

GIGA TRONICS INC
Form 10-K
June 09, 2015
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended March 28, 2015,

or

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

For the transition period from _____ to _____.

Commission File No. 0-12719

GIGA-TRONICS INCORPORATED

(Exact name of registrant as specified in its charter)

California 94-2656341
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

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

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

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

Title of each class Name of each exchange on which registered

Common Stock, No par value The NASDAQ Stock Market LLC

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

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

Yes No

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

Yes No

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

Yes No

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

Yes No

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

[X]

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company [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]

The aggregate market value of voting and non-voting common equity held by non-affiliates of the Registrant computed by reference to the price at which the common equity was sold or the average bid and asked prices as of September 27, 2014 was \$9,731,799.

There were a total of 6,725,281 shares of the Registrant's Common Stock outstanding as of June 2, 2015.

DOCUMENTS INCORPORATED BY REFERENCE

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

PART OF FORM 10-K	DOCUMENT
PART III	Registrant's PROXY STATEMENT for its 2015 Annual Meeting of Shareholders to be filed no later than 120 days after the close of the fiscal year ended March 28, 2015.

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PART 1

The forward-looking statements included in this report including, without limitation, statements containing the words “believes”, “anticipates”, “estimates”, “expects”, “intends” and words of similar import, which reflect management’s best judgment based on factors currently known, involve risks and uncertainties. Actual results could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including but not limited to those discussed under “Certain Factors Which May Adversely Affect Future Operations Or An Investment In Giga-tronics” in Item 1 below and in Item 7, “Management’s Discussion and Analysis”.

ITEM 1. BUSINESS

General

Giga-tronics Incorporated (Giga-tronics, or the Company) includes the operations of the Giga-tronics Division and Microsource Inc. (Microsource), a wholly owned subsidiary. Giga-tronics Division designs, manufactures and markets a broad line of test and measurement equipment used in the development, test and maintenance of wireless communications products and systems, flight navigational equipment, electronic defense systems and automatic testing systems. These products are used primarily in the design, production, repair and maintenance of commercial telecommunications, radar, and electronic warfare equipment.

Microsource develops and manufactures a broad line of YIG (Yttrium, Iron, Garnet) tuned oscillators, filters and microwave synthesizers, which are used by its customers in operational applications and in manufacturing a wide variety of microwave instruments and devices.

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

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

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

Industry Segments

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

For more information regarding the Company's two reporting segments, see "Part II-Item 8. Financial Statements and Supplementary Data – Notes to Consolidated Financial Statements-Significant Customers and Industry Segment Information."

Products and Markets

Giga-tronics

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

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

Microsource

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

Sources and Availability of Raw Materials and Components

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

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

Patents and Licenses

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

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

The Company presently holds 31 patents. Some of these are critical to the Company's ongoing business, and the Company intends to actively maintain them. Capitalized costs relating to these patents were both incurred and fully amortized prior to March 27, 2011. Accordingly, these patents have no recorded value included in the Company's consolidated financial statements for the fiscal years ended March 28, 2015 ("fiscal 2015") and March 29, 2014 ("fiscal 2014").

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

Seasonal Nature of Business

The business of the Company is not seasonal.

Working Capital Practices

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

Importance of Limited Number of Customers

The Company is a supplier of microwave and RF test instruments to various United States (U.S.) government defense agencies, as well as to their prime contractors. Management anticipates sales to U.S. government agencies and their prime contractors will remain significant in fiscal 2016. U.S. and international defense-related agencies accounted for 73% and 57% of net sales in fiscal 2015 and 2014, respectively. Commercial business accounted for the remaining 27% and 43% of net sales in fiscal 2015 and fiscal 2014, respectively.

At the Giga-tronics Division, U.S. defense agencies and their prime contractors accounted for 40% and 25% of net sales in fiscal 2015 and fiscal 2014, respectively. Microsource reported 98% and 96% of net sales to U.S. defense agencies and their prime contractors during fiscal 2015 and fiscal 2014, respectively.

During fiscal 2015, one customer accounted for 28% of the Company's consolidated revenues and was included in the Microsource reporting segment. A second customer accounted for 23% of the Company's consolidated revenues during fiscal 2015 and was also included in the Microsource reporting segment. A third customer accounted for 14% of the Company's consolidated revenues during fiscal 2015 and was included in the Giga-tronics Division reporting segment.

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

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

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

Backlog of Orders

On March 28, 2015, the Company's backlog of unfilled orders was approximately \$5.7 million compared to approximately \$6.7 million at March 29, 2014. As of March 28, 2015, there were approximately \$521,000 of orders scheduled for shipment beyond one year. As of March 29, 2014, there were approximately \$1.2 million of orders scheduled for shipment beyond one year. Orders for the Company's products include program orders from both the U.S. government and defense contractors with extended delivery dates. Accordingly, the backlog of orders may vary substantially from year to year and the backlog entering any single quarter may not be indicative of sales for any period.

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

Competition

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

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

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

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

Sales and Marketing

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

Product Development

Products of the type manufactured by Giga-tronics historically have had relatively long product life cycles. However, the electronics industry is subject to rapid technological changes at the component level. The future success of the Company is dependent on its ability to steadily incorporate advancements in component technologies into its new products. In fiscal 2015 and fiscal 2014, product development expenses totaled approximately \$3.2 million and \$3.9 million respectively.

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

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

Manufacturing

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

Environment

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

Employees

As of March 28, 2015 and March 29, 2014, the Company employed 71 and 76 individuals on a full-time basis, respectively. Management believes that the future success of the Company depends on its ability to attract and retain skilled personnel. None of the Company's employees are represented by a labor union, and the Company considers its employee relations to be good.

Information about Foreign Operations

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

Geographic Distribution of Net Sales

(Dollars in thousands)	2015	2014	2015	2014
Domestic	\$16,985	\$11,832	92 %	89 %
International	1,467	1,477	8 %	11 %
Total	\$18,452	\$13,309	100.0 %	100.0 %

See Item 8, footnote 7 of the consolidated financial statements for further breakdown of international sales for the last two years.

ITEM 1A. RISK FACTORS

Future liquidity is uncertain

Based on current levels of sales and expenses, and based on management's forecast of operations in the near future, management believes that cash and cash equivalents remain adequate to meet current operating needs. The cash forecasts are based on projections that may or may not be realized, and therefore actual cash usage could be greater than projected. In this circumstance, the Company could encounter a need to obtain additional funds from outside sources. If such additional working capital is required, there are no assurances that such financing sources will be available on favorable terms to the Company, if at all.

Customer orders and production of new product platform

The Company invested heavily in the development of its new product platform, the Advanced Signal Generation system. In the fourth quarter of fiscal 2015 two customers accepted their initial units of the Advanced Signal Generation System. Longer than anticipated sales cycles in fiscal 2016, or delays in production and shipping volume quantities, could significantly contribute to additional losses.

Ability to stay listed for trading on The NASDAQ Capital Market

If the Company's shareholders' equity falls below \$2.5 million, The Nasdaq Stock Market could delist the Company from The Nasdaq Capital Market. On February 20, 2015, the Company received a letter from The Nasdaq Stock Market informing the Company that a Nasdaq Hearings Panel (the "Panel") determined that the Company had regained compliance with Nasdaq Listing Rule 5550(b)(1), the minimum stockholders' equity rule (the "Stockholders' Equity Rule"). As a result, the Panel determined that the Company is in compliance with all applicable listing standards required for listing on The Nasdaq Capital Market, and accordingly, the Panel has determined to continue the listing of the Company's securities on The Nasdaq Stock Market. However, because the Company has met compliance with the Stockholders' Equity Rule by a relatively small margin, the Panel has imposed a Panel Monitor to monitor the Company's continued compliance with the Stockholders' Equity Rule until February 27, 2016. The Company is under certain notification obligations during this time period, including the obligation to notify the Panel Monitor if it fails to comply with the Stockholders' Equity Rule or any other applicable listing requirement. If the Company's Common Stock ceases to be listed for trading on The Nasdaq Capital Market, the Company expects that its Common Stock would be traded on the Over-the-Counter Bulletin Board on or about the same day.

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

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

Giga-tronics' markets involve rapidly changing technology and standards

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

Giga-tronics' common stock price is volatile

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

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

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

Products as complex as those Giga-tronics produces may contain unknown and undetected defects or performance problems. For example, it is possible that a product might not comply with stipulated specifications under all circumstances. In addition, Giga-tronics' customers generally use its products together with their own products an