Optex Systems Holdings Inc
Form 10-Q
February 10, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 27, 2009

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

For the transition period from ______to______.

OPTEX SYSTEMS HOLDINGS, INC.
(Exact Name of Registrant as Specified in Charter)

Delaware	333-143215	33-143215
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

1420 Presidential Drive, Richardson, TX	75081-2439
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (972) 644-0722

(Former Name or Former Address if Changed Since Last Report)

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

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

Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer o Smaller Reporting Company x

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o Not applicable.

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of February 8, 2010:
139,444,940 shares of common stock.

OPTEX SYSTEMS HOLDINGS, INC.
FORM 10-Q
December 27, 2009

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Item 1. Financial Information

OPTEX SYSTEMS HOLDINGS, INC.

UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 27, 2009

OPTEX SYSTEMS HOLDINGS, INC.

Optex Systems Holdings, Inc.
(formerly known as Sustut Exploration, Inc.)
Condensed Consolidated Balance Sheets

	Successor December 27, 2009 (Unaudited)	Successor September 27, 2009
ASSETS		
Current Assets		
Cash	$ 450,872	$ 915,298
Accounts Receivable	2,114,015	1,802,429
Net Inventory	8,683,366	8,013,881
Deferred Tax Asset	728,879	711,177
Prepaid Expenses	279,569	318,833
Total Current Assets	$ 12,256,701	$ 11,761,618
Property and Equipment		
Property Plant and Equipment	$ 1,344,487	$ 1,341,271
Accumulated Depreciation	(1,115,634)	(1,094,526)
Total Property and Equipment	$ 228,853	$ 246,745
Other Assets		
Security Deposits	$ 20,684	$ 20,684
Intangibles	1,706,201	1,965,596
Goodwill	7,110,415	7,110,415
Total Other Assets	$ 8,837,300	$ 9,096,695
Total Assets	$ 21,322,854	$ 21,105,058

The accompanying notes are an integral part of these financial statements

Optex Systems Holdings, Inc.
(formerly known as Sustut Exploration, Inc.)
Condensed Consolidated Balance Sheets - Continued

	Successor December 27, 2009 (Unaudited)	Successor September 27, 2009
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts Payable	$ 2,445,400	$ 2,497,322
Accrued Expenses	706,950	671,045
Accrued Warranties	81,530	81,530
Accrued Contract Losses	1,228,792	1,348,060
Loans Payable	250,000	-
Total Current Liabilities	$ 4,712,672	$ 4,597,957
Stockholders' Equity		
Optex Systems Holdings, Inc. – (par $0.001, 200,000,000 authorized, 139,444,940 shares issued and outstanding)	$ 139,445	$ 139,445
Optex Systems Holdings, Inc. Preferred Stock ($0.001 par, 5,000 authorized, 1,027 series A preferred issued and outstanding)	1	1
Additional Paid-in-capital	16,761,112	16,643,388
Retained Earnings (Deficit)	(290,376)	(275,733)
Total Stockholders' Equity	16,610,182	16,507,101
Total Liabilities and Stockholders' Equity	$ 21,322,854	$ 21,105,058

The accompanying notes are an integral part of these financial statements

Optex Systems Holdings, Inc.
(formerly known as Sustut Exploration, Inc.)
Condensed Consolidated Statements of Operations (unaudited)

	Successor Three months Ended December 27, 2009	Successor For the period October 15, 2008 through December 28, 2008	Predecessor For the period September 29, 2008 through October 14, 2008
Revenues	$ 5,915,302	$ 6,392,144	$ 871,938
Total Cost of Sales	5,160,402	5,565,182	739,868
Gross Margin	$ 754,900	$ 826,962	$ 132,070
General and Administrative			
Salaries and Wages	$ 165,151	$ 136,847	$ 22,028
Employee Benefits & Taxes	48,525	98,165	495
Employee Stock/Option Bonus Plan	22,500	4,812	(4,812)
Amortization of Intangible	79,823	101,159	-
Rent, Utilities and Building Maintenance	53,475	42,840	12,493
Investor Relations	87,405	-	-
Legal and Accounting Fees	50,740	75,860	360
Consulting and Contract Service Fees	55,416	68,795	10,527
Travel Expenses	10,466	13,319	-
Board of Director Fees	37,500	12,500	-
Other Expenses	77,565	20,128	16,155
Total General and Administrative	$ 688,566	$ 574,425	$ 57,246
Operating Income (Loss)	$ 66,334	$ 252,537	$ 74,824
Other Expenses			
Other Income and Expense	$ -	$ (436)	$ -
Interest (Income) Expense - Net	3,455	82,806	9,492
Total Other	$ 3,455	$ 82,370	$ 9,492
Income (Loss) Before Taxes	$ 62,879	$ 170,167	$ 65,332
Income Taxes (Benefit)	(17,702)	263,654	-
Net Income (Loss)	$ 80,581	$ (93,487)	$ 65,332
Less preferred stock dividend	$ (95,224)	$ -	$ -
Net income (loss) applicable to common shareholders	$ (14,643)	$ (93,487)	$ 65,332
Basic and diluted loss per share	$ (0.00)	$ (0.00)	$ 6.53

Weighted Average Common Shares Outstanding	139,444,940	50,000,000	10,000

The accompanying notes are an integral part of these financial statements

Optex Systems Holdings, Inc.
(formerly known as Sustut Exploration, Inc.)
Condensed Consolidated Statements of Cash Flows (unaudited)

	Successor Three months ended December 27, 2009	Successor For the period October 15, 2008 through December 28, 2008	Predecessor For the period September 29, 2008 through October 14, 2008
Cash flows from operating activities:			
Net Income (Loss)	$ 80,581	$ (93,487)	$ 65,332
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	280,504	544,549	9,691
Provision for (use of) allowance for inventory valuation	(44,433)	33,273	27,363
Noncash interest expense	3,455	82,798	9,500
Stock Option Compensation Expense	22,500	-	-
(Increase) decrease in accounts receivable	(311,586)	(720,394)	1,049,802
(Increase) decrease in inventory (net of progress billed)	(625,052)	(497,852)	(863,566)
(Increase) decrease in other current assets	39,264	242,154	18,541
(Increase) decrease in deferred tax asset	(17,702)	-	-
Increase (decrease) in accounts payable and accrued expenses	(19,473)	574,415	(186,051)
Increase (decrease) in accrued warranty costs	-	29,397	-
Increase (decrease) in due to parent	-	-	1,428
Increase (decrease) in accrued estimated loss on contracts	(119,268)	(63,263)	(15,304)
Increase (decrease) in income taxes payable	-	263,654	-
Total adjustments	$ (791,791)	$ 488,731	$ 51,404
Net cash (used)/provided by operating activities	$ (711,210)	$ 395,244	$ 116,736
Cash flows from investing activities:			
Cash Received through Optex Texas acquisition		$ 253,581	$ -
Purchased of property and equipment	(3,216)	(12,189)	(13,338)
Net cash used in investing activities	$ (3,216)	$ 241,392	$ (13,338)
Cash flows from financing activities:			
Proceeds (to) from Loans Payable	250,000	(139,484)	(20,000)
Net cash (used in) provided by financing activities	$ 250,000	$ (139,484)	$ (20,000)
	$ (464,426)	$ 497,152	$ 83,398

Net increase (decrease) in cash and cash equivalents						
Cash and cash equivalents at beginning of period		915,298		-		170,183
Cash and cash equivalents at end of period	$	450,872	$	497,152	$	253,581

The accompanying notes are an integral part of these financial statements

Optex Systems Holdings, Inc.
(formerly known as Sustut Exploration, Inc.)
Condensed Consolidated Statements of Cash Flows (unaudited) - continued

	Successor Three months ended December 27, 2009	Successor For the period October 15, 2008 through December 28, 2008	Predecessor For the period September 29, 2008 through October 14, 2008
Noncash investing and financing activities:			
Optex Delaware (Successor) purchase of Optex Texas (Predecessor)			
Cash received	-	253,581	-
Accounts Receivable	-	1,404,434	-
Inventory	-	5,383,929	-
Intangibles	-	4,036,790	-
Other Assets	-	632,864	-
Accounts Payable	-	(1,953,833)	-
Other Liabilities	-	(1,868,180)	-
Debt	-	(6,000,000)	-
Goodwill	-	7,110,415	-
Issuance of Stock	$ -	$ 9,000,000	$ -
Conversion of Debt to Series A Preferred Stock			
Additonal Paid in Capital (6,000,000 Debt Retirement plus accrued interest of $159,780)	$ -	$ 6,159,780	$ -
Supplemental cash flow information:			
Cash paid for interest	$ -	3,817	$ -
Cash paid for taxes	$ -	-	$ -

The accompanying notes are an integral part of these financial statements

Note 1 - Organization and Operations

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

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

In accordance with FASB ASC 805 (Prior authoritative literature: SFAS No. 141(R), “Business Combinations” and EITF 98-3 “Determining Whether a Non-monetary Transaction Involves Receipt of Productive Assets or of a Business”) Optex Systems, Inc. (Delaware)’s purchase of substantially all of the assets and assumption of certain liabilities represented the acquisition of a business. FASB ASC 805 outlines the guidance in determining whether a “business” has been acquired in a transaction. For a transferred set of activities and assets to be a business, it must contain all of the inputs and processes necessary for it to continue to conduct normal operations after the transferred set of assets is separated from the transferor, which include the ability to sustain a revenue stream by providing its outputs to customers. Optex Systems, Inc. (Delaware) obtained the inputs and processes necessary for normal operations.

Optex Systems, Inc. (Texas) was a privately held Subchapter “S” Corporation from inception in 1987 until December 30, 2005 when 70% of the issued and outstanding stock was acquired by Irvine Sensors Corporation, and Optex Systems, Inc. (Texas) was automatically converted to a Subchapter “C” Corporation. On December 29, 2006, the remaining 30% equity interest in Optex Systems, Inc. (Texas) was purchased by Irvine Sensors Corporation.

On February 20, 2009, Sileas Corporation., a newly-formed Delaware corporation, owned by present members of the company’s management, purchased 100% of Longview's equity and debt interest in Optex Systems, Inc. (Delaware), representing 90% of the issued and outstanding common equity interests in Optex Systems, Inc. (Delaware), in a private transaction (the “Acquisition”). See Note 4.

Optex Systems, Inc. (Delaware) operated as a privately-held Delaware corporation until March 30, 2009, when as a result of the reorganization agreement (described above and also in Note 5), it became a wholly-owned subsidiary of Optex Systems Holdings. Sileas is the majority owner (parent) of Optex Systems Holdings owning approximately 73.5% of Optex Systems Holdings. Optex Systems Holdings plans to carry on the business of Optex Systems, Inc. (Delaware) as its sole line of business and all of Optex Systems Holdings’ operations are conducted by and through its wholly-owned subsidiary, Optex Systems, Inc. (Delaware). Accordingly, in subsequent periods the financial statements presented will be those of the accounting acquirer. The financial statements of Optex Systems Holdings represent subsidiary statements and do not include the accounts of its majority owner.

The Company’s operations are based in Richardson, Texas in a leased facility comprising 49,100 square feet. As of December 27, 2009, Optex Systems Holdings operated with 107 full-time equivalent employees.

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

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

Note 2 - Accounting Policies

Basis of Presentation

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

The accompanying financial statements include the results of operations and cash flows of Optex Systems, Inc. (Delaware), the accounting acquirer in the Sustut reorganization and the Successor in the October 14, 2008 Optex Systems, Inc. (Texas) asset purchase transaction, for the three months ending December 27, 2009 and the period from October 15, 2008 through December 28, 2008 and the results of operations and cash flows for the period from September 29, 2008 through October 14, 2008 of Optex Systems, Inc. (Texas), Predecessor. The accompanying financial statements include the balance sheets at December 27, 2009 and September 27, 2009 for Optex Systems, Inc. (Delaware), the accounting acquirer.

These financial statements have been presented as subsidiary-only financial statements, reflecting the statements of operations and cash flows of the subsidiary as a stand-alone entity.

Although, Optex Systems, Inc. (Texas) (Predecessor) has been majority owned by various parent companies described in the preceding paragraphs, no accounts of the parent companies or the effects of consolidation with any parent companies have been included in the accompanying financial statements. The Optex Systems, Inc. (Texas) accounts have been presented on the basis of push down accounting in accordance with FASB ASC 805-50-S99 (Prior authoritative literature: Staff Accounting Bulletin No. 54 Application of "Push Down" Basis of Accounting in Financial Statements of Subsidiaries Acquired by Purchase). FASB ASC 805-50-S99 states that the push down basis of accounting should be used in a purchase transaction in which the entity becomes wholly-owned. Under the push down basis of accounting certain transactions incurred by the parent company, which would otherwise be accounted for in the accounts of the parent, are "pushed down" and recorded on the financial statements of the subsidiary. Accordingly, items resulting from the Optex Systems, Inc. (Texas) purchase transaction such as goodwill, debt incurred by the parent to acquire the subsidiary and other costs related to the purchase have been recorded on the financial statements of Optex Systems Holdings.

The condensed consolidated financial statements of Optex Systems Holdings included herein have been prepared by Optex Systems Holdings, without audit, pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in financial statements prepared in conjunction with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although Optex Systems Holdings believes that the disclosures are adequate to make the information presented not misleading. These condensed financial statements should be read in conjunction with the annual audited financial statements and the notes thereto included in Optex Systems Holdings' Form 10-K and other reports filed with the SEC.

The accompanying unaudited interim financial statements reflect all adjustments of a normal and 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 results of operations for these periods are not necessarily comparable to, or indicative of, results of any other interim period or for the fiscal year taken as a whole. Certain information that is not required for interim financial reporting purposes has been omitted.

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

Inventory: Inventory is recorded at the lower of cost or market value, and adjusted, as necessary, for decreases in valuation and obsolescence. Adjustments to the valuation and obsolescence reserves are made after analyzing market conditions, current and projected sales activity, inventory costs and inventory balances to determine appropriate reserve levels. Cost is determined using the first-in first-out method. Under arrangements by which progress payments are received against certain contracts, the customer retains a security interest in the undelivered inventory identified with these contracts. Payments received for such undelivered inventory are classified as unliquidated progress payments and deducted from the gross inventory balance. As of December 27, 2009, and September 27, 2009 inventory included:

	As of December 27, 2009 (unaudited)	As of September 27, 2009
Raw Materials	$ 6,466,594	$ 7,161,241
Work in Process	5,204,940	4,043,308
Finished Goods	260,230	245,056
Gross Inventory	$ 11,931,764	$ 11,449,605
Less:		
Unliquidated Progress Payments	(2,738,005)	(2,880,898)
Inventory Reserves	(510,393)	(554,826)
Net Inventory	$ 8,683,366	$ 8,013,881

Stock-Based Compensation: In December 2004, FASB issued FASB ASC 718 (Prior authoritative literature: SFAS No. 123R, “Share-Based Payment”). FASB ASC 718 establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services, but primarily focuses on transactions whereby an entity obtains employee services for share-based payments. FASB ASC 718 requires that the compensation cost relating to share-based payment transactions be recognized in the financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity’s equity instruments or that may be settled by the issuance of those equity instruments.

The Company’s accounting policy for equity instruments issued to consultants and vendors in exchange for goods and services follows the provisions of FASB ASC 505-50 (Prior authoritative literature: EITF 96-18, “Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services” and EITF 00-18, “Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees”). The measurement date for the fair value of the equity instruments issued is determined at the earlier of (i) the date at which a commitment for performance by the consultant or vendor is reached or (ii) the date at which the consultant or vendor’s performance is complete. In the case of equity instruments issued to consultants, the fair value of the equity instrument is recognized over the term of the consulting agreement. Stock-based compensation related to non-employees is accounted for based on the fair value of the related stock or options or the fair value of the services, whichever is more readily determinable in accordance with FASB ASC 718.

Income Tax/Deferred Tax: FASB ASC 740 (Prior Authoritative Literature: SFAS No. 109, “Accounting for Income Taxes”), requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on differing treatment of items for financial reporting and income tax reporting purposes. The deferred tax balances are adjusted to reflect tax rates by tax jurisdiction, based on currently enacted tax laws, which will be in effect in the years in which the temporary differences are expected to reverse. Under FASB ASC 740, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided for certain deferred tax assets if it is more likely than not that the Company will not realize tax assets through future operations. Optex Systems Holdings has recognized deferred income tax benefits on net operating loss carry-forwards to the extent Optex Systems Holdings believes it will be able to utilize them in future tax filings. The difference between the income tax expense and pretax accounting income is primarily attributable to $114,945 of deductable expenses representing permanent timing differences between book income and taxable income for the amortization of goodwill. This expense is deductable over 15 years for income tax purposes but is not amortized for accounting purposes. The tax effect of this permanent timing difference is a reduction of income tax expense of $39,081 for the period ended December 27, 2009.

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

The potentially dilutive securities the Company has outstanding are convertible preferred stock, stock options and warrants. In computing the dilutive effect of convertible preferred stock, the numerator is adjusted to add back any convertible preferred dividends and the denominator is increased to include the number of additional common shares if converted. The Company uses Treasury Stock Method to compute the diluted effect of stock options and warrants. Convertible preferred stocks, stock options and warrants that are antidilutive are excluded from the calculation of diluted earnings per common share.

For the three months ended December 27, 2009, 1,027 convertible preferred stocks and 2,665,649 stock options were excluded as antidilutive. There were no dilutive convertible securities issued and outstanding for the periods ended December 28, 2008 (successor) or October 14, 2008 (predecessor).

Note 3 - Recent Accounting Pronouncements

In June 2008, FASB issued FASB ASC 260-10-55 (Prior authoritative literature: FASB Staff Position EITF 03-6-1, “Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities”). FASB ASC 260-10-55 clarifies that share-based payment awards that entitle their holders to receive nonforfeitable dividends or dividend equivalents before vesting should be considered participating securities. As participating securities, we will be required to include these instruments in the calculation of our basic earnings per share, and we will need to calculate basic earnings per share using the "two-class method." Restricted stock is currently included in our dilutive earnings per share calculation using the treasury stock method. The two-class method of computing earnings per share is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. FASB ASC 260-10-55 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years. As such, Optex Systems Holdings adopted these provisions at the beginning of the interim period ended December 27, 2009. Adoption of FASB ASC 260-10-55 did not have a material effect on Optex Systems Holdings’ financial statements.

In May 2009, FASB issued FASB ASC 855-10 (Prior authoritative literature: SFAS No. 165, "Subsequent Events"). FASB ASC 855-10 establishes principles and requirements for the reporting of events or transactions that occur after the balance sheet date, but before financial statements are issued or are available to be issued. FASB ASC 855-10 is effective for financial statements issued for fiscal years and interim periods ending after June 15, 2009. As such, Optex Systems Holdings adopted these provisions at the beginning of the interim period ended June 28, 2009. Adoption of FASB ASC 855-10 did not have a material effect on Optex Systems Holdings' financial statements.

In June 2009, FASB issued ASC 105-10 (Prior authoritative literature: SFAS No. 168, "The FASB Accounting Standards Codification TM and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162"). FASB ASC 105-10 establishes the FASB Accounting Standards Codification TM (Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. FASB ASC 105-10 is effective for financial statements issued for fiscal years and interim periods ending after September 15, 2009. Optex Systems Holdings adopted these provisions at the beginning of the interim period ended December 27, 2009. Adoption of FASB ASC 105-10 did not have a material effect on Optex Systems Holding's financial statements.

In December 2007, FASB issued FASB ASC 805 (Prior authoritative literature: SFAS No. 141(R), "Business Combinations") and FASB ASC 810-10-65 (Prior authoritative literature: SFAS No. 160, "Accounting and Reporting of Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51"). These new standards will significantly change the accounting for and reporting of business combinations and non-controlling (minority) interests in consolidated financial statements. FASB ASC 805 and FASB ASC 810-10-65 are required to be adopted simultaneously and are effective for the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited. The adoption of FASB ASC 805 and FASB ASC 810-10-65 did not have a material impact on Optex Systems Holdings' financial position, results of operations, or cash flows.

In March 2008, FASB issued FASB ASC 815-10 (Prior authoritative literature: SFAS No. 161, " Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133"). FASB ASC 815-10 requires enhanced disclosures about an entity's derivative and hedging activities. FASB ASC 815-10 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008 with early application encouraged. As such, Optex Systems Holdings is required to adopt these provisions at the beginning of the fiscal year ended September 27, 2009. The adoption of FASB ASC 815-10 did not have a material impact Optex Systems Holdings' financial position, results of operations, or cash flows.

In May 2008, FASB issued FASB ASC 944 (Prior authoritative literature: SFAS No. 163, "Accounting for Financial Guarantee Insurance Contracts—an interpretation of FASB Statement No. 60"). FASB ASC 944 interprets Statement 60 and amends existing accounting pronouncements to clarify their application to the financial guarantee insurance contracts included within the scope of that Statement. FASB ASC 944 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years. Optex Systems Holdings adopted these provisions at the beginning of the interim period ended December 27, 2009. The adoption of issued FASB ASC 944 did not have a material impact on Optex Systems Holdings' financial position, results of operations, or cash flows.

Note 4 — Acquisition of Substantially All of the Assets of Optex Systems, Inc. (Texas)

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

On October 14, 2008, in a purchase transaction that was consummated via public auction, Optex Systems, Inc. (Delaware) (Successor) purchased all of the assets of Optex Systems, Inc. (Texas) (Predecessor) in exchange for $15 million of Irvine Sensors Corporation debt owned by it and the assumption of approximately $3.8 million of certain

Optex Systems, Inc. (Texas) liabilities. The $15 million of Irvine Sensors Corporation debt was contributed by Longview and Alpha to Optex Systems, Inc. (Delaware), in exchange for a $6 million note payable from Optex Systems, Inc. (Delaware) and a $9 million equity interest in Optex Systems, Inc. (Delaware) (which consisted of the issuance by Optex Systems, Inc. (Delaware) of 45,081,350 and 4,918,650 shares of its common stock to each of Longview Fund and Alpha, respectively). On October 30, 2008, Alpha sold its Optex Systems, Inc. (Delaware) common stock to Arland Holdings, Ltd. There was no contingent consideration associated with the purchase. Longview and Arland Holdings, Ltd. owned Optex Systems, Inc. (Delaware) together until February 20, 2009, when Longview sold 100% of its equity and debt interests in Optex Systems, Inc. (Delaware) to Sileas, as discussed below.

Optex Systems, Inc. (Delaware) purchased all of the assets of Optex Systems, Inc. (Texas), including: intellectual property, production processes and know-how, and outstanding contracts and customer relationships. Optex Systems, Inc. (Delaware) also assumed certain liabilities of Optex Systems, Inc. (Texas) consisting of accounts payable and accrued liabilities. Optex Systems Holdings' management intends to improve the business's ability to serve its existing customers and to attract new customers by providing quality products and superior service which will be achieved by improving Optex Systems Holdings' working capital availability as opposed to the limited working capital that was available during the time period in which the assets were owned by Irvine Sensors Corporation.

Pro forma revenue and earnings per share information is presented cumulatively in Note 5.

Secured Promissory Note Issued in Connection with Purchase by Optex Systems, Inc. (Delaware) (Successor)

In connection with the public sale of the Optex Systems, Inc. (Texas) (Predecessor) assets to Optex Systems, Inc. (Delaware) (Successor), Optex Systems, Inc. (Delaware) delivered to Longview and Alpha Secured Promissory Notes, due September 19, 2011, in the principal amounts of $5,409,762 and $540,976, respectively. On February 20, 2009, Longview sold its Optex Systems, Inc. (Delaware) promissory note to Sileas, as described below. On March 27, 2009, Sileas and Alpha exchanged their Notes plus accrued and unpaid interest of $159,780 for 1,027 shares of Optex Systems, Inc. (Delaware) Series A preferred stock.

Acquisition by Sileas on February 20, 2009

On February 20, 2009, Sileas purchased 100% of the equity and debt interest held by Longview, representing 90% of Optex Systems, Inc. (Delaware), in the "Acquisition". As of the date of this transaction, Sileas is the majority owner of Optex Systems Holdings.

Secured Promissory Note Due February 20, 2012/Longview Fund, LP

As a result of the transaction described above between Sileas and Longview Fund, LP on February 20, 2009, Sileas, currently majority owner of Optex Systems Holdings, executed and delivered to Longview, a Secured Promissory Note due February 20, 2012 in the principal amount of $13,524,405. The Note bears simple interest at the rate of 4% per annum, and the interest rate upon an event of default increases to 10% per annum. In the event Optex Systems Holdings sells or conveys all or substantially all its assets to a third party entity for more than nominal consideration, other than a reorganization into Sileas or reincorporation in another jurisdiction, then this Note shall be immediately due and owing without demand. In the event that such a major transaction occurs prior to the maturity date resulting in Sileas receiving net consideration with a fair market value in excess of the principal and interest due under the terms of the secured note, (the "Optex Consideration"), then in addition to paying the principal and interest due, Sileas shall also pay an amount equal to 90% of the Optex Consideration. The obligations of Sileas under the note are secured by a security interest in Optex Systems Holdings' common and preferred stock owned by Sileas that was granted to Longview pursuant to a Stock Pledge Agreement delivered by Sileas to Longview and also by a lien on all of the assets of Sileas.

Optex Systems Holdings has not guaranteed the note and Longview is not entitled to pursue Optex Systems Holdings in the event of a default by Sileas. Therefore, there are no actual or potential cash flow commitments from Optex Systems Holdings. In the event of default by Sileas on its obligations under the note, Longview would only be entitled to receive the Optex Systems Holdings common and preferred stock held by Sileas.

Note 5 –Reorganization Plan and Private Placement

Reorganization/Share Exchange

On March 30, 2009, the reorganization occurred whereby the then existing shareholders of Optex Systems, Inc. (Delaware) exchanged their shares of common stock with the shares of common stock of Optex Systems Holdings as follows: (i) the outstanding 85,000,000 shares of Optex Systems, Inc. (Delaware) common stock were exchanged by Optex Systems Holdings for 113,333,282 shares of Optex Systems Holdings common stock, (ii) the outstanding 1,027 shares of Optex Systems, Inc. (Delaware) Series A preferred stock were exchanged by Optex Systems Holdings for 1,027 shares of Optex Systems Holdings Series A preferred stock and (iii) the 8,131,667 shares of Optex Systems, Inc. (Delaware) common stock purchased in the private placement were exchanged by Optex Systems Holdings for 8,131,667 shares of Optex Systems Holdings common stock. Following the reorganization, Optex Systems, Inc. (Delaware) remained a wholly-owned subsidiary of Optex Systems Holdings.

Shares outstanding of Optex Systems Holdings just prior to the closing of the reorganization consisted of 17,449,991 shares which included 1,250,000 shares issued on March 27, 2009 as payment for Investor Relations Services. On June 29, 2009, 700,000 of the issued investor relations shares were surrendered to Optex Systems Holdings and cancelled upon termination of one of the Investor Relations contracts.

Private Placement

Prior to the closing of the reorganization agreement, as of March 30, 2009 , Optex Systems, Inc. (Delaware) accepted subscriptions from accredited investors for a total of 27.1 units, for $45,000 per unit, with each unit consisting of 300,000 shares of common stock, of Optex Systems, Inc. (Delaware) and warrants to purchase 300,000 shares of common stock for $0.45 per share for a period of five years from the initial closing, which were issued by Optex Systems, Inc. (Delaware) after the closing referenced above. Gross proceeds to Optex Systems, Inc. (Delaware) were $1,219,750, and after deducting (i) a cash finder's fee of $139,555, (ii) non-cash consideration of indebtedness owed to an investor of $146,250, and (iii) stock issuance costs of $59,416, net proceeds were $874,529. The finder also received five year warrants to purchase 2.39 units, at an exercise price of $49,500 per unit.

The following table represents the reorganization and private placement transactions which occurred on March 30, 2009 reflected in March 29, 2009 statements due to the election to report as of the accounting acquirers' period end:

Optex Systems Holdings, Inc.
Balance Sheet Adjusted for Reorganization and Private Placement

	Unaudited Quarter Ended March 29, 2009	Reorganization Adjustments (1)	Private Placement Adjustments	Unaudited Quarter Ended March 29, 2009
Assets				
Current Assets	$ 8,880,436	$ 187,500	$ 929,738	$ 9,997,674
Non current Assets	10,422,425	-	-	10,422,425
Total Assets	$ 19,302,861	$ 187,500	$ 929,738	$ 20,420,099
Liabilities				
Loans Payable	146,709		(146,250)	459
Other Current Liabilities	4,416,403	-	55,209	4,471,612
Total Liabilities	$ 4,563,112	$ -	$ (91,041)	$ 4,472,071
Equity				
Optex Systems Holdings, Inc. – (par $0.001per share, 200,000,000 shares authorized, 138,914,940 shares issued and outstanding as of March 29, 2009)	113,333	17,450	8,132	138,915
Optex Systems Holdings, Inc. preferred stock (par value $0.001 per share, 5,000 shares authorized, 1027 shares of Series A Preferred issued and outstanding)	1			1
Additional Paid in Capital	15,046,446	170,050	1,012,647	16,229,143
Retained Earnings	(420,031)			(420,031)
Total Stockholders Equity	$ 14,739,749	$ 187,500	$ 1,020,779	$ 15,948,028
Total Liabilities and Stockholders Equity	$ 19,302,861	$ 187,500	$ 929,738	$ 20,420,099

(1) Sustut Exploration, Inc. Balance Sheet as of the March 30, 2009 reorganization. Other assets include $187,500 in prepaid expenses for investor relation services to be realized over the next 12 months. The services were prepaid by the issuance of 1,250,000 Sustut shares by Sustut prior to March 30, 2009. The original prepaid expense covered April 2009 through April 2010. On June 29, 2009 700,000 of these shares were returned to Optex Systems Holdings due to the cancellation of one of the investor relations agreements. The amortized expense related to the remaining 550,000 shares has been reflected on the Consolidated Statement of Operations for Optex Systems Holdings as expensed.

The accompanying unaudited pro forma financial information for the consolidated successor three months ended December 27, 2009 and combined successor and predecessor three months ended December 28, 2008 present the historical financial information of the accounting acquirer. The pro forma financial information is presented for information purposes only. Such information is based upon the standalone historical results of each company and does not reflect the actual results that would have been reported had the acquisition been completed when assumed, nor is it indicative of the future results of operations for the combined enterprise.

The following represents condensed pro forma revenue and earnings information for the three months ended December 27, 2009 and December 28, 2008 as if the acquisition of Optex Systems, Inc. (Texas) and reorganization plan had occurred on the first day of each of the years.

	Unaudited Three Months Ended December 27, 2009	Unaudited Three Months Ended December 28, 2008
Revenues	5,915,302	7,264,082
Net Income (Loss) attributable to common shareholders	(14,643)	(65,010)
Diluted earnings per share	$ (0.00)	$ (0.00)
Weighted Average Shares Outstanding	139,444,940	138,914,940

The pro forma information depicted above reflect the impacts of reduced interest expense, increased intangible amortization expenses, the elimination of corporate allocation costs from Irvine Sensors Corporation and the elimination of employee stock bonus compensation previously allocated from Irvine Sensors Corporation to reflect the costs of the ongoing entity.

Note 6 - Commitments and Contingencies

Leases

As of December 27, 2009, Optex Systems Holdings leased its office and manufacturing facilities under two non-cancellable operating leases expiring November 2009 and February 2010 in addition to maintaining several non-cancellable operating leases for office and manufacturing equipment. Optex Systems Holdings concluded negotiations on an extension of its lease on the existing facilities effective as of January 4, 2010 (see Subsequent Events). Total expenses under the existing facility lease agreements as of the three months ended December 27, 2009 was $77,350 and total expenses for manufacturing and office equipment was $8,134. Total expenses under these facility lease agreements for the three months ended December 28, 2008 was $77,350. Total expenses for manufacturing and office equipment for the three months ended December 28, 2008 was $13,715.

As of December 27, 2009, the remaining minimum lease payments under the non-cancelable operating leases for equipment, office and facility space (taking into effect January 4, 2010 extension of the lease for the existing facilities) are as follows:

Fiscal Year		Operating Leases
2010	$	59,194
2011		246,292
2012		229,539
2013		231,574
2014		241,748
2015		201,457
Total minimum lease payments	$	1,209,804

Pursuant to the terms of the amendment to the facilities lease, there is no base rent payment due from March 1, 2010 through July 31, 2010, and the total value of this rent abatement is $133,898. The value of the deferred rent expense will be amortized monthly at a rate of $1,998 per month over the remaining life of the lease. The total expected facilities rent expense for the remaining nine months of 2010 is $154,168 or $51,389 per quarter.

Note 7 - Debt Financing

Related Parties

Short Term Note Payable/Longview Fund - On October 27, 2009, Optex Systems Holdings borrowed $250,000 from the Longview Fund pursuant to a promissory note, with an original maturity date of December 1, 2009, but as of an allonge dated January 5, 2010 the term of the note was extended until July 15, 2010. The note bears interest at the rate of 10% per annum, and all accrued and unpaid interest will be due upon maturity. However, Optex Systems Holdings is required to make a prepayment equal to 50% of the then outstanding principal amount plus accrued and unpaid interest thereon upon the closing of a credit facility or other equity or debt financing from which the net proceeds to Optex Systems Holdings are at least $900,000, with any remaining unpaid balance due on July 15, 2010. In exchange for the extension, Optex Systems Holdings granted Longview a warrant to purchase 100,000 shares of its restricted common stock with an exercise price of $0.15 per share for a term of three years.

Short term note payable (Qioptic) - On November 20, 2008, Optex Systems, Inc. (Delaware) issued a promissory note to Qioptiq Limited in the amount of $117,780. The note originated as a trade payable as of September 28, 2008 in the amount of $227,265, and was paid in full including accrued interest as of March 29, 2009.

Note 8 – Intangible Assets and Goodwill

On October 14, 2008, in a purchase transaction that was consummated via public auction, Optex Systems, Inc. (Delaware) (Successor) purchased all of the assets of Optex Systems, Inc. (Texas) (Predecessor) in exchange for $15 million of Irvine Sensors Corporation debt owned by it and the assumption of approximately $3.8 million of certain Optex Systems, Inc. (Texas) liabilities (see Note 4). Optex Systems, Inc. (Delaware) has allocated the consideration for its acquisition of the Purchased Assets among tangible and intangible assets acquired and liabilities assumed based upon their fair values. Assets that met the criteria for recognition as intangible assets apart from goodwill were also valued at their fair values.

The purchase price was assigned to the acquired interest in the assets and liabilities of Optex Systems Holdings as of October 14, 2008 as follows:

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Assets:	
Current assets, consisting primarily of inventory of $5,383,929 and accounts receivable of $1,404,434	$ 7,330,910
Identifiable intangible assets	4,036,789
Purchased Goodwill	7,110,416
Other non-current assets, principally property and equipment	343,898
Total assets	$18,822,013
Liabilities:	
Current liabilities, consisting of accounts payable of $1,953,833 and accrued liabilities of $1,868,180	3,822,013
Acquired net assets	$15,000,000

Goodwill was tested for impairment as of September 27, 2009 using a fair value approach and based on the review, no impairment was required.

The following table summarizes the estimate of the fair values of the intangible assets as of the asset transfer date:

	Total
Contracted Backlog - Existing Orders	$2,763,567
Program Backlog - Forecasted Indefinite Delivery/Indefinite Quantity awards	1,273,222
Total Intangible Asset to be amortized	$4,036,789

The amortization of identifiable intangible assets associated with the Optex Systems Inc. (Texas) acquisition on October 14, 2008 expensed for the three months ended December 27, 2009 was $259,395. The allocation between manufacturing cost of sales and general and administrative cost was $179,572 and $79,823, respectively. The amortization of identifiable intangible assets expensed for the three months ended December 28, 2008 was $517,798. The allocation between manufacturing cost of sales and general and administrative cost was $416,640 and $101,158, respectively. The identifiable intangible assets and recorded goodwill are amortized over five years for book purposes and over 15 years for income tax purposes. As of the December 27, 2009, the total unamortized balance of intangible assets was $1,706,201. The amortizable intangible assets were tested for impairment as of September 27, 2009 utilizing undiscounted, projected cash flows and based upon this analysis, no impairment was noted. Subsequent to the review, there have been no material changes to our assumptions or estimates that would result in impairment. However, we intend to continue to monitor the value of our intangible assets and goodwill in order to identify any impairment that may occur in the future.

Identifiable intangible assets primarily consist of customer and program backlog. The remaining unamortized balance of intangible assets will be amortized between general and administrative expenses and costs of sales over their remaining respective estimated useful lives as follows:

	2010	2011