GIGA TRONICS INC
Form 10-Q
February 05, 2010

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 26, 2009

or

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

Commission File No. 0-12719

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

| | |
|---|---|
| California | 94-2656341 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 4650 Norris Canyon Road, San Ramon, CA | 94583 |
| (Address of principal executive offices) | (Zip Code) |

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

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 [ 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 | [ ] | Smaller reporting company | [ X ] |

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).
Yes [ ] No [ X ]

There were a total of 4,885,271 shares of the Registrant's Common Stock outstanding as of February 1, 2010.

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Part I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

| (In thousands except share data) | | December 26, 2009 | | March 28, 2009 |
|---|---|---|---|---|
| Assets | | | | |
| Current assets | | | | |
| Cash and cash-equivalents | $ | 2,457 | $ | 1,518 |
| Trade accounts receivable, net of allowance | | | | |
| of $146 and $102, respectively | | 4,187 | | 3,110 |
| Inventories, net | | 6,229 | | 5,409 |
| Prepaid expenses and other current assets | | 234 | | 430 |
| Total current assets | | 13,107 | | 10,467 |
| | | | | |
| Property and equipment, net | | 264 | | 306 |
| Other assets | | 16 | | 16 |
| Total assets | $ | 13,387 | $ | 10,789 |
| | | | | |
| Liabilities and shareholders' equity | | | | |
| Current liabilities | | | | |
| Line of credit | $ | 500 | $ | - |
| Accounts payable | | 569 | | 1,219 |
| Accrued commission | | 193 | | 144 |
| Accrued payroll and benefits | | 688 | | 397 |
| Accrued warranty | | 169 | | 177 |
| Deferred revenue | | 2,276 | | 959 |
| Deferred rent | | 32 | | 118 |
| Capital lease obligation | | 16 | | 16 |
| Other current liabilities | | 274 | | 306 |
| Total current liabilities | | 4,717 | | 3,336 |
| Long term obligations - Deferred rent | | 65 | | 96 |
| Long term obligations - Capital lease | | 13 | | 25 |
| Total liabilities | | 4,795 | | 3,457 |
| | | | | |
| Commitments and contingencies | | - | | - |
| | | | | |
| Shareholders' equity | | | | |
| Preferred stock of no par value; | | | | |
| Authorized 1,000,000 shares; no shares outstanding | | | | |
| at December 26, 2009 and March 28, 2009 | | - | | - |
| Common stock of no par value; | | | | |
| Authorized 40,000,000 shares; 4,885,271 shares at December 26, 2009 | | | | |
| and 4,824,021 at March 28, 2009 issued and outstanding | | 13,913 | | 13,668 |
| Accumulated deficit | | (5,321) | | (6,336) |
| Total shareholders' equity | | 8,592 | | 7,332 |

| | | |
|---|---|---|
| Total liabilities and shareholders' equity | $ 13,387 | $ 10,789 |

See accompanying notes to unaudited condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

| (In thousands except per-share data) | Three Months Ended December 26, 2009 | Three Months Ended December 27, 2008 | Nine Months Ended December 26, 2009 | Nine Months Ended December 27, 2008 |
|---|---|---|---|---|
| Net sales | $ 4,784 | $ 5,099 | $ 13,876 | $ 12,276 |
| Cost of sales | 2,730 | 2,679 | 7,595 | 7,121 |
| Gross profit | 2,054 | 2,420 | 6,281 | 5,155 |
| | | | | |
| Engineering | 313 | 479 | 1,057 | 1,557 |
| Selling, general and administrative | 1,424 | 1,590 | 4,189 | 4,391 |
| Total operating expenses | 1,737 | 2,069 | 5,246 | 5,948 |
| | | | | |
| Operating income (loss) from continuing operations | 317 | 351 | 1,035 | (793) |
| | | | | |
| Other expense | - | - | (1) | - |
| Interest (expense) income, net | (7) | (2) | (16) | 7 |
| Income (loss) from continuing operations before income taxes | 310 | 349 | 1,018 | (786) |
| Provision for income taxes | 1 | - | 3 | 2 |
| Income (loss) from continuing operations | 309 | 349 | 1,015 | (788) |
| Income on discontinued operations, net of income taxes | - | - | - | 75 |
| Net income (loss) | $ 309 | $ 349 | $ 1,015 | $ (713) |
| | | | | |
| Basic and diluted earnings (loss) per share | | | | |
| From continuing operations | $ 0.06 | $ 0.07 | $ 0.21 | $ (0.16) |
| On discontinued operations | - | - | - | 0.01 |
| Basic and diluted earnings (loss) per share | $ 0.06 | $ 0.07 | $ 0.21 | $ (0.15) |
| | | | | |
| Shares used in per share calculation: | | | | |
| Basic | 4,846 | 4,824 | 4,833 | 4,824 |
| Diluted | 4,940 | 4,824 | 4,865 | 4,824 |

See accompanying notes to unaudited condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

| | Nine Months Ended | |
|---|---|---|
| (In thousands) | December 26, 2009 | December 27, 2008 |
| Cash flows from operations: | | |
| Net income (loss) | $ 1,015 | $ (713) |
| Adjustments to reconcile net income (loss) | | |
| to net cash provided by operations: | | |
| Depreciation and amortization | 109 | 122 |
| Loss on sale of fixed asset | 1 | - |
| Share based compensation | 130 | 173 |
| Deferred rent | (117) | (267) |
| Changes in operating assets and liabilities | (734) | 975 |
| Net cash provided by operations | 404 | 290 |
| | | |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (68) | (66) |
| Net cash used in investing activities | (68) | (66) |
| | | |
| Cash flows from financing activities: | | |
| Issuance of common stock | 115 | - |
| Proceeds from line of credit | 500 | - |
| Capital lease | (12) | 44 |
| Net cash provided by financing activities | 603 | 44 |
| | | |
| Increase in cash and cash equivalents | 939 | 268 |
| | | |
| Cash and cash equivalents at beginning of period | 1,518 | 1,845 |
| Cash and cash equivalents at end of period | $ 2,457 | $ 2,113 |
| | | |
| Supplementary disclosure of cash flow information: | | |
| Cash paid for income taxes | $ 3 | $ 2 |
| Cash paid for interest | $ 20 | $ 4 |

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 28, 2009.

The Company adopted The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162 effective September 26, 2009. This statement modifies the Generally Accepted Accounting Principles (“GAAP”) hierarchy by establishing only two levels of GAAP, authoritative and nonauthoritative accounting literature. Effective July 2009, the FASB Accounting Standards Codification (“ASC”), also known collectively as the “Codification,” is considered the single source of authoritative U.S. accounting and reporting standards, except for additional authoritative rules and interpretive releases issued by the SEC. Nonauthoritative guidance and literature would include, among other things, FASB Concepts Statements, American Institute of Certified Public Accounts Issue Papers and Technical Practice Aids and accounting textbooks. The Codification was developed to organize GAAP pronouncements by topic so that users can more easily access authoritative accounting guidance. It is organized by topic, subtopic, section, and paragraph, each of which is identified by a numerical designation. All accounting references have been updated, and therefore SFAS references have been replaced with topic references.

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

(2) Revenue Recognition

The Company recognizes revenue in accordance with GAAP which dictates that revenue is recorded when there is evidence of an arrangement, delivery has occurred, the price is fixed and determinable, and collectability is assured. This occurs when products are shipped, unless the arrangement involves acceptance terms. If the arrangement involves acceptance terms, the Company defers revenue until product acceptance is received.

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 26, 2009 and March 28, 2009.

| (Dollars in thousands) | December 26, 2009 | March 28, 2009 |
|---|---|---|
| Raw materials | $ 3,639 | $ 3,263 |
| Work-in-progress | 1,918 | 1,127 |
| Finished goods | 155 | 559 |
| Demonstration inventory | 517 | 460 |
| Total inventory | $ 6,229 | $ 5,409 |

(4) Earnings (Loss) Per Share

Basic earnings (loss) per share (EPS) is calculated by dividing net income or loss by the weighted average common shares outstanding during the period. Diluted earnings (loss) per share 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 the options' exercise price was above the average market price during the period. The shares used in per share computations are as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| (In thousands except per-share data) | December 26, 2009 | December 27, 2008 | December 26, 2009 | December 27, 2008 |
| Net income (loss) | $ 309 | $ 349 | $ 1,015 | $ (713 ) |
| | | | | |
| Weighted average: | | | | |
| Common shares outstanding | 4,846 | 4,824 | 4,833 | 4,824 |
| Potential common shares | 94 | - | 32 | - |
| Common shares assuming dilution | 4,940 | 4,824 | 4,865 | 4,824 |
| | | | | |
| Net income (loss) per share of common stock | $ 0.06 | $ 0.07 | $ 0.21 | $ (0.15 ) |
| Net income (loss) per share of common stock assuming dilution | $ 0.06 | $ 0.07 | $ 0.21 | $ (0.15 ) |
| Stock options not included in computation | 443 | 941 | 664 | 941 |

The number of stock options not included in the computation of diluted EPS for the three and nine month periods ended December 26, 2009 reflect stock options where the assumed proceeds from exercise and average unrecognized future compensation were greater than the average market price of the common shares and are, therefore, antidilutive. The number of stock options not included in the computation of diluted EPS for the three month period ended December 27, 2008 reflect stock options where the assumed proceeds from exercise and average unrecognized future compensation were greater than the average market price of the common shares and are, therefore, antidilutive. The number of stock options not included in the computation of diluted EPS for the nine month period ended December 27, 2008 is a result of the Company’s loss from continuing operations and, therefore, the options are anitdilutive. The weighted average exercise price of excluded options was $2.13 and $1.94 as of December 26, 2009 and December 27, 2008, 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 accounts for share based compensation in accordance with GAAP which requires compensation cost to be recorded at fair value over the requisite service period. There were option grants for 5,000 shares made in the three month period ended December 26, 2009. There were option grants made for 203,500 shares in the nine month period ended December 26, 2009. There were option grants for 146,500 shares made in the three and nine month periods ended December 27, 2008.

Cash flows resulting from the tax benefits derived from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as a cash flow from financing in the condensed consolidated statements of cash flows. These excess tax benefits were not significant for the Company, for each of the three and nine month periods ended December 26, 2009 and December 27, 2008.

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 December 26, 2009 | | Nine Months Ended December 26, 2009 | |
|---|---|---|---|---|
| Dividend yield | None | | None | |
| Expected volatility | 96.20 | % | 95.16 | % |
| Risk-free interest rate | 1.40 | % | 1.54 | % |
| Expected term (years) | 3.75 | | 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.

As of December 26, 2009, there was $399,000 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 1.30 years and will be adjusted for subsequent changes in estimated forfeitures. There were 48,250 options that vested during the quarter ended December 26, 2009. There were 65,125 options that vested during the quarter ended December 27, 2008. The total fair value of options vested during each of the quarters ended December 26, 2009 and December 27, 2008 was $70,000 and $94,000, respectively. There were 130,599 and 124,476 options that vested during the nine month periods ended December 26, 2009 and December 27, 2008, respectively. The total fair value of options vested during the nine month periods ended December 26, 2009 and December 27, 2008 was $146,000 and $153,000, respectively. Cash received from the exercise of stock options for the nine month period ended December 26, 2009 was $115,000. No cash was received from stock option exercises for the nine month period ended December 27, 2008.

(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. In FY 2010 the Company re-allocated its overhead expenses for each segment more in line with its proportionate share of revenue.

Information on reportable segments is as follows:

| (Dollars in thousands) | Three Months Ended December 26, 2009 | | Three Months Ended December 27, 2008 | |
|---|---|---|---|---|
| | Net Sales | Net Income (Loss) | Net Sales | Net Income (Loss) |
| Giga-tronics Division | $ 2,863 | $ (99) | $ 3,771 | $ 90 |
| Microsource | 1,921 | 408 | 1,328 | 259 |
| Total | $ 4,784 | $ 309 | $ 5,099 | $ 349 |

| (Dollars in thousands) | Nine Months Ended December 26, 2009 | | Nine Months Ended December 27, 2008 | |
|---|---|---|---|---|
| | Net Sales | Net Income (Loss) | Net Sales | Net Income (Loss) |
| Giga-tronics Division | $ 8,604 | $ (133) | $ 8,869 | $ (1,053) |
| Microsource | 5,272 | 1,148 | 3,407 | 340 |
| Total | $ 13,876 | $ 1,015 | $ 12,276 | $ (713) |

(7) Warranty Obligations

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| (Dollars in thousands) | December 26, 2009 | December 27, 2008 | December 26, 2009 | December 27, 2008 |
| Balance at beginning of period | $ 177 | $ 184 | $ 177 | $ 190 |
| Provision, net | 19 | 29 | 70 | 156 |
| Warranty costs incurred | (27) | (26) | (78) | (159) |
| Balance at end of period | $ 169 | $ 187 | $ 169 | $ 187 |

(8) Income Taxes

The Company accounts for income taxes using the asset and liability method as codified in Topic 740. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. A valuation allowance is applied to deferred tax assets which are less than likely to be realized on a future tax return. Benefits from uncertain tax positions are recorded only if they are more likely than not to be realized.

(9) Subsequent Events

Management has evaluated subsequent events through February 4, 2010, the date on which this Quarterly Report on Form 10-Q was filed with the SEC. There were no subsequent events required for disclosure purposes.

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 28, 2009 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, aeronautics, and wireless telecommunications. In fiscal 2010, the Company consisted of two operating and reporting segments: Giga-tronics Division and Microsource.

The Company's 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 2010 versus the first nine months of fiscal 2009. Defense orders improved during this period as compared to the same period last year, while commercial orders declined.

The Company continues to monitor costs, including reductions in personnel, facilities and other expenses, to more appropriately align costs with revenues. In March 2007, the Company moved ASCOR's engineering, sales and marketing, and administrative activities to the San Ramon, California facility, effectively abandoning its Fremont, California facility. Subsequently, in fiscal 2009, the ASCOR subsidiary was combined into the Giga-tronics Instrument Division. As a result, the Company has accrued its future lease obligations, net of estimated sub-lease income, through June 2009. As of June 30, 2009, the Fremont lease obligation has terminated. Microsource sales and marketing and engineering activities were also consolidated into the San Ramon facility to better integrate our component development activities with the Company's overall new product plans. The Microsource facility in Santa Rosa, California, however, remains open as a manufacturing operation.

Results of Operations

New orders received by segment are as follows for the periods shown:

New Orders

| (Dollars in thousands) | Three Months Ended December 26, 2009 | December 27, 2008 | % change |
|---|---|---|---|
| Giga-tronics Division | $ 2,052 | $ 3,052 | (33 %) |
| Microsource | 5,663 | 6,409 | (12 %) |
| Total | $ 7,715 | $ 9,461 | (18 %) |

| (Dollars in thousands) | Nine Months Ended December 26, 2009 | December 27, 2008 | % change |
|---|---|---|---|
| Giga-tronics Division | $ 8,675 | $ 9,457 | (8 %) |
| Microsource | 6,423 | 7,317 | (12 %) |
| Total | $ 15,098 | $ 16,774 | (10 %) |

New orders received in the third quarter of fiscal 2010 decreased by 18% to $7,715,000 from the $9,461,000 received in the third quarter of fiscal 2009. New orders received for the nine months ended December 26, 2009 decreased 10% to $15,098,000 from the $16,774,000 received for the same period a year ago. Orders at Giga-tronics Division and at Microsource decreased for the three and nine month periods ended December 26, 2009 primarily due to a decrease in new military orders.

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

Backlog

| (Dollars in thousands) | December 26, 2009 | December 27, 2008 | % change |
|---|---|---|---|
| Backlog of unfilled orders | $ 10,327 | $ 12,026 | (14 %) |
| Backlog of unfilled orders shippable within one year | 8,592 | 8,853 | (3 %) |
| Previous fiscal year end backlog reclassified during quarter as shippable later than one year | 849 | - | - |
| Net cancellations during the quarter | - | - | - |

Backlog at the end of the first half of fiscal 2010 decreased 14% as compared to the end of the same period last year.

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

Allocation of Net Sales

| | Three Months Ended | | |
|---|---|---|---|
| (Dollars in thousands) | December 26, 2009 | December 27, 2008 | % change |
| Giga-tronics Division | $ 2,863 | $ 3,771 | (24 %) |
| Microsource | 1,921 | 1,328 | 45 % |
| Total | $ 4,784 | $ 5,099 | (6 %) |

| | Nine Months Ended | | |
|---|---|---|---|
| (Dollars in thousands) | December 26, 2009 | December 27, 2008 | % change |
| Giga-tronics Division | $ 8,604 | $ 8,869 | (3 %) |
| Microsource | 5,272 | 3,407 | 55 % |
| Total | $ 13,876 | $ 12,276 | 13 % |

Fiscal 2010 third quarter net sales were $4,784,000, a 6% decrease from the $5,099,000 in the third quarter of fiscal 2009. Sales at Giga-tronics Division decreased 24% or $908,000 primarily due to a decrease in military shipments. Sales at Microsource increased 45% or $593,000 during the third quarter of fiscal 2010 versus the third quarter of fiscal 2009 primarily due to an increase in military shipments.

Net sales for the nine month period ended December 26, 2009 were $13,876,000, a 13% increase from the $12,276,000 in the nine month period ended December 27, 2008. Sales at Giga-tronics Division decreased 3% or $265,000 primarily due to a decrease in commercial shipments. Sales at Microsource increased 55% or $1,865,000 during the first nine months of fiscal 2010 versus the first nine months of fiscal 2009 primarily due to an increase in military shipments.

Cost of sales was as follows for the periods shown:

Cost of Sales

| | Three Months Ended | | |
|---|---|---|---|
| (Dollars in thousands) | December 26, 2009 | December 27, 2008 | % change |
| Cost of sales | $ 2,730 | $ 2,679 | 2 % |

| | Nine Months Ended | | |
|---|---|---|---|
| (Dollars in thousands) | December 26, 2009 | December 27, 2008 | % change |
| Cost of sales | $ 7,595 | $ 7,121 | 7 % |

In the third quarter of fiscal 2010, cost of sales increased 2% to $2,730,000 from $2,679,000 for the same period last year due to a favorable change in product mix partially offset by lower volume. Cost of sales as a percentage of sales improved by 4.6% for the third quarter of fiscal 2010 to 52.5% compared to 57.1% for the third quarter of fiscal 2009.

For the nine months ended December 26, 2009, cost of sales increased 7% to $7,595,000 from $7,121,000 for the similar period ended December 27, 2008 due to increased volume. Cost of sales as a percentage of sales improved by

3.3% for the first nine months of fiscal 2010 to 54.7% compared to 58.0% from the same period of fiscal 2009.

Operating expenses were as follows for the fiscal periods shown:

Operating Expenses

| | Three Months Ended | | |
|---|---|---|---|
| (Dollars in thousands) | December 26, 2009 | December 27, 2008 | % change |
| Engineering | $ 313 | $ 479 | (35 %) |
| Selling, general and administrative | 1,424 | 1,590 | (10 %) |
| Total | $ 1,737 | $ 2,069 | (16 %) |

| | Nine Months Ended | | |
|---|---|---|---|
| (Dollars in thousands) | December 26, 2009 | December 27, 2008 | % change |
| Engineering | $ 1,057 | $ 1,557 | (32 %) |
| Selling, general and administrative | 4,189 | 4,391 | (5 %) |
| Total | $ 5,246 | $ 5,948 | (12 %) |

Operating expenses improved by 16% or $332,000 in the third quarter of fiscal 2010 over fiscal 2009 due to a reduction in product development expenses of $166,000 which includes a transfer of expenses to customer order development (COD) engineering costs and a reduction in selling, general and administrative expenses of $166,000. The customer funded engineering, which is directed by the customer and is not an internally directed project or sustaining engineering, was $184,000 in the third quarter of fiscal 2010. In the third quarter of fiscal 2009 the customer funded engineering was not material. The reduction in selling, general and administrative expense is a result of lower commission expenses of $151,000 and lower administrative expenses of $87,000 offset by higher marketing of $72,000.

Operating expenses improved by 12% or $702,000 in the first nine months of fiscal 2010 over the same period in fiscal 2009 due to a reduction in product development expenses of $500,000 which includes a transfer of expenses to COD engineering costs and a reduction in selling, general and administrative expenses of $202,000. The customer funded engineering in the first nine months of fiscal 2010 was $407,000. In the same period of fiscal 2009 the customer funded engineering was not material. The reduction in selling, general and administrative expense is a result of lower commission expenses of $114,000 and lower administrative expenses of $105,000 offset by higher marketing of $17,000.

The Company recorded a net profit of $309,000 or $0.06 per fully diluted share for the third quarter of fiscal 2010 compared to a net profit of $349,000 or $0.07 per fully diluted share in the same period last year. The Company recorded a net profit of $1,015,000 or $0.21 per fully diluted share for the first nine months of fiscal 2010 compared to a net loss of $713,000 or $0.15 per fully diluted share in the same period last year. Provision for income taxes incurred for the third quarter were $1,000 in fiscal 2010 and zero in fiscal 2009, for the first nine months of fiscal 2010 and fiscal 2009 tax provisions were $3,000 and $2,000, respectively.

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

| (In thousands except per-share data) | Three Months Ended December 26, 2009 | Three Months Ended December 27, 2008 | Nine Months Ended December 26, 2009 | Nine Months Ended December 27, 2008 |
|---|---|---|---|---|
| Net income (loss) as reported | $ 309 | $ 349 | $ 1,015 | $ (713) |
| Share based Compensation | 50 | 55 | 130 | 173 |
| Net income (loss) non-GAAP | $ 359 | $ 404 | $ 1,145 | $ (540) |
| | | | | |
| Basic and diluted earnings (loss) per share as reported | $ 0.06 | $ 0.07 | $ 0.21 | $ (0.15) |
| Impact of share based compensation on earnings (loss) per share | 0.01 | 0.01 | 0.03 | 0.04 |
| Basic and diluted earnings (loss) per share non-GAAP | $ 0.07 | $ 0.08 | $ 0.24 | $ (0.11) |
| | | | | |
| Shares used in per share calculation: | | | | |
| Basic | 4,846 | 4,824 | 4,833 | 4,824 |
| Diluted | 4,940 | 4,824 | 4,865 | 4,824 |

Non-GAAP net income, which excludes share-based compensation expense, for the three month period ended December 26, 2009 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. For the same period last year, the Company’s non-GAAP net income would have been $55,000 higher or $404,000 and the basic and diluted earnings per share would have been $0.08 compared to $0.07 as reported.

Non-GAAP net income for the nine month period ended December 26, 2009 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. For the same period last year, the Company’s non-GAAP net loss would have been $173,000 lower or $540,000 and the basic and diluted share loss would have been $0.11 compared to $0.15 as reported.

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

Financial Condition and Liquidity

As of December 26, 2009, the Company had $2,457,000 in cash and cash equivalents, compared to $1,518,000 as of March 28, 2009.

Working capital at December 26, 2009 was $8,390,000 compared to $7,131,000 at March 28, 2009. The increase in working capital was primarily due to an increase in accounts receivable and an increase in inventory partially offset by an increase in deferred revenue in fiscal 2010.

The Company’s current ratio (current assets divided by current liabilities) at December 26, 2009 was 2.78 compared to 3.14 on March 28, 2009.

Cash provided by operations amounted to $404,000 for the nine months ended December 26, 2009. Cash provided by operations amounted to $290,000 in the same period of fiscal 2009. Cash provided by operations in the first nine months of fiscal 2010 is primarily attributed to increases in accounts receivable and inventory and an increase in deferred revenue. The lower level of cash provided by operations in the first nine months of fiscal 2009 was primarily attributed to the operating loss offset by the net change in operating assets and liabilities in the year.

Additions to property and equipment were $68,000 in the first nine months of fiscal 2010 compared to $66,000 for the same period last year. The capital equipment spending in fiscal 2010 was due to an upgrade of capital equipment enabling the manufacture of new products being released.

On June 16, 2009, the Company renewed its secured revolving line of credit for $1,500,000, with interest payable at prime rate plus 1.5%. The borrowing under this line of credit is based on the Company's accounts receivable and inventory and is secured by all of the assets of the Company. The Company borrowed $500,000 under this line of credit during the nine month period ended December 26, 2009 and was in compliance with all required covenants at December 26, 2009.

Future tax benefits are subject to a valuation allowance when management is unable to conclude that its deferred tax assets will more likely than not be realized from the results of operations. The Company has recorded a valuation allowance to reflect the estimated amount of deferred tax assets that may not be realized. The ultimate realization of deferred tax assets is dependent upon generation of future taxable income during the periods in which those temporary differences become deductible. Management considers projected future taxable income and tax planning strategies in making this assessment. Based on historical taxable income and projections for future taxable income over the periods in which the deferred tax assets become deductible, the Company may not realize benefits of these deductible differences as of December 26, 2009. Management has, therefore, established a full valuation allowance against its net deferred tax assets as of December 26, 2009.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements that have or are likely to have a current or future material effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

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 26, 2009, 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 28, 2009.

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.
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, 2010 | /s/ John R. Regazzi<br>John R. Regazzi<br>President and Chief Executive Officer<br>(Principal Executive Officer) |
| Date: February 4, 2010 | /s/ Patrick J. Lawlor<br>Patrick J. Lawlor<br>Vice President Finance/<br>Chief Financial Officer & Secretary<br>(Principal Accounting Officer) |