Precision Optics: Ross Acquisition Makes Long Case Intriguing

Expected Value vs. $1.42 Market Price (as of 9/11/19) = $2.85/share

101% Upside To PEYE's Price Target, Which Reflects a P/S Multiple of 3.7X

Comparable Companies Trade at an Average 5.7X Revenue Multiple, Versus Just 1.7X for PEYE

(See Section I.E herein for calculations)

Precision Optics Corporation (ticker PEYE) [SEC filings here] is a microcap medical device company whose products include microprecision lenses and micro medical camera, 3D endoscope, and robotic surgery systems. Over the past five years, PEYE has basically been treading water, with annual losses ranging from $350,000 to $1.2 million and annual revenues relatively flat in the $3 million to $4 million range. However, PEYE recently completed the acquisition of Ross Optical Industries, Inc., which appears to significantly improve PEYE's investment risk-reward calculus. On a *pro forma* basis giving effect to the transaction, PEYE was solidly profitable in FY 2018 and basically breakeven in the first three quarters of FY 2019. Moreover, the Ross transaction will cost PEYE shareholders just $2 million at most, pending a $500,000 contingent earnout payment, meaning PEYE acquired Ross at just a mid-single digit P/E multiple, a seeming bargain (see *Section I.B* below).

Acquisitions can really move the needle for an acquirer's investors, occasionally for the better, unfortunately more often for the worse (normally acquisitions are value destructive because they are made primarily for management's empire building purposes). Happily, however, in PEYE's case we think the Ross acquisition falls clearly in the former category. With high insider ownership (major shareholders hold around 45% of the outstanding common stock), one can expect the merged company's assets to be put to their highest and best use, with the benefits thereof accruing to the company's owners (PEYE longs). Given a recent stock price of $1.42/share, there is ample 101% upside for shareholders to our target price of $2.85/share (or ~3.7X our *pro forma* FY 2019 revenue estimate). This multiple appears more than reasonable given the combined company's nearly 25% organic revenue growth and near breakeven underlying operations. (For comparison purposes, peers in the medical device space trade at an average revenue multiple of 5.7X.) In sum, with the Ross Acquisition, PEYE's pie just got quite a bit large for shareholders, but with minimal dilution. Enterprising small and micro-cap investors should carve a slice out for their portfolios.[1]

[1] Bad puns included in this report free of charge.

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I. Investment Overview

A. Company Background and History

Precision Optics (ticker: PEYE) is a medical device company that makes endoscopes, endocouplers and extremely small lenses for noninvasive surgery. Below is a description of an endoscope [source: Wikipedia]:

Endoscope

From Wikipedia, the free encyclopedia

An **endoscope** is an illuminated optical, typically slender and tubular instrument (a type of borescope) used to look deep into the body and used in procedures called an endoscopy. "Endo" is Greek for "within" while "scope" comes from the Greek word "skopos" meaning to target or look out. It is used to examine the internal organs like the throat or esophagus. Specialized instruments are named after their target organ. Examples include the cystoscope (bladder), nephroscope (kidney), bronchoscope (bronchus), arthroscope (joints) and colonoscope (colon), and laparoscope (abdomen or pelvis).[1] They can be used to examine visually and diagnose, or assist in surgery such as an arthroscopy.

A flexible endoscope

Endoscopes are used in minimally invasive surgeries to allow doctors to view the inside of a patient's body (see *Section I.B* below). Endocouplers are devices that attach cameras to endoscopes [source]:

Endo Coupler

General Details | Features | Specifications | Attached Documents

Endocoupler allows for quick snap lock connection onto a digital SLR camera and c-mount adapter. Refer to c-mount

PEYE's history and lines of business are more fully described as follows (*emphases added*) [source: [2018 Form 10-K]]:

> PEYE has been developing and manufacturing advanced optical instruments since 1982. Today, the majority of PEYE's business is the design and manufacture of high-quality medical devices and approximately 17% of PEYE's revenue in fiscal year 2018 is from the design and manufacture of military and industrial products. PEYE's medical instrumentation line includes traditional endoscopes and endocouplers as well as other custom imaging and illumination products for use in minimally invasive surgical procedures. ***Much of PEYE's recent development efforts have been targeted at the development of next generation endoscopes***. Over the last ten years, PEYE has funded internal research and development programs to develop next generation capabilities for designing and manufacturing 3D endoscopes and very small Microprecision™ lenses, anticipating future requirements as the surgical community continues to demand smaller and more enhanced imaging systems for minimally invasive surgery. PEYE's unique proprietary technology in these areas, combined with recent developments in the areas of 3D displays and millimeter sized CMOS image sensors, has allowed PEYE to begin commercialization of these technologies. ***Thus, over 30% of PEYE's revenues in each of the fiscal years 2016, 2017 and 2018 were derived from engineering and design services PEYE performed for PEYE's customers to incorporate PEYE's technologies and capabilities into their medical device products***. PEYE believes that new products based on these technologies provide enhanced imaging for existing surgical procedures, which help to enable development of many new medical device products and related medical procedures. ***Over 50% of PEYE's total revenues in fiscal years 2016, 2017 and 2018 were derived from the assembly and manufacture of endoscopic medical devices***, sub-assemblies and optical components ordered by PEYE's customers and usually developed from the engineering and design services the company performs for them. PEYE expects sales revenue increases to come from the orders from PEYE's customers to manufacture the products PEYE helps them engineer and design.
>
> ***Principal Products and Services*** - PEYE's Current Core Business: Since 1982, PEYE has manufactured medical products such as endoscopes and endocouplers. PEYE has developed and sold endoscopes incorporating various optical technologies including PEYE's ***proprietary Lenslock™ technology***, for use in a variety of minimally invasive surgical and diagnostic procedures. Today, PEYE produces endoscopes for various applications, which are CE marked and therefore certified for sale throughout the European Economic Area. Since 1985, PEYE has developed, manufactured and sold a proprietary product line of endocouplers. PEYE also designs and manufactures custom optical medical devices to satisfy PEYE's customers' specific requirements. In addition to medical devices, PEYE also manufactures and sells components and assemblies specially designed for industrial and military use.
>
> ***Microprecision™ Lenses and Micro Medical Cameras***: While the size of endoscopes has gradually decreased over time, the widespread use of very small endoscopes, with diameters of one millimeter or smaller, has been limited, in part, PEYE believes, by the inability of traditional lens fabrication methods to support these smaller sizes with good image quality and acceptable manufacturing costs. PEYE's Microprecision™ optics technology provides a solution to this problem. Combined with recent advances by other companies in complementary metal-oxide-semiconductor, or CMOS, image sensor fabrication techniques, ***PEYE's Microprecision™ lenses and proprietary manufacturing techniques enable the***

> ***manufacture of micro medical cameras at low prices and with sizes on the order of one millimeter or less, characteristics that make them well suited to medical applications***.
>
> In June 2015, PEYE announced a partnership with OmniVision Technologies, Inc., and Fujikura, Ltd., in which PEYE jointly developed a CMOS based camera module with a diameter of 1.6 mm and 400 x 400 pixel resolution, representing superior image quality for camera modules of its size. In June 2017 OmniVision Technologies, Inc. announced PEYE's collaboration with them in the development of an even smaller, high-quality optical solution based on a newly developed OmniVision image sensor integrated with PEYE's Microprecsion™ lenses. This solution enables even smaller diameter endoscopes for use in medical procedures.
>
> ***PEYE is currently engaged in development projects with numerous customers to design and produce even smaller CMOS based camera modules together with customized illumination using various technologies to match the needs of the medical device endoscopes. PEYE is also currently designing disposable versions of PEYE's camera modules and assemblies designed for single-use and reduced risk of contamination from repeated use***. PEYE believes these on-going improvements are significant to the continued evolution and acceptance of PEYE's Microprecision™ technology platform.
>
> PEYE has been engaged by various customers for an increasing amount of development work relating to the design of endoscopes and camera assemblies that utilize PEYE's Microprecision™ technology. PEYE has now received two production orders exceeding $1 million each from two customers for their custom designed products, and PEYE believes in the future PEYE will receive follow-on orders from these customers as well as production orders from other customers currently in PEYE's engineering and design pipeline.
>
> ***3D Endoscopes***: PEYE's 3D endoscopes provide next generation optical imaging for minimally invasive surgical procedures that utilize hand-held rigid endoscopes by using the brain's natural ability to perceive depth, which is the third dimension, by viewing one's environment through two eyes. Utilizing PEYE's proprietary technology to provide independent images to right and left eyes, surgeons can view the operative field with 3D perception.

Historically, PEYE has plodded along, slowly growing revenues over time, albeit with significant shareholder dilution (shares outstanding have increased from 4,455,134 to approximately 12.8 million over the past 6 years, a CAGR of 19%) as well as continuing net losses (the company has racked up $45.5 million in historical losses through Q3 of its FY 2019). Normally, this would signify a company with minimal equity value, as is currently reflected in PEYE's $18 million market cap.

B. July 2019 Acquisition of Ross Optical

However, PEYE announced the acquisition of Ross Optical Industries, Inc. this past July, which we believe changes the investment calculus significantly (and for the better) [source here]:

NEWS RELEASE *POC19-0040*

FOR IMMEDIATE RELEASE **Monday July 8, 2019**

Precision Optics Corporation Acquires Ross Optical Industries

Strategic acquisition expands Precision Optics' product offering and presence within the U.S. defense sector

Company closes $950,000 equity raise tied to acquisition

GARDNER, MA, July 8, 2019. Precision Optics Corporation, Inc. (OTCQB: PEYE) ("Precision Optics"; the "Company"), a leading designer and manufacturer of advanced optical instruments for the medical and defense industries, announced today that it has completed the acquisition of certain assets of Ross Optical Industries, Inc. ("Ross Optical"), a privately-held company based in El Paso, Texas. The acquisition extends Precision Optics product offering to include a wider range of lens and optical system sizes and expands its presence in the U.S. defense sector. Further, it allows the combined company to leverage Precision Optics' technical proficiency in offering end-to-end solutions, from design through production, to the expansive Ross Optical customer base, increasing its value-add capabilities.

Ross Optical had revenues of $3.9 million and net income of $410,000 for the 12-month period ended December 31, 2018. As part of the transaction, Precision Optics is acquiring slightly over $1 million of net working capital. The total purchase price is up to $2 million, comprised of $1.5 million in cash at closing and additional payments up to $500,000 subject to a three-year earnout provision. Precision Optics completed an equity capital raise of $950,000 at a per share price of $1.25 concurrent with the closing of the acquisition.

Incorporated in 1989, Ross Optical has evolved from an optical components supplier into an expanded solutions provider. They have an extensive portfolio of optical fabrication and quality assurance equipment, technology, and technical solutions that supply a number of industries, including the defense, medical and industrial markets. Focused on high quality and difficult-to-find optical components, Ross Optical provides custom solutions as well as a wide range of standard lens sizes in an extensive catalog offering, through a robust worldwide sourcing network that allows them to provide cost- efficient optical components and assemblies.

Per the deal announcement, Divi Mangadu, who has been Ross's long-standing President, will continue in that role for a seamless transition. PEYE will continue to operate the acquired entity under Mr. Mangadu's leadership in its existing facility in El Paso, TX and "anticipates significant cooperation between sales, engineering and manufacturing teams of the two operations". For a description of Ross's product offerings, please visit their website: http://www.rossoptical.com.

Ross was acquired for just 4.3X its net income during PEYE's FY 2018 and 5.7X its run rate net income for first 9 months of PEYE's FY 2019.[2] Below are the financial statements for the combined PEYE/Ross entity (or "*Pro forma* PEYE") [source: PEYE Form 8-K, August 15, 2019]:

[2] Please note that PEYE's fiscal year ends June 30th.

FY 2018:

	Precision Optics Corporation, Inc. Year Ended 6/30/2018	Ross Optical Industries, Inc. Year Ended 6/30/2018	Adjustments: Owners' Salary & Bonus (Note 1)	Adjustments: Bank Debt Interest (Note 2)	Adjustments: Added Depr Exp (Note 3)	Adjustments: Federal Income Tax Expense (Note 4)	Pro Forma Year Ended 6/30/2018
Revenues	4,038,048	3,894,277					7,932,325
Cost of goods sold	2,556,130	2,034,370			19,451		4,609,951
Gross Profit	1,481,918	1,859,907					3,322,374
Research and development expenses	456,377	–					456,377
Selling, general and administrative expense	1,374,160	1,197,739	(200,590)				2,371,309
	1,830,537	1,197,739					2,827,686
Net income (loss) from operations	(348,619)	662,168					494,688
Other (income) expense							
Interest expense	1,859	9,985		(9,985)			1,859
Other	–	(6,670)					(6,670)
	1,859	3,315					(4,811)
Net income (loss) before taxes	(350,478)	658,853					499,499
Income tax expense	912	199,295				(173,025)	27,182
Net income (loss)	(351,390)	459,558					472,317

First 9 months FY 2019:

	Precision Optics Corporation, Inc. Nine Months 3/31/2019	Ross Optical Industries, Inc. Nine Months 3/31/2019	Adjustments: Owners' Salary & Bonus (Note 1)	Adjustments: Bank Debt Interest (Note 2)	Adjustments: Added Depr Exp (Note 3)	Adjustments: Federal Income Tax Expense (Note 4)	Pro Forma Nine Months 3/31/2019
Revenues	4,423,763	2,981,418					7,405,181
Cost of goods sold	3,149,598	1,631,008			14,588		4,795,194
Gross Profit	1,274,165	1,350,410					2,609,987
Research and development expenses	347,851	–					347,851
Selling, general and administrative expense	1,430,880	1,006,653	(162,973)				2,274,560
	1,778,731	1,006,653					2,622,411
Net income (loss) from operations	(504,566)	343,757					(12,424)
Other (income) expense							
Interest expense	1,150	5,858		(5,858)			1,150
Other		(3,983)					(3,983)
	1,150	1,875					(2,833)
Net income (loss) before taxes	(505,716)	341,882					(9,591)
Income tax expense	–	77,903				(72,000)	5,903
Net income (loss)	(505,716)	263,979					(15,494)

Notably, the combined company financials show dramatic improvement in profitability versus PEYE as a standalone entity. Given that both entities will continue operations at their current locations, it appears that minimal disruption will occur as they are integrated into a single company (note, however, that cost synergies will likewise be minimal).

For reference, below are PEYE's standalone historical financial statements for the two most recently completed fiscal years [source]:

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
for the Years Ended June 30, 2018 and 2017

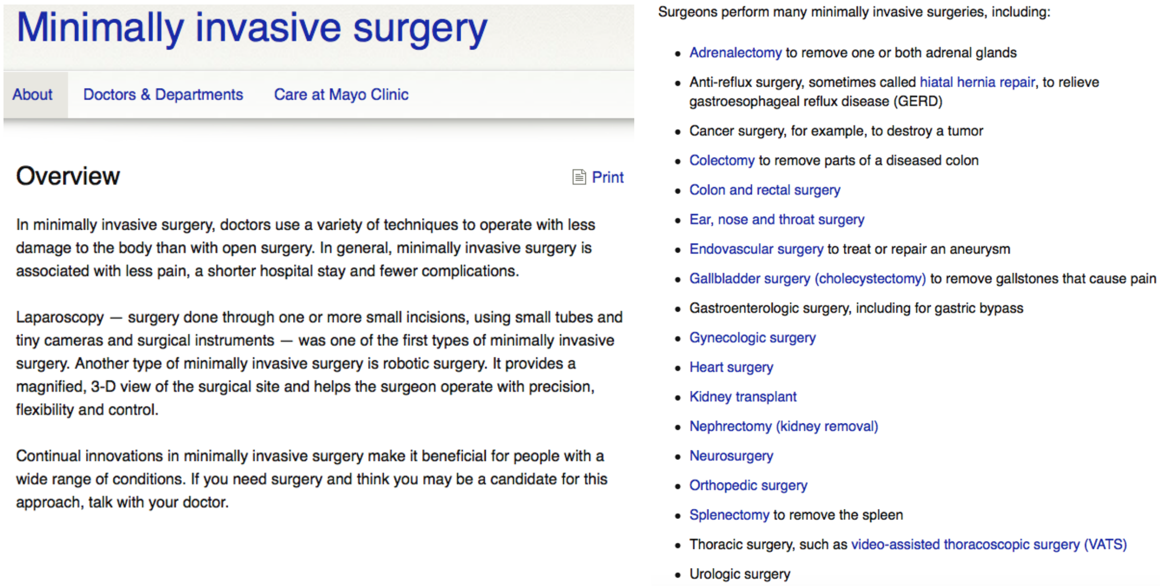
	2018	2017
Revenues	$ 4,038,048	$ 3,154,547
Cost of goods sold	2,556,130	2,380,823
Gross profit	1,481,918	773,724
Research and development expenses, net	456,377	464,162
Selling, general and administrative expenses	1,374,160	1,313,478
Gain on sale of assets	–	(1,515)
Total operating expenses	1,830,537	1,776,125
Operating loss	(348,619)	(1,002,401)
Interest expense	(1,859)	(3,144)
Loss before provision for income taxes	(350,478)	(1,005,545)
Provision for income taxes	912	912
Net loss	$ (351,390)	$ (1,006,457)
Loss per share:		
Basic and fully diluted	$ (0.04)	$ (0.12)
Weighted average common shares outstanding:		
Basic and fully diluted	9,826,151	8,343,235

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows for the
Years Ended June 30, 2018 and 2017

	2018	2017
Cash Flows from Operating Activities:		
Net loss	$ (351,390)	$ (1,006,457)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities-		
Depreciation and amortization	27,216	33,660
Provision for doubtful accounts receivable	227,500	(18,377)
Gain on sale of assets	–	(1,515)
Stock-based compensation expense	52,341	201,612
Non-cash consulting expense	2,400	33,900
Changes in operating assets and liabilities-		
Accounts receivable	(555,875)	300,209
Inventories	(88,621)	78,004
Prepaid expenses	(15,006)	32,144
Accounts payable	48,580	(457,603)
Customer advances	677,705	180,137
Accrued expenses	75,807	(43,148)
Net cash provided by (used in) operating activities	100,657	(667,434)
Cash Flows from Investing Activities:		
Proceeds from sale of assets	–	1,515
Additional patent costs	(17,189)	(7,212)
Purchases of fixed assets	(4,448)	(27,719)
Net cash used in investing activities	(21,637)	(33,416)
Cash Flows from Financing Activities:		
Payment of capital lease obligation	(8,392)	(7,857)
Gross proceeds from private placements of common stock	210,001	780,000
Gross proceeds from exercise of stock purchase warrants	6,667	–
Private placement expenses paid	(2,963)	(2,947)
Net cash provided by financing activities	205,313	769,196
Net increase in cash and cash equivalents	284,333	68,346
Cash and cash equivalents, beginning of year	118,405	50,059
Cash and cash equivalents, end of year	$ 402,738	$ 118,405
Supplemental disclosure of cash flow information:		
Cash paid during the year for income taxes	$ 912	$ 912
Supplemental disclosure of non-cash financing activities:		
Issuance of common stock to consultant	$ 51,000	$ –
Private placement expenses incurred but not yet paid	$ –	$ 21,000
Issuance of common stock in settlement of accounts payable	$ 40,000	$ 20,000

C. Minimally Invasive Surgery Growth

Endoscopes should benefit from the secular tailwind currently benefitting minimally invasive surgery ("MIS"), sometimes as referred to as "robotic surgery". What is MIS? We are glad you asked. Per the Mayo Clinic [source]:



Minimally invasive surgery

About Doctors & Departments Care at Mayo Clinic

Overview

Print

In minimally invasive surgery, doctors use a variety of techniques to operate with less damage to the body than with open surgery. In general, minimally invasive surgery is associated with less pain, a shorter hospital stay and fewer complications.

Laparoscopy — surgery done through one or more small incisions, using small tubes and tiny cameras and surgical instruments — was one of the first types of minimally invasive surgery. Another type of minimally invasive surgery is robotic surgery. It provides a magnified, 3-D view of the surgical site and helps the surgeon operate with precision, flexibility and control.

Continual innovations in minimally invasive surgery make it beneficial for people with a wide range of conditions. If you need surgery and think you may be a candidate for this approach, talk with your doctor.

Surgeons perform many minimally invasive surgeries, including:

- Adrenalectomy to remove one or both adrenal glands
- Anti-reflux surgery, sometimes called hiatal hernia repair, to relieve gastroesophageal reflux disease (GERD)
- Cancer surgery, for example, to destroy a tumor
- Colectomy to remove parts of a diseased colon
- Colon and rectal surgery
- Ear, nose and throat surgery
- Endovascular surgery to treat or repair an aneurysm
- Gallbladder surgery (cholecystectomy) to remove gallstones that cause pain
- Gastroenterologic surgery, including for gastric bypass
- Gynecologic surgery
- Heart surgery
- Kidney transplant
- Nephrectomy (kidney removal)
- Neurosurgery
- Orthopedic surgery
- Splenectomy to remove the spleen
- Thoracic surgery, such as video-assisted thoracoscopic surgery (VATS)
- Urologic surgery

One research firm estimates that the MIS market should expand from $36.5 billion in 2018 to over $58 million by 2024, representing a strong CAGR of 8% [source]. MIS seems to have momentum for several reasons: it is safer than conventional surgery (only a small incision is required), cheaper to perform and allows patients to recover more quickly and with less post-operative pain. In addition, it relieves doctors of fatigue, since they can remain in a sitting position while performing surgeries. One can track the rise of MIS by the stock price of Intuitive Surgical (ticker: ISRG), creator of the Da Vinci robotic surgical system, over the past five years:

Suffice it to say, we think that PEYE's principal lines of business should experience growth due to overall MIS industry expansion over the coming years, boding well for the stock.

D. Corporate Governance and Insider Incentives

Key Shareholders

PEYE's major (5%+) shareholders own 5.7 million shares, or approximately 45% of the outstanding common stock (*pro forma* for share issuance in connection with the Ross Acquisition)[3] [source: PEYE prospectus dated February 20, 2019]:

Stockholders Known by Us to Own Over 5% of Our Common Stock

Name and Address of Beneficial Owner	Amount of beneficial ownership (1): Shares Owned	Shares – Rights to Acquire	Total Number	Percent of Shares Beneficially Owned (2)
Dolphin Offshore Partners LP (3) 4828 First Coast Highway, STE 5 Fernandina, FL 32034	2,070,625	0	2,070,625	17.4%
Stuart L Sternberg (4) 85 Bellevue Ave Rye, NY 10580	1,091,355	0	1,091,355	9.2%
Hershey Strategic Capital, LP (5) 888 7th Ave., 17th Floor New York, New York 10019	986,480	0	986,480	8.3%
MHW Partners, L.P. (6) 150 East 52 nd Street 30th Fl. New York, New York 10022	674,013	90,000	764,013	6.4%
Norman H. Pessin & Sandra F. Pessin (7) 500 5th Avenue, Suite 2240 New York, New York 10110	885,303	0	885,303	7.4%

Peter Woodward, who heads major shareholder MHW Partners, is the board chairman:

Mr. Woodward was appointed to our Board effective July 9, 2014 and as chairman of the Board in connection with the sale and purchase agreement we entered into in July 2014. Mr. Woodward is the founder of MHW Capital Management, LLC, or MHW, a position he has held since September 2005. MHW specializes in large equity investments in public companies implementing operating strategies to significantly improve their profitability. From 1996 to 2005, Mr. Woodward was the Managing Director for Regan Fund Management, LLC. He served as the President and Chief Executive Officer and Director of Cartesian, Inc. from June 2015 to July 2018, and currently serves as Chairman of the Board and Chairman of the Audit Committee for TSS, Inc. Mr. Woodward holds a BA in economics from Colgate University and a Masters of International Affairs with a concentration in international economics and finance from Columbia University. He is also a Chartered Financial Analyst.

Joseph Forkey, son of founder and director emeritus Richard Forkey, is the current CEO:

Dr. Joseph N. Forkey, son of Richard E. Forkey, has served as our Chief Executive Officer, President and Treasurer since February 8, 2011. Dr. Forkey has been a member of our Board of Directors since 2006. He served as our Chairman of our Board of Directors from February 2011 to July 2014. He served as our Executive Vice President and Chief Scientific Officer from April 2006 to February 2011, and held the position of our Chief Scientist from September 2003 to April 2006. Since joining us, he has been involved in general technical and management activities of our Company, as well as investigations of opportunities that leverage our newly developed technologies. Dr. Forkey holds B.A. degrees in Mathematics and Physics from Cornell University, and a Ph.D. in Mechanical and Aerospace Engineering from Princeton University. Prior to joining us, Dr. Forkey spent seven years at the University of Pennsylvania Medical School as a postdoctoral fellow and research staff member. Dr. Forkey is a valuable member of our Board due to his depth of scientific, operating, strategic, transactional, and senior management experience in our industry. Additionally, Dr. Forkey has held positions of increasing responsibility at our Company and holds an intimate knowledge of our Company due to his longevity in the industry and with us.

[3] There are no preferred shares outstanding currently, nor will any be issued in connection with the Ross transaction.

In addition, several notable non-insiders are large shareholders: Stuart Sternberg, the owner of the Tampa Bay Rays [see here]; and the Pessins, prominent microcap activists investors [see here].

Executive Compensation

PEYE's executive compensation plan generally appears to align the interests of insiders with those of the shareholders. The C-suite members receive fairly low salaries, while receiving option grants that will only pay off if the stock appreciates over time:

Summary Executive Compensation Table for the Fiscal Years Ended June 30, 2018 and 2017

Name and Principal Position	Year June 30,	Salary ($)	Bonus ($)	Stock Awards ($) (1)	Option Awards ($) (2)	All Other Compensation ($)	Total ($)
Joseph N. Forkey	2018	120,000	0	0	0	0	120,000
Director, Chief Executive Officer, President and Treasurer	2017	120,000	0	0	0	0	120,000
Donald A. Major	2018	159,843	0	0	0	0	159,843
Chief Financial Officer, Secretary	2017	160,183	0	0	0	0	160,183
Richard G. Cyr	2018	145,000	38,120(3)	0	0	0	183,120
Optics Laboratory Manager	2017	145,000	8,127(3)	0	0	0	153,127

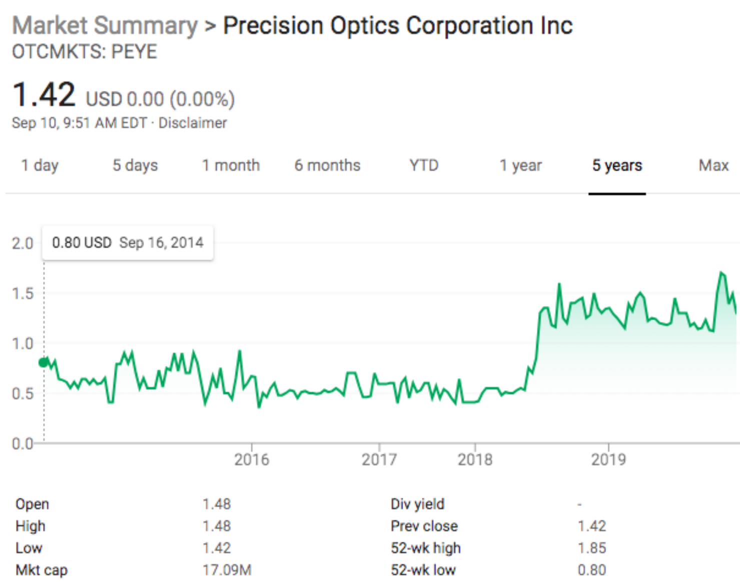
Officers and Directors

Name and address of beneficial owner (1)	Nature of beneficial ownership	Amount of beneficial ownership (2) Shares Owned	Shares – Rights to Acquire	Total Number	Percent of Shares Beneficially Owned (3)
Joseph N. Forkey (4)	Chief Executive Officer, President, Treasurer and Director	333,620	500,000	833,620	7.0%
Richard E. Forkey (5)	Director Emeritus	200,377	0	200,377	1.7%
Peter H. Woodward (6)	Chairman of the Board of Directors	674,013	90,000	764,013	6.4%
Richard B. Miles (7)	Director	15,112	74,400	89,512	*
Kenneth S. Schwartz (8)	Director	14,925	60,000	74,925	*
Andrew J. Miclot (9)	Director	0	60,000	60,000	*
Donald A. Major (10)	Chief Financial Officer, Secretary	125,778	306,000	431,778	3.6%
Richard G. Cyr (11)	Optics Laboratory Manager	0	55,000	55,000	*
All directors and executive officers as a group		**1,363,825**	**1,145,400**	**2,509,225**	**21.09%**

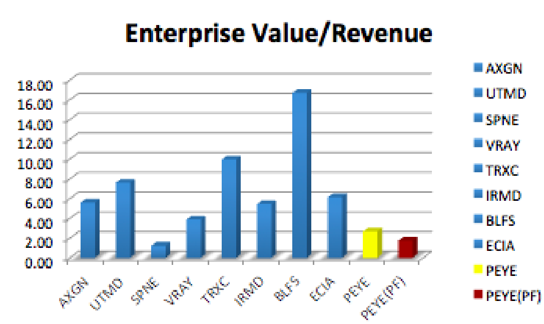
Although insiders have not been buying shares on the open market recently, neither have they been selling [source]; in fact, CEO Forkey appears to have never sold a share of his stock [source].

E. Valuation and Investment Opportunity

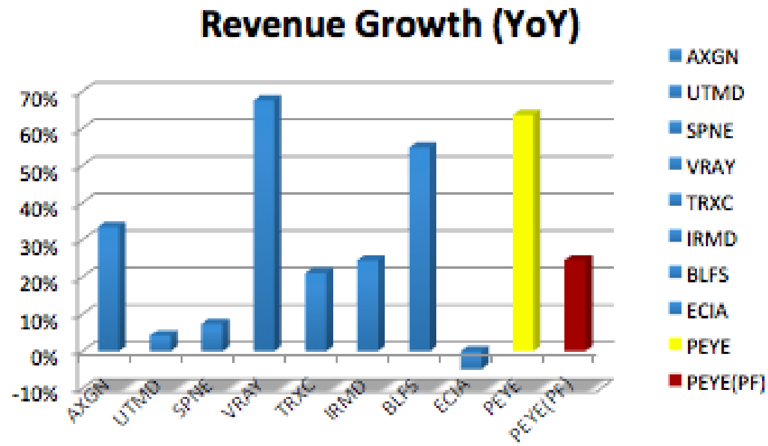
On a *pro forma* basis giving effect to the Ross acquisition, PEYE's enterprise value currently stands at a just $18.7 million (12.8MM shares outstanding multiplied by $1.42 stock price plus $500K potential earnout payment [the company has no debt outstanding]). Over the past 5 years, despite significant shareholder dilution, PEYE's stock has appreciated about 78%, a very respectable CAGR of 12%:



As indicated in <u>*Section I.A*</u> above, PEYE acquired Ross for just 4.3X its net income during PEYE's FY 2018 and 5.7X its run rate net income for first 9 months of PEYE's FY 2019. Given PEYE's expectation (based on our analysis of company filings) that the combined entity will experience nearly 25% year-over-year revenue growth and achieve basically breakeven financial results in FY 2019, "*pro forma* PEYE" currently trades at remarkably low 1.84X P/S and 1.89X EV/S multiples. Please see below how PEYE stacks up against peers with respect to these metrics:

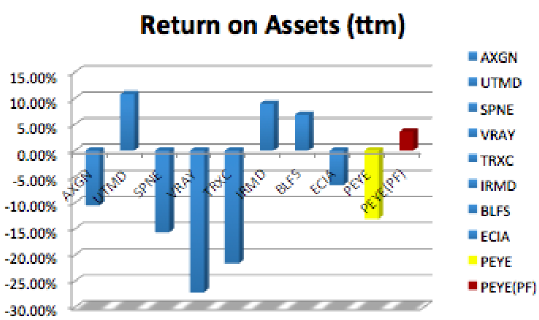


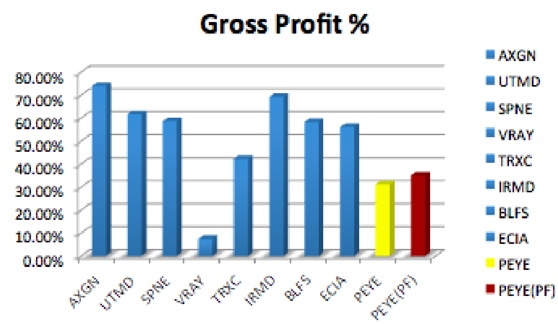
"*Pro forma* PEYE" trails only SPNE among peers, despite the fact that of all of these companies only UTMD, IRMD and BLFS are profitable, while AXGN, SPNE, VRAY, TRXC and ECIA are all burning significant amounts of cash. Below please find year-over-year revenue growth for the trailing twelve quarters:



From the above chart, we find that despite falling close to the bottom of peers with respect to the two above valuation metrics, PEYE and "*pro forma* PEYE" present among the most impressive revenue growth rates. Of course, historical growth does not always translate into future growth; nevertheless, we proceed on a base assumption that recent strong rates of growth are the best indicators of the future.

Finally, we look at profitability and gross profit percentages:





PEYE (standalone) does not appear overly impressive, however, given its low valuation, "*pro forma* PEYE" is somewhat of a standout. While obviously not yet in the best-of-class category of UTMD, IRMD and BLFS, the company appears superior to the rest of its peers, making us wonder whether the market realizes what PEYE has seemingly accomplished with the Ross acquisition. ***Thus, we think that PEYE should trade at a revenue multiple above the current 1.7X, but well below the average 10X P/S multiple for UTMD, IRMD and BLFS. Since the remainder of PEYE's peers trade at a P/S of 5.7X (despite appearing to have overall metrics on par with, or outright inferior to, "pro forma PEYE"), we think that 3.7X PEYE's expected pro forma revenues for FY 2019 is reasonable price target for its***

equity (i.e., the midpoint between 1.7X and 5.7X)[4]. This would imply a stock price for PEYE of $2.85/share[5], or 101% above the recent market price.

Please see ***Appendix A*** attached hereto for a complete set of financial metrics for PEYE and its peer group.

II. Risk Factors / Red Flags

As with any microcap company, there are various investment risks associated with an investment in PEYE. Below are several for investors to consider in particular[6]:

- *The Ross acquisition may not work out as anticipated and is therefore subject to the following risks*: The success of the PEYE/Ross combined company will depend, in part, on the combined company's ability to successfully combine and integrate Ross's business, and realize the anticipated benefits, including synergies, cost savings, innovation and technological opportunities and operational efficiencies in a manner that does not materially disrupt existing customer, supplier and employee relations and does not result in decreased revenues due to losses of, or decreases in orders by, customers. If the combined company is unable to achieve these objectives within the anticipated time frame, or at all, the anticipated benefits may not be realized fully or at all, or may take longer to realize than expected, and the value of the combined company common stock may decline. The combined company may fail to realize some or all of the anticipated benefits of the merger if the integration process takes longer than expected or is more costly than expected. In addition, the combined company will be significantly larger than the size of either PEYE or Ross's separate businesses. The combined company's ability to successfully manage its business will depend, in part, upon management's ability to design and implement strategic initiatives, but also the increased scale and scope of the combined business with its associated increased costs and complexity. There can be no assurances that the combined company will be successful in integrating the businesses or that it will realize the expected operating efficiencies, cost savings and other benefits currently anticipated from the acquisition.
- *PEYE has a history of losses, may continue to incur losses, may never achieve profitability and may need to raise additional funds*. PEYE has accumulated $45.5 million in historical losses through Q3 of its FY 2019. PEYE may incur losses for the foreseeable future and may never achieve sustained profitability. PEYE must generate sufficient cash flow or raise additional capital to pursue PEYE's product development initiatives, penetrate markets for the sale of PEYE's products and continue to conduct operations. PEYE cannot provide any assurance that PEYE will raise additional capital. PEYE believes it has access to capital resources through possible public or private equity offerings, debt financings, corporate collaborations, strategic alliances, or other means, but may not raise enough capital to meet PEYE's needs and the company may thus have to raise additional capital in the future. If PEYE is unable to secure additional capital, it may be required to curtail its research and development initiatives and take additional measures to reduce costs in order to conserve its cash in amounts sufficient to sustain operations and meet its obligations. These measures could cause significant delays in PEYE's efforts to further commercialize its products and complete development projects and manufacturing services for its customers, which are critical to the realization of PEYE's business plan and to its future operations.
- *PEYE relies on a small number of customers who may not consistently purchase PEYE's products in the future and if PEYE loses any one of these customers, PEYE's revenues may*

[4] A multiple below peers is warranted in light of PEYE's relatively low market capitalization and small float.
[5] Calculation = 3.7 X 9.87MM (pro forma annual revenue) / 12.8MM (shares outstanding).
[6] For a full set of risk factors, please see that included in PEYE's recent secondary offering prospectus here.

decline. For the nine months ended March 31, 2019, approximately 77% of PEYE's sales were made to seven customers. Of these, three were medium to large, international, medical device companies and one was a large defense contractor. Each of these customers has been our customer for numerous years. The other three customers were early-stage companies developing endoscopic products that incorporate our unique design capabilities. In the fiscal year ended June 30, 2018, PEYE's two largest customers represented approximately 16%, and 14%, respectively, of PEYE's total revenues. In the fiscal year ended June 30, 2017, PEYE's three largest customers represented approximately 11%, 10%, and 10%, respectively, of PEYE's total revenues. No other customer accounted for more than 10% of PEYE's revenues during those periods. At June 30, 2018, PEYE's largest customer account receivable balances were 22%, 16%, 13%, and 13%, respectively, of total accounts receivable. At June 30, 2017, PEYE's five largest account receivable balances were 16%, 15%, 12%, 12%, and 11%, respectively, of the total accounts receivable.

- _In the future, a small number of customers may continue to represent a significant portion of PEYE's total revenues in any given period. These customers may not consistently purchase PEYE's products at a particular rate over any subsequent period. A loss of any of these customers could adversely affect PEYE's revenues_. PEYE could suffer unrecoverable losses on PEYE's customers' accounts receivable, which would adversely affect PEYE's financial results. At June 30, 2018, PEYE's largest customer account receivable balances were 22%, 16%, 13%, and 13%, respectively, of total accounts receivable. While PEYE has a varied customer base and has experienced strong collections in the past, PEYE may experience changes in its customer base, including reductions in purchasing commitments, which could also have a material adverse effect on its revenues and liquidity. Additionally, PEYE's customers could become unable or unwilling to pay amounts owed to it. During fiscal 2018, PEYE recorded a $227,500 reserve against accounts receivable amounts owed by one customer that has not been able to pay for design services PEYE provided. PEYE has not purchased insurance on its accounts receivable balances. Large uncollectible accounts receivable balances could have a material adverse effect on PEYE's financial condition.
- _PEYE rely heavily upon the talents of PEYE's Chief Executive Officer, the loss of whom could damage PEYE's business_. PEYE's performance depends, to a large extent, on a small number of key scientific, technical, managerial and marketing personnel. In particular, PEYE's success is highly dependent upon the services and reputation of its Chief Executive Officer, Dr. Joseph N. Forkey. The loss of Dr. Forkey's services could damage PEYE's business. Dr. Forkey provides highly valuable contributions to PEYE's capabilities in optical instrument development, in management of new technology and in potentially significant longer-term Company initiatives.
- _PEYE 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 PEYE's business has been devoted to research, development and production under fixed-price purchase orders. For PEYE's purposes, a fixed-price purchase order is any purchase order under which PEYE 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 PEYE's total revenues during the last several years. PEYE expects that revenues from fixed-price purchase orders will continue to represent a significant portion of PEYE's total revenues in future fiscal years.
- _PEYE primarily performs engineering and manufacturing services for PEYE's customers who could decide to use another vendor for these services in the future_. A significant portion of PEYE's revenues are derived from engineering and manufacturing services that PEYE performs to design and fabricate medical device products or sub-assemblies of medical device products for its customers who in turn sell the products to the end users. PEYE's customers typically own the proprietary rights to and control commercial distribution of the final products. Therefore, in many of these cases PEYE does not own the proprietary rights to the medical device products that it manufactures or that its sub-assemblies are made a part of. PEYE's customers could decide to use other suppliers for these services based on cost, quality, delivery time, production capacities, competitive and regulatory considerations

or other factors. Thus, revenues from PEYE's customers and the products and services PEYE provides them are subject to significant fluctuation on a product to product basis from period to period.

III. Trading Volume and Short Interest

Although a microcap stock, PEYE has been fairly liquid recently, averaging over 18,000 shares traded per day over the past three months, meaning an individual investor could establish a decent position over a short period and a small fund could do so over a longer period. Please see the most recent 3 weeks worth of trading volume below [source]:

Date	Open	High	Low	Close / Last	Volume
16:00	N/A	N/A	N/A	1.42	0
09/10/2019	1.48	1.48	1.42	1.42	932
09/09/2019	1.49	1.5	1.42	1.42	6,800
09/06/2019	1.3	1.3	1.3	1.3	00
09/05/2019	1.3	1.3	1.3	1.3	6,259
09/04/2019	1.28	1.29	1.28	1.29	4,100
09/03/2019	1.45	1.45	1.25	1.25	17,600
08/30/2019	1.5	1.55	1.48	1.49	6,947
08/29/2019	1.18	1.5	1.12	1.5	5,460
08/28/2019	1.4	1.79	1.23	1.23	27,600
08/27/2019	1.43	1.5	1.29	1.35	29,350
08/26/2019	1.46	1.46	1.43	1.43	12,990
08/23/2019	1.32	1.5	1.31	1.39	10,500
08/22/2019	1.57	1.57	1.1601	1.4	50,900
08/21/2019	1.69	1.69	1.69	1.69	100
08/20/2019	1.67	1.67	1.67	1.67	00

Regarding short interest, the most recent figures show that PEYE's is virtually nonexistent, at just 900 shares [source].

IV. Conclusion

Occasionally an opportunity arises in the stock market where a company undergoes significant positive change, yet investors fail to see it in real time. Often this can happen when a company announces a game-changing acquisition. One means of detecting such a situation is by scrutiny of a deal's *pro forma* financials on file with the SEC—while the historical financial accounts may appear unappealing, those of the combined entity occasionally present an entirely different prospect. This is essentially what we see happening with PEYE, given the extremely low multiple of earnings PEYE has dished out for Ross Optical. While many risks abound for a company as small as PEYE (even after accounting for the acquired operations), we think PEYE's current market valuation is simply far too low given overall peer metrics. Assuming that PEYE continues to trade below peers on a P/S and EV/S basis, yet is able to close half of the current gap, we see significant (namely, 101%) upside for investors purchasing PEYE at prevailing market prices. It's pie time investors cut out a piece of this PEYE for their portfolios[7].

[7] See footnote 1 above.

V. Disclaimer

As of the publication date of this report, Seven Corners Capital Management and its affiliates (collectively, "Seven Corners") have long positions in the Precision Optics stock ("PEYE"). In addition, others that contributed research to this report and others that we have shared our research with (collectively with Seven Corners, the "Authors") likewise may have long positions in, and/or own options on, PEYE. The Authors stand to realize gains in the event that the price of the stock increases. Following publication of the report, the Authors may transact in the securities of the company covered herein. All content in this report represent the opinions of Seven Corners. The Authors have obtained all information herein from sources they believe to be accurate and reliable. However, such information is presented "as is," without warranty of any kind—whether express or implied. The Authors make no representation, express or implied, as to the accuracy, timeliness, or completeness of any such information or with regard to the results obtained from its use. All expressions of opinion are subject to change without notice, and the Authors do not undertake to update or supplement this report or any information contained herein.

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Any investment involves substantial risks, including, but not limited to, pricing volatility, inadequate liquidity, and the potential complete loss of principal. This report's estimated fundamental value only represents a best efforts estimate of the potential fundamental valuation of a specific security, and is not expressed as, or implied as, assessments of the quality of a security, a summary of past performance, or an actionable investment strategy for an investor.

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VI. Appendix A – Financial Metrics for PEYE and Peers

	AXGN	UTMD	SPNE	VRAY	TRXC	IRMD	BLFS	ECIA	PEYE	PEYE(PF)
Shares O/S per SEC filings (MM)	39.3	3.72	19.1	98.5	245.6	11.4	19	11.6	12.04	12.80
Recent Stock Price ($)	16.4	96.9	11	3.86	0.76	18.5	19.5	0.38	1.42	1.42
Recent Market Cap ($MM)	645	360	210	380	187	211	371	4.4	17.1	18.2
Valuation Measures										
Net Debt ($MM)	-107	-36	-28	-38	0	-28	17	0	0	0.50
Enterprise Value ($MM)	538	324	182	342	187	183	388	4.4	17.1	18.7
Trailing P/E [1]	N/A	21.55	N/A	N/A	N/A	28.2	143.46	N/A	N/A	38.50
Forward P/E [1]	-65.76	N/A	-8.08	-4.24	-2.54	18.5	51.34	N/A	N/A	71.00
PEG Ratio (5 yr expected) [1]	N/A	N/A	N/A	N/A	N/A	1.46	N/A	N/A	N/A	n/a
Price/Sales (ttm)	6.71	8.44	1.41	4.28	9.94	6.28	15.96	6.14	2.90	1.84
Price/Book (mrq)	4.66	3.84	1.69	3.09	1.27	4.40	7.96	2.00	7.10	4.18
Enterprise Value/Revenue	5.59	7.59	1.22	3.85	9.94	5.44	16.69	6.14	2.90	1.89
Enterprise Value/EBITDA [6]	-20.80	14.80	-7.09	-3.90	-2.90	22.64	86.30	-19.42	-29.94	24.90
Trading Information										
Stock Price History										
Beta (3Y Monthly)	0.77	0.92	0.03	1.83	3.05	2.06	1.5	0.43	0.88	0.88
52-Week Change [3]	-60.10%	5.15%	-33.46%	-62.94%	-85.80%	-37.00%	0.05%	-20.83%	-2.26%	-2.26%
S&P500 52-Week Change [3]	3.44%	3.44%	3.44%	3.44%	3.44%	3.44%	3.44%	3.44%	3.44%	3.44%
52 Week High [3]	41.5	102.7	20.75	10.44	6.98	39	22.44	0.48	1.85	1.85
52 Week Low [3]	11.82	73.98	10.44	2.76	0.7	16.7	9.15	0.29	0.8	0.8
50-Day Moving Average [3]	16.19	92.99	11.74	5.8168	1.0824	20.4	19.26	0.3926	1.4191	1.4191
200-Day Moving Average [3]	19.68	87.05	13.59	7.6714	1.6668	22.8	17.98	0.382	1.3033	1.3033

	AXGN	UTMD	SPNE	VRAY	TRXC	IRMD	BLFS	ECIA	PEYE	PEYE(PF)
Share Statistics										
Avg Vol (3 month) [3]	556.19k	16.19k	40.84k	1.9M	2.52M	78k	193.88k	7.63k	18.62k	18.62k
Avg Vol (10 day) [3]	304.78k	7.72k	41.17k	1.48M	2.94M	46k	156.63k	500	6.73k	6.73k
Shares Outstanding [5]	39.26	3.72	19.05	98.48	217.74	11.4	20.1	11.56	12.04	12.80
Float	29.08M	3.2M	14.5M	48.01M	191.99M	5.38M	11.5M	5.83M	8.28M	9.00M
% Held by Insiders [1]	3%	9%	17%	24%	12%	55%	30%	45%	36%	38%
% Held by Institutions [1]	89%	76%	60%	103%	36%	23%	42%	9%	23%	21%
Shares Short (Aug 14, 2019) [4]	1.88M	275.01k	104.35k	19.65M	30.41M	447k	1.42M	337	N/A	N/A
Short Ratio (Aug 14, 2019) [4]	2.33	19.82	2.97	6.5	12.39	3.9	7.76	0.49	0	1
Short % of Float (Aug 14, 2019) [4]	4.95%	9.25%	0.66%	26.74%	16.11%	8.68%	16.62%	N/A	N/A	N/A
Short % of Shares Outstanding (A	4.80%	7.39%	0.55%	19.95%	13.97%	3.93%	7.04%	0.05%	0.00%	0.00%
Shares Short (prior month Jul 14, :	1.88M	201.8k	112.68k	22.4M	32.8M	527k	1.34M	120	150	150
Short Interest	4.78%									
Dividends & Splits										
Forward Annual Dividend Rate [4]	N/A	1.1	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Forward Annual Dividend Yield [4]	N/A	1.17%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Trailing Annual Dividend Rate [3]	N/A	1.1	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Trailing Annual Dividend Yield [3]	N/A	1.12%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
5 Year Average Dividend Yield [4]	N/A	1.51	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Payout Ratio [4]	0.00%	24.39%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Dividend Date [3]	11-Feb-10	2-Oct-19	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Ex-Dividend Date [4]	26-Jan-10	11-Sep-19	N/A	N/A	N/A	N/A	N/A	12-May-96	N/A	N/A
Last Split Factor (new per old) [2]	100/105	3-Feb	N/A	1-Jan	1-May	N/A	14/1	N/A	25/1	25/1
Last Split Date [3]	10-Jul-94	21-Mar-93	N/A	7-Jul-15	1-Apr-14	N/A	28-Jan-14	N/A	10-Dec-08	10-Dec-08
Financial Highlights										
Fiscal Year										
Fiscal Year Ends	30-Dec-18	30-Dec-18	30-Dec-18	30-Dec-18	30-Dec-18	30-Dec-18	30-Dec-18	30-Mar-19	29-Jun-18	29-Jun-18
Most Recent Quarter (mrq)	29-Jun-19	29-Jun-19	29-Jun-19	29-Jun-19	29-Jun-19	29-Jun-19	29-Jun-19	29-Jun-19	30-Mar-19	30-Mar-19
Profitability										
Profit Margin	-26.91%	39.37%	-26.84%	-128.13%	0.00%	23.90%	14.59%	-5.24%	-8.31%	2.03%
Operating Margin (ttm)	-27.86%	40.36%	-24.48%	-103.35%	-410.87%	21.20%	17.22%	-4.85%	-10.20%	2.53%

	AXGN	UTMD	SPNE	VRAY	TRXC	IRMD	BLFS	ECIA	PEYE	PEYE(PF)
Management Effectiveness										
Return on Assets (ttm)	-10.55%	10.76%	-15.68%	-27.15%	-21.60%	8.94%	6.80%	-6.62%	-13.09%	3.61%
Return on Equity (ttm)	-17.93%	18.98%	-35.55%	-141.41%	-46.66%	19.30%	10.28%	-19.79%	-24.00%	5.88%
Income Statement										
Revenue (ttm)	96.08	42.73	149.32	88.78	18.77	33.60	23.22	8.33	5.89	9.87
Gross Profit %	73.91%	61.57%	58.58%	7.43%	42.25%	69.14%	58.27%	56.06%	31.14%	35.00%
Revenue Per Share (ttm)	2.44	11.49	7.82	0.90	0.08	2.95	1.22	0.72	0.49	0.77
Quarterly Revenue Growth (yoy)	30%	8%	8%	84%	-43%	25%	29%	-20%	89%	???
Gross Profit (ttm)	71.01	26.31	87.47	6.6	7.93	23.23	13.53	4.67	1.834	3.46
EBITDA	-25.84	21.93	-25.67	-87.78	-64.34	8.08	4.49	-0.227	-0.571	0.75
Net Income Avi to Common (ttm)	-25.86	16.82	-40.08	-113.75	-69.34	8.04	3.25	-0.437	-0.489	0.2
Diluted EPS (ttm)	-0.67	4.49	-2.27	-1.213	-0.338	0.66	0.14	-0.042	-0.048	0.02
Quarterly Earnings Growth (yoy)	N/A	-18.20%	N/A	N/A	N/A	54.20%	-26.40%	N/A	N/A	N/A
Balance Sheet										
Total Cash (mrq)	103.06	32.88	36.44	122.05	33.27	37.8	19.62	0.136	1.35	1.15
Total Cash Per Share (mrq)	2.62	8.84	1.91	1.24	0.15	3.33	1.03	0.01	0.11	0.12
Total Debt (mrq)	4.21	0.433	N/A	69.06	32.45	3.07	1.5	1.38	0.17	0.50
Total Debt/Equity (mrq)	3.05	0.46	N/A	56.19	24.68	6.5	3.23	63.52	0.69	0.15
Current Ratio (mrq)	8.7	12.1	3.6	4.01	3.08	10.3	9.42	2.44	2.88	2.61
Book Value Per Share (mrq)	3.52	25.25	6.51	1.25	0.6	4.2	2.45	0.19	0.2	0.34
Cash Flow Statement										
Operating Cash Flow (ttm)	-22.62M	14.13M	-17.54M	-122.91M	-68.84M	7.42M	2.47M	-276.18k	-746.69k	200k
Levered Free Cash Flow (ttm)	-24.05M	-10.45M	-15.36M	-64.38M	-36.27M	3.94M	169.82k	0.19	-795.69k	200k

Note: Data are as of 9/9/19, derived from multiple sources or as calculated by Yahoo Finance.