Optex Systems Holdings Inc
Form S-1/A
September 02, 2011

As filed with the Securities and Exchange Commission on September 1, 2011 Registration Statement No. 333-173502

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

AMENDMENT NO. 3 TO REGISTRATION STATEMENT
ON FORM S-1 UNDER
THE SECURITIES ACT OF 1933

OPTEX SYSTEMS HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

Delaware	90-0609531	3795
(State or other jurisdiction of incorporation or organization)	(I.R.S. Identification Number)	(Primary Standard Industrial Classification Code Number)

1420 Presidential Drive
Richardson, TX 75081-2439
Telephone (972) 644-0722

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

Stanley A. Hirschman
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Richardson, TX 75081-2439
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(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:
Jolie G. Kahn, Esq.
61 Broadway
Suite 2820
New York, NY 10006
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Approximate Date of Commencement of Proposed Sale to the Public:At such time or times after the effective date of this registration statement as we may determine. This offering is made to U.S. residents only.

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, check the following box.¨

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.¨

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.¨

If this Form is a post-effective amendment filed pursuant to Rule 462(d) 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.¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered	Proposed Maximum Offering Price per unit(1)	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee
Common Stock, par value $0.001 per share (3)(4)	25,000,000	$ 0.01	$ 250,000	$ 29.03

(1) The offering price has been arbitrarily determined by the Company and bears no relationship to assets, earnings, or any other valuation criteria. No assurance can be given that the shares offered hereby will have a market value or that they may be sold at this, or at any price.

(2) Estimated for the purpose of determining the registration fee pursuant to Rule 457(a). All shares offered hereunder shall be at a fixed price of $.01 per share.

(3) The offering will conclude at the earlier of the sale for all shares or 90 days after this registration statement becomes effective with the Securities and Exchange Commission.

(4) An indeterminate number of additional shares of common stock shall be issuable pursuant to Rule 416 to prevent dilution resulting from stock splits, stock dividends or similar transactions and in such an event the number of shares registered shall automatically be increased to cover the additional shares in accordance with Rule 416 under the Securities Act.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act or until this registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

The information in the prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell and is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

Subject to Completion, dated September 1, 2011

PROSPECTUS

OPTEX SYSTEMS HOLDINGS, INC.

25,000,000 Shares of Common Stock

This prospectus relates to the offer and sale of up 25,000,000 shares of common stock of Optex Systems Holdings, Inc., a Delaware corporation, to be offered to the public.

The offering of the 25,000,000 shares is a "best efforts" offering, which means that our directors and officers will use their best efforts to sell the common stock and there is no commitment by any person to purchase any shares. The shares will be offered at a fixed price of $0.01 per share for the duration of the offering. There is no minimum number of shares required to be sold to close the offering. This offering will continue for the earlier of: (i) 90 days after this registration statement becomes effective with the Securities and Exchange Commission, or (ii) the date on which all 25,000,000 shares registered hereunder have been sold. We may at our discretion extend the offering for an additional 90 days. Proceeds from the sale of the shares will be used to fund the initial stages of our business development. This offering will end no later than six (6) months from the offering date. The offering date is the date by which this registration statement becomes effective. This is a direct participation offering since our officers and directors, and not an underwriter, are offering the stock under an exemption from the broker requirements available under Rule 3a4-1, as amended, promulgated under the Securities Exchange Act of 1934, which exempts officers and directors offering our common stock from broker registration requirements under the Securities Exchange Act of 1934. Funds raised under this offering will not be held in trust or in any escrow account, and all funds raised regardless of the amount will be available to us. We will incur offering expenses even if we are unable to sell any shares of common stock under this registration, and there is no guarantee that any amount of common stock will be sold hereunder. Please refer to “Risk Factors”, “Use of Proceeds” and “Plan of Distribution” in this Prospectus for further information.

SHARES OFFERED BY COMPANY	PRICE TO PUBLIC	SELLING AGENT COMMISSIONS	PROCEEDS TO THE COMPANY
Per Share	$ 0.01	Not applicable	$ 0.01
Minimum Purchase	None	Not applicable	Not applicable
Total (25,000,000 shares)	$ 250,000	Not applicable	$ 250,000

On May 1, 2009, our common stock received a symbol change from FINRA and now trades on the Over the Counter Bulletin Board under the symbol “OPXS.OB”. The closing sale price on the OTC Bulletin Board on August 19, 2011, was $0.0125 per share.

Investing in the common stock offered by this prospectus is speculative and involves a high degree of risk. See “Risk Factors” commencing on p. 7 in this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a

criminal offense.

The date of this prospectus is September 1, 2011

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission using the Commission's registration rules for a delayed or continuous offering and sale of securities. Under the registration rules, using this prospectus and, if required, one or more prospectus supplements, we may distribute the shares of common stock covered by this prospectus. This prospectus also covers any shares of common stock that may become issuable as a result of stock splits, stock dividends or similar transactions.

A prospectus supplement may add, update or change information contained in this prospectus. We recommend that you read carefully this entire prospectus, especially the section entitled "Risk Factors" and any supplements before making a decision to invest in our common stock.

PROSPECTUS SUMMARY

This summary highlights important information about this offering and our business. It does not include all information you should consider before investing in our common stock. Please review this prospectus in its entirety, including the risk factors and our financial statements and the related notes, before you decide to invest.

Our Company

Organizational History

On March 30, 2009, Optex Systems Holdings, Inc. (formerly known as Sustut Exploration, Inc.), a Delaware corporation, along with Optex Systems, Inc. (Delaware), which was a privately held Delaware corporation that has since become Optex Systems Holdings' wholly-owned subsidiary, 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. At the closing of the reorganization, the registrant changed its name from Sustut Exploration Inc. to Optex Systems Holdings, Inc. and its year end from December 31 to a fiscal year ending on the Sunday nearest September 30. Optex Systems, Inc. (Delaware) has remained a wholly-owned subsidiary of Optex Systems Holdings, and Optex Systems, Inc. (Delaware)'s shareholders are now shareholders of Optex Systems Holdings.

Immediately prior to the closing under this reorganization agreement and plan of reorganization, as of March 30, 2009, Optex Systems, Inc. (Delaware) accepted subscriptions from accredited investors for a total of $1,219,750 in gross proceeds and $874,529 in net proceeds.

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

Our Business

Optex Systems Holdings manufactures optical sighting systems and assemblies primarily for United States Department of Defense applications. Optical sighting systems are used to enable a soldier to have improved vision and in some cases, protected vision. One type of system would be a binocular which would have a special optical filter

applied to the external lens which would block long wave length light (from a laser) from reaching the soldier's eyes. Another type of system would be a periscope where the soldier inside an armored vehicle needs to view the external environment outside of the tank. In this case, the visual path is reflected at two 90 degree angles enabling the soldier to be at a different plane than that of the external lens.

The following table describes the approximate percentage of revenue represented by the types of systems mentioned in the third and fourth sentences of the above paragraph. The table below reflects approximate product revenues for the nine months ended July 3, 2011 and is a balanced overview of our business based on the percentages.

	% of Revenue
Howitzer Programs	28%
Periscope Programs	64%
All Other	8%
Total	100%

Optex Systems Holdings' products consist primarily of build-to-customer print products that are delivered both directly to the armed services and to other defense prime contractors. Build-to-customer print products are those devices where the customer completes the design of the product and then brings these drawings to the supplier for production. In this case, the supplier would procure the piece parts from suppliers, build the final assembly, and then supply this product back to the original customer who designed it.

Our products are installed on various types of U.S. military land vehicles, such as the Abrams and Bradley fighting vehicles, light armored and armored security vehicles and have been selected for installation on the Stryker family of vehicles. Optex Systems Holdings also manufactures and delivers numerous periscope configurations, rifle and surveillance sights and night vision optical assemblies. Approximately 39% of our current revenue is in support of Abrams vehicles, 29% in support of Stryker vehicles, and 3% in support of Bradley vehicles (all percentages in this sentence for the nine months ended July 3, 2011). The products that we produce can be used on other vehicles; however, they were originally designed for the Abrams, the Bradley, and the Stryker vehicles. In addition, some of the periscopes that we produce can be used on both the Bradley and the Stryker vehicle. Finally, some customers combine their volumes for new vehicles with those requirements for replacement parts for vehicles coming back from the field. At this time, no vehicle generates more revenues than the Stryker vehicle other than the Abrams and Bradley vehicles.

Optex Systems, Inc. (Delaware), and its predecessor, Optex Systems, Inc. (Texas), have been in business since 1987. Optex Systems Holdings is located in Richardson, TX and is ISO 9001:2008 certified.

The Offering

Common stock offered by us:	25,000,000 shares of common stock, par value $0.001 per share.
Offering prices:	The shares offered by this prospectus shall be $0.01 per share.
Common stock outstanding:	139,444,940 shares as of August 19, 2011.
Dividend policy:	Dividends on our common stock may be declared and paid when and as determined by our board of directors. We have not paid and do not expect to pay dividends on our common stock.
OTCBB symbol:	OPXS.OB
Use of proceeds:	

	We will use the proceeds from this offering to finance sales and marketing and program development needs. Offering expenses of $11,029 are being paid directly by us in connection with the offering.
Minimum Number of Shares Offered:	None.
Termination of the Offering:	This offering will terminate upon the earlier to occur of (i) 90 days after this registration statement becomes effective with the Securities and Exchange Commission, or (ii) the date on which all 25,000,000 shares registered hereunder have been sold. We may, at our discretion, extend the offering for an additional 90 days. In any event, the offering will end within six months of this Registration Statement being declared effective.
Terms of the Offering:	Our officers and directors will sell the common stock upon effectiveness of this registration statement on a best efforts basis. There is no minimum offering amount, and there will be no proceeds hold in escrow. We will incur our offering expenses regardless of whether any securities are sold hereunder.

In order to accommodate the number of shares being offered and to have adequate numbers of shares to effect further future offerings and for other purposes, such as having shares available for acquiring synergistic business concerns, we also intend to obtain the consent of our shareholders to increase our authorized shares of common stock to 2 billion, as well as offering our warrant holders the right for a period of 30 days following the date of effectiveness of this registration statement the right to exercise their warrants at a reduced price of $.01 per share, which if fully exercised would result in an additional $99,487 raised (with all warrants not so exercised reverting to their original exercise price at the end of the 30 day period). Also, our preferred shareholders have agreed to waive our obligation to pay existing (in exchange for an increase in the per share stated value of the Series A preferred stock to $6,860.34, which is triggered by the effectiveness of this registration statement) and future dividends on their shares of preferred stock after the date of effectiveness of this registration statement in conjunction with the reduction in their per share conversion price to $0.01 as of the date of effectiveness in accordance with the terms of the preferred conversion feature of the Series A preferred stock. As a result of the post-offering reduction in exercise price of our warrants to $0.01 per share for 30 days and the resulting permanent decrease in the conversion price of our Series A preferred stock from $.15 per share to $.01 per share, the number of shares of common stock which can be received by both our warrant holders and holders of Series A preferred stock before and after giving effect to the offering (and for the preferred stock, the increase in the stated value thereof) set forth in this prospectus are set forth in the below table. Note that given the high level of dilution to be experienced, it is likely that this will cause a material adverse effect upon the price at which shares of our Common Stock are quoted on the OTC Bulletin Board.

Security	Pre-Offering Per Share Exercise/Conversion Price	Number of Shares	Post-Offering per Share Exercise/Conversion Price	Number of Shares	Percentage Dilution to Common Stockholders as a Result of Decrease in Exercise/Conversion Price
Warrants	$ .45	8,131,667	$ .01(1)	8,131,667	0%
Series A preferred stock	$ .15	41,080,000	$ .01	704,556,918	94.17%

(1) This $.01 exercise price shall only be in effect for 30 days from the date of effectiveness of this registration statement.

Risk Factors

See “Risk Factors” for a full discussion of factors you should carefully consider before deciding to invest in our common stock. Among other risk factors and other information, we suggest that you consider the following:

- We anticipate that we will have to raise additional funding in the future to finance our future working capital needs and service debt (should we incur any in the future);
- Two customers represent approximately 84% of our revenue and the loss of either could result in a material adverse effect on our business and operations;

- 73.52% (approximately) of our issued and outstanding common stock is controlled by one of our officers and directors;
  - All of the stock owned by that officer and director has been pledged to secure an obligation of an entity which is controlled by that officer and director and an inability to pay that note when due could result in a change in control in Optex Systems Holdings; and
- We expect gross revenues from our periscope business to decline 25% – 30% in fiscal 2011 as compared to fiscal 2010 and this could have a material adverse effect on our operations and financial condition.

Our Address

Our principal executive offices are located at 1420 Presidential Drive, Richardson, TX 75081-2439.

RISK FACTORS

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

Risks Related to our Business

We expect that we will need to raise additional capital in the future beyond any proceeds received from this offering; additional funds may not be available on terms that are acceptable to us, or at all.

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

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

- our ability to fulfill backlog;
- our ability to procure additional production contracts;
- our ability to control costs;
- the timing of payments and reimbursements from government and other contracts, including but not limited to changes in federal government military spending and the federal government procurement process;
- increased sales and marketing expenses;

- technological advancements and competitors’ response to our products;
- capital improvements to new and existing facilities;
- our relationships with customers and suppliers; and
- general economic conditions including the effects of future economic slowdowns, acts of war or terrorism and the current international conflicts.

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

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

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

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

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

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

Future general political and economic conditions, which cannot be accurately predicted, may directly and indirectly affect the quantity and allocation of expenditures by federal agencies. Even the timing of incremental funding commitments to existing, but partially funded, contracts can be affected by these factors. Therefore, cutbacks or re-allocations in the federal budget could have a material adverse impact on our results of operations. Given the continued adverse economic conditions, the federal government has slowed its pace with regard to the release of orders for the U.S. military. Since we depend on orders for equipment for the U.S. military for a significant portion of our revenues, this slower release of orders will continue to have a material adverse impact on our results of operations. Obtaining government contracts may also involve long purchase and payment cycles, competitive bidding, qualification requirements, delays or changes in funding, budgetary constraints, political agendas, extensive specification development, price negotiations and milestone requirements. In addition, our government contracts are primarily fixed price contracts, which may prevent us from recovering costs incurred in excess of budgeted costs. Fixed price contracts require us to estimate the total project cost based on preliminary projections of the project's requirements. The financial viability of any given project depends in large part on our ability to estimate such costs accurately and complete the project on a timely basis. Some of those contracts are for products that are new to our business and are thus subject to unanticipated impacts to manufacturing costs. Given the current economic conditions, it is also possible that even if our estimates are reasonable at the time made, that prices of materials are subject to unanticipated adverse fluctuation. In the event our actual costs exceed fixed contractual costs of our product contracts, we will not be able to recover the excess costs which could have a material adverse effect on our business and results of operations. We examine these contracts on a regular basis and accrue for anticipated losses on these contracts, if necessary. As of July 3, 2011, we had approximately $0.7 million of loss provision accrued for these fixed price contracts.

Approximately 95% of our contracts contain contract termination clauses for convenience. In the event these clauses should be invoked by our customer, future revenues against these contracts could be affected, however these clauses allow for a full recovery of any incurred contract costs plus a reasonable fee up through and as a result of the contract

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

We have sought to mitigate the adverse impact on our results of operations from U.S. military orders by seeking to obtain foreign military orders. We are still engaged in this process and cannot yet determine if our efforts will result in securing sufficient additional orders to mitigate the adverse impact on our results of operations from the slower pace of U.S. military orders.

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

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

We do not have long-term employment agreements with our key personnel, other than our Chief Operating Officer. If we are not able to retain our key personnel or attract additional key personnel as required, we may not be able to implement our business plan and our results of operations could be materially and adversely affected.

We depend to a large extent on the abilities and continued participation of our executive officers and other key employees. The loss of any key employee could have a material adverse effect on our business. We currently have only one employment agreement, with our Chief Operating Officer, and we do not presently maintain “key man” insurance on any key employees. We believe that as our activities increase and change in character, additional, experienced personnel will be required to implement our business plan. Competition for such personnel is intense, and we cannot assure you that they will be available when required, or that we will have the ability to attract and retain them. In addition, due to our small size, we do not presently have depth of staffing in our executive, operational and financial management areas in order to have an effective succession plan should the need arise. Thus, in the event of the loss of one or more of our management employees, our results of operations could be vulnerable to challenges associated with recruiting additional key personnel, if such recruiting efforts are not successful in a timely manner.

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

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

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

Each contract has a specific quantity of material which needs to be purchased, assembled, and finally shipped. Prior to bidding a contract, Optex Systems Holdings contacts potential sources of material and receives qualified quotations for this material. In some cases, the entire volume is given to a single supplier and in other cases, the volume might be split between several suppliers. If a contract has a single source supplier and that supplier fails to meet their obligations (e.g., quality, delivery), then Optex Systems Holdings would find an alternate supplier and bring this information back to the final customer. Contractual deliverables would then be re-negotiated (e.g., specifications, delivery, price). As of August 19, 2011, approximately 4% of our total material requirements are single-sourced across 10 suppliers representing approximately 12% of our active supplier base. Single-sourced component requirements span across all of our major product lines. The vast majority of these single-sourced components could be provided by another supplier with minimal interruption in schedule (supply delay of 3 months or less) or increased costs. We do not believe these single sourced materials to pose any significant risk to Optex Systems Holdings as other suppliers are capable of satisfying the purchase requirements in a reasonable time period with minimal increases in cost. Of these single sourced components, we have contracts (purchase orders) with firm pricing and delivery schedules in place with each of the suppliers to supply parts in satisfaction of our current contractual needs.

We consider only those specialized single source suppliers where a disruption in the supply chain would result in a period of three months or longer for Optex Systems Holdings to identify and qualify a suitable replacement to present a material financial or schedule risk. In the table below, we identify only those specialized single source suppliers and the product lines supported by those materials utilized by us as of August 19, 2011.

Product Line	Supplier	Supply Item	Risk	Purchase Orders
Periscopes	TSP, Inc.	Window used on all glass & plastic periscopes	Proprietary coatings would take in excess of 6 months to identify and qualify an alternative source	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.
Periscopes	Spartec Polycast	Acrylic raw material used in plastic periscope assemblies	This material has quality characteristics which would take in excess of 6 months to identify and qualify an alternative source.	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.

Other	SWS Trimac	Subcontracted Electron Beam Welding	Subcontracted welder that is the only qualified supplier for General Dynamics Land Systems muzzle reference system collimator assemblies. This operation would take in excess of 6 months to identify and qualify an alternative supplier.	Current firm fixed price & quantity purchase orders are in place with the supplier to meet all contractual requirements. Supplier is on schedule.

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

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

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

The possibility of future product failures could cause us to incur substantial expense to repair or replace defective products. Some of our customers require that we warrant the quality of our products to meet customer requirements and be free of defects for up to fifteen months subsequent to delivery. Approximately 60% of our current (as of July 3, 2011) contract deliveries are covered by these warranty clauses. We establish reserves for warranty claims based on our historical rate of less than one percent of returned shipments against these contracts. There can be no assurance that this reserve will be sufficient if we were to experience an unexpectedly high incidence of problems with our products. Significant increases in the incidence of such claims may adversely affect our sales and our reputation with consumers. Costs associated with warranty and product liability claims could materially affect our financial condition and results of operations.

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

For the nine months ended July 3, 2011, we derived approximately 91% of the gross business revenue from three customers, with 51% from General Dynamics Land Systems Divisions, 33% from Tank-automotive and Armaments Command and 7% from NorcaTec LLC. Procuring new customers and contracts may partially mitigate this risk. In particular, a decision by either General Dynamics Land System Division or Tank-automotive and Armaments Command to cease issuing contracts to us could have a significant material impact on our business and results of operations given that they represent 84% of our gross business revenue. There can be no assurance that we could replace these customers on a timely basis or at all.

We have approximately 90 discrete contracts with General Dynamics Land System Division and Tank-automotive and Armaments Command. If they choose to terminate these contracts, Optex Systems Holdings is entitled to fully recover all contractual costs and reasonable profits incurred up to or as a result of the terminated contract.

We do not possess any patents and rely solely on trade secrets to protect our intellectual property.

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

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

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

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

Conversion of our Series A preferred stock could cause substantial dilution to our existing common stock holders, and certain other rights of the preferred stock holders present other risks to our existing common stock holders.

As of July 3, 2011, we had 139,444,940 shares of our common stock issued and outstanding, as well as 1,027 shares of our Series A preferred stock issued and outstanding. The Series A preferred stock is currently convertible into 41,080,000 shares of our common stock, and upon conversion, the Series A preferred stock would represent 21.7% of our outstanding common stock. Upon effectiveness of this registration statement, with the increase in the stated value of the Series A preferred stock to $6,860.34 and the decrease in the exercise price to $0.01 per share, the Series A preferred stock would be convertible into 704,556,918 shares of our common stock, which would represent 94.17% of our outstanding common stock assuming a full conversion of the Series A preferred stock into shares of our common stock. This would greatly dilute the holdings of our existing common stockholders. In addition, the preferred shareholders vote on a one-to-one basis with our common shareholders on an as converted basis.

Furthermore, in the event of a liquidation, the holders of our Series A preferred stock would receive priority liquidation payments before payments to common shareholders equal to the amount of the stated value of the preferred stock before any distributions would be made to our common shareholders. The total stated value of our preferred stock is $7,045,569, so the preferred shareholders would be entitled to receive that amount before any distributions could be made to common shareholders. The liabilities on our balance sheet exceed the liquidation value of our assets; therefore, upon a liquidation, there would be no assets remaining for distribution to common shareholders.

The preferred shareholders also have the right, by majority vote of the shares of preferred stock, to generally approve any issuances by us of equity and/or indebtedness, which is not ordinary course of trade indebtedness. Therefore, the preferred shareholders can effectively prevent us from entering into a transaction which they feel is not in their best interests, even if the transaction might otherwise be in the best interests of Optex Systems Holdings and its common shareholders.

It is likely that the proposed reduction in the conversion price of our Series A preferred stock will cause a material adverse effect upon the price at which shares of our Common Stock are quoted on the OTC Bulletin Board.

As a result of the post-offering reduction in exercise price of our warrants to $0.01 per share for 30 days which triggers the resulting permanent decrease in the conversion price of our Series A preferred stock from $.15 per share to $.01 per share, the number of shares of common stock which can be received by our holders of Series A preferred stock before and after giving effect to the offering set forth in this prospectus is set forth in the below table. Note that given the high level of dilution to be experienced, it is likely that this will cause a material adverse effect upon the price at which shares of our Common Stock are quoted on the OTC Bulletin Board.

Security	Pre-Offering Per Share Exercise/Conversion Price	Number of Shares	Post-Offering per Share Exercise/Conversion Price	Number of Shares	Percentage Dilution to Common Stockholders as a Result of Decrease in Exercise/Conversion Price
Warrants	$ .45	8,131,667	$ .01 (1)	8,131,667	0 %
Series A preferred stock	$ .15	41,080,000	$ .01	704,556,918	94.17 %

(1) This $.01 exercise price shall only be in effect for 30 days from the date of effectiveness of this registration statement.

If resales of our stock by the selling shareholders listed in our original SB-2 were held to be in violation of the Securities Act of 1933, we could experience significant negative consequences.

We have attempted to determine whether the selling shareholders listed in our original Form SB-2, declared effective in May 2007, complied with the prospectus delivery requirements set forth in Section 5 of the Securities Act of 1933. If the prospectus delivery requirements were not met by the selling shareholders, then we could also be liable for violating Section 5. As current management was not appointed until 2009, we have to rely on third parties to obtain information from 2007. We have contacted prior company counsel for historical information, but they were unable to supply specific details, thus we still have insufficient information to form a definitive opinion regarding this matter. If a section 5 violation was found by a court or other legal body to have occurred, and the alleged violation was not barred by the statute of limitations of 5 years under Section 13 of the Securities Act of 1933, purchasers of the shares registered under the 2007 SB-2 could have a right of rescission or a claim for other damages, and the SEC could commence an enforcement action against us. Any of these actions could potentially have a material adverse effect on us and our stock price.

We have utilized various investor relations firms which have published materials regarding us; however, there may be materials published without our knowledge or consent. To the extent any of these materials describes our securities without disclosing the receipt of consideration by these investor relations firms, there may be liability under Section 17(b) of the Securities Act of 1933.

Section 17(b) of the Securities Act of 1933 states: “It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the

receipt, whether past or prospective, of such consideration and the amount thereof." With regard to services provided by ECON Corporate Services, there may have been materials published, without our knowledge or consent, that contained a description of our securities without appropriate disclosure of consideration received or to be received directly or indirectly from us. This nondisclosure could give rise to liability under Section 17(b).

Risks Relating to the Reorganization

One of our directors, who is also one of our executive officers, beneficially owns a substantial percentage of Optex Systems Holdings' outstanding common stock, which gives him control over certain major decisions on which Optex Systems Holdings' stockholders may vote, which may discourage an acquisition of Optex Systems Holdings.

As a result of the reorganization, Sileas Corp., which is owned by Optex Systems Holdings' three officers (one of whom is also one of Optex Systems Holdings' three directors), beneficially owns (before taking into account the additional dilution upon consummation of the transactions contemplated by this registration statement), in the aggregate, 73.52% of Optex Systems Holdings' outstanding common stock. One director who is also an executive officer, Stanley Hirschman, owns the majority equity interest in Sileas. The interests of Optex Systems Holdings' management may differ from the interests of other stockholders. As Optex Systems Holdings' executive management has the right and ability to control virtually all corporate actions requiring stockholder approval, irrespective of how Optex Systems Holdings' other stockholders may vote, including the following actions:

- confirming or defeating the election of directors;
- amending or preventing amendment of Optex Systems Holdings' certificate of incorporation or bylaws;
- effecting or preventing a reorganization, sale of assets or other corporate transaction; and
- controlling the outcome of any other matter submitted to the stockholders for vote.

Optex Systems Holdings' management's beneficial stock ownership may discourage a potential acquirer from seeking to acquire shares of Optex Systems Holdings' common stock or otherwise attempting to obtain control of Optex Systems Holdings, which in turn could reduce the stock price or prevent Optex Systems Holdings' stockholders from realizing a premium over Optex Systems Holdings' stock price.

If Sileas is unable to meet its obligations under the purchase money note to the party from which it purchased its stock holdings in Optex Systems Holdings, there could be a change in control in Optex Systems Holdings.

On February 20, 2009, Sileas purchased 100% of the equity and debt interest held by Longview Fund, L.P., representing 90% of Optex Systems, Inc. (Delaware), in a private transaction. The purchase price for the acquisition of Longview's position was $13,524,405, and the consideration was paid in the form of a promissory note. The obligations of Sileas under the promissory note are secured by a security interest in Optex Systems Holdings' common and preferred stock owned by Sileas. The promissory note owned by Sileas is due on February 20, 2012. As Sileas has no operations or business activities other than holding the purchased assets, Sileas is depending upon the value of its common stock and preferred stock holdings in Optex Systems Holdings to increase over time in order to pay its obligations under the promissory note. As of August 19, 2011, the market value of Optex Systems Holdings common stock owned by Sileas is $1,373,924 on an as converted basis. If the value of the holdings does not sufficiently increase, and Sileas is unable to meet its payment obligations, Longview could exercise its remedies with respect to its security interest and take control of the pledged stock, and thus there would be a change in control of Optex Systems Holdings, as Sileas is currently the majority owner of Optex Systems Holdings. There can be no guarantee that the investment objectives of Longview will be the same as those of Sileas or our other shareholders. In the event that control shifts to Longview from Sileas, Longview may vote its shares differently than Sileas would have voted under similar circumstances. Merrick Okamoto, a director of Optex Systems Holdings, is a control person of Viking Asset Management, which controls Longview Fund.

Public company compliance may make it more difficult to attract and retain officers and directors.

The Sarbanes-Oxley Act of 2002 and new rules subsequently implemented by the SEC have required changes in corporate governance practices of public companies. Additionally, we have yet fully determined the potential financial and compliance impact of the Dodd – Frank Wall Street Reform and Consumer Protection Act which was enacted in July 2010. As a public entity, Optex Systems Holdings expects these new rules and regulations to increase compliance costs in 2011 and beyond and to make certain activities more time consuming and costly. As a public entity, Optex Systems Holdings also expects that these new rules and regulations may make it more difficult and expensive for Optex Systems Holdings to obtain director and officer liability insurance in the future and it may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for Optex Systems Holdings to attract and retain qualified persons to serve as directors or as executive officers.

We did not give separate notice by mailing to then current shareholders of Sustut of the written consent by Andrey Oks as the majority shareholder of the reorganization.

Section 228(e) of the Delaware General Corporation Law requires "[p]rompt notice of the taking of the corporate action without a meeting by less than unanimous written consent shall be given to those stockholders . . . who have not consented in writing." Prior management of Sustut did not give notice to the other then existing shareholders of Sustut of the written consent of Andrey Oks in lieu of a meeting of stockholders approving the reorganization on March 26, 2009 in compliance with Section 228(e). On April 3, 2009, current management filed a Form 8-K which detailed the transaction although it did not specifically mention approval of the transaction by Andrey Oks as the majority shareholder of Sustut. Potential ramifications of this lack of compliance with Section 228(e) could include possible inquiry or litigation from then existing shareholders of Sustut for failure of being made aware of the consent. To the knowledge of current management of Optex Systems Holdings, there have been no claims or inquiries made and/or any litigation filed by then current shareholders of Sustut for failure to receive notice under Section 228(e) of the Delaware General Corporation Law.

As we do not have an escrow or trust account with subscriptions for investors, if we file for or are forced into bankruptcy, investors will lose the entire investment.

Invested funds for this offering will not be placed in an escrow or trust account, and if we file for bankruptcy or a petition for involuntary bankruptcy is filed by creditors against us, your funds will become part of the bankruptcy estate and administered according to the bankruptcy laws. As such, you will lose your investment and your funds will be used to pay creditors.

Risks Relating to our Common Stock

Optex Systems Holdings' stock price may be volatile.

The market price of Optex Systems Holdings' common stock is likely to be highly volatile and could fluctuate widely in price in response to various factors, many of which are beyond Optex Systems Holdings' control, including the following:

- additions or departures of key personnel;
- limited "public float" following the reorganization, in the hands of a small number of persons whose sales or lack of sales could result in positive or negative pricing pressure on the market price for the common stock;
- operating results that fall below expectations;
- economic and other external factors, including but not limited to changes in federal government military spending and the federal government procurement process; and
- period-to-period fluctuations in Optex Systems Holdings' financial results.

In addition, the securities markets have from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. These market fluctuations may also materially and adversely affect the market price of Optex Systems Holdings' common stock.

There is currently no liquid trading market for Optex Systems Holdings' common stock, and Optex Systems Holdings cannot ensure that one will ever develop or be sustained.

Our common stock is currently approved for quotation on the OTC Bulletin Board trading under the symbol OPXS.OB. However, there is limited trading activity and not currently a liquid trading market. There is no assurance as to when or whether a liquid trading market will develop, and if such a market does develop, there is no assurance that it will be maintained. Furthermore, for companies whose securities are quoted on the Over-The-Counter Bulletin Board maintained by Financial Industry Regulatory Authority, it is more difficult (1) to obtain accurate quotations, (2) to obtain coverage for significant news events because major wire services generally do not publish press releases about such companies, and (3) to raise needed capital. As a result, purchasers of Optex Systems Holdings' common stock may have difficulty selling their shares in the public market, and the market price may be subject to significant volatility.

Offers or availability for sale of a substantial number of shares of Optex Systems Holdings' common stock may cause the price of Optex Systems Holdings' common stock to decline or could affect Optex Systems Holdings' ability to raise additional working capital.

There are currently 14,999,991 unrestricted shares of Optex Systems Holdings which were outstanding prior to the March 2009 reorganization. Additionally, through a combination of the shares available under our pending registration statement when it becomes effective, and Rule 144, additional shares will become available.

Under Rule 144(i)(2), Optex Systems Holdings' stockholders can commence selling significant amounts of shares into the market one year after the filing of "Form 10" information with the SEC as long as the other requirements of Rule 144(i)(2) are met. While affiliates would be subject to volume limitations under Rule 144(e), which is one percent of the shares outstanding as shown by our then most recent report or statement published, nonaffiliates would then be able to sell their stock without volume limitations. If Optex Systems Holdings' current stockholders seek to sell substantial amounts of common stock in the public market either upon expiration of any required holding period under Rule 144 or pursuant to an effective registration statement, it could create a circumstance commonly referred to as "overhang," in anticipation of which the market price of Optex Systems Holdings' common stock could decrease substantially. The existence of an overhang, whether or not sales have occurred or are occurring, could also make it more difficult for Optex Systems Holdings to raise additional financing in the future through sale of securities at a time and price that Optex Systems Holdings deems acceptable.

The date on which current shareholders can sell a substantial amount of shares into the public market would be the earlier of the date on which the registration statement is effective and the one year anniversary of the date on which all Form 10 information is filed with the SEC (we have determined that September 28, 2009 is the date on which all Form 10 information was filed), which would then allow sales under Rule 144. The amount of shares which would be available would be 25,000,000 shares (all of those being registered for resale under this prospectus, when it becomes effective) and 8,131,667 shares (under Rule 144, which are the remaining shares of common stock underlying warrants purchased in the private placement which took place just prior to the reorganization). There are also 1,780,000 shares which were issued in transactions exempt from registration under Rule 144 since the date of the reorganization which became eligible for legend removal under Rule 144 on September 29, 2010.

The shares to become available either through a prospectus on Form S-1 upon effectiveness and under Rule 144 are set forth in the following table:

Prospectus	25,000,000
Shares from warrants issued in the reorganization	8,131,677
Shares issued since the reorganization, all with restrictive legends	1,780,000

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

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

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USE OF PROCEEDS

Our offering is being made on a self-underwritten basis: no minimum number of shares must be sold in order for the offering to proceed. The offering price per share is $0.01. The following table sets forth the uses of proceeds assuming the sale of 25%, 50%, 75% and 100%, respectively, of the securities offered for sale by us.

	25%	50%	75%	100%
Shares sold	6,250,000	12,500,000	18,750,000	25,000,000
Gross proceeds	$ 62,500	$ 125,000	$ 187,500	$ 250,000
Offering costs:				
SEC registration fee	$ 29	$ 29	$ 29	$ 29
Printing and engraving	1,000	1,000	1,000	1,000
Edgarization expenses	5,000	5,000	5,000	5,000
Legal fees and expenses	-	-	-	-
Accounting fees and expenses	5,000	5,000	5,000	5,000
Total offering costs	$ 11,029	$ 11,029	$ 11,029	$ 11,029
Net proceeds	$ 51,471	$ 113,971	$ 176,471	$ 238,971
Use of proceeds:				
Sales and marketing	$ 36,029	$ 79,780	$ 123,530	$ 167,279
Program development (1)	15,442	34,191	52,941	71,692
Total Use of Proceeds	$ 51,471	$ 113,971	$ 176,471	$ 238,971

1) Program development relates to efforts to survey and develop new commercial uses for our technology.
As offering costs are relatively minimal at $11, 029, we do not believe that the failure to raise funds hereunder will have a material adverse effect on us even if we do not raise adequate funds to cover our offering costs. Additionally, we are not utilizing proceeds for any one discreet project, thus the failure to sell any specific amount of shares offered hereunder will not hinder or delay the completion of any specific project.

MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

Effective with the start of trading on May 1, 2009, our stock received a ticker symbol change from "SSTX" to "OPXS" from FINRA and commenced trading under the new symbol on the OTC Bulletin Board. Trading in our stock has historically been sporadic, trading volumes have been low, and the market price has been volatile.

The following table shows the range of high and low prices for our common stock as reported by the OTC Bulletin Board for each quarter since the fourth quarter of 2007, as adjusted. All prices through the date of the reorganization are as reported on Sustut's periodic filings, as adjusted for the 2.5:1 forward split of Sustut's common stock authorized on February 27, 2009. All prices since the reorganization are derived from market information as to OTCBB prices as reported through the AOL Finance look up system. The quotations reflect inter-dealer prices, without retail markup, markdown or commission and may not represent actual transactions.

Period	High	Low
Commencement of Trading through Fourth Quarter 2007	$ 0.50	$ 0.50
First Quarter 2008	$ 0.50	$ 0.50
Second Quarter 2008	$ 0.50	$ 0.50
Third Quarter 2008	$ 0.50	$ 0.50
Fourth Quarter 2008	$ 0.50	$ 0.50
First Quarter 2009	$ 0.50	$ 0.50
Second Quarter 2009	$ 0.50	$ 0.14
Third Quarter 2009	$ 0.45	$ 0.08
Fourth Quarter 2009	$ 0.50	$ 0.17
First Quarter 2010	$ 0.50	$ 0.09
Second Quarter 2010	$ 0.15	$ 0.08
Third Quarter 2010	$ 0.09	$ 0.04
Fourth Quarter 2010	$ 0.055	$ 0.02

First Quarter 2011	$	0.025	$	0.011
Second Quarter 2011	$	0.02	$	0.014
Third Quarter 2011	$	0.02	$	0.005

On August 19, 2011, the sale price for our common stock as reported on the OTCBB was $.0125 per share.

Securities outstanding and holders of record

On August 19, 2011, there were approximately 86 record holders of our common stock and 139,444,940 shares of our common stock issued and outstanding.

Dividend Policy

We have not paid and do not expect to pay dividends on our common stock. Any future decision to pay dividends on our common stock will be at the discretion of our board and will depend upon, among other factors, our results of operations, financial condition and capital requirements.

Information respecting equity compensation plans

Summary Equity Compensation Plan Information

Optex Systems Holdings had no equity compensation plans as of September 30, 2008 and adopted its 2009 Stock Option Plan on March 26, 2009.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

For the year ended October 3, 2010

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

This management's discussion and analysis reflects information known to management as of October 3, 2010 and through the date of this filing. This MD&A is intended to supplement and complement our audited financial statements and notes thereto for the year ended October 3, 2010, prepared in accordance with U.S. generally accepted accounting principles (GAAP). You are encouraged to review our financial statements in conjunction with your review of this MD&A. The financial information in this MD&A has been prepared in accordance with GAAP, unless otherwise indicated. In addition, we use non-GAAP financial measures as supplemental indicators of our operating performance and financial position. We use these non-GAAP financial measures internally for comparing actual results from one period to another, as well as for planning purposes. We will also report non-GAAP financial results as supplemental information, as we believe their use provides more insight into our performance. When a non-GAAP measure is used in this MD&A, it is clearly identified as a non-GAAP measures and reconciled to the most closely corresponding GAAP measure.

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

Background

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

As a result of the reorganization, Optex Systems Holdings changed its name from Sustut Exploration Inc. to Optex Systems Holdings, Inc., and its year end from December 31 to a fiscal year ending on the Sunday nearest September 30.

Immediately prior to the closing under the reorganization agreement (and the exchange of shares referenced above), as of March 30, 2009, Optex Systems, Inc. (Delaware) accepted subscriptions from accredited investors for a total 27.1 units, at a purchase price of $45,000 per unit, with each unit consisting of 300,000 shares of common stock, no par value, 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 (5) years from the initial closing, which were issued by Optex Systems, Inc. (Delaware) after the closing referenced above. Gross proceeds to Optex Systems, Inc. (Delaware) were $1,219,750, and after deducting (i) a cash finder's fee of $139,555, (ii) non-cash consideration of indebtedness owed to an investor of $146,250, and (iii) stock issuance costs of $59,416, the net proceeds were $874,529. The finder also received five year warrants to purchase 2.39 units, at an exercise price of $49,500 per unit.

The proceeds were used as follows:

Description		Offering
Additional Personnel	$	150,000
Legal and Accounting Fees	$	100,000
Investor Relations Fees		96,000
Working Capital	$	528,529
Totals:	$	874,529

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

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

Optex Systems Holdings also anticipates the opportunity to integrate some of its night vision and optical sights products into commercial applications. 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 expected to be conducted by and through Optex Systems, Inc. (Delaware).

The business which is now carried on through Optex Systems, Inc. (Delaware) differs from the business of Irvine Sensors Corporation, which was the former owner of the assets through its subsidiary, Optex Systems, Inc. (Texas). Optex Systems, Inc. (Delaware) delivers high volume products, under multi-year contracts, to large defense contractors. It has the reputation and credibility with those customers as a strategic supplier. Irvine Sensors Corporation is predominately a research and design company with capabilities enabling only prototype or low quantity

volumes. Optex Systems, Inc. (Delaware) is predominately a high volume manufacturing company. Therefore the systems and processes needed to meet customer's needs are quite different. While both companies serve the military market, the customers within these markets are different. For example, two of the largest customers for Optex Systems, Inc. (Delaware) are General Dynamics Land Systems and U.S. Army Tank-armaments and Automotive Command. Irvine Sensors Corporation did not have any contracts or business relations with either of these two customers. Therefore, the separation has allowed Optex Systems, Inc. (Delaware) to focus on high volume manufacturing and the use of the six sigma manufacturing methodology. This shift in priorities has allowed Optex Systems, Inc. (Delaware) to improve delivery performance and reduce operational costs.

The successful completion of the separation from Irvine Sensors Corporation, which was accomplished by Optex Systems, Inc. (Delaware)'s acquisition of all of the assets and assumption of certain liabilities of Optex Systems, Inc. (Texas), eliminated the general and administrative costs allocated by Irvine Sensors Corporation. These costs represented services paid by Irvine Sensors Corporation for expenses incurred on Optex System, Inc. (Texas)'s behalf such as legal, accounting and audit, consulting fees and insurance costs in addition to significant amounts of Irvine Sensors Corporation's general overhead allocated to Optex Systems, Inc. (Texas).

The estimated total general and administrative expenses assuming Optex Systems, Inc. (Texas) was operated on a stand-alone basis during the 2008 fiscal year were:

Accounting and Auditing Fees	$	250,000
Legal Fees		60,000
Consulting Fees		60,000
Workers Comp and General Insurance		70,000
Total	$	440,000

As a result of the purchase of the assets of Optex Systems, Inc. (Texas) on October 14, 2008, these general and administrative costs are incurred and paid directly by Optex Systems, Inc. (Delaware) and have been reflected in the 2009 and 2010 financial results to the extent incurred for the periods presented herein.

The liabilities of Optex Systems, Inc. (Texas) not assumed by Optex Systems, Inc. (Delaware) relate to costs that would not have been incurred by Optex Systems, Inc. (Texas) if they were operated on a stand-alone basis. Among those liabilities not assumed by Optex Systems, Inc. (Delaware) was a note due to Tim Looney. The 2007 Looney promissory note had a principal amount of $2,000,000 together with accrued interest unpaid aggregating to approximately $2,300,000. The note was an amendment to Looney's earn-out agreement which was the consideration for Irvine Sensors Corporation's purchase of Optex Systems, Inc. (Texas).

The 2007 Looney promissory note was not assumed by Optex Systems, Inc. (Delaware) in the October 2008 transaction. The note and accrued interest was reported on the Optex Systems, Inc. (Texas) financial statements as of September 28, 2008 as a result of push down accounting for the acquisition of Optex Systems, Inc. (Texas) by Irvine Sensors Corporation. These costs would not be incurred by Optex Systems, Inc. (Texas) if operated as a stand-alone entity because it relates to Irvine Sensors Corporation's consideration for their purchase of Optex Systems, Inc. (Texas). Since this was not an operating cost associated with Optex Systems, Inc. (Texas) which would not incur these costs if operating as a stand-alone entity, we expect no impact to the future operating results or liquidity of Optex Systems, Inc. (Delaware).

Additionally, as of September 28, 2008, Optex Systems, Inc. (Texas) reported $4.3 million of liabilities attributable to corporate expenses allocated to Optex Systems, Inc. (Texas) through an intercompany payable account "Due to Parent". The outstanding "Due to Parent" balance was not acquired by Optex Systems, Inc. (Delaware) in the acquisition from Irvine Sensors Corporation.

To the extent that Optex Systems, Inc. (Delaware) has incurred these similar costs on an ongoing basis, these amounts have been funded from Optex Systems Inc. (Delaware)'s own operating cash flow.

Results of Operations

The table below summarizes our quarterly and full year operating results in terms of both a GAAP net income measure and a non-GAAP EBITDA measure. We use EBITDA as an additional measure for evaluating the performance of our business as "net income" includes the significant impact of noncash intangible amortization on our

income performance. Consequently, in order to have a meaningful measure of our operating performance on a continuing basis, we need to also consider an income measure which does not take into account this intangible amortization. We have summarized the quarterly revenue and margin below along with a reconciliation of the GAAP net loss to the non-GAAP EBITDA calculation for comparative purposes below. We believe that including both measures allows the reader to have a “complete picture” of our overall performance.

	Successor Qtr 1	Successor Qtr 2	Successor Qtr 3	Successor Qtr 4	Successor - Twelve months ended October 3, 2010	Predecessor - Qtr1 (September 29, 2008 through October 14, 2008)	Successor - Qtr1 (October 15, 2008 through December 27, 2008)	Successor Qtr2	Successor Qtr3	Successor Qtr4	Combined - Twelve months ended September 27, 2009
Net Loss Applicable to Common Shareholders – GAAP	$ -	$ (0.1)	$ (0.3)	$ (9.6)	$ (10.0)	$ (0.1)	$ 0.1	$ (0.3)	$ (0.3)	$ 0.4	$ (0.2)
Add:											
Interest Expense	-	-	-	0.1	0.1	-	0.1	0.1	-	-	0.2
Preferred Stock Dividend	0.1	0.1	0.1	0.1	0.4	-	-	-	-	0.2	0.2
Federal Income Taxes (Benefit)	-	(0.1)	(0.2)	-	(0.3)	-	0.2	0.1	0.1	(0.7)	(0.3)
Asset Impairment	-	-	-	8.0	8.0	-	-	-	-	-	-
Depreciation & Amortization	0.3	0.3	0.3	0.2	1.1	-	0.6	0.5	0.5	0.6	2.2
EBITDA - Non GAAP	$ 0.4	$ 0.2	$ (0.1)	$ (1.2)	$ (0.7)	$ (0.1)	$ 1.0	$ 0.4	$ 0.3	$ 0.5	$ 2.1

During the year ended October 3, 2010, we experienced significant reductions in forecasted sales volume due to changes in incremental funding commitments by federal agencies. We are currently evaluating the impact that anticipated reductions in government defense spending budgets will have on Optex Systems Holdings in the next fiscal year. The potential ramifications of the circumstances surrounding the 2011 Congressional budget have not been determined as of April 11, 2011 and are expected to unfold over the ensuing weeks. As a result of new periscope orders from non-traditional sources and an aggressive pursuit of increased market share for all of our existing product lines, we expect to mitigate some of the current decreased U.S. government requirements with other new business. We also continue to explore other opportunities for manufacturing outside of our traditional product lines for products which could be manufactured using our existing lines in order to fully utilize our existing capacity. Our EBITDA decreased by ($2.8) million in the year ending October 3, 2010 as compared to the year ending September 27, 2009. The decline in EBITDA is primarily the result of decreased revenue and lower gross margins due to changes in product mix and higher production costs as revenue declines outpaced manufacturing cost reductions. In the last quarter of 2010, we realized a reduction in revenue of roughly 21% over the average revenues in the prior three quarters, primarily in our higher product margin business. Our overall revenue declined by 17%, or $4.7 million, in the year ended October 3, 2010 as compared to the prior year ended September 27, 2009. We experienced a significant shift in revenue toward the less favorable Howitzer programs that exacerbated the losses on those programs as their share of the overhead pools increased, and as overall volume declined, our labor efficiencies were impacted across all product lines due to layoff/reorganization and lower economies of scale. Further, in September 2010, Optex received an unanticipated order against a loss Howitzer program which resulted in an immediate, realized loss of $0.2 million. As a business for which the major source of revenues is government contracts, we rely heavily on program cost estimates to determine our product margins. These estimates are very sensitive to any significant changes in revenue, production volume and product mix. Any increased cost over the estimates will be reflected in the year end annual physical inventory valuation.

We expect the next year to pose an even greater challenge. We are entering fiscal 2011 with a historically higher percentage of loss contracts to total shippable backlog and a reduced visibility into the anticipated orders in other product groups to be booked in the coming year. We continue to pursue cost reductions in our production and general and administrative areas to mitigate any further margin impacts and to improve overall product profitability.

Product mix is dictated by customer contracted delivery dates and volume of each product to be delivered on such delivery dates. Shifts in gross margin from period to period are primarily attributable to the differing product mix recognized as revenues during each respective period. Certain periscope contracts were awarded January 2003, and due to significant material price increases subsequent to the contract award date, we experienced losses on these contracts. During the period ending October 3, 2010, we recognized revenue of $1.2 million from these legacy periscope programs, with a remaining backlog of $0. We expect our gross margins on periscopes to improve in the next fiscal year as the legacy loss and low margin programs have completed. In addition, our Howitzer contracts awarded in August 2005 and September 2006 are experiencing losses as a result of unanticipated manufacturing costs due to design and technical data package issues impacting product manufacturability. During the year ended October 3, 2010, we recognized revenue of $6.1 million on our Howitzer programs as compared to $2.6 million in the year ended September 27, 2009 with a remaining backlog of $5.0 million expected to ship in fiscal year 2011. Contract loss reserves on these programs were $1.3 million as of October 3, 2010.

We are aggressively pursuing additional, potentially higher margin periscope business. In May 2009, Optex Systems Holdings was awarded a multi-year Indefinite Delivery/Indefinite Quantity type contract accompanied by the first delivery order from U.S. Army Tank-armaments and Automotive Command. In June 2009, we received an additional $3.4 million dollar award from General Dynamics Land Systems and in September 2009, we received an additional $1.9 million award to provide product beginning with delivery starting in 2011 at the completion of our current production contract In July 2010, Optex received new orders totaling $4.5 million of which $2.5 consisted of an additional delivery order against our M137 Howitzer contract.

As of December 27, 2010, we have not yet been able to capitalize upon potential external growth opportunities. However, as and when economic conditions become more favorable and opportunities may emerge, we plan to explore all opportunities to grow our operations through mergers and/or acquisitions. We have no acquisition agreements pending at this time and are not currently in discussions or negotiations with any third parties.

As a result of the October 14, 2008 acquisition of the assets of Optex Systems, Inc. (Texas), our amortizable intangible assets had increased significantly over prior years. The non cash amortization expense of intangible assets was $1 million in 2010 as compare to $2 million in 2009. We reviewed the fair market value of our goodwill and intangible assets as of October 3, 2010 and based on significant reductions in anticipated government military spending, a reduction in customer order trends, and lower contract backlog, we determined that that goodwill was impaired. The review was based on a projected cash flow analysis of our future operations. The impairment loss for goodwill was $7.1 million and was charged to general and administrative costs and impairment for intangible assets was $0.9 million. The impairment loss was split between cost of goods sold and general and administrative costs in the amount of 0.1 million $0.8 million, respectively. As of the year ended October 3, 2010, the total balance of unamortized intangible assets and goodwill was zero.

Backlog as of October 3, 2010 was $19.0 million as compared to a backlog of $26.5 million as of September 27, 2009, representing a decline of 28.3%. The following table depicts the current expected delivery by quarter of all contracts awarded as of October 3, 2010.

	2011				2012				2013			
Program Backlog (millions)	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2	Qtr 3	Total
Howitzer Programs	0.9	1.5	1.8	0.8	-	-	-	-	-	-	-	5.0
Periscope Programs	1.3	2.8	1.4	1.2	1.5	1.3	1.0	0.7	0.4	0.3	0.1	12.0

Sighting Systems	-	-	-	-	-	-	-	-	-	-	-	-
All Other	1.1	0.3	0.2	0.1	-	0.1	-	0.1	0.1	-	-	2.0
Total	3.3	4.6	3.4	2.1	1.5	1.4	1.0	0.8	0.5	0.3	0.1	19.0

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

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.

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

In some cases, we may receive an "undefinitized" (i.e., price, specifications and terms are not agreed upon before performance commenced) contract award for contracts that exceed the $700,000 (changed from $650,000 effective October 1, 2010), which is the federal government simplified acquisition threshold. These contracts are considered firm contracts at an undefinitized, but not to exceed specified limits threshold. Cost Accounting Standards Board covered contracts are subject to the Truth in Negotiations Act disclosure requirements and downward only price negotiation. As of October 3, 2010, none of our outstanding backlog fell under this criterion.

Twelve month period ended October 3, 2010 compared to the twelve month period ended September 27, 2009

Revenues:

The table below details the revenue changes by product line for the year ended October 3, 2010 as compared to the year ended September 27, 2009.

Product Line	Year ended 10/03/2010 (Successor)	Year ended 9/27/2009 (Combined (1))	Change
Howitzer Programs	$ 6.1	$ 2.6	3.5
Periscope Programs	$ 11.8	$ 14.9	(3.1)
Sighting Systems	$ .9	$ 4.7	(3.8)

All Other	$	4.1	$	5.4	(1.3)
Total	$	22.9	$	27.6	(4.7)
Percent decrease					(17.0)%

(1) Includes Revenue of $0.9 million for Optex Systems Texas (Predecessor) period from September 29, 2008 through October 14, 2008 and $26.7 million for Optex Systems, Inc. (Successor) period October 15, 2008 through September 27, 2009.

Revenues decreased by $3.1 million, or 20.8%, on our periscope line during fiscal year 2010 as compared to fiscal year 2009. During fiscal year 2009, periscope production from one of our major periscope contracts was accelerated to compensate for production delays that occurred during the last six months of fiscal year 2008. The delay was the result of a manufacturing control test failure related to the environmental testing of one of the products. Subsequent to the environmental control test failure, Optex Systems Holdings implemented a manufacturing process change to eliminate the potential for future failures and increased the production rate in the first six months of fiscal 2009 to compensate for the previous delay. Based on our current backlog demand and a recent decline of new federal government orders deliverable in fiscal year 2011, we expect the periscope product line deliveries to decline by an additional 25% to 30% in fiscal year 2011 as compared to revenues in fiscal year 2010. We continue to quote and receive awards for additional periscopes from multiple customers and are aggressively pursuing increased market share in the periscope market by drawing business away from our competitors; however, we cannot yet determine if we will be successful in gaining sufficient new additional periscope business to offset the downturn caused by the decline in new federal government orders. In order to preserve gross margins and mitigate the impact of the reduced periscope revenues in fiscal year 2011, we completed a reduction in force of approximately 24% as of June 24, 2010 and we are currently implementing additional measures to reduce costs for fiscal year 2011.

Revenues from the Howitzer programs increased $3.5 million, or 134.6%, over the prior year. In 2009, we worked aggressively with the federal government to resolve technical field issues related to two of our Howitzer programs and completed the First Article Testing and Acceptance requirements on a third program, for which government acceptance approval was obtained on August 25, 2009. These issues were resolved through our initiated engineering change proposals and customer changes to the statement of work, and contract schedules modified accordingly to implement the required changes. With the successful implementation of these changes in place, and the additional delivery order of $2.5 million awarded in July 2010, we are in full scale production on these units and expect deliveries on these programs to continue at the higher production rates until the third quarter of fiscal 2011 when production rates will begin to wind down with anticipated completion during the fourth quarter of fiscal year 2011. Sighting systems revenues decreased $3.8 million, or 80.9%, over the period ended September 27, 2009 as our U.S. government delivery order on back up sighting units was completed in the last nine months of fiscal 2009. We currently do not have a follow-on delivery order for additional sighting units; however, the primary contract ordering period does not expire until December 31, 2012. We continue to ship sighting systems pursuant to other contracts to both federal government and non-U.S. government customers and continue to pursue business on several substantial programs for commander weapon sighting systems and M36 thermal sighting units, which, if successfully consummated, would yield deliveries in fiscal year 2011.
Decreases in the other product line of $1.3 million, or 24.1%, for 2010 as compared to 2009 are primarily a result of decreased collimator assembly sales to the U.S. government and decreased sales in Big Eye Binoculars for a Navy contract that completed in June 2009, which are partially offset by increased revenues for miscellaneous subassemblies and spare parts.

Currently, we are experiencing losses in our Howitzer programs as a result of unanticipated manufacturing costs due to design and technical data package issues impacting the product manufacturability. These issues have resulted in increased labor and material costs due to higher scrap and extensive engineering costs incurred during the initiation phase of the programs. In addition some of our older “legacy” periscope programs, which were completed in the third fiscal quarter of 2010, experienced losses due to significant material price increases since the initial five year contract award in 2004. As of October 3, 2010, Optex Systems Holdings has reserved $1.3 million in contract loss reserves on these programs with a remaining backlog of $5 million expected to ship in fiscal year 2011. During 2010 we realized additional losses of $1.1 million to cover increased estimated completion costs as a result of higher production labor and material scrap rates, combined with increased sharing of fixed manufacturing overhead due to the significant decline in volume across the other product lines. Included in the total realized losses against the Howitzer programs for fiscal year 2010 is $0.8 million relating specifically to production issues encountered on one of our Howitzer product lines. Optex has requested an equitable adjustment (which is still pending as of August 19, 2011) on this

program due to significant design issues impacting the manufacturability of the product. As there is no guarantee that the request will be granted in part or in full, Optex has realized the entire loss in fiscal year 2010. In the event we are unsuccessful in obtaining an equitable adjustment, future margins on these revenues are expected to be zero as these losses have been previously recognized to the extent identified.

Cost of Goods Sold. During the period ended October 3, 2010, we recorded cost of goods sold of $22.0 million as opposed to $24.8 million during the period ended September 27, 2009 (Combined Predecessor and Successor), a decrease of $2.8 million or 11.3%. This decrease in cost of goods sold was primarily associated with decreased revenue on our periscope, sighting systems and other product lines from the prior year. The gross margin during the period ending October 3, 2010 was 3.9% of revenues as compared to a gross margin of 10.1% for the period ending September 27, 2009 (Combined Predecessor and Successor). The decrease in gross margin is primarily due to decreased revenues, a shift in product mix toward less profitable programs, increased contract losses on our Howitzer programs of ($1.1) million and year end physical inventory valuation losses totaling ($0.9) million across all product lines, partially offset by a decrease in intangible amortization and impairment allocable to cost of goods sold of $0.8 as compared to the prior year period.

G&A Expenses. During the period ending October 3, 2010, we recorded operating expenses of $10.7 million as opposed to $2.9 million (Combined Predecessor and Successor) during the period ending September 27, 2009, an increase of $7.8 million or 269.0%. The bulk of the increased general and administrative costs relates to non cash impairment of goodwill of $7.1 million and intangible assets of $0.9 million, partially offset by a reduction in amortized intangible assets of $0.1 million over the prior year. Increases in salaries and expenses based on labor are primarily due to one extra payroll week in 2010, as the year included 53 weeks as compared to 52 weeks in fiscal year 2009, combined with increased executive compensation and increases to employee stock option compensation expense for 2010 as a result of a full years amortization compared to a partial year in 2009. The increases were offset by reductions in other expenses including rent, legal expenses, and accounting fees. We expect our operating expenses to decline significantly in the next fiscal year as a result of the completion of an investor relations contract, reductions in force, changes in employee benefits, changes in medical and general insurance carriers and lower rent and utility costs due to newly negotiated agreements in 2010.

Operating Income (Loss). During the period ending October 3, 2010, we recorded an operating loss of ($9.9) million, as compared to an operating loss of $(0.13) (Combined Predecessor and Successor) million during the period ending September 27, 2009. Operating loss is higher in 2010 as compared to 2009, due to lower revenues of $4.7 million, changes in product mix toward less profitable Howitzer programs, increased loss reserves on Howitzer programs of $1.1 million, physical inventory valuation adjustments $0.9 million for all programs, impairment of goodwill and intangible assets of $7.1 million and $0.9 million respectively, partially offset by decreased intangible asset amortization in fiscal 2010 as compared to fiscal 2009.

Net Income (Loss) applicable to common shareholders. During the period ended October 3, 2010, we recorded a net loss of (10.0) million, as compared to a net loss of $(0.2) million (Combined Predecessor and Successor) for the period September 27, 2009. In fiscal 2010, we recognized a tax benefit of $0.3 million as compared to $0.3 million in the same period of fiscal year 2009. The tax benefit is primarily attributable the effect of temporary and permanent timing differences related to goodwill, intangible amortization and changes in reserve balances. The goodwill and intangible amortization expense is amortized over 15 years for income tax purposes whereas the remaining unamortized balance of both goodwill and intangibles was written off prior to year end for book purposes. Preferred dividends increased to $0.4 million from $.2 million in 2010 as compared to 2009. The net increase of $0.2 million was due to two additional quarters of preferred dividends over the prior year as preferred stock was issued on the last day of the second fiscal quarter in 2009.

Liquidity and Capital Resources

On October 27, 2009, Optex Systems Holdings secured a short term note payable from the Longview Fund in the amount of $250,000 bearing interest at 10% per annum. On March 22, 2010, Optex Systems Holdings repaid $125,000 in principal plus $10,000 in accrued interest on the outstanding Longview note. The balance of principal and interest due on the note were satisfied on June 4, 2010.

On March 10, 2010, the Company entered into a revolving credit facility with Peninsula Bank Business Funding, a division of the Private Bank of the Peninsula, which provides up to $2,000,000 in financing against eligible receivables. The material terms of the revolving credit facility are as follows:

- The interest rate for all advances shall be the greater of 8.5% and the then in effect prime rate plus 3.5% and subject to a minimum quarterly interest payment of $16,000.
- Interest shall be paid monthly in arrears.

- The expiration date of the facility is March 4, 2011, at which time any outstanding advances, and accrued and unpaid interest thereon, will be due and payable.

- In connection with the entry into the facility by Peninsula Bank Business Funding, Optex Systems, Inc.(Delaware) paid Peninsula Bank Business Funding a facility fee of $20,000 and issued a warrant to Peninsula Bank Business Funding to purchase 1,000,000 shares of its common stock. The warrant bears an exercise price of $0.10 per share and expires on March 3, 2016.

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

- The facility contains affirmative and negative covenants that require Optex Systems, Inc. (Delaware) to maintain certain minimum cash and EBITDA levels on a quarterly basis and contains other customary covenants. The facility also contains customary events of default. Upon the occurrence of an event of default that remains uncured after any applicable cure period, Peninsula Bank Business Funding's commitment to make further advances may terminate, and Peninsula Bank Business Funding would also be entitled to pursue other remedies against Optex Systems, Inc. (Delaware) and the pledged collateral.

- Pursuant to a guaranty executed by Optex Systems Holdings in favor of Peninsula Bank Business Funding, Optex Systems Holdings has guaranteed all obligations of Optex Systems, Inc. (Delaware) to Peninsula Bank Business Funding.

On August 3, 2010, Peninsula Bank Business Funding waived the Company's requirement to meet the EBITDA requirement set forth in Section 6.8 of its agreement with the Company for the quarter ended June 27, 2010. In addition, Peninsula Bank Business Funding agreed to amend Sections 6.8(c) and (d) of the aforesaid agreement to adjust the minimum EBITDA covenant for the fiscal quarter ending January 2, 2011 to $200,000.

On November 23, 2010, Peninsula Bank Business Funding waived the Company's requirement to meet the EBITDA requirement set forth in Section 6.8 (c) of the August 3, 2010 amended Agreement for the fourth quarter ended October 3, 2010. In addition, on November 29, 2010 Peninsula Bank Business Funding agreed to a second amendment for Sections 6.8 (d) of the Agreement to adjust the minimum EBITDA covenant for the fiscal quarter ending January 2, 2011 to $95,000.

On March 22, 2011, Peninsula Bank Business Funding and the Company, entered into a fourth amendment to the existing credit facility agreement between them to extend the maturity date to March 15, 2012 (a prior third amendment entered into on February 15, 2011 was in all material respects superseded by the amendments made in the fourth amendment). Section 1.1 was amended (i) to define "Borrowing Base" as $175,000, (ii) to delete the definition of "EBITDA", and (iii) to amend subsection (i) of the definition of "Eligible Accounts" so as to exclude any accounts for any account debtor (other than GDLS) which exceed 30% of all accounts and for GDLS to exclude those total obligations which exceed the lesser of 50% of all accounts or the aggregate sum of $500,000. Section 2.3(a)(ii) was amended so that the minimum semi annual interest payment is $20,000, and Section 6.8 was amended in its entirety so as to require the Company to maintain a zero balance on the revolving line for a period of at least 30 consecutive days during the period from March 15, 2011 and March 15, 2012.

As of October 3, 2010, the outstanding balance on the line of credit is $1,106,852, and on August 19, 2011, the latest practicable date, the balance was $0. For the period ended October 3, 2010 the total interest expense was $37,148.

We have historically met our liquidity requirements from a variety of sources, including government and customer funding through contract progress bills, short term loans, notes from related parties, and the sale of equity securities. Based upon our current working capital position and potential for expanded business revenues, we believe that our working capital is sufficient to fund our current operations for at least the next 12 months. However, based on our strategy and the anticipated growth in our business, we believe that our liquidity needs may increase in the future. The amount of such increase will depend on many factors, including the costs associated with the fulfillment of our projects, whether we upgrade our technology, and the amount of inventory required for our expanding business. If our liquidity needs do increase, we believe additional capital resources will be obtained from a variety of sources including, but not limited to, cash flow from operations and the issuance of our common stock and/or debt, including receivables funding through a commercial lender .

Period of September 27, 2009 through October 3, 2010

Cash and Cash Equivalents. As of October 3, 2010, we had cash and cash equivalents of $1.0 million as compared to $0.9 million for the period ended September 27, 2009. We increased cash and cash equivalents by $0.1 million primarily from the revolving credit facility with Peninsula Bank Business Funding that was put in place on March 10, 2010. As of October 3, 2010 our outstanding balance against the line of credit was $1.1 million.

Net Cash Used in Operating Activities. Net cash used in operating activities during the period beginning September 27, 2009 and ending October 3, 2010 totaled $(0.9) million. The primary uses of cash during this period resulted from a significant reduction in accounts payable of ($1.8) million, increases in accounts receivable of ($0.6) million due to an increase in accounts receivable days outstanding from one of our major customers, combined with decreases of inventory of $2.3 million due lower material purchases required to support the lower production volume in the last quarter of 2010. The effect of the current year net loss, combined with the non cash intangible amortization, asset impairment and deferred tax assets resulted in net cash used in operating activities in 2010 of ($0.8) million.

Net Cash Provided by Investing Activities. Net cash used by investing activities during the period beginning September 27, 2009 and ending October 3, 2010 totaled $(0.1) million and consisted of fixed asset purchases during the period, primarily in leasehold improvements and equipment purchased in support of 2010 cost reduction initiatives. These initiatives included reorganization of the plant facilities and equipment to improve manufacturing efficiencies, thereby reducing material movement and streamlining production cells. In addition to the $0.1 million capital investment by Optex Systems, additional facilities improvements of $0.2 million were paid by the property owner as a condition of the lease renewal in January 2010. All of the facilities improvements were completed in fiscal year 2010.

Net Cash Provided by Financing Activities. Net cash provided by financing activities during the period beginning September 27, 2009 and ending October 3, 2010 totaled $1.1 million and consisted of cash drawn down from the revolving line of credit obtained in March 2010. The revolving credit facility has allowed us the flexibility to more effectively manage the timing of incoming cash from our accounts receivable against our required cash outlay for operating activities.

Predecessor period of September 29, 2008 through October 14, 2008

Cash and Cash Equivalents. As of October 14, 2008, Optex Systems, Inc. (Texas), the predecessor company, had cash and cash equivalents of $0.3 million, an increase of $0.1 million from September 29, 2008. The slight increase in cash was primarily due to the timing of cash receipts on accounts receivable collections and supplier payments. The cash balance as of October 14, 2008 is included as cash received through Optex Systems, Inc. (Delaware) as of October 15, 2008.

Net Cash Provided by Operating Activities. Net cash provided by operating activities totaled $0.1 million for the period of September 29, 2008 through October 14, 2008. Cash provided by operating activities was primarily due to the timing of purchases and accounts receivable collections during the 15 day period prior to the acquisition of Optex Systems Inc, (Texas), by Optex Systems Inc., (Delaware). During this period, our net inventory increased by $(0.9) million to support substantially increased production rates across all of our product lines and our accounts receivable decreased $1.0 million due to timing of collections from one of our major customers in the second week of October 2008. Accounts payable and accrued expenses decreased by $0.2 million due to the timing of cash disbursements prior to the acquisition.

Net Cash Used in Investing Activities. There was no net cash used in investing activities during the Predecessor period beginning September 29, 2008 and ending October 14, 2008. Optex Systems Holdings' business is labor intensive, and we purchase equipment as it becomes necessary.

Net Cash Provided by Financing Activities. There was no net cash provided by financing activities during the Predecessor period beginning September 29, 2008 and ending October 14, 2008.

Successor period of October 15, 2008 through September 27, 2009

Cash and Cash Equivalents. As of September 27, 2009, we had cash and cash equivalents of $0.9 million. During the period of October 15, 2008 through September 27, 2009 we increased cash and cash equivalents by $0.6 million primarily attributable to the net proceeds received by us from the private sale of equity securities. A portion of the net proceeds was used to acquire additional inventory in support of the higher revenue and production rates during the period and which are expected to continue through 2010.

Net Cash Used in Operating Activities. Net cash used in operating activities during the period beginning October 15, 2008 and ending September 27, 2009 totaled $(0.1) million. The primary uses of cash during this period resulted from increases of inventory and accounts receivable in support of higher production and shipping volumes, partially offset by increases in accounts payable due to higher purchases required to support the increased revenues. In the period beginning October 15, 2008 and ending September 27, 2009, our net inventory increased by $2.5 million to support substantially increased production rates across all of our product lines. A large portion of this buildup in inventories was progress billable and, as such, was billed to our customers as costs were incurred. We expect similar cash flows from operations until later in fiscal year 2010 when our low margin legacy periscope programs are ending and will be replaced with newer programs carrying improved pricing and corresponding better margins.

Net Cash Provided by Investing Activities. In the period beginning October 15, 2008 and ending September 27, 2009, net cash provided by investing activities totaled $0.24 million and consisted of cash acquired during the Optex Systems, Inc. (Delaware) acquisition as of October 14, 2008 of $0.25 million and cash used to purchase equipment of $(0.01) million during the period.

Net Cash Provided by Financing Activities. Net cash provided by financing activities totaled $0.8 million during the period beginning October 15, 2008 through September 27, 2009, The change of $0.8 million is attributable to the sale of stock for cash of $1.0 million offset by funds used to repay outstanding loans of $(0.2) million. We raised funds through a private placement for working capital needs, primarily inventory purchases, and additional personnel to support increased revenue and production rates during the period.

Critical Accounting Policies

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. 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. FASB ASC 718 focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. 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.

Optex Systems Holdings' accounting policy for equity instruments issued to consultants and vendors in exchange for goods and services follows the provisions of FASB ASC 505-50 (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. We have provided deferred income tax benefits on net operating loss carry-forwards to the extent we believe we will be able to utilize them in future tax filings.

Revenue Recognition: Optex Systems Holdings recognizes revenue based on the modified percentage of completion method utilizing the units-of-delivery method, in accordance with FASB ASC 605-35 (Prior authoritative literature: SOP 81-1 “Accounting for Performance of Construction–Type and certain Production –Type Contracts”):

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

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

Estimated Costs at Completion and Accrued Loss on Contracts: Optex Systems Holdings reviews and reports on the performance of its contracts and production orders against the respective resource plans for such contracts/orders. These reviews are summarized in the form of estimates at completion. Estimates at completion include Optex Systems Holdings incurred costs to date against the contract/order plus management's current estimates of remaining amounts for direct labor, material, other direct costs and subcontract support and indirect overhead costs based on the completion status and future contractual requirements for each order. If an estimate at completion indicates a potential overrun (loss) against a fixed price contract/order, management generally seeks to reduce costs and /or revise the program plan in a manner consistent with customer objectives in order to eliminate or minimize any overrun and to secure necessary customer agreement to proposed revisions.

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

For the fiscal years ended October 3, 2010 and September 27, 2009, estimated loss reserves were $1,357,068 and $1,348,060, respectively. During 2010, Optex Systems Holdings realized increases losses against the Howitzer programs of $1,139,659 of which $762,864 relates specifically to production issues encountered on one of our Howitzer product lines. Contract losses attributable to program deliveries during the fiscal year 2010 were $1,130,651 for a net increase of $9,008 in the ending reserve balance. Increased losses were primarily attributable to manufacturing issues on our U.S. government Howitzers culminating in higher material scrap and labor hours, combined with a reduction in total production volume in 2010 which further impacted production efficiencies across

all product lines. Optex Systems Holdings has requested an equitable adjustment (which is still pending as of August 19, 2011) on this program due to significant design issues impacting the manufacturability of the product. As there is no guarantee that the request will be granted in part or in full, we realized the entire loss in fiscal year 2010. However, we believe there is a reasonable possibility that we will be able to recover a substantial amount of the incurred loss in fiscal year 2011 pending the outcome of the negotiations.

Government Contracts:Virtually all of our contracts are prime or subcontracted directly with the Federal government and as such, are subject to Federal Acquisition Regulation Subpart 49.5, “Contract Termination Clauses” and more specifically Federal Acquisition Regulation clauses 52.249-2 “Termination for Convenience of the Government (Fixed-Price)”, and 49.504 “Termination of fixed-price contracts for default”.
Warranty Costs: Some of Optex Systems Holdings’ customers require that the company warrant the quality of its products to meet customer requirements and be free of defects for up to fifteen months subsequent to delivery. In the years ended October 3, 2010 and September 27, 2009, Optex Systems Holdings recognized income of $56,530, and $145,470, respectively, related to improvements in the warranty experience rate for warranties expiring in each of the respective years. Future warranty costs are based on the estimated cost of replacement for expected returns based upon our most recent experience rate of defects as a percentage of warranty covered sales.
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 is required to adopt these provisions at the beginning of the fiscal year ending October 3, 2010. Optex Systems Holdings does not expect adoption of FASB ASC 260-10-55 to 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 February 2010, FASB issued ASU 2010-09 “Subsequent Event (Topic 855) Amendments to Certain Recognition and Disclosure Requirements”. ASU 2010-09 removes the requirement for an SEC filer to disclose a date in both issued and revised financial statements. Revised financial statements include financial statements revised as a result of either correction of an error or retrospective application of GAAP. All of the amendments in ASU 2010-09 are effective upon issuance of the final ASU, except for the use of the issued date for conduit debt obligors, which is effective for interim or annual periods ending after June 15, 2010. The Company adopted ASU 2010-09 in February 2010 and therefore omitted the disclosure previously required as referenced above.

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. As such, Optex Systems Holdings is required to adopt these provisions at the beginning of the interim period ending October 3, 2010.

Adoption of FASB ASC 105-10 did not have a material effect on Optex Systems Holding’s financial statements.

In September 2006, the FASB issued FASB ASC 820-10 (Prior authoritative literature: FASB Statement 157, “Fair Value Measurements”). FASB ASC 820-10 defines fair value, establishes a framework for measuring fair value under GAAP and expands disclosures about fair value measurements. FASB ASC 820-10 applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, FASB ASC 820-10 does not require any new fair value measurements. However, for some entities, the application of FASB ASC 820-10 will change current practice. The changes to current practice resulting from the application of FASB ASC 820-10 relate to the definition of fair value, the methods used to measure fair value and the expanded disclosures about fair value measurements. The provisions of FASB ASC 820-10 are effective as of January 1, 2008, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. However, delayed application of this statement is permitted for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The adoption of FASB ASC 820-10 did not have a material impact on Optex Systems Holdings’ financial position, results of operations, or cash flows.

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. Optex Systems Holdings is currently evaluating the impact of adopting FASB ASC 805 and FASB ASC 810-10-65 on its financial statements.

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 October 3, 2010. 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. As such, Optex Systems Holdings is required to adopt these provisions at the beginning of the fiscal year ended September 30, 2011. Optex Systems Holdings is currently evaluating the impact of FASB ASC 944 on its financial statements but does not expect it to have a material effect.

As of July 3, 2011

This management's discussion and analysis reflects information known to management as at July 3, 2011 and through the date of this filing. This MD&A is intended to supplement and complement our audited financial statements and notes thereto for the fiscal year ended October 3, 2010 and the quarter ended July 3, 2011, prepared in accordance with U.S. generally accepted accounting principles (GAAP). You are encouraged to review our financial statements in conjunction with your review of this MD&A. The financial information in this MD&A has been prepared in accordance with GAAP, unless otherwise indicated. In addition, we use non-GAAP financial measures as supplemental indicators of our operating performance and financial position. We use these non-GAAP financial measures internally for comparing actual results from one period to another, as well as for planning purposes. We will also report non-GAAP financial results as supplemental information, as we believe their use provides more insight into our performance. When non-GAAP measures are used in this MD&A, they are clearly identified as non-GAAP measures and reconciled to the most closely corresponding GAAP measure.

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

Background

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

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

In accordance with FASB ASC 805 Optex Systems, Inc.’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. obtained the inputs and processes necessary for normal operations.

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

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Optex Systems, Inc. operated as a privately-held Delaware corporation until March 30, 2009, when, as a result of a reverse merger transaction consummated pursuant to a reorganization agreement dated March 30, 2009, it became a wholly-owned subsidiary of Optex Systems Holdings. Sileas is the majority owner (parent) of Optex Systems Holdings, owning approximately 73.5% of the issued and outstanding equity interests in Optex Systems Holdings. The financial statements of Optex Systems Holdings represent subsidiary statements and do not include the accounts of its majority owner.

Optex Systems Holdings' operations are based in Richardson, Texas in a leased facility comprising 49,100 square feet. As of July 3, 2011, Optex Systems Holdings operated with 79 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.

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

Results of Operations

During the second half of calendar 2010, we experienced reductions in forecasted sales volume due to changes in incremental funding commitments by federal agencies. Approval of the 2011 Congressional budget for the fiscal year beginning on October 1, 2010 and ending September 30, 2011, was obtained in mid-April, although current U.S. government spending continues to be based upon appropriations at 2010 levels. The fiscal year 2012 budget shows approximately a five percent proposed general decrease in defense spending. In light of the recently enacted federal legislation pertaining to the debt ceiling increase, deficit spending and further anticipated spending cuts, we believe that it is unlikely there will be any increase or rebound relating to the future appropriation levels of Abrams tanks, Bradley fighting vehicles and Stryker wheeled vehicles, as well as other significant armored tank programs. We will continue to evaluate the potential impact of changes in government defense spending to Optex Systems Holdings as the information becomes available, although based upon information currently available, we do not anticipate any material changes. Due to new periscope orders from non-traditional sources and the aggressive pursuit of increased market share for all of our existing product lines, we expect to mitigate some of the current decreased U.S. government requirements with other new business. We also continue to explore other opportunities for manufacturing outside of our traditional product lines for products which could be manufactured using our existing lines in order to fully utilize our existing capacity.

The table below summarizes our quarterly and year to date operating results in terms of both a GAAP net income measure and a non GAAP EBITDA measure. We use EBITDA as an additional measure for evaluating the performance of our business as "net income" historically included the significant impact of noncash intangible amortization on our income performance. Consequently, in order to have a meaningful measure of our operating performance on a continuing basis, we need to evaluate an income measure which does not take into account this

intangible amortization. We have summarized the quarterly revenue and margin below along with a reconciliation of the GAAP net loss to the non GAAP EBITDA calculation for comparative purposes below. We believe that including both measures allows the reader to have a "complete picture" of our overall performance.

	Three months ending January 2, 2011	Three months ending April 3, 2011	Three months ending July 3, 2011	Nine months ending July 3, 2011	Three months ending December 27, 2009	Three months ending March 28, 2010	Three months ending June 27, 2010	Nine months ending October 3, 2010
Net Loss Applicable to Common Shareholders - GAAP	$ (0.05)	$ (0.12)	$ (0.13)	$ (0.30)	$ -	$ (0.10)	$ (0.30)	$ (0.40)
Add:								-
Interest Expense	0.02	0.03	0.01	0.06	-	-	-	-
Preferred Stock Dividend	0.10	0.10	0.10	0.30	0.10	0.10	0.10	0.30
Federal Income Taxes (Benefit)	0.03	(0.01)	(0.02)	-	-	(0.10)	(0.20)	(0.30)
Depreciation & Amortization	0.02	0.02	0.01	0.05	0.30	0.30	0.30	0.90
EBITDA - Non GAAP	$ 0.12	$ 0.02	$ (0.03)	$ 0.11	$ 0.40	$ 0.20	$ (0.10)	$ 0.50

Our EBITDA declined from $0.5 million to $0.11 million, a decrease of $0.39 million, for the nine months ended July 3, 2011 as compared to the prior year performance for the same period. The EBITDA reduction for the period was primarily attributable to a 34.0% or $6.2 million reduction in revenue over the prior year. Optex was able to minimize the impact of lower revenues through cost improvements resulting in a 4.6% increase in the gross margin percentage, and a 20.6% reduction in general and administrative costs. We continue to pursue cost efficiencies in the production and general and administrative areas.

Product mix is dictated by customer contracted delivery dates and volume of each product to be delivered on such delivery dates. Shifts in gross margin from quarter to quarter are primarily attributable to the differing product mix recognized as revenues during each respective period. In fiscal year 2010, we completed existing contracts which were awarded in 2003 for legacy loss and low margin periscope orders. In the nine months ending July 3, 2011, our gross margins on the remaining periscopes business has increased 3.9% over the gross margins rates for these products in the same period of the prior year. We expect our gross margins on these types of periscopes to continue to improve as new orders are booked and additional cost reduction initiatives are implemented.

We are currently experiencing losses on all of our U.S government Howitzer programs awarded from in August 2005 through September 2010 as a result of unanticipated manufacturing costs due to design and technical data package issues impacting product manufacturability. We entered fiscal 2011 with a historically higher percentage of loss Howitzer contracts, to total shippable backlog and a reduced visibility into the anticipated orders in other product groups to be booked in the current year. Our current backlog on these loss programs as of July 3, 2011 is $2.9 million with contract loss reserves of $0.7 million. We completed contract deliveries on one of our major Howitzer programs in March 2011, with the remaining two contracts expected to complete by April 2012. We continue to pursue cost reductions in our production and general and administrative areas to mitigate any further margin impacts and to improve overall product profitability. Optex Systems Holdings has requested an equitable adjustment (which is still pending as of August 19, 2011) on one of the Howitzer loss programs due to significant design issues impacting the manufacturability of the product. We are currently in negotiations regarding the equitable adjustment and expect to have final resolution on the request within the next three months. As there is no guarantee that the request will be granted in whole or in part, Optex Systems Holdings recognized the entire estimated loss in fiscal year 2010. In the

event we are unsuccessful in obtaining an equitable adjustment, future margins on these revenues are expected to be zero as these losses have been previously recognized to the extent identified.

We are aggressively pursuing additional, potentially higher margin business in periscopes, sighting systems and Howitzer programs. In April 2011, Optex Systems hired a Vice President-Business Development with an effective start date of May 16, 2011. Responsibilities of the position include the pursuit of new business opportunities through product development and customer growth within the current and future defense programs. New orders booked in the nine months ending July 3, 2011 were $6.4 million consisting primarily of $5.1 million in foreign and domestic periscopes orders from several major defense contractors combined with foreign Howitzer unit orders of $0.3 million and other product group orders of $1.0 million.

As a result of the October 14, 2008 acquisition of the assets of Optex Systems, Inc. (Texas), Optex Systems, Inc.'s amortizable intangible assets increased significantly in 2009 over prior years. In fiscal year 2010, the amortization rate of intangible assets was $0.26 million per fiscal quarter. We reviewed the fair market value of our goodwill and intangible assets as of October 3, 2010 and based on significant reductions in anticipated government military spending, a reduction in customer order trends, and lower contract backlog, we determined that that goodwill was impaired. The review was based on a projected cash flow analysis of our future operations. As of the year ended October 3, 2010, after impairment, the total balance of unamortized intangible assets and goodwill was zero, and as such there was no intangible asset amortization expense during the nine months ending July 3, 2011.

As of July 3, 2011, backlog was $13.5 million as compared to a backlog of $18.1 million as of June 27, 2010. The following table depicts the current expected delivery by quarter of all contracts awarded as of July 3, 2011.

	2011	2012				2013			
Program Backlog (millions)	Qtr 4	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2	Qtr 3	Total
Howitzers	0.7	0.9	0.9	0.4	-	-	-	-	2.9
Periscopes	2.4	2.4	1.6	1.4	0.9	0.4	0.4	0.1	9.6
Sighting Systems	-	0.2	-	-	-	-	-	-	0.2
All Other	0.3	0.1	0.1	0.1	0.1	0.1	-	-	0.8
Total	3.4	3.6	2.6	19	1.0	0.5	0.4	0.1	13.5

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

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

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

In some cases, we may receive an “undefinitized” (i.e., price, specifications and terms are not agreed upon before performance commenced) contract award for contracts that exceed the $700,000, which is the federal government simplified acquisition threshold. These contracts are considered firm contracts at an undefinitized, but not to exceed specified limits threshold. Cost Accounting Standards Board covered contracts are subject to the Truth in Negotiations Act disclosure requirements and downward only price negotiation. As of July 3, 2011, none of our outstanding backlog fell under this criterion.

Three Months Ended July 3, 2011 Compared to the Three Months Ended June 27, 2010

Revenues. In the three months ended July 3, 2011, revenues decreased by 45.3% from the respective prior period in 2010 as set forth in the table below (dollar amounts in thousands):

	(Millions, except for percentages) Three Months ended		
Product Line	July 3, 2011	June 27, 2010	Percent Change
Howitzer Programs	$0.5	$1.7	$(1.2)
Periscope Programs	2.5	2.9	(0.4)
Sighting Systems	-	0.2	(0.2)
All Other	0.2	1.1	(0.9)
Total	$3.2	$5.9	$(2.7)
Percent increase (decrease)			(-45.8)%

Revenues decreased by $0.4 million, or 13.8%, on our periscope line during the three months ended July 3, 2011 as compared to the three months ended June 27, 2010. Based on our current backlog demand in the remaining quarters of fiscal 2011, we expect the periscope product line deliveries to increase by 12-15% in the last quarters of fiscal year 2011 as compared to revenues in the same quarter in 2010. We continue to quote and receive awards for additional periscopes from multiple customers and are aggressively pursuing increased market share in the periscope market by drawing business away from our competitors; however, we cannot yet determine if we will be successful in gaining sufficient new additional periscope business to offset the downturn caused by the decline in new federal government orders.

Revenues from the Howitzer programs decreased $1.2 million, or 70.6%, over the same three months in the prior year. In March 2011, we completed one of our major Howitzer programs. In addition, we have stopped production on another Howitzer program due a delay in receiving specialty glass material to be provided by our customer. We expect to resume production on this line by September 2011. In July 2011, we completed negotiations for a new contract delivery schedule with our U.S. government customer, which resulted in a shift of $2.2 million of deliverable Howitzer backlog from fiscal year 2011 to the first three fiscal quarters of 2012. The total impact of the contract modification resulted in an overall shift of 35.0% of Howitzer revenue between fiscal 2011 and 2012 periods.

Sighting systems revenues decreased $0.2 million, or 100%, over the same three months in the prior year, due to the completion of U.S. government orders for back up sighting systems and General Dynamics commander weapon sighting systems in fiscal year 2010. We currently do not have a follow-on delivery order for additional sighting units; however, the primary contract ordering period for the U.S. government sighting systems does not expire until December 31, 2012. We continue to ship small sighting systems orders pursuant to other contracts to both federal government and non-U.S. government customers and continue to pursue business on several substantial programs for commander weapon sighting systems and M36 thermal sighting units, which if successfully consummated, would result in fiscal year 2012 deliveries.

Decreases in the other product lines of $0.9 million, or 81.8%, for the three months ending July 3, 2011 are primarily a result of decreased sales of big eye binoculars, mirror assemblies and TVS4 and PVS Objective assembly sales to multiple customers for contracts completed fiscal year 2010.
In order to preserve product margins and mitigate the impact of the reduced revenues since fiscal 2010, we have implemented several reductions in force during the last 21 months since the beginning of fiscal year 2010, representing a total decline of approximately 26.2% of our total workforce.

Currently, we are experiencing losses on our U.S government Howitzer programs as a result of unanticipated manufacturing costs due to design and technical data package issues impacting the product manufacturability. These issues have resulted in increased labor and material costs due to higher scrap and extensive engineering costs incurred during the start up phase of the programs. As of July 3, 2011, Optex Systems Holdings had reserved $0.7 million in contract loss reserves on these programs with a remaining backlog of $2.9 million. We are expecting to ship $0.7 million of the existing loss contract backlog in fiscal year 2011, with the remaining $2.2 million expected to ship in the first three quarters of fiscal year 2012. Optex Systems Holdings has requested an equitable adjustment (which is still pending as of August 19, 2011) on one of the Howitzer loss programs due to significant design issues impacting the manufacturability of the product. We are currently in negotiations regarding the equitable adjustment and expect to have final resolution on the request within the next three months. As there is no guarantee that the request will be granted in part or in full, Optex Systems Holdings recognized the entire estimated loss in fiscal year 2010. In the event we are unsuccessful in obtaining an equitable adjustment, future margins on these revenues are expected to be zero as these losses have been previously recognized to the extent identified.

Cost of Goods Sold. During the three months ended July 3, 2011, we recorded cost of goods sold of $2.7 million as opposed to $5.5 million during the three months ended June 27, 2010, a decrease of $2.8 million or 50.9%. This decrease in cost of goods sold was primarily associated with decreased revenues from the comparable three month period in the prior year, in addition to decreased intangible amortization in the three months ended July 3, 2011 as compared to the three months ended June 27, 2010, due to the write off of intangible assets associated with the Optex Systems, Inc. (Texas) acquisition during the year ending October 3, 2010. The gross margin during the three months ended July 3, 2011 was $0.6 million or 18.8% of revenues as compared to a gross margin of $0.4 million or 6.8% for the three months ended June 27, 2010. The increase in gross margin percentage for the quarter as compared to the prior year is primarily due to the elimination in intangible amortization allocable to cost of goods sold of $0.2 combined with increased gross margins as a result of cost reductions implemented over the last twelve months.

G&A Expenses. During the three months ended July 3, 2011, we recorded operating expenses of $0.6 million as opposed to $0.8 million, during the three months ended June 27, 2010, a decrease of $0.2 million or 25.0%. Operating expenses decreased primarily due to the elimination of intangible amortization of $0.1 million attributable to the write-off of intangible assets in the last quarter of fiscal year 2010 combined with reduced spending in general insurance, legal expenses and investor relations over prior year levels., We expect our operating expenses to continue to decline throughout the fiscal year compared to the prior year, as a result of the elimination of intangible amortization expense combined with other cost reduction initiatives implemented in the last twelve months.

Operating Income (Loss). During the three months ended July 3, 2011, we recorded an operating loss of $0.04 million, as compared to an operating loss of $0.35 million during the three months ended June 27, 2010. Despite the reduction in revenues for the quarter, we have been able to improve on our prior year operating loss for the same period by $0.31 million due to improvements in gross margin and reduced general and administrative costs.

Net Income (Loss) applicable to common shareholders. During the three months ended July 3, 2011, we recorded a net loss applicable to common shareholders of $0.14 million, as compared to $0.31 million for the three months ended June 27, 2010, representing a decreased loss of $0.17 million. In the third three months of fiscal 2010 we recognized a tax benefit of $0.02 million as compared to $0.17 in the same period of fiscal year 2010. The change in taxes is primarily due to the effect of temporary and permanent timing differences related to intangible amortization and changes in reserve balances. Interest expense decreased by $0.17 million in the current year quarter as compared to the prior year quarter.

Nine months ended July 3, 2011 Compared to the nine months ended June 27, 2010

Revenues. In the nine months ended July 3, 2011, revenues decreased by 34.0% from the respective prior period in 2010:

	(Millions, except for percentages) Nine months ended		
Product Line	July 3, 2011	June 27, 2010	Percent Change
Howitzer Programs	$2.8	$4.3	$(1.5)
Periscope Programs	8.1	9.3	(1.2)
Sighting Systems	0.1	0.9	(0.8)
All Other	1.0	3.6	(2.6)
Total	$12.0	$18.1	$(6.1)
Percent increase (decrease)			(33.7)%

Revenues decreased by $1.2 million, or 12.9%, on our periscope line during the nine months ended July 3, 2011 as compared to the nine months ended June 27, 2010. Based on our current backlog demand deliverable in the remaining quarter of fiscal 2011, we expect the periscope product line deliveries to decline by 12-15% in the remaining quarters of fiscal year 2011 as compared to revenues in the same period in 2010. We continue to quote and receive awards for additional periscopes from multiple customers and are aggressively pursuing increased market share in the periscope market by drawing business away from our competitors; however, we cannot yet determine if we will be successful in gaining sufficient new additional periscope business to offset the downturn caused by the decline in new federal government orders.

Revenues from the Howitzer programs decreased by $1.5 million, or 34.9%, over the prior year period. In March 2011, we completed one of our major Howitzer programs. In addition, we have stopped production on another Howitzer program due a delay in receiving specialty glass material to be provided by our customer. We expect to resume production on this line by September 2011. In July 2011, we completed negotiations for a new contract delivery schedule with our U.S. government customer, which resulted in a shift of $2.2 million of deliverable Howitzer backlog from fiscal year 2011 to the first three fiscal quarters of 2012. The total impact of the contract modification resulted in an overall shift of 35.0% of Howitzer revenue between fiscal 2011 and 2012 periods.

Sighting systems revenues decreased $0.8 million, or 88.9%, over the same nine months in the prior year, due to the completion of orders for U.S. government back up sighting systems and General Dynamics commander weapon sighting systems in fiscal year 2010. We currently do not have a follow-on delivery order for additional sighting units; however, the primary contract ordering period for the U.S. government sighting systems does not expire until December 31, 2012. We continue to ship small sighting systems orders pursuant to other contracts to both federal government and non-U.S. government customers and continue to pursue business on several substantial programs for commander weapon sighting systems and M36 thermal sighting units, which if successfully consummated, would yield deliveries in fiscal year 2012.

Decreases in other product lines of $1.8 million, or 72.0%, for the nine months ending July 3, 2011 are primarily a result of decreased sales of big eye binoculars, mirror assemblies and TVS4 and PVS Objective assembly sales to multiple customers associated with contracts completed in fiscal year 2010.

In order to preserve product margins and mitigate the impact of the reduced revenues since fiscal 2010, we have implemented several reductions in force during the last 21 months since the beginning of fiscal year 2010, representing a total decline of approximately 26.2% of our total workforce.

Currently, we are experiencing losses on our U.S government Howitzer programs as a result of unanticipated manufacturing costs due to design and technical data package issues impacting the product manufacturability. These issues have resulted in increased labor and material costs due to higher scrap and extensive engineering costs incurred during the start up phase of the programs. As of July 3, 2011, Optex Systems Holdings has reserved $0.7 million in contract loss reserves on these programs with a remaining backlog of $2.9 million. We are expecting to ship $0.7 million of the existing loss contract backlog in fiscal year 2011, with the remaining $2.2 million expected to ship in the first three quarters of fiscal year 2012. Optex Systems Holdings has requested an equitable adjustment (which is still pending as of August 19, 2011) on one of the Howitzer loss programs due to significant design issues impacting the manufacturability of the product. We are currently in negotiations regarding the equitable adjustment and expect to have final resolution on the request within the next three months. As there is no guarantee that the request will be granted in part or in full, Optex Systems Holdings recognized the entire estimated loss in fiscal year 2010. In the event we are unsuccessful in obtaining an equitable adjustment, future margins on these revenues are expected to be zero as these losses have been previously recognized to the extent identified.

Cost of Goods Sold. During the nine months ended July 3, 2011, we recorded cost of goods sold of $10.2 million as opposed to $16.2 million during the nine months ended June 27, 2010, a decrease of $6.0 million or 37.0%. This decrease in cost of goods sold was primarily associated with decreased revenues from the comparable nine month period in the prior year, in addition to decreased intangible amortization in the first nine months of fiscal 2011 as compared to the first nine months of fiscal 2010 due to the write off of intangible assets associated with the Optex Systems, Inc. (Texas) acquisition as of the year ending October 3, 2010. The gross margin during the nine months ended July 3, 2011 was $1.8 million or 15.0% of revenues as compared to a gross margin of $1.9 million or 10.5% for the nine months ended June 27, 2010. The increase in gross margin percentage in the first three fiscal quarters of 2011 as compared to the prior year is primarily due to the elimination in intangible amortization allocable to cost of goods sold of $0.4 million combined with increased gross margins as a result of cost reductions implemented in the last twelve months.

G&A Expenses. During the nine months ended July 3, 2011, we recorded operating expenses of $1.7 million as opposed to $2.2 million, during the nine months ended June 27, 2010, a decrease of $0.5 million or 22.8%. Operating expenses decreased primarily due to the elimination of intangible amortization of $0.2 million attributable to the write off of intangible assets in the last quarter of fiscal year 2010 as well as several other cost reduction measures implemented in fiscal year 2011. We expect our operating expenses to continue to decline throughout the fiscal year, as compared to the prior year, due to the elimination of intangible amortization expense combined with other cost reduction initiatives implemented in the last twelve months.

Operating Income (Loss). During the nine months ended July 3, 2011, we recorded operating income of $0.06 million, as compared to an operating loss of $0.30 million during the nine months ended June 27, 2010. Our operating loss has decreased by $0.24 million or 80%, despite the reduction in revenues. The decreased operating loss is primarily due to the elimination of intangible amortization expense combined with cost reduction initiatives implemented in the last twelve months that mitigated the decline in revenue and helped to maintain our competitive position.

Net Income (Loss) applicable to common shareholders. During the nine months ended July 3, 2011, we recorded a net loss applicable to common shareholders of $0.3 million, as compared to $0.4 million for the nine months ended March 3, 2010, representing a decreased loss of $0.1 million. The decreased loss is primarily due to the decrease in operating loss, offset by the deferred tax benefit incurred in fiscal year 2010.

Liquidity and Capital Resources

On March 10, 2010, the Company entered into a revolving credit facility with Peninsula Bank Business Funding, a division of the Private Bank of the Peninsula, which provides up to $2.0 million in financing against eligible receivables. The revolving credit facility has allowed Optex the flexibility to more effectively manage the timing of incoming cash from our accounts receivable against our required cash outlay for operating activities. The material terms of the revolving credit facility are as follows:

- The interest rate for all advances shall be the greater of 8.5% and the then in effect prime rate plus 3.5% and subject to a minimum quarterly interest payment of $16 thousand.
- Interest shall be paid monthly in arrears.
- The expiration date of the facility was originally March 4, 2011 (since extended to March 15, 2012), at which time any outstanding advances, and accrued and unpaid interest thereon, will be due and payable.
- In connection with the entry into the facility by Peninsula Bank Business Funding, Optex Systems, Inc. paid Peninsula Bank Business Funding a facility fee of $20 thousand and issued a warrant to Peninsula Bank Business Funding to purchase 1,000,000 shares of its common stock. The warrant bears an exercise price of $0.10 per share and expires on March 3, 2016.
- The obligations of Optex Systems, Inc. to Peninsula Bank Business Funding are secured by a first lien on all of its assets (including intellectual property assets should it have any in the future) in favor of Peninsula Bank Business Funding.
- The facility contains affirmative and negative covenants that require Optex Systems, Inc. to maintain certain minimum cash and EBITDA levels on a quarterly basis and contains other customary covenants. The facility also contains customary events of default. Upon the occurrence of an event of default that remains uncured after any applicable cure period, Peninsula Bank Business Funding's commitment to make further advances may terminate, and Peninsula Bank Business Funding would also be entitled to pursue other remedies against Optex Systems, Inc.

and the pledged collateral.

- Pursuant to a guaranty executed by Optex Systems Holdings in favor of Peninsula Bank Business Funding, Optex Systems Holdings has guaranteed all obligations of Optex Systems, Inc. to Peninsula Bank Business Funding.

On August 3, 2010, Peninsula Bank Business Funding agreed to amend Sections 6.8(c) and (d) of the aforesaid agreement to adjust the minimum EBITDA covenant for the fiscal quarter ending October 2, 2010 to $20 thousand, and for the fiscal quarter ending July 3, 2011 to $200 thousand.

On November 23, 2010, Peninsula Bank Business Funding waived the Company's requirement to meet the EBITDA requirement set forth in Section 6.8 (c) of the August 3, 2010 amended Agreement for the fourth quarter ended October 3, 2010. In addition, on November 29, 2010 Peninsula Bank Business Funding agreed to a second amendment for Sections 6.8 (d) of the Agreement to adjust the minimum EBITDA covenant for the fiscal quarter ending July 3, 2011 to $95 thousand.

On March 22, 2011, Peninsula Bank Business Funding and Optex Systems, Inc. (the "Company"), the wholly-owned subsidiary of Optex Systems Holdings, Inc., entered into a fourth amendment (which superseded a third interim amendment) to the existing credit facility agreement between them to extend the maturity date to March 15, 2012. Section 1.1 was amended to: (i) define "Borrowing Base" as $175,000, (ii) delete the definition of "EBITDA", and (iii) amend subsection (i) of the definition of "Eligible Accounts" so as to exclude any accounts for any account debtor (other than GDLS) which exceed 30% of all accounts and for GDLS to exclude those total obligations that exceed the lesser of 50% of all accounts or the aggregate sum of $500,000. Section 2.3(a)(ii) was amended so that the minimum semiannual interest payment is $20,000, and Section 6.8 was amended in its entirety so as to require the Company to maintain a zero balance on the credit facility for a period of at least 30 consecutive days during the period from March 15, 2011 to March 15, 2012.

As of July 3, 2011, the outstanding balance on the line of credit was $400 thousand and on August 15, 2011, the latest practicable date, the balance was $0. The company intends to maintain the credit facility balance at zero during the period from August 4, 2011 through September 3, 2011 in satisfaction of the 30 consecutive days zero balance loan requirement included in section 6.8 of amendment 4 noted above.

We have historically met our liquidity requirements from a variety of sources, including government and customer funding through contract progress bills, short term loans, notes from related parties, and the sale of equity securities. Based upon our current working capital position and potential for expanded business revenues, we believe that our working capital is sufficient to fund our current operations for at least the next 12 months. However, based on our strategy and the anticipated growth in our business, we believe that our liquidity needs may increase in the future. The amount of such increase will depend on many factors, including the costs associated with the fulfillment of our projects, whether we upgrade our technology, and the amount of inventory required for our expanding business. If our liquidity needs do increase, we believe additional capital resources will be obtained from a variety of sources including, but not limited to, cash flow from operations and the issuance of our common stock and/or debt, including receivables funding through a commercial lender.

Our ability to utilize progress billing on government contract was temporarily on hold since March 2011 pending completion of a 2011 Defense Contract Audit Agency (DCAA) Progress Billing Audit and Accounting System Review. Progress billing audits and accounting system reviews are conducted periodically by the government to ensure the Company's systems meet the necessary requirements. The progress billing audit was successfully completed in July 2011 and based upon the audit results, the contracting officer approved a pending progress payment of $1.3 million related to incurred contract cost through April 2011 on one of our Howitzer programs. The progress bill payment was subsequently received by the Company on August 3, 2011. Pending final completion of the Accounting Systems Review expected in August, we anticipate the submission and approval of an additional progress bill against the program for approximately $0.3 million in the next 30-60 days.

Cash Flows for the Period from October 4, 2010 through July 3, 2011

Cash and Cash Equivalents. As of July 3, 2011, we had cash and cash equivalents of $0.7 million. During the period from October 4, 2010 through July 3, 2011, we decreased cash and cash equivalents by $0.3 million primarily attributable to payments made against the open line of credit.

Net Cash Provided by Operating Activities. Net cash provided by operating activities during the period from October 4, 2010 to July 3, 2011 totaled $0.4 million. The primary sources of cash during this period relate to collections of accounts receivable of approximately $0.5 million.

Net Cash (Used) by Investing Activities. In the nine months ended July 3, 2011, net cash used by investing activities totaled $0.03 million and consisted of fixed asset purchases during the period.

Net Cash (Used) by Financing Activities. Net cash used by financing activities totaled $0.7 million during the nine months ended July 3, 2011 due to the repayment of $0.7 million of the outstanding balance of the revolving credit facility since October 3, 2010.

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 of our assets or liabilities and financial results. These policies are described in “Critical Policies and Accounting Pronouncements” and Note 2 (Accounting Policies) to Financial Statements in our Annual Report on Form 10-K for the year ended October 3, 2010.

Recent Accounting Pronouncements

None.

Cautionary Factors That May Affect Future Results

This registration statement on Form S-1 contains so-called “forward-looking statements”. To the extent any statements made in this registration statement on Form S-1 contain information that is not historical these statements are essentially forward-looking. You can identify these forward-looking statements by their use of words such as “expects,” “plans,” “will,” “estimates,” “forecasts,” “projects” and other words of similar meaning. You can identify them by the fact that they do not relate strictly to historical or current facts. These statements are likely to address Optex Systems Holdings’ growth strategy, financial results and product and development programs. You must carefully consider any such statement and should understand that many factors could cause actual results to differ from Optex Systems Holdings’ forward-looking statements. These factors include inaccurate assumptions and a broad variety of other risks and uncertainties, including some that are known and some that are not. No forward-looking statement can be guaranteed and actual future results may vary materially.

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

BUSINESS

Background

Prior History - Sustut Exploration, Inc.

Sustut was a Delaware corporation formed on April 11, 2006 to search for available properties in North Central British Columbia. In May 2006, Sustut entered into an agreement, which was negotiated at arms-length with Richard

Simpson, to acquire a 100% interest in the WILLOW claim purported to be located in the Omineca Mining Division, NTS map sheet 94D/10E. The property could have been acquired from Simpson by paying a total of $75,000 in two option payments with the last option payment being due on May 15, 2008; however, Sustut did not make the required payments and did not acquire title to those property rights.

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

Reorganization

On March 30, 2009, a reorganization occurred whereby the then existing shareholders of Optex Systems, Inc., a private Delaware corporation ("Optex Systems, Inc. (Delaware)"), exchanged their shares of Optex Systems, Inc. (Delaware) common stock with the shares of common stock of Optex Systems Holdings as follows: (i) the outstanding 85,000,000 shares of Optex Systems, Inc. (Delaware) common stock were exchanged for 113,333,282 shares of Optex Systems Holdings common stock, (ii) the outstanding 1,027 shares of Optex Systems, Inc. (Delaware) Series A preferred stock were exchanged for 1,027 shares of Optex Systems Holdings Series A preferred stock and (iii) the 8,131,667 shares of Optex Systems, Inc. (Delaware) common stock purchased in the private placement were exchanged for 8,131,667 shares of Optex Systems Holdings common stock. Optex Systems, Inc. (Delaware) has remained a wholly-owned subsidiary of Optex Systems Holdings, and the Optex Systems, Inc. (Delaware) shareholders are now shareholders of Optex Systems Holdings. As a result of the reorganization, Sileas Corporation, a former shareholder of Optex Systems, Inc. (Delaware), beneficially owns approximately 73.52% of the issued and outstanding common stock of Optex Systems Holdings and Arland Holdings, Ltd., a former shareholder of Optex Systems, Inc. (Delaware) owns 5.89% of the issued and outstanding common stock of Optex Systems Holdings. Furthermore, at the time of the reorganization, Andrey Oks resigned as the sole officer and director of Optex Systems Holdings. Additionally, Stanley Hirschman, Ronald Richards and Merrick Okamoto were appointed as its directors, and Stanley Hirschman, Danny Schoening and Karen Hawkins were appointed as its President, COO and V.P. of Finance/Controller, respectively.

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

Contracts

Each contract with Optex Systems Holdings' customers has specific quantities of material that need to be purchased, assembled, and then shipped. Prior to bidding a contract, Optex Systems Holdings contacts potential sources of material and receives qualified quotations for this material. In some cases, the entire volume is given to a single supplier and in other cases, the volume might be split between several suppliers. If a contract has a single source supplier and that supplier fails to meet their obligations (e.g., quality, delivery), then Optex Systems Holdings would attempt to find an acceptable alternate supplier, and if successful, it would then renegotiate contractual deliverables (e.g., specifications, delivery, price). As of August 29, 2011, approximately 14% of our material requirements are single-sourced across 11 suppliers representing approximately 12% of our active supplier base. Single sourced component requirements span across all of our major product lines. Of these single sourced components, we have material contracts (purchase orders) with firm pricing and delivery schedules in place with each of the suppliers to supply the parts necessary to satisfy our current contractual needs.

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

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

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

First Article Testing and Acceptance requirements consist of specific steps. For example, the first article testing associated with Howitzer-type product is comprehensive and time consuming. The dimensions and material specifications of each piece of the assembly must be verified, and each product has in excess of 100 piece parts. Once the individual piece parts are verified to be compliant to the specification, the assembly processes are documented and verified. A sample of the production (typically three units) is verified to meet final performance specifications. Once the units meet the final performance specification, they are then subjected to accelerated life testing, a series of tests which simulate the lifetime use of the product in the field. This consists of exposing the units to thermal extremes, humidity, mechanical shock, vibration, and other physical exposure tests. Once completed, the units undergo a final verification process to ensure that no damage has occurred as a result of the testing and that they continue to meet the performance specification. All of the information and data is recorded into a final first article inspection and test report and submitted to the customer along with the test units for final approval. First Article Acceptance and Testing is

generally required on new contracts/product awards but may also be required on existing products or contracts where there has been a significant gap in production, or where the product has undergone significant manufacturing process, material, tooling, equipment or product configuration changes.

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

The aforementioned licenses are valid for 48 months from date that each such license is issued as set forth on the table below (updated as of August 19, 2011).

DSP-5 Licenses	Issue Date	Expiration Date (48 months from date of issue)
50137740	1/5/2009	1/4/2013
50146207	3/13/2009	3/12/2013
50137823	1/5/2009	1/4/2013
50128943	11/24/2008	11/23/2012
50169739	6/4/2009	6/3/2013
50185923	8/28/2009	8/27/2013
50187735	3/19/2010	3/18/2014
50230854	3/30/2010	3/29/2014
50220671	10/1/2009	9/30/2013
50233257	6/10/2010	6/9/2014
50221743	4/1/2010	3/31/2014
50209709	2/23/2010	2/22/2014
50302078	5/27/2011	5/26/2015
50187735	10/1/2009	9/30/2013
50269333	1/7/2011	1/6/2015
50274142	1/5/2011	1/4/2015
50184920	8/19/2009	8/18/2013
50275888	2/28/2011	2/27/2015
50284334	3/1/2011	2/28/2015
50290287	4/13/2011	4/12/2015
50290963	5/2/2011	5/1/2015

DSP-73 Licenses	Issue Date	Expiration Date (48 months from date of issue)
730024737	2/16/2010	2/15/2014
730007737	8/13/2008	8/12/2012
730008340	9/26/2008	9/25/2012
730008736	11/18/2008	11/17/2012
730010051	2/27/2009	2/26/2013
730026913	6/15/2010	6/15/2014

730030429	2/22/2011	2/21/2015

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

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

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

The material terms of our three material contracts are as follows (updated as of August 28, 2011):

Customer	Contract	Contract Quantities	Total Award	Progress Billable