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

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands except per share data)	**Three Months Ended June 28, 2014**	June 29, 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,	**June 29,**
	2014	**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 At June 28, 2014**	**June 28 2014**		**Three Month Periods Ended 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	**Ended**
	June 28,	**June 29,**
	2014	**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 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 include 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 ($500,000) if the Company does not meet the performance milestones required under the agreement. As of June 28, 2014, the Company has total debt outstanding of $1.5 million with PFG.

Interest on the initial $1.0 million term loan is fixed at 9.75% per annum and requires 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 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.

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 are recorded within prepaid expenses and will be amortized to interest expense over the remaining three-year 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 June 28, 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 are 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 in fiscal 2015 net sales of at least $18.0 million and net income of at least $1.0 million.

If the warrants are not exercised before expiration on March 13, 2019, the warrants associated with the First Draw would be settled for $150,000 in cash, the warrants associated with the Amendment would be settled for $67,000 in cash and the warrants that would be issued if the additional $500,000 is funded would be settled for $33,000 in cash. 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 June 28, 2014, the estimated fair values of the derivative liabilities associated with the warrants issued in connection with the First Draw and Amendment were $308,000 and $136,000, respectively, for a combined value of $444,000. The change in the fair value of the derivative liabilities since their respective dates of issuance totaled $193,000 and is reported in earnings as loss 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.

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.

(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”), 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 newly designated Series C Convertible Voting Perpetual Preferred Stock (“Series C Preferred Stock”) to the Investor, an investment vehicle sponsored by Active Value Investors, LLC, 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 from the amendment described above, 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 (“SPA”), Under the terms of the SPA, the Company sold to the Investor 5,111.86 shares of a new 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 noted above 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.

The table below presents information as of June 28, 2014 and March 29, 2014.

Series B, C and D Preferred Stock

	As of June 28, 2014 and March 29,2014			
	Designated Shares	Shares Issued	Shares Outstanding	Liquidation Preference
Series B	10,000.00	9,997.00	9,997.00	2309
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 "Certain Factors Which May Adversely Affect Future Operations or an Investment in Giga-tronics", 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 (“U.S. Navy”) for its Model 8003 Precision Scalar Analyzers product (“8003”). The Company expects to recognize the associated revenue in the first three quarters of fiscal 2015. The Navy was a significant customer for the Company in the first quarter of fiscal 2015. In the first three months of fiscal 2014 the Giga-tronics division had a broad range of customers, both domestic and international, and there were not any significant customers.

In the first three months of fiscal 2015 the Microsource business unit received a $6.2 million order (“New Order”) for non-recurring engineering (“NRE”) 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 a third aircraft platform. The Company expects to recognize the majority of revenue 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.

In the first three months of fiscal 2015 almost all of the orders and sales for the Microsource business unit were from two large aerospace customers. In the first three months of fiscal 2014 almost all of the orders and sales for the Microsource business unit were from one large aerospace customer. Almost all the orders and revenue for the Microsource business is associated with programs for retrofitting radar filter components on existing military aircraft, and radar filter components for new military aircraft being manufactured. The timing of orders and milestone achievements associated with this customer causes significant differences in orders, sales, deferred revenue, inventory and cash flow when comparing one fiscal period to another.

The Navy 8003 order and the Microsource New Order received in the first quarter of fiscal 2015 resulted in significant improvements to sales and results from operations when compared the first quarter of 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 ship from these new orders and begin to ship our new product platform to customers.

Results of Operations

New orders received by segment are as follows:

NEW ORDERS

(Dollars in thousands)	**Three Month Periods Ended**			
	June 28, 2014	**June 29, 2013**	**% change**	
Giga-tronics Division	**$3,330**	**$2,251**	48	%
Microsource	**6,461**	**72**	8874	%
Total	**$9,791**	**$2,323**	321	%

New orders received in the first quarter of fiscal 2015 increased by 321% to $9.8 million from the $2.3 million received in the first quarter of fiscal 2014. The increase in orders is primarily due to the Microsource business unit in

the first quarter of fiscal 2015 being awarded approximately $6.2 million in long term NRE contracts from a large aerospace company. The increase in the Giga-tronics division was primarily the result of the $2.4 million order from the U.S. Navy for the 8003.

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

BACKLOG

(Dollars in thousands)	**June 28, 2014**	**June 29, 2013**	**% change**	
Backlog of unfilled orders at end of period:				
Giga-tronics Division	**$3,927**	**$1,396**	181	%
Microsource	**8,026**	**4,384**	83	%
Total	**$11,953**	**$5,780**	107	%
Backlog of unfilled orders shippable within one year:				
Giga-tronics Division	**$3,927**	**$1,396**	181	%
Microsource	**6,155**	**4,384**	40	%
Total	**$10,082**	**$5,780**	74	%

Backlog at the end of the first quarter of fiscal 2015 increased 107% compared to the end of the same period last year. The increase in backlog is primarily due to the increase in new orders mentioned above.

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

ALLOCATION OF NET SALES

(Dollars in thousands)	**Three Month Periods Ended**		
	June 28,	**June 29,**	**%**
	2014	**2013**	**Change**
Giga-tronics Division	**$1,702**	**$1,906**	(11%)
Microsource	**2,806**	**1,131**	148 %
Total	**$4,508**	**$3,037**	48 %

Fiscal 2015 first quarter net sales were $4.5 million, a 48% increase from the $3.0 million in the first quarter of fiscal 2014. Sales at Giga-tronics Division decreased 11% or $204,000 primarily due to lower sales of its switching devices. Sales at Microsource increased 148% or $1.7 million primarily due to the partial fulfillment of the New Order for NRE 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**		
	June 28,	**June 29,**	**%**
	2014	**2013**	**change**
Cost of sales	**$2,670**	**$1,913**	40 %

Cost of sales as a percentage of sales decreased for the first quarter of fiscal 2015 to 59.2% compared to 63.0 % for the first quarter of fiscal 2014. This percentage decrease was primarily due to the delivered NRE associated with the Microsource New 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 June 28, 2014	June 29, 2013	% change
Engineering	$929	$1,106	(16%)
Selling, general and administrative	1,027	1,313	(22%)
Restructuring	-	195	(100%)
Total	$1,956	$2,614	(25%)

Operating expenses decreased 25% or $658,000 in the first quarter of fiscal 2015 over fiscal 2014. Engineering expenses decreased $177,000 primarily due to portion of our engineers being assigned to the Microrsource NRE project which is recorded as cost of sales. Selling, general and administrative decreased by $286,000 primarily due to personnel and other cost reductions over the prior nine months. The restructuring activities were completed in fiscal year 2014, (see 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 $816,000 during the first quarter of fiscal 2014 and $913,000 for all of fiscal 2014, (see Note 5, Gain on Sale of Product Line).

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

The Company recorded an expense of $193,000 and $24,000 in the first quarter of fiscal 2015 related to revaluation of the derivative liability and accretion of discount, respectively, associated with warrants issued with the PFG Loan (see Note 14, Term Loan, Revolving Line of Credit and Warrants).

Net Interest Expense

Net interest expense for the first quarter of fiscal 2015 was $59,000, an increase of $46,000 over the first quarter of fiscal 2014 and was primarily due to borrowings under the SVB line of credit and the loans with PFG.

Net Loss

Giga-tronics recorded a net loss of $443,000 for the first quarter of fiscal 2015 versus net loss of $681,000 the first quarter of fiscal 2014. The lower net loss in the first quarter of fiscal 2015 compared to the first quarter of fiscal 2014 was primarily due to increased revenues associated with the Microsource New Order for NRE and the decrease in selling, general and administrative expenses discussed above, which was partially offset by the revaluation of the derivative liabilities of $193,000 which was caused by the increase in our stock price during June 2014.

Financial Condition and Liquidity

As of June 28, 2014, Giga-tronics had $1.3 million in cash and cash equivalents, compared to $1.1 million as of March 29, 2014.

Working capital at both June 28, 2014 and March 29, 2014 was $1.0 million. The current ratio (current assets divided by current liabilities) at June 28, 2014 was 1.14 compared to 1.17 on March 29, 2014.

Cash provided from operating activities was $599,000 for the three month period ended June 28, 2014. Cash provided from operating activities in the first quarter of 2015 resulted from an increase in accounts payable of $1.2 million and deferred revenue of $773,000, which was partially offset by an increases in inventories of $605,000 and accounts receivables of $533,000, and the net loss of $443,000. Accounts payable increased due to the timing of payments to vendors, and due to the increased inventory purchases. Inventories increased as the Company purchased materials needed for the Navy 8003 order. Deferred revenue and receivables increased due to invoicing associated with the Microsource New Order for NRE.

Cash used in operating activities amounted to $1.0 million for the three month period ended June 29, 2013. Cash used in operating activities for the first quarter of fiscal year 2014 was primarily attributed to an operating loss of $1.5 million and a $483,000 decrease in deferred revenue during the quarter with associated milestone achievements of the Microsource business for a large aerospace company. These were partially offset by proceeds on the sale of a product line to Teradyne of $816,000, (see Note 5, Gain on Sale of Product Line).

Additions to property and equipment were $49,000 in the first quarter of 2015, all of which was financed through a capital lease, compared to $91,000 for the same period last year. The additions in the first quarter of fiscal 2015 were associated with equipment needed to manufacture the new product platform. The additions in the prior year were primarily due to lease-hold improvements associated with the move of Microsource manufacturing to the San Ramon facility.

Cash used in financing activities for the quarter ended June 28, 2014 was $369,000, due to a net decline of $803,000 in the use of the Line of Credit from Silicon Valley Bank which was partially offset by $500,000 of additional debt received from PFG. 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, and the Company borrowed the entire amount on June 17, 2014. The Company now has total debt of $1.5 million with PFG. 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 if the Company meets the performance criteria discussed above, (see Note 14, Term Loan, Revolving Line of Credit, and Warrant).

As of June 28, 2014, the Company's outstanding borrowings under the New Amended Credit Facility with SVB was $362,000. Management intends to draw upon the New Amended Credit Facility throughout fiscal 2015 to meet projected cash requirements. As of June 28, 2014, the line of credit was near 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 has incurred net losses of $443,000 for the first three months of fiscal 2015, which contributed to an increase in our 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 cause 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, the Company borrowed the entire amount on June 17, 2014. On March 13, 2014 the Company entered into a three year, term loan agreement with PFG under which the Company received $1.0 million on March 14, 2014. 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 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 Analyzers 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 losses 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.

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 June 28, 2014, the Company's internal control over financial reporting was effective based on the criteria described in the "COSO Internal Control – Integrated Framework."

II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

As of June 28, 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

On February 12, 2014, the Company received a notification letter from The NASDAQ Stock Market ("NASDAQ") advising the Company of its failure to comply with the required minimum of $2.5 million 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 $2.0 million 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. On April 10, 2014, the Company received a notification letter from NASDAQ advising the Company that an extension to August 11, 2014, had been granted to take the steps necessary to regain compliance with NASDAQ listing rule 5550(b) (1) and promptly thereafter to file a report describing the transaction or event enabling the company to satisfy the applicable requirement for continued listing.

The Company does not expect that its plans to comply with the required minimum of $2.5 million in shareholders' equity will be successful by August 11, 2014. If the Company does not meet this requirement it plans to request a hearing and ask for an additional 180 day extension. NASDAQ may allow companies to remain listed during the hearing process that typically takes 30 to 45 days. There can be no assurances that the Company will be granted an additional 180 day extension. 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 on the Over-the-Counter Bulletin Board on or about the same day.

The market price of the Company's Common Stock may be adversely affected if it ceases to be listed for trading on the Nasdaq Capital Market.

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: August 5, 2014 /s/ John R. Regazzi
John R. Regazzi
President and Chief
Executive Officer
(Principal
Executive Officer)

Date: August 5, 2014 /s/ Steven D. Lance
Steven D. Lance
Vice President of
Finance
Chief Financial
Officer & Secretary