per share and an
expiration date of December 18, 2020. During the three months ended December 30, 2018, 34,980 vested sto
options expired (forfeited) unexercised. There were no new grants of stock options during the three months
ended December 30, 2018.

Restricted Stock Units issued to Officers and Employees

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

	Outstanding Unvested RSU's
Unvested as of October 1, 2017	182,000
Granted - year ended September 30, 2018	—
Vested - year ended September 30, 2018	(83,000)
Unvested as of September 30, 2018	99,000
Granted – three months ended December 30, 2018	—

Vested - three months ended December 30, 2018	—
Unvested as of December 30, 2018	99,000

There were no restricted stock units granted or vested during the three months ended December 30, 2018. On January 1, 2019, 82,500 restricted stock units were vested. On January 2, 2019, pursuant to board authorizati on November 20, 2018, 200,000 restricted stock units were granted to Danny Schoening (150,000) and Kare Hawkins (50,000) which will vest over three years on each January 1, 2020 through January 1, 2022. See subsequent events.

Stock Based Compensation Expense

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

Stock Compensation (thousands)

	Recognized Compensation Expense Three months ended		Unrecognized Compensation Expense As of period ending	
	December 30, 2018	December 31, 2017	December 30, 2018	September 30, 2018
Stock Options	$ —	$ 8	$ —	$ —
Restricted Stock Units	36	36	13	49
Total Stock Compensation	$ 36	$ 44	$ 13	$ 49

Note 8 Stockholders' Equity

Dividends

On June 26, 2017, the board of directors approved a resolution authorizing a $0.02 per share (and per warran dividend payment on July 12, 2017, for common and preferred series C shareholders and warrant holders of record as of July 5, 2017 and for three subsequent quarterly record dates thereafter. During the three months ended December 31, 2017, Optex Systems Holdings recorded $262 in declared dividends for share and warra holders of record as of January 12, 2018 which was paid on January 19, 2018. As of period ended December 2018, there were no declared or outstanding dividends payable. There are no additional dividend payments declared subsequent to the April 12, 2018 record date.

Common stock

As of September 30, 2018, the outstanding common shares were 8,333,353. There were no issuances of com stock during the three months ended December 30, 2018. On January 7, 2019, there were 55,565 common sh issued, net of tax withholding, in settlement of 82,500 restricted stock units which vested on January 1, 2019 Also see Note 9, "Subsequent Events".

Series C Preferred Stock

As of September 30, 2018 and December 31, 2018, there were zero preferred Series C shares outstanding. D the three months ended December 31, 2017 there were no new issues of preferred Series C shares, and conversions of 96 preferred Series C shares, or $0.5 million, into 400,000 common shares.

Note 9 Subsequent Events

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

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

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

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

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

Management's Discussion and Analysis or Plan of Operations

This MD&A is intended to supplement and complement our audited consolidated financial statements and no thereto for the fiscal year ended September 30, 2018 and our reviewed but unaudited consolidated financial statements and footnotes thereto for the quarter ended December 30, 2018, prepared in accordance with U.S. generally accepted accounting principles (GAAP). You are encouraged to review our consolidated financial statements in conjunction with your review of this MD&A. The financial information in this MD&A has bee 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 planning purposes. We will also report non-GAAP financial results as supplemental information, as we belie their use provides more insight into our performance. When non-GAAP measures are used in this MD&A, th are clearly identified as non-GAAP measures and reconciled to the most closely corresponding GAAP measu

The following discussion highlights the principal factors that have affected our financial condition and resul 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 statemen "Risk factors" for a discussion of the uncertainties, risks and assumptions associated with these forward-loo statements. The operating results for the periods presented were not significantly affected by inflation.

Background

Optex Systems, Inc. (Delaware) manufactures optical sighting systems and assemblies, primarily for Depart 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 f installation on the Stryker family of vehicles. Optex Systems, Inc. (Delaware) also manufactures and deliver 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 bo directly to the armed services and to other defense prime contractors. Less than 1% of today's revenue is rela to the resale of products substantially manufactured by others. In this case, the product would likely be a sim replacement part of a larger system previously produced by Optex Systems, Inc. (Delaware).

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We are both a prime and sub-prime contractor to the Department of Defense. Sub-prime contracts are typical issued through major defense contractors such as General Dynamics Land Systems, Raytheon Corp., BAE, NorcaTec and others. We are also a military supplier to foreign governments such as Israel, Australia and NAMSA and South American countries and as a subcontractor for several large U.S. defense companies serv 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 sub to Federal Acquisition Regulation Subpart 49.5, "Contract Termination Clauses" and more specifically Fede Acquisition Regulation clauses 52.249-2 "Termination for Convenience of the Government Fixed-Price)", ar 49.504 "Termination of fixed-price contracts for default". These clauses are standard clauses on our prime m 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 av 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 co incurred by the government to acquire supplies from another supplier similar to those terminated from us. W would not be liable for any excess costs if the failure to perform the contract arises from causes beyond the control and without the fault or negligence of the Company as defined by Federal Acquisition Regulation cla 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, 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 t benefit, thereby minimizing the working capital impact on Optex Systems Holdings for materials and labor required to complete the contracts.

Recent Orders

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

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

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

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

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

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

Recent Events

Stock Repurchases

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

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

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

Executive and Board Compensation

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

A 30% officer bonus of base salary to Danny Schoening and Karen Hawkins for fiscal year 2018 performar to be paid during December 2018. The bonuses of $76 thousand, and $56 thousand were paid to Danny Schoening and Karen Hawkins, respectively on December 7, 2018.

A base salary increase of 8% for Danny Schoening and Karen Hawkins effective as of January 1, 2019.

The issuance of 150,000 and 50,000 restricted stock units with a January 2, 2019 grant date, to Danny Schoening and Karen Hawkins, respectively, and vesting as of January 1 each year subsequent to the grant over a three year period at a rate of 34% in year one, and 33% each year thereafter.

Results of Operations

Non GAAP Adjusted EBITDA

We use adjusted earnings before interest, taxes, depreciation and amortization (EBITDA) as an additional measure for evaluating the performance of our business as "net income" includes the significant impact of no valuation gains and losses on warrant liabilities, noncash compensation expenses related to equity stock issu well as depreciation, amortization, interest expenses and federal income taxes. We believe that Adjusted EBITDA is a meaningful indicator of our operating performance because it permits period-over-period comparisons of our ongoing core operations before the excluded items. Adjusted EBITDA is a financial mea not required by, or presented in accordance with, U.S. generally accepted accounting principles ("GAAP").

Adjusted EBITDA has limitations and should not be considered in isolation or a substitute for performance measures calculated under GAAP. This non-GAAP measure excludes certain cash expenses that we are obli to make. In addition, other companies in our industry may calculate Adjusted EBITDA differently than we d may not calculate it at all, which limits the usefulness of Adjusted EBITDA as a comparative measure.

The table below summarizes our three month operating results for periods ended December 30, 2018 and December 31, 2017, in terms of both the GAAP net income measure and the non-GAAP Adjusted EBITDA measure. We believe that including both measures allows the reader to have a "complete picture" of our over performance.

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	(Thousands) Three months ended December 30, 2018	December 31, 2017
Net Income (Loss) (GAAP)	$2,025	$ (94)
Add:		
(Gain) Loss on Change in Fair Value of Warrants	(1,385)	344
Federal Income Tax Expense - Current	54	90
Depreciation	85	81
Stock Compensation	36	44
Royalty License Amortization	8	7
Interest Expense	6	3
Adjusted EBITDA - Non GAAP	**$829**	**$ 475**

Our adjusted EBITDA increased by $0.35 million to $0.83 million during the three months ended December 2018 as compared $0.48 million during the three months ended December 31, 2017. EBITDA improvements directly correlated with significant increases in revenue, improvements in our gross margins, combined with reductions in general and administrative costs. During the three months ended December 30, 2018, we experienced product revenue growth of 23.3% and improved gross margin percentages of 1.1% over the prio year three months ended December 31, 2017. In addition, we have reduced general and administrative expen by 3.9% during the three months ended December 30, 2018 as compared to the prior year period. Revenue growth was primarily concentrated in our Optex-Richardson segment, which represents a 43.7% increase ov the prior year first quarter and is primarily driven by increased defense spending on our periscope and other product lines. Gross margin performance improvements were primarily driven by our Applied Optics Center segment and related to revenue shifts from our less profitable commercial products toward higher margin military laser filters, windows and mirrors. Operating segment performance is discussed in greater detail throughout the following sections.

During the three months ended December 30, 2018, we recognized a gain on the change in fair value of warr of ($1.4) million as compared to a loss of $344 thousand in the prior year quarter. As this is a non-cash gain driven by the current fair market value of our outstanding warrants and unrelated to our core business operat performance, the gain has been excluded from our adjusted EBITDA calculations presented above. Further discussion regarding the gain on changes in fair value of the warrants and the related warrant liability can be found under "Other Income (Expense)" in the three months comparative narratives of this report, as well as i 1, "Consolidated Financial Statements, Note 6 - Warrant Liabilities".

Segment Information

We have presented the operating results by segment to provide investors with an additional tool to evaluate o operating results and to have a better understanding of the overall performance of each business segment and 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 t organization accordingly. Segments are determined based on differences in products, location, internal repor and how operational decisions are made. Management has determined that the Optex Systems, Richardson p and the Applied Optics Center, Dallas plant, which was acquired on November 3, 2014, are separately manag organized, and internally reported as separate business segments. The table below provides a summary of selective statement of operations data by operating segment for the three months ended December 30, 2018 a December 31, 2017 reconciled to the Consolidated Results of Operations as presented in Item 1, "Consolidat Financial Statements."

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Results of Operations Selected Financial Info by Segment

(Thousands)

	Three months ending December 30, 2018				December 31, 2017			
	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)	Consoli
Revenue from External Customers	$3,830	$2,061	$ —	$ 5,891	$2,665	$2,112	$ —	$ 4,777
Intersegment Revenues	—	415	(415)	—	—	371	(371)	—
Total Segment Revenue	3,830	2,476	(415)	5,891	2,665	2,483	(371)	4,777
Total Cost of Sales	3,023	1,840	(415)	4,448	2,072	1,960	(371)	3,661
Gross Margin	807	636	—	1,443	593	523	—	1,116
Gross Margin %	21.1 %	25.7 %	—	24.5 %	22.3 %	21.1 %	—	23.4
General and Administrative Expense	571	136	36	743	611	118	44	773
Segment Allocated G&A Expense	(170)	170	—	—	(156)	156	—	—
Net General & Administrative Expense	401	306	36	743	455	274	44	773
Operating Income (Loss)	406	330	(36)	700	138	249	(44)	343
Operating Income (Loss) %	10.6 %	13.3 %	—	11.9 %	5.2 %	10.0 %	—	7.2
Gain (Loss) on Change in Fair Value of Warrants	—	—	1,385	1,385	—	—	(344)	(344
Interest Expense	—	—	(6)	(6)	—	—	(3)	(3

Net Income (Loss) before taxes	$406	$330	$ 1,343	$ 2,079	$138	$249	$ (391)	$ (4
Net Income (Loss) before taxes %	10.6 %	13.3 %	—	35.3 %	5.2 %	10.0 %	—	(0.1

Our total revenues increased by $1.1 million or 23.3% during the three months ended December 30, 2018 as compared to the three months ended December 31, 2017. Increased revenues during the quarter were driven increased revenue of $1.2 million at the Optex Richardson segment offset by a slight decrease of ($0.1) milli the Applied Optics Center segment. Optex Richardson revenue increases were primarily due to increased mi spending for periscopes deliveries and other military products of $1.0 million and $0.3 million, which offset decreases in sighting systems of ($0.1) million from the prior year quarter. Applied Optics revenue remained with a sizable revenue shift of $0.7 million to military products (coated filters, windows and mirrors) which offset by a decrease in commercial optical assemblies of ($0.7) million. Intersegment revenues increased slig above the prior year level by $.04 million in support of higher periscope delivery schedules at the Optex Richardson segment. Intersegment revenues relate primarily to coated filters provided by the Applied Optics Center to Optex Richardson in support of the Optex Systems periscope line.

Both the gross margin and the gross margin percentages increased on a consolidated basis during the three months ended December 30, 2018 as compared to the prior year period on higher revenue and changes in pro mix. Total gross margin increased by $0.3 million, and 1.1% to 24.5% from 23.4%. The gross margin percen improvement was primarily centered in our Applied Optics Center segment which increased from 21.1% to 25.7% and by $0.1 million from the prior year period. The increased Applied Optics Center margins were primarily driven by a shift in revenue mix from our commercial optical assemblies toward more profitable military products, combined with manufacturing yield and quality and improvements on the military filter an commercial optical assembly lines. Gross margins at the Optex Richardson segment increased by $0.2 millio primarily on higher revenues, with a (1.2%) lower gross margin percentage due to changes in product mix as compared to the prior year period.

During the three months ended December 30, 2018, the Applied Optics Center absorbed $0.17 million of fix general and administrative costs incurred by Optex Systems for support services, as compared to $0.16 milli absorbed in the prior year period ended December 31, 2017. These expenses cover accounting, executive, hu resources, information technology, board fees and other corporate expenses paid by Optex Systems and shar across both operating segments.

Our operating income increased by $0.4 million in the three months ended December 30, 2018, to $0.7 milli as compared to the prior year period operating income of $0.3 million. Operating income increased at each o segments on the increase in revenue (Optex Richardson), gross margin percentage (Applied Optics Center) combined with lower general and administrative costs (Optex Richardson).

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During the three months ended December 30, 2018 we recognized a $1.4 million gain on change in valuation warrant liabilities as compared to a ($0.3) million loss in the prior year quarter. The changes in valuation on warrants are not allocated by segment as they relate to non-cash expenses which recognize fair value change warrants due to market conditions beyond the control of the segment operating activities.

Backlog

Backlog as of December 30, 2018, was $23.5 million as compared to a backlog of $23.3 million as of Septem 30, 2018, representing an increase of $0.2 million or 0.9%. During the three months ended December 30, 20 the Company booked $5.7 million in new orders, representing a $2.1 million, or 58.3%, increase from the bo orders of $3.6 million in the prior year three months ended December 31, 2017.

The following table depicts the current expected delivery by period of all contracts awarded as of December 2018 in millions of dollars:

	(Millions)								
Product Line	Q2 2019	Q3 2019	Q4 2019	2019 Delivery	2020+ Delivery	Total Backlog 12/30/2018	Total Backlog 9/30/2018	Variance	% Chg
Howitzer				—		—	—	—	0.0
Periscopes	3.6	2.7	0.6	6.9	3.3	10.2	8.3	1.9	22.
Sighting Systems	0.1	1.1	0.5	1.7	1.2	2.9	1.7	1.2	70.
Other	1.7	2.1	1.2	5.0	0.5	5.5	6.6	(1.1)	(16
Optex Systems - Richardson	5.4	5.9	2.3	13.6	5.0	18.6	16.6	2.0	12.
Applied Optics Center - Dallas	1.9	1.6	0.7	4.2	0.7	4.9	6.7	(1.8)	(26
Total Backlog	7.3	7.5	3.0	17.8	5.7	23.5	23.3	0.2	0.9

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Optex Systems - Richardson:

During the three months ended December 30, 2018, backlog for the Optex Systems Richardson segment increased by $2.0 million, or12.0%, to $18.6 million from the fiscal year-end backlog of $16.6 million. The increased backlog was primarily driven by an increase of $1.9 million, or 22.9% in the periscope product gro and an increase of $1.2 million, or 70.6% in commander weapon station sighting units (CWSS). Optex Richardson backlog declined on other products by ($1.1) million, or (16.7%) from our fiscal year-end backlo we continue ship muzzle reference system (MRS) collimator assembly units and assorted spare window, mir and cell assembly units against our existing contracts.

During the three months ended December 30, 2018 we booked new periscope orders of $4.1 million, representing a 127.8% increase of $2.3 million over the $1.8 million in periscope orders booked during the p year three months ended December 31, 2017. The new periscope orders span multiple customers and include both our standard acrylic periscopes as well as Integrated Combat Weapon System (ICWS) glass periscopes deliverable in 2019 and 2020. We anticipate additional periscope contracts in addition to task order awards against our existing IDIQ contracts for delivery in 2019 and beyond.

We booked new orders of $0.9 million in sighting systems and $0.4 million in other product lines during the three months ended December 30, 2018 for a total of $1.3 million in new orders as compared to the prior yea levels of $1.6, consisting of $0.5 million and $1.1 million in sighting systems and other product lines, respectively. We are anticipating additional new spare orders against our sighting systems for delivery in fisc year 2020.

Applied Optics Center – Dallas

During the three months ended December 30, 2018, the Applied Optics Center backlog decreased by (26.9% ($1.8) million, to $4.9 million from the fiscal year end level of $6.7 million. New orders for our Applied Opt Center were $0.3 million in the three months ended December 30, 2018 as compared to $0.2 million in the p year three month period, an increase of $0.1 million. We anticipate additional orders during the next nine mo for deliveries in fiscal year 2019.

The Company continues to aggressively pursue international and commercial opportunities in addition to maintaining its current footprint with U.S. vehicle manufactures, with existing as well as new product lines. 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, whi could be manufactured using our current production facilities in order to capitalize on our existing capacity. Further, we continue to look for strategic businesses to acquire that will strengthen our existing product line, expand our operations, and enter new markets.

Three Months Ended December 30, 2018 Compared to the Three Months Ended December 31, 2017

Revenues. In the three months ended December 30, 2018, revenues increased by $1.1 million or 23.3% from respective prior period in fiscal year 2018 as set forth in the table below:

	Three months ended (Thousands)			
Product Line	December 30, 2018	December 31, 2017	Variance	**% Chg.**
Periscopes	$2,540	1,589	951	59.8
Sighting Systems	721	858	(137)	(16.0)
Other	569	218	351	161.0
Optical Systems – Richardson	3,830	2,665	1,165	43.7
Applied Optics Center – Dallas	2,061	2,112	(51)	(2.4)
Total Revenue	$5,891	4,777	1,114	23.3

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Revenues on our periscope line increased by $1.0 million during the three months ended December 30, 2018
compared to the three months ended December 31, 2017 based on increased military spending and customer
demand combined with changes in periscope mix and delivery schedules between the respective periods.

Sighting systems revenues for the three months ended December 30, 2018 decreased by ($0.1) million or
(16.0%) from revenues incurred in the prior year period. The decrease in sighting systems was primarily driv
by lower CWSS collimator assemblies delivered during the current period as compared to the prior year. Bas
on increased backlog for CWSS units over the coming months we anticipate revenues for sighting systems to
increase primarily in the second half of the fiscal year, but to remain below the prior year levels due to
completion of several DDAN contracts during the year ended September 30, 2018. Lower revenues in sightin
systems are expected to be fully offset by increased revenues in the periscope and other product groups.

Revenues for Optex Richardson other products increased by $0.3 million, or 161.0% during the three months
ended December 30, 2018 as compared to the prior year three month period. Increases were primarily driven
increased customer demand for MRS collimators, windows, objective cell assemblies and other spare parts in
support of the increased defense budget.

Applied Optics Center revenue decreased by ($0.1) million or (2.4%) during the three months ended Decemb
30, 2018 as compared to the three months ended December 31, 2017 primarily due to lower customer deman
commercial optical assemblies, ($0.73) million which was offset by increased revenue in military coated filte
and windows of $0.68 million on higher defense spending. We anticipate the total annual Applied Optics Ce
revenue to increase over the prior year, primarily during the third and fourth fiscal quarters with a sizable shi
product mix from commercial to military products.

Gross Margin. The gross margin during the period ended December 30, 2018 was 24.5% of revenue as comp
to a gross margin of 23.4% of revenue for the period ended December 31, 2017. Cost of sales increased to $4
million for the current period as compared to the prior year period of $3.7 million on increased revenues of $
million. The gross margin increased by $0.3 million in the current year period to $1.4 million as compared to
prior year period of $1.1 million. We attribute the improvement in gross margin to higher revenue combined
changes in product mix, and improvements in quality and manufacturing yields between the respective perio

G&A Expenses. During the three months ended December 30, 2018, we recorded operating expenses of $0.7
million as opposed to $0.77 million, during the three months ended December 31, 2017, a net decrease of ($0
million. Decreased general and administrative costs during the current year period were primarily driven by
decreases in board of director fees in the current year quarter as compared to the prior year quarter. We antic
the total G&A expenses for the 2019 fiscal year to be inline, or slightly above the 2018 annual spending leve

Operating Income. During the three months ended December 30, 2018, we recorded an operating income of million, as compared to operating income of $0.3 million during the three months ended December 31, 2017 $0.4 million increased operating income in the current year period over the prior year period is primarily due increased gross margin on higher revenue and lower general and administrative costs in the current year quar as compared to the prior year quarter.

Other Income (Expense). During the three months ended December 30, 2018, we recognized a $1.4 million g on change in the fair value of warrants as compared to a ($0.3) million loss in three months ended December 2017. The change in gain on fair value is attributable to a change in accounting estimate on the warrant liabil of our outstanding 4,260,785 warrants.

Net Income (Loss) applicable to common shareholders. During the three months ended December 30, 2018, recorded a net income applicable to common shareholders of $1.35 million as compared to net a net loss applicable to common shareholders of ($0.18) million during the three months ended December 31, 2017. Th increase in net income of $1.5 million is primarily attributable to increased operating income of $0.4 million changes in the gain on the fair value of warrant liabilities of $1.7 million which was offset by changes in dividends distributed and deemed dividends of ($0.6) million during the current year period as compared to t prior year period.

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Liquidity and Capital Resources

As of December 30, 2018, the Company had working capital of $9.2 million, as compared to $8.5 million as September 30, 2018. During the three months ended December 30, 2018, the Company generated net income $2.0 million before dividends, as compared to a net loss of ($0.1) million and an increase of $1.1 million in revenues to $5.9 million as compared to the $4.8 million in the prior year period ended December 31, 2017. Company's adjusted EBITDA increased by $0.3 million during the three months ended December 30, 2018 $0.8 million from $0.5 million during the three months ended December 31, 2017. Backlog as of December 2018 has increased by $0.2 million or 0.9% to $23.5 million as compared to backlog of $23.3 million as of September 30, 2018.

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

The Company has historically funded its operations through working capital, convertible notes, preferred sto offerings and bank debt. The Company's ability to generate positive cash flows depends on a variety of facto including the continued development and successful marketing of the Company's products. At December 30 2018, the Company had approximately $1.2 million in cash and an outstanding payable balance of $0.5 milli 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 December 30, 2018 our outstanding accounts receivable was $2.7 million. The Company expects to incur net income, increased adjusted EBITD and positive cash flow from operating activities throughout 2019 on revenue growth and increased product g margins. Our net income of $2.0 million (before distributed and deemed dividends) during the first quarter o fiscal year 2019 marked a significant improvement of $2.1 million from the prior year first quarter net loss o ($0.1) million. Successful transition to attaining and maintaining profitable operations is dependent upon maintaining a level of revenue adequate to support the Company's cost structure. We have experienced significant increases in our customer backlog from the prior year on increased customer orders and multiyear contracts, primarily in our defense products. Management intends to manage operations commensurate with 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 progran 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 ultim business plan, certain assets may not be recoverable. Maintaining the Company profitability is dependent up maintaining a level of revenue adequate to support the Company's cost structure. Management intends to ma operations commensurate with its level of working capital and facilities line of credit during the next three months; however, uneven revenue levels driven by changes in customer delivery demands, first article inspe requirements or other program delays combined with increasing inventory and production costs required to support a higher backlog could create a working capital shortfall. In the event the Company does not success implement its ultimate business plan, certain assets may not be recoverable.

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

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

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Cash Flows for the Period from September 30, 2018 through December 30, 2018

Cash and Cash Equivalents: As of December 30, 2018 and September 30, 2018, we had cash and cash equivalents of $1.2 and $1.1 million, representing a net change of $0.1 million.

Net Cash Used in Operating Activities. Net cash used in operating activities during the three months from September 30, 2018 to December 30, 2018 totaled ($0.2) million. The primary uses of cash during the perioc relate to increases in inventory of ($0.9) million in support of new orders, which is offset by a $0.5 million reduction in accounts payable, $0.3 million in EBITDA (earnings before non-cash related interest, taxes, depreciation, amortization and changes in the fair value of warrants) and other working capital changes of ($ million.

Net Cash Used in Investing Activities. In the three months ended December 30, 2018, cash used in investing activities was insignificant.

Net Cash Provided by Financing Activities. Net cash provided by financing activities was $0.2 million durin three months ended December 30, 2018 and relate to borrowing against the revolving credit facility in suppo increased working capital needs to support new customer orders.

Critical Policies and Accounting Pronouncements

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

Cautionary Factors That May Affect Future Results

This Quarterly Report on Form 10-Q and other written reports and oral statements made from time to time b Optex Systems Holdings may contain so-called “forward-looking statements,” all of which are subject to risl uncertainties. You can identify these forward-looking statements by their use of words such as “expects,” “pl “will,” “estimates,” “forecasts,” “projects” and other words of similar meaning. You can identify them by th 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 con 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 va of other risks and uncertainties, including some that are known and some that are not. No forward-looking statement can be guaranteed and actual future results may vary materially.

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

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by our Quarterly Report on Form 10-Q for the quarter ended December 3 2018, management performed, with the participation of our Principal Executive Officer and Principal Financ 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 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 our Principal Financial Officer, to allow timely decisions regarding required disclosures. Based upon the evaluation described above, our Principal Executive Officer and our Principal Financial Officer concluded th as of December 30, 2018, our disclosure controls and procedures were effective.

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Changes in Internal Control Over Financial Reporting

During the three months ended December 30, 2018, there were no changes in our internal control over financ reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

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

Item 4. Mine Safety Disclosures

Not applicable.

Item 6. Exhibits

Exhibit No.	Description
31.1 and 31.2	Certifications pursuant to Section 302 of Sarbanes Oxley Act of 2002
32.1 and 32.2	Certifications pursuant to Section 906 of Sarbanes Oxley Act of 2002

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

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	OPTEX SYSTEMS HOLDINGS, INC.
Date: February 11, 2019	By:*/s/ Danny Schoening* Danny Schoening Principal Executive Officer
	OPTEX SYSTEMS HOLDINGS, INC.
Date: February 11, 2019	By:*/s/ Karen Hawkins* Karen Hawkins Principal Financial Officer and Principal Accounting Officer

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