PRECISION OPTICS CORPORATION, INC.
Form 10-Q
February 14, 2018

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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, 2017

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 x No o

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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, 2018 was 10,095,139 shares.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	December 31, 2017	June 30, 2017
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$381,752	$118,405
Accounts Receivable, net	753,152	468,548
Inventories, net	987,791	1,055,447
Prepaid Expenses	78,432	55,985
Total Current Assets	2,201,127	1,698,385
PROPERTY AND EQUIPMENT		
Machinery and Equipment	2,507,190	2,507,190
Leasehold Improvements	553,596	553,596
Furniture and Fixtures	148,303	148,303
	3,209,089	3,209,089
Less: Accumulated Depreciation and Amortization	(3,152,639)	(3,136,835)
Net Fixed Assets	56,450	72,254
Patents, net	47,275	30,086
TOTAL ASSETS	$2,304,852	$1,800,725
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current Portion of Capital Lease Obligation	$8,672	$8,391
Accounts Payable	699,507	694,958
Customer Advances	463,289	180,137
Accrued Employee Compensation	179,601	189,783
Accrued Professional Services	107,500	71,000
Accrued Warranty Expense	25,000	25,000

Other Accrued Liabilities	46,125	49,512
Total Current Liabilities	1,529,694	1,218,781
Capital Lease Obligation, net of current portion	19,156	23,564
STOCKHOLDERS' EQUITY		
Common Stock, $0.01 par value - Authorized - 50,000,000 shares; Issued and Outstanding – 10,095,139 shares at December 31, 2017 and 8,872,916 shares at June 30, 2017	100,952	88,729
Additional Paid-in Capital	45,414,893	45,140,383
Accumulated Deficit	(44,759,843)	(44,670,732)
Total Stockholders' Equity	756,002	558,380
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$2,304,852	$1,800,725

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

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE MONTHS ENDED

December 31, 2017 AND 2016

(UNAUDITED)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
Revenues	$812,773	$601,590	$1,841,519	$1,451,138
Cost of Goods Sold	512,551	453,183	1,154,555	1,135,680
Gross Profit	300,222	148,407	686,964	315,458
Research and Development Expenses, net	90,031	119,215	208,458	236,207
Selling, General and Administrative Expenses	270,035	342,487	566,619	686,269
Gain on Sale of Assets	–	(1,200)	–	(1,515)
Total Operating Expenses	360,066	460,502	775,077	920,961
Operating Loss	(59,844)	(312,095)	(88,113)	(605,503)
Interest Expense	(482)	–	(998)	–
Net Loss	(60,326)	(312,095)	(89,111)	(605,503)
Loss Per Share:				
Basic	$(0.01)	$(0.04)	$(0.01)	$(0.08)
Diluted	$(0.01)	$(0.04)	$(0.01)	$(0.08)
Weighted Average Common Shares Outstanding:				
Basic	9,979,197	8,104,800	9,543,810	7,822,191
Diluted	9,979,197	8,104,800	9,543,810	7,822,191

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

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PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED

December 31, 2017 AND 2016

(UNAUDITED)

	Six Months Ended December 31, 2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Loss	$(89,111)	$(605,503)
Adjustments to Reconcile Net Loss to Net Cash Provided From (Used In) Operating Activities -		
Depreciation and Amortization	15,804	16,019
Gain on Sale of Assets	–	(1,515)
Stock-based Compensation Expense	33,028	110,433
Non-cash Consulting Expense	(3,387)	17,400
Changes in Operating Assets and Liabilities -		
Accounts Receivable, net	(284,604)	308,293
Inventories, net	67,656	35,560
Prepaid Expenses	(22,447)	(5,915)
Accounts Payable	41,586	(168,433)
Customer Advances	283,152	37,100
Accrued Liabilities	26,318	(22,880)
Net Cash Provided From (Used In) Operating Activities	67,995	(279,441)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additional Patent Costs	(17,189)	(5,848)
Purchases of Property and Equipment	–	(25,843)
Proceeds from Sale of Assets	–	1,515
Net Cash Used In Investing Activities	(17,189)	(30,176)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of Capital Lease Obligation	(4,127)	(3,864)
Gross Proceeds from Private Placement of Common Stock	210,001	780,000
Gross Proceeds from Exercise of Stock Purchase Warrants	6,667	–
Net Cash Provided From Financing Activities	212,541	776,136
NET INCREASE IN CASH AND CASH EQUIVALENTS	263,347	466,519

CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	118,405	50,059
CASH AND CASH EQUIVALENTS, END OF PERIOD	$381,752	$516,578
SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING AND INVESTING ACTIVITIES:		
Issuance of Common Stock in Settlement of Accounts Payable	$40,000	$–
Offering Costs Included in Accounts Payable	$2,963	$–

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

PRECISION OPTICS CORPORATION, INC.

NOTES TO CONSOLIDATED INTERIM 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 and six months of the Company's fiscal year 2018. 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, 2017, together with the Report of Independent Registered Public Accounting Firm filed under cover of the Company's 2017 Annual Report on Form 10-K, filed with the Securities and Exchange Commission on September 28, 2017.

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 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. For the three and six months ended December 31, 2017 and 2016, the effect of such securities was antidilutive and not included in the diluted calculation because of the net loss generated in these periods.

The following is the calculation of loss per share for the three and six months ended December 31, 2017 and 2016:

	Three Months Ended December 31		Six Months Ended December 31	
	2017	2016	2017	2016
Net Income (Loss) - Basic and Diluted	$(60,326)	$(312,095)	$(89,111)	$(605,503)
Basic and Dilutive Weighted Average Shares Outstanding	9,979,197	8,104,800	9,543,810	7,822,191
Loss Per Share - Basic and Diluted	$(0.01)	$(0.04)	$(0.01)	$(0.08)

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 1,708,867 and 5,113,224 for the three months ended December 31, 2017 and 2016, respectively, and approximately 4,739,960 and 5,113,224 for the six months ended December 31, 2017 and 2016, 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.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-09, *Revenue from Contracts with Customers* which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU guidance requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. The guidance also requires expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required regarding customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. The standard will be effective for the Company for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The Company is reviewing the financial statement effect, if any, of implementing ASU No. 2014-09, that will go into effect on July 1, 2018.

2. INVENTORIES

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

	December 31, 2017	June 30, 2017
Raw Materials	$413,778	$501,346
Work-In-Progress	368,152	388,614
Finished Goods	205,861	165,487
Total Inventories	$987,791	$1,055,447

3. CAPITAL LEASE OBLIGATION

The Company entered into a five-year capital lease obligation in January 2016 for the acquisition of manufacturing equipment totaling $51,252. At December 31, 2017, future minimum lease payments under the capital lease obligation are as follows:

Fiscal Year Ending June 30:	Amount
2018	$5,979
2019	10,250
2020	10,250
2021	5,126
Total minimum payments	31,605
Less: amount representing interest	3,777
Present value of minimum lease payments	27,828
Less: current portion	8,672
	$19,156

4. STOCK-BASED COMPENSATION

The following table summarizes stock-based compensation expense for the three and six months ended December 31, 2017 and 2016:

	Three Months Ended December 31		Six Months Ended December 31	
	2017	2016	2017	2016
Cost of Goods Sold	$–	$8,669	$8,669	$17,338
Research and Development	320	6,692	7,012	16,009
Selling, General and Administrative	6,651	34,171	17,347	77,086
Stock Based Compensation Expense	$6,971	$49,532	$33,028	$110,433

No compensation has been capitalized because such amounts would have been immaterial.

The following tables summarize stock option activity for the six months ended December 31, 2017:

	Options Outstanding		
	Number of Shares	**Weighted Average Exercise Price**	**Weighted Average Contractual Life**
Outstanding at June 30, 2017	1,078,400	$0.78	7.01 years
Granted	25,000		
Expired or Cancelled	(61,200)		
Outstanding at December 31, 2017	1,042,200	$0.79	6.57 years

Information related to the stock options outstanding as of December 31, 2017 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	3.54	$ 0.27	40,000	$ 0.27
$0.40	15,000	9.33	$ 0.40	5,000	$ 0.40
$0.48	60,000	8.25	$ 0.48	40,000	$ 0.48
$0.50	80,000	8.47	$ 0.50	45,000	$ 0.50
$0.50	20,000	3.47	$ 0.50	20,000	$ 0.50
$0.55	29,500	4.11	$ 0.55	29,500	$ 0.55
$0.65	25,000	9.86	$ 0.65	0	$ 0.65
$0.73	514,500	7.38	$ 0.73	474,500	$ 0.73
$0.85	9,000	5.01	$ 0.85	9,000	$ 0.85
$0.90	9,000	6.01	$ 0.90	9,000	$ 0.90
$0.95	30,000	6.53	$ 0.95	30,000	$ 0.95
$1.20	207,800	4.17	$ 1.20	207,800	$ 1.20
$1.25	1,200	0.90	$ 1.25	1,200	$ 1.25
$1.35	1,200	1.90	$ 1.35	1,200	$ 1.35
$0.27–$1.35	1,042,200	6.57	$ 0.77	912,200	$ 0.79

The aggregate intrinsic value of the Company's "in-the-money" outstanding and exercisable options as of December 31, 2017 was $5,750 and $5,650, respectively.

5. WARRANTS

As of September 30, 2017, there were warrants outstanding for the issuance of an aggregate of 666,667 shares of common stock, $0.01 par value, at a purchase price of $0.01 per share. All warrants for 666,667 shares were exercised on or before October 16, 2017, by payment to the Company for the aggregate purchase price of $6,667. There are no warrants for the purchase of the Company's stock outstanding as of December 31, 2017.

6. SALE OF STOCK

On August 22, 2017, the Company entered into agreements with accredited investors for the sale and purchase of 466,668 unregistered shares of its common stock, $0.01 par value at a purchase price of $0.45 per share. The Company received $210,001 in gross proceeds from the offering. The Company is using the net proceeds from this placement for general working capital purposes.

Concurrently with the placement, the Company entered into an agreement with an investor for the sale of 88,888 unregistered shares of its common stock for services provided to the Company at a price of $0.45 per share.

In connection with the placement, the Company also entered into a registration rights agreement with the investors, whereby the Company was obligated to file a registration statement with the Securities Exchange Commission on or before 90 calendar days after August 22, 2017 to register the resale by the investors of 555,556 shares of our common stock purchased in the placement. The registration statement was filed with the Securities and Exchange Commission on November 20, 2017 and became effective on December 13, 2017.

7. INCOME TAXES

On December 22, 2017, the Tax Cuts and Jobs Act was signed into law. The Tax Cuts and Jobs Act will significantly change the taxation of U.S.-based multinational corporations, by, among other things, reducing the U.S. corporate income tax rate, adopting elements of a territorial tax system, affecting the deductibility of capital expenditures, assessing a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, continuing the moratorium on Medical Device Excise Tax, and the creation of new taxes on certain foreign-sourced earnings. The legislation is unclear in some respects and will require interpretations and implementing regulations by the Internal Revenue Service, as well as state tax authorities, and the legislation could be subject to potential amendments and technical corrections, any of which could lessen or increase certain adverse impacts of the legislation. The Company is in the process of determining what, if any, effect those provisions will have on its financial results.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and notes to those statements included elsewhere in this Quarterly Report on Form 10-Q for the quarter and six months ended December 31, 2017 and with our audited consolidated financial statements for the year ended June 30, 2017 included in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission on September 28, 2017.

This Quarterly Report on Form 10-Q contains forward-looking statements. When used in this report, the words "anticipate," "suggest," "estimate," "plan," "project," "continue," "ongoing," "potential," "expect," "predict," "believe," "intend," "may," "will," "should," "could," "would" and similar expressions are intended to identify forward-looking statements. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in the forward-looking statements for many reasons, including the risks described in this report, the risks described in our Annual Report on Form 10-K for the year ended June 30, 2017 and other reports we file with the Securities and Exchange Commission. Although we believe the expectations reflected in the forward-looking statements are reasonable, they relate only to events as of the date on which the statements are made. We do not intend to update any of the forward-looking statements after the date of this report to conform these statements to actual results or to changes in our expectations, except as required by law.

Overview

We have been developing and manufacturing advanced optical instruments since 1982. Today, the vast majority of our business is the design and manufacture of high-quality medical devices and less than 10% of our business is the design and manufacture of military and industrial products. Our medical instrumentation line includes traditional endoscopes and endocouplers as well as other custom imaging and illumination products for use in minimally invasive surgical procedures. Much of our recent development efforts have been targeted at the development of next generation endoscopes. Over the last ten years, we have funded internal research and development programs to develop next generation capabilities for designing and manufacturing 3D endoscopes and very small Microprecision™ lenses, anticipating future requirements as the surgical community continues to demand smaller and more enhanced imaging systems for minimally invasive surgery.

Our unique proprietary technology in the areas of micro optical lenses and prisms, micro medical fiber and CMOS based cameras, and custom design of medical grade instruments, combined with recent developments in the areas of 3D displays, has allowed us to begin commercialization of related product and service offerings to a widening group of customers addressing various medical device, defense and aerospace applications. Thus, a portion of our revenues are now derived from engineering and design services we performed for our customers to incorporate our technologies and capabilities into their medical device products. We believe that new products based on these technologies provide enhanced imaging for existing surgical procedures and can enable development of many new medical device products and related medical procedures.

We are registered to the ISO 9001:2008 and ISO 13485:2003 Quality Standards and comply with the FDA Good Manufacturing Practices and the European Union Medical Device Directive for CE marking of our medical products. Our internet website is www.poci.com. Information on our website is not intended to be integrated into this report.

The markets in which we do business are highly competitive and include both foreign and domestic competitors. Many of our competitors are larger and have substantially greater resources than we do. Furthermore, other domestic or foreign companies, some with greater financial resources than we have, may seek to produce products or services that compete with ours. We routinely outsource specialized production efforts as required to obtain the most cost effective production.

We believe that competition for sales of our medical products and services, which have been principally sold to original equipment manufacturers, or OEM, customers, is based on our ability to design and produce technical features, performance, engineering service and production scheduling, on-time delivery, quality control and product reliability, and competitive pricing.

We believe that our future success depends to a large degree on our ability to develop new optical products and services to enhance the performance characteristics and methods of manufacture of existing products. Accordingly, we expect to continue to seek and obtain product-related design and development contracts with customers and to selectively invest our own funds on research and development, particularly in the areas of Microprecision™ optics, micro medical cameras and 3D endoscopes.

For the six months ended December 31, 2017, approximately 75% of our sales were made to seven customers. Of these, four were medium to large, international, medical device companies and one was a large defense contractor. Each of these customers has been our customer for numerous years. The other two customers were early-stage companies developing endoscopic products that incorporate our unique design capabilities. Sales to these seven customers included both products we developed over five years ago and products we are currently developing which rely heavily on our unique, proprietary Microprecision™ lens technology and optical visualization system expertise.

Current sales and marketing activities are intended to broaden awareness of the benefits of our new technology platforms, which we believe are ready for general application to medical device projects requiring surgery-grade visualization from sub-millimeter sized devices and 3D endoscopy. We market directly to established medical device companies primarily in the United States that we believe could benefit from our advanced endoscopy visualization systems. Through this direct marketing, referrals, attendance at trade shows including Medical Design and Manufacturing West and MD&M East, and periodically a presence in online professional association websites, we have expanded our on-going pipeline of projects to significant medical device companies as well as well-funded emerging technology companies. We expect our customer pipeline to continue to expand as development projects transition to production orders and new customer projects enter the development phase.

General

This management's discussion and analysis of financial condition and results of operations is based upon our unaudited consolidated financial statements, which have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. We base our 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.

There have been no significant changes in our critical accounting policies as disclosed in the Notes to our Financial Statements contained in our Annual Report on Form 10-K for the year ended June 30, 2017 filed with the Securities and Exchange Commission on September 28, 2017.

Results of Operations

Our total revenues for the quarter ended December 31, 2017, were $812,773, as compared to $601,590 for the same period in the prior year, an increase of $211,183, or 35.1%. Revenues increased during the quarter ended December 31, 2017 compared to the same quarter of the prior year in the engineering services and production categories by 75% and 16%, respectively. The majority of our revenues are derived from engineering design and manufacturing services related to products marketed or under development by our OEM customers. Therefore, our revenues are subject to fluctuations on a product by product basis from period to period. The increase in production revenue during the quarter ended December 31, 2017 when compared to the same quarter of the prior year resulted primarily from an increase in sales of a traditional product to a long-standing customer. Engineering service revenue during the quarter ended December 31, 2017, when compared to the same quarter of the prior year included a similar number of projects, but increases in revenue from two specific customers, one of which is now transitioning from the engineering to production phase. We believe most engineering design projects have the potential to generate production revenues when our customers achieve commercialization of the products under design.

Our total revenues for the six months ended December 31, 2017 were $1,841,519, as compared to $1,451,138 for the same period in the prior year, an increase of $390,381, or 26.9%. The increase in revenues for the six month period ended December 31, 2017 compared to the same period of the prior year resulted from increases in engineering and production revenues of 41% and 18%, respectively. The engineering revenue increase during the quarter ended December 31, 2017 compared to the same period of the prior year resulted primarily from two large customer projects, one of which is now transitioning to production. These increases were partially offset by the previously mentioned loss of a customer's Microprecision™ technology product in fiscal 2017. Production revenues increased during the quarter ended December 31, 2017 compared to the same period of the prior year due to the addition of an optical component project and a cyclical increase in traditional laryngoscopes.

Gross profit for the quarter ended December 31, 2017 was $300,222, compared to $148,407 for the same period in the prior year, reflecting an increase of $151,815, or 102.3%. Gross profit for the quarter ended December 31, 2017 as a percentage of our revenues was 36.9%, an increase from the gross profit percentage of 24.7% for the same period in the prior year. Gross profit for the six months ended December 31, 2017 was $686,964, as compared to $315,458 for the same period in the prior year, which reflects an increase of $371,506 or 117.8%. Gross profit for the six months ended December 31, 2017 as a percentage of our revenues was 37.3%, an increase from the gross profit percentage of 21.7% for the same period in the prior year. Quarterly gross profit and gross profit percentage depend on a number of factors, including overall sales volume, facility utilization, product sales mix, and the costs of engineering services and initial production in connection with new products. The improvement in our gross profit performance during the quarter and six month periods ended December 31, 2017 resulted from increased revenues absorbing a higher percentage of fixed manufacturing costs, and lower fixed compensation expense during the quarter. Management expects compensation costs to increase since new hires for these or similar positions are planned. Additionally, targeted or better margins were realized on most engineering and production projects during the quarter ended December 31, 2017, including the larger revenue projects in each category, due to experienced related efficiencies in producing traditional products and engineering development activities associated with Microprecision™ technologies.

Research and development expenses were $90,031 for the quarter ended December 31, 2017, compared to $119,215 for the same period in the prior year, a decrease of $29,184, or 24.5%. Research and development expenses were $208,458 for the six months ended December 31, 2017, compared to $236,207 for the same period in the prior year, a decrease of $27,749, or 11.7%. The decrease in research and development expenses during the quarter and six months ended December 31, 2017, compared to the same periods of the prior year, resulted from a temporary reduction in engineering department staffing and a higher percentage of available engineering resources being consumed in revenue generating engagements with our customers for the development of their products. In-house research and development and certain internal functions not directly related to customer engagements are classified as research and development expenses.

Selling, general and administrative expenses were $270,035 for the quarter ended December 31, 2017, compared to $342,487 for the same period in the prior year, a decrease of $72,452, or 21.2%. Selling, general and administrative expenses were $566,619 for the six months ended December 31, 2017, compared to $686,269 for the same period in the prior year, a decrease of $119,650, or 17.4%.The decrease in the quarter and six months ended December 31, 2017, compared to the same periods in the prior year was primarily due to reduced stock based compensation expense relating to stock options and stock accrued for consulting services, plus reduced wages resulting from the retirement of a sales person in January 2017 and a temporarily vacated administrative position which has since been filled. The expense reductions were partially offset by a $25,000 increase in the reserve for doubtful accounts receivable relating to one specific customer and increased sales commissions for a lesser amount.

No income tax provision was recorded in the quarter and six month periods ended December, 2017 and 2016 because of the losses generated in those periods.

Liquidity and Capital Resources

We have sustained recurring net losses for several years. During the quarter and six month periods ended December 31, 2017, we incurred net losses of $60,326 and $89,111, respectively. We also incurred net losses of $1,006,457 and $1,034,765 during the fiscal years ended June 30, 2017 and 2016, respectively, and used cash in operating activities of $667,434 and $876,298 during the same fiscal periods, respectively. As of December 31, 2017, cash and cash equivalents were $381,752, accounts receivable were $753,152, and current liabilities were $1,529,694. Our working capital was $671,433 and $479,604 at December 31, 2017 and June 30, 2017, respectively.

We have traditionally funded working capital needs through product sales, management of working capital components of our business, and by cash received from public and private offerings of our common stock, warrants to purchase shares of our common stock or convertible notes. We have incurred quarter to quarter operating losses during our efforts to develop current products including Microprecision™ optical elements, micro medical camera assemblies and 3D endoscopes. Our management believes that the opportunities represented by these products have the potential to generate sales increases to achieve sustained breakeven and profitable results. However, our current financial condition may raise doubt regarding our ability to continue as a going concern, as referenced by the Report of our Independent Registered Public Accounting Firm on our financial statements for the year ended June 30, 2017, included in our Annual Report on Form 10-K.

We recognize that the working capital described above and our cash and accounts receivable as of December 31, 2017 is low considering the level of cash historically used in our operations at our current sales levels. Our accounts receivable and cash balances are subject to significant fluctuations based on the timing and amount of customer billings and accounts receivable collections as well as the terms of vendor payment obligations. If quarterly sales revenues do not increase and maintain near or above cash breakeven levels in the next six to nine months, we may be required to obtain cash for operations from non-working capital sources, which may not be available, in which case we would have to significantly decrease or cease operations.

The sale of additional equity or convertible debt securities would result in additional dilution to our stockholders, and debt financing, if available, may involve restrictive covenants that could restrict our operations or finances. Financing, if necessary, may not be available in amounts or on terms acceptable to us, if at all. If we cannot raise funds on acceptable terms or achieve positive cash flow, we may not be able to continue to conduct operations, develop new products, grow market share, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, any of which would negatively impact our business, operating results and financial condition.

Capital equipment and patent application related expenditures during the six months ended December 31, 2017 and 2016 were $17,189 and $31,691, respectively. Future capital equipment and patent application expenditures will be dependent upon future sales and success of on-going research and development efforts.

We have contractual cash commitments related to open purchase orders as of December 31, 2017 of approximately $338,000, including a $27,828 commitment remaining under a five-year capital lease obligation for the acquisition of equipment (see Note 3. Capital Lease Obligation). We have no other contractual cash commitments since leased facilities are currently on a month-to-month basis.

Off-Balance Sheet Arrangements

We currently have no off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

As a smaller reporting company, as defined by Rule 12b-2 of the Exchange Act and in Item 10(f)(1) of Regulation S-K, we are electing scaled disclosure reporting obligations and therefore are not required to provide the information requested by this Item.

Item 4. Controls and Procedures.

Management's Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer and our Chief Financial Officer evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures, including internal control over financial reporting, were not effective, as of December 31, 2017, to ensure the information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934, as amended (i) is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are intended to be designed to provide reasonable assurance that such information is accumulated and communicated to our management. Based on this evaluation, our management concluded that our internal control over financial reporting was not effective as of December 31, 2017.

The following is a description of two material weaknesses in our internal control over financial reporting:

Segregation of Duties: As previously disclosed in our Annual Reports on Form 10-K for the fiscal years ended June 30, 2008-2017, our management identified a control deficiency during the 2008 fiscal year because we lacked sufficient staff to segregate accounting duties. We believe the control deficiency resulted primarily because we have the equivalent of one and one-half persons performing all accounting-related on-site duties. As a result, we did not maintain adequate segregation of duties within our critical financial reporting applications, the related modules and financial reporting processes. This control deficiency could result in a misstatement of balance sheet and income statement accounts in our interim or annual consolidated financial statements that would not be detected. Accordingly, management has determined that this control deficiency constitutes a material weakness. During the period beginning with fiscal year 2008 through June 30, 2017, no audit adjustments resulting from this condition were required.

To address and remediate the material weakness in internal control over financial reporting described above, beginning with the quarter ended September 30, 2008, we instituted a procedure whereby our Chief Executive Officer, our Chief Financial Officer and other members of our Board of Directors perform a higher level review of the quarterly and annual reports on Form 10-Q and Form 10-K prior to filing.

We believe that the step outlined above strengthens our internal control over financial reporting and mitigates the material weakness described above. As part of our assessment of internal control over financial reporting for the fiscal year ended June 30, 2017, our management has evaluated this additional control and has determined that it is operating effectively.

Inventory Valuation: As previously disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2017, we reported a material weakness with respect to the valuation of our inventories. Specifically, the amounts used to value our inventory at June 30, 2009 with respect to overhead rates and purchased items were often inconsistent with the supporting documentation, due to year-to-year changes in overhead rates and costs of purchased items that were not properly reflected in inventory valuation. Accordingly, management had determined that this control deficiency constituted a material weakness as of June 30, 2009. Audit adjustments of approximately $58,000 and $41,000 to our audited financial statements as of June 30, 2011 and June 30, 2017, respectively, were necessary as a result of this condition.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the first quarter of our fiscal year covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

To address and remediate the material weakness in internal control over financial reporting described above, beginning in the quarter ended September 30, 2009 and continuing through the quarter ended December 31, 2017, we implemented processes to improve our inventory controls and documentation surrounding inventory valuation for overhead rates, and performed procedures to ensure that the pricing of inventory items was consistent with the supporting documentation. We believe that the step outlined above strengthens our internal control over financial reporting and mitigates the material weakness described above.

We intend to continue to remediate material weaknesses and enhance our internal controls but cannot guarantee that our efforts will result in remediation of our material weaknesses or that new issues will not be exposed in this process.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

Our Company, on occasion, may be involved in legal matters arising in the ordinary course of our business. While management believes that such matters are currently insignificant, matters arising in the ordinary course of business for which we are or could become involved in litigation may have a material adverse effect on our business, financial condition or results of operations. We are not aware of any pending or threatened litigation against us or our officers and directors in their capacity as such that could have a material impact on our operations or finances.

Item 1A. Risk Factors.

Other than as described below, there have been no material changes from the risk factors previously disclosed in our annual report on Form 10-K for the fiscal year ended June 30, 2017, as filed with the Securities and Exchange Commission on September 28, 2017; and our quarterly report for the quarter ended September 30, 2017, as filed with the Securities and Exchange Commission on November 14, 2017.

As of December 31, 2017, we may not have sufficient cash to continue operations for the next six to nine months.

As of December 31, 2017, we had $381,752 in cash and cash equivalents, $753,152 in accounts receivable, and $1,529,694 in current liabilities. We incurred net losses of $89,111 and $1,006,457 during the six months ended December 31, 2017 and the fiscal year ended June 30, 2017, respectively. If quarterly sales revenues do not increase and maintain near or above cash breakeven levels in the next six to nine months, we may be required to obtain cash for operations from non-working capital sources, which may not be available, in which case we would have to significantly decrease or cease operations. The sale of additional equity or convertible debt securities would result in additional dilution to our stockholders, and debt financing, if available, may involve restrictive covenants that could restrict our operations or finances. Financing, if necessary, may not be available in amounts or on terms acceptable to us, if at all. If we cannot raise funds on acceptable terms or achieve positive cash flow, we may not be able to continue to conduct operations, develop new products, grow market share, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, any of which would negatively impact our business, operating results and financial condition.

The newly enacted Tax Cuts and Jobs Act may affect our financial results, including our net deferred tax asset, and we are in the process of evaluating its effects.

On December 22, 2017, the Tax Cuts and Jobs Act was signed into law. The Tax Cuts and Jobs Act will significantly change the taxation of U.S.-based multinational corporations, by, among other things, reducing the U.S. corporate income tax rate, adopting elements of a territorial tax system, affecting the deductibility of capital expenditures, assessing a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, continuing the moratorium on Medical Device Excise Tax, and the creation of new taxes on certain foreign-sourced earnings. The legislation is unclear in some respects and will require interpretations and implementing regulations by the Internal Revenue Service, as well as state tax authorities, and the legislation could be subject to potential amendments and technical corrections, any of which could lessen or increase certain adverse impacts of the legislation. We are in the process of determining what, if any, effect those provisions will have on our financial results, and there can be no assurance of whether such additional effects will be positive or negative.

The Tax Cuts and Jobs Act also reduces the federal corporate income tax rate from 35% to 21% effective January 1, 2018, which we expect will positively impact our future effective tax rate and after-tax earnings in the United States. As a result of the reduction in the corporate income tax rate, we are required to revalue our net deferred tax asset to account for the future impact of lower corporate tax rates on this deferred amount and record any change in the value of such asset as a one-time non-cash charge on our income statement.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

We did not issue any unregistered equity securities during the quarter ended December 31, 2017.

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit	Description
2.1	Asset Purchase Agreement between the Company and Optometrics Corporation, dated January 18, 2008 (included as Exhibit 2.1 to the Form 8-K filed January 25, 2008 and incorporated herein by reference).
3.1	Articles of Organization of Precision Optics Corporation, Inc., as amended (included as Exhibit 3.1 to the Form SB-2 filed March 16, 2007, and incorporated herein by reference).
3.2	Bylaws of Precision Optics Corporation, Inc. (included as Exhibit 3.2 to the Form S-1 filed December 18, 2008, and incorporated herein by reference).
3.3	Articles of Amendment to the Articles of Organization of Precision Optics Corporation, Inc., dated November 25, 2008 and effective December 11, 2008 (included as Exhibit 3.1 to the Form 8-K filed December 11, 2008, and incorporated herein by reference).
3.4	Amended and Restated Bylaws of Precision Optics Corporation, Inc. (included as Exhibit 3.1 to the Current Report on Form 8-K filed July 11, 2014, and incorporated herein by reference).
10.1	Precision Optics Corporation, Inc. 2011 Equity Incentive Plan, dated October 13, 2011 (included as Exhibit 10.2 to Form S-8 filed October 14, 2011, and incorporated herein by reference.)
10.2	Precision Optics Corporation, Inc. Amended 2011 Equity Incentive Plan, dated October 14, 2011, as amended on April 16, 2015 (included as Exhibit 10.1 to the Company’s Registration Statement on Form S-8 filed April 20, 2015, and incorporated herein by reference).
10.3	Consulting Agreement with Donald A. Major dated June 15, 2016 (included as Exhibit 10.1 to the Company’s Current Report on Form 8-K filed on June 23, 2016, and incorporated herein by reference).
10.4	Form of Purchase Agreement, by and among Precision Optics Corporation, Inc. and several Investors, dated November 22, 2016 (included as Exhibit 10.1 to the Company’s Current Report on Form 8-K filed November 29, 2016, and incorporated herein by reference).
10.5	Form of Registration Rights Agreement, by and among Precision Optics Corporation, Inc. and several Investors, dated November 22, 2016 (included as Exhibit 10.2 to the Company’s Current Report on Form 8-K filed on November 29, 2016, and incorporated herein by reference).
10.6	Form of Purchase Agreement, by and among Precision Optics Corporation, Inc. and several Investors, dated August 22, 2017 (included as Exhibit 10.1 to the Company’s Current Report on Form 8-K filed on August 25, 2017, and incorporated herein by reference).
10.7	Form of Registration Rights Agreement, by and among Precision Optics Corporation, Inc. and several Investors, dated August 22, 2017 (included as Exhibit 10.2 to the Company’s Current Report on Form 8-K filed

	on August 25, 2017, and incorporated herein by reference).
14.1	Precision Optics Corporation, Inc. Corporate Code of Ethics and Conduct (included as Exhibit 14.1 to the Form 10-K filed September 28, 2008, and incorporated herein by reference).
31.1*	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Officers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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

*Filed herewith.

SIGNATURES

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

		PRECISION OPTICS CORPORATION, INC.
Date: February 14, 2018	By:	/s/ Joseph N. Forkey Joseph N. Forkey Chief Executive Officer (Principal Executive Officer)
Date: February 14, 2018	By:	/s/ Donald A. Major Donald A. Major Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)