GIGA TRONICS INC
Form 10-Q
January 29, 2015
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended **December 27, 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 No. **0-12719**

GIGA-TRONICS INCORPORATED
(Exact name of registrant as specified in its charter)

California	**94-2656341**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4650 Norris Canyon Road, San Ramon, CA 94583	**(925) 328-4650**
(Address of principal executive offices)	Registrant’s telephone number, including area code

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

Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No [ ]

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

Large accelerated filer	[ ]	Accelerated filer	[ ]
Non-accelerated filer (Do not check if a smaller reporting company)	[ ]	Smaller reporting company	[X]

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

Yes [ ] No [X]

There were a total of 5,444,747 shares of the Registrant's Common Stock outstanding as of January 29, 2015.

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Section 906 of
Sarbanes-Oxley
Act.

FORWARD-LOOKING STATEMENTS

This report on Form 10-Q contains forward-looking statements about Giga-tronics Incorporated (the “Company”) for which it claims the protection of the safe harbor provisions contained in the Private Securities Litigation Reform Act of 1995. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, expenses, income or loss, earnings or loss per share, capital structure and other financial items; (ii) statements of plans, objectives and expectations of the Company or its management or board of directors, including those relating to products, revenue or cost savings; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes", "anticipates", "expects", "intends", "targeted", "projected", "continue", "remain", "will", "should", "may" and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

These forward-looking statements are based on Management’s current knowledge and belief and include information concerning the Company’s possible or assumed future financial condition and results of operations. A number of factors, some of which are beyond the Company’s ability to predict or control, could cause future results to differ materially from those contemplated. These factors include but are not limited to risks related to (1) the Company’s potential inability to obtain necessary capital to finance its operations; (2) the Company’s ability to develop competitive products in a market with rapidly changing technology and standards; (3) risks related to customers’ credit worthiness/profiles; (4) changes in the Company’s credit profile and its ability to borrow; (5) a potential decline in demand for certain of the Company’s products; (6) potential product liability claims; (7) the potential loss of key personnel; and (8) U.S. and international economic conditions. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business operations. The reader is directed to the Company's annual report on Form 10-K for the year ended March 29, 2014 or further discussion of factors that could affect the Company's business and cause actual results to differ materially from those expressed in any forward-looking statement made in this report. The Company undertakes no obligation to update any forward-looking statements in this report.

PART I - FINANCIAL SYSTEMS

ITEM 1 - FINANCIAL STATEMENTS

GIGA-TRONICS INCORPORATED

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands except share data)	December 27, 2014	March 29, 2014
Assets		
Current assets:		
Cash and cash-equivalents	$ 1,396	$ 1,059
Trade accounts receivable, net of allowance of $45 and $44, respectively	2,532	1,846
Inventories, net	3,275	3,321
Prepaid expenses and other current assets	246	349
Total current assets	7,449	6,575
Property and equipment, net	780	949
Other long term assets	78	69
Total assets	$ 8,307	$ 7,593
Liabilities and shareholders' equity		
Current liabilities:		
Line of credit	$ 1,622	$ 1,165
Current portion of long term debt	801	200
Accounts payable	1,035	1,430
Accrued payroll and benefits	563	755
Deferred revenue	1,519	1,329
Deferred rent	121	104
Capital lease obligations	72	147
Other current liabilities	380	472
Total current liabilities	6,113	5,602
Long term loan and warrant debt, net of discounts	464	672
Derivative liability –at estimated fair value	235	128
Long term obligations - deferred rent	144	237
Long term obligations - capital lease	67	77
Total liabilities	7,023	6,716
Commitments and contingencies		
Shareholders' equity:		

Convertible preferred stock of no par value; Authorized - 1,000,000 shares		
Series A - designated 250,000 shares; no shares at December 27, 2014 and March 29, 2014 issued and outstanding	—	—
Series B, C, D- designated 19,500 shares; 18,533.51 shares at December 27, 2014 and March 29, 2014 issued and outstanding; (liquidation preference of $3,540)	2,911	2,911
Common stock of no par value; Authorized - 40,000,000 shares; 5,444,747 shares at December 27, 2014 and 5,181,247 at March 29, 2014 issued and outstanding	16,914	16,224
Accumulated deficit	(18,541)	(18,258)
Total shareholders' equity	1,284	877
Total liabilities and shareholders' equity	$ 8,307	$ 7,593

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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GIGA-TRONICS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands except per share data)	Three Month Periods Ended December 27, 2014	Three Month Periods Ended December 28, 2013	Nine Month Periods Ended December 27, 2014	Nine Month Periods Ended December 28, 2013
Net sales	$4,509	$ 3,417	$14,127	$ 10,404
Cost of sales	2,637	2,130	8,101	6,672
Gross margin	1,872	1,287	6,026	3,732
Operating expenses:				
Engineering	672	979	2,563	3,040
Selling, general and administrative	1,133	1,066	3,401	3,674
Restructuring	—	36	—	360
Total operating expenses	1,805	2,081	5,964	7,074
Operating income/(loss)	67	(794)	62	(3,342)
Gain on sale of product line	—	97	—	913
Gain on adjustment of derivative liability to fair value	107	—	16	—
Other income	—	—	—	7
Interest expense, net	(62)	(21)	(199)	(52)
Accretion of loan and warrant debt discounts	(45)	—	(115)	—
Income/(loss) before income taxes	67	(718)	(236)	(2,474)
Provision for income taxes	—	—	47	2
Net income/(loss)	$67	$ (718)	$(283)	$ (2,476)
Earnings/(loss) per common share – basic	$0.01	$ (0.14)	$(0.05)	$ (0.49)
Earnings/(loss) per common share – diluted	$0.01	$ (0.14)	$(0.05)	$ (0.49)
Weighted average shares used in per share calculation:				
Basic	5,208	5,060	5,166	5,057
Diluted	5,463	5,060	5,166	5,057

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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GIGA-TRONICS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS
OF CASH FLOWS (UNAUDITED)

	Nine Month Periods Ended	
(In thousands)	**December 27, 2014**	**December 28, 2013**
Cash flows from operating activities:		
Net loss	$(283)	$(2,476)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	237	166
Share based compensation	545	395
Loss on adjustment of derivative liability to fair value	(16)	—
Accretion of discounts on loan and warrant debt	115	—
Change in deferred rent	(76)	(59)
Changes in operating assets and liabilities	(1,035)	457
Net cash used in operating activities	(513)	(1,517)
Cash flows from investing activities:		
Purchases of property and equipment	(30)	(262)
Net cash used in investing activities	(30)	(262)
Cash flows from financing activities:		
Payments on capital leases	(123)	(60)
Proceeds from line of credit	8,125	136
Proceeds from issuance of debt	500	—
Proceeds from exercise of stock options	145	—
Proceeds from issuance of preferred stocks, net of issuance costs totaling $41	—	817
Repayments of line of credit	(7,668)	(40)
Repayments of debt	(99)	—
Net cash provided by financing activities	880	853
Increase/(decrease) in cash and cash-equivalents	337	(926)
Beginning cash and cash-equivalents	1,059	1,882
Ending cash and cash-equivalents	$1,396	$956
Supplementary disclosure of other cash flow information:		
Cash paid for income taxes	$2	$2
Cash paid for interest	$172	$52
Supplementary disclosure of noncash financing activities:		
Equipment acquired under capital lease	$49	$86

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The condensed consolidated financial statements included herein have been prepared by Giga-tronics Incorporated (the "Company"), pursuant to the rules and regulations of the Securities and Exchange Commission. The consolidated results of operations for the interim periods shown in this report are not necessarily indicative of results to be expected for the fiscal year. In the opinion of management, the information contained herein reflects all adjustments (consisting of normal recurring entries) necessary to make the consolidated results of operations for the interim periods a fair statement of such operations. For further information, refer to the consolidated financial statements and footnotes thereto, included in the Annual Report on Form 10-K, filed with the Securities and Exchange Commission for the year ended March 29, 2014.

Fiscal Year The Company's financial reporting year consists of either a 52 week or 53 week period ending on the last Saturday of the month of March. Fiscal year 2015, ending on March 28, 2015 is a 52 week year, and fiscal year 2014, ended on March 29, 2014 was a 52 week year. Quarterly periods within each such fiscal year are in most cases 13 weeks as opposed to three calendar months. All references to three or nine month periods, and years in the consolidated financial statements relate to fiscal periods or years rather than three or nine month calendar quarters or calendar years.

Derivatives The Company accounts for free standing derivatives and embedded derivatives required to be bifurcated and accounted for on a stand-alone basis at estimated fair value. Changes in fair value are reported in earnings as gain or loss on adjustment of derivative liability to fair value.

New Accounting Standards In April 2014, the Financial Accounting Standards Board (FASB) issued an accounting standard update that changes the criteria for reporting discontinued operations. Under the accounting standard update, a disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has, or will have, a major effect on an entity's operations and financial results when either it qualifies as held for sale, disposed of by sale, or disposed of other than by sale. This accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2016. The Company is currently evaluating the impact of this accounting standard update on its Consolidated Financial Statements.

In May 2014, the FASB amended the accounting standards by creating a new Topic 606 which is in response to a joint initiative of the FASB and the International Accounting Standards Board to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. generally accepted accounting principles and international financial reporting standards that would:

1. Remove inconsistencies and weaknesses in revenue requirements.
2. Provide a more robust framework for addressing revenue issues.
3. Improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets.
4. Provide more useful information to users of financial statements through improved disclosure requirements.
5. Simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer.

For a public entity, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. The Company is currently evaluating the impact this new accounting standard will have on its financial statements.

In June 2014, the FASB amended ASC 718, Share Based Compensation, to require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. For all entities, the amendments in this update are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. The Company is currently evaluating the impact this accounting standard update may have on its financial statements.

In August 2014, the FASB issued ASU 2014-15 which provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. The new standard requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued. An entity must provide certain disclosures if conditions or events raise substantial doubt about the entity's ability to continue as a going concern. The ASU applies to all entities and is effective for annual periods ending after December 15, 2016, and interim periods thereafter, with early adoption permitted. The Company is currently evaluating the impact this accounting standard update may have on its financial statements.

(2) Going Concern and Management's Plan

The Company incurred a net loss of $283,000 for the first nine months of fiscal 2015 and $3,742,000 for the fiscal year ended March 29, 2014. These losses contributed to an accumulated deficit of $18.5 million as of December 27, 2014.

In the first nine months of fiscal 2015 and all of fiscal 2014 the Company invested heavily in the development of a new Giga-tronics Division product platform, the Advanced Signal Generation System. The Company anticipates long-term revenue growth and improved gross margins from the new product platform, but the delay in completing it contributed significantly to the losses of the Company. The Advanced Signal Generation System's initial customer deliveries occurred in the second and third quarters of fiscal 2015, and are approaching final customer acceptance. Additional delays in shipping volume quantities, or longer than anticipated sales cycles, could significantly contribute to additional losses.

To help fund operations, the Company relies on advances under the line of credit with Silicon Valley Bank. However the Bank may terminate or suspend advances under the line of credit if the Bank determines there has been a material adverse change in the Company's general affairs, financial forecasts or general ability to repay. (Note 13, Line of Credit). As of December 27, 2014, borrowings under the line of credit were $1.6 million.

These matters, along with recurring losses in prior years, raise substantial doubt as to the ability of the Company to continue as a going concern.

To address this matter, the Company's management has taken several actions to provide additional liquidity and reduce costs and expenses going forward. These actions are described in the following paragraphs.

On June 16, 2014, Giga-tronics amended its loan agreement with Partners For Growth IV, L.P. (“PFG”). Under the terms of the amendment, PFG made a revolving line of credit available to Giga-tronics in the amount of $500,000 and the Company borrowed the entire amount on June 17, 2014. The Company’s original agreement with PFG was entered into on March 13, 2014 under which the Company received $1.0 million from a three-year term loan. Pursuant to the amended loan agreement, the Company may borrow an additional $500,000. The loan agreement contains financial covenants associated with the Company achieving minimum quarterly net sales and maintaining a minimum monthly shareholders’ equity. In the event of default by the Company, all or any part of the Company’s obligation to PFG could become immediately due.

In the first three months of fiscal 2015 the Microsource business unit received a $6.2 million order (“NRE Order”) for the non-recurring engineering and for the delivery of a limited number of flight-qualified prototype hardware from a major aerospace company to develop a variant of its high performance fast tuning YIG filters for an aircraft platform. The Company expects to recognize the majority of revenue from the NRE Order in fiscal 2015. The Company expects to finalize in the next few months a multi-year follow-on order for approximately $10.0 million associated with the production units, which are anticipated to start shipping in April of 2016. No assurances can be given that the parties will agree on the final multi-year production agreement, or what the actual terms will be.

Also in the first three months of fiscal 2015 the Giga-tronics Division received a $2.4 million order from the United States Navy (“Navy”) for its Model 8003 Precision Scalar Analyzer product (“8003”). The Company recognized the associated revenue and invoiced the Navy in the first two quarters of fiscal 2015.

To assist with the upfront purchases of inventory required for future product deliveries, the Company entered into advance payment arrangements with certain of its customers whereby the customers reimburse the Company for raw material purchases prior to the shipment of the finished products. In fiscal 2014 the Company entered into advance payment arrangements totaling $1.3 million, and during the first three quarters of fiscal 2015 the Company entered into $1.4 million of advance payment arrangements. The Company will continue to seek similar terms in future agreements with these and other customers.

Management will continue to review all aspects of the business in an effort to improve cash flow and reduce costs and expenses, while continuing to invest, to the extent possible, in new product development for future revenue streams.

Management will also continue to seek additional working capital through debt, equity financing or possible product line sales, but there are no assurances that such financings or sales will be available at all, or on terms acceptable to the Company.

The current year to date loss and the impacts of recurring losses in prior years have had a significant negative impact on the financial condition of the Company and raise substantial doubt about the Company’s ability to continue as a going concern. The Consolidated Financial Statements have been prepared assuming the Company will continue as a going concern and do not include any adjustments that might result if the Company were unable to do so.

(3) Revenue Recognition

The Company records revenue when there is persuasive evidence of an arrangement, delivery has occurred, the price is fixed and determinable, and collectability is reasonably assured. This occurs when products are shipped or the customer accepts title transfer. If the arrangement involves acceptance terms, the Company defers revenue until product acceptance is received. The Company limits the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations or subject to customer-specified return or refund privileges. The Company evaluates each deliverable in an arrangement to determine whether they represent separate units of accounting. On certain large development contracts, revenue is recognized upon achievement of substantive milestones. Determining whether a milestone is substantive is a matter of judgment and that assessment is performed only at the inception of the arrangement. The consideration earned from the achievement of a milestone must meet all of the following for the milestone to be considered substantive:

a. It is commensurate with either of the following:

1. The Company’s performance to achieve the milestone.

2. The enhancement of the value of the delivered item or items as a result of a specific outcome resulting from the Company's performance to achieve the milestone.

b. It relates solely to past performance.

c. It is reasonable relative to all of the deliverables and payment terms (including other potential milestone consideration) within the arrangement.

Milestones are agreed upon with the customer prior to the start of the contract and some milestones will be tied to product shipping while others will be tied to design review. During the three and nine months ended December 27, 2014 revenue recognized on a milestone basis were $1.6 million and $4.5 million respectively. During the three and nine months ended December 28, 2013 revenue recognized on a milestone basis were $89,000 and $397,000, respectively.

On certain contracts with several of the Company's significant customers the Company receives payments in advance of manufacturing. Advanced payments are recorded as deferred revenue until the revenue recognition criteria described above have been met.

Accounts receivable are stated at their net realizable value. The Company has estimated an allowance for uncollectable accounts based on analysis of specifically identified accounts, outstanding receivables, consideration of the age of those receivables, the Company's historical collection experience, and adjustments for other factors management believes are necessary based on perceived credit risk.

The Company provides for estimated costs that may be incurred for product warranties at the time of shipment. The Company's warranty policy generally provides twelve to eighteen months depending on the customer. The estimated cost of warranty coverage is based on the Company's actual historical experience with its current products or similar products. For new products, the required reserve is based on historical experience of similar products until such time as sufficient historical data has been collected on the new product. Adjustments are made as new information becomes available.

(4) Inventories

(In thousands)	**December 27, 2014**	**March 29, 2014**
Raw materials	$ 1,674	$1,501
Work-in-progress	1,456	1,400
Finished goods	73	353
Demonstration inventory	72	67
Total	$ 3,275	$3,321

(5) Gain on Sale of Product Line

On March 18, 2013, the Company entered into an Asset Purchase Agreement with Teradyne Inc. ("Teradyne"), whereby Teradyne agreed to purchase the Giga-tronics Division product line known as SCPM for $1.0 million, resulting in a net gain of $913,000, of which $816,000 was recorded during the first quarter of fiscal 2014. In April 2013 the Company received $800,000 in proceeds at the closing of the transaction upon delivery of electronic data associated with the purchase. The Company also earned an additional $50,000 associated with training of Teradyne employees, which was offset by $34,000 of associated costs. The balance of the consideration ($150,000) was subject to a hold back arrangement until December 31, 2013 to cover certain contingencies and the requirement to deliver certain inventory. During fiscal 2014, the Company delivered to Teradyne all of the associated inventory, totaling $53,000. On December 6, 2013, the Company received the remaining $150,000 along with confirmation from Teradyne that the holdback provisions were removed.

(6) Earnings/Loss Per Share

Basic earnings (loss) per common share (EPS) is calculated by dividing net income or loss attributable to common shareholders by the weighted average common shares outstanding during the period. Net income attributable to common shareholders excludes distributed and undistributed earnings attributable to preferred stock, which constitute participating securities due to their dividend rights, and to which the Company applies the two-class method of calculating and presenting earnings per share. Diluted EPS reflects the net incremental shares that would be issued if unvested restricted shares became vested and dilutive outstanding stock options and warrants were exercised, using the treasury stock method. In the case of a net loss, it is assumed that no incremental shares would be issued because they would be antidilutive. In addition, certain options and restricted stock are considered antidilutive because assumed proceeds from exercise price, related tax benefits and average future compensation was greater than the weighted average number of options outstanding multiplied by the average market price during the period.

The shares used in per share computations are as follows:

(In thousands except per share data)	Three Month Periods Ended December 27, 2014	Three Month Periods Ended December 28, 2013	Nine Month Periods Ended December 27, 2014	Nine Month Periods Ended December 28, 2013
Net income/(loss) as reported	$67	$ (718)	$(283)	$ (2,476)
Net income/(loss) attributable to participating securities	(18)	—	—	—
Net income/(loss) attributable to common shareholders	$49	$ (718)	$(283)	$ (2,476)
Weighted average:				
Common shares outstanding	5,208	5,060	5,166	5,057
Potential common shares	255	—	—	—
Common shares assuming dilution	5,463	5,060	5,166	5,057
Net earnings/(loss) per common share – basic	$0.01	$ (0.14)	$(0.05)	$ (0.49)
Net earnings/(loss) per common share - diluted	$0.01	$ (0.14)	$(0.05)	$ (0.49)
Stock options not included in computation that could potentially dilute EPS in the future	1,376	1,751	1,759	1,751
Restricted stock awards not included in computation that could potentially dilute EPS in the future	187	122	237	122
Convertible preferred stock not included in computation that could potentially dilute EPS in the future	—	1,853	1,853	1,853
Warrants not included in computation that could potentially dilute EPS in the future	—	1,017	1,277	1,017

The restricted stock awards and stock options not included in the computation of diluted earnings per share for the three month period ended December 27, 2014 are as a result of these instruments being anti-dilutive after application of the treasury method described above. The restricted stock awards, stock options, warrants and convertible preferred stock not included in the computation of diluted earnings per share (EPS) for the nine month periods ended December 27, 2014 and December 28, 2013 and for the three months ended December 28, 2013 are a result of the Company's net loss and, therefore, these instruments are anti-dilutive.

(7) Share Based Compensation

The Company has established the 2000 Stock Option Plan and the 2005 Equity Incentive Plan, which provide for the granting of options and restricted stock for up to 2,250,000 shares of common stock at 100% of fair market value at the date of grant, with each grant requiring approval by the Board of Directors of the Company. Option grants under the 2000 Stock Option Plan are no longer available. Options granted generally vest in one or more installments in a four or five year period and must be exercised while the grantee is employed by the Company or within a certain period after termination of employment. Options granted to employees shall not have terms in excess of 10 years from the grant date. Holders of options may be granted stock appreciation rights (SARs), which entitle them to surrender outstanding awards for a cash distribution under certain changes in ownership of the Company, as defined in the stock option plan. As of December 27, 2014, no SAR's have been granted under the option plan. As of December 27, 2014, the total number of shares of common stock available for issuance is 475,650. All outstanding options have either a five year or a ten year life. The Company records compensation cost associated with share-based compensation equivalent to the estimated fair value of the awards over the requisite service period. There were 35,000 options granted in the third quarter of fiscal 2015 and options for 264,500 granted in the first nine months of fiscal 2015 with weighted average grant date fair values of $1.23 and $1.68 per share, respectively. There were options for 35,000 shares granted in the third quarter of fiscal 2014 and options for 430,750 shares granted in the first nine months of fiscal 2014 with weighted average grant date fair values of $1.05 and $1.09 per share, respectively.

Included in the options granted during fiscal 2014 are performance-based options for 100,000 shares granted as an inducement to an employee which were outside the 2005 plan. A portion of the options vest following the filing of the Company's Form 10-K for fiscal 2015 provided certain bookings goals are achieved by the Company. No compensation cost had been recognized for these stock options through the first quarter of fiscal 2015 or during fiscal 2014 because management believed it was not probable that the performance criteria would be met. During the second quarter of fiscal 2015, management's assessment changed as it now appears probable that the criteria will be met. The expense of $39,000 will be recognized ratably over the remaining vesting period. For the third quarter of fiscal 2015, $10,000 was recognized as compensation expense.

In calculating compensation related to stock option grants, the fair value of each stock option is estimated on the date of grant using the Black-Scholes-Merton option-pricing model and the following weighted average assumptions:

	Three Month Periods Ended December 27, 2014	**Three Month Periods Ended December 28, 2013**	**Nine Month Periods Ended December 27, 2014**	**Nine Month Periods Ended December 28, 2013**
Dividend yield	—	—	—	—
Expected volatility	93.03 %	88.38 %	91.68 %	86.33 %
Risk-free interest rate	1.62 %	1.37 %	1.65 %	1.02 %
Expected term (years)	8.36	8.36	8.36	7.91

The computation of expected volatility used in the Black-Scholes-Merton option-pricing model is based on the historical volatility of the Company's share price. The expected term is estimated based on a review of historical employee exercise behavior with respect to option grants. The risk-free interest rate is based on the U.S. Treasury rates with maturity similar to the expected term of the option on the date of grant.

A summary of the changes in stock options outstanding for the nine month period ended December 27, 2014 and the fiscal year ended March 29, 2014 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Terms (Years)	Aggregate Intrinsic Value
Outstanding at March 30, 2013	1,556,250	$ 1.62	6.8	$ 252

Granted	430,750	1.32		
Exercised	—	—		
Forfeited / Expired	248,250	1.72		
Outstanding at March 29, 2014	1,738,750	$ 1.53	6.8	$ 113
Granted	264,500	$ 2.04		
Exercised	76,500	$ 1.89		
Forfeited / Expired	167,900	$ 1.72		
Outstanding at December 27, 2014	1,758,850	$ 1.58	6.9	$ 217
Exercisable at December 27, 2014	626,475	$ 1.67	5.9	$ 57
At December 27, 2014, expected to vest in the future	778,448	$ 1.53	7.5	$ 106

As of December 27, 2014, there was $765,000 of total unrecognized compensation cost related to non-vested options. That cost is expected to be recognized over a weighted average period of 3.1 years. There were 71,750 options that vested during the quarter ended December 27, 2014. There were 74,050 options that vested during the quarter ended December 28, 2013. The total grant date fair value of options vested during the quarters ended December 27, 2014 and December 28, 2013 was $97,000 and $100,000, respectively. There were 231,150 options that vested during the nine month period ended December 27, 2014. There were 241,025 options that vested during the nine month period ended December 28, 2013. The total grant date fair value of options vested during the nine month periods ended December 27, 2014 and December 28, 2013 was $280,000 and $303,000, respectively. No shares were exercised in the three month periods ended December 27, 2014 and December 28, 2013. Options of 76,500 shares were exercised in the nine month period ended December 27, 2014 and no shares were exercised in the nine month period ended December 28, 2013. Share based compensation cost recognized in operating results for the three month periods ended December 27, 2014 and December 28, 2013 totaled $103,000 and $36,000, respectively. Share based compensation cost recognized in operating results for the nine month periods ended December 27, 2014 and December 28, 2013 totaled $280,000 and $316,000, respectively.

During the nine months ended December 28, 2013, the vesting for 40,000 options was accelerated in connection with a termination agreement with a former employee. This modification did not result in any incremental compensation expense, however $38,000 of stock-based compensation expense was accelerated and recognized during the nine months ended December 28, 2013.

During the nine months ended December 27, 2014, 25,000 options were exercised by certain members of the Company's Board of Directors. No options were exercised by Board members in Fiscal 2014.

Restricted Stock

The Company granted 187,000 shares of restricted stock during the first nine months of fiscal 2015 to the members of the Board of Directors in lieu of cash compensation for services to be performed in fiscal 2015. The weighted average grant date fair value was $2.47. The Company granted 71,500 shares of restricted stock during the first nine months of fiscal 2014 to certain members of the Board of Directors in lieu of cash compensation for services to be performed in fiscal 2014. The weighted average grant date fair value was $1.53 per share. The Company also granted 30,000 shares of unrestricted stock during the first nine months of fiscal 2014 as part of a severance agreement with a former employee. The 30,000 shares did not have a restriction period because they vested immediately on the grant date, but are included in the roll forward schedule of restricted stock below because they were granted under the 2005 Plan. The restricted stock awards are considered fixed awards as the number of shares and fair value at the grant date is amortized over the requisite service period net of estimated forfeitures.

As of December 27, 2014, there was $262,000 of total unrecognized compensation cost related to non-vested restricted awards. That cost is expected to be recognized over a weighted average period of 0.5 years. Compensation cost was recognized for the restricted and unrestricted stock awards for the three and nine month periods ended December 27, 2014 totaling $131,000 and $265,000, respectively. These amounts include $16,000 and $32,000 for the three and nine months ended December 27, 2014 for performance awards based on bookings for which probability of attainment appears likely. Compensation cost was recognized for the restricted and unrestricted stock awards for the three and nine month periods ended December 28, 2013 totaling $31,000 and $79,000, respectively. No amounts were included for performance awards based on bookings as their probability of attainment did not appear likely at that time.

A summary of the changes in non-vested restricted stock awards outstanding at December 27, 2014 and at March 29, 2014 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Non-vested at March 30, 2013	50,000	$ 1.18
Granted	101,500	1.53
Vested	30,000	1.53
Forfeited or cancelled	—	—
Non-vested at March 29, 2014	121,500	$ 1.39
Granted	187,000	2.47
Vested	71,500	1.53
Forfeited or cancelled	—	—
Non-vested at December 27, 2014	237,000	$ 2.20

8) <u>Significant Customer and</u> <u>Industry Segment Information</u>

The Company has two reportable segments: Giga-tronics Division and Microsource.

Giga-tronics Division produces a broad line of test and measurement equipment used in the development, test and maintenance of wireless communications products and systems, flight navigational equipment, electronic defense systems and automatic testing systems and designs, manufactures, and markets a line of switching devices that link together many specific purpose instruments that comprise automatic test systems. These products are used primarily in the design, production, repair and maintenance of commercial telecommunications, radar, and electronic warfare equipment. Microsource develops and manufactures a broad line of YIG (Yttrium, Iron, Garnet) tuned oscillators, filters and microwave synthesizers, which are used by its customers in operational applications and in manufacturing a wide variety of microwave instruments and devices.

The tables below present information for the three and nine month periods ended December 27, 2014 and December 28, 2013.

		Three Month Periods Ended			**Three Month Periods Ended**	
(In thousands)	**At Dec. 27, 2014**	**December 27, 2014**		**At Dec. 28, 2013**	**December 28, 2013**	
	Total Assets	**Net Sales**	**Net Income (Loss)**	**Total Assets**	**Net Sales**	**Net Income (Loss)**
Giga-tronics Division	$5,431	$2,021	$(1,266)	$5,341	$1,539	$(1,209)
Microsource	2,876	2488	1,333	1,821	1,878	491
Total	$8,307	$4,509	$67	$7,162	$3,417	$(718)

		Nine Month Periods Ended		**Nine Month Periods Ended**
(In thousands)	**At Dec. 27, 2014**	**December 27, 2014**	**At Dec. 28, 2013**	**December 28, 2013**

	Total Assets	Net Sales	Net Income (Loss)	Assets	Net Sales	Net Income (Loss)
Giga-tronics Division	$5,431	$6,638	$(3,962)	$5,341	$5,336	$(2,961)
Microsource	2,876	7,489	3,679	1,821	5,068	485
Total	$8,307	$14,127	$(283)	$7,162	$10,404	$(2,476)

During the third quarter of fiscal 2015, one customer accounted for 36% of the Company's consolidated revenues and was included in the Microsource segment. A second customer accounted for 16% of the Company's consolidated revenue for the three months ended December 27, 2014 and was primarily included in the Microsource segment. A third customer accounted for 15% of the Company's consolidated revenue for the three months ended December 27, 2014 and was primarily included in the Giga-tronics Division. During the third quarter of fiscal 2014, one customer accounted for 41% of the Company's consolidated revenue and was primarily included in the Microsource segment. A second customer accounted for 20% and was included in the Giga-tronics Division.

During the first nine months of fiscal 2015, one customer accounted for 32% of the Company's consolidated revenues and was primarily included in the Microsource segment. A second customer accounted for 19% of the Company's consolidated revenue for the nine months ended December 27, 2014 and was included in the Giga-tronics Division. A third customer accounted for 18% of the Company's consolidated revenue for the nine months ended December 27, 2014 and was primarily included in the Microsource segment. One customer accounted for 43% of the Company's consolidated revenues for the nine months ended December 28, 2013 and was primarily included in the Microsource segment. A second customer accounted for 14% of the Company's consolidated revenues for the nine months ended December 28, 2013 and was included in the Giga-tronics Division.

(9) Income Taxes

The Company accounts for income taxes using the asset and liability method as codified in Topic 740. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards.

The Company did not incur tax expense for the three months ended December 27, 2014 and December 28, 2013. The Company's tax expense for the nine months ending December 27, 2014 and December 28, 2013 was $47,000 and $2,000, respectively. The Company's actual tax expense differed from the expected amount using statutory rates primarily as a result of the valuation allowance against deferred tax assets.

As of December 27, 2014, the Company had recorded $70,000 for unrecognized tax benefits related to uncertain tax positions. The unrecognized tax benefit is netted against the non-current deferred tax asset on the Consolidated Balance Sheet. The Company does not expect the liability for unrecognized tax benefits to change materially within the next 12 months. The Company does have a California Franchise Tax Board audit that is currently in process. The Company is working with the California Franchise Tax Board to resolve all audit issues and does not believe any material taxes, penalties and fees are due. However, as a result of the on-going examination, the Company recorded an estimated associated tax liability of $45,000 in the first quarter of fiscal 2015.

(10) Warranty Obligations

The Company records a provision in cost of sales for estimated warranty obligations at the date products are sold. Adjustments are made as new information becomes available. The following provides a reconciliation of changes in the Company's warranty reserve. The Company provides no other guarantees.

	Three Month Periods Ended		**Nine Month Periods Ended**	
(In thousands)	**December 27, 2014**	**December 28, 2013**	**December 27, 2014**	**December 28, 2013**
Balance at beginning of period	$73	$ 80	$61	$ 114
Provision, net	29	6	56	(3)
Warranty costs incurred	(24)	(17)	(39)	(42)

Balance at end of period	$78	$ 69	$78	$ 69

(11) Restructuring

The Company took steps to reduce expenses and personnel by combining its operations in Santa Rosa into its San Ramon facility. This physical move was completed on May 31, 2013. Certain employee retention agreements were extended through December 2013. Substantially all of the restructuring costs were for the Microsource reportable segment. As of March 29, 2014 the Company had expensed $780,000 related to these restructuring costs, of which $36,000 was recorded in the third quarter of fiscal 2014 and $360,000 for the nine months ended December 28, 2013. There were no restructuring costs during the first nine months of fiscal 2015 and the Company does not anticipate any additional restructuring costs.

(12) Fair Value of Financial Instruments

Fair Value of Financial Instruments and Fair Value Measurements The Company's financial instruments consist principally of cash and cash-equivalents, line of credit, term loan, warrant debt and warrant derivative liability. The fair value of a financial instrument is the amount at which the instrument could be exchanged in an orderly transaction between market participants to sell the asset or transfer the liability. The Company uses fair value measurements based on quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity can access as of the measurement date (Level 1), significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data (Level 2), or significant unobservable inputs reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability (Level 3), depending on the nature of the item being valued.

The carrying amounts of the Company's cash and cash-equivalents and line of credit approximate their fair values at each balance sheet date due to the short-term maturity of these financial instruments. The fair values of term loan and warrant debt are based on the present value of expected future cash flows and assumptions about current interest rates and the creditworthiness of the Company (Level 3), and at December 27, 2014 and March 29, 2014 resulted in the carrying amounts approximating fair values due to the fact that the agreements were entered into near the balance sheet dates and in management's opinion there were no significant changes to the credit risk of the instruments since they were issued, nor were there significant changes in interest rates or other market factors. The estimated fair value of the bifurcated conversion feature represented by the warrant derivative liability which is measured at fair value on a recurring basis is based on a Black Scholes option pricing model with assumptions for stock price, exercise price, volatility, expected term, risk free interest rate and dividend yield similar to those described previously for share-based compensation which were generally observable (Level 2). The Company had no assets or liabilities measured at fair value on a non-recurring basis, nor were there any transfers between Level 1 and Level 2 of the fair value hierarchy.

(13) Line of Credit

On June 11, 2013 the Company entered into an amendment to the Second Amended Credit Facility (the "New Amended Credit Facility") with Silicon Valley Bank. The New Amended Credit Facility amended the Second Amended Credit Facility by expanding the definition of eligible accounts, increasing the maximum limit, and extending the maturity date. The New Amended Credit Facility, which expires on April 15, 2015, is secured by all assets of the Company and provides for a borrowing capacity equal to 80% of eligible accounts receivable (70% of eligible foreign accounts receivable) on an aggregate basis, up to a maximum of $3.0 million, provided the Company maintains borrowing base eligibility, that is, a minimum of $750,000 of cash in excess of its line of credit liability.

The New Amended Credit Facility contains a collateral handling fee of one-tenth of one percent (0.10%) on outstanding financed receivables for each calendar month based upon a 360 day year. When the Company is borrowing base eligible, the collateral handling fee is not applicable. Interest accrues on the average outstanding borrowings at a floating per annum rate equal to the greater of the Prime Rate plus two percent (2.00%) or six percent (6.00%). When the Company is borrowing base eligible, any borrowings under the New Amended Credit Facility can be repaid and such repaid amounts re-borrowed until the maturity date. When the Company is not borrowing base eligible, advances are made on the New Amended Credit facility on individual accounts receivable and the Company is required to instruct its customers to remit payments to a lockbox at the Bank and when the Company is not borrowing base eligible, such payments are applied by the Bank to the line of credit to the extent monies were advanced to the Company based on such specific accounts receivable. As of December 27, 2014, the Company was not borrowing base eligible and had outstanding borrowings of $1.6 million which have been classified as a current liability since the New Amended Credit Facility expires in less than twelve months.

As of March 29, 2014, the Company was not borrowing base eligible and, as a result, the Company's outstanding borrowings under the New Amended Credit Facility of $1.2 million was classified as a current liability.

As of December 27, 2014 the borrowing of $1.6 million approached the maximum borrowing capacity under the Line of Credit. No material additional amounts were available to draw at December 27, 2014 or March 29, 2014. The Bank may terminate or suspend advances under the line of credit if the Bank determines there has been a material adverse change in the Company's general affairs, financial forecasts or general ability to repay.

(14) Term Loan, Revolving Line of Credit and Warrants

On March 13, 2014 the Company entered into a three year, $2.0 million term loan agreement with PFG (the "PFG Loan") under which the Company received $1.0 million on March 14, 2014 (the "First Draw"). Pursuant to the agreement, the Company had the ability to borrow an additional $1.0 million following the Company's achievement of certain performance milestones which included achieving $7.5 million in net sales during the first half of fiscal 2015 and two consecutive quarters of net income greater than zero during fiscal 2015.

On June 16, 2014, the Company amended its loan agreement with PFG (the "Amendment"). Under the terms of the Amendment, PFG made a revolving credit line available to Giga-tronics in the amount of $500,000, and the Company borrowed the entire amount on June 17, 2014. The revolving line has a thirty-three month term. The Amendment reduced the future amount potentially available for the Company to borrow under the PFG Loan agreement from $1.0 million to $500,000. During the period ended December 27, 2014, the Company repaid $99,000 in principal to PFG. As of December 27, 2014, the Company had total debt outstanding of $1.4 million with PFG.

Interest on the initial $1.0 million term loan is fixed at 9.75% per annum and required monthly interest only payments during the first six months of the agreement followed by monthly principal and interest payments over the remaining thirty months. The Company may prepay the loan at any time prior to maturity by paying all future scheduled principal and unearned interest payments.

Interest on the $500,000 revolving line is fixed, calculated on a daily basis at a rate of 12.50% per annum. The Company may prepay the loan at any time prior to the March 13, 2017 maturity date without a penalty. Beginning in October 2014, PFG has the right to convert the $500,000 revolving loan into a term loan and require principal payments to be amortized over the remaining loan term. No payments were made in the period ended December 27, 2014.

The PFG Loan is secured by all of the assets of the Company under a lien that is junior to the SVB lien described in Note 13, and limits borrowing under the SVB credit line to $3.0 million. The Company paid a loan fee of $30,000 for the First Draw, $15,000 for the Amendment, and will pay $5,000 if the final $500,000 is drawn. The loan fees paid are recorded as prepaid expenses and amortized to interest expense over the remaining term of the PFG amended loan agreement.

The amended loan agreement contains financial covenants associated with the Company achieving minimum quarterly net sales and maintaining a minimum monthly shareholders' equity. In the event of default by the Company, all or any part of the Company's obligation to PFG could become immediately due. The lender can accelerate the maturity of the loan in case of a default. As of December 27, 2014, the Company was in compliance with the financial covenants.

The loan agreement also provided for the issuance of warrants convertible into 300,000 shares of the Company’s common stock, of which 180,000 were exercisable upon receipt of the initial $1.0 million from the First Draw, 80,000 became exercisable with the Amendment, and 40,000 would become exercisable if the remaining $500,000 is funded. Each warrant issued under the loan agreement has a term of five years from the First Draw and an exercise price of $1.42 which is equal to the average NASDAQ closing price of the Company’s common stock for the ten trading days prior to the First Draw. The number of shares exercisable under each of the aforementioned warrant agreements is subject to downward adjustment from 180,000 to 155,000, 80,000 to 67,500 and 40,000 to 27,500, respectively, if the Company achieves net sales of at least $18.0 million and net income of at least $1.0 million in fiscal 2015.

If the warrants are not exercised before expiration on March 13, 2019, the Company would be required to pay PFG $150,000 and $67,000 as settlement for warrants associated with the First Draw and the Amendment, respectively together with $33,000 assuming the Company borrowed the remaining $500,000 and the associated warrants to be issued in connection therewith were not exercised by PFG. The warrants could be settled for cash at an earlier date in the event of any acquisition or other change in control of the Company, future public issuance of Company securities or liquidation (or substantially similar event) of the Company. The Company currently has no plans for any of the aforementioned events, and as a result, the cash payment date is estimated to be the expiration date unless warrants are exercised before then. Due to the fixed payment amount on the expiration date, the warrant structure is in substance a debt arrangement (the “Warrant Debt”) with a zero interest rate, a fixed maturity date and a feature that makes the debt convertible to common stock. The conversion feature is an embedded derivative and due to the downward adjustment feature based on performance criteria is not considered indexed solely to the Company’s stock. Thus, for accounting purposes, the conversion feature is bifurcated and accounted for separately from the host debt instrument as a derivative liability measured at fair value which resulted in an initial carrying value of $128,000 for the derivative liability associated with the warrants issued in connection with the First Draw and an initial carrying value of $123,000 for the derivative liability associated with the warrants issued in connection with the Amendment. As of December 27, 2014, the estimated fair values of the derivative liabilities associated with the warrants issued in connection with the First Draw and Amendment were $165,000 and $70,000, respectively, for a combined value of $235,000. As of September 27, 2014, the estimated fair values of the derivative liabilities associated with the warrants issued in connection with the First Draw and Amendment were $235,000 and $106,000, respectively, for a combined value of $341,000. The change in the fair value of the derivative liabilities since September 27, 2014 totaled $107,000 and is reported in earnings as gain on adjustment of derivative liability to fair value for the three months ended December 27, 2014. The change in the fair value of the derivative liabilities since their respective dates of issuance totaled $16,000 and is reported in earnings as gain on adjustment of derivative liability to fair value.

The proceeds from the initial $1.0 million First Draw were allocated between the PFG Loan and the Warrant Debt (inclusive of its conversion feature) based on their relative fair values on the date of issuance which resulted in initial carrying values of $822,000 and $178,000, respectively. The conversion feature was bifurcated from the Warrant Debt and recorded at its $128,000 estimated fair value resulting in a remaining carrying value of $50,000 associated with the Warrant Debt. The resulting discounts of $178,000 on the PFG Loan and $100,000 on the Warrant Debt are being accreted to interest expense under the effective interest method over the three-year term of the PFG Debt and the five-year term of the Warrant Debt. Accretion expense for the three and nine months ended December 27, 2014 was $26,000 and $59,000, respectively.

The proceeds from the $500,000 credit line issued in connection with the Amendment were allocated between the PFG Loan and the Warrant Debt (inclusive of its conversion feature) based on their relative fair values on the date of issuance which resulted in initial carrying values of $365,000 and $135,000, respectively. The conversion feature was bifurcated from the Warrant Debt and recorded at its $123,000 estimated fair value resulting in a remaining carrying value of $12,000 associated with the Warrant Debt. The resulting discounts of $135,000 on the PFG Loan and $55,000 on the Warrant Debt will be accreted to interest expense under the effective interest method over the thirty-three month remaining term of the PFG Loan and the fifty-seven month remaining term of the Warrant Debt. Accretion expense for the three and nine months ended December 27, 2014 was $19,000 and $56,000 respectively.

(15) Series B, C, D Convertible Voting Perpetual Preferred Stock and Warrants

On November 10, 2011, the Company received $2,199,000 in cash proceeds from Alara Capital AVI II, LLC, a Delaware limited liability company (the “Investor”), an investment vehicle sponsored by Active Value Investors, LLC, under a Securities Purchase Agreement entered into on October 31, 2011. Under the terms of the Securities Purchase Agreement, the Company issued 9,997 shares of its Series B Convertible Voting Perpetual Preferred Stock (“Series B Preferred Stock”) to the Investor at a price of $220 per share. The Company has recorded $2.0 million as Series B Preferred Stock on the consolidated balance sheet. This amount is net of stock offering costs of approximately $202,000 and represents the value attributable to both the convertible preferred stock and warrants issued to the Investor. After considering the value of the warrants, the effective conversion price of the preferred stock was greater than the common stock price on date of issue and therefore no beneficial conversion feature was present.

On February 19, 2013, the Company entered into a Securities Purchase Agreement (the “SPA”) pursuant to which it agreed to sell 3,424.65 shares of its Series C Convertible Voting Perpetual Preferred Stock (“Series C Preferred Stock”) to the Investor, for aggregate consideration of $500,000, which is approximately $146.00 per share. The Company has recorded $457,000 as Series C Preferred Stock on the consolidated balance sheet, which is net of stock offering costs of approximately $43,000. After considering the reduction in the value of the warrant, the effective conversion price of the preferred stock was greater than the common stock price on the date of issue and therefore no beneficial conversion feature was present.

On July 8, 2013 the Company received $817,000 in net cash proceeds from the Investor under a Securities Purchase Agreement. The Company sold to the Investor 5,111.86 shares of its Series D Convertible Voting Perpetual Preferred Stock (Series D Preferred Stock) and a warrant to purchase up to 511,186 additional shares of common stock at the price of $1.43 per share. The allocation of the $858,000 in gross proceeds from issuance of Series D Preferred Stock based on the relative fair values resulted in an allocation of $498,000 (which was recorded net of $41,000 of issuance costs) to Series D Preferred Stock and $360,000 to Common Stock. In addition, because the effective conversion rate based on the $498,000 allocated to Series D Preferred Stock was $0.97 per common share which was less than the Company’s stock price on the date of issuance, a beneficial conversion feature was present at the issuance date. The beneficial conversion feature totaled $238,000 and was recorded as a reduction of common stock and an increase to accumulated deficit.

Each share of Series B, Series C and Series D Preferred Stock is convertible into one share of the Company's common stock. The investor also holds warrants to purchase 1,017,405 shares at an exercise price of $1.43 per share.

The table below presents information for the periods ended December 27, 2014 and March 29, 2014

Preferred Stock

As of December 27, 2014 and March 29,2014

	Designated Shares	Shares Issued	Shares Outstanding	Liquidation Preference (in thousands)
Series B	10,000.00	9,997.00	9,997.00	$ 2,309
Series C	3,500.00	3,424.65	3,424.65	500
Series D	6,000.00	5,111.86	5,111.86	731
Total	19,500.00	18,533.51	18,533.51	$ 3,540

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

The forward-looking statements included in this report including, without limitation, statements containing the words "believes", "anticipates", "estimates", "expects", "intends" and words of similar import, which reflect management's best judgment based on factors currently known, involve risks and uncertainties. Actual results could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including but not limited to those listed in Giga-tronics' Annual Report on Form 10-K for the fiscal year ended March 29, 2014 Part I, under the heading "Risk Factors", and Part II, under the heading "Management's Discussion and Analysis of Financial Conditions and Results of Operations".

Overview

Giga-tronics produces instruments, subsystems and sophisticated microwave components that have broad applications in both defense electronics and wireless telecommunications. The Company has two reporting segments: Giga-tronics Division and Microsource.

Giga-tronics Division produces a broad line of test and measurement equipment used in the development, test and maintenance of wireless communications products and systems, flight navigational equipment, electronic defense systems and automatic testing systems and designs, manufactures, and markets a line of switching devices that link together many specific purpose instruments that comprise automatic test systems. These products are used primarily in the design, production, repair and maintenance of commercial telecommunications, radar, and electronic warfare equipment. Microsource develops and manufactures a broad line of YIG (Yttrium, Iron, Garnet) tuned oscillators, filters and microwave synthesizers, which are used by its customers in operational applications and in manufacturing a wide variety of microwave instruments and devices.

In the first three months of fiscal 2015 the Giga-tronics Division received a $2.4 million order from the United States Navy ("Navy") for its Model 8003 Precision Scalar Analyzers product ("8003"). The Navy was a significant customer for the Company in the first nine months of fiscal 2015. Also, in the first nine months of fiscal 2014 the Giga-tronics Division had a range of customers, both domestic and international, and one significant reseller.

In the first three months of fiscal 2015 the Microsource business unit received a $6.2 million order ("NRE Order") for non-recurring engineering and for delivery of a limited number of flight-qualified prototype hardware from a major aerospace company to develop a variant of its high performance fast tuning YIG filters for an aircraft platform. The Company expects to recognize the majority of revenue in fiscal 2015 from the order. The Company expects to finalize in the next few months a multi-year follow-on order for approximately $10.0 million associated with the production units, which are anticipated to start shipping in April of 2016.

In the third quarter and first nine months of fiscal 2015, almost all of the orders and sales for the Microsource business unit were from two large aerospace customers. Almost all the orders and revenue for the Microsource business was associated with programs for retrofitting radar filter components on existing military aircraft and radar filter components for new military aircraft. The timing of orders and milestone achievements associated with these customers causes significant differences in orders, sales, deferred revenue, inventory and cash flow when comparing one fiscal period to another.

The Microsource NRE Order received early in fiscal 2015 resulted in significant improvements to sales and results of operations in the third quarter and first nine months of fiscal 2015, when compared to the same periods in fiscal 2014. We expect to see continued improvements in operating results for the remainder of fiscal 2015, when compared to fiscal 2014, as we continue to deliver on the Microsource NRE Order.

Results of Operations

New orders received by segment are as follows:

NEW ORDERS

(Dollars in thousands)	Three Month Periods Ended December 27, 2014	December 28, 2013	% change
Giga-tronics Division	$2,484	$ 2,165	15 %
Microsource	1,555	1,315	18 %
Total	$4,039	$ 3,480	16 %

(Dollars in thousands)	Nine Month Periods Ended December 27, 2014	December 28, 2013	% change
Giga-tronics Division	$7,037	$ 7,123	(1%)
Microsource	8,130	2,232	264 %
Total	$15,167	$ 9,355	62 %

New orders received in the third quarter of fiscal 2015 increased by 16% to $4.0 million from the $3.5 million received in the third quarter of fiscal 2014. The increase is primarily due to a large order for legacy Giga-tronics Division Signal Generator products.

New orders received in the first nine months of fiscal 2015 increased 62% to $15.2 million from the $9.4 million received in the first nine months of fiscal 2014. The increase in orders is primarily due to the Microsource business unit in the first quarter of fiscal 2015 being awarded an approximately $6.2 million NRE contract from a large aerospace company.

The following table shows order backlog and related information at the end of the respective periods:

BACKLOG

(Dollars in thousands)	**December 27, 2014**	**December 28, 2013**	**% change**
Backlog of unfilled orders at end of period:			
Giga-tronics Division	$ 2,698	$ 2,741	(2%)
Microsource	5,012	2,607	92%
Total	$ 7,710	$ 5,348	44%
Backlog of unfilled orders shippable within one year:			
Giga-tronics Division	$ 2,698	$ 2,741	(2%)
Microsource	3,939	2,607	51%
Total	$ 6,637	$ 5,348	24%

Backlog at the end of the third quarter of fiscal 2015 increased 44% compared to the end of the same period last year. The increase in backlog is primarily due to the $6.2 million NRE Order the Microsource business unit received in the first quarter of fiscal 2015, and the receipt of a $1.3 million Microsource business unit order for radar filter components.

The allocation of net sales was as follows for the periods shown:

ALLOCATION OF NET SALES

(Dollars in thousands)	Three Month Periods Ended December 27, 2014	December 28, 2013	% change	
Giga-tronics Division	$2,021	$ 1,539	31	%
Microsource	2,488	1,878	32	%
Total	$4,509	$ 3,417	32	%

(Dollars in thousands)	Nine Month Periods Ended December 27, 2014	December 28, 2013	% change	
Giga-tronics Division	$6,638	$ 5,336	24	%
Microsource	7,489	5,068	48	%
Total	$14,127	$ 10,404	36	%

Net sales in the third quarter of fiscal 2015 were $4.5 million, a 32% increase from the $3.4 million in fiscal 2014, primarily due to partial fulfillment of the Microsource NRE Order and the Giga-tronics Division shipment of a new switching product.

Net sales in the first nine months of fiscal 2015 increased 36% to $14.1 million from the $10.4 million in the first nine months of fiscal 2014. Sales for the Giga-tronics Division increased 24% primarily due to the fulfillment of the Navy 8003 order. Sales for Microsource increased 48% primarily due to the partial fulfillment of the NRE Order with a large aerospace company.

Cost of sales was as follows for the periods shown:

COST OF SALES

(Dollars in thousands)	Three Month Periods Ended December 27,	December 28, 2013	% change

	2014			
Cost of sales	$2,637	$ 2,130	24	%

(Dollars in thousands)	Nine Month Periods Ended December 27, 2014	December 28, 2013	% change	
Cost of sales	$8,101	$ 6,672	21	%

Cost of sales as a percentage of sales decreased for the third quarter of fiscal 2015 to 58.5% compared to 62.3% for the third quarter of fiscal 2014. Cost of sales as a percentage of sales also decreased for the nine months ended December 27, 2014 to 57.3% compared to 64.1% from the first nine months of fiscal 2014. The percentage decreases were primarily due to the fulfilment of the Microsource NRE Order, which had a lower cost of sales compared to product sales.

Operating expenses were as follows for the periods shown:

OPERATING EXPENSES

(Dollars in thousands)	**Three Month Periods Ended December 27, 2014**	**December 28, 2013**	**% change**
Engineering	$672	$ 979	(31)%
Selling, general and administrative	1,133	1,066	6 %
Restructuring	—	36	(100)%
Total	$1,805	$ 2,081	(13)%

(Dollars in thousands)	**Nine Month Periods Ended December 27, 2014**	**December 28, 2013**	**% change**
Engineering	$2,563	$ 3,040	(16)%
Selling, general and administrative	3,401	3,674	(7)%
Restructuring	—	360	(100)%
Total	$5,964	$ 7,074	(16)%

Operating expenses decreased 13% or $276,000 in the third quarter of fiscal 2015 over fiscal 2014. Operating expenses decreased 16% or $1.1 million in the first nine months of fiscal 2015 over fiscal 2014. Engineering expenses decreased $307,000 in the third quarter of fiscal 2015 and $477,000 in the first nine months of fiscal 2015, primarily due to a portion of our engineers being assigned to the Microsource NRE Order which is recorded as cost of sales. Selling, general and administrative decreased by $273,000 in the first nine months of fiscal 2015 primarily due to personnel and other cost reductions over the prior 21 months. The restructuring activities were completed in fiscal year 2014. (Note 11, Restructuring).

Gain on the Sale of Product Line

On March 18, 2013, the Company entered into an Asset Purchase Agreement with Teradyne Inc. (“Teradyne”), whereby Teradyne agreed to purchase the Giga-tronics Division product line known as SCPM for $1.0 million, resulting in a net gain of $97,000 during the third quarter of fiscal 2014 and $913,000 for all of fiscal 2014. (Note 5, Gain on Sale of Product Line).

Derivative Liability and Accretion of Discounts on Term Loan and Warrant Debt Notes

The Company recorded a gain of $107,000 and $16,000 for the three and nine months ended December 27, 2014, in association with the revaluation of the PFG debt derivative liability. The Company also recorded accretion of discount expense associated with the warrants issued with the PFG Loan of $45,000 for the three months ended December 27, 2014, and $115,000 for the nine months ended December 27, 2014. (Note 14, Term Loan, Revolving Line of Credit and Warrants).

Net Interest Expense

Net interest expense for the third quarter of fiscal 2015 was $62,000, an increase of $41,000 over the third quarter of fiscal 2014. Net interest expense for the first nine months of fiscal 2015 was $199,000, an increase of $147,000 over the first nine months of fiscal 2014. The fiscal 2015 increases were primarily the result of increased borrowings under the SVB line of credit and the loans with PFG.

Net Income and Net Loss

Giga-tronics recorded net income of $67,000 for the third quarter of fiscal 2015 versus a net loss of $718,000 in the third quarter of fiscal 2014. The profit in the third quarter of fiscal 2015 compared to the loss in the third quarter of fiscal 2014 was primarily due to increased revenues associated with the Microsource NRE Order.

Giga-tronics recorded a net loss of $283,000 for the first nine months of fiscal 2015 versus a net loss of $2.5 million for the first nine months of fiscal 2014. The lower net loss in the first nine months of fiscal 2015 compared to the first nine months of fiscal 2014 was primarily due to increased revenues associated with the Microsource NRE Order and the Navy 8003 order, and the decrease in operating expenses discussed above.

Financial Condition and Liquidity

As of December 27, 2014, Giga-tronics had $1.4 million in cash and cash equivalents, compared to $1.1 million as of March 29, 2014.

Working capital at December 27, 2014 and March 29, 2014 was $1.3 million and $973,000, respectively. The current ratio (current assets divided by current liabilities) at December 27, 2014 was 1.22 compared to 1.17 on March 29, 2014.

Cash used in operating activities was $513,000 for the nine month period ended December 27, 2014. Cash used in operating activities in the first nine months of fiscal 2015 primarily resulted from an increase in accounts receivable of $686,000 due to the increase in customer sales. Cash used in operating activities amounted to $1.5 million for the nine month period ended December 28, 2013. Cash used in operating activities for the first nine months of fiscal year 2014 was primarily attributed to the net loss of $2.5 million, which was partially offset by the $449,000 increase in accounts payable and the $395,000 in noncash expense for share based compensation.

Additions to property and equipment were $30,000 in the first nine months of fiscal 2015 compared to $262,000 for the same period last year. The additions in the first nine months of fiscal 2015 were associated with equipment needed to manufacture the new product platform. The additions in the prior year were primarily due to leasehold improvements associated with the move of the Microsource manufacturing to the San Ramon facility.

Cash provided by financing activities for the first nine months ended December 27, 2014 was $880,000, primarily due to $500,000 of debt proceeds received from PFG and $457,000 of net proceeds from the line of credit from Silicon Valley Bank. On June 16, 2014, the Company amended its loan agreement with PFG. Under the terms of the amendment, PFG made a revolving line available to Giga-tronics in the amount of $500,000 for which the Company borrowed the entire amount on June 17, 2014. The Company had total debt of $1.4 million with PFG as of December 27, 2014. The amended loan agreement also provides for the Company’s ability to request an additional term loan of up to $500,000 in Fiscal 2015. (Note 14, Term Loan, Revolving Line of Credit, and Warrants).

As of December 27, 2014, the Company’s outstanding borrowings under the New Amended Credit Facility with SVB, which expires on April 15, 2015, were $1.6 million. Management intends to draw upon the New Amended Credit Facility throughout fiscal 2015 to meet projected cash requirements. As of December 27, 2014, the line of credit was at its maximum borrowing capacity. SVB may terminate or suspend advances under the line of credit if SVB determines there has been a material adverse change in the Company’s general affairs, financial forecasts or general ability to repay.

The Company incurred a net loss of $283,000 for the first nine months of fiscal 2015 and $3,742,000 for the fiscal year ended March 29, 2014. These losses have contributed to an accumulated deficit of $18.5 million as of December 27, 2014.

In the first nine months of fiscal 2015 and all of fiscal 2014 the Company invested heavily in the development of a new Giga-tronics Division product platform, the Advanced Signal Generation System. The Company anticipates long-term revenue growth and improved gross margins from the new product platform, but the delay in completing it contributed significantly to the losses of the Company. The Advanced Signal Generation System's initial customer deliveries occurred in the second and third quarters of fiscal 2015, and are approaching final customer acceptance. Additional delays in shipping volume quantities, or longer than anticipated sales cycles, could significantly contribute to additional losses.

To help fund operations, the Company relies on advances under the line of credit with Silicon Valley Bank. However the Bank may terminate or suspend advances under the line of credit if the Bank determines there has been a material adverse change in the Company's general affairs, financial forecasts or general ability to repay. (Note 13, Line of Credit). As of December 27, 2014, borrowings under the line of credit were $1.6 million.

These matters, along with recurring losses in prior years, raise substantial doubt as to the ability of the Company to continue as a going concern.

To address this matter, the Company's management has taken several actions to provide additional liquidity and reduce costs and expenses going forward. These actions are described in the following paragraphs.

On June 16, 2014, Giga-tronics amended its loan agreement with Partners For Growth IV, L.P. ("PFG"). Under the terms of the amendment, PFG made a revolving line of credit available to Giga-tronics in the amount of $500,000 and the Company borrowed the entire amount on June 17, 2014. The Company's original agreement with PFG was entered into on March 13, 2014 under which the Company received $1.0 million from a three-year term loan. Pursuant to the amended loan agreement, the Company may borrow an additional $500,000. The loan agreement contains financial covenants associated with the Company achieving minimum quarterly net sales and maintaining a minimum monthly shareholders' equity. In the event of default by the Company, all or any part of the Company's obligation to PFG could become immediately due.

In the first three months of fiscal 2015 the Microsource business unit received a $6.2 million order ("NRE Order") for the non-recurring engineering and for the delivery of a limited number of flight-qualified prototype hardware from a major aerospace company to develop a variant of its high performance fast tuning YIG filters for an aircraft platform.

The Company expects to recognize the majority of revenue from the NRE Order in fiscal 2015. The Company expects to finalize in the next few months a multi-year follow-on order for approximately $10.0 million associated with the production units, which are anticipated to start shipping in April of 2016. No assurances can be given that the parties will agree on the final multi-year production agreement, or what the actual terms will be.

Also in the first three months of fiscal 2015 the Giga-tronics Division received a $2.4 million order from the United States Navy (“Navy”) for its Model 8003 Precision Scalar Analyzer product (“8003”). The Company recognized the associated revenue and invoiced the Navy in the first two quarters of fiscal 2015.

To assist with the upfront purchases of inventory required for future product deliveries, the Company entered into advance payment arrangements with certain of its customers, whereby the customers reimburse the Company for raw material purchases prior to the shipment of the finished products. In fiscal 2014 the Company entered into advance payment arrangements totaling $1.3 million, and during the first three quarters of fiscal 2015 the Company entered into $1.4 million of advance payment arrangements. The Company will continue to seek similar terms in future agreements with these and other customers.

Management will continue to review all aspects of the business in an effort to improve cash flow and reduce costs and expenses, while continuing to invest, to the extent possible, in new product development for future revenue streams.

Management will also continue to seek additional working capital through debt, equity financing or possible product line sales, but there are no assurances that such financings or sales will be available at all, or on terms acceptable to the Company.

The current year to date loss and the impacts of recurring losses in prior years have had a significant negative impact on the financial condition of the Company and raise substantial doubt about the Company’s ability to continue as a going concern. Management believes that through the actions to date and possible future actions described above, the Company should have the necessary liquidity to continue its operations at least for the next twelve months, though no assurances can be made in this regard based on uncertainties with respect to the continued manufacturing and marketing efforts of the Company’s new product platform and the material adverse change clause in the Company’s line of credit agreement discussed above. The Consolidated Financial Statements have been prepared assuming the Company will continue as a going concern and do not include any adjustments that might result if the Company were unable to do so.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4 - CONTROLS AND PROCEDURES

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to provide reasonable assurances that (i) the information the Company is required to disclose in the reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time period required by the Commission's rules and forms, and (ii) such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

There were no significant changes in the Company's internal control over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

Based on the above described procedures and actions taken, the Company's management, including its Chief Executive Officer and its Chief Financial Officer have concluded that as of December 27, 2014, the Company's internal control over financial reporting was effective based on the criteria described in the 1992 "COSO Internal Control – Integrated Framework."

II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

As of December 27, 2014, Giga-tronics had no material pending legal proceedings. From time to time, Giga-tronics is involved in various disputes and litigation matters that arise in the ordinary course of business.

ITEM 1A - RISK FACTORS

Other than discussed below there has been no material change in the risk factors disclosed in the registrant's Annual Report on Form 10-K for the fiscal year ended March 29, 2014.

Ability to stay listed for trading on The NASDAQ Capital Market

In February 2014, The NASDAQ Stock Market ("NASDAQ") initiated proceedings to delist the Company from the NASDAQ Capital Market for failure to maintain the minimum required shareholders' equity. The Company appealed that determination and certain subsequent determinations, and on November 17, 2014, the Company received a notification letter from NASDAQ advising the Company that the hearing panel granted an extension of the Company's listing through February 16, 2015.

The Company previously reported that it received a notification letter from NASDAQ dated February 12, 2014, advising the Company of its failure to comply with the required minimum of $2,500,000 in shareholders' equity for continued listing on The Nasdaq Capital Market, pursuant to NASDAQ listing rule 5550(b)(1). The Company fell below the minimum requirement with reported shareholders' equity of $2,044,000 in its Form 10-Q for the quarterly period ended December 28, 2013.

NASDAQ stated in the February 12, 2014 letter that under the NASDAQ listing rules the Company had 45 calendar days to submit a plan to regain compliance. The Company submitted a plan on March 31, 2014, and NASDAQ notified the Company on April 10, 2014 of NASDAQ's acceptance of the plan and the granting of an extension to comply with the required minimum of $2,500,000 in shareholders' equity by August 11, 2014. The terms of the extension required the Company to complete certain contemplated sales or other transactions by August 11, 2014, but the Company was unable to do so.

On August 14, 2014, the Company received a notification letter from NASDAQ advising the Company of its failure to comply with the terms of the extension granted to meet the required minimum in shareholders' equity. The Company requested, and was granted, a hearing that took place on November 6, 2014.

During the extension period the Company is required to provide NASDAQ a written monthly update regarding its progress towards compliance. The Company must also provide NASDAQ prompt notice of significant events that occur during the extension, including any event that might call into question the Company's ability to regain compliance. NASDAQ reserves the right to reconsider the extension or its terms if it believes that any new development or information makes the Company's continued listing inadvisable or unwarranted. Unless the Company regains compliance, continuation of the Company's listing on NASDAQ will cease on, or shortly after February 16, 2015.

Regaining compliance will most likely depend on the Company's ability to sell one or more of its legacy product lines or raise equity capital through the exercise of certain existing warrants. No assurance can be given that the Company will regain compliance by February 16, 2015, or that NADAQ will not reconsider the extension or its terms before that date. If the Company's Common Stock ceases to be listed for trading on the Nasdaq Capital Market, the Company expects that its Common Stock would be traded over the counter on the OTCQB marketplace on or about the same day or shortly thereafter.

ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4 - MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5 - OTHER INFORMATION

None.

ITEM 6 - EXHIBITS

31.1	Certification of Chief Executive Officer pursuant to Section 302 of Sarbanes-Oxley Act.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of Sarbanes-Oxley Act.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of Sarbanes-Oxley Act.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of Sarbanes-Oxley Act.

101.INS** XBRL Instance

101.SCH** XBRL Taxonomy Extension Schema

101.CAL** XBRL Taxonomy Extension Calculation

101.DEF** XBRL Taxonomy Extension Definition

101.LAB** XBRL Taxonomy Extension Labels

101.PRE** XBRL Taxonomy Extension Presentation

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.

	GIGA-TRONICS INCORPORATED (Registrant)
	By:
Date: January 29, 2015	/s/ John R. Regazzi John R. Regazzi President and Chief Executive Officer (Principal Executive Officer)
Date: January 29, 2015	/s/ Steven D. Lance Steven D. Lance Vice President of Finance Chief Financial Officer & Secretary

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