

GIGA TRONICS INC  
Form 10-K  
June 24, 2014  
UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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**FORM 10-K**

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

For the fiscal year ended March 29, 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  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (925) 328-4650

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, No par value	The NASDAQ Stock Market LLC

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Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes  No

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

Yes  No

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

Yes  No

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

[ X ]

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  Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes  No

The aggregate market value of voting and non-voting common equity held by non-affiliates of the Registrant computed by reference to the price at which the common equity was sold or the average bid and asked prices as of September 28, 2013 was \$6,321,121.

There were a total of 5,181,247 shares of the Registrant's Common Stock outstanding as of June 16, 2014.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents have been incorporated by reference into the parts indicated:

PART OF FORM 10-K    DOCUMENT  
PART III

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Registrant's PROXY STATEMENT for its 2014 Annual Meeting of Shareholders to be filed no later than 120 days after the close of the fiscal year ended March 29, 2014.

**TABLE OF CONTENTS**

	<u>Page</u>
<b>PART I</b>	
ITEM 1. Business	4
ITEM 1A. Risk Factors	7
ITEM 1B. Unresolved Staff Comments	9
ITEM 2. Properties	9
ITEM 3. Legal Proceedings	9
ITEM 4. Mine Safety Disclosures	9
<b>PART II</b>	
ITEM 5. Market for Common Equity, Related Stockholder Matters and Issuer Repurchases of Equity Securities	10
ITEM 6. Selected Financial Data	11
ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations	11
ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk	19
ITEM 8. Financial Statements and Supplementary Data	20
Consolidated Balance Sheets as of March 29, 2014 and March 30, 2013	21
Consolidated Statements of Operations for the years ended March 29, 2014 and March 30, 2013	22
Consolidated Statements of Shareholders' Equity for the years ended March 29, 2014 and March 30, 2013	23
Consolidated Statements of Cash Flows for the years ended March 29, 2014 and March 30, 2013	24
Notes to Consolidated Financial Statements	25
Report of Independent Registered Public Accounting Firm	42
ITEM 9. Changes In and Disagreements With Accountants On Accounting and Financial Disclosure	43
ITEM 9A. Controls and Procedures	43
ITEM 9B. Other Information	44
<b>PART III</b>	
ITEM 10. Directors, Executive Officers and Corporate Governance	45
ITEM 11. Executive Compensation	45
ITEM 12. Security Ownership Of Certain Beneficial Owners and Management and Related Shareholder Matters	45
ITEM 13. Certain Relationships and Related Transactions, and Director Independence	45
ITEM 14. Principal Accountant Fees and Services	45

**PART IV**

ITEM 15. Exhibits and Financial Statements Schedules	45
SIGNATURES	46

## **PART 1**

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 discussed under “Certain Factors Which May Adversely Affect Future Operations Or An Investment In Giga-tronics” in Item 1 below and in Item 7, “Management’s Discussion and Analysis”.

### **ITEM 1. BUSINESS**

#### **General**

Giga-tronics Incorporated (Giga-tronics, or the Company) includes the operations of the Giga-tronics Division and Microsource Inc. (Microsource), a wholly owned subsidiary. Giga-tronics Division designs, manufactures and markets 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. 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.

Giga-tronics was incorporated on March 5, 1980, and Microsource was acquired by Giga-tronics on May 18, 1998.

The combined Company principal executive offices are located at 4650 Norris Canyon Road, San Ramon, California, and its telephone number at that location is (925) 328-4650.

Giga-tronics intends to broaden its product lines and expand its market primarily through internal development of new products.

## **Industry Segments**

The Company manufactures products used in test, measurement and control. The Company has two reporting segments: Giga-tronics Division and Microsource.

## **Products and Markets**

### Giga-tronics

The Giga-tronics Division produces signal sources, generators, power measurement and amplification instruments for use in the microwave and radio frequency (RF) range (10 kilohertz (kHz) to 50 gigahertz (GHz)). Within each product line are a number of different models and options allowing customers to select frequency range and specialized capabilities, features and functions. The end-user markets for these products can be divided into three broad segments: electronic warfare, radar and commercial telecommunications. These instruments are used in the design, production, repair and maintenance and calibration of other manufacturers' products, from discrete components to complex systems.

The Giga-tronics Division also produces switching systems that operate with a bandwidth from direct current (DC) to optical frequencies. These switch systems may be incorporated within customers' automated test equipment. The end-user markets for these products are primarily related to defense, aeronautics, communications, satellite and electronic warfare, commercial aviation and semiconductors.

### Microsource

The Microsource segment develops and manufactures a broad line of YIG tuned oscillators, filters, filter components, and microwave synthesizers, which are used by its customers in operational applications and in manufacturing a wide variety of microwave instruments or devices. The end-user markets for these products are primarily related to defense and commercial aerospace.



## **Sources and Availability of Raw Materials and Components**

Substantially all of the components required by Giga-tronics to make its assemblies are available from more than one source. The Company occasionally uses sole source arrangements to obtain leading-edge technology or favorable pricing or supply terms, but not in any material volume. In the Company's opinion, the loss of any sole source arrangement it has would not be material to its operations. Some suppliers are also competitors of Giga-tronics. In the event a competitor-supplier chooses not sell its products to Giga-tronics, production delays could occur as the Company seeks new suppliers; or, the Company re-designs components to its products.

Although extended delays in receipt of components from its suppliers could result in longer product delivery schedules for the Company, the Company believes that its protection against this possibility stems from its practice of dealing with well-established suppliers and maintaining good relationships with such suppliers.

## **Patents and Licenses**

The Company's competitive position is largely dependent upon its ability to provide performance specifications for its instruments and systems that (a) are easy to use and effectively and reliably meet customers' needs and (b) selectively surpass competitors' specifications in competing products. Patents may occasionally provide some short-term protection of proprietary designs. However, because of the rapid progress of technological development in the Company's industry, such protection is most often, although not always, short-lived. Therefore, although the Company occasionally pursues patent coverage, it places major emphasis on the development of new products with superior performance specifications and the upgrading of existing products toward this same end.

The Company's products are based on its own designs, which are derived from its own engineering abilities. If the Company's new product engineering efforts fall behind, its competitive position weakens. Conversely, effective product development greatly enhances its competitive status.

The Company presently holds 31 patents. Some of these are critical to the Company's ongoing business, and the Company intends to actively maintain them. Capitalized costs relating to these patents were both incurred and fully amortized prior to March 27, 2011. Accordingly, these patents have no recorded value included in the Company's consolidated financial statements for the fiscal years ended March 29, 2014 ("fiscal 2014") and March 30, 2013 ("fiscal 2013").

The Company is not dependent on trademarks, licenses or franchises. It does utilize certain software licenses in certain functional aspects for some of its products. Such licenses are readily available, non-exclusive and are obtained at either no cost or for a relatively small fee.

### **Seasonal Nature of Business**

The business of the Company is not seasonal.

### **Working Capital Practices**

The Company generally strives to maintain adequate levels of inventory and generally sells to customers on 30-day payment terms in the U.S. and generally allows more time for overseas payments. Typically, the Company receives payment terms of 30 days from its suppliers. The Company believes that these practices are consistent with typical industry practices.

### **Importance of Limited Number of Customers**

The Company is a supplier of microwave and RF test instruments to various United States (U.S.) government defense agencies, as well as to their prime contractors. Management anticipates sales to U.S. government agencies and their prime contractors will remain significant in fiscal 2015. U.S. and international defense-related agencies accounted for 57% and 58% of net sales in fiscal 2014 and 2013, respectively. Commercial business accounted for the remaining 43% and 42% of net sales in fiscal 2014 and fiscal 2013, respectively.

At the Giga-tronics Division, U.S. defense agencies and their prime contractors accounted for 25% and 40% of net sales in fiscal 2014 and fiscal 2013, respectively. Microsource reported 96% and 91% of net sales to U.S. defense agencies and their prime contractors during fiscal 2014 and year 2013, respectively.

During fiscal 2014, one customer accounted for 39% of the Company's consolidated revenues and was included in the Microsource reporting segment. A second customer accounted for 16% of the Company's consolidated revenues during fiscal 2014 and was included in the Giga-tronics Division reporting segment.



During fiscal 2013, one customer accounted for 30% of the Company's consolidated revenues and was included in the Microsource reporting segment. A second customer accounted for 12% of the Company's consolidated revenues during fiscal 2013 and was included in the Giga-tronics Division reporting segment.

In management's opinion, the Company could experience a material adverse effect on its financial stability if there was a significant loss of either its defense or commercial customers.

The Company's products are largely capital investments for its customers, and the Company's belief is that its customers have economic cycles in which capital investment budgets for the kinds of products that the Company produces expand and contract. The Company, therefore, expects that a major customer in one year will often not be a major customer in the following year. Accordingly, the Company's net sales and earnings will decline if the Company is unable to find new customers or increase its business with other existing customers to replace declining net sales from the previous year's major customers. A substantial decline in net sales to U.S. government defense agencies and their prime contractors would also have a material adverse effect on the Company's net sales and results of operations unless replaced by net sales in the commercial sector.

### **Backlog of Orders**

On March 29, 2014, the Company's backlog of unfilled orders was approximately \$6.7 million compared to approximately \$7.3 million at March 30, 2013. As of March 29, 2014, there were approximately \$1.2 million of orders scheduled for shipment beyond one year. As of March 30, 2013, there were approximately \$638,000 of orders scheduled for shipment beyond one year. Orders for the Company's products include program orders from both the U.S. government and defense contractors with extended delivery dates. Accordingly, the backlog of orders may vary substantially from year to year and the backlog entering any single quarter may not be indicative of sales for any period.

Backlog includes only those customer orders for which a delivery schedule has been agreed upon between the Company and the customer and, in the case of U.S. government orders, for which funding has been appropriated.

### **Competition**

Giga-tronics serves the broad market for electronic instrumentation with applications ranging from the design, test, calibration and maintenance of other electronic devices to providing sophisticated components for complex electronic systems to sub-systems capable of sorting and identifying high frequency signals. These applications cut across the military, commercial and industrial segments of the broader market. The Company has a variety of competitors. Several of its competitors such as Agilent/Keysight, Anritsu and Rohde & Schwarz are much larger than the Company and have greater resources in research and development and manufacturing with substantially broader product lines and channels. Others are of comparable size or have small product divisions with more limited product lines, such as EADS, VTI, Elcom, Aeroflex and Herley.

To compete effectively in this circumstance, the Company (a) places strong emphasis on maintaining a high degree of technical competence as it relates to the development of new products and the upgrading of existing products in less competitive growth areas, (b) is highly selective in establishing technological objectives and (c) focuses sales and marketing activities in areas that are weakly served or underserved. The Company does not attempt to compete 'across the board', but selectively based upon its particular strengths, the competitors' perceived limitations, the customer's needs and market opportunities.

The Company is able to compete by offering differentiated products that meet a customer's particular specification requirements in high value niches; by being able to present the correct product functionality at a high quality level, and by configuring its core platforms to fit the application need. All of these advantages are attributable to the Company's continuing investment in platform research and development and in a highly trained engineering staff.

When the opportunity involves custom solutions, satisfying the customer's specific requirements assumes greater importance and the Company has more flexibility in making modifications and enhancements than its larger and more structured competitors.

## **Sales and Marketing**

Giga-tronics and Microsource market their products through various independent distributors and representatives to commercial and government customers for its instrument products but sell primarily direct on its switch and component products, although not necessarily through the same distributors and representatives.

## **Product Development**

Products of the type manufactured by Giga-tronics historically have had relatively long product life cycles. However, the electronics industry is subject to rapid technological changes at the component level. The future success of the Company is dependent on its ability to steadily incorporate advancements in component technologies into its new products. In fiscal 2014 and fiscal 2013, product development expenses totaled approximately \$3.9 million and \$4.3

million including non-recurring engineering (NRE) costs, respectively.

6

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Activities included the development of new products and the improvement of existing products. It is management's intention to maintain product development at levels required to sustain its competitive position. The Company's product development activities are funded internally, or through outside equity investment and debt. Product development activities are expensed as incurred.

Giga-tronics expects to continue to make significant investments in research and development. There can be no assurance that future technologies, processes or product developments will not render Giga-tronics' current product offerings obsolete or that Giga-tronics will be able to develop and introduce new products or enhancements to existing products that satisfy customer needs in a timely manner or achieve market acceptance. The failure to do so could adversely affect Giga-tronics' business.

### **Manufacturing**

The assembly and testing of Giga-tronics Division and Microsource's products are done at its San Ramon facility.

### **Environment**

To the best of its knowledge, the Company is in compliance with all Federal, state and local laws and regulations involving the protection of the environment.

### **Employees**

As of March 29, 2014, Giga-tronics employed 76 individuals on a full-time basis compared to 90 as of March 30, 2013. Management believes that the future success of the Company depends on its ability to attract and retain skilled personnel. None of the Company's employees are represented by a labor union, and the Company considers its employee relations to be good.

### **Information about Foreign Operations**

The Company sells to its international customers through a network of foreign technical sales representative organizations. All transactions between the Company and its international customers are in U.S. dollars.

**Geographic Distribution of Net Sales**

(Dollars in thousands)	2014	2013	2014	2013
Domestic	\$11,832	\$11,260	88.9 %	79.0 %
International	1,477	2,927	11.1 %	21.0 %
Total	\$13,309	\$14,187	100.0 %	100.0 %

See Item 8, footnote 8 of the consolidated financial statements for further breakdown of international sales for the last two years.

**ITEM 1A. RISK FACTORS**

**Future liquidity is uncertain**

The Company incurred net losses of \$3.7 million in fiscal 2014, and \$4.2 million in fiscal 2013. These losses have contributed to an accumulated deficit of \$18.3 million at March 29, 2014, and have resulted in the Company using cash in its operations of \$2.5 million in fiscal 2014. 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.

In fiscal 2014 and 2013 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 to the losses of the Company. The new product platform is currently forecasted to start shipping in the second quarter of fiscal 2015, but further delays could cause additional losses.

To help fund operations, the Company relies on advances under its line of credit with Silicon Valley Bank (“SVB”). However the 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. (see Note 15, Line of Credit).

To address this matter, the Company’s management has taken several actions to address liquidity concerns during fiscal 2014, and reduce the costs and expenses going forward. These actions are described in Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations and in the Notes to Consolidated Financial



Statements (Note 2, Going Concern and Management's Plan).

7

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Management believes that through the actions described in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and in the Notes to Consolidated Financial Statements (Note 2, Going Concern and Management's Plan), 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.

#### **Delivery of new products in development**

The Company continues to invest heavily in the development of a new product platform forecasted to start shipping in the second quarter of fiscal 2015. The Company anticipates long-term revenue growth and improved gross margins from the new product platform. No assurances can be made that the new product platform will be delivered to customers in the second quarter of fiscal 2015 or that there will be sufficient market acceptance of it.

#### **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.

There can be no assurance that the Company's plans to comply with the required minimum of \$2.5 million in shareholders' equity will be successful by August 11, 2014. 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.

**Giga-tronics' sales are substantially dependent on the defense industry**

Giga-tronics has a significant number of defense-related orders. If the defense market demand decreases, actual shipments could be less than projected shipments with a resulting decline in sales. The Company's product backlog has a number of risks and uncertainties such as the cancellation or deferral of orders, dispute over performance and the Company's ability to collect amounts due under these orders. If any of these events occur, actual shipments could be lower than projected shipments and revenues could decline.

**Giga-tronics' markets involve rapidly changing technology and standards**

The market for electronics equipment is characterized by rapidly changing technology and evolving industry standards. Giga-tronics believes that its future success will depend in part upon its ability to develop and commercialize its existing products, and in part to develop, manufacture and successfully introduce new products and product lines with improved capabilities and to continue to enhance existing products. There can be no assurance that Giga-tronics will successfully complete the development of current or future products, or that such products will achieve market acceptance. The inability to develop new products in a timely manner could have a material adverse impact on operating performance and liquidity.

**Giga-tronics' common stock price is volatile**

The market price of the Company's common stock could be subject to significant fluctuations in response to variations in quarterly operating results, reduction in revenues or lower earnings or increased losses and reduced levels of liquidity when compared to previous quarterly periods, and other factors such as announcements of technological innovations or new products by Giga-tronics or by competitors, government regulations or developments in patent or other proprietary rights. In addition, The Nasdaq Capital Market and other stock markets have experienced significant price fluctuations in recent years. Some of these fluctuations often have been unrelated to the reported operating performance of the specific companies whose stocks are traded. Broad market fluctuations, as well as general foreign and domestic economic conditions, may adversely affect the market price of the common stock.

Giga-tronics stock at any time has historically traded on low volume on The Nasdaq Capital Market. Sales of a significant volume of stock could result in a decline of Giga-tronics' share price.

**Performance problems in Giga-tronics' products or problems arising from the use of its products together with other vendors' products may harm its business and reputation**

Products as complex as those Giga-tronics produces may contain unknown and undetected defects or performance problems. For example, it is possible that a product might not comply with stipulated specifications under all circumstances. In addition, Giga-tronics' customers generally use its products together with their own products and products from other vendors. As a result, when problems occur in a combined environment, it may be difficult to identify the source of the problem. A defect or performance problem could result in lost revenues, increased warranty costs, diversion of engineering and management time and effort, impaired customer relationships and injury to Giga-tronics' reputation generally. To date, performance problems in Giga-tronics' products or in other products used together with Giga-tronics' products have not had a material adverse effect on its business. However, management cannot be certain that a material adverse impact will not occur in the future.

**Giga-tronics' competition has greater resources**

The Company's instrument, switch, oscillator and synthesizer products compete with Agilent/Keysight, Anritsu, EADS, Aeroflex and Rohde & Schwarz. Many of these companies have substantially greater research and development, manufacturing, marketing, financial, and technological personnel and managerial resources than Giga-tronics. These resources also make these competitors better able to withstand difficult market conditions than the Company. There can be no assurance that any products developed by the competitors will not gain greater market acceptance than any developed by Giga-tronics.

**Giga-tronics acquisitions may not be effectively integrated and their integration may be costly**

As part of its business strategy, Giga-tronics may broaden its product lines and expand its markets, in part through the acquisition of other business entities. Giga-tronics is subject to various risks in connection with any future acquisitions. Such risks include, among other things, the difficulty of assimilating the operations and personnel of the acquired companies, the potential disruption of the Company's business, the inability of management to maximize the financial and strategic position of the Company by the successful incorporation of acquired technology and rights into its product offerings, the maintenance of uniform standards, controls, procedures and policies, and the potential loss of key employees of acquired companies. No assurance can be given that any acquisition by Giga-tronics will or will not

occur, that if an acquisition does occur, that it will not materially harm the Company or that any such acquisition will be successful in enhancing the Company's business. The Company currently contemplates that future acquisitions may involve the issuance of additional shares of common stock. Any such issuance may result in dilution to all Giga-tronics' shareholders, and sales of such shares in significant volume by the shareholders of acquired companies may depress the price of its common stock.

The Company has not made any acquisitions in the past several years.

#### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

#### **ITEM 2. PROPERTIES**

Giga-tronics' principal executive office and the marketing, sales and engineering offices and manufacturing facilities are located in approximately 47,300 square feet in San Ramon, California, which the Company occupies under a lease agreement expiring December 31, 2016.

The Company believes that its facilities are adequate for its business activities.

#### **ITEM 3. LEGAL PROCEEDINGS**

As of March 29, 2014, the Company has 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 4. MINE SAFETY DISCLOSURES**

Not Applicable



**PART II****ITEM 5. MARKET FOR COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER REPURCHASES OF EQUITY SECURITIES****Common Stock Market Prices**

Giga-tronics' common stock is traded on the Nasdaq Capital Market using the symbol 'GIGA'. The number of record holders of the Company's common stock as of March 29, 2014 was approximately 1,500. The table below shows the high and low closing bid quotations for the common stock during the indicated fiscal periods. These quotations reflect inter-dealer prices without mark-ups, mark-downs, or commission and may not reflect actual transactions.

	<b>2014</b>	<b>High</b>	<b>Low</b>	<b>2013</b>	<b>High</b>	<b>Low</b>
First Quarter	<b>(4/1 - 6/30)</b>	<b>\$1.79</b>	<b>\$1.37</b>	(4/1 - 6/30)	\$1.21	\$0.92
Second Quarter	<b>(7/1 - 9/28)</b>	<b>1.44</b>	<b>1.22</b>	(7/1 - 9/29)	1.80	1.01
Third Quarter	<b>(9/29 - 12/28)</b>	<b>1.24</b>	<b>0.90</b>	(9/30 - 12/29)	1.75	1.25
Fourth Quarter	<b>(12/29 - 3/29)</b>	<b>1.55</b>	<b>0.92</b>	(12/30 - 3/30)	1.71	1.32

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.

As of March 29, 2014, the Company's shareholders' equity was \$877,000. There can be no assurance that the Company's plans to comply with the required minimum of \$2.5 million in shareholders' equity will be successful by

August 11, 2014. 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.

Giga-tronics has not paid cash dividends in the past and has no current plans to do so in the future, believing the best use of its available capital is in the enhancement of its product position.

In fiscal year 2014 Giga-tronics issued 5,111.86 shares of Series D convertible preferred stock at no par value to Alara Capital AVI II, LLC ("Alara") for \$143 per share and a warrant to purchase up to 511,186 additional shares of common stock at the price of \$1.43 per share in private transactions not registered with the Commission. It also issued warrants for up to 300,000 shares of common stock at an exercise price of \$1.42 per share in connection with debt financing provided by Partners for Growth IV, L.P. in a private transaction without registration. All such transactions were previously reported in current reports on Form 8-K.



## Equity Compensation Plan Information

The following table provides information on options and other equity rights outstanding and available at March 29, 2014.

## Equity Compensation Plan Information

Plan Category	No. of securities to be issued upon exercise of outstanding options, stock awards, warrants and rights (1)	Weighted average price of outstanding options, stock awards, warrants and rights	No. of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	1,575,250	\$1.5200	711,427
Equity compensation plans not approved by security holders - options	235,000	\$1.1100	n/a
Equity compensation plans not approved by security holders	50,000	\$0.0000	n/a
Total	1,860,250	\$1.4300	711,427

(1) Includes 189,000 shares issuable under the 2000 Stock Option Plan, 1,386,250 shares issuable under the 2005 Equity Incentive Plan, 285,000 shares issuable outside of the 2005 Equity Incentive Plan.

## Issuer Repurchases

The Company did not repurchase any of its equity securities during the fiscal year ended March 29, 2014.

## ITEM 6. SELECTED FINANCIAL DATA

Pursuant to Item 301(c) of Regulation S-K., the Company, as a smaller reporting company, is not required to provide the information required by this item.

## **ITEM 7. 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.

The Giga-tronics Division produces signal sources, generators, power measurement and amplification instruments for use in the microwave and radio frequency (RF) range (10 kilohertz (kHz) to 50 gigahertz (GHz)). Within each product line are a number of different models and options allowing customers to select frequency range and specialized capabilities, features and functions. The end-user markets for these products can be divided into three broad segments: electronic warfare, radar and commercial telecommunications. These instruments are used in the design, production, repair and maintenance and calibration of other manufacturers' products, from discrete components to complex systems.

The Giga-tronics Division also produces switching systems that operate with a bandwidth from direct current (DC) to optical frequencies. These switch systems may be incorporated in customers' automated test equipment. The end-user markets for these products are primarily related to defense, aeronautics, communications, satellite and electronic warfare, commercial aviation and semiconductors.

The Microsource segment develops and manufactures a broad line of YIG tuned oscillators, filters, filter components, and microwave synthesizers, which are used by its customers in operational applications and in manufacturing a wide variety of microwave instruments or devices. The end-user markets for these products are primarily related to defense and commercial aerospace.

In fiscal 2014 and fiscal 2013 almost all of the sales for Microsource were to one large aerospace customer 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 the contractual shipment schedule associated with this customer cause significant differences in orders, sales, deferred revenue, inventory and cash flow when comparing one fiscal period to another.



A second large aerospace company has engaged Microsource for design services and a production bid associated with a similar radar filter program. On August 13, 2013 Microsource received an initial order for \$733,000, on May 6, 2014 a follow on order of \$659,000 was received, and then on May 20, 2014 the complete order for an additional \$5.5 million was received. The total orders for the design and production bid for the associated program is \$6.9 million. The Company anticipates the associated multi-year production agreement to be for approximately \$10.0 million and for it to finalize in calendar 2014. No assurances can be given that the parties will agree on the final multi-year production agreement, or what the actual terms will be. (see Note 20, Subsequent Events)

In fiscal 2014 the Company saw a continuation of substantial losses as legacy Giga-tronics Division products sales and gross margins decreased, while the Company continued to invest 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 to the existence of substantial doubt about the Company's ability to continue as a going concern.

In fiscal 2014 the Microsource business unit completed its move from Santa Rosa, California, to the Company's headquarters in San Ramon, California. Microsource maintained all defense and manufacturing related certifications during the move and increased revenue shipments by 25% in fiscal 2014 when compared to fiscal 2013. Microsource also started working with a second large aerospace company on another radar filter program, and finalized the total \$6.9 million design and production bid on May 20, 2014. (see Note 20, Subsequent Events)

Since March 2013 the Company has raised additional capital and generated liquidity to support the ongoing development of a new Giga-tronics Division product platform by selling a product line, issuing equity in the Company, increasing its debt, and cutting costs. The Company's management will continue to look at all these strategies in fiscal 2015 in order to complete development of the new product design, market introduction and volume production.

## Results of Operations

New orders by reporting segment are as follows for the fiscal years ended:

<b>NEW ORDERS</b>		<b>%</b>
		<b>change</b>
	<b>2014</b>	<b>2013</b>
	<b>vs.</b>	<b>vs.</b>

(Dollars in thousands)	2014	2013	2013	2012
Giga-tronics Division	<b>\$8,684</b>	\$9,013	(4.0% )	(20.0%)
Microsource	<b>4,947</b>	8,679	(43.0%)	334.0 %
Total	<b>\$13,631</b>	\$17,692	(23.0%)	33.0 %

New orders received in fiscal 2014 decreased 23% to \$13.6 million from the \$17.7 million received in fiscal 2013. The decrease in orders was primarily due to Microsource's receipt in fiscal 2013 of \$8.2 million in long term contracts from a large aerospace company. In fiscal 2014 Microsource received annual extensions of these contracts totaling \$4.0 million, and an initial \$733,000 order from a second large aerospace company for design services and a production bid associated with a similar radar filter program. The decrease in new orders for the Giga-tronics Division in fiscal 2014 was primarily due to the sale of the SCPM product line to Teradyne in April 2013 (see Note 6, Gain on Sale of Product).

New orders received in fiscal 2013 increased 33% to \$17.7 million from the \$13.3 million received in fiscal 2012. The increase was primarily due to Microsource's receipt in fiscal 2013 of \$8.2 million in long term contracts from a large aerospace company compared to \$1.6 million in fiscal 2012. This was partially offset by a \$2.2 million decrease in Giga-tronics Division defense orders, primarily from a decrease of switch modules associated with the older SCPM product line that was sold to Teradyne in April 2013 (see Note 6, Gain on Sale of Product).

The following table shows order backlog and related information at fiscal year-end:

<b>Backlog</b>			% change	
	<b>2014</b>	2013	<b>2014</b>	2013
			<b>vs.</b>	vs.
(Dollars in thousands)	<b>2014</b>	2013	<b>2013</b>	2012
Backlog of unfilled orders	<b>\$6,669</b>	\$7,344	<b>(9% )</b>	91 %
Backlog of unfilled orders shippable within one year	<b>5,438</b>	6,706	<b>(19%)</b>	75 %
Long term backlog reclassified during year as shippable within one year	<b>931</b>	2,162	<b>(57%)</b>	31 %

The decreases in backlog at the end of fiscal 2014 when compared to fiscal 2013 are primarily due to the Microsource business unit's fulfilling \$6.1 million of scheduled shipments over the past year attributable to long term contracts awarded in fiscal 2013. This was partially offset by the Microsource business unit's receipt in fiscal 2014 of \$4.0 million follow on orders, and an initial order of design services and a production bid for \$733,000 from a second aerospace company for radar filters.

The increase in backlog at year-end 2013 of 91% was primarily due to the Microsource business unit's receipt of long term contracts from a large aerospace company.

The allocation of net sales by reporting segment was as follows for the fiscal years shown:

<b>Allocation of Net Sales</b>			% change	
	<b>2014</b>	2013	<b>2014</b>	2013
			<b>vs.</b>	vs.
(Dollars in thousands)	<b>2014</b>	2013	<b>2013</b>	2012
Giga-tronics Division	<b>\$7,290</b>	\$9,385	<b>(22%)</b>	(11%)
Microsource	<b>6,019</b>	4,802	<b>25 %</b>	84 %
Total	<b>\$13,309</b>	\$14,187	<b>(6% )</b>	8 %

Net sales in fiscal 2014 were \$13.3 million, a 6% decrease from \$14.2 million in fiscal 2013. Sales for the Giga-tronics Division decreased 22%, or \$2.1 million, primarily due to a decrease in SCPM switch product sales as a result of the sale of this product line during fiscal 2014 (see Note 6, Gain on Sale of Product). Sales for the Microsource business unit increased 25%, or \$1.2 million, largely due to the contractual timing of shipments associated with long-term contracts from a large aerospace company.

Net sales in fiscal 2013 were \$14.2 million, an 8% increase from \$13.1 million in fiscal 2012. The Microsource business unit's sales increased 84%, or \$2.2 million, primarily due to increased defense sales caused by the fulfillment of radar filter component orders. Sales at Giga-tronics Division decreased 11%, or \$1.1 million, primarily due to lower defense sales caused by the SG VXI product end of life program in fiscal 2012.

The allocation of cost of sales by reporting segment was as follows for the fiscal years shown:

<b>Cost of Sales</b>			<i>% change</i>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
			<b>vs.</b>	<b>vs.</b>
(Dollars in thousands)	<b>2014</b>	<b>2013</b>	<b>2013</b>	<b>2012</b>
Giga-tronics Division	<b>\$5,093</b>	\$5,727	<b>(11 %)</b>	(18 %)
Microsource	<b>3,718</b>	2,983	<b>25 %</b>	0 %
Total	<b>\$8,811</b>	\$8,710	<b>1 %</b>	(13 %)

Cost of sales as a percentage of sales increased in fiscal 2014 to 66.2%, compared to 61.4% for fiscal 2013. The increase in fiscal 2014 was primarily due to the change in product mix of Giga-tronics Division, which saw an increase in the sales of lower margin legacy products in fiscal 2014 when compared to fiscal 2013.

In fiscal 2013 cost of sales as a percentage of sales decreased to 61.4%, compared to 76.2% for fiscal 2012. The decrease is primarily due to a \$1.5 million excess and obsolete inventory reserve charge in fiscal 2012.

Operating expenses were as follows for the fiscal years shown:

Operating Expenses			% change	
	2014	2013	2014	2013
(Dollars in thousands)	2014	2013	vs. 2013	vs. 2012
Engineering	\$3,897	\$4,282	(9 %)	48 %
Selling, general and administrative	4,809	4,976	(3 %)	(18 %)
Restructuring	331	418	(21 %)	1248 %
Total	\$9,037	\$9,676	(7 %)	8 %

Operating expenses decreased 7%, or \$639,000, in fiscal 2014 compared to fiscal 2013. Engineering expenses decreased \$385,000 during fiscal 2014 when compared to fiscal 2013, the decrease is primarily due to some engineers being assigned to a Microsource nonrecurring engineering project that is recorded as cost of sales. Selling, general and administrative expenses decreased \$167,000 in fiscal 2014 when compared to fiscal 2013, primarily due to reductions in personnel. Restructuring expenses decreased \$87,000 in fiscal 2014 when compared to fiscal 2013, primarily due to the Company's completion of its closure of the Santa Rosa facility in May 2013.

The Company is currently spending approximately \$1.0 million to \$1.1 million in research and development per quarter. The majority of these expenses are associated with the development of the new product platform that experienced delays and is currently forecasted to begin shipping in the second quarter of fiscal 2015. Expenses associated with the development of the new product platform have significantly contributed to the losses in fiscal 2014 and fiscal 2013.

In order to reduce its manufacturing and facilities costs, Giga-tronics made the decision during the fourth quarter of fiscal 2012 to consolidate its Santa Rosa, CA operations with those of its facility in San Ramon, CA. The Company announced its intentions to employees in February 2012, and entered into employment agreements with all key Santa Rosa employees to retain the talent needed to continue shipments during the transition and to help ensure the new operation in San Ramon would run smoothly.

The major types of costs associated with this move and estimates of their respective totals were as follows:

Type of cost (In thousands)	
Retention agreements for employees	\$542
Preparation of San Ramon facility	59



Training of San Ramon employees	4
Moving expenses	24
Clean-up of Santa Rosa facility	151
Total	\$780

Of the total estimated expense of \$780,000, \$331,000 was expensed during fiscal 2014; \$418,000 was expensed during fiscal 2013; and \$31,000 was expensed during fiscal 2012. The Company vacated its Santa Rosa facility on May 31, 2013 and does not anticipate any additional expenses.

### **Gain on the Sale of Product Line**

On March 18, 2013, the Company entered into an Asset Purchase Agreement with 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. 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. Net sales for the SCPM product line during fiscal 2014 and fiscal 2013 were \$265,000 and \$1.7 million, respectively.

## Net Interest Expense

Net interest expense in fiscal 2014 was \$106,000, an increase of \$90,000 over fiscal 2013 and was primarily due to borrowings under the SVB line of credit. In order to support operations during the last seven months of fiscal 2014 the Company borrowed on substantially all eligible receivables under the Line of Credit.

Giga-tronics recorded a pre-tax loss of \$3.7 million for fiscal 2014 versus pre-tax loss of \$4.2 million for fiscal 2013. The lower pre-tax loss in fiscal 2014 compared to fiscal 2013 was primarily due to lower operating expenses and the gain on the sale of the SCPM product line discussed above, which was partially offset by a decline in gross margin.

## Net Inventories

Inventories consisted of the following:

Net Inventories	March 29, 2014	March 30, 2013	% change 2014 vs. 2013	
(Dollars in thousands)				
Raw materials	<b>\$1,501</b>	\$2,157	<b>(30</b>	%)
Work-in-progress	<b>1,400</b>	2,049	<b>(32</b>	%)
Finished goods	<b>353</b>	50	<b>606</b>	%)
Demonstration inventory	<b>67</b>	304	<b>(78</b>	%)
Total	<b>\$3,321</b>	\$4,560	<b>(27</b>	%)

Net inventories decreased by \$1.2 million from March 30, 2013 to March 29, 2014. The decrease was primarily due to the sale of lower margin legacy products, or demonstration inventory, and a reduction of raw materials on hand supporting the Giga-tronics manufacturing production line.

## Financial Condition and Liquidity

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As of March 29, 2014, Giga-tronics had \$1.1 million in cash and cash-equivalents, compared to \$1.9 million as of March 30, 2013.

Working capital at the end of fiscal year 2014 was \$1.0 million as compared to \$3.2 million at the end of fiscal year 2013.

The current ratio (current assets divided by current liabilities) at March 29, 2014 was 1.17 as compared to 1.60 at March 30, 2013. The decrease in working capital was primarily attributable to the net loss of \$3.7 million for fiscal 2014, which was partially offset by \$817,000 of cash proceeds from the issuance of preferred stock.

Cash used in operating activities amounted to \$2.5 million in fiscal 2014 and \$1.6 million in fiscal 2013. Cash used in fiscal year 2014 operating activities was primarily attributed to the net loss of \$3.7 million for the year, which was partially offset by a \$1.2 million decrease in inventories. Cash used in fiscal year 2013 operating activities was primarily attributed to the net loss of \$4.2 million for the year, which was partially offset by a \$2.3 million increase in deferred revenue associated with progress billings for completed contract milestones prior to final delivery of the finished product.

Additions to property and equipment were \$482,000 in fiscal 2014, of which \$254,000 were related to capital lease obligations, compared to \$349,000 in fiscal 2013, of which \$170,000 were related to capital lease obligations. The increase in property and equipment in fiscal 2014 was primarily attributable to leasehold improvements associated with the move of the Microsource business unit's manufacturing to the San Ramon facility. The increase in property and equipment in fiscal 2013 was primarily attributable to test equipment needed to prepare a manufacturing line for the new Giga-tronics product platform.

Cash provided by financing activities in fiscal year 2014 was \$2.1 million, primarily due to \$1.0 million in proceeds from a term loan with Partners For Growth IV, L.P. ("PFG"), \$817,000 in net proceeds from the issuance of Series D convertible preferred stock, and \$308,000 of net proceeds from the Company's line of credit with Silicon Valley Bank ("SVB"). Cash provided by financing activities in fiscal year 2013 of \$1.3 million was primarily due to \$857,000 in net proceeds from the Company's line of credit with SVB, and \$457,000 in net proceeds from the issuance of Series C convertible preferred stock.

On March 13, 2014 the Company entered into a three year, \$2.0 million term loan agreement with PFG under which the Company received \$1.0 million on March 14, 2014. Pursuant to the agreement, the Company may borrow an additional \$1.0 million 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 PFG loan agreement provides for a fixed interest rate of 9.75% 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. The PFG Loan is secured by all of the assets of the Company under a lien that is junior to the SVB position described in Note 15, and limits borrowing under the SVB credit line limit to \$3.0 million. 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.

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 First Draw and 120,000 would be exercisable if the Second Draw is funded. Each warrant issued under the loan agreement has a term of five years 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 the warrant agreements is subject to downward adjustment from 180,000 to 155,000 and from 120,000 to 95,000 if the Company achieves in fiscal 2015 net sales of at least \$18.0 million and net income of at least \$1.0 million.

In the event of any acquisition or other change in control of the Company, future public issuance of Company securities, liquidation (or substantially similar event) of the Company, or expiration of the warrants, the warrants associated with the First Draw can be exchanged for \$150,000 in cash and the warrants associated with the Second Draw can be exchanged for \$100,000 in cash. The Company has no plans for public offering, so the cash out 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 in substance is a debt arrangement (Warrant Debt) with a zero interest rate, a fixed maturity date and a feature that makes the debt convertible to common stock. 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.

The proceeds from the First Draw were allocated between the PFG Debt 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 is bifurcated from the Warrant Debt and recorded at fair value resulting in a remaining carrying value of \$50,000 associated with the Warrant Debt. The resulting discounts of \$178,000 and \$100,000, respectively, will be 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. (See Note 16, Term Loan).

On June 11, 2013 the Company entered into an amendment to the Second Amended Credit Facility (the "New Amended Credit Facility") with SVB. 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 \$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.

As of March 29, 2014, the Company's outstanding borrowings under the New Amended Credit Facility were \$1.2 million. Management intends to draw upon the New Amended Credit Facility throughout fiscal 2015 to meet projected cash requirements. As of March 29, 2014, the line of credit was at its maximum borrowing capacity. SVB may terminate or suspend advances under the line of credit if SVB determines there has been a material adverse

change in the Company's general affairs, financial forecasts or general ability to repay.

The Company has incurred net losses of \$3.7 million in fiscal 2014, and \$4.2 million in fiscal 2013. These losses have contributed to an accumulated deficit of \$18.3 million at March 29, 2014, and have resulted in the Company using cash in its operations of \$2.5 million in fiscal 2014.

In fiscal 2014 and 2013 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 could cause additional losses.

To help fund operations, the Company relies on advances under the line of credit with Silicon Valley Bank. However the Bank may terminate or suspend advances under the line of credit if the Bank determines there has been a material adverse change in the Company's general affairs, financial forecasts or general ability to repay. (see Note 15, Line of Credit). As of March 29, 2014, the line of credit was at its maximum borrowing capacity.

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 during fiscal 2014, and reduce costs and expenses going forward. These actions are described in the following paragraph.

On March 13, 2014 the Company entered into a three year, \$2.0 million term loan agreement with PFG under which the Company received \$1.0 million on March 14, 2014. Pursuant to the agreement, the Company may borrow an additional \$1.0 million 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 PFG loan agreement provides for a fixed interest rate of 9.75% 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. The PFG Loan is secured by all of the assets of the Company under a lien that is junior to the SVB position described in Note 15, and limits borrowing under the SVB credit line limit to \$3.0 million. 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. (see Note 16, Term Loan).

On June 16, 2014 the Company amended the term loan agreement with PFG creating a \$500,000 revolving line of credit that the Company drew \$500,000. (see note 20, Subsequent Events).

On July 8, 2013 the Company received \$817,000 in net cash proceeds from Alara Capital AVI II, LLC, a Delaware limited liability company (the "Investor"). Under a Securities Purchase Agreement ("SPA"), the Company sold to the Investor 5,111.86 shares of a new Series D Convertible Voting Perpetual Preferred Stock and warrants to purchase up to 511,186 additional shares of common stock at the price of \$1.43 per share. (see Note 19, Series D Convertible Voting Perpetual Preferred Stock and Warrants).

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 will seek similar terms in future agreements with this customer, and other customers.

A second large aerospace company has engaged Microsource for design services and a production bid associated with a similar radar filter program. On August 13, 2013 Microsource received an initial order for \$733,000, on May 6, 2014 a follow on order of \$659,000 was received, and then on May 20, 2014 the complete order for an additional \$5.5 million was received. The total orders for the design and production bid for the associated program is \$6.9 million. The Company anticipates the associated multi-year production agreement to be for approximately \$10.0 million and for it to finalize in calendar 2014. No assurances can be given that the parties will agree on the final multi-year production agreement, or what the actual terms will be. (see Note 20, Subsequent Events)

Management also plans to further improve asset management by continuing to reduce product inventories that are on hand at March 29, 2014. In addition, 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.

### **Contractual Obligations**

The Company leases its facility under an operating lease that expires in December 2016 and leases certain equipment under operating leases. Total future minimum lease payments under these leases amount to approximately \$2.0 million.

The Company leases equipment under capital leases that expire through September 2018. The future minimum lease payments under these leases are approximately \$245,000.



The Company is committed to pay the PFG loan with a maturity date of March 2017. Future payments under this loan consist of \$1.0 million in principal and \$175,000 in interest.

The Company is committed to purchase certain inventory under non-cancelable purchase orders. As of March 29, 2014, total non-cancelable purchase orders were approximately \$2.1 million through fiscal 2015 and are scheduled to be delivered to the Company at various dates through March 2015.

### **Critical Accounting Policies**

The Company's discussion and analysis of its financial condition and the results of operations are based upon the consolidated financial statements included in this report and the data used to prepare them. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and management is required to make judgments, estimates and assumptions in the course of such preparation. The Summary of Significant Accounting Policies included with the consolidated financial statements describes the significant accounting policies and methods used in the preparation of the consolidated financial statements. On an ongoing basis, the Company re-evaluates its judgments, estimates and assumptions, including those related to revenue recognition, product warranties, accounts receivable and allowance for doubtful accounts, valuation of inventories, income taxes and valuation allowance on deferred tax assets, and share based compensation. The Company bases its judgment and estimates on historical experience, knowledge of current conditions, and its beliefs of what could occur in the future considering available information. Actual results may differ from these estimates under different assumptions or conditions. Management of Giga-tronics has identified the following as the Company's critical accounting policies:

#### Revenue Recognition

Revenues are recognized when there is evidence of an arrangement, delivery has occurred, the price is fixed or determinable, and collectability is reasonably assured. This generally occurs when products are shipped and the risk of loss has passed. Revenue related to products shipped subject to customers' evaluation is recognized upon final acceptance. Revenue recognized under the milestone method is recognized once milestones are met. 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 one 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.

#### Product Warranties

The Company's warranty policy generally provides one to three years of coverage depending on the product. The Company records a liability for estimated warranty obligations at the date products are sold. 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 sufficient historical data has been collected on the new product. Adjustments are made as new information becomes available.

#### Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are stated at their net realizable values. The Company has estimated an allowance for uncollectible accounts based on analysis of specifically identified problem 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.

### Inventory

Inventories are stated at the lower of cost or market. Cost is determined on a first-in, first-out basis. The Company periodically reviews inventory on hand to identify and write down excess and obsolete inventory based on estimated product demand.

### Income Taxes

Income taxes are accounted for using the asset and liability 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 carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Future tax benefits are subject to a valuation allowance when management is unable to conclude that its deferred tax assets will more likely than not be realized. The ultimate realization of deferred tax assets is dependent upon generation of future taxable income during the periods in which those temporary differences become deductible. Management considers both positive and negative evidence and tax planning strategies in making this assessment.

The Company considers all tax positions recognized in the consolidated financial statements for the likelihood of realization. When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the positions taken or the amounts of the positions that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above, if any, would be reflected as unrecognized tax benefits, as applicable, in the accompanying consolidated balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. The Company recognizes accrued interest and penalties, if any, related to unrecognized tax benefits as a component of the provision for income taxes in the consolidated statements of operations.

### Share Based Compensation

The Company has a stock incentive plan that provides for the issuance of stock options and restricted stock to employees and directors. The Company calculates share based compensation expense for stock options using a Black-Scholes-Merton option pricing model and records the fair value of stock option and restricted stock awards expected to vest over the requisite service period. In so doing, the Company makes certain key assumptions in making estimates used in the model. The Company believes the estimates used, which are presented in Note 1 of Notes to Consolidated Financial Statements, are appropriate and reasonable.

#### **Off-Balance-Sheet Arrangements**

The Company has no other off-balance-sheet arrangements (including standby letters of credit, guaranties, contingent interests in transferred assets, contingent obligations indexed to its own stock or any obligation arising out of a variable interest in an unconsolidated entity that provides credit or other support to the Company), that have or are likely to have a material effect on its financial conditions, changes in financial conditions, revenue, expense, results of operations, liquidity, capital expenditures or capital resources.

#### **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not applicable.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

Index To Financial Statements And Schedules

Financial Statements	Page
Consolidated Balance Sheets - As of March 29, 2014 and March 30, 2013	21
Consolidated Statements of Operations - Years ended March 29, 2014 and March 30, 2013	22
Consolidated Statements of Shareholders' Equity - Years ended March 29, 2014 and March 30, 2013	23
Consolidated Statements of Cash Flows - Years ended March 29, 2014 and March 30, 2013	24
Notes to Consolidated Financial Statements	25 - 41
Reports of Independent Registered Public Accounting Firm	42

**CONSOLIDATED BALANCE SHEETS**

<b>(In thousands except share data)</b>	<b>March 29, 2014</b>	<b>March 30, 2013</b>
<b>Assets</b>		
Current assets:		
Cash and cash-equivalents	<b>\$1,059</b>	\$1,882
Trade accounts receivable, net of allowance of \$44 and \$35, respectively	<b>1,846</b>	1,666
Inventories, net	<b>3,321</b>	4,560
Prepaid expenses and other current assets	<b>349</b>	442
Total current assets	<b>6,575</b>	8,550
Property and equipment, net	<b>949</b>	751
Other long term-assets	<b>69</b>	59
<b>Total assets</b>	<b>\$7,593</b>	\$9,360
<b>Liabilities and shareholders' equity</b>		
Current liabilities:		
Line of credit	<b>\$1,165</b>	\$577
Current portion of long term debt	<b>200</b>	-
Accounts payable	<b>1,430</b>	788
Accrued payroll and benefits	<b>755</b>	1,047
Deferred revenue	<b>1,329</b>	2,278
Deferred rent	<b>104</b>	81
Capital lease obligations	<b>147</b>	66
Other current liabilities	<b>472</b>	505
Total current liabilities	<b>5,602</b>	5,342
Long term obligation - line of credit	-	280
Long term loan and warrant debt, net of discounts	<b>672</b>	-
Derivative liability, at estimated fair value	<b>128</b>	-
Long term obligations - deferred rent	<b>237</b>	341
Long term obligations - capital lease	<b>77</b>	89
<b>Total liabilities</b>	<b>6,716</b>	<b>6,052</b>
Commitments and contingencies	-	-
Shareholders' equity:		
Convertible preferred stock of no par value;		
Authorized - 1,000,000 shares		
Series A - designated 250,000 shares; no shares at March 29, 2014 and March 30, 2013 issued and outstanding	-	-
Series B - designated 10,000 shares; 9,997 shares at March 29, 2014 and March 30, 2013 issued and outstanding; (liquidation preference of \$2,309)	<b>1,997</b>	1,997
Series C - designated 3,500 shares; 3,424.65 shares at March 29, 2014 and March 30, 2013 issued and outstanding; (liquidation preference of \$500)	<b>457</b>	457
Series D - designated 6,000 shares; 5,111.86 shares at March 29, 2014 and no shares at March 30, 2013 issued and outstanding; (liquidation preference of \$731)	<b>457</b>	-
Common stock of no par value; Authorized - 40,000,000 shares; 5,181,247 shares at March 29, 2014 and 5,079,747 at March 30, 2013 issued and outstanding	<b>16,224</b>	15,132
Accumulated deficit	<b>(18,258)</b>	(14,278)

<b>Total shareholders' equity</b>	<b>877</b>	3,308
<b>Total liabilities and shareholders' equity</b>	<b>\$7,593</b>	\$9,360

*See Accompanying Notes to Consolidated Financial Statements*

**CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>Years Ended</b>	
	<b>March</b>	March
(In thousands except per-share data)	<b>29,</b>	30,
	<b>2014</b>	2013
<b>Net sales</b>	<b>\$13,309</b>	\$14,187
Cost of sales	<b>8,811</b>	8,710
<b>Gross margin</b>	<b>4,498</b>	5,477
Operating expenses:		
Engineering	<b>3,897</b>	4,282
Selling, general and administrative	<b>4,809</b>	4,976
Restructuring	<b>331</b>	418
Total operating expenses	<b>9,037</b>	9,676
<b>Operating loss</b>	<b>(4,539 )</b>	(4,199 )
Gain on sale of product line	<b>913</b>	-
Other income (loss)	<b>(8 )</b>	11
Interest expense, net	<b>(106 )</b>	(16 )
<b>Loss before income taxes</b>	<b>(3,740 )</b>	(4,204 )
Provision for income taxes	<b>2</b>	2
<b>Net loss</b>	<b>\$(3,742 )</b>	\$(4,206 )
<b>Loss per common share – basic</b>	<b>\$(0.74 )</b>	\$(0.84 )
<b>Loss per common share – diluted</b>	<b>\$(0.74 )</b>	\$(0.84 )
<b>Weighted average common shares used in per share calculation:</b>		
Basic	<b>5,058</b>	5,030
Diluted	<b>5,058</b>	5,030

*See Accompanying Notes to Consolidated Financial Statements*



**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

(In thousands except share data)	Preferred Stock		Common Stock		Accumulated	
	Shares	Amount	Shares	Amount	Deficit	Total
<b>Balance at March 31, 2012</b>	9,997	1,997	5,079,747	14,822	(10,072 )	6,747
Net loss					(4,206 )	(4,206)
Share based compensation	-	-	-	310	-	310
Series C preferred stock issuance, net of offering costs of \$43	3,425	457	-	-	-	457
<b>Balance at March 30, 2013</b>	<b>13,422</b>	<b>\$ 2,454</b>	<b>5,079,747</b>	<b>\$ 15,132</b>	<b>\$ (14,278 )</b>	<b>\$ 3,308</b>
Net loss					(3,742 )	(3,742)
Restricted stock granted			71,500	-		-
Stock granted without restrictions			30,000	-		-
Share based compensation	-	-	-	494	-	494
Series D preferred stock issuance, net of offering costs of \$41	5,112	457	-	598	(238 )	817
<b>Balance at March 29, 2014</b>	<b>18,534</b>	<b>\$ 2,911</b>	<b>5,181,247</b>	<b>\$ 16,224</b>	<b>\$ (18,258 )</b>	<b>\$ 877</b>

*See Accompanying Notes to Consolidated Financial Statements*

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Years Ended</b>	
(In thousands)	<b>March 29, 2014</b>	<b>March 30, 2013</b>
<b>Cash flows from operating activities:</b>		
Net loss	<b>\$(3,742)</b>	\$(4,206)
Adjustments to reconcile net loss to net cash used in operations:		
Depreciation and amortization	<b>284</b>	209
Share based compensation	<b>494</b>	310
Change in deferred rent	<b>(81 )</b>	(70 )
Changes in operating assets and liabilities:		
Trade accounts receivable	<b>(180 )</b>	(396 )
Inventories	<b>1,239</b>	140
Prepaid expenses and other assets	<b>83</b>	(157 )
Accounts payable	<b>642</b>	175
Accrued payroll and benefits	<b>(292 )</b>	308
Deferred revenue	<b>(949 )</b>	2,271
Other current liabilities	<b>(33 )</b>	(152 )
<b>Net cash used in operating activities</b>	<b>(2,535)</b>	(1,568)
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	<b>(228 )</b>	(179 )
<b>Net cash used in investing activities</b>	<b>(228 )</b>	(179 )
<b>Cash flows from financing activities:</b>		
Payments on capital leases	<b>(185 )</b>	(50 )
Proceeds from line of credit	<b>5,917</b>	1,552
Proceeds from issuance of term debt	<b>1,000</b>	-
Repayments of line of credit	<b>(5,609)</b>	(695 )
Proceeds from issuance of preferred stock, net of stock offering costs of \$41 and \$43	<b>817</b>	457
<b>Net cash provided by financing activities</b>	<b>1,940</b>	1,264
<b>Decrease in cash and cash-equivalents</b>	<b>(823 )</b>	(483 )
<b>Beginning cash and cash-equivalents</b>	<b>1,882</b>	2,365
<b>Ending cash and cash-equivalents</b>	<b>\$1,059</b>	\$1,882
<b>Supplementary disclosure of cash flow information:</b>		
Cash paid for income taxes	<b>\$2</b>	\$2
Cash paid for interest	<b>106</b>	17
<b>Supplementary disclosure of noncash financing activities:</b>		
Equipment acquired under capital lease	<b>\$254</b>	\$170

*See Accompanying Notes to Consolidated Financial Statements*

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**1 Summary of Significant Accounting Policies**

*The Company* The accompanying consolidated financial statements include the accounts of Giga-tronics Incorporated (“Giga-tronics”) and its wholly-owned subsidiary, Microsource Incorporated (“Microsource”), collectively the “Company”. The Company’s corporate office and manufacturing facilities are located in San Ramon, California. Giga-tronics and its subsidiary company design, manufacture and market 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. The Company also manufactures and markets a line of test, measurement, and handling equipment used in the manufacturing of semiconductor devices. The Company’s products are sold worldwide to customers in the test and measurement and semiconductor industries. The Company currently has no foreign-based operations or material amounts of identifiable assets in foreign countries. Its gross margins on foreign and domestic sales are similar, and all non-U.S. sales are made in U.S. dollars.

*Principles of Consolidation* The consolidated financial statements include the accounts of Giga-tronics and its wholly-owned subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation.

*Use of Estimates* The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The allowance for doubtful accounts, inventory reserves, warranty reserves, share-based compensation, income taxes, and warrant derivative liability are particularly subject to change.

*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 2014, ended on March 29, 2014 resulting in a 52 week year. Fiscal year 2013, ended on March 30, 2013 also resulting in a 52 week year. All references to years in the consolidated financial statements relate to fiscal years rather than calendar years.

*Reclassifications* Certain reclassifications, none of which affected the prior year’s net loss or shareholders’ equity, have been made to prior year balances in order to conform to the current year presentation.

*Revenue Recognition and Deferred Revenue* 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. 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 activity in the reserve account is as follows for the years ending March 29, 2014 and March 30, 2013:

(Dollars in thousands)	<b>March 29, 2014</b>	March 30, 2013
Beginning balance	<b>\$ 35</b>	\$ 96
Provisions (reversals of previous provisions) for doubtful accounts	<b>22</b>	(53 )
Write-off of doubtful accounts	<b>(13 )</b>	(8 )
Ending balance	<b>\$ 44</b>	\$ 35

*Accrued Warranty* The Company's warranty policy generally provides one to three years of coverage depending on the product. The Company records a liability for estimated warranty obligations at the date products are sold. 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.

*Inventories* Inventories are stated at the lower of cost or fair value using full absorption and standard costing. Cost is determined on a first-in, first-out basis. Standard costing and overhead allocation rates are reviewed by management periodically, but not less than annually. Overhead rates are recorded to inventory based on capacity management expects for the period the inventory will be held. Reserves are recorded within cost of sales for impaired or obsolete inventory when the cost of inventory exceeds its estimated fair value. Management evaluates the need for inventory reserves based on its estimate of the amount realizable through projected sales including an evaluation of whether a product is reaching the end of its life cycle. When inventory is discarded it is written off against the inventory reserve, as inventory generally has already been fully reserved for at the time it is discarded.

*Research and Development* Research and development expenditures, which include the cost of materials consumed in research and development activities, salaries, wages and other costs of personnel engaged in research and development, costs of services performed by others for research and development on the Company's behalf and indirect costs are expensed as operating expenses when incurred. Research and development costs totaled approximately \$3.9 million and \$4.3 million for the years ended March 29, 2014 and March 30, 2013, respectively.

*Property and Equipment* Property and equipment are stated at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of the respective assets, which range from three to ten years for machinery and equipment and office fixtures. Leasehold improvements and assets acquired under capital leases are amortized using the straight-line method over the shorter of the estimated useful lives of the respective assets or the lease term.

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If such review indicates that the carrying amount of an asset exceeds the sum of its expected future cash flows on an undiscounted basis, the asset's carrying amount would be written down to fair value. Additionally, the Company reports long-lived assets to be disposed of at the lower of carrying amount or fair value less cost to sell. As of March 29, 2014 and March 30, 2013, management believes there has been no impairment of the Company's long-lived assets.

*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 other income or loss.

*Deferred Rent* Rent expense is recognized in an amount equal to the guaranteed base rent plus contractual future minimum rental increases amortized on the straight-line basis over the terms of the leases, including free rent periods.

*Income Taxes* Income taxes are accounted for using the asset and liability 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 carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Future tax benefits are subject to a valuation allowance when management is unable to conclude that its deferred tax assets will more likely than not be realized. The ultimate realization of deferred tax assets is dependent upon generation of future taxable income during the periods in which those temporary differences become deductible. Management considers both positive and negative evidence and tax planning strategies in making this assessment.

The Company considers all tax positions recognized in its financial statements for the likelihood of realization. When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the positions taken or the amounts of the positions that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above, if any, would be reflected as unrecognized tax benefits, as applicable, in the accompanying consolidated balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. The Company recognizes accrued interest and penalties, if any, related to unrecognized tax benefits as a component of the provision for income taxes in the consolidated statements of operations.

*Product Development Costs* The Company incurs pre-production costs on certain long-term supply arrangements. The costs, which represent non-recurring engineering and tooling costs, are capitalized as other assets and amortized over their useful life when reimbursable by the customer. All other product development costs are charged to operations as incurred. There were no capitalized pre-production costs included in other assets as of March 29, 2014 or March 30, 2013.

*Software Development Costs* Development costs included in the research and development of new products and enhancements to existing products are expensed as incurred, until technological feasibility in the form of a working model has been established. To date, completion of software development has been concurrent with the establishment of technological feasibility, and accordingly, no costs have been capitalized.

*Share-based Compensation* The Company has established the 2005 Equity Incentive Plan, which provides for the granting of options for up to 2,250,000 shares of Common Stock. The Company records share-based compensation expense for the fair value of all stock options and restricted stock that are ultimately expected to vest as the requisite service is rendered.

The cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) are classified as cash flows from financing in the statements of cash flows. These excess tax benefits were not significant for the Company for the fiscal years ended March 29, 2014 or March 30, 2013.



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. The computation of expected volatility used in the Black-Scholes-Merton option-pricing model is based on the historical volatility of Giga-tronics' 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 for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected dividend yield was not considered in the option pricing formula since the Company has not paid dividends and has no current plans to do so in the future.

The fair value of restricted stock awards is based on the fair value of the underlying shares at the date of the grant. Management makes estimates regarding pre-vesting forfeitures that will impact timing of compensation expense recognized for stock option and restricted stock awards.

*Earnings or Loss Per Common Share* Basic earnings or loss per common share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share incorporate the incremental shares issuable upon the assumed exercise of stock options and warrants using the treasury stock method. Anti-dilutive options are not included in the computation of diluted earnings per share. Non-vested shares of restricted stock have nonforfeitable dividend rights and are considered participating securities for the purpose of calculating basic and diluted earnings per share under the two-class method.

*Comprehensive Income or Loss* There are no items of comprehensive income or loss other than net income or loss.

*Financial Instruments and Concentration of Credit Risk* Financial instruments that potentially subject the Company to credit risk consist of cash, cash-equivalents and trade accounts receivable. The Company's cash-equivalents consist of overnight deposits with federally insured financial institutions. Concentration of credit risk in trade accounts receivable results primarily from sales to major customers. The Company individually evaluates the creditworthiness of its customers and generally does not require collateral or other security. At March 29, 2014, three customers combined accounted for 65% of consolidated gross accounts receivable primarily due to the timing of the receivables. At March 30, 2013, three customers combined accounted for 59% of consolidated gross accounts receivable primarily due to the timing of the receivables

*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 debt, warrant liability 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 debt 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) at March 29, 2014 and resulted in the carrying amount approximating fair value due to the fact that the agreement was entered into near the balance sheet date. The 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.

*Adoption of New Accounting Standards* In July 2013, the FASB amended existing guidance related to the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. These amendments provide that an unrecognized tax benefit, or a position thereof, be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date to settle any additional income taxes that would result from disallowance of a tax position, or the tax law does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, then the unrecognized tax benefit should be presented as a liability. The effect of adopting this standard did not have a material effect on the Company's operating results or financial condition since the Company was already accounting for unrecognized tax benefits in a manner that is consistent with this standard.

## **2 Going Concern and Management's Plan**

The Company has incurred net losses of \$3.7 million in fiscal 2014, and \$4.2 million in fiscal 2013. These losses have contributed to an accumulated deficit of \$18.3 million at March 29, 2014, and have resulted in the Company using cash in its operations of \$2.5 million in fiscal 2014.

In fiscal 2014 and 2013 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 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 15, Line of Credit). As of March 29, 2014, the line of credit was at its maximum borrowing capacity.

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 during fiscal 2014, and reduce costs and expenses going forward. These actions are described in the following paragraph.

On March 13, 2014 the Company entered into a three year, \$2.0 million term loan agreement with Partners For Growth IV, L.P. ("PFG") under which the Company received \$1.0 million on March 14, 2014. Pursuant to the agreement, the Company may borrow an additional \$1.0 million 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 PFG loan agreement provides for a fixed interest rate of 9.75% 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. The PFG Loan is secured by all of the assets of the Company under a lien that is junior to the SVB position described in Note 15, and limits borrowing under the SVB credit line limit to \$3.0 million. 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. (see Note 16, Term Loan).

On June 16 the Company amended the term loan agreement with PFG creating a \$500,000 revolving line of credit that the Company drew \$500,000. (see Note 20, Subsequent Events).

On July 8, 2013 the Company received \$817,000 in net cash proceeds from Alara Capital AVI II, LLC, a Delaware limited liability company (the "Investor"). Under a Securities Purchase Agreement ("SPA"), the Company sold to the Investor 5,111.86 shares of a new Series D Convertible Voting Perpetual Preferred Stock and warrants to purchase up to 511,186 additional shares of common stock at the price of \$1.43 per share. (see Note 19, Series D Convertible Voting Perpetual Preferred Stock and Warrants).

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 will seek similar terms in future agreements with this customer, and other customers.

A second large aerospace company has engaged Microsource for design services and a production bid associated with a similar radar filter program. On August 13, 2013 Microsource received an initial order for \$733,000, on May 6, 2014 a follow on order of \$659,000 was received, and then on May 20, 2014 the complete order for an additional \$5.5 million was received. The total orders for the design and production bid for the associated program is \$6.9 million. The Company anticipates the associated multi-year production agreement to be for approximately \$10.0 million and for it to finalize in calendar 2014. No assurances can be given that the parties will agree on the final multi-year production agreement, or what the actual terms will be. (see Note 20, Subsequent Events)

Management also plans to further improve asset management by continuing to reduce product inventories that are on hand at March 29, 2014. In addition, 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.

### **3 Cash and Cash-Equivalents**

Cash and cash-equivalents of \$1.1 million and \$1.9 million at March 29, 2014 and March 30, 2013, respectively, consisted of demand deposits with a financial institution that is a member of the Federal Deposit Insurance Corporation (FDIC). At March 29, 2014, \$929,000 of the Company's demand deposits exceeded FDIC insurance limits.

### **4 Inventories**

Inventories, net of reserves, consisted of the following:

(Dollars in thousands)	<b>March 29, 2014</b>	March 30, 2013
Raw materials	<b>\$1,501</b>	\$2,157
Work-in-progress	<b>1,400</b>	2,049
Finished goods	<b>353</b>	50
Demonstration inventory	<b>67</b>	304
Total	<b>\$3,321</b>	\$4,560

**5 Property, Plant and Equipment, net**

Property, plant and equipment, net is comprised of the following:

	<b>March</b>	March
(Dollars in thousands)	<b>29,</b>	30,
	<b>2014</b>	2013
Leasehold improvements	<b>\$327</b>	608
Machinery and equipment	<b>3,848</b>	12,889
Computer and software	<b>388</b>	2,729
Furniture and office equipment	<b>325</b>	786
Vehicles	<b>15</b>	23
Construction in progress	<b>227</b>	101
	<b>5,130</b>	17,136
Less: accumulated depreciation and amortization	<b>(4,181)</b>	