GIGA TRONICS INC
Form 10-Q
August 05, 2014

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 **June 28, 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 5,391,247 shares of the Registrant's Common Stock outstanding as of July 31, 2014.

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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 INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands except share data)	June 28, 2014	March 29, 2014
Assets		
Current assets:		
Cash and cash-equivalents	**$1,289**	$1,059
Trade accounts receivable, net of allowance of $45 and $44, respectively	**2,379**	1,846
Inventories, net	**3,926**	3,321
Prepaid expenses and other current assets	**326**	349
Total current assets	**7,920**	6,575
Property and equipment, net	**913**	949
Other long term assets	**86**	69
Total assets	**$8,919**	$7,593
Liabilities and shareholders' equity		
Current liabilities:		
Line of credit	**$362**	$1,165
Current portion of long term debt	**564**	200
Accounts payable	**2,654**	1,430
Accrued payroll and benefits	**569**	755
Deferred revenue	**2,102**	1,329
Deferred rent	**110**	104
Capital lease obligations	**93**	147
Other current liabilities	**470**	472
Total current liabilities	**6,924**	5,602
Long term loan and warrant debt, net of discounts	**709**	672
Derivative liability-at estimated fair value	**444**	128
Long term obligations - deferred rent	**210**	237
Long term obligations - capital lease	**92**	77
Total liabilities	**8,379**	6,716
Shareholders' equity:		
Convertible preferred stock of no par value;		
Authorized - 1,000,000 shares		
Series A - designated 250,000 shares; no shares at June 28, 2014 and March 29, 2014 issued and outstanding	**-**	-
Series B, C, D - designated 19,500 shares; 18,533.51 shares at June 28, 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; 5,193,747 shares at June 28, 2014 and 5,181,247 at March 29, 2014 issued and outstanding	**16,330**	16,224
Accumulated deficit	**(18,701)**	(18,258)
Total shareholders' equity	**540**	**877**
Total liabilities and shareholders' equity	**$8,919**	$7,593

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands except per share data)	**Three Months Ended**	
	June 28,	June 29,
	2014	2013
Net sales	**$4,508**	$3,037
Cost of sales	**2,670**	1,913
Gross margin	**1,838**	1,124
Operating expenses:		
Engineering	**929**	1,106
Selling, general and administrative	**1,027**	1,313
Restructuring	**-**	195
Total operating expenses	**1,956**	2,614
Operating loss	**(118)**	(1,490)
Gain on sale of product line	**-**	816
Loss on adjustment of derivative liability to fair value	**(193)**	-
Other (expense) income	**(2)**	8
Interest expense, net	**(59)**	(13)
Accretion of loan and warrant debt discounts	**(24)**	-
Loss before income taxes	**(396)**	(679)
Provision for income taxes	**47**	2
Net loss	**$(443)**	$(681)
Loss per common share - basic	**$(0.09)**	$(0.13)
Loss per common share - diluted	**$(0.09)**	$(0.13)
Weighted average common shares used in per share calculation:		
Basic	**5,113**	5,052
Diluted	**5,113**	5,052

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)	Three Months Ended June 28, 2014	June 29, 2013
Cash flows from operating activities:		
Net loss	**$(443)**	$(681)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	**75**	54
Share based compensation	**84**	155
Loss on adjustment of derivative liability to fair value	**193**	-
Accretion of discounts on loan and warrant debt	**24**	-
Change in deferred rent	**(21)**	(15)
Changes in operating assets and liabilities	**687**	(544)
Net cash provided by (used in) operating activities	**599**	(1,031)
Cash flows from investing activities:		
Purchases of property and equipment	**-**	(91)
Net cash used in investing activities	**-**	(91)
Cash flows from financing activities:		
Payments on capital leases	**(88)**	(16)
Proceeds from line of credit	**2,536**	611
Proceeds from issuance of debt	**500**	-
Proceeds from exercise of stock options	**22**	-
Repayments of line of credit	**(3,339)**	(577)
Net cash (used in) provided by financing activities	**(369)**	18
Increase (decrease) in cash and cash-equivalents	**230**	(1,104)
Beginning cash and cash-equivalents	**1,059**	1,882
Ending cash and cash-equivalents	**$1,289**	$778
Supplementary disclosure of cash flow information:		
Cash paid for income taxes	**$2**	$2
Cash paid for interest	**45**	13
Supplementary disclosure of noncash financing activities:		
Equipment acquired under capital lease	**$49**	$-

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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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 month period, and years in the consolidated financial statements relate to fiscal periods or years rather than three month calendar quarters, nine calendar months or calendar years.

Certain prior period amounts have been reclassified to conform to the current period's presentation. None of these reclassifications had an effect on the prior periods' net loss or shareholders' equity.

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 (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.

(2) Going Concern and Management's Plan

The Company incurred a net loss of $443,000 for the first three months of fiscal 2015, which has contributed to an accumulated deficit of $18.7 million as of June 29, 2014.

In the first quarter of fiscal 2015 and all of fiscal 2014 the Company invested heavily in the development of a new Giga-tronics Division product platform. The Company anticipates long-term revenue growth and improved gross margins from the new product platform, but delays in completing it have contributed significantly to the losses of the Company. The new product platform is forecasted to start shipping in the second quarter of fiscal 2015, but further delays 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 ("SVB" or "the 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. (See Note 13, Line of Credit). As of June 28, 2014, borrowings under the line of credit were $362,000.

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 following the Company's achievement of certain performance milestones which includes 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. 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 ("New Order") for the non-recurring engineering ("NRE") 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 a third

aircraft platform. The Company expects to recognize the majority of revenue from the New 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 ("U.S. Navy") for its Model 8003 Precision Scalar Analyzer product ("8003"). The Company expects to recognize the associated revenue in the first three quarters of fiscal 2015.

To assist with the upfront purchases of inventory required for future product deliveries, the Company entered into an advance payment arrangements with a large customer, whereby the customer reimburses 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 quarter of fiscal 2015 the Company entered into $652,000 of advance payment arrangements. The Company will continue to seek similar terms in future agreements with this customer 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 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 development, 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.

(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 for revenue recognition 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.

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 has 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)	**June 28, 2014**	**March 29, 2014**
Raw materials	**$1,446**	**$1,501**
Work-in-progress	**2,293**	**1,400**
Finished goods	**124**	**353**
Demonstration inventory	**63**	**67**
Total	**$3,926**	**$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) Loss Per Share

Basic loss per share (EPS) is calculated by dividing net income or loss by the weighted average common shares outstanding during the period. Diluted EPS reflects the net incremental shares that would be issued if unvested restricted shares became vested and dilutive outstanding stock options 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 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 Months Ended**	
	June 28, 2014	**June 29, 2013**
Net loss	**$(443)**	$(681)
Weighted average:		
Common shares outstanding	**5,113**	5,052
Potential common shares	**-**	-
Common shares assuming dilution	**5,113**	5,052
Net loss per share of common stock – basic	**$(0.09)**	$(0.13)
Net loss per share of common stock – diluted	**$(0.09)**	$(0.13)
Stock options not included in computation that could potentially dilute EPS in the future	**1,713**	1,612
Restricted stock awards not included in computation that could potentially dilute EPS in the future	**50**	122
Convertible preferred stock not included in computation that could potentially dilute EPS in the future	**1,853**	1,342
Warrants not included in computation that could potentially dilute EPS in the future	**1,277**	506

The number of restricted stock awards, stock options and warrants not included in the computation of diluted earnings per share (EPS) for the three month periods ended June 28, 2014 and June 29, 2013 are a result of the Company's net loss and, therefore, the restricted stock awards, stock options, warrants are anti-dilutive. In addition, of the restricted stock awards, 50,000 shares are considered contingently issuable shares for which the performance conditions necessary for the awards to vest had not been met as of June 28, 2014 and June 29, 2013. The number of convertible preferred shares not included in the computation of diluted EPS for the three month periods ended June 28, 2014 and June 29, 2013 reflects convertible preferred stock where the assumed proceeds from conversion were greater than the average market price of the common shares and are, therefore, 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 June 28, 2014, no SAR's have been granted under the option plan. As of June 28, 2014, the total number of shares of common stock available for issuance is 724,427. 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 no options granted in the first quarter of fiscal 2015 and options for 137,000 shares were granted in the first quarter of fiscal 2014 with a weighted average grant date fair value of $1.26.

Included in the options granted during fiscal 2014 are performance-based options for 20,000 shares granted as an inducement to an employee. A portion of the options vest following the filing of the Company's Form 10K for fiscal 2015 provided certain bookings goals are achieved by the Company. No compensation cost was recognized for these stock options during the first quarter of fiscal 2015 or 2014 because management believes it is not probable that the performance criteria will be met.

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 Months Ended June 28, 2014	June 29, 2013
Dividend yield	**-**	None
Expected volatility	**-**	80.00 %
Risk-free interest rate	**-**	0.72 %
Expected term (years)	**-**	7.31

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 three month period ended June 28, 2014 and the 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	-	-		
Exercised	12,500	1.75		
Forfeited / Expired	13,000	1.43		
Outstanding at June 28, 2014	**1,713,250**	**$ 1.53**	**6.5**	**$ 1,879**
Exercisable at June 28, 2014	**597,575**	**$ 1.80**	**4.5**	**$ 498**
At June 28, 2014 expected to vest in the future	**813,117**	**$ 1.39**	**7.5**	**$ 1,009**

As of June 28, 2014, there was $632,242 of total unrecognized compensation cost related to non-vested options. That cost is expected to be recognized over a weighted average period of 3.25 years and will be adjusted for subsequent changes in estimated forfeitures. There were 61,250 options that vested during the quarter ended June 28, 2014, and 45,600 options that vested during the quarter ended June 29, 2013. The total fair value of options vested during each of the quarters ended June 28, 2014 and June 29, 2013 was $78,455 and $59,947, respectively. Options for 12,500 shares of common stock were exercised in the three month period ended June 28, 2014 and no options were exercised in the three months ended June 29, 2013. Share based compensation cost related to stock options recognized in operating results for the three months ended June 28, 2014 and June 29, 2013 totaled $81,000 and $78,000, respectively.

Restricted Stock

No restricted awards were granted during the first quarter of fiscal 2015. The Company granted 71,500 shares of restricted stock during the first quarter of fiscal 2014 to 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. The Company also granted 30,000 shares of unrestricted stock during the first quarter of fiscal 2014 as part of severance to a previous 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. Compensation cost of $3,000 and $77,000 was recognized for the restricted and unrestricted stock awards during the first quarters of fiscal 2015 and 2014, respectively.

A summary of the changes in non-vested restricted stock awards outstanding for the three month period ended June 28, 2014 and the fiscal year ended March 29, 2014 is as follows:

	Shares	Weighted Average 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	-	-
Vested	71,500	1.53
Forfeited or cancelled	-	-
Non-Vested at June 28, 2014	**50,000**	**$ 1.18**

(8) Significant Customer and Industry Segment Information

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 month periods ended June 28, 2014 and June 29, 2013.

(In thousands)	**Three Month Periods Ended**			**Three Month Periods Ended**		
	At June 28, 2014	**June 28 2014**		**At June 29, 2013**	**June 29, 2013**	
	Assets	**Net Sales**	**Net Income (Loss)**	**Assets**	**Net Sales**	**Net Income (Loss)**
Giga-tronics Division	**$6,052**	**$1,702**	**$ (615)**	$5,420	$1,906	$ (484)
Microsource	**2,867**	**2,806**	**172**	2,886	1,131	(197)
Total	**$8,919**	**$4,508**	**$ (443)**	$8,306	$3,037	$ (681)

During the first quarter of 2015, one customer accounted for 24% of the Company's consolidated revenues at June 28, 2014 and was included in the Microsource segment. A second and third customer accounted for 34% and 16%, respectively, of the Company's consolidated revenue as of June 28, 2014 and was included in the Giga-tronics Division. During the first quarter of 2014, one customer accounted for 36% of the Company's consolidated revenues at June 29, 2013 and was included in the Microsource segment.

(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's tax expense for the three months ending June 28, 2014 and June 29, 2013 was $47,000 and $2,000, respectively. The effective tax rate for the three months ending June 28, 2014 and June 29, 2013 was 12% and 0% primarily due to a valuation allowance recorded against the net deferred tax asset balance.

As of June 28, 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 liability 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.

(In thousands)	**Three Months**	**Three Months**

	Ended June 28, 2014	Ended June 29, 2013
Balance at beginning of period	**$ 61**	$ 114
Provision, net	**4**	(15)
Warranty costs incurred	**(2)**	(6)
Balance at end of period	**$ 63**	$ 93

The company is currently reviewing a potential warranty issue associated with a Microsource radar filter customer. The Company estimates the potential liability associated with the radar filter to range from zero to approximately $135,000. This potential liability has not been included in the warranty reserve balance as of June 28, 2014.

(11) Restructuring

The Company took steps to reduce current and future expenses by reducing staff and by combining the operations in Santa Rosa into the 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 are for the Microsource reportable segment. As of March 29, 2014 the Company had expensed $780,000 related to these restructuring costs, of which $195,000 was recorded in the first quarter of fiscal 2014. There were no restructuring costs during the first quarter 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 June 28, 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 “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 Second Amended Credit Facility and New Amended Credit Facility contain 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 June 28, 2014, the Company was borrowing base eligible and had outstanding borrowings of $362,000 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 June 28, 2014 and March 29, 2014 maximum borrowing capacity under the Line of Credit was near the $362,000 and $1.2 million drawn, respectively. No material additional amounts were available to draw at June 28, 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 Co