PRECISION OPTICS CORPORATION INC
Form 10-Q
February 14, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2010

or

o 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	**04-2795294**

(State or other jurisdiction of incorporation or organization)	(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 x No o

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 o No o

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.

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

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

The number of shares outstanding of the issuer s common stock, par value $0.01 per share, at February 14, 2011 was 1,018,411 shares.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	December 31, 2010	June 30, 2010
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 99,588	$ 416,040
Accounts Receivable, net	270,945	505,200
Inventories, net	649,224	684,321
Prepaid Expenses	51,657	33,499
Total Current Assets	1,071,414	1,639,060
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	(3,004,453)	(2,991,441)
Net Property and Equipment	73,088	86,100
OTHER ASSETS		
Patents, net	193,306	203,539
TOTAL ASSETS	$ 1,337,808	$ 1,928,699
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
CURRENT LIABILITIES		
10% Senior Secured Convertible Notes	$ 750,833	$ 720,833
Accounts Payable	463,900	448,894
Customer Advances	35,992	101,068
Accrued Employee Compensation	673,846	730,241
Accrued Professional Services	34,571	66,000
Accrued Warranty Expense	25,000	25,000
Other Accrued Liabilities		912
Total Current Liabilities	1,984,142	2,092,948
STOCKHOLDERS EQUITY (DEFICIT)		
Common Stock, $0.01 par value -		
Authorized - 50,000,000 shares		
Issued 1,018,411 shares at December 31, 2010 and at June 30, 2010	10,184	10,184
Additional Paid-in Capital	38,243,510	38,236,325
Accumulated Deficit	(38,899,554)	(38,410,758)
	(645,860)	(164,249)
Treasury Stock, 47,398 shares, at cost	(474)	
Total Stockholders Equity (Deficit)	(646,334)	(164,249)

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)	$	1,337,808	$	1,928,699

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, 2010 AND 2009

(UNAUDITED)

	Three Months Ended December 31, 2010	Three Months Ended December 31, 2009	Six Months Ended December 31, 2010	Six Months Ended December 31, 2009
Revenues	$ 435,770	$ 686,036	$ 1,119,672	$ 1,309,420
Cost of Goods Sold	342,980	447,277	674,645	851,635
Gross Profit	92,790	238,759	445,027	457,785
Research and Development Expenses, net	246,093	180,016	473,587	194,663
Selling, General and Administrative Expenses	180,657	300,617	460,429	613,303
Gain on Sale of Assets	(17,938)	(2,483)	(29,991)	(3,353)
Total Operating Expenses	408,812	478,150	904,025	804,613
Operating Loss	(316,022)	(239,391)	(458,998)	(346,828)
Interest Income	72	168	202	330
Interest Expense	(15,000)	(64,875)	(30,000)	(129,750)
Net Loss	$ (330,950)	$ (304,098)	$ (488,796)	$ (476,248)
Loss Per Share - Basic and Diluted	$ (0.33)	$ (0.30)	$ (0.48)	$ (0.47)
Weighted Average Common Shares Outstanding - Basic and Diluted	1,017,896	1,018,411	1,018,153	1,018,411

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 30, 2010 AND 2009

(UNAUDITED)

	Six Months Ended December 30, 2010		Six Months Ended December 30, 2009	
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net Loss	$	(488,796)	$	(476,248)
Adjustments to Reconcile Net Loss to Net Cash				
Used In Operating Activities - Depreciation and Amortization		29,394		42,130
Gain on Sale of Assets		(29,991)		(3,353)
Stock-based Compensation and Consulting Expense		7,185		7,971
Non-cash Interest Expense		30,000		129,750
Changes in Operating Assets and Liabilities-				
Accounts Receivable, net		234,255		27,824
Inventories		35,097		(21,690)
Prepaid Expenses		(18,158)		(9,266)
Accounts Payable		15,006		(3,744)
Customer Advances		(65,076)		100,175
Accrued Expenses		(88,736)		56,673
Net Cash Used In Operating Activities		(339,820)		(149,778)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of Property and Equipment				(1,063)
Proceeds from Sale of Assets		29,991		3,353
Additional Patent Costs		(6,149)		(20,545)
Net Cash Provided By (Used In) Investing Activities		23,842		(18,255)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Purchase of treasury stock (47,398 shares)		(474)		
Net Cash Used In Financing Activities		(474)		
NET DECREASE IN CASH AND CASH EQUIVALENTS		(316,452)		(168,033)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		416,040		384,593
CASH AND CASH EQUIVALENTS, END OF PERIOD	$	99,588	$	216,560
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash Paid for-Income Taxes	$	912	$	912

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. All significant intercompany accounts and transactions have been eliminated in consolidation. All shares and per share data reflect the 1-for-25 reverse stock split that became effective on December 11, 2008.

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 2011. 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, 2010 together with the Report of Independent Registered Public Accounting Firm filed under cover of the Company s 2010 Annual Report on Form 10-K.

The Company has sustained recurring net losses and negative cash flows from operations for several years. During the quarter ended December 31, 2010, the Company incurred a net loss of $330,950 and used cash in operations of $181,439. As of December 31, 2010, cash and cash equivalents were $99,588, accounts receivable were $270,945 and current liabilities were $1,984,142. The Company and certain Officers and Directors have agreed that deferred officers salaries and director consulting expenses accrued at December 31, 2010 will be settled by issuing 245,326 shares of restricted common stock rather than by cash payments. These deferred amounts included in current liabilities at December 31, 2010 total $674,645. These factors raise substantial doubt about the Company s ability to continue as a going concern. The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. During the latter part of fiscal year 2008, the Company implemented plans to reduce costs and to streamline operations in an effort to reduce net losses. The Company believes that the recent introduction of several new products, along with new and on-going customer relationships, will generate additional revenues, which are required in order for the Company to achieve profitability. If these additional revenues are not achieved on a timely basis, the Company will be required and is prepared to implement further cost reduction measures, as necessary.

The Company has incurred quarter to quarter operating losses during its recent efforts to develop current products including endoscopes, image couplers, beamsplitters, night vision and micro-optic lenses, prisms and assemblies for various applications and utilizing a number of proprietary and patent-pending technologies including Lenslock endoscope and micro-precision lens technologies. Management expects that such operating losses will continue through fiscal year 2011, and until sales increase to breakeven and profitable levels. Management also believes that the opportunities represented by these products have the potential to generate sales increases to achieve breakeven and profitable results. The Company will continue its review of other expense areas to determine where additional reductions in discretionary spending can be achieved. There can be no assurance that the Company s operating plans will be successful, and if so required, that the Company will be successful in obtaining the capital necessary to continue ongoing operations.

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.

Loss Per Share

Basic loss per share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. For the three and six months ended December 31, 2010 and 2009, the effect of stock options and warrants was antidilutive; therefore, they were not included in the computation of diluted loss per share. The number of shares issuable upon the exercise of outstanding stock options and warrants that were excluded from the computation was 1,112,253 and 992,999 for the three and six months ended December 30, 2010 and 2009, 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, 2010		June 30, 2010
Raw Materials	$	313,964	$	335,093
Work-In-Progress		248,142		275,340
Finished Goods		87,118		73,888
Total Inventories	$	649,224	$	684,321

3. 10% SENIOR SECURED CONVERTIBLE NOTES

On June 25, 2008, the Company entered into a Purchase Agreement 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. On June 25, 2008, we entered into a Purchase Agreement, as amended on December 11, 2008, with certain accredited investors (the Investors) pursuant to which we sold an aggregate of $600,000 of 10% Senior Secured Convertible Notes (the Notes). The Investors amended the Notes on several dates to extend the Stated Maturity Date of the Notes. On February 7, 2011, the Investors further amended the Notes to extend the Stated Maturity Date to February 25, 2011. 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 covered by the registration statement, as amended from time to time, have been sold and (ii) the date on which all the securities covered by such registration statement 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.

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.

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

		December 31, 2010		June 30, 2010
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	$	600,000	$	600,000
Accrued interest 10% coupon		150,833		120,833
	$	750,833	$	720,833

4. STOCK-BASED COMPENSATION

Stock-based compensation costs recognized during the three and six month periods ended December 31, 2010 amounted to $3,176 and $6,352, respectively, and for the three and six month periods ended December 31, 2009 amounted to $ 4,795 and $7,971, respectively, and were included in the accompanying consolidated statements of operations. No compensation has been capitalized because such amounts would have been immaterial. There was no net income tax benefit recognized related to such compensation for the three and six month periods ended December 31, 2010 and 2009, as the Company is currently in a loss position.

As of December 31, 2010, the unrecognized compensation costs related to options vesting will be primarily recognized over a period of approximately six months:

OPTIONS		**2011**		**Total**
Compensation Expense	$	6,352	$	6,352

There was no stock option activity during the first six months of fiscal year 2011.

Information related to the stock options outstanding as of December 31, 2010 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**
$1.35	1,200	8.90	$	1.35		