

Inrad Optics, Inc.  
Form 10-Q  
August 14, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended **JUNE 30, 2014**

**OR**

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

For the transition period from to

Commission file number **0-11668**

**INRAD OPTICS, INC.**

(Exact name of registrant as specified in its charter)

**New Jersey**

(State or other jurisdiction of incorporation or organization)

**22-2003247**

(I.R.S. Employer Identification Number)

**181 Legrand Avenue, Northvale, NJ 07647**

(Address of principal executive offices)

(Zip Code)

**(201) 767-1910**

(Registrant's telephone number, including area code)

(Former name, former address and formal fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer, accelerated filer and smaller reporting company" in Rule 12b-2 of the exchange Act. (Check one):

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Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

**The number of shares of the registrant's common stock outstanding, \$0.01 par value, as of August 14, 2014 was 12,349,493**

INRAD OPTICS, INC AND SUBSIDIARIES

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**INRAD OPTICS, INC AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

	June 30, 2014 (Unaudited)	December 31, 2013 (Audited)
<u>Assets</u>		
Current assets:		
Cash and cash equivalents	\$959,636	\$2,451,263
Accounts receivable (net of allowance for doubtful accounts of \$15,000 in 2014 and 2013)	1,121,043	1,236,958
Inventories, net	2,917,718	3,129,855
Other current assets	103,409	144,581
Total current assets	5,101,806	6,962,657
Plant and equipment:		
Plant and equipment, at cost	15,674,367	15,638,759
Less: Accumulated depreciation and amortization	(13,874,280)	(13,931,775 )
Total plant and equipment	1,800,087	1,706,984
Precious Metals	483,676	474,960
Goodwill	311,572	311,572
Intangible Assets, net	319,479	358,760
Other Assets	33,122	33,122
Total Assets	\$8,049,742	\$9,848,055
Liabilities and Shareholders' Equity		
Current Liabilities:		
Current portion of other long term notes	\$156,600	\$156,600
Accounts payable and accrued liabilities	919,537	967,963
Customer advances	251,370	146,784
Total current liabilities	1,327,507	1,271,347
Related Party Convertible Notes Payable	2,500,000	2,500,000
Other Long Term Notes, net of current portion	635,339	712,868
Total liabilities	4,462,846	4,484,215
Commitments		
Shareholders' Equity:		
Common stock: \$.01 par value; 60,000,000 authorized shares; 12,354,093 shares issued at June 30, 2014 and 12,050,603 issued at December 31, 2013	123,543	120,508
Capital in excess of par value	18,419,966	18,293,782
Accumulated deficit	(14,941,663)	(13,035,500 )
	3,601,846	5,378,790
Less - Common stock in treasury, at cost (4,600 shares)	(14,950 )	(14,950 )

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Total shareholders' equity	3,586,896	5,363,840
Total Liabilities and Shareholders' Equity	\$8,049,742	\$9,848,055

See Notes to Condensed Consolidated Financial Statements (Unaudited)

**INRAD OPTICS, INC AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	<b>2014</b>	2013
Total revenue	\$2,227,546	\$2,694,598	\$4,131,926	\$5,771,724
Cost and expenses:				
Cost of goods sold	2,307,000	2,386,866	4,288,678	4,764,894
Restructuring costs	61,951	—	120,616	—
Selling, general and administrative expenses	844,581	909,664	1,603,686	1,763,472
	3,213,532	3,296,530	6,012,980	6,528,366
Loss from operations	(985,986 )	(601,932 )	(1,881,054 )	(756,642 )
Other expense:				
Interest expense—net	(45,308 )	(45,832 )	(90,183 )	(91,476 )
Gain on sale of plant and equipment	—	—	65,074	31,000
	(45,308 )	(45,832 )	(25,109 )	(60,476 )
Net loss before income taxes	(1,031,294 )	(647,764 )	(1,906,163 )	(817,118 )
Income tax (provision) benefit	—	—	—	—
Net loss	\$(1,031,294 )	\$(647,764 )	\$(1,906,163 )	\$(817,118 )
Net loss per common share—basic and diluted	\$(0.08 )	\$(0.05 )	\$(0.16 )	\$(0.07 )
Weighted average shares outstanding—basic and diluted	12,349,490	12,046,003	12,133,666	11,926,328

See Notes to Condensed Consolidated Financial Statements (Unaudited)



**INRAD OPTICS, INC AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

	<b>Six Months Ended June 30,</b>	
	<b>2014</b>	<b>2013</b>
<b>Cash flows from operating activities:</b>		
Net (loss)	\$(1,906,163)	\$(817,118 )
<b>Adjustments to reconcile net (loss) to net cash (used in) operating activities:</b>		
Depreciation and amortization	295,721	259,094
401K common stock contribution	71,255	80,922
(Gain) on sale of plant and equipment	(65,074 )	(31,000 )
Stock based compensation	57,964	80,284
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	115,915	185,660
Inventories, net	212,137	200,393
Other current assets	41,172	46,797
Accounts payable and accrued liabilities	(48,427 )	(26,180 )
Customer advances	104,586	(112,512 )
Total adjustments and changes	785,249	683,458
<b>Net cash (used in) operating activities</b>	<b>(1,120,914)</b>	<b>(133,660 )</b>
<b>Cash flows from investing activities:</b>		
Capital expenditures	(362,848 )	(447,039 )
Purchase of precious metal tools	(8,716 )	—
Proceeds from sale of plant and equipment	78,380	31,000
<b>Net cash (used in) investing activities</b>	<b>(293,184 )</b>	<b>(416,039 )</b>
<b>Cash flows from financing activities:</b>		
Principal payments on notes payable-other	(77,529 )	(74,169 )
<b>Net cash (used in) financing activities</b>	<b>(77,529 )</b>	<b>(74,169 )</b>
<b>Net (decrease) in cash and cash equivalents</b>	<b>(1,491,627)</b>	<b>(623,868 )</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>2,451,263</b>	<b>3,089,013</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$959,636</b>	<b>\$2,465,145</b>
Supplemental Disclosure of Cash Flow Information:		
Interest paid	\$55,000	\$59,000
Income taxes paid	\$2,000	\$2,000

See Notes to Condensed Consolidated Financial Statements (Unaudited)

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**INRAD OPTICS, INC AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**NOTE 1 -SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements include the accounts of Inrad Optics, Inc. and its subsidiaries (collectively, the “Company”). All significant intercompany balances and transactions have been eliminated.

The condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments of a normal recurring nature considered necessary for a fair presentation have been included. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for the full fiscal year. For further information, refer to the consolidated financial statements and accompanying footnotes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013.

In preparing these consolidated financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through the date the consolidated financial statements were issued.

**Management Estimates**

These unaudited condensed consolidated financial statements and related disclosures have been prepared in conformity with U.S. GAAP which 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 reported in those financial statements. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, and makes adjustments when facts and circumstances dictate. As future events

and their effects cannot be determined with precision, actual results could differ significantly from those estimates and assumptions. Significant changes, if any, in those estimates resulting from continuing changes in the economic environment will be reflected in the consolidated financial statements in future periods.

## Inventories

Inventories are stated at the lower of cost (first-in-first-out basis) or market. The Company records a reserve for slow moving inventory as a charge against earnings for all products identified as surplus, slow-moving or discontinued. Excess work-in-process costs are charged against earnings whenever estimated costs-of-completion exceed unbilled revenues.

Inventories are comprised of the following and are shown net of inventory reserves, in thousands:

	June 30, 2014 (Unaudited)	December 31, 2013
Raw materials	\$1,028	\$ 1,012
Work in process, including manufactured parts and components	1,145	1,155
Finished goods	745	963
	\$2,918	\$ 3,130

## Income Taxes

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Deferred tax assets and liabilities are determined based on the difference between the financial statements carrying amounts and the tax basis of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse.

For the three and six months ended June 30, 2014 and 2013 the Company did not record a current provision for either state or federal income tax due to the losses incurred for both income tax and financial reporting purposes or the availability of net operating loss carry-forwards to offset against federal and state income tax.

In evaluating the Company's ability to recover deferred tax assets in future periods, management considers the available positive and negative factors, including the Company's recent operating results, the existence of cumulative losses and near term forecasts of future taxable income consistent with the plans and estimates that management uses to manage the underlying business. A significant piece of objective negative evidence evaluated was the cumulative loss incurred by the Company in the three-year period ended December 31, 2013 as well as the six months ended June 30, 2014. Such objective evidence limits the ability to consider other subjective evidence such as our projections for future growth.

On the basis of this evaluation as of June 30, 2014, the Company's management concluded that it is more likely than not that the Company will not be able to realize any portion of the benefit on the net deferred tax balance of \$4,287,000 and therefore the Company continues to maintain a valuation allowance for the full amount of the net deferred tax balance.

When sufficient positive evidence exists, the Company's income tax expense will be charged with the increase or decrease in its valuation allowance. An increase or reversal of the Company's valuation allowance could have a significant negative or positive impact on the Company's future earnings.

## Net (Loss) Income per Common Share

Basic net (loss) income per common share is computed by dividing net (loss) income by the weighted average number of common shares outstanding during the period. Diluted net (loss) income per common share is computed by dividing net (loss) income by the weighted average number of common shares and common stock equivalents outstanding, calculated on the treasury stock method for options, stock grants and warrants using the average market

prices during the period, including potential common shares issuable upon conversion of outstanding convertible notes, except if the effect on the per share amounts is anti-dilutive.

For the three and six months ended June 30, 2014, all common stock equivalents were excluded from the computation of diluted net loss per share because their effect is anti-dilutive. This included 2,500,000 common shares and 1,875,000 warrants issuable upon conversion of outstanding related party convertible notes in each respective period, in addition to 923,651 common stock options and grants, in each respective period.

For the three and six months ended June 30, 2013, all common stock equivalents were excluded from the computation of diluted net loss per share because their effect is anti-dilutive. This included 2,500,000 common shares and 1,875,000 warrants issuable upon conversion of outstanding related party convertible notes in each respective period, in addition to 970,211 common stock options and grants, in each respective period.

#### Stock-Based Compensation

Stock-based compensation expense is estimated at the grant date based on the fair value of the award. The Company estimates the fair value of stock options granted using the Black-Scholes option pricing model. The fair value of restricted stock units granted is based on the closing market price of the Company's common stock on the date of the grant. The fair value of these awards, adjusted for estimated forfeitures, is amortized over the requisite service period of the award, which is generally the vesting period.

## Recently Adopted Accounting Standards

In July 2013, the Financial Accounting Standard Board ("FASB") amended its guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, similar tax loss, or a tax credit carryforward exists. This guidance is effective for fiscal periods beginning after December 15, 2013. The adoption of this amendment did not have a material impact on the Company's consolidated financial statements.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). This updated outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. This new guidance is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016; early adoption is not permitted. Companies have the option of using either a full retrospective or a modified retrospective approach to adopt the guidance. This update could impact the timing and amounts of revenue recognized. The Company is currently evaluating the effect that implementation of this update will have on its consolidated financial position and results of operations upon adoption.

## NOTE 2- EQUITY COMPENSATION PROGRAM AND STOCK BASED COMPENSATION

### a) Stock Option Expense

The Company's results of operations for the three months ended June 30, 2014 and 2013 include stock-based compensation expense for stock option grants totaling \$24,425 and \$38,930, respectively. Such amounts have been included in the accompanying Condensed Consolidated Statements of Operations within cost of goods sold in the amount of \$11,000 (\$20,314 for 2013), and selling, general and administrative expenses in the amount of \$13,425 (\$18,616 for 2013).

The Company's results of operations for the six months ended June 30, 2014 and 2013 include stock-based compensation expense for stock option grants totaling \$56,752 and \$77,860, respectively. Such amounts have been included in the accompanying Condensed Consolidated Statements of Operations within cost of goods sold in the amount of \$27,190 (\$40,628 for 2013), and selling, general and administrative expenses in the amount of \$29,562 (\$37,232 for 2013).

As of June 30, 2014 and 2013, there were \$67,629 and \$148,232 of unrecognized compensation cost, net of estimated forfeitures, related to non-vested stock options, which are expected to be recognized over a weighted average period

of approximately 1.2 years and 1.4 years, respectively.

There were 103,000 and 80,000 stock options granted during the six months ended June 30, 2014 and 2013. The following range of weighted-average assumptions were used to determine the fair value of stock option grants during the six months ended June 30, 2014 and 2013:

	Six Months Ended	
	June 30, 2014	2013
Expected Dividend yield	— %	—%
Expected Volatility	116.4 %	98.1 – 110%
Risk-free interest rate	1.9 %	1.9 – 2.1%
Expected term	10 years	8 – 10 years



## b) Stock Option Activity

The following table represents stock options granted, exercised and forfeited during the six month period ended June 30, 2014:

<b>Stock Options</b>	Number of Options	Weighted Average Exercise Price per Option	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at January 1, 2014	979,021	\$ .96	5.7	\$ —
Granted	103,000	.27		
Exercised	—	—		
Expired/Forfeited	(158,370)	.83		
Outstanding at June 30, 2014	923,651	\$ .91	5.7	\$ 300
Exercisable at June 30, 2014	691,397	\$ 1.07	5.3	\$ 50

The following table represents non-vested stock options granted, vested and forfeited for the six months ended June 30, 2014.

	Options	Weighted-Average Grant-Date Fair Value
Non-vested - January 1, 2014	206,897	\$ 0.55
Granted	103,000	\$ 0.26
Vested	(69,516 )	\$ 0.95
Forfeited	(8,127 )	\$ 0.84
Non-vested – June 30, 2014	232,254	\$ 0.38

The total fair value of options vested during the six months ended June 30, 2014 and 2013 was \$65,993 and \$81,133, respectively.

## c) Restricted Stock Unit Awards

There were no grants of restricted stock units granted under the 2010 Equity Compensation Program during the six months ended June 30, 2014 and 2013.

Restricted stock units granted usually vest over a three year period at the rate of one-third per year, contingent on continued employment or service during the vesting period.

All of the restricted stock units last granted were fully vested during the first quarter of 2014 and therefore there was no remaining expense to be recognized during the three months ended June 30, 2014. The Company's results of operations for the three months ended June 30, 2013 include stock-based compensation expense for restricted stock unit grants totaling \$1,212 and such amounts have been included in the accompanying Consolidated Statements of Operations within selling, general and administrative expenses.

The Company's results of operations for the six months ended June 30, 2014 and 2013 include stock-based compensation expense for restricted stock unit grants totaling \$1,212 and \$2,424, respectively, and such amounts have been included in the accompanying Consolidated Statements of Operations within selling, general and administrative expenses.

A summary of the Company's non-vested restricted stock units at June 30, 2014 is presented below:

	Restricted Stock Units	Weighted-Average Grant-Date Fair Value
Non-vested - January 1, 2014	5,000	\$ 0.97
Granted	—	—
Vested	(5,000 )	\$ 0.97
Forfeited	—	—
Non-vested – June 30, 2014	—	—

#### NOTE 3- STOCKHOLDERS' EQUITY

For the six months ended June 30, 2014, the Company issued 5,000 common shares on vesting of restricted stock awards. In April 2014, the Company issued an additional 298,490 common shares to the Inrad Optics 401k plan as a match to employee contributions for the 2013 Plan year.

#### NOTE 4 – RELATED PARTY TRANSACTIONS

On July 29, 2014, the maturity dates of a \$1,500,000 Subordinated Convertible Promissory Note to Clarex Limited (“Clarex”) and a \$1,000,000 Subordinated Convertible Promissory Note to an affiliate of Clarex were each extended to April 1, 2017 from April 1, 2015. The notes bear interest at 6%. Interest accrues yearly and is payable on maturity. Unpaid interest, along with principal, may be converted into securities of the Company as follows: the notes are convertible in the aggregate into 1,500,000 units and 1,000,000 units, respectively, with each unit consisting of one share of common stock and one warrant. Each warrant allows the holder to acquire 0.75 shares of common stock at a price of \$1.35 per share. As part of the agreement, the expiration dates of the warrants were extended from April 1, 2018 to April 1, 2020.. The Company is currently paying interest of \$37,500 quarterly.

#### NOTE 5 – OTHER LONG TERM NOTES

On July 26, 2012, the Company entered into a term loan agreement in the amount of \$750,000 with Valley National Bank, Wayne, NJ. The loan is payable in equal monthly installments over five years beginning in August 2012 and bears an interest rate of 4.35% annually. The loan is secured with a security interest in new equipment, which the Company placed in service in 2013. In 2012, the Company made a down-payment of \$500,000 on the equipment and the balance of the purchase price of \$325,000 was paid in 2013 when the equipment was placed in service. The full

amount of the asset was included in Machinery and Equipment at December 31, 2013.

The Company also has a note payable to the U.S. Small Business Administration which bears interest at the rate of 4.0% and is due in 2032.

Other Long Term Notes consist of the following:

	June 30, 2014	December 31, 2013
	(in thousands)	
Term Note Payable, payable in equal monthly installments of \$13,953 and bearing an interest rate of 4.35% and expiring in July 2017	\$481	\$ 554
U.S. Small Business Administration term note payable in equal monthly installments of \$1,922 and bearing an interest rate of 4.0% and expiring in April 2032.	\$310	\$ 315
	791	869
Less current portion	(156)	(156)
Long-term debt, excluding current portion	\$635	\$ 713

#### NOTE 6 – RESTRUCTURING COSTS

In November 2013, the Company announced plans to move the operations of its Sarasota, FL metal optics facility to its Northvale, NJ optical production center and corporate headquarters. The consolidation is part of a larger strategic effort to improve the Company's value proposition to its customers as well as improve its financial results. The physical integration of all development and production in one location is intended to enhance operating efficiencies and reduce overhead costs and centralize the Company's optical problem solving skills. This will allow for beneficial cross-pollination of expertise, including leveraging the Florida metal optics facility's single point diamond turning capability over a broader range of optical materials.

The decision also reflects the continued uncertainty in U.S. defense funding. Much of the Company's metal optics business serves U.S. government installations and defense prime contractors. The company experienced a falloff in bookings from these customer groups in 2013 and through the six months ended June 30, 2014.

As of March 31, 2014, the Company completed the transfer of the Sarasota operations to the Northvale facility and closed the Florida facility as scheduled. Through June 30, 2014, the Company incurred one-time charges of approximately \$746,000, primarily associated with employee termination and relocation, moving of equipment, preparation of the Northvale facility and other general costs associated with consolidation. Of the total, \$313,000 of restructuring costs were expensed in the fourth quarter of 2013. In addition, approximately \$62,000 and \$121,000 have been expensed in the three and six months ended June 30, 2014, respectively. Also included in the total are capital expenditures for leasehold improvements associated with this project. In the three and six months ended June 30, 2014, these were approximately \$171,000 and \$312,000, respectively and have been included in Plant and Equipment in the Company's Condensed Consolidated Balance Sheets at June 30, 2014. Depreciation of these and

associated capital expenditures will begin in the third quarter of 2014. Accrued restructuring costs related to severance and other costs in the amount of \$47,000 are expected to be paid through the end of 2014 and are included in Accounts Payable and Accrued Liabilities in the Company's Condensed Consolidated Balance Sheets at June 30, 2014.

Overall annual reductions in operational costs are expected to be in the range of \$800,000 to \$1,000,000 per year starting in the second quarter of 2014.

The following table summarizes restructuring information by type of cost:

(In Thousands)	Termination and Relocation	Northvale Facility Expenditures	Moving and Other Costs	Total
Restructuring costs expected to be incurred	\$ 227	\$ 374	\$ 145	\$746
Accrued balance December 31, 2013	\$ 227	\$ —	\$ 70	\$297
Provisions	—	41	18	59
Cash expenditures	(25 )	(41 )	(58 )	(124)
Accrued balance March 31, 2014	\$ 202	\$ —	\$ 30	\$232
Provisions	—	5	57	62
Cash expenditures	(155 )	(5 )	(87 )	(247)
Accrued balance June 30, 2014	\$ 47	\$ —	\$ —	\$47

#### NOTE 7 – WORKFORCE REDUCTION

In the first quarter of 2013, the Company instituted a plan to reduce its combined headcount by approximately 11%, in order to reduce costs and align its workforce with current business requirements while ensuring the Company would continue to meet its customers' needs. The reductions affected both the Company's Northvale, NJ and the Sarasota, FL operations. Annualized savings from the reductions are expected to be approximately \$700,000. Severance and other separation costs of \$112,000 and \$29,000 were expensed in the first and second quarters of 2013, respectively, and offset payroll savings of approximately \$45,000 and \$175,000, respectively.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Caution Regarding Forward Looking Statements

This Quarterly Report contains forward-looking statements as that term is defined in the federal securities laws. The Company wishes to insure that any forward-looking statements are accompanied by meaningful cautionary statements in order to comply with the terms of the safe harbor provided by the Private Securities Litigation Reform Act of 1995. The events described in the forward-looking statements contained in this Quarterly Report may not occur. Generally, these statements relate to business plans or strategies, projected or anticipated benefits or other consequences of the Company's plans or strategies, projected or anticipated benefits of acquisitions made by the Company, projections

involving anticipated revenues, earnings, or other aspects of the Company's operating results. The words "may", "will", "expect", "believe", "anticipate", "project", "plan", "intend", "estimate", and "continue", and their opposites and similar expressions are intended to identify forward-looking statements. The Company cautions you that these statements are not guarantees of future performance or events and are subject to a number of uncertainties, risks, and other influences, many of which are beyond the Company's control, that may influence the accuracy of the statements and the projections upon which the statements are based. Factors which may affect the Company's results include, but are not limited to, the risks and uncertainties discussed in Items 1A, 7 and 7A of the Company's most recent Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the Securities and Exchange Commission on March 31, 2014. Any one or more of these uncertainties, risks, and other influences could materially affect the Company's results of operations and whether forward-looking statements made by the Company ultimately prove to be accurate. Readers are further cautioned that the Company's financial results can vary from quarter to quarter, and the financial results for any period may not necessarily be indicative of future results. The foregoing is not intended to be an exhaustive list of all factors that could cause actual results to differ materially from those expressed in forward-looking statements made by the Company. The Company's actual results, performance and achievements could differ materially from those expressed or implied in these forward-looking statements. The Company undertakes no obligation to publicly update or revise any forward looking statements, whether from new information, future events, or otherwise.



## Critical Accounting Policies and Estimates

Our significant accounting policies are described in Note 1 of the accompanying consolidated financial statements and further discussed in our annual financial statements included in our annual report on Form 10-K for the year ended December 31, 2013. In preparing our condensed consolidated financial statements, we made estimates and judgments that affect the results of our operations and the value of assets and liabilities we report. These include estimates used in evaluating goodwill and intangibles for impairment such as market multiples used in determining the fair value of reporting units, discount rates applicable in determining net present values of future cash flows, projections of future sales, earnings and cash flow and capital expenditures. It also includes estimates about the amount and timing of future taxable income in determining the Company's valuation allowance for deferred income tax assets. Our actual results may differ from these estimates under different assumptions or conditions.

For additional information regarding our critical accounting policies and estimates, see the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our annual report filed with the Securities and Exchange Commission on Form 10-K for the year ended December 31, 2013.

## Results of Operations

Inrad Optics, Inc.'s business falls into two main categories: Optical Components and Laser System Devices/Instrumentation.

The Optical Components category is focused on custom optics manufacturing. The Company specializes in high-end precision components. It develops, manufactures and delivers precision custom optics and thin film optical coating services through its Custom and Metal Optics operations. Glass, metal, and crystal substrates are processed using modern manufacturing equipment, complex processes and techniques to manufacture components, deposit optical thin films, and assemble sub-components used in advanced photonic systems. The majority of custom optical components and optical coating services supplied are used in inspection, process control systems, defense and aerospace electro-optical systems, laser system applications, industrial scanners, and medical system applications.

The Laser System Devices/Instrumentation category includes the growth and fabrication of crystalline materials with electro-optic (EO) and non-linear optical properties for use in both standard and custom products. This category also includes the manufactured crystal based devices and associated instrumentation. The majority of crystals, crystal components and laser devices manufactured are used in laser systems, defense EO systems, medical lasers and R&D applications by engineers within corporations, universities and national laboratories.

The Company operates a manufacturing facility in Northvale, New Jersey. As of March 31, 2014 the Company's Florida facility has been closed and all manufacturing operations have been relocated to the New Jersey facility.

## Revenue

Sales for the three months ended June 30, 2014 were \$2,228,000, a decrease of 17.3%, from \$2,695,000 for the three months ended June 30, 2013. For the six months ended June 30, 2014, sales were \$4,132,000, a decrease of 28.4%, compared to \$5,771,000 for the six months ended June 30, 2013. This was primarily due to decreases in shipments to customers in the defense and the university and national lab markets. The decline in sales to the defense market was mainly due to the two large customers which were partially offset by an increase in another large customer. The decrease in the university and national lab market was spread across a number of the Company's existing customers. An increase in shipments to customers in the laser systems and process control & metrology markets partially offset the overall decline in sales.

Sales of Optical Components decreased by 18% while sales of Laser Devices/Instrumentation products decreased by 48.9% for the six months ended June 30, 2014 compared with the prior year.

In the six months ended June 30, 2014, the Company had one major customer representing more than 10% of total sales. In the six months ended June 30, 2013, no one customer represented more than 10% of total sales.

The Company's top five customers represented 46.7% of total sales in the six month period ended June 30, 2014, compared to 35.3% in the same period in 2013. Although the percentage of sales for the top five customers represented a higher percentage than the corresponding period last year, the overall sales for this group decreased by 4.7%. Only two of these customers were included in the top five in the corresponding period last year.

Orders booked during the first six months of 2014 increased to \$5.4 million compared to \$4.8 million in the comparable period last year.

Order backlog increased to \$5.6 million at June 30, 2014, compared to \$4.4 million at December 31, 2013 and \$4.9 million at June 30, 2013.

#### Cost of Goods Sold

For the three months ended June 30, 2014, cost of goods sold was \$2,369,000, including restructuring costs, compared to \$2,387,000 in the same quarter in 2013 or a decrease of \$18,000. For the six months ended June 30, 2014, cost of goods sold decreased by \$355,000 or 7.5% to \$4,409,000, including restructuring costs, compared to \$4,765,000 in the same period in 2013. As a percentage of sales, cost of goods sold increased in the three and six months ended June 30, 2014 compared to the respective periods in 2013. The decrease in cost of goods sold is mainly the result of the decrease in sales noted above although at a lower level than the sales decrease due to the relatively fixed nature of the Company's manufacturing overhead costs.

Manufacturing wages and salaries including related fringe benefits, decreased by 4.8% and 8.7%, respectively, during the three and six months ended June 30, 2014 compared to the same period last year. The decrease in 2014 included the impact of reductions made in the first and second quarters of 2013 related to the workforce reduction discussed in Note 7 to the Condensed Consolidated Financial Statements.

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Cost of goods sold in the three and six months ended June 30, 2014 include \$62,000 and \$131,000, respectively, of restructuring costs related to the relocation of the Florida operations as discussed in Note 6 to the Condensed Consolidated Financial Statements. Cost of goods sold for the six months ended June 30, 2013 includes severance costs of \$66,000 offset by associated payroll savings of \$106,000 and \$134,000, respectively, for the three and six months ended June 30, 2013.

Material costs for the three and six months ended June 30, 2014 decreased to 17.8% and 18.3% of sales, respectively, compared with 18.3% and 19.7% in the same period in 2013.

Gross margin decreased for the three and six months ended June 30, 2014 as a result of the factors discussed above. Gross margin in the second quarter of 2014 was (\$141,000), including restructuring costs, or (6.3%) versus \$308,000 or 11.4% in the same period in 2013. For the six months ended June 30, 2014, gross margin was (\$277,000), including restructuring costs, or (6.7%) versus \$1,007,000 or 17.4% in the same period in 2013.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses (“SG&A” expenses) in the three and six months ended June 30, 2014 amounted to \$845,000 or 37.9% of sales and \$1,604,000 or 38.8% of sales, respectively. This compared to \$910,000 or 33.8% of sales and \$1,763,000 or 30.6% of sales, respectively, for the same periods in 2013. For the three and six months ended June 30, 2013, SG&A expenses included approximately \$29,000 and \$75,000 in severance costs related to the workforce reduction discussed in Note 7 to the Condensed Consolidated Financial Statements. Associated payroll savings from the workforce reduction was \$69,000 and \$85,000 for the three and six months ended June 30, 2013.

### Loss from Operations

The Company had an operating loss of \$986,000 in the three months ended June 30, 2014 compared with an operating loss of \$602,000 in the three months ended June 30, 2013. For the six months ended June 30, 2014, the Company had an operating loss of \$1,881,000 compared with an operating loss of \$757,000 in the same period last year. The operating losses in 2014 and 2013 primarily reflect the impact of the level of sales on the Company’s relatively fixed cost structure in those periods. The operating losses for the three and six months ended June 30, 2014 include \$62,000 and \$121,000, respectively, of restructuring costs related to the relocation of the Florida operations as noted above. The operating losses for the three and six months ended June 30, 2013 include payroll savings net of the impact of severance costs from the reduction in workforce of approximately (\$146,000) and (\$79,000), respectively.

### Other Income and Expense

Interest expense for the three months ended June 30, 2014 was \$46,000 compared to \$48,000 in the same period in 2013. Interest expense for the six months ended June 30, 2014 was \$93,000 compared to \$96,000 in the same period in 2013.

In the first quarter of 2014 and 2013, the Company sold surplus machinery and recorded a gain of \$65,000 and \$31,000, respectively.

### Income Taxes

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Deferred tax assets and liabilities are determined based on the difference between the financial statements carrying amounts and the tax basis of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse.

For the three and six months ended June 30, 2014 and 2013, the Company did not record a current provision for either state or federal income tax due to the losses incurred for both income tax and financial reporting purposes or the availability of net operating loss carry-forwards to offset against federal and state income tax.

In evaluating the Company's ability to recover deferred tax assets in future periods, management considers the available positive and negative factors, including the Company's recent operating results, the existence of cumulative losses and near term forecasts of future taxable income consistent with the plans and estimates that management uses to manage the underlying business. A significant piece of objective negative evidence evaluated was the cumulative loss incurred by the Company over the three-year period ended December 31, 2013 as well as the six months ended June 30, 2014. Such objective evidence limits the ability to consider other subjective evidence such as our projections for future growth.

On the basis of this evaluation, as of June 30, 2014, the Company's management concluded that it is more likely than not that the Company will not be able to realize any portion of the benefit on the net deferred tax balance of \$4,287,000. As a result, the Company maintains a valuation allowance for the full amount of the net deferred tax balance.

When sufficient positive evidence exists, the Company's income tax expense will be charged with the increase or decrease in its valuation allowance. An increase or reversal of the Company's valuation allowance could have a significant negative or positive impact on the Company's future earnings.

## Net Loss

For the three and six months ended June 30, 2014, the Company had a net loss of \$1,031,000 and \$1,906,000, respectively, compared to a net loss of \$648,000 and \$817,000, respectively, for the same periods in 2013.

## Liquidity and Capital Resources

The Company's primary source of liquidity is cash and cash equivalents and on-going collection of accounts receivable. The Company's major use of cash in recent years has been for the payment of accrued and current interest on convertible debt, the servicing of long term debt and for capital expenditures.

As of June 30, 2014 and December 31, 2013, the Company had cash and cash equivalents of \$960,000 and \$2,451,000, respectively.

On July 26, 2012, the Company entered into a term loan agreement with Valley National Bank, Wayne, NJ, in the amount of \$750,000. The loan is secured with a security interest in new equipment acquired by the Company in the amount of \$825,000 which enhances the Company's thin film coating capabilities. The loan is repayable in equal monthly installments over five years beginning in August 2012 and bears an interest rate of 4.35% annually. The equipment was placed in service in 2013 and the full amount of the asset was included in Machinery and Equipment at December 31, 2013.

We believe that existing cash resources held by the Company and anticipated to be generated from future operating activities are sufficient to meet working capital requirements, anticipated capital expenditures, debt servicing payments and other contractual obligations over the next twelve months.

On July 29, 2014, the maturity dates of a \$1,500,000 Subordinated Convertible Promissory Note to Clarex Limited ("Clarex") and a \$1,000,000 Subordinated Convertible Promissory Note to an affiliate of Clarex were each extended to April 1, 2017 from April 1, 2015. The notes bear interest at 6%. Interest accrues yearly and is payable on maturity. Unpaid interest, along with principal, may be converted into securities of the Company as follows: the notes are convertible in the aggregate into 1,500,000 units and 1,000,000 units, respectively, with each unit consisting of one share of common stock and one warrant. Each warrant allows the holder to acquire 0.75 shares of common stock at a price of \$1.35 per share. As part of the agreement, the expiration dates of the warrants were extended from April 1, 2018 to April 1, 2020. The Company is currently paying interest of \$37,500 quarterly.

The following table summarizes net cash (used in) operating, investing and financing activities for the six months ended June 30, 2014 and 2013:

	Six Months Ended June 30, <b>2014</b> <b>2013</b> (In thousands)	
Net cash (used in) operating activities	\$(1,121)	\$(134)
Net cash (used in) investing activities	(293 )	(416)
Net cash (used in) financing activities	(78 )	(74 )
Net (decrease) in cash and cash equivalents	\$(1,492)	\$(624)

Net cash used in operating activities was \$1,121,000 for the six months ended June 30, 2014 compared to \$134,000 in the same period last year. The increase in net cash used in operating activities in the first six months of 2014 compared to 2013 resulted primarily from the higher net loss, before non-cash deductions for depreciation and amortization and stock based compensation, generated in the current period offset by working capital improvements.

Accounts receivables decreased by \$116,000 at June 30, 2014 compared to a decrease of \$186,000 the same period last year. The decrease was mainly a result of the timing of the collection of balances and the effect of lower sales volumes in the first six months of the 2014 compared to the prior year.

Inventory balances decreased by \$212,000 at June 30, 2014 compared to a decrease of \$200,000 for the six months ended June 30, 2013 primarily attributable to the reduction in orders.

Accounts payable and accrued liabilities decreased by \$48,000 in the six months ended June 30, 2014 compared to a decrease of \$26,000 in 2013 principally due to the timing of payments while the Company strives to optimize its use of cash.



Net cash used in investing activities was \$293,000 during the six months ended June 30, 2014 compared to \$416,000 last year. Capital expenditures for the six months ended June 30, 2014 and 2013 were \$363,000 and \$447,000, respectively. The expenditures in 2014 were primarily incurred to refurbish the Northvale operating facility for the relocation of the metal optics operation from the former Florida location. The expenditures in 2013 were primarily incurred to refurbish operating facilities in New Jersey and Florida and to purchase manufacturing equipment. In the first six months of 2013, the Company paid the balance of the purchase price of \$325,000 of the new equipment when the equipment was placed in service and the full amount of the asset was included in Machinery and Equipment at December 31, 2013. In the six months ended June 30, 2014 the Company paid \$9,000 for precious metal tools used in the crystal growth process. Offsetting these expenditures, the Company sold surplus machinery during the six months ended June 30, 2014 and 2013 and received net proceeds of \$78,380 and \$31,000, respectively.

Net cash used in financing activities was \$78,000 and \$74,000 during the six months ended June 30, 2014 and 2013, respectively, for required principal payments made on other long term notes.

Overall, the Company had a net decrease in cash and cash equivalents of \$1,492,000 and \$624,000 in the six months ended June 30, 2014 and 2013, respectively.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company is a smaller reporting company and not required to provide the information required under this item.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **a. Disclosure Controls and Procedures**

Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of June 30, 2014 (the "Evaluation Date"), have concluded that as of the Evaluation Date, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports we file or submit under the Exchange Act (1) is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms, and (2) is accumulated and communicated to our management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow for timely decisions regarding required disclosure.

#### **b. Changes in Internal Controls over Financial Reporting**

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There were no changes in our internal control over financial reporting during the quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

None.

**ITEM 1A. RISK FACTORS**

Not applicable

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UNDER SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

11. An exhibit showing the computation of per-share earnings is omitted because the computation can be clearly determined from the material contained in this Quarterly Report on Form 10-Q.

31.1 Certificate of the Registrant's Chief Executive Officer, Amy Eskilson, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certificate of the Registrant's Chief Financial Officer, William J. Foote, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certificate of the Registrant's Chief Executive Officer, Amy Eskilson, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certificate of the Registrant's Chief Financial Officer, William J. Foote, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 The following financial information from Inrad Optics, Inc.'s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2014 formatted in Extensible Business Reporting Language (XBRL): (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations, (iii) Condensed Consolidated Statements of Cash Flows, and (iv) the Notes to the Condensed Consolidated Financial Statements.\*

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Users of this interactive data file are advised pursuant to Rule 406T of Regulations S-T that this interactive data file \*is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these Sections.

SIGNATURES

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

**Inrad Optics, Inc.**

By: /s/ Amy Eskilson  
**Amy Eskilson**  
**President and Chief Executive Officer**

By: /s/ William J. Foote  
William J. Foote  
**Chief Financial Officer,**  
**Secretary and Treasurer**

Date: August 14, 2014