

GIGA TRONICS INC
Form 10-Q
November 13, 2012

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 29, 2012

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
(State or other jurisdiction of incorporation or
organization)

94-2656341
(I.R.S. Employer Identification No.)

4650 Norris Canyon Road, San Ramon, CA 94583
(Address of principal executive offices)

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

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

Yes No

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 | <input type="checkbox"/> | Accelerated filer | <input type="checkbox"/> |
| Non-accelerated filer | <input type="checkbox"/> | Smaller reporting company | <input checked="" type="checkbox"/> |

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(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 [X]

There were a total of 5,029,747 shares of the Registrant's Common Stock outstanding as of November 9, 2012.

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XBRL (“eXtensible Business Reporting Language”): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Cash Flows, and (iv) the Notes to the Consolidated Financial Statements, tagged as blocks of text (furnished but not filed).

Part I – Financial Information

Item 1 - Financial Statements

GIGA-TRONICS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

| (In thousands except share data) | September 29, 2012 | March 31, 2012 |
|--|-----------------------|-------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash-equivalents | \$2,096 | \$2,365 |
| Trade accounts receivable, net of allowance of \$115 and \$96, respectively | 2,408 | 1,270 |
| Inventories, net | 4,343 | 4,700 |
| Prepaid expenses and other current assets | 439 | 328 |
| Total current assets | 9,286 | 8,663 |
| Property and equipment, net | 759 | 611 |
| Other assets | - | 16 |
| Total assets | \$10,045 | \$9,290 |
| Liabilities and shareholders' equity | | |
| Current liabilities: | | |
| Accounts payable | \$915 | \$613 |
| Accrued commission | 72 | 129 |
| Accrued payroll and benefits | 849 | 739 |
| Accrued warranty | 156 | 210 |
| Deferred revenue | 1,976 | 7 |
| Deferred rent | 70 | 59 |
| Capital lease obligations | 73 | 20 |
| Other current liabilities | 315 | 318 |
| Total current liabilities | 4,426 | 2,095 |
| Long term obligations - deferred rent | 390 | 433 |
| Long term obligations - capital lease | 122 | 15 |
| Total liabilities | 4,938 | 2,543 |
| Commitments | | |
| Shareholders' equity: | | |
| Preferred stock of no par value; | | |
| Authorized - 1,000,000 shares | | |
| Series A - designated 250,000 shares; 0 shares at September 29, 2012 and March 31, 2012 issued and outstanding | | |
| Series B - designated 10,000 shares; 9,997 shares at September 29, 2012 and March 31, 2012 issued and outstanding; (liquidation preference of \$2,309) | | |
| | 1,997 | 1,997 |
| Common stock of no par value; | | |
| Authorized - 40,000,000 shares; 5,029,747 shares at September 29, 2012 and March 31, 2012 issued and outstanding | | |
| | 14,953 | 14,822 |
| Accumulated deficit | (11,843) | (10,072) |
| Total shareholders' equity | 5,107 | 6,747 |
| Total liabilities and shareholders' equity | \$10,045 | \$9,290 |

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

GIGA-TRONICS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

| (In thousands except per share data) | Three Month Periods Ended | | Six Month Periods Ended | |
|--|---------------------------|-----------------------|-------------------------|-----------------------|
| | September 29, 2012 | September 24, 2011 | September 29, 2012 | September 24, 2011 |
| Net sales | \$ 3,405 | \$ 4,086 | \$ 7,463 | \$ 7,583 |
| Cost of sales | 2,122 | 2,554 | 4,550 | 4,608 |
| Gross margin | 1,283 | 1,532 | 2,913 | 2,975 |
| Operating expenses: | | | | |
| Engineering | 1,047 | 635 | 1,980 | 1,315 |
| Selling, general and administrative | 1,206 | 1,562 | 2,516 | 2,996 |
| Restructuring | 92 | - | 184 | - |
| Total operating expenses | 2,345 | 2,197 | 4,680 | 4,311 |
| Operating loss | (1,062) | (665) | (1,767) | (1,336) |
| Interest expense, net | (2) | (1) | (2) | (1) |
| Loss before income taxes | (1,064) | (666) | (1,769) | (1,337) |
| (Benefit) provision for income taxes | - | (1) | 2 | 2 |
| Net loss | \$ (1,064) | \$ (665) | \$ (1,771) | \$ (1,339) |
| Loss per common share – basic | \$ (0.21) | \$ (0.13) | \$ (0.35) | \$ (0.27) |
| Loss per common share – diluted | \$ (0.21) | \$ (0.13) | \$ (0.35) | \$ (0.27) |
| Weighted average common shares used in per share calculation: | | | | |
| Basic | 5,029 | 5,006 | 5,029 | 5,000 |
| Diluted | 5,029 | 5,006 | 5,029 | 5,000 |

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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

| (In thousands) | Six Month Periods Ended | |
|--|-------------------------|-----------------------|
| | September 29, 2012 | September 24, 2011 |
| Cash flows from operating activities: | | |
| Net loss | \$(1,771 |) \$(1,339 |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 104 | 61 |
| Share based compensation | 131 | 117 |
| Change in deferred rent | (32 |) (21 |
| Change in other assets | 16 | - |
| Changes in operating assets and liabilities | 1,375 | 2,790 |
| Net cash (used in) provided by operating activities | (177 |) 1,608 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (82 |) (117 |
| Net cash used in investing activities | (82 |) (117 |
| Cash flows from financing activities: | | |
| Proceeds from exercise of stock options | - | 41 |
| Payments on capital leases | (10 |) (60 |
| Net cash used in financing activities | (10 |) (19 |
| (Decrease) increase in cash and cash-equivalents | (269 |) 1,472 |
| Beginning cash and cash-equivalents | 2,365 | 1,408 |
| Ending cash and cash-equivalents | \$2,096 | \$2,880 |
| Supplementary disclosure of cash flow information: | | |
| Cash paid for income taxes | \$2 | \$2 |
| Cash paid for interest | \$2 | \$1 |
| Supplementary disclosure of noncash financing activities: | | |
| Equipment acquired under capital lease | \$170 | \$- |

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

GIGA-TRONICS INCORPORATED
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The condensed consolidated financial statements included herein have been prepared by Giga-tronics Incorporated (the “Company”), pursuant to the rules and regulations of the Securities and Exchange Commission. The consolidated results of operations for the interim periods shown in this report are not necessarily indicative of results to be expected for the fiscal year. In the opinion of management, the information contained herein reflects all adjustments (consisting of normal recurring entries) necessary to make the consolidated results of operations for the interim periods a fair statement of such operations. For further information, refer to the consolidated financial statements and footnotes thereto, included in the Annual Report on Form 10-K, filed with the Securities and Exchange Commission for the year ended March 31, 2012.

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 2013, ending on March 30, 2013 is a 52 week year, while fiscal year 2012, ended on March 31, 2012 was a 53 week year. Quarterly periods within each such fiscal year are in most cases 13 weeks as opposed to three calendar months. All references to three month period, six month period and years in the consolidated financial statements relate to fiscal periods or years rather than three month calendar quarters, six calendar months or calendar years.

(2) Revenue Recognition

The Company records revenue when there is persuasive evidence of an arrangement, delivery has occurred, the price is fixed and determinable, and collectability is reasonably assured. This occurs when products are shipped or the customer accepts title transfer. If the arrangement involves acceptance terms, the Company defers revenue until product acceptance is received. 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.

The Company provides for estimated costs that may be incurred for product warranties at the time of shipment. The Company’s warranty policy generally provides one to three years depending on the product. 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.

(3) Inventories

Inventories consisted of the following:

| (In thousands) | September 29, 2012 | March 31, 2012 |
|-------------------------|-----------------------|-------------------|
| Raw materials | \$2,234 | \$2,313 |
| Work-in-progress | 1,613 | 1,651 |
| Finished goods | 142 | 241 |
| Demonstration inventory | 354 | 495 |
| Total | \$4,343 | \$4,700 |

(4) Loss Per Common Share

Basic loss per common share (EPS) is calculated by dividing net income or loss by the weighted average common shares outstanding during the period. Diluted EPS reflects the net incremental shares that would be issued if unvested restricted shares became vested and dilutive outstanding stock options were exercised using the treasury stock method. In the case of a net loss, it is assumed that no incremental shares would be issued because they would be antidilutive. The shares used in per share computations are as follows:

| (In thousands except per share data) | Three Month Periods Ended | | Six Month Periods Ended | |
|---|---------------------------|-----------------------|-------------------------|-----------------------|
| | September 29, 2012 | September 24, 2011 | September 29, 2012 | September 24, 2011 |
| Net loss | \$ (1,064) | \$ (665) | \$ (1,771) | \$ (1,339) |
| Weighted average: | | | | |
| Common shares outstanding | 5,029 | 5,006 | 5,029 | 5,000 |
| Potential common shares | - | - | - | - |
| Common shares assuming dilution | 5,029 | 5,006 | 5,029 | 5,000 |
| Net loss per common share – basic | \$ (0.21) | \$ (0.13) | \$ (0.35) | \$ (0.27) |
| Net loss per common share - diluted | \$ (0.21) | \$ (0.13) | \$ (0.35) | \$ (0.27) |
| Stock options not included in computation that could potentially dilute EPS in the future | 1,522 | 784 | 1,522 | 784 |
| Restricted stock awards not included in computation that could potentially dilute EPS in the future | 50 | 90 | 50 | 90 |
| Convertible preferred stock not included in computation that could potentially dilute EPS in the future | 1,000 | - | 1,000 | - |
| Warrants not included in computation that could potentially dilute EPS in the future | 849 | - | 849 | - |

The number of stock options, restricted stock awards, convertible preferred stock, and warrants not included in the computation of diluted EPS for the three and six month periods ended September 29, 2012 and September 24, 2011 is a result of the Company's net loss and, therefore, these securities are antidilutive. The weighted average exercise

price of excluded options was \$1.62 and \$1.98 as of September 29, 2012 and September 24, 2011, respectively.

(5) Share Based Compensation

The Company has established the 2005 Equity Incentive Plan, (the “2005 Plan”), which currently provides for the granting of options or awards for up to 1,750,000 shares of Common Stock. The Company records compensation cost associated with share-based compensation equivalent to the estimated fair value of the awards over the requisite service period. There were options for 325,500 shares granted in the second quarter of fiscal 2013 and options for 411,000 shares granted in the first half of fiscal 2013 with weighted average grant date fair values of \$0.89 and \$0.88, respectively. There were options for 47,500 shares granted during the second quarter of fiscal 2012 and options for 65,000 shares granted in the first half of fiscal 2012 with weighted average grant date fair values of \$1.25 and \$1.37, respectively.

Included in the options granted during the second quarter of fiscal 2013 are performance-based options for 100,000 shares granted as an inducement to a new employee outside the 2005 Plan. A portion of the options shall vest following the filing of the Company's Form 10K for fiscal 2014 provided certain bookings goals are achieved by the Company. No compensation cost was recognized for these stock options during the three or six month periods ended September 29, 2012 because management believes it is not more than likely than not that the performance criteria will be met.

The Company also granted 50,000 shares of restricted stock outside the 2005 Plan in the second quarter of fiscal 2013. The weighted average grant date fair value was \$1.18. No restricted stock awards were granted in the first quarter of fiscal 2013 or during the first half of fiscal 2012. The restricted stock awards are considered fixed awards as the number of shares and fair value are known at the grant date and the fair value at the grant date is amortized over the requisite service period net of estimated forfeitures. The restricted stock awards are performance-based and a portion of the shares shall vest and become free of any restrictions following the filing of the Company's Form 10K for fiscal 2014 provided certain bookings goals are achieved by the Company. Compensation cost of \$7,000 was recognized for restricted stock awards during the six month period ended September 29, 2012. No compensation cost was recognized for restricted stock awards during the six month period ended September 24, 2011 because management believed it was more than likely that the performance criteria will not be met for the then non-vested restricted stock awards.

Cash flows resulting from the tax benefits derived from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) are classified as cash flows from financing activities in the statement of cash flows. The Company had no excess tax benefits for each of the three and six month periods ended September 29, 2012 and September 24, 2011.

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

| | Three Month Periods Ended | | Six Month Periods Ended | |
|-------------------------|---------------------------|-----------------------|-------------------------|-----------------------|
| | September 29, 2012 | September 24, 2011 | September 29, 2012 | September 24, 2011 |
| Dividend yield | None | None | None | None |
| Expected volatility | 86.70 % | 92.61 % | 87.73 % | 92.84 % |
| Risk-free interest rate | 0.47 % | 1.54 % | 0.53 % | 1.54 % |
| Expected term (years) | 5.7 | 8.36 | 6.19 | 7.83 |

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

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A summary of the changes in all stock options outstanding for the six month period ended September 29, 2012 and the year ended March 31, 2012 is as follows:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Terms (Years) | Aggregate Intrinsic Value |
|--|-----------|---------------------------------------|--|---------------------------------|
| Outstanding at March 26, 2011 | 885,014 | \$ 1.96 | 2.5 | \$ 459,708 |
| Granted | 744,000 | 1.58 | | |
| Exercised | 35,590 | 1.36 | | |
| Forfeited / Expired | 372,112 | 1.96 | | |
| Outstanding at March 31, 2012 | 1,221,312 | \$ 1.74 | 6.7 | \$ 3,041 |
| Granted | 411,000 | 1.22 | | |
| Exercised | - | - | | |
| Forfeited / Expired | 110,685 | 1.47 | | |
| Outstanding at September 29, 2012 | 1,521,627 | \$ 1.62 | 6.8 | \$ 234,105 |
| Exercisable at September 29, 2012 | 343,502 | \$ 2.03 | 1.9 | \$ 7,850 |
| At September 29, 2012, expected to vest in the future | 838,932 | \$ 1.50 | 8.2 | \$ 199,336 |

As of September 29, 2012, there was \$783,000 of total unrecognized compensation cost related to non-vested options and restricted stock granted under the 2005 Plan and outside of the 2005 Plan. That cost is expected to be recognized over a weighted average period of 2.07 years. There were 42,750 options that vested during the quarter ended September 29, 2012. There were 68,125 options that vested during the quarter ended September 24, 2011. The total fair value of options vested during the quarters ended September 29, 2012 and September 24, 2011 was \$54,000 and \$76,000, respectively. There were 81,875 options that vested during the six month period ended September 29, 2012. There were 112,500 options that vested during the six month period ended September 24, 2011. The total fair value of options vested during the six month periods ended September 29, 2012 and September 24, 2011 was \$111,000 and \$139,000, respectively. No cash was received from the exercise of stock options for the three or six month periods ended September 29, 2012. Cash received from the exercise of stock options for the three and six month periods ended September 24, 2011 was \$37,000 and \$42,000, respectively, and related excess tax benefits or deficiencies were not significant. Share based compensation cost recognized in operating results for the three month periods ended September 29, 2012 and September 24, 2011 totaled \$75,000 and \$63,000, respectively. Share based compensation cost recognized in operating results for the six month periods ended September 29, 2012 and September 24, 2011 totaled \$131,000 and \$117,000, respectively.

(6) Industry Segment Information

The Company has two reportable segments: Giga-tronics Division and Microsource. Giga-tronics Division produces a broad line of test and measurement equipment used in the development, test and maintenance of wireless communications products and systems, flight navigational equipment, electronic defense systems and automatic testing systems and designs, manufactures, and markets a line of switching devices that link together many specific purpose instruments that comprise automatic test systems. Microsource develops and manufactures a broad line of YIG (Yttrium, Iron, Garnet) tuned oscillators, filters and microwave synthesizers, which are used in a wide variety of microwave instruments and devices.

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The tables below present information for the three and six month periods ended September 29, 2012 and September 24, 2011.

| (In thousands) | At Sep. 29, 2012 | Three Month Periods Ended | | | Three Month Periods Ended | | |
|------------------------------|---------------------|---------------------------|--------------------|----------------------|---------------------------|------------------|----------------------|
| | | September 29, 2012 | | | September 24, 2011 | | |
| | | Assets | Net Sales | Net Income (Loss) | Assets | Net Sales | Net Income (Loss) |
| Giga-tronics Division | \$ 6,859 | \$ 2,244 | \$ (860) | \$ 8,568 | \$ 3,588 | \$ 55 | |
| Microsource | 3,186 | 1,161 | (204) | 3,035 | 498 | (720) | |
| Total | \$ 10,045 | \$ 3,405 | \$ (1,064) | \$ 11,603 | \$ 4,086 | \$ (665) | |

| (In thousands) | At Sep. 29, 2012 | Six Month Periods Ended | | | Six Month Periods Ended | | |
|------------------------------|---------------------|-------------------------|--------------------|----------------------|-------------------------|--------------------|----------------------|
| | | September 29, 2012 | | | September 24, 2011 | | |
| | | Assets | Net Sales | Net Income (Loss) | Assets | Net Sales | Net Income (Loss) |
| Giga-tronics Division | \$ 6,859 | \$ 5,071 | \$ (1,504) | \$ 8,568 | \$ 6,011 | \$ (261) | |
| Microsource | 3,186 | 2,392 | (267) | 3,035 | 1,572 | (1,078) | |
| Total | \$ 10,045 | \$ 7,463 | \$ (1,771) | \$ 11,603 | \$ 7,583 | \$ (1,339) | |

(7) Warranty Obligations

The following table provides a reconciliation of changes in the Company's warranty reserve. The Company provides no other product guarantees.

| (In thousands) | Three Month Periods Ended | | Six Month Periods Ended | |
|--------------------------------|---------------------------|-----------------------|-------------------------|-----------------------|
| | September 29, 2012 | September 24, 2011 | September 29, 2012 | September 24, 2011 |
| Balance at beginning of period | \$ 189 | \$ 200 | \$ 210 | \$ 200 |
| (Benefit) / Provision, net | (9) | 43 | (5) | 108 |
| Warranty costs incurred | (24) | (52) | (49) | (117) |
| Balance at end of period | \$ 156 | \$ 191 | \$ 156 | \$ 191 |

(8) Income Taxes

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

The Company's tax expense for the six month period ending September 29, 2012 was \$2,000. The effective tax rate for the six month periods ending September 29, 2012 and September 24, 2011 was 0% due to a valuation allowance recorded against the net deferred tax asset balance.

As of September 29, 2012, the Company did not record any unrecognized tax benefits related to uncertain tax positions. The unrecognized tax benefit is netted against the non-current deferred tax asset on the Consolidated

Balance Sheet. The Company has not recorded a liability for any penalties or interest related to the unrecognized tax benefits. The Company is currently undergoing an audit by the California Franchise Tax Board for the fiscal years ended March 27, 2010 and March 26, 2011 and does not expect the liability for unrecognized tax benefits to change materially within the next 12 months.

(9) Restructuring

The Company took steps to reduce current and future expenses by reducing staff and by combining the operations in Santa Rosa into the San Ramon facility. This physical move is underway and is expected to be complete by May of 2013, as the Company must vacate its Santa Rosa facility at that time. Certain employee retention agreements will extend through December 2013. Substantially all of the restructuring costs are for the Microsource reportable segment. As of September 29, 2012 the Company had accrued \$215,000 within accounts payable related to these restructuring costs and no amounts have been paid through September 29, 2012.

A summary of the total restructuring costs, the amounts previously recognized, the amounts recognized for the six month periods ended September 29, 2012 and the amounts expected to be recognized between September 30, 2012 and December 28, 2013 are as follows:

| Type of cost expected to be incurred: | Total Restructuring Cost | Recognized during the fiscal year ended Mar 31, 2012 | Recognized during the six month periods ended Sep. 29, 2012 | Expected to be recognized between Sep. 30, 2012 and Dec 28, 2013 |
|---------------------------------------|--------------------------------|---|---|--|
| (Dollars in thousands) | | | | |
| Retention agreements for employees | \$ 506 | \$ 31 | \$ 184 | \$ 291 |
| Preparation of San Ramon facility | 103 | | | 103 |
| Training of San Ramon employees | 34 | | | 34 |
| Moving expenses | 56 | | | 56 |
| Clean-up of Santa Rosa facility | 67 | | | 67 |
| Total | \$ 766 | \$ 31 | \$ 184 | \$ 551 |

(10) Subsequent Events

On October 12, 2012, the Company entered into a Second Amended and Restated Loan and Security Agreement” (the “New Credit Facility”) with Silicon Valley Bank (the “Bank”). The New Credit Facility replaced the Company’s previous revolving line of credit with the Bank that had an expiration date of September 12, 2012, but was extended to October 15, 2012. The New Credit Facility, which expires on October 12, 2013, is secured by all assets of the Company and provides for a borrowing capacity equal to 80% of eligible accounts receivable on an aggregate basis, up to a maximum \$2.0 million, provided the Company maintains borrowing base eligibility, that is, a minimum cash balance of \$750,000. When the Company is not borrowing base eligible the Bank may limit credit extension to the 80% advance rate multiplied by the face amount of specific eligible accounts. The New Credit Facility contains a collateral handling fee of one-tenth of one percent (0.10%) on outstanding financed receivables for each calendar month based upon a 360 day year. When borrowing base eligible, the collateral handling fee is not applicable. Interest accrues on the average outstanding borrowings at a floating per annum rate equal to the greater of the Prime Rate plus two percent (2.00%) or six percent (6.00%). Any borrowings under the New Credit Facility may be repaid and such repaid amounts re-borrowed until the maturity date. Unless terminated by the Company or accelerated by the Bank in accordance with the terms of the agreement, the New Credit Facility will terminate on October 12, 2013, at which time all outstanding borrowings must be repaid by the Company.

Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

The forward-looking statements included in this report including, without limitation, statements containing the words "believes", "anticipates", "estimates", "expects", "intends" and words of similar import, which reflect management's best judgment based on factors currently known, involve risks and uncertainties. Actual results could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including but not limited to those listed in Giga-tronics' Annual Report on Form 10-K for the fiscal year ended March 31, 2012 Part I, under the heading "Certain Factors Which May Adversely Affect Future Operations or an Investment in Giga-tronics", and Part II, under the heading "Management's Discussion and Analysis of Financial Conditions and Results of Operations".

Overview

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

Our business is highly dependent on government spending in the defense electronics sector and wireless telecommunications markets. The Company has seen an increase in defense orders for the second quarter of fiscal 2013 versus the second quarter of fiscal 2012. Commercial orders have decreased slightly for the quarter ended September 29, 2012 as compared to the quarter ended September 24, 2011. The Company has seen an increase in defense orders and commercial orders for the first half of fiscal 2013 versus the same period last year.

The Company continues to monitor costs; including personnel, facilities and other expenses to more appropriately align costs with revenues.

Results of Operations

New orders received by segment are as follows:

NEW ORDERS

| (Dollars in thousands) | Three Month Periods Ended | | % change | |
|------------------------|---------------------------|-----------------------|----------|----|
| | September 29, 2012 | September 24, 2011 | | |
| Giga-tronics Division | \$2,101 | \$2,330 | (10 | %) |
| Microsource | 1,717 | 135 | 1172 | % |
| Total | \$3,818 | \$2,465 | 55 | % |

| (Dollars in thousands) | Six Month Periods Ended | | % change | |
|------------------------|-------------------------|-----------------------|----------|----|
| | September 29, 2012 | September 24, 2011 | | |
| Giga-tronics Division | \$4,282 | \$6,215 | (31 | %) |
| Microsource | 8,216 | 1,798 | 357 | % |
| Total | \$12,498 | \$8,013 | 56 | % |

New orders received in the second quarter of fiscal 2013 increased by 55% to \$3,818,000 from the \$2,465,000 received in fiscal 2012. New orders received in the first half of fiscal 2013 increased 56% to \$12,498,000 from the \$8,013,000 received in the first half of fiscal 2012. Orders at Giga-tronics Division decreased for the three month period ended September 29, 2012 primarily due to a decrease in commercial orders, whereas orders for the first half of fiscal 2013 decreased primarily due to a decrease in military demand for its products. In fiscal year 2012, Giga-tronics

Division received a large first quarter signal generator order from the military which did not repeat in the first quarter of fiscal 2013. Orders at Microsource increased for the three and six month periods ended September 29, 2012 compared to the three and six month periods ended September 24, 2011, primarily due to booking a significant order from the military sector.

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

BACKLOG

| (Dollars in thousands) | September 29, 2012 | September 24, 2011 | % change | |
|--|-----------------------|-----------------------|----------|----|
| Backlog of unfilled orders at end of period: | | | | |
| Giga-tronics Division | \$1,484 | \$1,675 | (11 | %) |
| Microsource | 7,390 | 2,404 | 207 | % |
| Total | \$8,874 | \$4,079 | 118 | % |
| Backlog of unfilled orders shippable within one year: | | | | |
| Giga-tronics Division | \$1,478 | \$1,675 | (12 | %) |
| Microsource | 5,577 | 1,262 | 342 | % |
| Total | \$7,055 | \$2,937 | 140 | % |
| Previous fiscal year end (FYE) long term backlog reclassified during the period as shippable within one year: | | | | |
| Giga-tronics Division | \$- | \$- | 0 | % |
| Microsource | - | 163 | (100 | %) |
| Total | \$- | \$163 | (100 | %) |
| Net cancellations during the period of previous FYE one-year backlog: | | | | |
| Giga-tronics Division | \$- | \$- | 0 | % |
| Microsource | - | - | 0 | % |
| Total | \$- | \$- | 0 | % |

Backlog at the end of the second quarter of fiscal 2013 increased 118% as compared to the end of the same period last year. A significant order from the defense sector for Microsource components was received but not shipped in the second quarter of fiscal 2013. Approximately one half of the order is classified as noncurrent as of September 29, 2012.

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

ALLOCATION OF NET SALES

| (Dollars in thousands) | Three Month Periods Ended | | % change | |
|------------------------|---------------------------|-----------------------|----------|----|
| | September 29, 2012 | September 24, 2011 | | |
| Giga-tronics Division | \$2,244 | \$3,588 | (37 | %) |
| Microsource | 1,161 | 498 | 133 | % |
| Total | \$3,405 | \$4,086 | (17 | %) |
| (Dollars in thousands) | Six Month Periods Ended | | % change | |
| | September 29, 2012 | September 24, 2011 | | |
| Giga-tronics Division | \$5,071 | \$6,011 | (16 | %) |
| Microsource | 2,392 | 1,572 | 52 | % |
| Total | \$7,463 | \$7,583 | (2 | %) |

Net sales in the second quarter of fiscal 2013 were \$3,405,000, a 17% decrease from the \$4,086,000 in fiscal 2012. Net sales in the first half of fiscal 2013 decreased 2% to \$7,463,000 from the \$7,583,000 in the first half of fiscal 2012. Sales at Giga-tronics Division decreased for the three and six month periods ended September 29, 2012 primarily due to a decrease in military shipments. The prior year shipments included a last time sale to a military customer for a now discontinued model. Sales in the first half of fiscal year 2013 were not enough to compensate for the sales lost to a discontinued model. Shipments at Microsource increased for the three and six month periods ended September 29, 2012 compared to the three and six month periods ended September 24, 2011, primarily due to shipment of a significant order for the military.

Cost of sales was as follows for the periods shown:

COST OF SALES

| (Dollars in thousands) | Three Month Periods Ended | | % change |
|------------------------|---------------------------|-----------------------|----------|
| | September 29, 2012 | September 24, 2011 | |
| Cost of sales | \$2,122 | \$2,554 | (17 %) |

| (Dollars in thousands) | Six Month Periods Ended | | % change |
|------------------------|-------------------------|-----------------------|----------|
| | September 29, 2012 | September 24, 2011 | |
| Cost of sales | \$4,550 | \$4,608 | (1 %) |

Cost of sales as a percentage of sales decreased by 0.2% for the second quarter of fiscal 2013 to 62.3% compared to 62.5% for the second quarter of fiscal 2012.

Cost of sales as a percentage of sales increased by 0.2% for the first half of fiscal 2013 to 61.0% compared to 60.8% from the first half of fiscal 2012.

Operating expenses were as follows for the periods shown:

OPERATING EXPENSES

| (Dollars in thousands) | Three Month Periods Ended | | % change |
|-------------------------------------|---------------------------|-----------------------|----------|
| | September 29, 2012 | September 24, 2011 | |
| Engineering | \$1,047 | \$635 | 65 % |
| Selling, general and administrative | 1,206 | 1,562 | (23 %) |
| Restructuring | 92 | - | 0 % |
| Total | \$2,345 | \$2,197 | 7 % |

| (Dollars in thousands) | Six Month Periods Ended | | % change |
|-------------------------------------|-------------------------|-----------------------|----------|
| | September 29, 2012 | September 24, 2011 | |
| Engineering | \$1,980 | \$1,315 | 51 % |
| Selling, general and administrative | 2,516 | 2,996 | (16 %) |
| Restructuring | 184 | - | 0 % |
| Total | \$4,680 | \$4,311 | 9 % |

Operating expenses increased 7% or \$148,000 in the second quarter of fiscal 2013 over the second quarter of fiscal 2012 primarily due to an increase of \$412,000 in product development expenses including costs associated with

constructing prototype and beta test units, which was partially offset by a \$356,000 reduction in selling, general and administrative expenses primarily related to lower sales commission expense due to house account sales and personnel reductions in fiscal 2012. The Company plans to aggressively invest in its new instrument products but anticipates a future reduction in operating costs once the planned move of the Microsource operation from Santa Rosa to San Ramon is completed later this fiscal year.

Operating expenses increased 9% or \$369,000 in the first half of fiscal 2013 over fiscal 2012 due to an increase of \$665,000 in product development expenses including prototype and beta test unit costs, which was partially offset by a \$480,000 reduction in selling, general and administrative expenses primarily related to lower sales commission expense due to house account sales and personnel reductions in fiscal 2012. The Company plans to aggressively invest in its instrument products but anticipates a future reduction in operating costs once the planned move of the Microsource operation from Santa Rosa to San Ramon is completed later this fiscal year.

In the fourth quarter of fiscal 2012, Giga-tronics made the decision to move ahead with the relocation of its Santa Rosa, CA operation into one facility in San Ramon, CA to help with overhead absorption in San Ramon and to eliminate the facility expense in Santa Rosa. The Company announced its intentions to employees in February, 2012 and entered into employment agreements with all key Santa Rosa individuals to retain the talent needed to continue shipments during the transition and to ensure the new operation in San Ramon will run smoothly.

The major types of cost associated with this move and estimates of their respective total costs are shown:

| Type of Cost | Estimated Total Expense (In thousands) |
|------------------------------------|--|
| Retention Agreements for employees | \$506 |
| Preparation of San Ramon facility | 103 |
| Training of San Ramon Employees | 34 |
| Moving expenses | 56 |
| Clean-up of Santa Rosa facility | 67 |
| Total | \$766 |

Of the total estimated expense, only a prorated portion of the retention bonuses have been accrued as of September 29, 2012. The total expense related to retention bonuses for the three and six month periods ending September 29, 2012 were \$92,000 and \$184,000, respectively. The balance of the restructuring costs will be expensed throughout the remainder of fiscal 2013 and through the third quarter of fiscal year 2014. The Company is required to vacate its Santa Rosa facility by May of 2013.

In summary, Giga-tronics recorded a loss before income taxes of \$1,064,000 for the second quarter of fiscal 2013 versus a loss before income taxes of \$666,000 for the same period last year. The loss before income taxes for the first half of fiscal 2013 was \$1,769,000 compared to \$1,337,000 for the first half of fiscal 2012.

Financial Condition and Liquidity

As of September 29, 2012, Giga-tronics had \$2,096,000 in cash and cash equivalents, compared to \$2,365,000 as of March 31, 2012.

Working capital at September 29, 2012 was \$4,860,000 compared to \$6,568,000 at March 31, 2012. The decrease in working capital was primarily attributable to the net loss of \$1,771,000 for the first half of fiscal 2013.

The Company's current ratio (current assets divided by current liabilities) at September 29, 2012 was 2.10 compared to 4.14 on March 31, 2012.

Cash used in operating activities amounted to \$177,000 for the six month period ended September 29, 2012, compared to cash provided by operating activities of \$1,608,000 for the six month period ended September 24, 2011. Cash used in operating activities during the first half of fiscal 2013 was primarily attributed to the net loss which was partially

offset by cash received through advance customer payments which is recorded as deferred revenue. Cash provided by operating activities for the first half of fiscal 2012 which was primarily attributable to the collection of accounts receivable.

Additions to property and equipment were \$252,000 in the first half of fiscal 2013, of which \$170,000 were related to new capital lease obligations, compared to \$117,000 in the first half of fiscal 2012. The increase in property and equipment in fiscal 2013 was attributable to new engineering projects. The increase in property and equipment in fiscal 2012 was due to an upgrade of manufacturing equipment required for certain new products.

Deferred revenue was \$1,967,000 at September 29, 2012 compared to \$7,000 at March 31, 2012. The increase of \$1,960,000 was due primarily to cash received from advance customer billings during the first six months of fiscal 2013 associated with a contract with a large aircraft manufacturer.

On October 12, 2012, the Company entered into a Second Amended and Restated Loan and Security Agreement” (the “New Credit Facility”) with Silicon Valley Bank (the “Bank”). The New Credit Facility replaced the Company’s previous revolving line of credit with the Bank with an expiration date of September 12, 2012, which was subsequently extended to October 15, 2012. The New Credit Facility, which expires on October 12, 2013, is secured by all assets of the Company and provides for a borrowing capacity equal to 80% of eligible accounts receivable on an aggregate basis, up to a maximum \$2.0 million, provided the Company maintains borrowing base eligibility, that is, a minimum cash balance of \$750,000. When the Company is not borrowing base eligible the Bank may limit credit extension to the 80% advance rate multiplied by the face amount of specific eligible accounts. The New Credit Facility contains a collateral handling fee of one-tenth of one percent (0.10%) on outstanding financed receivables for each calendar month based upon a 360 day year. When borrowing base eligible, the collateral handling fee is not applicable. Interest accrues on the average outstanding borrowings at a floating per annum rate equal to the greater of the Prime Rate plus two percent (2.00%) or six percent (6.00%). Any borrowings under the New Credit Facility may be repaid and such repaid amounts re-borrowed until the maturity date. Unless terminated by the Company or accelerated by the Bank in accordance with the terms of the agreement, the New Credit Facility will terminate on October 12, 2013, at which time all outstanding borrowings must be repaid by the Company. The total borrowing capacity for Giga-tronics would have been in excess of \$2 million if the New Credit Facility had been in effect at September 29, 2012. If Giga-tronics does not maintain borrowing base eligibility, that is, a cash balance of \$750,000.00 or greater, then the borrowing capacity is not based upon accounts receivable in the aggregate but rather it is limited to 80% of specific eligible accounts receivable. The specific eligible accounts receivable are subject to the Bank’s discretion and will generally exclude past due accounts, foreign receivables and certain receivables from the government among other exclusions. Thus Giga-tronics would be able to borrow funds from the Bank; however, the borrowing capacity would be reduced. Using balances at September 29, 2012 as an illustration, had the cash balance fallen below \$750,000, the borrowing capacity would have been reduced to approximately \$1.9 million.

In order to achieve sustained profitability and positive cash flows from operations, the Company may need to further reduce operating expenses and increase revenue. Last year Giga-tronics completed a series of cost reduction actions which have improved the operating expense structure, exclusive of new product development expense. The Company will continue to perform additional actions, as necessary. The ability to maintain, or increase, current revenue levels to sustain profitability will depend, in part, on demand for the Company’s products. Management believes that existing cash and cash equivalent balances, along with cash expected to be generated from product sales, and the careful management of working capital requirements, will be sufficient to fund operations, new product development efforts, anticipated capital expenditures, working capital, and other financing requirements for the next 12 months. In order to increase working capital, the Company may seek to obtain additional debt or equity financing. However, the Company cannot assure that such financing will be available or on terms favorable to the Company.

Item 3 - Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4 - Controls and Procedures

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

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

Based on the above described procedures and actions taken, the Company's management, including its Chief Executive Officer and its Chief Financial Officer have concluded that as of September 29, 2012, the Company's internal control over financial reporting was effective based on the criteria described in the "COSO Internal Control – Integrated Framework."

Part II - Other Information

Item 1 - Legal Proceedings

As of September 29, 2012, Giga-tronics 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 1a - Risk Factors

There has been no material change to the risk factors disclosed in the registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2012.

Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds

In July 2012, the Company engaged an individual as its vice president of sales. As an inducement for the position, the Company granted (i) options under the 2005 Equity Incentive Plan (the "2005 Plan") to acquire 100,000 shares of common stock at an exercise price of \$1.18 per share, vesting ratably over five years, (ii) options outside the 2005 Plan to acquire 100,000 additional shares of common stock at \$1.18 per share, vesting in increments if sales exceed certain agreed thresholds during the two year period ending in March 2014; and (iii) 50,000 shares of restricted stock outside the 2005 Plan, also vesting in increments if sales exceed certain agreed thresholds during the two year period ending in March 2014. The 100,000 share option grant and the restricted stock grant were treated as private placements and were not registered under the Securities Act of 1933 (the "Act"). No underwriter was involved in the transaction. The issuances were exempt from registration under Section 4(2) of the Act.

Item 3 - Defaults Upon Senior Securities

None.

Item 4 - Mine Safety Disclosures

Not applicable.

Item 5 - Other Information

None.

Item 6 - Exhibits

31.1 Certification of Chief Executive Officer pursuant to Section 302 of Sarbanes-Oxley Act.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of Sarbanes-Oxley Act.

32.1 Certification of Chief Executive Officer pursuant to Section 906 of Sarbanes-Oxley Act.

32.2 Certification of Chief Financial Officer pursuant to Section 906 of Sarbanes-Oxley Act.

101.1 The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2011, formatted in XBRL ("eXtensible Business Reporting Language"): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Cash Flows, and (iv) the Notes to the Consolidated Financial Statements, tagged as blocks of text (furnished but not filed).

Signatures

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

GIGA-TRONICS INCORPORATED
(Registrant)

By:

Date: November 9, 2012

/s/ John R. Regazzi
John R. Regazzi
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 9, 2012

/s/ Frank D. Romejko
Frank D. Romejko
Vice President of Finance
Interim Chief Financial Officer
(Principal Accounting Officer)