

PRECISION OPTICS CORPORATION INC

Form S-1

December 18, 2008

[Table of Contents](#)

As filed with the Securities and Exchange Commission on December 18, 2008

Registration Statement No.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM S-1

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

PRECISION OPTICS CORPORATION, INC.

(Exact name of registrant as specified in its charter)

Massachusetts

(State or other jurisdiction of incorporation
or organization)

3845

(Primary Standard Industrial
Classification Code Number)

04-2795294

(I.R.S. Employer Identification Number)

Precision Optics Corporation, Inc.
22 East Broadway
Gardner, Massachusetts 01440
(978) 630-1800

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

Richard Forkey
Precision Optics Corporation, Inc.
22 East Broadway
Gardner, Massachusetts 01440
(978) 630-1800

(Name, address, including zip code, and telephone number,
including area code, of agent for service)

offices)

Copies of communications to:

Amy M. Trombly, Esq.

1320 Centre Street, Suite 202

Newton, MA 02459

Phone (617) 243-0060

Fax (617) 243-0066

Approximate date of proposed sale to the public: From time to time after this registration statement becomes effective.

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 smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Accelerated filer

Smaller reporting company

CALCULATION OF REGISTRATION FEE

Edgar Filing: PRECISION OPTICS CORPORATION INC - Form S-1

| Title of Each Class of Securities to be Registered | Amount to be Registered (1) | Proposed Maximum Offering Price Per Unit (2) | Proposed Maximum Aggregate Offering Price | Amount of Registration Fee |
|---|-----------------------------|--|---|----------------------------|
| Common Stock, par value \$0.01, to be sold by existing stockholders | 1,074,621 \$ | 0.25 \$ | 268,655.25 \$ | 10.56 |

(1) Pursuant to Rule 416(a) of the Securities Act of 1933, as amended, this registration statement shall be deemed to cover additional securities that may be offered or issued to prevent dilution resulting from stock splits, stock dividends or similar transactions.

(2) The price of \$0.25 per share, which was the average of the high and low prices of the registrant's common stock, as reported on the Over-the-Counter Bulletin Board on December 16, 2008, is set forth solely for purposes of calculating the registration fee pursuant to Rule 457(c) of the Securities Act of 1933, as amended.

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 of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

Table of Contents

The information in this 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 declared effective. This prospectus is not an offer to sell these securities, and we are not soliciting offers to buy these securities, in any state where the offer or sale is not permitted.

PROSPECTUS

PRECISION OPTICS CORPORATION, INC.

OFFERING UP TO 1,074,621 COMMON SHARES

This prospectus relates to the sale or other disposition of up to 1,074,621 shares of our common stock by selling stockholders. We are not selling any securities in this offering and therefore will not receive any proceeds from this offering. We may receive proceeds from the possible future exercise of warrants. All costs associated with this registration will be borne by us. Our common stock is traded on the Over-The-Counter Bulletin Board under the trading symbol PEYE.OB. On December 16, 2008, the last reported sale price of our common stock on the Over-The-Counter Bulletin Board was \$0.25 per share.

**THIS INVESTMENT INVOLVES A HIGH DEGREE OF RISK. YOU SHOULD PURCHASE
SECURITIES ONLY IF YOU CAN AFFORD A COMPLETE LOSS.**

SEE RISK FACTORS BEGINNING ON PAGE 2.

You should rely only on the information provided in this prospectus or any supplement to this prospectus and information incorporated by reference. We have not authorized anyone else to provide you with different information. Neither the delivery of this prospectus nor any distribution of the shares of common stock pursuant to this prospectus shall, under any circumstances, create any implication that there has been

Edgar Filing: PRECISION OPTICS CORPORATION INC - Form S-1

no change in our affairs since the date of this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

Subject to completion, the date of this prospectus is December 18, 2008.

Table of Contents

TABLE OF CONTENTS

| | Page |
|--|------|
| <u>Prospectus Summary</u> | 1 |
| <u>Risk Factors</u> | 2 |
| <u>Use of Proceeds</u> | 7 |
| <u>Selling Security Holders</u> | 7 |
| <u>Plan of Distribution</u> | 8 |
| <u>Description of Securities Being Registered</u> | 10 |
| <u>Interests of Named Experts and Counsel</u> | 10 |
| <u>Information About the Company</u> | 11 |
| <u>Description of Business</u> | 11 |
| <u>Description of Property</u> | 15 |
| <u>Legal Proceedings</u> | 15 |
| <u>Market Price of and Dividends on Common Equity and Related Stockholder Matters</u> | 16 |
| <u>Financial Statements</u> | 17 |
| <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 46 |
| <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u> | 53 |
| <u>Directors, Executive Officers, Promoters and Control Persons</u> | 53 |
| <u>Executive Compensation</u> | 54 |
| <u>Security Ownership of Certain Beneficial Owners and Management</u> | 58 |
| <u>Transactions with Related Persons, Promoters and Certain Control Persons, Director Independence</u> | 60 |
| <u>Disclosure of Commission Position on Indemnification for Securities Act Liabilities</u> | 60 |

Table of Contents

PRECISION OPTICS CORPORATION, INC.

PROSPECTUS SUMMARY

The following information is a summary of the prospectus and it does not contain all of the information you should consider before making an investment decision. You should read the entire prospectus carefully, including the financial statements and the notes relating to the financial statements.

ABOUT US

We incorporated in Massachusetts in December 1982 and have been publicly-owned since November 1990. References to our Company contained in this prospectus include our two wholly-owned subsidiaries, Precise Medical, Inc. and Wood's Precision Optics Corporation, Limited, except where the context otherwise requires. Our fiscal year end is June 30. Our principal executive offices are located at 22 East Broadway, Gardner, Massachusetts 01440-3338. Our telephone number is (978) 630-1800. Our website is www.poci.com. Information contained on our website does not constitute part of this prospectus.

We have been a developer and manufacturer of advanced optical instruments since 1982. We design and produce high-quality medical instruments, optical thin film coatings, micro-optics with characteristic dimensions less than 1 millimeter, or mm, and other advanced optical systems. Our medical instrumentation line includes laparoscopes, arthroscopes and endocouplers and a line of world-class 3-D endoscopes for use in minimally invasive surgical procedures. We are registered to the ISO 9001:2000, ISO 13485:2003, and Canadian Medical Devices Conformity Assessment System, or CMDCAS, Quality Standards, and comply with the FDA Good Manufacturing Practices and the European Union Medical Device Directive for CE marking of our medical products.

THE OFFERING

| | |
|--|--|
| Common stock outstanding as of December 15, 2008 | 1,018,411 shares |
| Common stock to be registered | 1,074,621 shares includes 480,000 shares underlying convertible promissory notes, 96,000 shares underlying potential interest due on the notes and 498,621 shares underlying warrants. |
| Use of proceeds | We will not receive any proceeds from the sale or other disposition of common stock by the selling stockholders. We may receive proceeds from the exercise of warrants. We intend to use the proceeds from the exercise of warrants, if any, for working capital purposes. |
| Stock symbol | PEYE.OB |

THE TRANSACTION

On June 25, 2008, we entered into a Purchase Agreement with institutional and other accredited investors pursuant to which we sold a total of \$600,000 of 10% Senior Secured Convertible Notes, referred to as the Notes, that are convertible into a total of 480,000 shares of our common stock at a conversion rate of \$1.25. We also issued warrants to purchase a total of 316,800 shares of our common stock at an exercise price of \$1.75 per share, referred to as the Warrants. Interest accrues on the Notes at a rate of 10% per year and is payable upon the earlier of conversion or maturity of the Notes. Interest accrued under the Notes is also convertible into shares of our common stock at a conversion rate of \$1.25. The Notes mature on June 25, 2010 and the Warrants expire on June 25, 2015, subject to extension.

Pursuant to the Purchase Agreement, the Notes and Warrants were not convertible or exercisable until we implemented a 1 for 6 reverse stock split, which required the approval of our stockholders. On November 25, 2008, we 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, we effected a 1 for 25 reverse split of our common stock.

Table of Contents

Pursuant to a Registration Rights Agreement entered into with the investors on June 25, 2008, we 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, plus the common stock issuable for interest on the Notes.

USE OF PROCEEDS

We will not receive any proceeds from the sale or other disposition by selling stockholders of our common stock. We may receive proceeds from the exercise of warrants. We intend to use the proceeds from the exercise of warrants, if any, for working capital.

MARKET FOR THE SECURITIES

Our common stock is traded on the Over-The-Counter Bulletin Board, or OTCBB, under the symbol PEYE.OB.

RISK FACTORS

Risks Related to Our Business

An investment in our common stock involves a high degree of risk. You should carefully consider the following risk factors and other information included in this prospectus. If any of the following risks actually occur, our business, financial condition or results of operations could be materially and adversely affected and you may lose some or all of your investment.

Our independent auditors have issued a going concern opinion and, if we do not generate enough cash from operations to sustain our business, we may have to liquidate assets or curtail our operations.

The accompanying financial statements have been prepared assuming we will continue as a going concern. During the years ended June 30, 2008 and 2007, we incurred net losses of \$1,623,354 and \$2,889,829, respectively. Our auditors have issued a going concern qualification in their opinion related to our financial statements for the period ended June 30, 2008. This opinion is based on our history of operating losses, negative cash flows from operations, and our cash position as of June 30, 2008.

Conditions exist which raise substantial doubt about our ability to continue as a going concern. Our ability to continue as a going concern depends on our ability to generate sufficient cash flows to meet our obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitable operations. However, we may not be able to obtain additional financing or achieve profitable operations or sufficient cash flows in the future.

Our existing and future debt obligations could impair our liquidity and financial condition.

As of September 30, 2008, we had outstanding notes payable of \$600,000 and we may incur additional debt in the future to fund all or part of our capital requirements. Effective June 25, 2008, we completed a financing in which we issued 10% Senior Secured Convertible Notes and Warrants. Our outstanding debt and future debt obligations could impair our liquidity and could:

- make it more difficult for us to satisfy our other obligations;
- require us to dedicate a substantial portion of any cash flow we may generate to payments on our debt obligations, which would reduce the availability of our cash flow to fund working capital, capital expenditures and other corporate requirements;
- impede us from obtaining additional financing in the future for working capital, capital expenditures, acquisitions and general corporate purposes; and
- make us more vulnerable in the event of a downturn in our business prospects and limit our flexibility to plan for, or react to, changes in our industry.

Table of Contents

If we were to fail in the future to make any required payment under agreements governing indebtedness, or equity issues, or fail to comply with the financial and operating covenants contained in those agreements, we would be in default in regards to that financing transaction. A debt default could significantly diminish the market value and marketability of our common stock. Our lenders would have the ability to require that we immediately pay all outstanding indebtedness, and we might not have sufficient assets to satisfy their demands. In this event, we may be forced to seek protection under bankruptcy laws, which could harm our future operations and overall financial condition.

We rely on a small number of customers who may not consistently purchase our products in the future and if we lose any one of these customers, our revenues may decline.

In the fiscal year ended June 30, 2008, our three largest customers represented approximately 25%, 20% and 11%, respectively, of our total revenues. In the fiscal year ended June 30, 2007, our three largest customers represented approximately 27%, 22% and 10%, respectively, of our total revenues. No other customer accounted for more than 10% of our revenues during those periods. At June 30, 2008, receivables from our three largest customers were 27%, 25% and 17%, respectively, of the total accounts receivable.

In the future, a small number of customers may continue to represent a significant portion of our total revenues in any given period. These customers may not consistently purchase our products at a particular rate over any subsequent period. A loss of any of these customers could adversely affect our revenues.

We rely heavily upon the talents of our Chief Executive Officer and Chief Scientific Officer, the loss of whom could severely damage our business.

Our performance depends to a large extent on a small number of key scientific, technical, managerial and marketing personnel. In particular, we believe our success is highly dependent upon the services and reputation of our Chief Executive Officer, Mr. Richard E. Forkey. Loss of Mr. Forkey's services could severely damage our business.

Additionally, Dr. Joseph N. Forkey, our Executive Vice President and Chief Scientific Officer, provides highly valuable contributions to our capabilities in optical instrument development, in management of new technology and in potentially significant longer-term initiatives in biophysics and biomedical instrumentation. The loss of Dr. Forkey's management and scientific contributions could severely damage our business.

We must continue to be able to attract employees with the scientific and technical skills that our business requires and if we are unable to attract and retain such individuals, our business could be severely damaged.

Our ability to attract employees with a high degree of scientific and technical talent is crucial to the success of our business. There is intense competition for the services of such persons, and we cannot guarantee that we will be able to attract and retain individuals possessing the necessary qualifications. If we cannot attract such individuals, we may not be able to produce our products and our business could be damaged.

We are subject to a high degree of regulatory oversight and, if we do not continue to receive the necessary regulatory approvals, our revenues may decline.

The FDA has allowed us to market the medical products we currently sell in the United States. However, prior FDA approval may be required before we can market additional medical products that we may develop in the future. We may also seek to sell current or future medical products in a manner that requires us to obtain FDA permission to market such products. We may also require the regulatory approval or license of other federal, state or local agencies or comparable agencies in other countries.

We may not continue to receive the FDA's permission to market our current products or may not obtain the necessary regulatory permission, approvals or licenses for the marketing of any of our future products. Also, we

Table of Contents

cannot predict the impact on our business of FDA regulations or determinations arising from future legislation or administrative action. If we lose the FDA's permission to market our current products or we do not obtain regulatory permission to market our future products, our revenues may decline and our business may be harmed.

We face risks inherent in product development and production under fixed price purchase orders and these purchase orders may not be profitable over time.

A portion of our business has been devoted to research, development and production under fixed price purchase orders. For our purposes, a fixed price purchase order is any purchase order under which we will provide products or services for a fixed price over an extended period of time, usually six months or longer. Fixed price purchase orders represented approximately 25% to 50% of our total revenues during the last several years. We expect that revenues from fixed price purchase orders will continue to represent a significant portion of our total revenues in future fiscal years.

Because they involve performance over time, we cannot predict with certainty the expenses involved in meeting our obligations under fixed price purchase orders. Therefore, we can never be sure at the time we enter into any single fixed price purchase order that such purchase order will be profitable for us.

Third parties may infringe on our patents and as a result, we could incur significant expense in protecting our patents or not have sufficient resources to protect them.

We hold a number of patents that are important to our business. Although we are not currently aware of any past or present infringements of our patents, we plan to protect these patents from infringement and obtain additional patents whenever feasible. To this end, we have obtained confidentiality agreements from our employees and consultants and others who have access to the design of our products and other proprietary information. Protecting and obtaining patents, however, is both time consuming and expensive. We therefore may not have the resources necessary to assert all potential patent infringement claims or pursue all patents that might be available to us. If our competitors or other third parties infringe on our patents, our business may be harmed.

Third parties may claim that we have infringed on their patents and as a result, we could be prohibited from using all or part of any technology used in our products.

Should third parties claim a proprietary right to all or part of any technology that we use in our products, such a claim, regardless of its merit, could involve us in costly litigation. If successful, such a claim could also result in us being unable to freely use the technology that was the subject of the claim, or sell products embodying such technology. If we engage in litigation, our expenses may increase and our business may be harmed. If we are prohibited from using a particular technology in our products, our revenues may decline and our business may be harmed.

We depend on the availability of certain key supplies and services that are available from only a few sources and if we experience difficulty with a supplier, we may have difficulty finding alternative sources of supply.

We require certain key supplies for our products, particularly precision grade optical glass, that are available from only a few sources, each of which is located outside the United States. Also, outside vendors grind and polish certain of our lenses and other optical components, such as prisms and windows. Based upon our ordering experience to date, we believe the materials and services required for the production of our products are currently available in sufficient quantities. Our requirements are small relative to the total supply, and we are not currently encountering problems with availability. However, this does not mean that we will continue to have timely access to adequate supplies of essential materials and services in the future or that supplies of these materials and services will be available on satisfactory terms when the need arises. Our business could be severely damaged if we become unable to procure essential materials and services in adequate quantities and at acceptable prices.

From time to time, subcontractors may produce certain of our products for us, and our business is subject to the risk that these subcontractors fail to make timely delivery. Our products and services are also from time to time used as components of the products and services of other manufacturers. We are therefore subject to the risk that manufacturers that integrate our products or services into their own products or services are unable to acquire

Table of Contents

essential supplies and services from third parties in a timely fashion. If this occurs, we may not be able to deliver our products on a timely basis and our revenues may decline.

Our customers may claim that the products we sold them were defective and if our insurance is not sufficient to cover a claim, we would be liable for the excess.

Like any manufacturer, we are and always have been exposed to liability claims resulting from the use of our products. We maintain product liability insurance to cover us in the event of liability claims, and as of December 15, 2008, no such claims have been asserted or threatened against us. However, our insurance may not be sufficient to cover all possible future product liabilities.

We would be liable if our business operations harmed the environment and a failure to maintain compliance with environmental laws could severely damage our business.

Our operations are subject to a variety of federal, state and local laws and regulations relating to the protection of the environment. From time to time, we use hazardous materials in our operations. Although we believe that we are in compliance with all applicable environmental laws and regulations, our business could be severely damaged by any failure to maintain such compliance.

Our quarterly financial results vary quarter to quarter which may adversely affect our stock price. As a result, we cannot predict with a high degree of certainty our operating results in any particular fiscal quarter.

Our quarterly operating results may vary significantly depending upon factors such as:

- the timing of completion of significant orders;
- the timing and amount of our research and development expenditures;
- the costs of initial product production in connection with new products;
- the timing of new product introductions both by us and by our competitors;
- the timing and level of market acceptance of new products or enhanced versions of our existing products;
- our ability to retain existing customers and customers continued demand for our products and services;
- our customers inventory levels, and levels of demand for our customers products and services; and

- competitive pricing pressures.

We may not be able to grow or sustain revenues or achieve or maintain profitability on a quarterly or annual basis and levels of revenue and/or profitability may vary from one such period to another.

We have a number of large, well-financed competitors who have research and marketing capabilities that are superior to ours.

The industries in which we compete are highly competitive. Many of our existing and potential competitors have greater financial resources and manufacturing capabilities, more established and larger marketing and sales organizations and larger technical staffs than we have. Other companies, some with greater experience in the telecommunications, optics, semiconductor or medical products industries, are seeking to produce products and services that compete with our products and services.

Risks Related to Our Stock

Trading in our common stock is limited and the price of our common stock may be subject to substantial volatility.

Our common stock was delisted from the NASDAQ Capital Market at the opening of business on December 27, 2005, and is now traded on the Over-The-Counter Bulletin Board, or OTCBB, under the ticker symbol PEYE.OB, where we expect our common stock to remain for the near future. Broker-dealers often decline to trade in OTCBB

Table of Contents

stocks given the market for such securities is often limited, the stocks are more volatile and the risk to investors is greater. These factors may reduce the potential market for our common stock by reducing the number of potential investors. This may make it more difficult for investors in our common stock to sell shares to third parties or to otherwise dispose of their shares. This could cause our stock price to decline.

Additionally, the price of our common stock may be volatile as a result of a number of factors, including, but not limited to, the following:

- our ability to successfully conceive and to develop new products and services to enhance the performance characteristics and methods of manufacture of existing products;
- our ability to retain existing customers and customers' continued demand for our products and services;
- the timing of our research and development expenditures and of new product introductions;
- the timing and level of acceptance of new products or enhanced versions of our existing products; and
- price and volume fluctuations in the stock market at large which do not relate to our operating performance.

Penny stock rules may make buying or selling our securities difficult which may make our stock less liquid and make it harder for investors to buy and sell our securities.

Trading in our securities is subject to the SEC's penny stock rules and it is anticipated that trading in our securities will continue to be subject to the penny stock rules for the foreseeable future. The SEC has adopted regulations that generally define a penny stock to be any equity security that has a market price of less than \$5.00 per share, subject to certain exceptions. These rules require that any broker-dealer who recommends our securities to persons other than prior customers and accredited investors must, prior to the sale, make a special written suitability determination for the purchaser and receive the purchaser's written agreement to execute the transaction. Unless an exception is available, the regulations require the delivery, prior to any transaction involving a penny stock, of a disclosure schedule explaining the penny stock market and the risks associated with trading in the penny stock market. In addition, broker-dealers must disclose commissions payable to both the broker-dealer and the registered representative and current quotations for the securities they offer. The additional burdens imposed upon broker-dealers by these requirements may discourage broker-dealers from recommending transactions in our securities, which could severely limit the liquidity of our securities and consequently adversely affect the market price for our securities.

We are contractually obligated to issue shares in the future, diluting your interest in us.

As of December 15, 2008, there were approximately 93,178 shares of our common stock issuable upon exercise of stock options outstanding, at a weighted average exercise price of \$16.17 per share. An additional 135,898 shares of our common stock are reserved for issuance under our 2006 Equity Incentive Plan as of December 15, 2008. Also outstanding as of December 15, 2008 are warrants for the issuance of an additional 898,621 shares of our common stock, at a weighted average exercise price of \$4.18 per share. The foregoing information gives effect to a 1 for 25 reverse stock split effective December 11, 2008. Moreover, we expect to issue additional shares and options to purchase shares of our common stock to compensate employees, consultants and directors, and we may issue additional shares to raise capital. Any such issuances will have the effect of further diluting the interest of the holders of our securities.

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements that involve risks and uncertainties. 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 reasons described in our Risk Factor section. 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 prospectus to conform these statements to actual results or to changes in our expectations, except as required by law.

Table of Contents

USE OF PROCEEDS

This prospectus relates to shares of our common stock that may be offered and sold from time to time by certain selling stockholders. We will not receive proceeds from the sale or other disposition of shares of common stock being sold by our selling stockholders. However, we may receive proceeds from the exercise of warrants. We cannot predict when or if the warrants will be exercised. It is possible that the warrants may expire and may never be exercised. If we receive proceeds from the exercise of warrants, we intend to use the proceeds for working capital.

SELLING SECURITY HOLDERS

Based upon information available to us as of December 15, 2008, the following table sets forth the names of the selling stockholders, the number of shares owned, the number of shares registered by this Registration Statement and the number and percent of outstanding shares that the selling stockholders will own, assuming all of the shares are sold. The information provided in the table and discussions below has been obtained from the selling stockholders. The selling stockholders may have sold, transferred or otherwise disposed of, or may sell, transfer or otherwise dispose of, at any time or from time to time since the date on which it provided the information regarding the shares beneficially owned, all or a portion of the shares of common stock beneficially owned in transactions exempt from the registration requirements of the Securities Act of 1933. As used in this prospectus, selling stockholder includes donees, pledgees, transferees or other successors-in-interest selling shares received from the named selling stockholder as a gift, pledge, distribution or other transfer.

Beneficial ownership is determined in accordance with Rule 13d-3(d) promulgated by the Commission under the Securities Exchange Act of 1934. Unless otherwise noted, each person or group identified possesses sole voting and investment power with respect to the shares, subject to community property laws where applicable.

| Name of Selling Security Holder | Ownership Before Offering (1) | Number of Shares Offered | Number of Shares Owned After Offering (2) | Percentage Owned After Offering (3) |
|---|-------------------------------|--------------------------|---|-------------------------------------|
| Special Situations Fund III QP, L.P. (4)(5) | 816,260 | 481,928 | 334,332 | 29.2% |
| Special Situations Private Equity Fund, L.P. (4)(6) | 768,561 | 481,928 | 286,633 | 25.0% |
| Arnold Schumsky (7) | 140,339 | 85,310 | 55,029 | 5.3% |
| Joel Pitlor (8) | 188,737 | 18,182 | 170,555 | 16.1% |
| LaPlace Group LLC (9) | 39,273 | 7,273 | 32,000 | 3.1% |

* All information set forth herein gives effect to a 1 for 25 reverse stock split on December 11, 2008.

(1) Includes common stock beneficially owned, including shares being registered by this prospectus.

(2) These numbers assume the selling stockholders sell all of their shares being registered in this Registration Statement subsequent to the completion of the offering.

(3) Based on 1,018,411 shares outstanding as of December 15, 2008.

(4) MGP Advisors Limited, or MGP, is the general partner of the Special Situations Fund III, QP, L.P. AWM Investment Company, Inc., or AWM, is the general partner of MGP, the general partner of and investment adviser to

Table of Contents

the Special Situations Private Equity Fund, L.P. Austin W. Marx and David M. Greenhouse are the principal owners of MGP and AWM. Through their control of MGP and AWM, Messrs. Marx and Greenhouse share voting and dispositive control over the portfolio securities of each of the funds listed above.

(5) The shares being registered for Special Situations Fund III QP, L.P. are issuable upon exercise of Warrants and conversion of a 10% Senior Secured Convertible Note with a face value of \$275,000 issued in exchange for \$275,000, as part of a private placement that closed June 25, 2008. The Warrants are exercisable at \$1.75 per share to purchase 145,200 shares of our common stock and expire on June 25, 2015, subject to extension. The Note is convertible at a rate of \$1.25 into 220,000 shares of our common stock and matures on June 25, 2010. An additional 44,000 shares of our common stock are being registered in the event the holder elects to convert all accrued interest payable under the Note into common stock, however, only 10,633 of these shares may be acquired in the 60 days following December 15, 2008. Additionally, we are registering 72,728 of the 232,728 shares issuable upon conversion of a warrant with an exercise price of \$5.50 per share and expiration date of February 1, 2012. The number of shares issuable under the warrant increased as a result of anti-dilution provisions in the warrant being triggered on June 25, 2008.

(6) The shares being registered for Special Situations Private Equity Fund, L.P. are issuable upon exercise of Warrants and conversion of a 10% Senior Secured Convertible Note with a face value of \$275,000 issued in exchange for \$275,000, as part of a private placement that closed June 25, 2008. The Warrants are exercisable at \$1.75 per share to purchase 145,200 shares of our common stock and expire on June 25, 2015, subject to extension. The Note is convertible at a rate of \$1.25 into 220,000 shares of our common stock and matures on June 25, 2010. An additional 44,000 shares of our common stock are being registered in the event the holder elects to convert all accrued interest payable under the Note into common stock, however, only 10,633 of these shares may be acquired in the 60 days following December 15, 2008. Additionally, we are registering 72,728 of the 232,728 shares issuable upon conversion of a warrant with an exercise price of \$5.50 per share and expiration date of February 1, 2012. The number of shares issuable under the warrant increased as a result of anti-dilution provisions in the warrant being triggered on June 25, 2008.

(7) The shares being registered for Arnold Schumsky are issuable upon exercise of Warrants and conversion of a 10% Senior Secured Convertible Note with a face value of \$50,000, as part of a private placement that closed June 25, 2008. The Warrants are exercisable at \$1.75 per share to purchase 26,400 shares of our common stock and expire on June 25, 2015, subject to extension. The Note is convertible at a rate of \$1.25 into 40,000 shares of our common and matures on June 25, 2010. Up to 8,000 shares of our common stock are being registered in the event the holder elects to convert all accrued interest payable under the Note into common stock, however, only 1,933 of these shares may be acquired in the 60 days following December 15, 2008. Additionally, we are registering 10,910 of the 34,910 shares issuable upon conversion of a warrant with an exercise price of \$5.50 per share and expiration date of February 1, 2012. The number of shares issuable under the warrant increased as a result of anti-dilution provisions in the warrant being triggered on June 25, 2008.

(8) We are registering 18,182 of the 58,182 shares issuable upon conversion of a warrant with an exercise price of \$5.50 per share and expiration date of February 1, 2012. The number of shares issuable under the warrant increased as a result of anti-dilution provisions in the warrant being triggered on June 25, 2008. Mr. Pitlor is a director of our Company.

(9) Reuven Dessler, as managing member for LaPlace Group LLC, has voting and dispositive control over the shares. We are registering 7,273 of the 23,273 shares issuable upon conversion of a warrant with an exercise price of \$5.50 per share and expiration date of February 1, 2012. The number of shares issuable under the warrant increased as a result of anti-dilution provisions in the warrant being triggered on June 25, 2008.

PLAN OF DISTRIBUTION

The selling stockholders, which as used herein includes donees, pledgees, transferees or other successors-in-interest selling shares of common stock or interests in shares of common stock received after the date of this prospectus

Table of Contents

from a selling stockholder as a gift, pledge, partnership distribution or other transfer, may, from time to time, sell, transfer or otherwise dispose of any or all of their shares of common stock or interests in shares of common stock on any stock exchange, market or trading facility on which the shares are traded or in private transactions. These dispositions may be at fixed prices, at prevailing market prices at the time of sale, at prices related to the prevailing market price, at varying prices determined at the time of sale, or at negotiated prices.

The selling stockholders will act independently of us in making decisions with respect to the timing, manner and size of each sale. The selling stockholders may use any one or more of the following methods when disposing of shares or interests therein:

- ordinary brokerage transactions and transactions in which the broker-dealer solicits purchasers;
- block trades in which the broker-dealer will attempt to sell the shares as agent, but may position and resell a portion of the block as principal to facilitate the transaction;
- purchases by a broker-dealer as principal and resale by the broker-dealer for its account;
- an exchange distribution in accordance with the rules of the applicable exchange;
- privately negotiated transactions;
- short sales effected after the date the registration statement of which this prospectus is a part is declared effective by the SEC;
- through the writing or settlement of options or other hedging transactions, whether through an options exchange or otherwise;
- broker-dealers may agree with the selling stockholders to sell a specified number of such shares at a stipulated price per share;
- a combination of any such methods of sale; or
- any other method permitted by law.

The selling stockholders may, from time to time, pledge or grant a security interest in some or all of the shares of common stock owned by them and, if they default in the performance of their secured obligations, the pledgees or secured parties may offer and sell the shares of common stock, from time to time, under this prospectus, or under an amendment to this prospectus under Rule 424(b)(3) or other applicable provision of the Securities Act of 1933 amending the list of selling stockholders to include the pledgee, transferee or other successors in interest as selling stockholders under this prospectus. The selling stockholders also may transfer the shares of common stock in other circumstances, in which case the transferees, pledgees or other successors in interest will be the selling beneficial owners for purposes of this prospectus.

In connection with the sale of our common stock or interests therein, the selling stockholders may enter into hedging transactions with broker-dealers or other financial institutions, which may in turn engage in short sales of the common stock in the course of hedging the positions they assume. The selling stockholders may also sell shares of our common stock short and deliver these securities to close out their short

Edgar Filing: PRECISION OPTICS CORPORATION INC - Form S-1

positions, or loan or pledge the common stock to broker-dealers that in turn may sell these securities. The selling stockholders may also enter into option or other transactions with broker-dealers or other financial institutions or the creation of one or more derivative securities which require the delivery to such broker-dealer or other financial institution of shares offered by this prospectus, which shares such broker-dealer or other financial institution may resell pursuant to this prospectus (as supplemented or amended to reflect such transaction).

The aggregate proceeds to the selling stockholders from the sale of the common stock offered by them will be the purchase price of the common stock less discounts or commissions, if any. Each of the selling stockholders reserves the right to accept and, together with their agents from time to time, to reject, in whole or in part, any proposed purchase of common stock to be made directly or through agents. We will not receive any of the proceeds from this offering. Upon any exercise of the warrants by payment of cash, however, we will receive the exercise price of the warrants.

The selling stockholders also may resell all or a portion of the shares in open market transactions in reliance upon Rule 144 under the Securities Act, provided that they meet the criteria and conform to the requirements of that rule.

Table of Contents

The selling stockholders and any underwriters, broker-dealers or agents that participate in the sale of the common stock or interests therein may be underwriters within the meaning of Section 2(11) of the Securities Act. Any discounts, commissions, concessions or profit they earn on any resale of the shares may be underwriting discounts and commissions under the Securities Act. Selling stockholders who are underwriters within the meaning of Section 2(11) of the Securities Act will be subject to the prospectus delivery requirements of the Securities Act.

To the extent required, the shares of our common stock to be sold, the names of the selling stockholders, the respective purchase prices and public offering prices, the names of any agents, dealer or underwriter, any applicable commissions or discounts with respect to a particular offer will be set forth in an accompanying prospectus supplement or, if appropriate, a post-effective amendment to the registration statement that includes this prospectus.

In order to comply with the securities laws of some states, if applicable, the common stock may be sold in these jurisdictions only through registered or licensed brokers or dealers. In addition, in some states the common stock may not be sold unless it has been registered or qualified for sale or an exemption from registration or qualification requirements is available and is complied with.

We have advised the selling stockholders that the anti-manipulation rules of Regulation M under the Exchange Act may apply to sales of shares in the market and to the activities of the selling stockholders and their affiliates. In addition, to the extent applicable we will make copies of this prospectus (as it may be supplemented or amended from time to time) available to the selling stockholders for the purpose of satisfying the prospectus delivery requirements of the Securities Act. The selling stockholders may indemnify any broker-dealer that participates in transactions involving the sale of the shares against certain liabilities, including liabilities arising under the Securities Act.

We have agreed to indemnify the selling stockholders against liabilities, including liabilities under the Securities Act and state securities laws, relating to the registration of the shares offered by this prospectus.

We have agreed with the selling stockholders to keep the registration statement of which this prospectus constitutes a part effective until the earlier of (1) such time as all of the shares covered by this prospectus have been disposed of pursuant to and in accordance with the registration statement or (2) the date on which the shares may be sold without restriction pursuant to Rule 144 of the Securities Act.

DESCRIPTION OF SECURITIES TO BE REGISTERED

The following description of our capital stock and provisions of our Articles of Organization and By-laws, each as amended, is only a summary. You should also refer to our Articles of Organization, a copy of which is incorporated by reference as an exhibit to the registration statement of which this prospectus is a part, and our By-laws, a copy of which is incorporated by reference as an exhibit to the registration statement of which this prospectus is a part. Our authorized capital stock consists of 50,000,000 shares of common stock, par value \$0.01 per share.

Holders of our common stock are entitled to one vote for each share held on all matters submitted to a vote of our stockholders. Holders of our common stock have no rights under our Articles of Organization or our By-laws regarding dividends unless and until dividends are declared by the board of directors, nor do they have any rights under our Articles of Organization or our By-laws regarding preemption rights. The

outstanding shares of common stock are fully paid and non-assessable.

INTERESTS OF NAMED EXPERTS AND COUNSEL

No expert or counsel named in this prospectus as having prepared or certified any part of this prospectus or having given an opinion upon the validity of the securities being registered or upon other legal matters in connection with the registration or offering of the common stock was employed for such purpose on a contingency basis, or had, or is to receive, in connection with this offering, a substantial interest, direct or indirect, in us or any of our subsidiaries, nor was any such person connected with us or any of our subsidiaries as a promoter, managing or principal underwriter, voting trustee, director, officer, or employee.

Table of Contents

INFORMATION ABOUT THE COMPANY

DESCRIPTION OF BUSINESS

History

We incorporated in Massachusetts in December 1982 and have been publicly-owned since November 1990. References to our Company contained herein include our two wholly-owned subsidiaries, Precise Medical, Inc. and Wood's Precision Optics Corporation, Limited, except where the context otherwise requires.

Our Business

We have been a developer and manufacturer of advanced optical instruments since 1982. We design and produce high-quality medical instruments, optical thin film coatings, micro-optics with characteristic dimensions less than 1 millimeter, or mm, and other advanced optical systems. Our medical instrumentation line includes laparoscopes, arthroscopes and endocouplers and a line of world-class 3-D endoscopes for use in minimally invasive surgical procedures. We are registered to the ISO 9001:2000, ISO 13485:2003, and Canadian Medical Devices Conformity Assessment System, or CMDCAS, 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 website is www.poci.com. Information contained on our website does not constitute part of this prospectus.

Principal Products and Services and Methods of Distribution

Medical Products: Endoscopes and Image Couplers. We have manufactured, since 1982, medical products including endoscopes, as well as image couplers, beamsplitters and adapters, all of which are used as accessories to endoscopes. We have developed and sold endoscopes incorporating various optical technologies for use in a variety of minimally invasive surgical and diagnostic procedures. Our current line of specialized endoscopes include arthroscopes, which are used in joint surgery, laryngoscopes, which are used in the diagnosis of diseases of the larynx, laparoscopes, which are used in abdominal surgery, ENT scopes, which are used for ear, nose and throat procedures, and stereo endoscopes and cameras, which are used in cardiac and general surgery and enable surgeons to visualize the surgical field in 3-D imagery.

We produce autoclavable endoscopes for various applications, which are CE mark certified for European use, and have been designed and tested to withstand sterilization by autoclave which is sterilization in a superheated steam under pressure, as well as all other commonly used medical sterilization means. The major benefits of instruments that can be autoclaved include increased patient safety, quick turnaround, and elimination of hazardous sterilant and by-product materials, all of which provide increased value to the user compared to alternative sterilization methods.

Since 1985, we developed, manufactured and sold a proprietary product line of instrumentation to couple endoscopes to video cameras. Included in this product line are imaging couplers. For example, the Series 200 Parfocal Zoom Couplers and the Series 950 Universal Couplers, which physically connect the endoscope to a video camera system and transmit the image viewed through the scope to the video camera. Our Series 800 Beamsplitters perform the same function while preserving for the viewer an eye port for direct, simultaneous viewing through the endoscope. These devices are sold primarily to endoscope and video camera manufacturers and suppliers for resale under our customers' names. All of the image couplers and beamsplitters that we manufacture are approved for surgery-approved sterilization. We believe we are one of only a few manufacturers of autoclavable image couplers worldwide.

Medical Products: Next Generation Lenslock™ Endoscopes. We continue to develop and ship our next generation endoscopes that incorporate our leading proprietary Lenslock™ technology (patent pending). Since December 2005, we have shipped over 400 ENT endoscopes with diameter of 2.7 mm that incorporate Lenslock™ technology. We recently completed prototypes of our 4 mm Lenslock™ sinuscope, and 5 mm Lenslock™ laproscope, and are actively pursuing development of our new 4 mm Lenslock™ wide field arthroscope. We believe that Lenslock™ technology has advantages over competitive products due to ease of manufacture and repair, superior image quality, significant cost effectiveness and quality of repair and that further incorporating this into our endoscope product line could lead to increased sales of this product.

Table of Contents

Medical Products: Sub-millimeter Optics and Endoscopes. Utilizing recently developed proprietary techniques, including patent pending micro-precision TM lens fabrication technology, we design and manufacture ultra-small lenses, prisms and assemblies with sizes as small as 0.2 mm. Assemblies range in complexity from the combination of two lens elements to entire imaging systems utilizing multiple micro-optical elements in combination with larger, conventional optics. Developments in medical procedures requiring minimally invasive visualization in very small spaces, in such specialties as spinal surgery, neurosurgery, cardiothoracic surgery, cardiology and pulmonology, have led to products requiring lenses and endoscopes as small as 0.2 millimeters in diameter. Utilizing our proprietary technology, we currently manufacture a number of products with length and/or diameter less than 1 mm and are actively expanding our product line in this area.

Medical Products: Custom Design and Device Production. We design prototypes and manufacture custom optical medical products to satisfy our customers' specific requirements. During fiscal year 2007, we completed development and began shipments of an advanced surgical visualization system to a significant new customer. We have received initial follow-on orders for delivery in fiscal year 2009. The size and extent of future follow-on orders will depend on market acceptance and other considerations.

Industrial Products. In addition to our medical products, we also sell components and assemblies such as image couplers and beamsplitters specially designed for industrial use, including the video-monitored examination of a variety of industrial cavities and interiors, as well as specialized borescopes for industrial applications. Utilizing micro-precision TM technology, we also design and manufacture sub-millimeter optical components and assemblies for industrial use.

Night Vision Optics. We continue to pursue a partnership effort for the proprietary development of a new class of color night vision devices including a new patent-pending eyepiece lens. With a second round of prototypes nearing completion, it is expected that the product incorporating our new night vision lenses will be evaluated by the U.S. government in the near future. We cannot control the timing of current evaluations and cannot therefore predict when, if ever, these night vision lenses might begin to generate revenue.

Optical System Design and Development Services. We are able to provide customers with advanced lens design, imaging analysis, optical system design, structural design and analysis, prototype production and evaluation, optics testing, and optical system assembly. Some of our efforts have led to optical system production business for our Company, and we believe our prototype development service may lead to new product production from time to time.

Competition and Markets

We sell our products in a highly competitive market and we compete for business with both foreign and domestic manufacturers. Many of our current competitors are larger and have substantially greater resources than we do. In addition, there is an ongoing risk that other domestic or

Edgar Filing: PRECISION OPTICS CORPORATION INC - Form S-1

foreign companies who do not currently service or manufacture products for our target markets, some with greater experience in the optics industry and greater financial resources than we have, may seek to produce products or services that compete directly with ours.

We believe that competition for sales of our medical products and services, which have been principally sold to medical device companies who incorporate our products into their systems, is based on performance and other technical features, as well as other factors, such as scheduling and reliability, in addition to competitive pricing. We market and sell our endoscopes to customers for incorporation into their own product lines and for resale under their own name. A number of domestic and foreign competitors also sell endoscopes to these customers and our share of the endoscope market is nominal. We believe that, while our resources are substantially more limited than those of our competitors, we can compete successfully in this market on the basis of product quality, price, delivery and innovation.

We currently sell our image couplers, beamsplitters and adapters to a market that consists of approximately 30 to 35 potential customers who manufacture and sell video cameras, endoscopes and video-endoscopy systems. In the past, we have been successful in marketing and selling our products to approximately two-thirds of these customers, and currently estimate that we maintain approximately 20% to 30% of the market share in these products. We plan to continue to focus our sales and marketing efforts in this area, and to work to increase our market share. However, a

Table of Contents

challenge we face is customers' own in-house capabilities to manufacture such products. We estimate that approximately 50% of the market demand for image couplers, beamsplitters and adapters is met by these captive facilities. In general, and despite in-house capacity, we believe that many customers continue to purchase products from us in order to devote their own technical resources to their primary products, such as cameras or endoscopes.

Marketing

In May 2006, we initiated efforts to update our sales and marketing activities. As part of these efforts, we generated new marketing materials for recently developed products, including a newly designed website, www.poci.com. Since initiating these efforts, we have taken a much more comprehensive view of trade show opportunities, targeting those with specific relevance to recently developed products. Coupled with the recently renewed efforts for select key trade show attendance by our Chief Scientific Officer as well as our overall sales and marketing staff, we believe we have a greater opportunity to reach and follow up a broader customer base than we have previously been able to achieve. These efforts have contributed to recent year-over-year revenue increases, and continue to generate prospects for our leading technologies including, Lenslock™, micro-precision™, and custom applications of our core optical capabilities. This includes renewed interest in some of our well-developed products such as our classic autoclavable endoscopes and endocouplers, as well as new applications with our micro (fiberoptic) endoscopes.

International Business

We have had negligible direct export sales to date. However, our medical products have received the CE Mark Certification, which permits sales into the European marketplace. We may establish or use production facilities overseas to produce key components for our business, such as lenses. Since the 1990s we have maintained a Hong Kong subsidiary to support business and quality control activities as required throughout Asia. We believe that the cost savings from such production may be essential to our ability to compete on a price basis in the medical products area particularly and to our profitability generally.

Research and Development

We believe that our future success depends to a large degree on our ability to continue to conceive and 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 to obtain product-related design and development contracts with customers and to invest our own funds on research and development. We spent \$757,852 and \$1,312,240 of our own funds, net of reimbursements, during fiscal years 2008 and 2007, respectively, on research and development.

We are currently incorporating our Lenslock™ technology (patent pending) into our line of endoscopes. This proprietary technology ensures lower cost, easier reparability and enhanced durability. We are also aggressively pursuing the design, development and manufacture of ultra-small instruments, some with lenses less than one millimeter in diameter, utilizing its micro-precision™ lens technology (patent pending).

Raw Materials and Principal Suppliers

The basic raw material of the majority of our product line is precision grade optical glass, which we obtain from a few suppliers, principally Schott and Ohara. For optical thin film coatings, the basic raw materials we utilize are metals and dielectric compounds, which we obtain from a variety of chemical suppliers. Certain of the thin film coatings utilized in our products are currently procured from an outside supplier, but most thin film coatings are produced in-house. We believe that our demand for these raw materials and thin film coating services is small relative to the total supply, and that the materials and services required for the production of our products are currently available in sufficient production quantities and will be available for fiscal year 2009. We believe, however, that there are relatively few suppliers of the high quality lenses and prisms, which our endoscopes require. In response, we have established our own optical shop for producing ultra-high quality prisms, micro-optics and other specialized optics for a variety of medical and industrial applications.

Table of Contents

Patents and Trademarks

We rely, in part, upon patents, trade secrets and proprietary knowledge as well as personnel policies and employee confidentiality agreements concerning inventions and other creative efforts to develop and to maintain our competitive position. We do not believe that our business is dependent upon any patent, patent pending or license, although we believe that trade secrets and confidential know-how may be important to our scientific and commercial success.

We plan to file for patents, copyrights and trademarks in the United States and in appropriate countries to protect our intellectual property rights to the extent practicable. We hold the rights to several United States and foreign patents and have several patent applications pending, including those for our new generation of 3-D endoscopes, our Lenslock™ endoscope technology and our innovative micro-precision™ lens technology. These patents have expiration dates ranging from June 2009 to June 2028. We are not aware of any infringements of our patents. We plan to protect our patents from infringement in each instance where we determine that doing so would be economical in light of the expense involved and the level and availability of our financial resources. While we believe that our pending applications relate to patentable devices or concepts, these patents may not be issued and we may not be able to successfully defend these patents or effectively limit the development of competitive products and services.

Employees

As of December 15, 2008, we had 19 full-time employees and 8 part-time employees. There were 15 employees in manufacturing, 6 in engineering/research and development, 1 in sales and marketing and 5 in finance and administration. We are not a party to any collective bargaining agreements. We believe our relations with our employees are good.

Customers

Revenues from our largest customers, as a percentage of total revenues, for fiscal years 2008 and 2007 were as follows:

| | 2008 | 2007 |
|------------|------|------|
| Customer A | 25% | 27% |
| Customer B | 20 | 22 |
| Customer C | 11 | 10 |
| All Others | 44 | 41 |
| | 100% | 100% |

No other customer accounted for more than 10% of our revenues in fiscal years 2008 and 2007. At June 30, 2008, receivables from our largest customers were 27%, 25% and 17% of the total accounts receivable.

Environmental Matters

Our operations are subject to a variety of federal, state and local laws and regulations relating to the discharge of materials into the environment or otherwise relative to the protection of the environment. From time to time we use a small amount of hazardous materials in our operations. We believe that we comply with all applicable environmental laws and regulations.

Government Regulations on the Business

Domestic Regulation. We currently develop, manufacture and sell several medical products, the marketing of which is subject to governmental regulation in the United States. Medical devices are regulated in the United States by the Food and Drug Administration, or FDA, and, in some cases, by certain state agencies. The FDA regulates the research, testing, manufacture, safety, effectiveness, labeling, promotion and distribution of medical devices in the United States. Generally, medical devices require clearance or approval prior to commercial distribution. Additionally, certain material changes to, and changes in intended use of, medical devices also are subject to FDA review and clearance or approval. Non-compliance with applicable requirements can result in failure of the FDA to

Table of Contents

grant pre-market clearance or approval, withdrawal or suspension of approval, suspension of production, or the imposition of various other penalties.

We notified the FDA of our intent to market our endoscopes, image couplers, beamsplitters, adapters and video ophthalmoscopes, and the FDA has determined that we may market such devices, subject to the general controls provisions of the Food, Drug and Cosmetic Act. We obtained this FDA permission without the need to undergo a lengthy and expensive approval process due to the FDA's determination that such devices meet the regulatory standard of being substantially equivalent to an existing approved device.

In the future, we plan to market additional endoscopes and related medical products that may require the FDA's permission to market such products. We may also develop additional products or seek to sell some of our current or future medical products in a manner that requires us to obtain the permission of the FDA to market such products, as well as the regulatory approval or license of other federal, state and local agencies or similar agencies in other countries. The FDA has authority to conduct detailed inspections of manufacturing plants in order to assure that good manufacturing practices are being followed in the manufacture of medical devices, to require periodic reporting of product defects to the FDA and to prohibit the sale of devices which do not comply with law.

Foreign Requirements. Sales of medical device products outside the United States are subject to foreign regulatory requirements that may vary from country to country. Our failure to comply with foreign regulatory requirements would jeopardize our ability to market our products in foreign jurisdictions. The regulatory environment in the European Union for medical device products differs from that in the United States. Medical devices sold in the European Economic Area must bear the CE mark. Devices are classified by manufacturers according to the risks they represent, with a classification of Class III representing the highest risk devices and Class I representing the lowest risk devices. Once a device has been classified, the manufacturer can follow one of a series of conformity assessment routes, typically through a registered quality system, and demonstrate compliance to a European Notified Body. The CE mark may then be applied to the device. Maintenance of the system is ensured through annual on-site audits by the notified body and a post-market surveillance system requiring the manufacturer to submit serious complaints to the appropriate governmental authority. All of our medical products are CE mark certified.

DESCRIPTION OF PROPERTY

We conduct our domestic operations at two facilities in Gardner, Massachusetts. The main Gardner facility is leased from a corporation owned by an individual who is one of our officers, and who serves on our board of directors. The lease terminated in December 1999 and we are currently a tenant-at-will. We rent the other Gardner facility on a month-to-month basis. We rent office space in Hong Kong for sales, marketing and supplier quality control and liaison activities of our Hong Kong subsidiary.

We believe these facilities are adequate for our current operations and adequately covered by insurance. Significant increases in production or the addition of significant equipment additions or manufacturing capabilities in connection with the production of our line of endoscopes, optical thin films and other products may, however, require the acquisition or lease of additional facilities. We may establish production facilities domestically or overseas to produce key assemblies or components, such as lenses, for our products. Overseas facilities may subject us to the political and economic risks associated with overseas operations. The loss of or inability to establish or maintain such additional domestic or

overseas facilities could materially adversely affect our competitive position and profitability.

LEGAL PROCEEDINGS

We may be involved from time to time in ordinary litigation, negotiation and settlement matters that will not have a material effect on our operations or finances. 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.

Table of Contents

MARKET PRICE OF AND DIVIDENDS ON COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

Our common stock is quoted on the Over-The-Counter Bulletin Board, or OTCBB, under the symbol PEYE.OB. The following table sets forth the high and low bid prices for our common stock for each quarter during the last two fiscal years and the subsequent interim period as quoted on the OTCBB. Such OTCBB market quotations reflect inter-dealer prices, without retail markup, markdown or commissions and may not necessarily represent actual transactions.

| | High | Low |
|---|----------|---------|
| <u>For the Fiscal Year Ended June 30, 2009</u> | | |
| First Quarter ended September 30, 2008 | \$ 3.25 | \$ 1.00 |
| <u>For the Fiscal Year Ended June 30, 2008</u> | | |
| First Quarter ended September 30, 2007 | \$ 10.00 | \$ 5.00 |
| Second Quarter ended December 31, 2007 | \$ 8.75 | \$ 3.00 |
| Third Quarter ended March 31, 2008 | \$ 6.00 | \$ 2.75 |
| Fourth Quarter ended June 30, 2008 | \$ 5.00 | \$ 2.50 |
| <u>For the Fiscal Year Ended June 30, 2007</u> | | |
| First Quarter ended September 30, 2006 | \$ 12.25 | \$ 6.25 |
| Second Quarter ended December 31, 2006 | \$ 12.25 | \$ 6.25 |
| Third Quarter ended March 31, 2007 | \$ 15.00 | \$ 8.00 |
| Fourth Quarter ended June 30, 2007 | \$ 12.50 | \$ 8.00 |

* Prices have been adjusted to reflect a 1 for 25 reverse stock split, effective December 11, 2008.

Holdings

As of December 9, 2008, we had approximately 81 holders of record of our common stock. Holders of record include nominees who may hold shares on behalf of multiple owners.

Dividends

We have not declared any dividends during the last two fiscal years and through the quarter ended September 30, 2008. At present, we intend to retain our earnings, if any, to finance research and development and expansion of our business.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information as of June 30, 2008, regarding our compensation plans (including individual compensation arrangements) under which our equity securities are authorized for issuance. Information set forth herein gives effect to a 1 for 25 reverse stock split on December 11, 2008.

Equity Compensation Plan Information

| Plan Category | Number of securities to be issued upon exercise of outstanding options, warrants and rights (a) | Weighted-average exercise price of outstanding options, warrants and rights (b) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c) |
|--|--|--|--|
| Equity compensation plans approved by security holders | 97,232 | \$ 15.75 | 137,098 |
| Equity compensation plans not approved by security holders | | | |
| Total | 97,232 | \$ 15.75 | 137,098 |

Table of Contents

FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of

Precision Optics Corporation, Inc.:

We have audited the accompanying consolidated balance sheets of Precision Optics Corporation, Inc. and subsidiaries (the Company) as of June 30, 2008 and the related consolidated statements of operations, stockholders' equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal controls over financial reporting. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Precision Optics Corporation, Inc. and subsidiaries as of June 30, 2008 and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has suffered recurring net losses and negative cash flows from operations, which raises substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are described in Note 1. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Stowe & Degon

Leominster, Massachusetts

September 23, 2008 except with respect to the stock split discussed in Note 9

as to which the date is December 15, 2008

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of

Precision Optics Corporation, Inc.:

We have audited the accompanying consolidated balance sheet of Precision Optics Corporation, Inc. and subsidiaries (the Company) as of June 30, 2007 and the related consolidated statements of operations, stockholders' equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal controls over financial reporting. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Precision Optics Corporation, Inc. and subsidiaries as of June 30, 2007 and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 of the notes to the consolidated financial statements, effective July 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has suffered recurring net losses and negative cash flows from operations, which raises substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are described in Note 1. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Vitale, Caturano & Company, Ltd.

VITALE, CATURANO & COMPANY, LTD.

Boston, Massachusetts

September 26, 2007 (except with respect
to the reverse stock split discussed in Note 9
as to which the date is December 15, 2008)

Table of Contents**PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES****Consolidated Balance Sheets at June 30, 2008 and 2007**

| | 2008 | 2007 |
|---|--------------|--------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 885,988 | \$ 840,179 |
| Accounts receivable (net of allowance for doubtful accounts of approximately \$7,400 and \$11,159 in 2008 and 2007, respectively) | 387,224 | 801,206 |
| Inventories | 608,431 | 904,736 |
| Prepaid expenses | 36,749 | 53,039 |
| Total current assets | 1,918,392 | 2,599,160 |
| Fixed Assets: | | |
| Machinery and equipment | 2,352,634 | 3,559,384 |
| Leasehold improvements | 553,596 | 553,596 |
| Furniture and fixtures | 149,738 | 150,603 |
| Vehicles | 42,343 | 42,343 |
| | 3,098,311 | 4,305,926 |
| Less Accumulated depreciation and amortization | 2,935,922 | 4,148,239 |
| Net fixed assets | 162,389 | 157,687 |
| Other Assets: | | |
| Cash surrender value of life insurance policies | 5,465 | 4,438 |
| Patents, net | 195,391 | 274,311 |
| Total other assets | 200,856 | 278,749 |
| | \$ 2,281,637 | \$ 3,035,597 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$ 364,409 | \$ 343,730 |
| Customer advances | 91,105 | 2,690 |
| Accrued employee compensation | 293,497 | 270,437 |
| Accrued professional services | 94,312 | 75,616 |
| Accrued warranty expense | 25,000 | 25,000 |
| Other accrued liabilities | 912 | 914 |
| Total current liabilities | 869,235 | 718,387 |
| 10% Senior secured convertible notes | 10,304 | |
| Commitments (Note 3) | | |
| Stockholders' Equity: | | |
| Common stock, \$0.01 par value- | | |
| Authorized 50,000,000 shares | | |
| Issued and outstanding 1,018,411 shares at June 30, 2008 and June 30, 2007 | 10,184 | 10,184 |
| Additional paid-in capital | 38,149,655 | 37,441,413 |
| Accumulated deficit | (36,757,741) | (35,134,387) |

Edgar Filing: PRECISION OPTICS CORPORATION INC - Form S-1

| | | |
|----------------------------|--------------|--------------|
| Total stockholders' equity | 1,402,098 | 2,317,210 |
| | \$ 2,281,637 | \$ 3,035,597 |

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

Table of Contents**PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES****Consolidated Statements of Operations for the****Years Ended June 30, 2008 and 2007**

| | 2008 | 2007 |
|--|----------------|----------------|
| Revenues | \$ 2,902,219 | \$ 2,477,469 |
| Cost of Goods Sold | 2,110,217 | 2,002,196 |
| Gross profit | 792,002 | 475,273 |
| Research and Development Expenses, net | 757,852 | 1,312,240 |
| Selling, General and Administrative Expenses | 1,867,093 | 2,097,959 |
| Gain on Sale of Product Line | (210,549) | |
| Total operating expenses | 2,414,396 | 3,410,199 |
| Operating loss | (1,622,394) | (2,934,926) |
| Interest Income (Expense), net | (48) | 46,011 |
| Loss before provision for income taxes | (1,622,442) | (2,888,915) |
| Provision for Income Taxes | 912 | 914 |
| Net loss | \$ (1,623,354) | \$ (2,889,829) |
| Loss per Share - Basic and Diluted | \$ (1.59) | \$ (3.68) |
| Weighted Average Common Shares Outstanding - Basic and Diluted | 1,018,411 | 784,995 |

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

Table of Contents**PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES****Consolidated Statements of Stockholders' Equity****for the Years Ended June 30, 2008 and 2007**

| | Number of Shares | Common Stock | Additional Paid-in Capital | Accumulated Deficit | Total Stockholders Equity |
|--|---------------------|-----------------|----------------------------------|------------------------|---------------------------------|
| Balance, June 30, 2006 | 618,411 | \$ 6,184 | \$ 34,878,271 | \$ (32,244,558) | \$ 2,639,897 |
| Proceeds from sale of common stock and warrants, net | 400,000 | 4,000 | 2,372,216 | | 2,376,216 |
| Stock-based compensation | | | 190,926 | | 190,926 |
| Net loss | | | | (2,889,829) | (2,889,829) |
| Balance, June 30, 2007 | 1,018,411 | \$ 10,184 | \$ 37,441,413 | \$ (35,134,387) | \$ 2,317,210 |
| Proceeds from issuance of senior convertible notes and warrants allocated to warrants | | | 399,000 | | 399,000 |
| Proceeds from issuance of senior convertible notes and warrants allocated to beneficial conversion feature | | | 201,000 | | 201,000 |
| Stock-based compensation | | | 108,242 | | 108,242 |
| Net loss | | | | (1,623,354) | (1,623,354) |
| Balance, June 30, 2008 | 1,018,411 | \$ 10,184 | \$ 38,149,655 | \$ (36,757,741) | \$ 1,402,098 |

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

Table of Contents**PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows for the****Years Ended June 30, 2008 and 2007**

| | 2008 | 2007 |
|---|----------------|----------------|
| Cash Flows from Operating Activities: | | |
| Net loss | \$ (1,623,354) | \$ (2,889,829) |
| Adjustments to reconcile net loss to net cash used in operating activities- Depreciation and amortization | 161,169 | 120,404 |
| Gain on sale of product line | (210,549) | |
| Provision for inventory write-down | 39,059 | 31,100 |
| Stock-based compensation expense | 108,242 | 190,926 |
| Non-cash interest expense | 10,304 | |
| Changes in operating assets and liabilities- | | |
| Accounts receivable, net | 413,982 | (420,109) |
| Inventories | 237,141 | (490,034) |
| Prepaid expenses | 16,290 | (7,127) |
| Accounts payable | 20,679 | 125,072 |
| Customer advances | 88,415 | 2,690 |
| Accrued expenses | 41,754 | 1,989 |
| Net cash used in operating activities | (696,868) | (3,334,918) |
| Cash Flows from Investing Activities: | | |
| Purchases of property and equipment | (58,718) | (139,667) |
| Proceeds from sale of product line | 250,000 | |
| Product line sale costs | (19,051) | |
| Increase in other assets | (29,554) | (91,880) |
| Net cash provided by (used in) investing activities | 142,677 | (231,547) |
| Cash Flows from Financing Activities: | | |
| Proceeds from issuance of senior convertible notes and warrants | 600,000 | |
| Gross proceeds from private placement | | 2,500,000 |
| Payment of offering costs | | (123,784) |
| Net cash provided by financing activities | 600,000 | 2,376,216 |
| Net increase (decrease) in cash and cash equivalents | 45,809 | (1,190,249) |
| Cash and cash equivalents, beginning of year | 840,179 | 2,030,428 |
| Cash and cash equivalents, end of year | \$ 885,988 | \$ 840,179 |
| Supplemental Disclosure of Cash Flow Information: | | |
| Cash paid during the year for- Income taxes | \$ 912 | \$ 914 |
| Supplemental Disclosure of Non-Cash Investing and Financing Activities: | | |
| Cost of inventory sold as part of product line disposal | \$ 20,105 | \$ |

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

Table of Contents

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Nature of Business and Liquidity

Precision Optics Corporation, Inc. (the Company) designs, develops, manufactures and sells specialized optical systems and components and optical thin-film coatings. The Company conducts business in one industry segment only and its customers are primarily domestic. The Company's products and services fall into two principal areas: (i) medical products for use by hospitals and physicians and (ii) advanced optical system design and development services and products used by industrial customers.

The Company has sustained recurring net losses and negative cash flows from operations for several years. During the year ended June 30, 2008, the Company incurred a net loss of \$1,623,354 and used cash in operations of \$696,868. As of June 30, 2008, cash and cash equivalents were \$885,988, accounts receivable were \$387,224 and current liabilities were \$869,235, resulting in a net liquid asset amount of \$403,977. 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. This has resulted in an increase in gross profit and simultaneous decreases in operating expenses, thereby reducing losses substantially, particularly in the third and fourth quarters of fiscal year 2008. 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, thin film coatings, 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 2009, 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.

In April 2006 the Company completed a private placement, issuing 338,000 shares of common stock. Net cash proceeds to the Company (after offering costs of \$49,725) were \$2,062,775. In February 2007 the Company completed a private placement, pursuant to which it sold an aggregate of 400,000 shares of common stock and warrants to purchase an aggregate of 400,000 shares of common stock at an exercise price of \$8.00 per share. Net cash proceeds to the Company (after offering costs of \$123,784) were \$2,376,216 (see Note 4). In June 2008 the Company issued senior secured convertible notes and warrants, raising cash proceeds of \$600,000.

During the past year, the introduction of several new products, along with new and on-going customer relationships, has resulted in significant revenue growth. The Company believes that with continued promotion, these opportunities have the potential to continue the general trend of increasing revenues, which, along with enhanced operations are required in order for the Company to achieve profitability.

Table of Contents

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(b) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its two wholly owned subsidiaries. All inter-company accounts and transactions have been eliminated in consolidation. All shares and per share data reflect the effects of a 1-for-25 reverse stock split that became effective on December 11, 2008.

(c) Revenues

The Company recognized revenue in accordance with Securities and Exchange Commission issued Staff Accounting Bulletin No. 104, *Revenue Recognition* (SAB No. 104) which requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services rendered; (3) the price to the buyer is fixed and determinable; and (4) collectability is reasonably assured. The Company's shipping terms are customarily FOB shipping point. The Company's revenue recognition practices comply with the guidance in the bulletin.

The sales price of products and services sold is fixed and determinable after receipt and acceptance of a customer's purchase order or properly executed sales contract, typically before any work is performed. Management reviews each customer purchase order or sales contract to determine that the work to be performed is specified and there are no unusual terms and conditions that would raise questions as to whether the sales price is fixed or determinable. The Company assesses credit worthiness of customers based upon prior history with the customer and assessment of financial condition. Accounts receivable are stated at the amount management expects to collect from outstanding balances. An allowance for doubtful accounts is provided for that portion of accounts receivable considered to be uncollectible, based upon historical experience and management's evaluation of outstanding accounts receivable at the end of the year. Bad debts are written off against the allowance when identified.

The Company's revenue transactions typically do not contain multiple deliverable elements for future performance obligations to customers, other than a standard one-year warranty on materials and workmanship, the estimated costs for which are provided for at the time revenue is recognized.

Revenues for industrial and medical products sold in the normal course of business are recognized upon shipment when delivery terms are FOB shipping point and all other revenue recognition criteria have been met. Gross shipping charges reimbursable from customers, to deliver product, are insignificant and are included in Revenues, while shipping costs are classified as the Selling, General and Administrative Expenses section of the Consolidated Statement of Operations.

(d) Cash and Cash Equivalents

The Company includes in cash equivalents all highly liquid investments with original maturities of three months or less at the time of acquisition. Cash and cash equivalents of \$885,988 and \$840,179 at June 30, 2008 and 2007, respectively, consist primarily of cash at banks and money market funds. The Company maintains its cash and cash equivalents in bank deposit accounts that, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents.

(e) Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market and include material, labor and manufacturing overhead. The components of inventories at June 30, 2008 and 2007 are as follows:

| | 2008 | | 2007 |
|------------------|-------------|----|-------------|
| Raw material | \$ 347,298 | \$ | 511,588 |
| Work-in-progress | 177,464 | | 349,936 |
| Finished goods | 83,669 | | 43,212 |
| | \$ 608,431 | \$ | 904,736 |

Table of Contents

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

The Company provides for estimated obsolescence on unmarketable inventory based upon assumptions about future demand and market conditions. If actual demand and market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Inventory, once written down, is not subsequently written back up, as these adjustments are considered permanent adjustments to the carrying value of the inventory.

During fiscal years 2008 and 2007, the Company recorded pre-tax non-cash provisions for slow-moving and obsolete inventories of approximately \$39,000 and \$31,100, respectively.

(f) Property and Equipment

Property and equipment are recorded at cost. Maintenance and repair items are expensed as incurred. The Company provides for depreciation and amortization by charges to operations, using the straight-line and declining-balance methods, which allocate the cost of property and equipment over the following estimated useful lives:

| Asset Classification | Estimated Useful Life |
|-----------------------------|--|
| Machinery and equipment | 2-7 years |
| Leasehold improvements | Shorter of lease term or estimated useful life |
| Furniture and fixtures | 5 years |
| Vehicles | 3 years |

Amortization of assets under capital leases is included in depreciation expense. Depreciation expense was \$53,720 and \$57,911 for the years ended June 30, 2008 and 2007, respectively.

(g) Significant Customers and Concentration of Credit Risk

Statement of Financial Accounting Standards (SFAS) No. 105, *Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk*, requires disclosure of any significant off-balance sheet and credit risk.

Financial instruments that subject the Company to credit risk consist primarily of cash equivalents and trade accounts receivable. The Company places its investments with highly rated financial institutions. The Company has not experienced any losses on these investments to date. At

Edgar Filing: PRECISION OPTICS CORPORATION INC - Form S-1

June 30, 2008, receivables from the Company's largest customers were 27%, 25% and 17% of the total accounts receivable. At June 30, 2007, receivables from the Company's largest customer were 61% of the total accounts receivable. No other customer accounted for more than 10% of the Company's receivables as of June 30, 2008 and 2007. The Company has not experienced any material losses related to accounts receivable from individual customers. The Company generally does not require collateral or other security as a condition of sale rather relying on credit approval, balance limitation and monitoring procedures to control credit risk of trade account financial instruments. Management believes that allowances for doubtful accounts, which are established based upon review of specific account balances and historical experience, are adequate.

Revenues from the Company's largest customers, as a percentage of total revenues, were as follows:

| | 2008 | 2007 |
|------------|------|------|
| Customer A | 25% | 27% |
| Customer B | 20 | 22 |
| Customer C | 11 | 10 |
| All Others | 44 | 41 |
| | 100% | 100% |

No other customer accounted for more than 10% of the Company's revenues in fiscal years 2008 and 2007.

Table of Contents

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(h) Loss per Share

The Company calculates earnings per share according to SFAS No. 128, *Earnings 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 each of the two years in the periods ended June 30, 2008 and 2007, the effect of stock options was anti-dilutive; 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, as their effect would be anti-dilutive, was approximately 996,066 and 501,303 during fiscal 2008 and 2007, respectively.

(i) Stock-Based Compensation

On July 1, 2006, the Company adopted SFAS No. 123(R), *Accounting for Stock-Based Compensation* (SFAS No. 123(R)), which requires the measurement and recognition of all compensation costs for all stock based awards made to employees and the Board of Directors based upon fair value over the requisite service period for awards expected to vest. Prior to adoption, the Company accounted for stock options under the intrinsic value method set in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, and provided the required pro forma disclosures prescribed by SFAS No. 123, *Accounting for Share-based Compensation* (SFAS No. 123), as amended.

SFAS 123(R) requires the Company to estimate the fair value of share-based awards on the date of grant using an option-pricing model. The Company adopted SFAS 123(R) using the modified prospective transition method which required the application of the accounting standard starting July 1, 2006, the first day of the Company's fiscal year 2007. Prior period information has not been restated to reflect the fair value method of expensing share-based awards. Stock-based compensation costs recognized for the year ended June 30, 2008 and 2007 amounted to \$108,242 and \$190,926, respectively.

(j) Foreign Currency Translation

The Company translates certain accounts and financial statements of its foreign subsidiary in accordance with SFAS No. 52, *Foreign Currency Translation*. The functional currency of the Company's foreign subsidiary is the United States dollar. Transaction gains or losses are reflected in the accompanying consolidated statements of operations and have not been significant.

(k) Patents

Patents are carried at cost, less accumulated amortization of \$623,063 and \$515,615 at June 30, 2008 and 2007, respectively. Such costs are amortized using the straight-line method over the shorter of their legal or estimated useful lives, generally five to ten years. Amortization expense was \$107,448 and \$62,493 for the years ended June 30, 2008 and 2007, respectively. Amortization expense is expected to be approximately \$30,000, \$28,000, \$27,000, \$26,000 and \$25,000, respectively, for the years ending June 30, 2009 through June 30, 2013.

(l) Financial Instruments

SFAS No. 107, *Disclosure About Fair Value of Financial Instruments*, requires disclosures about the fair value of financial instruments. Financial instruments consist principally of cash equivalents, accounts receivable, accounts payable, and accrued expenses. The estimated fair value of these financial instruments approximates their carrying value due to the short-term nature of these financial instruments.

Table of Contents**PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements****(m) Long-Lived Assets**

The Company accounts for long-lived assets in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(n) Warranty Costs

The Company does not incur future performance obligations in the normal course of business other than providing a standard one-year warranty on materials and workmanship to its customers. The Company provides for estimated warranty costs at the time product revenue is recognized. Warranty costs have been included as a component of cost of goods sold in the accompanying consolidated statements of operations. The following tables summarize warranty reserve activity for the two years ended June 30, 2008:

| | 2008 | | 2007 | |
|--|------|---------|------|----------|
| Balance at beginning of period | \$ | 25,000 | \$ | 50,000 |
| Provision (credit) for warranty claims | | 2,619 | | (14,197) |
| Warranty claims incurred | | (2,619) | | (10,803) |
| Balance at end of period | \$ | 25,000 | \$ | 25,000 |

(o) Research and Development

Research and development expenses are charged to operations as incurred. The Company groups development and prototype costs and related reimbursements in research and development. For the years ended June 30, 2008 and 2007, research and development expense is shown net of reimbursements of \$224,107 and \$101,309, respectively, in the accompanying statements of operations.

(p) Comprehensive Income

SFAS No. 130, *Reporting Comprehensive Income*, requires disclosure of all components of comprehensive income on an annual and interim basis. Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owners sources.

The Company's comprehensive loss for the years ended June 30, 2008 and 2007 was equal to its net loss for the same periods.

(q) 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 carry-forwards. 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.

Table of Contents

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

In assessing the likelihood of utilization of existing deferred tax assets, management has considered historical results of operations and the current operating environment.

(r) Segment Reporting

SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*, establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to stockholders. SFAS No. 131 also establishes standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision-making group, in making decisions about how to allocate resources and assess performance. The Company's chief decision-maker, as defined under SFAS No. 131, is the Chief Executive Officer. To date, the Company has viewed its operations and manages its business as principally one segment. For all periods presented, over 90% of the Company's sales have been to customers in the United States.

(s) Use of Estimates

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

(t) Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS No. 141(R)), which replaces SFAS No. 141. SFAS No. 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141(R) is to be applied prospectively to business combinations for which the acquisition date is on or after an entity's fiscal year that begins after December 15, 2008 (July 1, 2009 for the Company). The impact of this Statement on the Company's financial position, results of operations and cash flows will be dependent on the terms, conditions and details of such acquisitions.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which allows the Company to choose to measure selected financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 (July 1, 2008 for the Company). The Company is in the process of evaluating the impact of this authoritative guidance on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which provides a single definition of fair value, and requires additional disclosure about the use of fair value to measure assets and liabilities. SFAS No. 157 emphasizes that fair value is a market-based measurement defined as the price that would be received to sell an asset or liability in an orderly transaction between market participants at the measurement date. Thus, SFAS No. 157 adheres to a definition of fair value based upon exit price as opposed to entry price (i.e. the price paid to acquire an asset or liability). This pronouncement is effective for fiscal years beginning after November 15, 2007 (July 1, 2008 for the Company). The Company is in the process of evaluating the impact of this authoritative guidance on its consolidated financial statements.

Table of Contents

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(2) 10% SENIOR SECURED CONVERTIBLE NOTES

On June 25, 2008, the Company entered into a Purchase Agreement with institutional and other accredited investors pursuant to which it sold an aggregate of \$600,000 of 10% Senior Secured Convertible Notes, which are convertible into an aggregate of 480,000 shares of common stock, par value \$0.01 per share, at a conversion price of \$1.25 per share, and warrants to purchase an aggregate of 316,800 shares of common stock at an exercise price of \$1.75 per share. The Investors are current stockholders of the Company. Interest accrues on the Notes at a rate of 10% per annum and is payable upon the earlier of conversion or maturity of the Notes. The Notes mature on June 25, 2010, and the Warrants expire on June 25, 2015. The Notes and Warrants are not convertible or exercisable until the Company implements a reverse stock split, which requires the approval of its stockholders and the effectiveness of an amendment (the Amendment) to its Articles of Organization to effect the reverse stock split. The closing of the sale of the Notes and Warrants occurred on June 25, 2008.

The Purchase Agreement contains customary representations and warranties of the Company and the Investors, and the Notes contain customary covenants binding on the Company and customary events of default. 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 Notes are secured by a pledge of the Company's assets under the terms of a Pledge and Security Agreement and the security documents ancillary thereto.

Pursuant to a Registration Rights Agreement entered into with the Investors on June 25, 2008, the Company has 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 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, plus the common stock issuable in lieu of cash interest on the Notes. The Company has also agreed to use its commercially reasonable efforts to have the registration statement declared effective as soon as practicable after filing and has agreed to take certain other actions related to the effectiveness of the registration statement.

The 10% senior secured convertible notes consist of the following:

| | June 30, 2008 | June 30, 2007 |
|---|------------------|------------------|
| 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, June 25, 2010. | \$ 600,000 | \$ |

Edgar Filing: PRECISION OPTICS CORPORATION INC - Form S-1

| | | | |
|-----------------------------|----|-----------|----|
| Accrued interest 10% coupon | | 833 | |
| Unamortized discount | | (590,529) | |
| | \$ | 10,304 | \$ |

Upon issuance of the Notes and Warrants, the proceeds of \$600,000 were allocated between the Notes and Warrants based on relative fair values. The value of the Warrants was recorded as a discount to the Notes, with a corresponding increase to additional paid-in capital. The fair value of the Warrants was determined using the Black-Scholes method, with the following assumptions:

| | |
|--------------------|---------|
| Expected life | 7 years |
| Risk-free rate | 4.84% |
| Expected Dividends | 0.00% |
| Volatility factor | 154% |

In accordance with EITF 00-27, *Application of EITF Issue No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios*, the proceeds from the issuance of the 10% senior secured convertible notes were first allocated between the Notes and the Warrants. The value of the

Table of Contents

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

conversion feature was then calculated, which resulted in an effective conversion ratio that was less than the market price of the Company's common stock. The intrinsic value of this beneficial conversion feature was recorded as a further discount to the Notes, equal to the difference between the effective conversion ratio and the market price of the Company's common stock, with a corresponding increase to additional paid-in capital.

The following summarizes the discount on 10% senior secured convertible notes as of June 30:

| | 2008 | 2007 |
|---|---------|------|
| Discount beginning balance | \$ | \$ |
| Proceeds allocated to warrants | 399,000 | |
| Beneficial conversion feature intrinsic value | 201,000 | |
| Less: amortization of discount | | |