

PRECISION OPTICS Corp INC
Form 10-Q
February 14, 2012

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

FORM 10-Q

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

For the quarterly period ended December 31, 2011

or

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

For the transition period from _____ to _____

Commission File Number: 001-10647

PRECISION OPTICS CORPORATION, INC.
(Exact name of registrant as specified in its charter)

Massachusetts
(State or other jurisdiction of incorporation or
organization)

04-2795294
(I.R.S. Employer Identification No.)

22 East Broadway, Gardner, Massachusetts 01440-3338
(Address of principal executive offices) (Zip Code)

(978) 630-1800
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

The number of shares outstanding of the issuer's common stock, par value \$0.01 per share, at February 14, 2012 was 1,245,339 shares.

PRECISION OPTICS CORPORATION, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

| | December 31, 2011 | June 30, 2011 |
|--|----------------------|---------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and Cash Equivalents | \$ 786,726 | \$ 19,556 |
| Accounts Receivable, net | 162,911 | 148,824 |
| Inventories, net | 622,397 | 666,285 |
| Prepaid Expenses | 48,224 | 37,664 |
| Total Current Assets | 1,620,258 | 872,329 |
| PROPERTY AND EQUIPMENT | | |
| Machinery and Equipment | 2,355,968 | 2,355,968 |
| Leasehold Improvements | 553,596 | 553,596 |
| Furniture and Fixtures | 148,303 | 148,303 |
| Vehicles | 19,674 | 19,674 |
| | 3,077,541 | 3,077,541 |
| Less: Accumulated Depreciation | (3,025,297) | (3,015,315) |
| Net Property and Equipment | 52,244 | 62,226 |
| OTHER ASSETS | | |
| Patents, net | - | 188,260 |
| TOTAL ASSETS | \$ 1,672,502 | \$ 1,122,815 |
| LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | | |
| CURRENT LIABILITIES | | |
| 10% Senior Secured Convertible Notes | \$ 67,569 | \$ 780,833 |
| Accounts Payable | 212,259 | 709,395 |
| Customer Advances | 28,579 | 36,292 |
| Accrued Employee Compensation | 156,533 | 711,015 |
| Accrued Professional Services | 11,083 | 54,000 |
| Accrued Warranty Expense | 25,000 | 25,000 |
| Other Accrued Liabilities | - | 912 |
| Total Current Liabilities | 501,023 | 2,317,447 |
| STOCKHOLDERS' EQUITY (DEFICIT) | | |
| Common Stock, \$0.01 par value - Authorized - 50,000,000 shares Issued and Outstanding -1,245,339 shares at December 31, 2011 and 971,013 shares at June 30, 2011 | 12,453 | 9,710 |
| Additional Paid-in Capital | 38,948,831 | 38,259,029 |
| Accumulated Deficit | (37,789,805) | (39,463,371) |
| Total Stockholders' Equity (Deficit) | 1,171,479 | (1,194,632) |

| | | |
|--|--------------|--------------|
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | \$ 1,672,502 | \$ 1,122,815 |
|--|--------------|--------------|

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

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND SIX MONTHS ENDED
DECEMBER 31, 2011 AND 2010
(UNAUDITED)

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|--|------------------------------------|--------------|----------------------------------|--------------|
| | 2011 | 2010 | 2011 | 2010 |
| Revenues | \$493,774 | \$435,770 | \$998,523 | \$1,119,672 |
| Cost of Goods Sold | 382,454 | 342,980 | 747,909 | 674,645 |
| Gross Profit | 111,320 | 92,790 | 250,614 | 445,027 |
| Research and Development Expenses, net | 149,044 | 246,093 | 300,234 | 473,587 |
| Selling, General and Administrative Expenses | 274,718 | 180,657 | 528,074 | 460,429 |
| Gain on Sale of Assets | (99) | (17,938) | (2,149) | (29,991) |
| Total Operating Expenses | 423,663 | 408,812 | 826,159 | 904,025 |
| Operating Loss | (312,343) | (316,022) | (575,545) | (458,998) |
| Gain on Sale of Patents | - | - | 2,276,286 | - |
| Interest Income | 176 | 72 | 533 | 202 |
| Interest Expense | (12,708) | (15,000) | (27,708) | (30,000) |
| Net Income (Loss) | \$(324,875) | \$(330,950) | \$1,673,566 | \$(488,796) |
| Income (Loss) Per Share: | | | | |
| Basic | \$(0.27) | \$(0.33) | \$1.55 | \$(0.48) |
| Diluted | \$(0.27) | \$(0.33) | \$1.47 | \$(0.48) |
| Weighted Average Common Shares Outstanding: | | | | |
| Basic | 1,191,138 | 1,017,896 | 1,081,075 | 1,018,153 |
| Diluted | 1,191,138 | 1,017,896 | 1,160,355 | 1,018,153 |

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

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED
DECEMBER 31, 2011 AND 2010
(UNAUDITED)

| | Six Months Ended December 31, | |
|--|----------------------------------|-------------------|
| | 2011 | 2010 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net Income (Loss) | \$1,673,566 | \$(488,796) |
| Adjustments to Reconcile Net Loss to Net Cash Used In Operating Activities - | | |
| Depreciation and Amortization | 13,081 | 29,394 |
| Gain on Sale of Patents | (2,276,286) | - |
| Gain on Sale of Assets | (2,149) | (29,991) |
| Stock-based Compensation Expense | 17,900 | 7,185 |
| Non-cash Interest Expense | 27,708 | 30,000 |
| Changes in Operating Assets and Liabilities - | | |
| Accounts Receivable, net | (14,087) | 234,255 |
| Inventories | 43,888 | 35,097 |
| Prepaid Expenses | (10,560) | (18,158) |
| Accounts Payable | (327,136) | 15,006 |
| Customer Advances | (7,713) | (65,076) |
| Accrued Expenses | (93,666) | (88,736) |
| Net Cash Used In Operating Activities | (955,454) | (339,820) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Net Proceeds from Sale of Patents | 2,463,171 | - |
| Proceeds from Sale of Assets | 2,149 | 29,991 |
| Additional Patent Costs | (1,724) | (6,149) |
| Net Cash Provided By Investing Activities | 2,463,596 | 23,842 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payment of principal and interest on 10% Senior Convertible Notes | (740,972) | - |
| Purchase of treasury stock (47,398 shares) | - | (474) |
| Net Cash Used In Financing Activities | (740,972) | (474) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 767,170 | (316,452) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 19,556 | 416,040 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$786,726 | \$99,588 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Cash Paid for Income Taxes | \$912 | \$912 |
| SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES: | | |
| Issuance of common stock to satisfy deferred compensation obligations (245,326 shares) | \$674,645 | \$- |

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

PRECISION OPTICS CORPORATION, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Operations

The accompanying consolidated financial statements include the accounts of Precision Optics Corporation, Inc. and its wholly-owned subsidiaries (the "Company"). All significant intercompany accounts and transactions have been eliminated in consolidation.

These consolidated financial statements have been prepared by the Company, without audit, and reflect normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the results of the second quarter of the Company's fiscal year 2012. These consolidated financial statements do not include all disclosures associated with annual consolidated financial statements and, accordingly, should be read in conjunction with footnotes contained in the Company's consolidated financial statements for the year ended June 30, 2011 together with the Report of Independent Registered Public Accounting Firm filed under cover of the Company's 2011 Annual Report on Form 10-K, filed with the Securities and Exchange Commission on September 28, 2011.

Use of Estimates

The preparation of these consolidated financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Income (Loss) Per Share

Basic income (loss) per share is computed by dividing net income or net loss by the weighted average number of shares of common stock outstanding during the period. Diluted income (loss) per share is computed by dividing net income or net loss (adjusted by adding back interest expense on senior convertible notes) by the weighted average number of shares of common stock outstanding during the period, plus the number of potentially dilutive securities outstanding during the period such as stock options and warrants and shares issuable upon conversion of senior convertible notes. For the three months ended December 31, 2011 and for the three and six months ended December 31, 2010, the effect of such securities was antidilutive and not included in the diluted calculation because of the net loss generated in those periods.

The following is the calculation of income (loss) per share for the three and six months ended December 31, 2011 and 2010:

| | Three Months Ended December 31 | | Six Months Ended December 31 | |
|--|-----------------------------------|--------------|---------------------------------|--------------|
| | 2011 | 2010 | 2011 | 2010 |
| Net Income (Loss) – Basic | \$ (324,875) | \$ (330,950) | \$ 1,673,566 | \$ (488,796) |
| Interest Expense on Senior Convertible Notes | - | - | 27,708 | - |
| Net Income (Loss) – Diluted | \$ (324,875) | \$ (330,950) | \$ 1,701,274 | \$ (488,796) |

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| | | | | |
|---|-----------|-----------|-----------|-----------|
| Basic Weighted Average Shares Outstanding | 1,191,138 | 1,017,896 | 1,081,075 | 1,018,153 |
| Potentially Dilutive Securities | - | - | 79,280 | - |
| Diluted Weighted Average Shares Outstanding | 1,191,138 | 1,017,896 | 1,160,355 | 1,018,153 |

Income (Loss) Per Share

| | | | | | | | | |
|---------|----|--------|----|--------|----|------|----|--------|
| Basic | \$ | (0.27) | \$ | (0.33) | \$ | 1.55 | \$ | (0.48) |
| Diluted | \$ | (0.27) | \$ | (0.33) | \$ | 1.47 | \$ | (0.48) |

The number of shares issuable upon the exercise of outstanding stock options and warrants that were excluded from the computation as their effect was antidilutive was approximately 1,050,000 and 1,112,000 for the three months ended December 31, 2011 and 2010, respectively, and approximately 1,012,000 and 1,112,000 for the six months ended December 31, 2011 and 2010, respectively.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

In assessing the likelihood of utilization of existing deferred tax assets, management has considered historical results of operations and the current operating environment. Based on this evaluation, a full valuation reserve has been provided for the deferred tax assets.

2. INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out) or market and consist of the following:

| | December 31, 2011 | June 30, 2011 |
|-------------------|----------------------|------------------|
| Raw Materials | \$ 246,427 | \$ 271,608 |
| Work-In-Progress | 294,282 | 312,097 |
| Finished Goods | 81,688 | 82,580 |
| Total Inventories | \$ 622,397 | \$ 666,285 |

3. 10% SENIOR SECURED CONVERTIBLE NOTES

On June 25, 2008, the Company entered into a Purchase Agreement, as amended on December 11, 2008, with institutional and other accredited investors (the "Investors") pursuant to which it sold a total of \$600,000 of 10% Senior Secured Convertible Notes (the "Notes") that are convertible at the Investor's option into a total of 480,000 shares of the Company's common stock at a conversion rate of \$1.25. The Company also issued warrants to purchase a total of 316,800 shares of its common stock at an exercise price of \$1.75 per share (the "Warrants"). Interest accrues on the Notes at a rate of 10% per year and is payable in cash upon the earlier of conversion or maturity of the Notes. The original maturity of the Notes was June 25, 2010 and the Warrants expire on June 25, 2015, subject to extension. By mutual agreement with the Company, the Investors amended the Notes on several dates to extend the "Stated Maturity Date" of the Notes. The conversion price of the Notes and the exercise price of the Warrants may be adjusted downward in the event the Company issues shares of common stock or securities convertible into common stock at a price lower than the conversion price of the Notes or exercise price of the Warrants at the time of issuance.

Pursuant to the Purchase Agreement, the Notes and Warrants were not convertible or exercisable until the Company implemented a 1 for 6 reverse stock split, which required the approval of its stockholders. On November 25, 2008, the Company entered into a Side Letter Agreement in which the Investors agreed to change the ratio of the reverse split from 1 for 6 to 1 for 25. On December 11, 2008, the Company effected a 1 for 25 reverse split of its common stock.

Pursuant to a Registration Rights Agreement entered into with the Investors on June 25, 2008, the Company agreed to file a registration statement with the Securities and Exchange Commission by the earlier of (i) two days following the effectiveness of the amendment to implement a reverse stock split, and (ii) December 15, 2008, to register the resale of the common stock issuable upon the conversion of the Notes and the exercise of the Warrants. The Company agreed to keep the registration statement effective until the earlier of (i) the date on which all the securities have been sold, and (ii) the date on which all the securities may be sold without restriction pursuant to Rule 144 of the Securities

Act of 1933.

The Notes contain covenants binding on the Company and certain events of default, including but not limited, to:

the failure of the Company to make a scheduled payment;

the failure of the Company to make payments in excess of \$100,000 on any liability or obligation, or if there is an acceleration of the stated maturity of any liability or obligation in excess of \$100,000; or

the Company entering bankruptcy.

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If an event of default occurs and is uncured within the allowable grace period, if any, the Investors may declare all amounts under the Notes immediately due and payable and may pursue any other available remedies.

On December 15, 2011, the Company repaid Special Situations Fund III QP, L.P. a principal repayment of \$275,000 and accrued interest of \$95,486, for a total payment of \$370,486. On December 15, 2011, the Company repaid Special Situations Private Equity Fund, L.P. a principal repayment of \$275,000 and accrued interest of \$95,486, for a total payment of \$370,486. The Notes held by Special Situations Fund III QP, L.P. and Special Situations Private Equity Fund, L.P. have been satisfied in full and the obligations thereunder have been terminated.

On January 31, 2012, one of the Investors, Arnold Schumsky, further amended his remaining Note to extend the “Stated Maturity Date” to March 31, 2012.

The 10% Senior Secured Convertible Notes consist of the following:

| | December 31, 2011 | June 30, 2011 |
|--|----------------------|------------------|
| 10% Senior Secured Convertible Notes issued on June 25, 2008, convertible into common stock at \$1.25 per share, bearing interest at 10% per annum. Outstanding principal and accrued interest are due at maturity, March 31, 2012 | \$ 50,000 | \$ 600,000 |
| Accrued interest—10% coupon | 17,569 | 180,833 |
| | \$ 67,569 | \$ 780,833 |

4. STOCK-BASED COMPENSATION

Stock-based compensation costs recognized during the quarters ended December 31, 2011 and 2010 amounted to \$13,400 and \$4,009, respectively, and the costs were included in the accompanying consolidated statements of operations in: selling, general and administrative expenses (2011 - \$12,500; 2010 - \$833), and cost of goods sold (2011 - \$900; 2010 - \$3,176). Stock-based compensation costs recognized during the six month periods ended December 31, 2011 and 2010 amounted to \$17,900 and \$7,185, respectively, and were included in the accompanying consolidated statements of operations in: selling, general and administrative expenses (2011 - \$12,500; 2010 - \$833), and cost of goods sold (2011 - \$5,400, 2010 - \$6,352). No compensation has been capitalized because such amounts would have been immaterial. No income tax provision was recorded in the second quarter or first six months of fiscal years 2012 or 2011 because of the availability of loss carryforwards to offset any anticipated taxable income in fiscal year 2012 and fiscal year 2011.

The following tables summarize stock option activity during the first six months of fiscal year 2012:

| | Number of Shares | Options Outstanding Weighted Average Exercise Price | Weighted Average Contractual Life |
|----------------------------------|---------------------|---|--------------------------------------|
| Outstanding at June 30, 2011 | 94,138 | \$ 15.97 | 4.50 years |
| Grants | 40,000 | 0.27 | |
| Cancellations | (271) | 13.75 | |
| Outstanding at December 31, 2011 | 133,867 | \$ 11.30 | 5.73 years |

As of December 31, 2011, the unrecognized compensation costs related to options vesting will be primarily recognized over a period of approximately 1.75 years.

Information related to the stock options outstanding as of December 31, 2011 is as follows:

| Range of Exercise Prices | Number of Shares | Weighted-Average Remaining Contractual Life (years) | Weighted-Average Exercise Price | Exercisable Number of Shares | Exercisable Weighted-Average Exercise Price |
|--------------------------------|---------------------|--|------------------------------------|------------------------------------|---|
| \$ 0.27 | 40,000 | 9.54 | \$ 0.27 | 13,334 | \$ 0.27 |
| \$ 1.35 | 1,200 | 7.90 | 1.35 | 1,200 | 1.35 |
| \$ 1.25 | 1,200 | 6.91 | 1.25 | 1,200 | 1.25 |
| \$ | | | | | |