

GIGA TRONICS INC
Form 10-Q
February 04, 2011

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

FORM 10-Q

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

For the quarterly period ended December 25, 2010

or

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

For the transition to
period from

Commission File No. 0-12719

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

California
(State or other jurisdiction of incorporation or
organization)

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

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

94583
(Zip Code)

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

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

Yes No

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

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Part I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

| (In thousands except share data) | December 25, 2010 | March 27, 2010 |
|--|-------------------|----------------|
| Assets | | |
| Current assets | | |
| Cash and cash-equivalents | \$ 2,786 | \$ 3,074 |
| Trade accounts receivable, net of allowance of \$207 and \$95, respectively | 3,318 | 4,332 |
| Inventories, net | 5,686 | 5,803 |
| Prepaid expenses and other current assets | 195 | 383 |
| Deferred income tax | 2,017 | - |
| Total current assets | 14,002 | 13,592 |
| Property and equipment, net | 566 | 311 |
| Deferred income tax - long term | 11,620 | - |
| Other assets | 16 | 16 |
| Total assets | \$ 26,204 | \$ 13,919 |
| Liabilities and shareholders' equity | | |
| Current liabilities | | |
| Accounts payable | 904 | 881 |
| Accrued commission | 99 | 227 |
| Accrued payroll and benefits | 565 | 698 |
| Accrued warranty | 154 | 139 |
| Deferred revenue | 1,037 | 2,682 |
| Deferred rent | 144 | - |
| Capital lease obligation | 107 | 57 |
| Other current liabilities | 147 | 225 |
| Total current liabilities | 3,157 | 4,909 |
| Long term obligations - deferred rent | 170 | 31 |
| Long term obligations - capital lease | 24 | 36 |
| Total liabilities | 3,351 | 4,976 |
| Commitments | | |
| Shareholders' equity | | |
| Preferred stock of no par value; Authorized 1,000,000 shares; no shares outstanding | | |
| at December 25, 2010 and March 27, 2010 | - | - |
| Common stock of no par value; Authorized 40,000,000 shares; 4,966,682 shares at December 25, 2010 and 4,891,394 shares at March 27, 2010 | | |
| issued and outstanding | 14,353 | 13,979 |
| Retained earnings (accumulated deficit) | 8,500 | (5,036) |
| Total shareholders' equity | 22,853 | 8,943 |
| Total liabilities and shareholders' equity | \$ 26,204 | \$ 13,919 |

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

| | Three Months Ended | | Nine Months Ended | |
|---------------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| | December 25, 2010 | December 26, 2009 | December 25, 2010 | December 26, 2009 |
| (In thousands except per-share data) | | | | |
| Net sales | \$ 4,640 | \$ 4,784 | \$ 14,090 | \$ 13,876 |
| Cost of sales | 2,574 | 2,730 | 8,181 | 7,595 |
| Gross margin | 2,066 | 2,054 | 5,909 | 6,281 |
| Engineering | 559 | 313 | 1,608 | 1,057 |
| Selling, general and administrative | 1,493 | 1,424 | 4,406 | 4,189 |
| Total operating expenses | 2,052 | 1,737 | 6,014 | 5,246 |
| Operating income (loss) | 14 | 317 | (105) | 1,035 |
| Other expense, net | - | - | - | (1) |
| Interest income (expense), net | 4 | (7) | 4 | (16) |
| Income (loss) before income taxes | 18 | 310 | (101) | 1,018 |
| Provision (benefit) for income taxes | 29 | 1 | (13,637) | 3 |
| Net (loss) income | \$ (11) | \$ 309 | \$ 13,536 | \$ 1,015 |
| (Loss) earnings per share - basic | \$ (0.00) | \$ 0.06 | \$ 2.75 | \$ 0.21 |
| (Loss) earnings per share - diluted | \$ (0.00) | \$ 0.06 | \$ 2.70 | \$ 0.21 |
| Shares used in per share calculation: | | | | |
| Basic | 4,946 | 4,846 | 4,920 | 4,833 |
| Diluted | 4,946 | 4,940 | 5,014 | 4,865 |

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| (In thousands) | Nine Months Ended | |
|--|-------------------|-------------------|
| | December 25, 2010 | December 26, 2009 |
| Cash flows from operations: | | |
| Net income | \$ 13,536 | \$ 1,015 |
| Adjustments to reconcile net income to net cash (used in) provided by operations: | | |
| Depreciation and amortization | 107 | 109 |
| Loss on sale of fixed asset | - | 1 |
| Deferred income taxes | (13,637) | - |
| Share-based compensation | 227 | 130 |
| Change in deferred rent | 283 | (117) |
| Changes in operating assets and liabilities | (627) | (734) |
| Net cash (used in) provided by operations | (111) | 404 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (362) | (68) |
| Net cash used in investing activities | (362) | (68) |
| Cash flows from financing activities: | | |
| Issuance of common stock and related tax benefits | 147 | 115 |
| Proceeds from line of credit | - | 500 |
| Proceeds (payments) on capital lease | 38 | (12) |
| Net cash provided by financing activities | 185 | 603 |
| (Decrease) increase in cash and cash equivalents | (288) | 939 |
| Beginning cash and cash equivalents | 3,074 | 1,518 |
| Ending cash and cash equivalents | \$ 2,786 | \$ 2,457 |
| Supplementary disclosure of cash flow information: | | |
| Cash paid for income taxes | \$ 2 | \$ 3 |
| Cash paid for interest | 3 | 20 |

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The condensed consolidated financial statements included herein have been prepared by Giga-tronics Incorporated (the "Company"), pursuant to the rules and regulations of the Securities and Exchange Commission. The consolidated results of operations for the interim periods shown in this report are not necessarily indicative of results to be expected for the fiscal year. In the opinion of management, the information contained herein reflects all adjustments (consisting of only normal recurring accruals) 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 27, 2010.

Certain prior period amounts have been reclassified to conform with the current period's presentation.

(2) Revenue Recognition

The Company records revenue when there is persuasive evidence of an arrangement, delivery has occurred, the price is fixed and determinable, and collectability is reasonably assured. This occurs when products are shipped or the customer accepts title transfer. If the arrangement involves acceptance terms, the Company defers revenue until product acceptance is received. On certain large development contracts, revenue is recognized upon achievement of substantive milestones. Determining whether a milestone is substantive is a matter of judgment and that assessment is performed only at the inception of the arrangement. The consideration earned from the achievement of a milestone must meet all of the following for the milestone to be considered substantive:

- a. It is commensurate with either of the following:
 1. The Company's performance to achieve the milestone
 2. The enhancement of the value of the delivered item or items as a result of a specific outcome resulting from the Company's performance to achieve the milestone.
- b. It related solely to past performance.
- c. It is reasonable relative to all of the deliverables and payment terms (including other potential milestone consideration) within the arrangement.

Milestones for revenue recognition are agreed upon with the customer prior to the start of the contract and some milestones will be tied to product shipping while others will be tied to design review.

The Company provides for estimated costs that may be incurred for product warranties at the time of shipment. The Company's warranty policy generally provides one to three years depending on the product. The estimated cost of warranty coverage is based on the Company's actual historical experience with its current products or similar products. For new products, the required reserve is based on historical experience of similar products until such time as sufficient historical data has been collected on the new product. Adjustments are made as new information becomes available.

(3) Inventories

Inventory is comprised of the following at December 25, 2010 and March 27, 2010.

| (In thousands) | December 25, 2010 | March 27, 2010 |
|-------------------------|-------------------|----------------|
| Raw materials | \$ 3,422 | \$ 3,337 |
| Work-in-progress | 1,756 | 1,930 |
| Finished goods | 87 | 128 |
| Demonstration inventory | 421 | 408 |
| Total | \$ 5,686 | \$ 5,803 |

(4) Earnings (Loss) Per Share

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

| (In thousands except per-share data) | Three Months Ended | | Nine Months Ended | |
|---|--------------------|-------------------|-------------------|-------------------|
| | December 25, 2010 | December 26, 2009 | December 25, 2010 | December 26, 2009 |
| Net (loss) income | \$ (11) | \$ 309 | \$ 13,536 | \$ 1,015 |
| Weighted average: | | | | |
| Common shares outstanding | 4,946 | 4,846 | 4,920 | 4,833 |
| Potential common shares | - | 94 | 94 | 32 |
| Common shares assuming dilution | 4,946 | 4,940 | 5,014 | 4,865 |
| Net (loss) income per share of common stock | \$ (0.00) | \$ 0.06 | \$ 2.75 | \$ 0.21 |
| Net (loss) income per share of common stock assuming dilution | \$ (0.00) | \$ 0.06 | \$ 2.70 | \$ 0.21 |
| Stock options not included in computation that could potentially dilute basic EPS in the future | 927 | 443 | 487 | 664 |
| Restricted stock awards not included in computation that could potentially dilute basic EPS in the future | 90 | - | 90 | - |

The number of stock options not included in the computation of diluted EPS for the three month period ended December 25, 2010 is a result of the Company's loss from continuing operations and, therefore, the options are antidilutive. The number of stock options not included in the computation of diluted EPS for nine month periods ended December 25, 2010 and the three and nine month periods ended December 26, 2009 that could potentially dilute basic EPS in the future reflect stock options where the 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 of the common shares and are, therefore, antidilutive. The number of restricted stock awards not included in the computation of diluted EPS for the three and nine month periods ended December 25, 2010 reflect contingently issuable shares for

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which the performance conditions necessary for the awards to vest had not been met as of December 25, 2010. The weighted average exercise price of excluded options for the three and nine month periods ended December 25, 2010 was \$1.96 and \$2.23, respectively. The weighted average exercise price of excluded options for the three and nine month periods ended December 26, 2009 was \$2.28 and \$2.13, respectively.

(5) Share Based Compensation

The Company has established the 2000 Stock Option Plan and the 2005 Equity Incentive Plan, each of which provided for the granting of options for up to 700,000 shares of Common Stock. The Company records compensation cost associated with share-based compensation equivalent to the estimated fair value of the awards over the requisite service period. There were 5,000 options granted in each of the three month periods ended December 25, 2010 and December 26, 2009. There were 140,000 options granted in the nine month period ended December 25, 2010 with a weighted average grant date fair value of \$1.60. There were 203,500 options granted in the nine month period ended December 26, 2009 with a weighted average grant date fair value of \$1.27. There were 90,000 restricted stock awards granted in the nine month period ended December 25, 2010 and no restricted stock awards granted in the nine month period ended December 26, 2009. The restricted stock awards are considered fixed awards as the number of shares and fair value is known at the grant date and the fair value at the grant date is amortized over the requisite service period net of estimated forfeitures. The restricted stock awards are performance-based and one-third will vest annually through 2013 only if certain sales and profit goals are achieved by the Company. The weighted average grant date fair value of awards granted during the nine months ended December 25, 2010 was \$2.34. No compensation cost was recognized for restricted stock awards during the three and nine months ended December 25, 2010 and December 26, 2009 because management believes it is not more likely than not that the performance criteria will be met.

Cash flows resulting from the tax benefits derived from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) are classified as cash flows from financing activities in the statement of cash flows. These excess tax benefits were not significant for the Company for each of the three and nine months ended December 25, 2010 and December 26, 2009.

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

| | Three Months Ended | | Nine Months Ended | |
|-------------------------|--------------------|-------------------|-------------------|-------------------|
| | December 25, 2010 | December 26, 2009 | December 25, 2010 | December 26, 2009 |
| Dividend yield | None | None | None | None |
| Expected volatility | 94.79 % | 96.20 % | 101.15 % | 95.16 % |
| Risk-free interest rate | 0.74 % | 1.40 % | 1.13 % | 1.54 % |
| Expected term (years) | 3.75 | 3.75 | 3.17 | 3.75 |

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 terms based on the expected term of the option on the date of grant.

A summary of the changes in stock options outstanding for the nine month period ended December 25, 2010 and the year ended March 27, 2010 is as follows:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Terms (Years) | Average Intrinsic Value |
|----------------------------------|---------|---------------------------------------|---|-------------------------------|
| Outstanding at March 28, 2009 | 747,900 | \$ 1.91 | 2.7 | \$ 2,795 |
| Granted | 320,500 | 2.07 | | |
| Exercised | 67,373 | 1.85 | | |
| Forfeited / Expired | 133,000 | 2.46 | | |
| Outstanding at March 27, 2010 | 868,027 | \$ 1.89 | 3.0 | \$ 332,127 |
| Granted | 140,000 | 2.41 | | |
| Exercised | 75,288 | 1.95 | | |
| Forfeited / Expired | 5,625 | 2.04 | | |
| Outstanding at December 25, 2010 | 927,114 | \$ 1.96 | 2.7 | \$ 596,711 |
| Exercisable at December 25, 2010 | 420,989 | \$ 1.84 | 1.4 | \$ 323,251 |

As of December 25, 2010, there was \$418,000 of total unrecognized compensation cost related to non-vested options granted under the plans. That cost is expected to be recognized over a weighted average period of 1.18 years. There were 48,625 options that vested during the quarter ended December 25, 2010. There were 48,250 options that vested during the quarter ended December 26, 2009. The total fair value of options vested during each of the quarters ended December 25, 2010 and December 26, 2009 was \$71,000 and \$70,000, respectively. Cash received from the exercise of stock options for the nine month periods ended December 25, 2010 and December 26, 2009 was \$147,000 and \$115,000, respectively. The share-based compensation cost recognized during the three months ended December 25, 2010 and December 26, 2009 totaled \$91,000 and \$50,000, respectively. The share-based compensation cost recognized during the nine months ended December 25, 2010 and December 26, 2009 totaled \$227,000 and \$130,000, respectively.

(6) Industry Segment Information

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

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The tables below present information for the three and nine month periods ended December 25, 2010 and December 26, 2009.

| (In thousands) | Three Months Ended December 25, 2010 | | | Three Months Ended December 26, 2009 | | |
|-----------------------|---|-----------|-------------------------|---|-----------|-------------------------|
| | Assets | Net Sales | Net Income (Loss) | Assets | Net Sales | Net Income (Loss) |
| Giga-tronics Division | \$ 21,544 | \$ 2,988 | \$ (77) | \$ 7,276 | \$ 2,863 | \$ (99) |
| Microsource | 4,660 | 1,652 | 66 | 6,111 | 1,921 | 408 |
| Total | \$ 26,204 | \$ 4,640 | \$ (11) | \$ 13,387 | \$ 4,784 | \$ 309 |

| (In thousands) | Nine Months Ended December 25, 2010 | | | Nine Months Ended December 26, 2009 | | |
|-----------------------|--|-----------|-------------------------|--|-----------|-------------------------|
| | Assets | Net Sales | Net Income (Loss) | Assets | Net Sales | Net Income (Loss) |
| Giga-tronics Division | \$ 21,544 | \$ 8,036 | \$ 13,294 | \$ 7,276 | \$ 8,604 | \$ (133) |
| Microsource | 4,660 | 6,054 | 242 | 6,111 | 5,272 | 1,148 |
| Total | \$ 26,204 | \$ 14,090 | \$ 13,536 | \$ 13,387 | \$ 13,876 | \$ 1,015 |

(7) Warranty Obligations

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

| (In thousands) | Three Months Ended | | Nine Months Ended | |
|--------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| | December 25, 2010 | December 26, 2009 | December 25, 2010 | December 26, 2009 |
| Balance at beginning of period | \$ 126 | \$ 177 | \$ 139 | \$ 177 |
| Provision, net | 83 | 19 | 140 | 70 |
| Warranty costs incurred | (55) | (27) | (125) | (78) |
| Balance at end of period | \$ 154 | \$ 169 | \$ 154 | \$ 169 |

(8) Income Taxes

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

The Company's tax benefit for the nine months ending December 25, 2010 was \$13,637,000. The effective tax rate for the nine months ending December 26, 2009 was 0% due to a valuation allowance recorded against the net deferred tax asset balance. During the first quarter of 2011, the Company performed an analysis of the need for a valuation allowance, and management determined that it was more likely than not that the deferred tax assets would be realized in the future. Accordingly, the valuation allowance has been removed and a deferred tax benefit of \$13,569,000 was recognized on the Consolidated Statement of Operations during the three months ended June 26, 2010.

As of December 25, 2010, the Company recorded unrecognized tax benefits of \$799,000 related to uncertain tax positions. The unrecognized tax benefit is netted against the non-current deferred tax asset on the Consolidated Balance Sheet. The Company has not recorded a liability for any penalties or interest related to

the unrecognized tax benefits. The Company is not currently undergoing any audits by the tax authorities and does not expect the liability for unrecognized tax benefits to change materially within the next 12 months.

(9) Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2009-13, Multiple-Deliverable Revenue Arrangements. The objective of this Update is to address the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. Vendors often provide multiple products or services to their customers. Those deliverables often are provided at different points in time or over different time periods. Subtopic 605-25, Revenue Recognition—Multiple-Element Arrangements, establishes the accounting and reporting guidance for arrangements under which the vendor will perform multiple revenue-generating activities. Specifically, this Subtopic addresses how to separate deliverables and how to measure and allocate arrangement consideration to one or more units of accounting. The amendments in this Update will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. Management is currently assessing the impact this Update will have on the Company's financial condition, operations and cash flows.

In April 2010, the FASB issued Accounting Standards Update No. 2010-17, Revenue Recognition-Milestone Method. The objective of this Update is to provide guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. Research or development arrangements frequently include payment provisions whereby a portion or all of the consideration is contingent upon milestone events such as successful completion of phases or achieving a specific result from the research or development efforts. An entity often recognizes these milestone payments as revenue in their entirety upon achieving the related milestone, commonly referred to as the milestone method. The amendments in this Update will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. Management is currently assessing the impact this Update will have on the Company's financial condition, operations and cash flows.

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 27, 2010 Part I, under the heading "Certain Factors Which May Adversely Affect Future Operations or an Investment in Giga-tronics", and Part II, under the heading "Management's Discussion and Analysis of Financial Conditions and Results of Operations".

Overview

Giga-tronics produces instruments, subsystems and sophisticated microwave components that have broad applications in both defense electronics and wireless telecommunications. In fiscal 2011, the Company consisted of two operating and reporting segments: Giga-tronics Division and Microsource.

Our business is highly dependent on government spending in the defense electronics sector and on the wireless telecommunications market. The Company has seen a decrease in orders for the first nine months of fiscal 2011 versus the first nine months of fiscal 2010. Commercial orders improved during this period as compared to the same period last year, while defense orders declined.

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

Results of Operations

New orders received, net of orders cancelled by segment, are as follows for the periods shown:

NEW ORDERS, NET

| (Dollars in thousands) | Three Months Ended | | % change |
|------------------------|----------------------|----------------------|----------|
| | December 25, 2010 | December 26, 2009 | |
| Giga-tronics Division | \$ 6,599 | \$ 2,052 | 222 % |
| Microsource | (378) | 5,663 | (107 %) |
| Total | \$ 6,221 | \$ 7,715 | (19 %) |

| (Dollars in thousands) | Nine Months Ended | | % change |
|------------------------|----------------------|----------------------|----------|
| | December 25, 2010 | December 26, 2009 | |
| Giga-tronics Division | \$ 11,432 | \$ 8,675 | 32 % |
| Microsource | 1,478 | 6,423 | (77 %) |
| Total | \$ 12,910 | \$ 15,098 | (14 %) |

New orders received, net of orders cancelled in the third quarter of fiscal 2011 decreased by 19% to \$6,221,000 from the \$7,715,000 received in the third quarter of fiscal 2010. New orders received, net of orders cancelled, for the nine months ended December 25, 2010 decreased 14% to \$12,910,000 from the \$15,098,000 received for the same period a year ago. Orders at Giga-tronics Division increased for the three and nine month periods ended December 25, 2010 primarily due to an increase in commercial orders whereas orders at Microsource decreased for the three and nine month periods ended December 25, 2010 primarily due to a decrease in new military orders and cancellation of previous quarter's backlog.

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

BACKLOG

| (Dollars in thousands) | Three Months Ended | | % change |
|--|----------------------|----------------------|----------|
| | December 25, 2010 | December 26, 2009 | |
| Backlog of unfilled orders | \$ 7,316 | \$ 10,327 | (29 %) |
| Backlog of unfilled orders shippable within one year | 6,694 | 8,592 | (22 %) |
| Previous fiscal year end (FYE) long term backlog reclassified during year as shippable within one year | 587 | 433 | 36 % |
| Net cancellations during year of | | | |

| | | | | |
|-------------------------------|-----|---|-----|---|
| previous FYE one-year backlog | 460 | - | 100 | % |
|-------------------------------|-----|---|-----|---|

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Backlog at the end of the third quarter of fiscal 2011 decreased 29% as compared to the end of the same period last year. This is due to the completion of the Boeing 5 year contract and the completion of the 2 year F-15 contract. The backlog cancellation this quarter was a result of the F/a-18's RFTF spares order originally for 16 units was reduced to 2 units.

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

ALLOCATION OF NET SALES

| (Dollars in thousands) | Three Months Ended | | % change |
|------------------------|--------------------|-------------------|----------|
| | December 25, 2010 | December 26, 2009 | |
| Giga-tronics Division | \$ 2,988 | \$ 2,863 | 4 % |
| Microsource | 1,652 | 1,921 | (14 %) |
| Total | \$ 4,640 | \$ 4,784 | (3 %) |

| (Dollars in thousands) | Nine Months Ended | | % change |
|------------------------|-------------------|-------------------|----------|
| | December 25, 2010 | December 26, 2009 | |
| Giga-tronics Division | \$ 8,036 | \$ 8,604 | (7 %) |
| Microsource | 6,054 | 5,272 | 15 % |
| Total | \$ 14,090 | \$ 13,876 | 2 % |

Fiscal 2011 third quarter net sales were \$4,640,000, a 3% decrease from the \$4,784,000 in the third quarter of fiscal 2010. Sales at Giga-tronics Division increased 4% or \$125,000 primarily due to an increase in commercial shipments. Sales at Microsource decreased 14% or \$269,000 during the third quarter of fiscal 2011 versus the third quarter of fiscal 2010 primarily due to a decrease in military shipments.

Net sales for the nine month period ended December 25, 2010 were \$14,090,000, a 2% increase from the \$13,876,000 in the nine month period ended December 26, 2009. Sales at Giga-tronics Division decreased 7% or \$568,000 primarily due to a decrease in military shipments. Sales at Microsource increased 15% or \$782,000 during the first nine months of fiscal 2011 versus the first nine months of fiscal 2010 primarily due to an increase in military shipments.

Cost of sales was as follows for the periods shown:

COST OF SALES

| (Dollars in thousands) | Three Months Ended | | % change |
|------------------------|--------------------|-------------------|----------|
| | December 25, 2010 | December 26, 2009 | |
| Cost of sales | \$ 2,574 | \$ 2,730 | (6 %) |

| (Dollars in thousands) | Nine Months Ended | | % change |
|------------------------|-------------------|-------------------|----------|
| | December 25, 2010 | December 26, 2009 | |
| Cost of sales | \$ 8,181 | \$ 7,595 | 8 % |

In the third quarter of fiscal 2011, cost of sales decreased 6% to \$2,574,000 from \$2,730,000 for the same period last year due to a favorable change in product mix and lower volume. Cost of sales as a percentage of sales improved by 1.6% for the third quarter of fiscal 2011 to 55.5% compared to 57.1% for the third quarter of fiscal 2010.

For the nine months ended December 25, 2010, cost of sales increased 8% to \$8,181,000 from \$7,595,000 for the similar period ended December 26, 2009 due to increased volume and a less favorable product mix. Cost of sales as a percentage of sales increased by 3.3% for the first nine months of fiscal 2011 to 58.0% compared to 54.7% from the same period of fiscal 2010.

Operating expenses were as follows for the fiscal periods shown:

OPERATING EXPENSES

| (Dollars in thousands) | Three Months Ended | | % change |
|-------------------------------------|----------------------|----------------------|----------|
| | December 25, 2010 | December 26, 2009 | |
| Engineering | \$ 559 | \$ 313 | 79 % |
| Selling, general and administrative | 1,493 | 1,424 | 5 % |
| Total | \$ 2,052 | \$ 1,737 | 18 % |

| (Dollars in thousands) | Nine Months Ended | | % change |
|-------------------------------------|----------------------|----------------------|----------|
| | December 25, 2010 | December 26, 2009 | |
| Engineering | \$ 1,608 | \$ 1,057 | 52 % |
| Selling, general and administrative | 4,406 | 4,189 | 5 % |
| Total | \$ 6,014 | \$ 5,246 | 15 % |

Operating expenses increased 18% or \$315,000 in the third quarter of fiscal 2011 over fiscal 2010 due to an increase of \$246,000 in product development expenses and an increase of \$69,000 in selling, general and administrative expense. The increase in product development expenses is due to lower customer funded projects. The increase in selling, general and administrative expense is a result of higher administrative expenses of \$120,000 offset by a decrease of \$28,000 in sales commission expenses and a decrease of \$23,000 in marketing expenses.

Operating expenses increased 15% or \$768,000 for the first nine months of fiscal 2011 over fiscal 2010 due to an increase of \$551,000 in product development expenses and an increase of \$217,000 in selling, general and administrative expense. The increase in product development expenses is due to lower customer funded projects. The increase in selling, general and administrative expense is a result of higher administrative expenses of \$199,000 and higher marketing of \$137,000 offset by a decrease of \$119,000 in sales commission expenses.

The Company recorded a net loss of \$11,000 or \$0.00 per fully diluted share for the third quarter of fiscal 2011 compared to a net profit of \$309,000 or \$0.06 per fully diluted share in the same period last year. Provision for income taxes incurred for the third quarters of fiscal 2011 and fiscal 2010 was \$29,000 and \$1,000, respectively.

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The following provides a reconciliation of GAAP to non-GAAP net income (loss).

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|-------------------|-------------------|-------------------|
| | December 25, 2010 | December 26, 2009 | December 25, 2010 | December 26, 2009 |
| (In thousands except per-share data) | | | | |
| Net (loss) income as reported | \$ (11) | \$ 309 | \$ 13,536 | \$ 1,015 |
| Share based compensation, net of related tax benefit | 86 | 50 | 199 | 130 |
| Net income non-GAAP | \$ 75 | \$ 359 | \$ 13,735 | \$ 1,145 |
| Basic (loss) earnings per share as reported | \$ (0.00) | \$ 0.06 | \$ 2.75 | \$ 0.21 |
| Impact of share-based compensation on earnings per share | 0.02 | 0.01 | 0.04 | 0.03 |
| Basic earnings per share non-GAAP | \$ 0.02 | \$ 0.07 | \$ 2.79 | \$ 0.24 |
| Diluted (loss) earnings per share as reported | \$ (0.00) | \$ 0.06 | \$ 2.70 | \$ 0.21 |
| Impact of share-based compensation on earnings per share | 0.02 | 0.01 | 0.04 | 0.03 |
| Diluted earnings per share non-GAAP | \$ 0.02 | \$ 0.07 | \$ 2.74 | \$ 0.24 |
| Shares used in per share calculation: | | | | |
| Basic | 4,946 | 4,846 | 4,920 | 4,833 |
| Diluted | 4,946 | 4,940 | 5,014 | 4,865 |

Non-GAAP net income, which excludes the after-tax effect of share-based compensation, for the three month period ended December 25, 2010 would have been \$86,000 higher or \$75,000. Non-GAAP basic and diluted loss per share would have been \$0.02 compared to a loss of \$0.00 as reported. For the same period last year, the Company's non-GAAP net income would have been \$50,000 higher or \$359,000. Non-GAAP basic and diluted earnings per share would have been \$0.07 compared to \$0.06 as reported.

Non-GAAP net income, which excludes the after-tax effect of share-based compensation, for the nine month period ended December 25, 2010 would have been \$199,000 higher or \$13,735,000. Non-GAAP basic earnings per share would have been \$2.79 compared to \$2.75 as reported. Non-GAAP diluted earnings per share would have been \$2.74 compared to \$2.70 as reported. For the same period last year, the Company's non-GAAP net income would have been \$130,000 higher or \$1,145,000. Non-GAAP basic and diluted earnings per share would have been \$0.24 compared to \$0.21 as reported.

Management has included this information as this expense is a non-cash item with no net equity impact.

Deferred Tax Assets

Deferred tax assets are subject to a valuation allowance when management is unable to conclude that its deferred tax assets will more likely than not be realized from the results of operations. The Company has reviewed all available evidence (both positive and negative) as described in Accounting Standards Codification 740. The Company had demonstrated consistent pre-tax book income for the past seven quarters when the valuation allowance on deferred tax assets was reversed in the first quarter of FY 2011 and does not have cumulative losses over the past three years. Even with the second quarter pre-tax loss, the Company's FY 2011 Budget and Strategic Plans for FY 2012 and FY 2013 are all forecasted to be profitable. The Company continues to maintain a two year backlog of orders for its

YIG (Yttrium, Iron, Garnet) filters and currently expects to continue receiving such orders. Its legacy Model 8003 precision scalar analyzer continues to receive orders from the U.S. Navy one of which was booked for \$1.1 million in the first quarter.

The Company is now serving a new market in the consumer wireless handheld telecommunication market with its high volume production automation switch for which it received several small orders in the first quarter which is expected to lead to much larger orders in the future. The Company has entered the semiconductor market with its new integrated switch product for testing thin-film memory storage components. The Test and Measurement market is forecasted to grow at the rate of 4% per year, per industry forecasting experts. The Company has no known contingencies or unsettled circumstances. The ultimate realization of deferred tax assets is dependent upon generation of future taxable income during the periods in which those temporary differences become deductible. Management considers projected future taxable income and tax planning strategies in making this assessment. Based on historical income and projections for future taxable income over the periods in which the deferred tax assets become deductible, management believes the Company is more likely than not to realize benefits of these deductible differences. Management has, therefore, reversed the valuation allowance against its deferred tax assets, resulting in an income tax benefit of \$13,637,000 for the nine month period ended December 25, 2010. Gross unrecognized tax benefit changed from \$120,000 at March 27, 2010 to approximately \$799,000 at December 25, 2010 due to additional amounts established for Federal and California tax credits.

Financial Condition and Liquidity

As of December 25, 2010, the Company had \$2,786,000 in cash and cash equivalents, compared to \$3,074,000 as of March 27, 2010.

Working capital at December 25, 2010 was \$10,845,000 compared to \$8,683,000 at March 27, 2010. The increase in working capital was primarily due to an increase in deferred taxes and a decrease in deferred revenue, offset by a decrease in accounts receivable in fiscal 2011.

The Company's current ratio (current assets divided by current liabilities) at December 25, 2010 was 4.44 compared to 2.77 on March 27, 2010.

Cash used in operations amounted to \$111,000 for the nine months ended December 25, 2010. Cash provided by operations amounted to \$404,000 in the same period of fiscal 2010. Cash used in operations in the first nine months of fiscal 2011 is primarily attributed to a decrease in deferred revenue. Cash provided by operations in the first nine months of fiscal 2010 was primarily attributed to increases in accounts receivable and inventory and an increase in deferred revenue.

Additions to property and equipment were \$362,000 in the first nine months of fiscal 2011 compared to \$68,000 for the same period last year. The capital equipment spending in fiscal 2011 was due to an upgrade of capital equipment.

On June 15, 2010, the Company renewed its secured revolving line of credit for \$1,500,000, with interest payable at prime rate plus 1%. The borrowing under this line of credit is based on the Company's accounts receivable and is secured by all of the assets of the Company. The Company was in compliance with all required covenants at December 25, 2010. During the nine months ended December 25, 2010 the Company did not utilize the line of credit. The Company borrowed \$500,000 under this line of credit during the nine month period ended December 26, 2009.

Recent Accounting Pronouncements

For a discussion of recent accounting pronouncements, see Note 9 to the Condensed Consolidated Financial Statements included in this report.

Item 3 – Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4T - Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures provide reasonable assurances that 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 are effective to ensure that information required to be disclosed in the reports that the company files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. 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.

Part II - OTHER INFORMATION

Item 1 - Legal Proceedings

As of December 25, 2010, the Company has no material pending legal proceedings. From time to time, the Company is involved in various disputes and litigation matters that arise in the ordinary course of business.

Item 1a - Risk Factors

There has been no material change in the risk factors disclosed in the registrant's Annual Report on Form 10-K for the fiscal year ended March 27, 2010.

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

None.

Item 3 - Defaults Upon Senior Securities

None.

Item 4 - Submission of Matters to a Vote of Security Holders

None.

Item 5 - Other Information

None.

Item 6 - Exhibits

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

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

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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 4, 2011

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

Date: February 4, 2011

/s/ Patrick J. Lawlor
Patrick J. Lawlor
Vice President Finance/
Chief Financial Officer & Secretary
(Principal Accounting Officer)

