GIGA TRONICS INC
Form 10-Q
February 06, 2017
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended **December 24, 2016**

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File No. **0-12719**

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

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

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

Yes [X] No [ ]

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

Yes [X] No [ ]

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

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

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

Yes [ ] No [X]

There were a total of 9,549,703 shares of the Registrant’s Common Stock outstanding as of February 1, 2017.

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FORWARD-LOOKING STATEMENTS

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

These forward-looking statements are based on Management’s current knowledge and belief and include information concerning the Company’s possible or assumed future financial condition and results of operations. A number of factors, some of which are beyond the Company’s ability to predict or control, could cause future results to differ materially from those contemplated. These factors include but are not limited to risks related to (1) the Company’s potential inability to obtain necessary capital to finance its operations and to continue as a going concern; (2) the Company’s ability to develop competitive products in a market with rapidly changing technology and standards; (3) the results of pending or threatened litigation; (4) risks related to customers’ credit worthiness/profiles; (5) changes in the Company’s credit profile and its ability to borrow; (6) a potential decline in demand for certain of the Company’s products; (7) potential product liability claims; (8) the potential loss of key personnel; and (9) U.S. and international economic conditions. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business operations. The reader is directed to the Company's annual report on Form 10-K for the year ended March 26, 2016 or further discussion of factors that could affect the Company's business and cause actual results to differ materially from those expressed in any forward-looking statement made in this report. The Company undertakes no obligation to update any forward-looking statements in this report.

PART I – FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

GIGA-TRONICS INCORPORATED

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands except share data)	December 24, 2016	March 26, 2016
Assets		
Current assets:		
Cash and cash-equivalents	$ 1,640	$ 1,331
Trade accounts receivable, net of allowance of $45, respectively	2,534	2,129
Inventories, net	6,088	5,694
Prepaid expenses and other current assets	150	318
Total current assets	10,412	9,472
Property and equipment, net	602	837
Other long term assets	8	8
Capitalized software development costs	1,176	876
Total assets	$ 12,198	$ 11,193
Liabilities and shareholders' equity		
Current liabilities:		
Line of credit	$ 704	$ 800
Current portion of long term debt, net of discount	10	370
Accounts payable	1,287	1,924
Accrued payroll and benefits	423	647
Deferred revenue	6,463	2,804
Deferred rent	—	110
Capital lease obligations	49	44
Deferred liability related to asset sale	375	375
Other current liabilities	417	621
Total current liabilities	9,728	7,695
Warrant liability, at estimated fair value	217	353
Long term obligations - capital lease	128	165
Total liabilities	10,073	8,213
Commitments and contingencies		
Shareholders' equity:		
Convertible preferred stock of no par value Authorized - 1,000,000 shares; Series A - designated 250,000 shares; no shares at December 24, 2016 and March 26, 2016 issued and outstanding	—	—
	2,911	2,911

Series B, C, D- designated 19,500 shares; 18,533.51 shares at December 24, 2016 and March 26, 2016 issued and outstanding; (liquidation value of $3,540 at December 24, 2016 and March 26, 2016)		
Common stock of no par value; Authorized - 40,000,000 shares; 9,549,703 shares at December 24, 2016 and March 26, 2016 issued and outstanding	24,322	24,104
Accumulated deficit	(25,108)	(24,035)
Total shareholders' equity	2,125	2,980
Total liabilities and shareholders' equity	$ 12,198	$ 11,193

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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GIGA-TRONICS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands except per share data)	Three Month Periods Ended December 24, 2016	Three Month Periods Ended December 26, 2015	Nine Month Periods Ended December 24, 2016	Nine Month Periods Ended December 26, 2015
Net sales	$3,202	$ 4,483	$11,037	$ 11,921
Cost of sales	2,108	2,868	7,788	7,701
Gross margin	1,094	1,615	3,249	4,220
Operating expenses:				
Engineering	627	614	1,724	2,179
Selling, general and administrative	1,077	1,417	3,429	4,221
Total operating expenses	1,704	2,031	5,153	6,400
Operating loss	(610)	(416)	(1,904)	(2,180)
Gain on sale of product line	—	—	802	—
Gain/(loss) on adjustment of warrant liability to fair value	62	(98)	136	(51)
Interest expense:				
Interest expense, net	(24)	(54)	(84)	(164)
Interest expense from accretion of loan discount	(3)	(34)	(21)	(140)
Total interest expense, net	(27)	(88)	(105)	(304)
Loss before income taxes	(575)	(602)	(1,071)	(2,535)
Provision for income taxes	—	—	2	2
Net loss	$(575)	$ (602)	$(1,073)	$ (2,537)
Loss per common share - basic	$(0.06)	$ (0.09)	$(0.11)	$ (0.40)
Loss per common share - diluted	$(0.06)	$ (0.09)	$(0.11)	$ (0.40)
Weighted average shares used in per share calculation:				
Basic	9,550	6,484	9,550	6,402
Diluted	9,550	6,484	9,550	6,402

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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GIGA-TRONICS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)	Nine Month Periods Ended December 24, 2016	December 26, 2015
Cash flows from operating activities:		
Net loss	$(1,073)	$ (2,537)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	306	220
Share based compensation	218	717
Adjustment of warrant liability to fair value	(136)	51
Capitalized software development costs	(334)	—
Accretion of discounts and issuance costs on debt	30	140
Change in deferred rent	(110)	(94)
Gain on sale of product line	(802)	
Changes in operating assets and liabilities:		
Trade accounts receivable	(405)	218
Inventories	(394)	(946)
Prepaid expenses and other assets	168	(236)
Accounts payable	(637)	1,458
Accrued payroll and benefits	(224)	(96)
Deferred revenue	3,659	267
Other current liabilities	(252)	43
Net cash provided by (used in) operating activities	14	(795)
Cash flows from investing activities:		
Cash received from sale of product lines	1,225	—
Cash returned related to sale of product line	(375)	—
Purchases of property and equipment	(37)	(109)
Net cash provided by (used in) investing activities	813	(109)
Cash flows from financing activities:		
Proceeds from line of credit	—	1,200
Repayments of debt	(390)	(680)
Repayments of line of credit	(96)	—
Payments on capital leases	(32)	(65)
Proceeds from exercise of stock options	—	62
Net cash (used in) provided by financing activities	(518)	517
Increase /(Decrease) in cash and cash-equivalents	309	(387)

Beginning cash and cash-equivalents	1,331	1,170
Ending cash and cash-equivalents	$1,640	$ 783
Supplementary disclosure of cash flow information:		
Cash paid for income taxes	$2	$ 2
Cash paid for interest	$63	$ 120
Supplementary disclosure of noncash financing activities:		
Equipment disposal	$174	$ —
Equipment acquired under capital lease	$—	$ 163

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Organization and Significant Accounting Policies

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 26, 2016.

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.

Derivatives The Company accounts for certain of its warrants as derivatives. Changes in fair values are reported in earnings as gain or loss on adjustment of warrant liability to fair value.

Software Development Costs Development costs included in the research and development of new software products and enhancements to existing software products are expensed as incurred, until technological feasibility in the form of a working model has been established. Capitalized development costs are amortized over the expected life of the product and evaluated each reporting period for impairment.

Discontinued Operations The Company reviews its reporting and presentation requirements for discontinued operations in accordance with the guidance provided by ASC 205-20 as it moves to newer technology within the test and measurement market from legacy products to the newly developed Advanced Signal Generator. The disposal of these product line sales represent an evolution of the Company's Giga-tronics Division to a more sophisticated product offered to the same customer base. The Company has evaluated the sales of product lines (see Note 9, Sale of Product Lines) concluding that each product line does not meet the definition of a "component of an entity" as defined by ASC 205-20.The Company is able to distinguish revenue and gross margin information as disclosed in Note 9, Sale of Product Lines to the accompanying financial statements; however, operations and cash flow information is not clearly distinguishable and the company is unable to present meaningful information about results of operations and cash flows from those product lines.

New Accounting Standards In April 2016, the FASB issued ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing.* The amendments in ASU 2016-10 affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements in ASU 2016-10 are the same as the effective date and transition requirements of ASU 2014-09. ASU 2015-14, *Revenue from Contracts with Customers (Topic 606)*. The amendments in this ASU is effective for public business entities with annual reporting periods beginning after 15 December 2017, including interim reporting periods within that reporting period. The Company is currently evaluating the impact this accounting standard update may have on its financial statements.

(2) Going Concern and Management's Plan

The Company incurred net losses of $575,000 for the third quarter of fiscal 2017 and $1.1 million for the first nine months of fiscal 2017, respectively. These losses have contributed to an accumulated deficit of $25.1 million as of December 24, 2016.

The Company has experienced delays in the development of features, orders, and shipments for the new Advanced Signal Generator ("ASG"). These delays have contributed, in part, to a decrease in working capital from $1.8 million at March 26, 2016, to $684,000 at December 24, 2016. The new ASG product has shipped to several customers, but potential delays in the development of features, longer than anticipated sales cycles, or the ability to efficiently manufacture the ASG, could significantly contribute to additional future losses and decreases in working capital.

To help fund operations, the Company relies, in part, on advances under the line of credit with Bridge Bank. The line of credit expires on May 7, 2017. The agreement includes a subjective acceleration clause, which allows for amounts due under the facility to become immediately due in the event of a material adverse change in the Company's business condition (financial or otherwise), operations, properties or prospects, or ability to repay the credit based on the lender's judgment. As of December 24, 2016, the line of credit had an outstanding balance of $704,000, and additional borrowing capacity of $1.7 million.

These matters raise substantial doubt as to the Company's ability to continue as a going concern.

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

On June 20, 2016, the Company entered into an Asset Purchase Agreement with Astronics Test Systems Inc. (Astronics), (see Note 9, Sale of Product Lines). Upon signing, Astronics paid $850,000 for the intellectual property of the product line. Astronics also purchased approximately $960,000 of related raw materials and work-in-progress inventory from the Company during the second quarter ended September 24, 2016. Proceeds from the asset sale will be used for working capital and general corporate purposes.

In July 2016, Microsource received a $1.9 million non-recurring engineering order associated with redesigning a component of its high performance YIG filter used on an aircraft platform. The Company delivered NRE services for approximately $256,000 and $663,000, respectively, during the three and nine months ended December 24, 2016 and expects to continue such services over the next nine to twelve months.

In June 2016, the Giga-tronics Division received a $3.3 million order from the United States Navy for the Company's Real-Time Threat Emulation Systems ("TEmS") (which combines the Company's ASG hardware platform along with software developed and licensed to the Company from a major aerospace and defense company) which the Company expects to ship in the fourth quarter of fiscal 2017. In July 2016, the Giga-tronics Division also received an order for $542,000 from the United States Navy for the ASG hardware only platform. The Company fulfilled the ASG hardware only order in the second quarter ended September 24, 2016.

In April 2016, Microsource received a $4.5 million order for YIG RADAR filters for a fighter jet platform, representing a 50% increase compared to the customer's previous jet platform order in fiscal 2016. We shipped approximately $1.4 million and $3.3 million, respectively of the fiscal 2017 order during the three and nine months ended December 24, 2016, respectively, and we expect to ship the remainder over the next three to six months.

With the elimination of Giga-tronics Switch, Power Meter, Amplifier, and Signal Generator legacy product lines resulting from the Asset Purchase Agreements with Spanawave and Astronics, (see Note 9, Sale of Product Lines), we have been able to reduce the number of employees by approximately 20%, from 71 in November 2015 to 56 on December 24, 2016, while providing additional cash for operations from the proceeds of the sales.

Giga-tronics plans to work with Bridge Bank to renew the line of credit prior to its May 7, 2017 expiration.

In the first quarter of fiscal 2016, the Company's Microsource business unit finalized a multiyear $10.0 million YIG production order ("YIG Production Order"). The Company started shipping the YIG Production Order in the second quarter of fiscal 2017. We shipped approximately $431,000 and $898,000 during the three and nine months ended December 24, 2016, respectively, and we expect to ship the remainder through 2020.

To assist with the upfront purchases of inventory required for future product deliveries, the Company entered into advance payment arrangements with certain customers, whereby the customers reimburse the Company for raw material purchases prior to the shipment of the finished products. The Company will continue to seek similar terms in future agreements with these customers and other customers.

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

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

Cumulative losses have had a significant negative impact on the financial condition of the Company and raise substantial doubt about the Company's ability to continue as a going concern. The Consolidated Financial Statements have been prepared assuming the Company will continue as a going concern and do not include any adjustments that might result if the Company were unable to do so.

(3) Revenue Recognition

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

a. It is commensurate with either of the following:

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

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

b. It relates solely to past performance.

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

Milestones 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. In fiscal 2015 the Company’s Microsource business unit received a $6.5 million order from a major aerospace company for non-recurring engineering services to develop a variant of its high performance fast tuning YIG filters for an aircraft platform and to deliver a limited number of flight-qualified prototype hardware units (the “NRE Order”) which is being accounted for on a milestone basis. The Company considered factors such as estimated completion dates and product acceptance of the order prior to accounting for the NRE Order as milestone revenue. There was no revenue recognized during the three month period ended December 24, 2016 as the Company had delivered all milestones associated with this contract. During the nine month period ended December 24, 2016, revenue recognized on a milestone basis were $478,000. During the three and nine month periods ended December 26, 2015, revenue recognized on a milestone basis were $6,000 and $716,000, respectively.

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

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

The Company provides for estimated costs that may be incurred for product warranties at the time of shipment. The Company’s warranty policy generally provides twelve to eighteen months depending on the customer. The estimated cost of warranty coverage is based on the Company’s actual historical experience with its current products or similar products. For new products such as the Company’s new ASG, 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. The actual cost that the Company may have to pay and the timing of the repairs to be carried out are uncertain. Actual results could differ from the estimated amount and such differences could be material. Adjustments are made as new information becomes available.

(4) Inventories

Inventories consisted of the following:

(In thousands)	December 24, 2016	March 26, 2016
Raw materials	$ 2,086	$3,489
Work-in-progress	3,522	2,156
Finished goods	228	2
Demonstration inventory	252	47
Total	$ 6,088	$5,694

(5) Software Development Costs

On September 3, 2015, the Company entered into a software development agreement with a major aerospace and defense company whereby the aerospace company would develop and license its simulation software to the Company. The simulation software (also called Open Loop Simulator or OLS technology) is currently the aerospace company's intellectual property. The OLS technology generates threat simulations and enables various hardware to generate signals for performing threat analysis on systems under test. The Company will license the OLS software as a bundled or integrated solution with its Advanced Signal Generator system. The Company is obligated to pay the aerospace company software development costs and fees for OLS of $1.2 million in the aggregate (this includes an amendment to the software development agreement for additional features and functionality), which is payable in monthly installments as the work is performed by the aerospace company. The OLS technology is a perpetual license agreement that may be terminated by the Company at any time as long as the Company provides a notice to the aerospace company and pays for the development costs incurred through the notice termination date. The Company is also obligated to pay royalties to the aerospace company on net sales of its Advanced Signal Generator product sold with the OLS software equal to seven percent of net sales price of each ASG system sold and subject to certain minimums. The Company expenses research and development costs as they are incurred. Development costs of computer software to be sold, leased, or otherwise marketed are subject to capitalization beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers. As of December 24, 2016, capitalized software costs were $1.2 million. There was no additional costs capitalized in the three months ended December 24, 2016 as the development was substantially complete. The Company began amortizing the costs of capitalized software to cost of sales in the three months ended December 24, 2016, using a straight line methodology over a three year period. Amortization of capitalized software costs were $34,000 during three and nine month periods ended December 24, 2016.

(6) Accounts Receivable Line of Credit

On June 1, 2015 the Company entered into a $2.5 million Revolving Accounts Receivable Line of Credit agreement with Bridge Bank. The agreement provides for a maximum borrowing capacity of $2.5 million of which $2.0 million is subject to a borrowing base calculation and $500,000 is non-formula based.

The loan is secured by all assets of the Company including intellectual property and general intangibles and provides for a borrowing capacity equal to 80% of eligible accounts receivable. The loan matures on May 7, 2017 and bears an interest rate equal to 1.5% over the bank's prime rate of interest (which was 3.75% at December 24, 2016 resulting in an interest rate of 5.25%). Interest is payable monthly with principal due upon maturity. In connection with the agreement, the Company paid a commitment fee of $12,500. The loan agreement also contains financial and non-financial covenants that are customary for this type of lending and includes a covenant to maintain an asset coverage ratio of at least 135% (defined as unrestricted cash and cash equivalents maintained with Bridge Bank, plus eligible accounts receivable aged less than 90 days from the invoice date, divided by the total amount of outstanding principal of all obligations under the loan agreement). As of December 24, 2016, the Company was in compliance with all the financial covenants under the agreement. The line of credit requires a lockbox arrangement, which provides for receipts to be swept daily to reduce borrowings outstanding at the discretion of Bridge Bank. This arrangement, combined with the existence of the subjective acceleration clause in the line of credit agreement, necessitates the line of credit be classified as a current liability on the balance sheet. The acceleration clause allows for amounts due under the facility to become immediately due in the event of a material adverse change in the Company's business condition (financial or otherwise), operations, properties or prospects, or ability to repay the credit based on the lender's judgment. As of December 24, 2016, the Company's total outstanding borrowings and remaining borrowing capacity under the Bridge Bank line of credit were $704,000 and $1.7 million, respectively.

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

On March 13, 2014 the Company entered into a three year, $2.0 million term loan agreement with PFG (Partners For Growth IV, L.P.) under which the Company received $1.0 million on March 14, 2014 ("Initial Borrowing"). Interest on the $1.0 million term loan borrowing was fixed at 9.75% and required monthly interest only payments during the first six months of the agreement followed by monthly principal and interest payments over the remaining thirty months. The Company could prepay the loan at any time prior to maturity by paying all future scheduled principal and interest payments. As of December 24, 2016, the Company's total outstanding debt associated with the initial PFG loan was $10,000.

On June 16, 2014, the Company amended its loan agreement with PFG (the "Amendment"). Under the terms of the Amendment, PFG made a revolving credit line available to Giga-tronics in the amount of $500,000, for which the Company borrowed the entire amount on June 17, 2014. The revolving credit line had a thirty-three month term. The interest on the PFG revolving credit line was fixed, calculated on a daily basis at a rate of 12.50% per annum. The

Company was allowed to prepay the credit line borrowings at any time prior to its March 13, 2017 maturity date without a penalty.

On June 3, 2015, the Company further amended its loan agreement with PFG (the “Second Amendment”). The Second Amendment cancelled the Company’s $500,000 of remaining term loan borrowing availability under the June 2014 Amendment and required the Company to pay PFG $150,000 towards its existing $500,000 outstanding balance under the revolving line of credit, which the Company paid in July 2015. The Company also agreed to pay PFG an additional $10,000 per month towards its remaining credit line balance until repaid, followed by like payments towards its term loan balance until repaid. The revolving credit line balance was fully repaid in March 2016.

The PFG loan is secured by all of the Company’s assets under a lien that is junior to the Bridge Bank debt described in Note 6, and limits borrowing under the Bridge Bank credit line to $2.5 million.

The PFG 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. As of December 24, 2016, the Company was in compliance with all the financial covenants under the agreement.

The PFG loan agreement also initially 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 $1.0 million term loan borrowing from the Initial Borrowing, 80,000 became exercisable with the first Amendment and 40,000 were cancelled with the Second Amendment. Each warrant issued under the loan agreement has a term of five years and an exercise price of $1.42 which was equal to the average NASDAQ closing price of the Company’s common stock for the ten trading days prior to the Initial Borrowing.

If the warrants are not exercised before expiration on March 13, 2019, the Company would be required to pay PFG $150,000 and $67,000 as settlement for warrants associated with the Initial Borrowing and the Amendment, respectively. The warrants could be settled for cash at an earlier date in the event of any acquisition or other change in control of the Company, future public issuance of Company securities, or liquidation (or substantially similar event) of the Company. The Company currently has no definitive plans for any of the aforementioned events, and as a result, the cash payment date is estimated to be the expiration date unless warrants are exercised before then. The warrants have the characteristics of both debt and equity and are accounted for as a derivative liability measured at fair value each reporting period with the change in fair value recorded in earnings. The initial fair value of the warrants associated with the Initial Borrowing and Amendment were $173,000 and $168,000, respectively.

As of December 24, 2016, the estimated fair values of the derivative liabilities associated with the warrants issued in connection with the Initial Borrowing and Amendment were $130,000 and $87,000, respectively, for a combined value of $217,000. As of March 26, 2016, the estimated fair value of the derivative liability associated with the warrant issued in connection with the Initial Borrowing and Amendment was $212,000 and $141,000, respectively for a combined value of $353,000.

During the three and nine month periods ended December 24, 2016, the change in the fair value of the warrant liability totaled $62,000 and $136,000 respectively. These changes are reported in the accompanying statement of operations as a gain on adjustment of derivative liability to fair value. During the three and nine month periods ended December 26, 2015, the change in the fair value of the warrant liability totaled $98,000 and $51,000, respectively. These changes are reported in the accompanying statement of operations as a loss on adjustment of derivative liability to fair value.

The initial $1.0 million in proceeds under the term loan agreement were allocated between the PFG loan and the warrants 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 resulting discount of $178,000 on the PFG loan is being accreted to interest expense under the effective interest method over the term of the PFG loan. During the three and nine month periods ended December 24, 2016, the Company recorded accretion of discount expense associated with the warrants issued with the PFG loan of $3,000 and $21,000 respectively. During the three and nine month periods ended December 26, 2015, the Company recorded accretion of discount expense associated with the warrants issued with the PFG loan of $34,000 and $140,000, respectively.

(8) Fair Value

Pursuant to the accounting guidance for fair value measurement and its subsequent updates, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the “exit price”) in an orderly transaction between market participants at the measurement date. The accounting guidance establishes a hierarchy for inputs used in measuring fair value that minimizes the use of unobservable inputs by requiring the use of observable market data when available. Observable inputs are inputs that market participants would use in pricing the asset or liability based on active market data. Unobservable inputs are inputs that reflect the assumptions market participants would use in pricing the asset or liability based on the best information available in the circumstances.

The fair value hierarchy is broken down into the three input levels summarized below:

• *Level 1* —Valuations are based on quoted prices in active markets for identical assets or liabilities and readily accessible by us at the reporting date. Examples of assets and liabilities utilizing Level 1 inputs are certain money market funds, U.S. Treasuries and trading securities with quoted prices on active markets.

- *Level 2* —Valuations based on inputs other than the quoted prices in active markets that are observable either directly or indirectly in active markets. Examples of assets and liabilities utilizing Level 2 inputs are U.S. government agency bonds, corporate bonds, commercial paper, certificates of deposit and over-the- counter derivatives.

- *Level 3* —Valuations based on unobservable inputs in which there are little or no market data, which require us to develop our own assumptions.

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, and generally result in inputs categorized as Level 1 within the fair value hierarchy. The fair values of term debt are based on the present value of expected future cash flows and assumptions about current interest rates and the creditworthiness of the Company and generally result in inputs categorized as Level 3 within the fair value hierarchy. At December 24, 2016 and March 26, 2016, the carrying amounts of the Company's term debt totaled $10,000 and $370,000, respectively and the estimated fair value totaled $10,000 and $384,000, respectively. The fair value was calculated using a discounted cash flow model and utilized a 14% and 20% discount rate, respectively. The rates are commensurate with market rates given the remaining term, principal repayment schedule, the Company's creditworthiness and outstanding loan balance.

The Company's derivative warrant liability is measured at fair value on a recurring basis and is categorized as Level 3 in the fair value hierarchy. The derivative warrant liability is valued using a Monte Carlo simulation model, which used the following assumptions as of December 24, 2016: (i) the remaining expected life of 2.3 years, (ii) the Company's historical volatility rate of 96.9%, (iii) risk-free interest rate of 1.30%, and (iv) a discount rate of 14%.

The aforementioned derivative warrant liability is the Company's only asset and liability recognized and measured at fair value on a recurring or non-recurring basis. The following table presents the fair value measurements for warrant liability:

Fair Value Measurements as of December 24, 2016 (In Thousands):

	Level 1	Level 2	Level 3
Warrant Liability	$ —	—	$217
Total	$ —	—	$217

Fair Value Measurements as of March 26, 2016 (In Thousands):

	Level 1	Level 2	Level 3
Warrant Liability	$ —	—	$353
Total	$ —	$ —	$353

There were no transfers between Level 1, Level 2, or Level 3 for the three and nine month periods ended December 24, 2016 and March 26, 2016.

The table below summarizes changes in gains and losses recorded in earnings for Level 3 assets and liabilities that are still held at December 24, 2016:

(In thousands)	Three Month Periods Ended December 24, 2016	Three Month Periods Ended December 26, 2015	Nine Month Periods Ended December 24, 2016	Nine Month Periods Ended December 26, 2015
Warrant liability at beginning of period	$279	$ 294	$353	$ 341
Gains (recorded in other income/expense)	(62)	—	(136)	—
Losses (recorded in other income/expense)	—	98	—	51
Warrant liability at end of period	$217	$ 392	$217	$ 392

There were no assets measured at fair value on a recurring basis and there were no assets or liabilities measured on a non-recurring basis at December 24, 2016 or March 26, 2016.

The following table presents quantitative information about recurring Level 3 fair value measurements at December 24, 2016 and March 26, 2016:

December 24, 2016	Valuation Technique(s)	Unobservable Input	
Warrant liability	Monte Carlo	Discount rate	14%

March 26, 2016	Valuation Techniques(s)	Unobservable Input	
Warrant liability	Monte Carlo	Discount rate	20%

The discount rate of fourteen percent is management's estimate of the current cost of capital given the Company's credit worthiness. A significant increase in the discount rate would significantly decrease the fair value, but the magnitude of this decrease would be less significant in a scenario where the Company's stock price is significantly higher than the exercise price since the holder's option to take a cash payment at maturity represents a smaller component of the total fair value when the Company's stock price is higher. The Monte Carlo simulation model simulated the Company's stock price through the maturity date of March 31, 2019. At the end of the simulated period, the value of the warrant was determined based on the greater of (1) the net share settlement value, (2) the net exercise value, or (3) the fixed cash put value.

(9) Sale of Product Lines

On June 20, 2016, the Company entered into an Asset Purchase Agreement for the sale of its Switch product line to Astronics Test Systems Inc. (Astronics). Upon signing the agreement, Astronics paid $850,000 for the intellectual property of the product line. The Company recognized a net gain of $802,000 in the first quarter ended June 25, 2016 after related expenses were subtracted from the sales price. The following table presents the breakdown of the gain recognized related to the asset sale:

(In thousands)	
Cash received from Astronics	$850
Cash paid to buy out future commission obligation	(170)
Employee severance	(97)
Legal fees	(13)
Commissions	(46)
Warranty Liability released	278
Net gain recognized	$802

In calculating the gain included in the accompanying consolidated financial statements, the Company released $278,000 of deferred warranty obligations related to the Switch asset. Pursuant to the terms of the agreement, Astronics assumed all the warranty obligations for the Switch product line, including the products sold prior to the asset being transferred to Astronics. The deferred warranty obligation was previously included in other current liabilities in the consolidated financial statements. The Company also had an existing agreement with a consultant supporting the Switch product line which included a three percent commission on the sales of the Switch product line for a period of 4 years ending in January 2020. The agreement allowed for a buyout of future commissions associated with the Switch product which the Company exercised in connection with the Astronics transaction in June 2016 resulting in a payment of $170,000 by the Company.

During the three month period ended December 24, 2016, the Switch product line did not account for any product revenue. During the nine month period ended December 24, 2016, the Switch product line accounted for $2.1 million in product revenue. Gross margins of the Switch product line for the nine month period ended December 24, 2016 was $437,000. During the three and nine month periods ended December 26, 2015, the Switch product line accounted for approximately $714,000 and $1.8 million in product revenue, respectively, and related margins were $280,000 and $668,000, respectively. While the Company is able to distinguish revenue and gross margin information related to the sale of the Switch product line to Astronics, the Company is unable to present meaningful information about results of operation and cash flows from the Switch product line.

On December 15, 2015, the Company entered into an Asset Purchase Agreement with Spanawave Corporation, whereby Spanawave agreed to purchase the Giga-tronics' Division product lines for its Power Meters, Amplifiers, and Legacy Signal Generators for $1.5 million. The agreement provided for the transfer of these product lines to

Spanawave sequentially in six phases beginning with certain sensor and amplifier products. During the second quarter ended September 24, 2016, the Company and Spanawave became engaged in a dispute, including litigation initiated by Spanawave and an arbitration proceeding initiated by Spanawave's affiliate Liberty Test Equipment, Inc., as to whether the Company has fulfilled all the requirements to close phases one through five and become entitled to the $375,000 received during the first quarter of fiscal 2017.

The complaint seeks specific performance of the agreement and damages. Spanawave's affiliate Liberty Test Equipment also filed an arbitration claim for $440,000 under a distribution agreement between the Company and Liberty. The Company has filed cross-complaints in both the litigation and arbitration asserting breach of the respective agreements by Spanawave and Liberty. The Company had previously asserted that the distribution agreement does not extend to the products with respect to which the claim has been made. Certain customers of the lines of business sold to Spanawave are also customers of the Company's ongoing Advance Signal Generator business. Continued disruption of the phase 6 signal generator business could have an adverse effect on the ASG business. The parties have negotiated in an effort to settle the dispute notwithstanding the filings. The expenses and potential liability of negotiation, any settlement or continued litigation or arbitration could have a material adverse effect on the Company.

During the nine months ended December 24, 2016, the Company had received $750,000 from Spanawave under the agreement. Of this amount, the Company returned $375,000 to Spanawave on July 28, 2016 resulting from the dispute regarding the status of phases one through five. The remaining $375,000 is included in deferred liability related to asset sales in the consolidated balance sheet. In addition, in June 2016, the Company received approximately $275,000 in exchange for raw material purchases. The purchase price of the raw materials approximated its carrying value, therefore no gain or loss was recognized. The parties are currently attempting to resolve this dispute. No gain has been recognized in connection with this product line sale because of the aforementioned dispute. These product lines accounted for approximately $75,000 and $425,000 in revenue during the three and nine month periods ended December 24, 2016, respectively. These product lines also accounted for $637,000 and $2.1 million, respectively, during the three and nine month periods ended December 26, 2015. There was no margin associated with the revenue for the first nine months of fiscal 2017 as the revenues were primarily related to inventory transfer at book value. For the three and nine month periods ended December 26, 2015, gross margins on these revenues were $106,000 and $462,000, respectively. While the Company is able to distinguish revenue and gross margin information related to the sale of these product lines, the Company is unable to present meaningful information about results of operation and cash flows from these product lines.

(10) Loss Per Share

Basic loss per share (EPS) is calculated by dividing net loss by the weighted average common shares outstanding during the period. Diluted EPS reflects the net incremental shares that would be issued if unvested restricted shares became vested and dilutive outstanding stock options were exercised, using the treasury stock method. In the case of a net loss, it is assumed that no incremental shares would be issued because they would be antidilutive. In addition, certain options are considered antidilutive because assumed proceeds from exercise price, related tax benefits and average future compensation was greater than the weighted average number of options outstanding multiplied by the average market price during the period. The shares used in per share computations are as follows:

	Three Month Periods Ended		Nine Month Periods Ended	
(In thousands except per share data)	**December 24, 2016**	**December 26, 2015**	**December 24, 2016**	**December 26, 2015**
Net loss	$(575)	$ (602)	$(1,073)	$ (2,537)
Weighted average:				
Common shares outstanding	9,550	6,484	9,550	6,402
Potential common shares	—	—	—	—
Common shares assuming dilution	9,550	6,484	9,550	6,402
Net earnings/ loss per share - basic	$(0.06)	$ (0.09)	$(0.11)	$ (0.40)
Net earnings/ loss per share - diluted	$(0.06)	$ (0.09)	$(0.11)	$ (0.40)
Stock options not included in computation that could potentially dilute EPS in the future	1,137	1,598	1,137	1,598
Restricted stock awards not included in computation that could potentially dilute EPS in the future	45	245	45	245
Convertible preferred stock not included in computation that could potentially dilute EPS in the future	1,853	1,853	1,853	1,853
Warrants not included in computation that could potentially dilute EPS in the future	3,737	1,353	3,737	1,353

The exclusion of stock options, restricted stock, convertible preferred stocks and warrants from the computation of diluted earnings per share (EPS) for the three and nine month periods ended December 24, 2016 and December 26, 2015 is a result of the Company’s net loss and, therefore, the effect of these instruments would be anti-dilutive.

(11) Share Based Compensation

The Company has established the 2005 Equity Incentive Plan, which provides for the granting of options and restricted stock for up to 2,850,000 shares of common stock at 100% of fair market value at the date of grant, with each grant requiring approval by the Board of Directors of the Company. The 2005 Plan has been extended to be effective until 2025. Option grants under the 2000 Stock Option Plan are no longer available. Options granted generally vest in one or more installments in a four or five year period and must be exercised while the grantee is employed (or during the service period in the case of non-employees) by the Company or within a certain period after termination of employment. Options granted to employees shall not have terms in excess of 10 years from the grant date. Holders of options may be granted stock appreciation rights (SARs), which entitle them to surrender outstanding awards for a cash distribution under certain changes in ownership of the Company, as defined in the stock option plan. As of December 24, 2016, no SAR's have been granted under the option plan. As of December 24, 2016, the total number of shares of common stock available for issuance was 1,257,927. All outstanding options have a ten year life from the date of grant. The Company records compensation cost associated with share-based compensation equivalent to the estimated fair value of the awards over the requisite service period.

Stock Options

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		**Nine Month Periods Ended**	
	December 24, 2016	**December 26, 2015**	**December 24, 2016**	**December 26, 2015**
Dividend yield	—	—	—	—
Expected volatility	98.51%	97.18%	98.73%	97.18%
Risk-free interest rate	1.35%	1.56%	1.36%	1.36%
Expected term (years)	8.36	8.36	8.36	8.36

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

A summary of the changes in stock options outstanding for the nine month periods ended December 24, 2016 and the fiscal year ended March 26, 2016 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Terms (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at March 28, 2015	1,726,975	$ 1.57		
Granted	35,000	1.22		
Exercised	48,550	1.59		
Forfeited / Expired	121,225	2.15		
Outstanding at March 26, 2016	1,592,200	$ 1.52	6.8	$ 69
Granted	103,000	1.03		
Exercised	—	—		
Forfeited / Expired	558,100	1.56		
Outstanding at December 24, 2016	1,137,100	$ 1.45	6.2	$ —
Exercisable at December 24, 2016	815,450	$ 1.47	5.7	$ —
At December 24, 2016, expected to vest in the future	213,435	$ 1.40	7.4	$ —

As of December 24, 2016, there was $179,000 of total unrecognized compensation cost related to non-vested options. That cost is expected to be recognized over a weighted average period of 2.8 years. There were 56,150 options and 73,000 options that vested during the quarter ended December 24, 2016 and December 26, 2015, respectively. The total grant date fair value of options vested during the quarters ended December 24, 2016 and December 26, 2015 was $73,000 and $98,000, respectively. There were 187,300 and 364,150 options that vested during the nine month periods ended December 24, 2016 and December 26, 2015, respectively. The total grant date fair value of options vested during the nine month periods ended December 24, 2016 and December 26, 2015 was $233,000 and $383,000, respectively. No shares were exercised in the three month and nine month periods ended December 24, 2016. Options for 27,300 and 39,300 were exercised in the three and nine month periods ended December 26, 2015, respectively. Share based compensation cost recognized in operating results for the three month periods ended December 24, 2016 and December 26, 2015 totaled $61,000 and $93,000, respectively. Share based compensation cost recognized in operating results for the nine month periods ended December 24, 2016 and December 26, 2015 totaled $211,000 and $317,000, respectively.

Restricted Stock

The Company granted 44,500 restricted awards during the third quarter and the first nine months of fiscal 2017. No restricted awards were granted in the third quarter or the first nine months of fiscal 2016. No restricted awards vested during the third quarter or first nine months of fiscal 2017. The Company granted 50,000 shares of restricted stock outside the 2005 Plan in fiscal 2013 that vested in the first quarter of fiscal 2016. The restricted stock awards are considered fixed awards as the number of shares and fair value at the grant date is amortized over the requisite service period net of estimated forfeitures.

As of December 24, 2016, there was $19,000 of total unrecognized compensation cost related to restricted awards. That cost is expected to be recognized over a weighted average period of 0.2 years. Compensation cost recognized for restricted and unrestricted stock awards during the three and nine month periods ended December 24, 2016 was $7,000. Compensation cost recognized for the restricted and unrestricted stock awards for the three and nine month periods ended December 26, 2015 was $90,000 and $400,000, respectively.

A summary of the changes in non-vested restricted stock awards outstanding at December 24, 2016 and March 28, 2016 is as follows:

	Shares	Wt. Avg. Grant Date Fair Value
Non-Vested at March 28, 2015	482,000	$ 2.02
Granted	—	—
Vested	482,000	2.02
Forfeited or cancelled	—	—
Non-Vested at March 26, 2016	—	$ —
Granted	44,500	0.66
Vested	—	—
Forfeited or cancelled	—	—
Non-Vested at December 24, 2016	45,500	$ 0.66

(12) Significant Customer and Industry Segment Information

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

The Giga-tronics Division has historically produced a broad line of test and measurement equipment used primarily for the design, production, repair and maintenance of products in aerospace, telecommunications, RADAR, and electronic warfare. The Giga-tronics Division recently transitioned within the test and measurement market from legacy products to its newly developed Advanced Signal Generator product for the electronic warfare market (see Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Company Overview).

Microsource primarily develops and manufactures YIG RADAR filters used in fighter jet aircraft for two prime contractors.

The tables below present information for the three and nine month periods ended December 24, 2016 and December 26, 2015.

		Three Month Period Ended			Three Month Period Ended	
(In thousands)	**Dec. 24, 2016**	**Dec. 24, 2016**		**Dec. 26, 2015**	**Dec. 26, 2015**	
	Assets	**Net Sales**	**Net Income (Loss)**	**Assets**	**Net Sales**	**Net Income (Loss)**
Giga-tronics Division	$8,666	$838	$(1,471)	$6,639	$2,692	$(1,306)
Microsource	3,532	2,364	896	2,044	1,791	704
Total	$12,198	$3,202	$(575)	$8,683	$4,483	$(602)

		Nine Month Period Ended			Nine Month Period Ended	
(In thousands)	**Dec. 24, 2016**	**Dec. 24, 2016**		**Dec. 26, 2015**	**Dec. 26, 2015**	
	Assets	**Net Sales**	**Net Income (Loss)**	**Assets**	**Net Sales**	**Net Income (Loss)**

Giga-tronics Division	$8,666	$4,660	$(3,435)	$6,639	$6,908	$(4,560)
Microsource	3,532	6,377	2,362	2,044	5,013	2,023
Total	$12,198	$11,037	$(1,073)	$8,683	$11,921	$(2,537)

During the third quarter of fiscal 2017, two customers accounted for 76% of the Company's consolidated revenues. One of the customers accounted for 52% of the Company's consolidated revenue and was included in the Microsource segment. A second customer accounted for 24% of the Company's consolidated revenue and was included in the Giga-tronics Division. A third customer accounted for 13% of the Company's consolidated revenue and was primarily included in the Microsource segment. During the third quarter of fiscal 2016, one customer accounted for 40% of the Company's consolidated revenues and was included in the Microsource segment. A second customer accounted for 21% of the Company's consolidated revenue for the three months ended December 26, 2015 and was primarily included in the Giga-tronics Division.

During the first nine months of fiscal 2017, one customer accounted for 38% of the Company's consolidated revenues and was primarily included in the Microsource segment. A second customer accounted for 15% of the Company's consolidated revenue and was also included in the Microsource segment. During the first nine months of fiscal 2016, one customer accounted for 34% of the Company's consolidated revenues and was primarily included in the Microsource segment. A second customer accounted for 13% of the Company's consolidated revenue and was included in the Giga-tronics Division.

(13) Income Taxes

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

The Company recorded $2,000 tax expense for the three and nine month periods ended December 24, 2016 and December 26, 2015. The effective tax rate for the three and nine month periods ended December 24, 2016 and December 26, 2015 was 0%, primarily due to a valuation allowance recorded against the net deferred tax asset balance.

As of December 24, 2016, the Company had recorded $106,000 for unrecognized tax benefits related to uncertain tax positions. The unrecognized tax benefit is netted against the non-current deferred tax asset on the Consolidated Balance Sheet. The Company does not expect the liability for unrecognized tax benefits to change materially within the next 12 months. The Company does have a California Franchise Tax Board audit that is currently in process. The Company is working with the California Franchise Tax Board to resolve all audit issues and does not believe any material taxes, penalties or fees are due. However, as a result of the on-going examination, the Company recorded an estimated associated tax liability of $45,000 in the first quarter of fiscal 2015.

(14) Warranty Obligations

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

(In thousands)	Three Month Periods Ended December 24, 2016	Three Month Periods Ended December 26, 2015	Nine Month Periods Ended December 24, 2016	Nine Month Periods Ended December 26, 2015
Balance at beginning of period	$60	$ 67	$60	$ 76
Provision, net	3	14	115	40
Warranty costs incurred	(2)	(10)	(114)	(45)
Balance at end of period	$61	$ 71	$61	$ 71

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

On November 10, 2011, the Company received $2,199,000 in cash proceeds from Alara Capital AVI II, LLC, a Delaware limited liability company (the "Investor"), an investment vehicle sponsored by Active Value Investors, LLC, under a Securities Purchase Agreement entered into on October 31, 2011. Under the terms of the Securities Purchase Agreement, the Company issued 9,997 shares of its Series B Convertible Voting Perpetual Preferred Stock ("Series B Preferred Stock") to the Investor at a price of $220 per share. The Company has recorded $2.0 million as Series B

Preferred Stock on the consolidated balance sheet which is net of stock offering costs of approximately $202,000 and represents the value attributable to both the convertible preferred stock and warrants issued to the Investor. After considering the value of the warrants, the effective conversion price of the preferred stock was greater than the common stock price on date of issue and therefore no beneficial conversion feature was present.

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

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

Each share of Series B, Series C, and Series D Preferred Stock is convertible into one hundred shares of the Company’s common stock. The investor also held warrants to purchase 1,017,405 shares of common stock at an exercise price of $1.43 per share which were exercised in February and May 2015 as discussed in Note 17, Exercise of Series C and Series D Warrants.

The table below presents information as of December 24, 2016 and March 26, 2016.

Preferred Stock as of December 24, 2016 and March 26, 2016

Designated Shares	Shares Issued	Shares Outstanding	Liquidation Preference (in thousands)

Series B	10,000.00	9,997.00	9,997.00	$ 2,309
Series C	3,500.00	3,424.65	3,424.65	500
Series D	6,000.00	5,111.86	5,111.86	731
Total	19,500.00	18,533.51	18,533.51	$ 3,540

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(16) Private Placement Offering

On January 19, 2016, the Company entered into a Securities Purchase Agreement for the sale of 2,787,872 Units, each consisting of one share of common stock and a warrant to purchase 0.75 shares of common stock, to approximately 20 private investors. The purchase price for each Unit was $1.24375. Gross proceeds were approximately $3.5 million. Net proceeds to the Company after fees was approximately $3.1 million. The portion of the purchase price attributable to the common shares included in each Unit was $1.15, which was the consolidated closing bid price for the Company's common stock on January 15, 2016. The warrant price was $.09375 per Unit (equivalent to $0.125 per whole warrant share), with an exercise price of $1.15 per share. The warrants expire on January 29, 2021. Emerging Growth Equities, Ltd also received warrants to purchase 292,727 shares of common stock at an exercise price of $1.15 per share as part of its consideration for serving as placement agent in connection with the private placement.

(17) Exercise of Series C and Series D Warrants

On February 16, 2015, the Company entered into a Securities Purchase Agreement and Warrant Agreement with Alara Capital AVI II, LLC in which the Company received total gross cash proceeds of approximately $1.5 million. Funds were received from Alara in separate closings dated February 16, 2015 and February 23, 2015 in which Alara exercised a total of 1,002,818 of its existing Series C and Series D warrants to purchase common shares, all of which had an exercise price of $1.43 per share for total cash proceeds of $1,434,000, which was recorded net of $42,000 of stock issuance costs. As part of the consideration for this exercise, the Company sold to Alara two new warrants ("new Warrants") to purchase an additional 898,634 and 194,437 common shares at an exercise price of $1.78 and $1.76 per share, respectively, for a total purchase price of $137,000 or $0.125 per share, The new warrants have a term of five years and may be paid in cash or through a cashless net share settlement. The Company and Alara amended the remaining 14,587 warrants as part of the February closings. On May 14, 2015, Alara exercised the remaining 14,587 warrants by acquiring 7,216 of shares of the Company's common stock through a cashless net share settlement. The Company recorded the issuance of the new Warrants using their estimated fair value on the date of issuance. The Company estimated the fair value of the new Warrants using the Black-Scholes option valuation model with the following assumptions: expected term of 5 years, a risk-free interest rate of 1.54%, expected volatility of 90% and 0% expected dividend yield. The resulting $1.2 million from the issuance of the new Warrants was recorded as a charge to other expense in the fourth quarter of fiscal 2015.

(18) Subsequent Event

On January 5, 2017, the Company entered into a seventy seven month commercial building lease agreement for a 23,873 square feet facility in Dublin, California. The lease, estimated to begin on or about April 1, 2017, provides for base rent of approximately $41,000 per month. Total base rent payable over the lease period is approximately $3.2 million. The Company has an option to extend the term of the lease for an additional five year period. On January 12, 2017, the Company extended its current lease agreement for its 47,300 square foot facility located in San Ramon, California (which expired on December 31, 2016) through April 30, 2017 at a monthly rate of $88,000, which is equal to 150% of its previous monthly rent. The Company expects to relocate to its new facility before April 30th, 2017.

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 26, 2016 Part I, under the heading "Risk Factors", and Part II, under the heading "Management's Discussion and Analysis of Financial Conditions and Results of Operations".

Company Overview

We produce an Advanced Signal Generator (ASG) for the electronic warfare market and YIG (Yttrium, Iron, Garnet) RADAR filters used in fighter jet aircraft. We have two reporting segments: Giga-tronics Division and Microsource.

The Giga-tronics Division over the past thirty five years has produced a broad line of test and measurement equipment used primarily for the design, production, repair and maintenance of products in aerospace, telecommunications, RADAR, and electronic warfare. Giga-tronics has recently completed a move within the test and measurement market from legacy products to the newly developed ASG. As part of this evolution certain legacy product lines were sold to raise additional capital. In December of 2015 Giga-tronics sold its Power Meters, Amplifiers, and Legacy Signal Generators to Spanawave (see Note 9, Sale of Product Lines). In June of 2016 Giga-tronics sold its Switch product line to Astronics (see Note 9, Sale of Product Lines). With the sales of these legacy product lines, as of July 31, 2016 the Giga-tronics Division is solely focused on the ASG product in the test and measurement equipment market.

Microsource primarily develops and manufactures YIG RADAR filters used in fighter jet aircraft for two prime contractors. The Microsource YIG RADAR filters provide us with long term production and development contracts with strong gross margins. In recent years we have produced these RADAR filters for two fighter jet platforms, and started production for a third platform in the second quarter of the current fiscal year.

The ASG has the potential to significantly grow our sales and achieve strong gross margins. However, we have experienced significant delays developing, manufacturing, and receiving ASG customer orders. The ASG is the most technically complex and advanced product Giga-tronics has developed and manufactured, and we have experienced delays in bringing the product to market and efficiently manufacturing it. It is also priced significantly higher than any other previous Giga-tronics product, and we have experienced longer than anticipated procurement cycles in the electronic warfare market it services. The delays in the development and manufacturing of the ASG, along with the longer than anticipated procurement cycles, have contributed to the increased operating losses in fiscal 2017 and prior years. Giga-tronics could continue to experience similar losses in the current fiscal year if there are further delays in ASG features currently being developed, manufacturing efficiencies are not achieved, and customer orders are delayed. To bring the ASG to its full potential, Giga-tronics may be required to seek additional working capital; however, there are no assurances that such working capital will be available, or on terms acceptable to the Company.

Significant Orders

Both the Giga-tronics Division and Microsource receive large customer orders each year. The timing of orders, and any associated milestone achievement, causes significant differences in orders received, backlog, sales, deferred revenue, inventory, and cash flow when comparing one fiscal period to another. Below is a review of recently received significant orders:

In June 2016, the Giga-tronics Division received a $3.3 million order from the United States Navy for our Real-Time TEmS which is a combination of the ASG hardware platform, along with software developed and licensed to the Company from a major Aerospace and Defense Company. The complete order includes two ASG chassis and seven ASG blades, along with engineering services to integrate the Real-Time TEmS product with additional third party hardware and software for the customer. We expect to fulfill the order during the fourth quarter of the current fiscal year. An additional order for $542,000 was received in July 2016 from the United States Navy for our ASG hardware only platform. We fulfilled this order in the quarter ended September 24, 2016.

In July 2016, Microsource received a $1.9 million non-recurring engineering order associated with redesigning a component of its high performance YIG filter used on an aircraft platform. Of this NRE service order, we delivered approximately $256,000 and $663,000 in services during the three and nine months ended December 24, 2016 respectively, and we expect to continue such services over the next nine to twelve months.

In December 2016, the Giga-tronics Division received a $764,000 Real-Time TEmS order from one of our customers. The order was fulfilled in the quarter ended December 24, 2016.

In October 2015, the Giga-tronics Division received a $1.4 million order from a major prime contractor for our ASG. In January 2016, a $433,000 ASG follow-on order was received from the major prime contractor. The combined order was for four chassis and thirteen ASG blades. We delivered these chassis and blades in December 2015 and April 2016, respectively.

Our Giga-tronics Division received a $1.5 million order in the first quarter of fiscal 2016 from the United States Navy for our legacy Model 8003 Precision Scalar Analyzers and associated accessories. We shipped all of the $1.5 million order in the first and second quarters of fiscal 2016. The Model 8003 was designed about 25 years ago, and Giga-tronics is no longer able to purchase key components and materials used to manufacture the Model 8003. The Navy orders marked the end of life of the Model 8003 and its associated accessories.

In the first quarter of fiscal 2016, the Microsource business unit received a $3.0 million YIG RADAR filter order (Ongoing Production Order) associated with a fighter jet platform for which we have been manufacturing since fiscal 2014. We shipped all of the $3.0 million order in fiscal 2016. In the first quarter of fiscal 2017, the Microsource business unit received a $4.5 million YIG RADAR filter order for the same fighter jet platform, representing a 50% year over year increase in the order size compared to the fiscal 2016 order. We shipped approximately $1.4 million and $3.3 million of the fiscal 2017 order during the three and nine months ended December 24, 2016, respectively, and we expect to ship the remainder over the next three to six months.

In fiscal 2015 Microsource received a $6.5 million order (“NRE Order”) for non-recurring engineering and for delivery of a limited number of flight-qualified prototype hardware from a second prime defense contractor to develop a variant of our high performance fast tuning YIG RADAR filters for an aircraft platform. We completed the final milestone for the NRE Order in the second quarter of fiscal 2017. In fiscal 2016 our Microsource business unit also finalized an associated multiyear $10.0 million YIG production order (“YIG Production Order”). We started shipping a portion of the YIG Production Order in the second quarter of fiscal 2017, and we expect to continue shipping the balance through fiscal 2020.

The majority of the deliverables under the Microsource NRE Order occurred in fiscal 2015 and early fiscal 2016. We started delivering the flight-qualified prototype hardware in the second quarter of fiscal 2017.

Critical Accounting Policies

Please refer to the section of the Company’s Annual Report on Form 10-K for the year ended March 26, 2016 entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations —Critical Accounting Policies” for a discussion of our critical accounting policies. During the three and nine month periods ended December 24, 2016, there were no material changes to these policies other than as disclosed in Note 1 Organization and Significant Accounting Policies.

In preparing the consolidated financial statements, management is required to make estimates based on the information available that affect the reported amounts of assets and liabilities as of the balance sheet dates and revenues and expenses for the reporting periods. While we believe that these accounting policies and estimates are based on sound measurement criteria, actual future events can and often do result in outcomes that can be materially different from these estimates and forecasts.

Results of Operations

New orders received by segment are as follows:

NEW ORDERS

(Dollars in thousands)	Three Month Periods Ended December 24, 2016	December 26, 2015	% change
Giga-tronics Division	$1,298	$ 2,875	(55)%
Microsource	50	5	900 %
Total	$1,348	$ 2,880	(53)%

(Dollars in thousands)	Nine Month Periods Ended December 24, 2016	December 26, 2015	% change
Giga-tronics Division	$7,439	$ 7,164	4 %
Microsource	7,159	13,178	(46)%
Total	$14,598	$ 20,342	(28)%

New orders received in the third quarter of fiscal 2017 decreased by 53% to $1.3 million from the $2.9 million received in the third quarter of fiscal 2016. The Giga-tronics Division saw a $1.5 million or 55% decrease in orders. Approximately $1.1 million of the decrease is related to legacy products the Company no longer manufactures. The additional decrease is primarily driven by the timing of the receipt of orders. The Microsource business unit saw a $45,000 increase in orders in comparison to the same period in the prior year. The new orders received for both periods were all related to radar filter components.

New orders received in the first nine months of fiscal 2017 decreased by 28% to $14.6 million from the $20.3 million received in the first nine months of fiscal 2016. The Giga-tronics Division saw a $275,000 or 4% increase in orders primarily due to a $1.9 million increase in orders associated with the Company's ASG product in comparison to the first nine months of fiscal 2016. The Microsource business unit saw a 46% decrease in the first nine months of fiscal 2017 due to the receipt of a $4.5 million order for YIG RADAR filters and the receipt of a $1.9 million non-recurring engineering order in comparison to the larger $10.0 million YIG Production Order and the $3.0 million Ongoing Production Order received in the first nine months of fiscal 2016.

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

BACKLOG

(Dollars in thousands)	**December 24, 2016**	**December 26, 2015**	**% change**	
Backlog of unfilled orders at end of period:				
Giga-tronics Division	$ 4,036	$ 2,527	60	%
Microsource	12,062	11,623	4	%
Total	$ 16,098	$ 14,150	14	%
Backlog of unfilled orders shippable within one year:				
Giga-tronics Division	$ 4,036	$ 2,527	60	%
Microsource	5,222	3,263	60	%
Total	$ 9,258	$ 5,790	60	%

Backlog at the end of the third quarter of fiscal 2017 increased 14% compared to the same period end in the prior year. The Giga-tronics division saw a 60% increase in backlog primarily due to the ASG orders discussed above. Microsource saw a 4% increase in backlog in the third quarter of fiscal 2017. The increase is primarily due to the receipt of a $4.5 million YIG production Order and the receipt of a $1.9 million non-recurring engineering order in the current period.

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

ALLOCATION OF NET SALES

(Dollars in thousands)	**Three Month Periods Ended**		
	December 24,	**December 26,**	**% change**

	2016	2015	
Giga-tronics Division	$838	$ 2,692	(69)%
Microsource	2,364	1,791	32 %
Total	$3,202	$ 4,483	(29)%

	Nine Month Periods Ended		
(Dollars in thousands)	**December 24, 2016**	**December 26, 2015**	**% change**
Giga-tronics Division	$4,660	$ 6,908	(33)%
Microsource	6,377	5,013	27 %
Total	$11,037	$ 11,921	(7)%

Net sales in the third quarter of fiscal 2017 were $3.2 million, a 29% decrease from the $4.5 million in fiscal 2016. Net sales for the Giga-tronics Division decreased by $1.9 million or 69% primarily due to lower sales associated with the Company's new ASG product. ASG sales were $764,000 for the quarter compared to the $1.3 million in the third quarter of fiscal 2016. Net sales were also lower due to legacy products divestitures to Spanawave and Astronics, and a decrease associated with the Navy 8003 orders, from $1.5 million in fiscal 2016 to none in fiscal 2017 due the end of life status of the 8003 product (see Significant Orders above). Net sales for Microsource increased by $573,000 or 32% primarily due to the YIG Production Order which started shipping in the second quarter of fiscal 2017.

Net sales in the first nine months of fiscal 2017 decreased 7% to $11.0 million from the $11.9 million in the first nine months of fiscal 2016. Net sales for the Giga-tronics Division decreased by $2.2 million or 33% primarily due to the decrease in sales associated with the legacy products sold to Spanawave and Astronics, and the decrease in sales associated with the size of the Navy 8003 orders discussed above. The decrease in Giga-tronics net sales were partially offset by a $659,000 increase associated with the Company's new ASG product. Net sales for Microsource increased by $1.4 million or 27% primarily due an increase in the size of the YIG RADAR filter order over fiscal 2016 and the YIG Production Order as the filter moved into production in fiscal 2017.

Gross margin was as follows for the periods shown:

GROSS MARGIN

(Dollars in thousands)	Three Month Periods Ended December 24, 2016	December 26, 2015	% change
Gross Margin	$1,094	$ 1,615	(32)%

(Dollars in thousands)	Nine Month Periods Ended December 24, 2016	December 26, 2015	% change
Gross Margin	$3,249	$ 4,220	(23)%

Gross margin decreased in the third quarter of fiscal 2017 to $1.1 million from $1.6 million for the third quarter of fiscal 2016. The decrease was commensurate with the decrease in net sales. For the nine months ended December 24, 2016, gross margin decreased to $3.2 million from $4.2 million for the nine months ended December 26, 2015. Gross margins were negatively impacted by higher manufacturing overhead costs needed to absorb factory variances as well as the decrease in sales.

Operating expenses were as follows for the periods shown:

OPERATING EXPENSES

(Dollars in thousands)	Three Month Periods Ended December 24, 2016	December 26, 2015	% change
Engineering	$627	$ 614	2 %
Selling, general and administrative	1,077	1,417	(24)%
Total	$1,704	$ 2,031	(16)%

(Dollars in thousands)	Nine Month Periods Ended December 24, 2016	December 26, 2015	% change
Engineering	$1,724	$ 2,179	(21)%
Selling, general and administrative	3,429	4,221	(19)%
Total	$5,153	$ 6,400	(19)%

Total operating expenses decreased 16% or $327,000 in the third quarter of fiscal 2017 over fiscal 2016. Engineering expenses was relatively flat in the third quarter of fiscal 2017 in comparison to the third quarter of fiscal 2016. Selling, general and administrative expenses decreased $340,000 or 24% primarily due to a decrease of $116,000 associated with the non-cash stock based compensation; a $60,000 decrease in personnel related expenses as a result of the departure of one of our officers; a $46,000 decrease in outside services related to marketing and tradeshows and a $65,000 decrease in bonuses and commissions as a result of the sale of the legacy products to Astronics and Spanawave.

Total operating expenses decreased 19% or $1.2 million in the first nine months of fiscal 2017 over fiscal 2016. Engineering expenses decreased $455,000 or 21% primarily due to a $415,000 decrease in personnel related expenses as a result of the sale of the Switch and Legacy product lines. Selling, general and administrative decreased by $792,000 or 19% primarily due to a decrease of $495,000 associated with the non-cash stock based compensation (primarily in connection with director compensation); a $116,000 decrease in personnel related charges as a result of the departure of one of our officers; a $74,000 decrease in outside services related to management consulting and a decrease of $68,000 in bonuses and commissions as a result of the sale of the legacy products to Astronics and Spanawave.

Gain on Sale of Product Line

On June 20, 2016, the Company entered into an Asset Purchase agreement for the sale of its Switch product line to Astronics. Upon signing the agreement, Astronics paid $850,000 to the Company for the intellectual property of the product line. The Company recognized a net gain of $802,000 in the first quarter ended June 25, 2016 after related expenses were subtracted from the sales price. The gain is included in the accompanying consolidated financial statements. During the three and nine month periods ended December 24, 2016, net Switch sales were zero and $2.1 million, respectively. During the three and nine month periods ended December 26, 2015, net Switch sales were $714,000 and $1.8 million, respectively (see Note 9, Sale of Product Lines).

Derivative Liability

The Company recorded a gain of $62,000 and $136,000 in the three and nine month periods ended December 24, 2016, related to revaluation of the derivative liability associated with warrants issued with the PFG loan (see Note 7, Term Loan, Revolving Line of Credit and Warrants). The Company recorded a loss of $98,000 and $51,000 in the three and nine month periods ended December 26, 2015, related to revaluation of the derivative liability associated with warrants issued with the PFG loan.

Interest Expense

Net interest expense in the third quarter of fiscal 2017 was $27,000, a decrease of $61,000 over the third quarter of fiscal 2016. Interest expense decreased primarily due to the lower principal balance on the PFG loan. For the third quarter of fiscal 2017, interest expense includes $3,000 of accretion of discounts on the PFG loan and warrant debt compared to $34,000 recorded in the third quarter of fiscal 2016. Net interest expense in the first nine months of fiscal 2017 was $105,000, a decrease of $199,000 over the first nine months of fiscal 2016. For the first nine months of fiscal 2017, interest expense includes $21,000 of accretion of discounts on the PFG loan and warrant debt compared to $140,000 recorded in the first nine months of fiscal 2016.

Net Loss

Net loss for the third quarter of fiscal 2017 was $575,000, compared to a net loss of $602,000 recorded in the third quarter of fiscal 2016. The decrease in net loss was primarily due to the lower operating expenses in the current period in comparison to the same prior year period as discussed above. Net loss for the first nine months of fiscal 2017 was $1.1 million compared to a net loss of $2.5 million recorded in the first nine months of fiscal 2016. The decrease in net loss was primarily due to the $802,000 gain recorded associated with the sale of the Switch product line in the first quarter of fiscal 2017 as well as lower operating expenses as discussed above.

Financial Condition and Liquidity

As of December 24, 2016, Giga-tronics had $1.6 million in cash and cash equivalents, compared to $1.3 million as of March 26, 2016. Working capital was $684,000 at December 24, 2016 compared to $1.8 million at March 26, 2016. The current ratio (current assets divided by current liabilities) at December 24, 2016 was 1.07 compared to 1.23 at March 26, 2016. The decrease in working capital was primarily attributable to our net loss.

Cash provided by operating activities was $14,000 for the nine month period ended December 24, 2016. Cash provided by operating activities in the first nine months of fiscal 2017 resulted primarily from an increase of $3.7 million in deferred revenue due to advance payment arrangements for raw materials with customers, which was partially offset by a $637,000 decrease in accounts payable, increase of accounts receivable of $405,000, and increase in inventory of $394,000.

Cash used in operating activities was $795,000 for the nine month period ended December 26, 2015. Cash used in operating activities in the first nine months of 2016 was primarily attributable to an operating loss of $2.5 million, which was partially offset by a $1.5 million increase in accounts payable. Accounts payables increased as payments to vendors were deferred due to working capital constraints.

Cash provided by investing activities was $813,000 for the nine month period ended December 24, 2016. Cash provided by investing activities in the first nine months of fiscal 2017 resulted primarily from a cash payment from Astronics of $850,000 pertaining to the sale of our Switch product line, as well as a cash payment from Spanawave of $750,000 pertaining to the sale of our legacy product lines. The Company and Spanawave have been engaged in a dispute as to whether the Company has fulfilled all the requirements to close phases one through five and to the application of $375,000 related to the proposed commencement of phase 6 which was received during the first quarter of fiscal 2017. The parties are attempting to resolve this dispute, and the Company returned the $375,000 to Spanawave on July 28, 2016. The cash payments were partially offset by additions to property and equipment of $37,000 in the nine month period ended December 24, 2016.

Cash used in investing activities was $109,000 for the nine month period ended December 26, 2015. Cash used was for the equipment additions to manufacture the ASG.

Cash used in financing activities for the nine month period ended December 24, 2016 was $518,000, primarily due to the repayment of the Company’s term loan with PFG and a portion of the line of credit with Bridge Bank.

Cash provided by financing activities for the nine months ended December 26, 2015 was $517,000, primarily due to $1.2 million in proceeds from the accounts receivable line of credit with Bridge Bank (see Note 6, Accounts Receivable Line of Credit) which was partially offset by a $680,000 repayment of the Company’s term loan with PFG.

The Company incurred net losses of $575,000 for the third quarter of fiscal 2017 and $1.1 million for the first nine months of fiscal 2017, which contributed to an increase in our accumulated deficit of $25.1 million as of December 24, 2016.

The Company has experienced delays in the development of features, orders, and shipments for the new ASG. These delays have contributed, in part, to a decrease in working capital from $1.8 million at March 26, 2016, to $684,000 at December 24, 2016. The new ASG product has shipped to several customers, but potential delays in the development of features, longer than anticipated sales cycles, or the ability to efficiently manufacture the ASG, could significantly contribute to additional future losses and decreases in working capital.

To help fund operations, the Company relies, in part, on advances under the line of credit with Bridge Bank. The line of credit expires on May 7, 2017. The agreement includes a subjective acceleration clause, which allows for amounts due under the facility to become immediately due in the event of a material adverse change in the Company's business condition (financial or otherwise), operations, properties or prospects, or ability to repay the credit based on the lender's judgment. As of December 24, 2016, the line of credit had an outstanding balance of $704,000, and additional borrowing capacity of $1.7 million.

These matters raise substantial doubt as to our ability to continue as a going concern.

To address these matters, our management team has taken several actions to provide additional liquidity and reduce costs and expenses going forward. These actions are described in the following paragraphs.

On June 20, 2016, we entered into an Asset Purchase Agreement with Astronics Test Systems Inc. (Astronics), (see Note 9, Sale of Product Lines). Upon signing, Astronics paid $850,000 for the intellectual property of the product line. Astronics also purchased approximately $960,000 of related raw materials and work-in-progress inventory from the Company during of the second quarter ended September 24, 2016. Proceeds from the asset sale will be used for working capital and general corporate purposes.

In July 2016, Microsource received a $1.9 million non-recurring engineering order associated with redesigning a component of its high performance YIG filter used on an aircraft platform. The Company delivered NRE services for approximately $256,000 and $663,000, respectively, during the three and nine months ended December 24, 2016 and expects to continue such services over the next nine to twelve months.

In June 2016, the Giga-tronics Division received a $3.3 million order from the United States Navy for the Company's Real-Time Threat Emulation Systems ("TEmS") (which combines the Company's ASG hardware platform along with software developed and licensed to the Company from a major aerospace and defense company) which the Company expects to ship in the fourth quarter of fiscal 2017. In July 2016, the Giga-tronics Division also received an order for $542,000 from the United States Navy for the ASG hardware only platform. The Company fulfilled the ASG hardware only order in the quarter ended September 24, 2016.

In April 2016, Microsource received a $4.5 million YIG RADAR filter order for a fighter jet platform, representing a 50% increase compared to the customer's previous jet platform order in fiscal 2016. We shipped approximately $1.4 million and $3.3 million, respectively of fiscal 2017 order during the three months and nine months ended December 24, 2016, respectively, and we expect to ship the remainder over the next three to six months.

With the elimination of Giga-tronics Switch, Power Meter, Amplifier, and Signal Generator legacy product lines resulting from the Asset Purchase Agreements with Spanawave and Astronics, (see Note 9, Sale of Product Lines), we have been able to reduce the number of employees by approximately 20%, from 71 in November 2015 to 56 on December 24, 2016, while providing additional cash for operations from the proceeds of the sales.

Giga-tronics plans to work with Bridge Bank to renew the line of credit prior to its May 7, 2017 expiration.

In the first quarter of fiscal 2016, the Company's Microsource business unit also finalized a multiyear $10.0 million YIG production order ("YIG Production Order"). The Company started shipping the YIG Production Order in the second quarter of fiscal 2017. We shipped approximately $431,000 and $898,000 during the three and nine months ended December 24, 2016, respectively, and we expect to ship the remainder through 2020.

To assist with the upfront purchases of inventory required for future product deliveries, the Company entered into advance payment arrangements with certain customers, whereby the customers reimburse the Company for raw material purchases prior to the shipment of the finished products. The Company will continue to seek similar terms in future agreements with these customers and other customers.

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

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

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

ITEM 3 – QUANTITATI VE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Pursuant to Item 305 of Regulation S-K, the Company, as a smaller reporting company, is not required to provide the information required by this item.

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 Acting Chief Executive Officer and Principal Financial & Accounting 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 Acting Chief Executive Officer and Principal Financial & Accounting 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 Acting Chief Executive Officer and Principal Financial & Accounting 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 Acting Chief Executive Officer and its Principal Financial & Accounting Officer have concluded that as of December 24, 2016, the Company’s internal control over financial reporting was effective based on the criteria described in the “2013 COSO Internal Control – Integrated Framework.”

II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

From time to time, the Company is involved in various disputes and litigation matters that arise in the ordinary course of business.

The Company is party to an Asset Purchase Agreement dated November 25, 2015 with Spanawave Corporation under which Spanawave agreed to purchase certain product lines and associated business and assets from the Company. The Company and Spanawave have been engaged in a dispute over their respective rights and obligations under the agreement and have negotiated in an effort to resolve the dispute. The agreement calls for an aggregate purchase of $1,500,000 plus the value of inventory. The Company has received $375,000, against a contract price of $750,000, plus certain inventory payment for phases 1 through 5 of the subject businesses. Because of the dispute, the status of phase 6 (legacy signal generators), which has a contract price of another $750,000 plus the value of inventory is uncertain. On August 19, 2016, Spanawave filed an action against the Company in Contra Costa Superior Court for alleged breach of contract and alleged breach of the implied covenant of good faith and fair dealing. The complaint seeks specific performance of the agreement and damages. Spanawave’s affiliate Liberty Test Equipment also filed an arbitration claim for $440,000 under a distribution agreement between the Company and Liberty. The Company has filed cross-complaints in both the litigation and arbitration asserting breach of the respective agreements by Spanawave and Liberty. The Company had previously asserted that the distribution agreement does not extend to the products with respect to which the claim has been made. Certain customers of the lines of business sold to Spanawave are also customers of the Company’s ongoing ASG business. Continued disruption of the phase 6 signal generator business could have an adverse effect on the ASG business. The parties have negotiated in an effort to settle the dispute notwithstanding the filings. The expenses and potential liability of negotiation, any settlement or continued litigation or arbitration could have a material adverse effect on the Company.

ITEM 1A - RISK FACTORS

Our ASG product is complex and could have unknown defects or errors, which may increase our costs, harm our reputation with customers, give rise to costly litigation, or divert our resources from other purposes.

Our new advanced signal generator product is extremely complex. Despite testing, our product has contained defects and errors and may in the future contain defects, errors, or performance problems when first introduced, when new versions or enhancements are released, or even after these products have been used by our customers for a period of time. These problems could result in expensive and time-consuming design modifications or warranty charges, delays in the introduction of new products or enhancements, significant increases in our service and maintenance costs, diversion of our personnel’s attention from our product development efforts, exposure to liability for damages, damaged customer relationships, and harm to our reputation, any of which could materially harm our results of operations. In addition, increased development and warranty costs could be substantial and could reduce our operating margins.

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There has been no other material change in the risk factors disclosed in the registrant's Annual Report on Form 10-K for the fiscal year ended March 26, 2016.

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

None other than as previously reported.

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

	Certification of Principal Financial Officer pursuant to Section 906 of Sarbanes-Oxley Act.
101.INS**	XBRL Instance
101.SCH**	XBRL Taxonomy Extension Schema
101.CAL**	XBRL Taxonomy Extension Calculation
101.DEF**	XBRL Taxonomy Extension Definition
101.LAB**	XBRL Taxonomy Extension Labels
101.PRE**	XBRL Taxonomy Extension Presentation

SIGNATURES

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

		GIGA-TRONICS INCORPORATED (Registrant)
		By:
Date:	February 6, 2017	/s/ William J. Thompson William J. Thompson Acting Chief Executive Officer (Principal Executive Officer)
Date:	February 6, 2017	/s/ Temi Oduozor Temi Oduozor Corporate Controller (Principal Accounting & Financial Officer)