TFS Financial CORP
Form DEF 14A
January 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

Filed by the Registrant þ   Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

þ Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to Rule 14a-12

TFS FINANCIAL CORPORATION

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

þ No fee required.

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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

Table of Contents

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To our Stockholders:

The 2012 annual meeting of stockholders of TFS Financial Corporation (the Company) will be held at the offices of Third Federal Savings and Loan, 7007 Broadway Avenue, Cleveland, Ohio 44105, on Thursday, February 23, 2012, at 9:00 a.m., local time, for the following purposes:

1. To elect five directors, two to hold office for two-year terms and three to hold office for three-year terms, each until his or her successor has been duly elected and qualified;

2. To ratify the selection of Deloitte & Touche LLP as the Company s independent accountant for the Company s fiscal year ending September 30, 2012; and

3. To transact all other business that properly comes before the meeting.

Only stockholders of record at the close of business on December 27, 2011 will be entitled to notice of and to vote at the meeting or any adjournment thereof. You are invited to attend the annual meeting, and we request that you vote on the proposals described in this proxy statement. You do not need to attend the meeting to vote your shares. Instead, you may simply complete, date and sign the available proxy card and return it to the Company. Alternatively, you may vote via telephone or over the Internet.

All stockholders of record entitled to vote at the annual meeting should receive a Notice of Internet Availability of Proxy Materials (the Notice of Internet Availability). The Notice of Internet Availability will instruct you as to how you may access and review all of the important information contained in the proxy materials. If you received a Notice of Internet Availability by mail and would like to receive a printed copy of our proxy materials, you should follow the instructions for requesting such materials included in the Notice of Internet Availability. The principal address of the Company is 7007 Broadway Avenue, Cleveland, Ohio 44105.

By order of the Board of Directors,

David S. Huffman

Secretary

January 9, 2012

YOUR VOTE IS IMPORTANT. PLEASE SIGN, DATE AND RETURN THE AVAILABLE

PROXY CARD OR VOTE VIA TELEPHONE OR OVER THE INTERNET.

Table of Contents

TABLE OF CONTENTS

Table of Contents

TFS FINANCIAL CORPORATION

7007 Broadway Avenue

Cleveland, Ohio 44105

PROXY STATEMENT

Our Board of Directors is providing this proxy statement to ask for your vote as a stockholder of TFS Financial Corporation (the Company, we, us or our) on certain matters to be voted on at our upcoming annual meeting of stockholders, which will be held at the offices of Third Federal Savings and Loan, 7007 Broadway Avenue, Cleveland, Ohio 44105, on Thursday, February 23, 2012, at 9:00 a.m., local time. We are making these proxy materials, along with our 2011 Annual Report to Stockholders, available to you electronically on or about January 9, 2012.

ABOUT THE MEETING

What Is the Purpose of the Annual Meeting of Stockholders?

At our annual meeting of stockholders, stockholders will act upon the matters outlined in the accompanying notice of meeting, including the election of five directors and a proposal to ratify the selection of Deloitte & Touche LLP as the Company s independent accountant for the Company s fiscal year ending September 30, 2012. We are not aware of any other matter that will be presented for your vote at the meeting.

Who Is Entitled to Vote?

Only stockholders of record at the close of business on the record date, December 27, 2011, are entitled to receive notice of and to vote the shares of our common stock that they held on the record date at the meeting, or any postponement or adjournment of the meeting. Each outstanding share of common stock entitles its holder as of the record date to cast one vote on each matter acted upon at the meeting. As of the record date, the Company had outstanding 308,915,893 shares of common stock.

What if My Shares Are Held in the Third Federal Savings Associate Stock Ownership Plan or the Third Federal Savings 401(k) Savings Plan?

If you are a participant in the Third Federal Savings Associate Stock Ownership Plan (the ASOP) or the Third Federal Savings 401(k) Savings Plan (the 401(k) Plan) and you own shares of our common stock through those plans, you have been provided voting instruction forms with respect to shares you may vote under those plans. Although the trustee or administrator for each plan votes all shares of our common stock held by that plan, each participant may direct the trustee or administrator how to vote the shares of our common stock allocated to his or her plan account. You must provide voting instructions to the trustee or administrator by February 18, 2012 for them to be effective. If you own shares of our common stock through either of these plans and do not provide voting instructions to the trustee or administrator by February 18, 2012, the respective trustee or administrator will vote the shares of common stock in accordance with the terms of the respective plans, which provide that the trustee or administrator will vote any shares of our common stock for which it has received no voting instructions in the same proportions as it votes the shares of our common stock for which it has received instructions from plan participants. You also may revoke previously given voting instructions prior to February 18, 2012 by filing with the trustee or administrator either written notice of revocation or a properly completed voting instruction form bearing a later date.

Who Can Attend the Meeting?

Only stockholders as of the record date, or their duly appointed proxies, may attend the meeting. Please note that if you hold your shares in street name (that is, through a broker or other nominee), your name does not appear in the Company s records, and you will need to bring to the annual meeting a copy of your brokerage statement reflecting your ownership of shares of our common stock as of the record date in order to be admitted.

Table of Contents

When and Where Is the Meeting?

The meeting will be held at the offices of Third Federal Savings and Loan, 7007 Broadway Avenue, Cleveland, Ohio 44105, on Thursday, February 23, 2012, at 9:00 a.m., local time. Parking is available in our visitor parking lot, which you can enter from Aetna Avenue.

What Constitutes a Quorum?

The presence at the meeting, either in person or by proxy, of the holders of a majority of the shares of our common stock outstanding on the record date will represent a quorum, permitting the conduct of business at the meeting. Proxies received by the Company but marked as abstentions and broker non-votes will be included in the calculation of the number of shares considered to be present at the meeting for purposes of establishing a quorum. A broker non-vote occurs if your shares are held in street name by a broker or nominee and the broker or nominee reports your shares as non-votes because you did not provide your broker or nominee with voting instructions for your shares.

What Vote Is Required to Approve Each Proposal, Assuming that a Quorum Is Present at the Annual Meeting of Stockholders?

Proposal One: Election of Directors. The five nominees for director who receive the greatest number of affirmative votes will be elected directors, and abstentions and broker non-votes will not count as votes for any nominee for director.

Proposal Two: Ratification of the Selection of Deloitte & Touche LLP as the Company s Independent Accountant. The Audit Committee of our Board of Directors plans to reappoint Deloitte & Touche LLP as the Company s independent accountant to audit our financial statements for the fiscal year ending September 30, 2012, subject to the ratification of the appointment by our stockholders as required by our bylaws. See page 40 under Proposal Two: Ratification of the Selection of Deloitte & Touche LLP as the Company s Independent Accountant for additional information. If a majority of votes cast on this proposal are cast in favor of approval, the proposal will be approved. Abstentions will be treated as cast and will have the same effect as a vote against ratification. Broker non-votes are not considered votes cast and will not be counted either for or against ratification.

How Does Third Federal Savings and Loan Association of Cleveland, MHC Intend to Vote Its Shares?

All stockholder votes will include the vote of Third Federal Savings and Loan Association of Cleveland, MHC, which, as of December 27, 2011, owned 227,119,132 shares, or 73.52%, of our outstanding common stock. **As such, the vote of Third Federal Savings and Loan Association of Cleveland, MHC will be determinative of the outcome of any vote or election. Third Federal Savings and Loan Association of Cleveland, MHC intends to vote for the election of the Board of Directors five nominees for director, to vote for ratification of the selection of Deloitte & Touche LLP, and to vote in accordance with the recommendation of our Board of Directors on any other matter that properly comes before the meeting.**

How Do I Vote?

You may cast your vote in person at the meeting or in any one of the following ways:

By Telephone: You may call the toll-free number printed on the accompanying proxy card. Follow the simple instructions and use the personalized control number printed on your Notice of Internet Availability in order to vote your shares. You will be able to confirm that your vote has been properly recorded. Telephone voting is available 24 hours a day. If you vote by telephone, you should not return a proxy card.

Table of Contents

Over the Internet: You may visit the web site printed on the accompanying proxy card. Follow the simple instructions and use the personalized control number printed on your Notice of Internet Availability in order to vote your shares. You will be able to confirm that your vote has been properly recorded. Internet voting is available 24 hours a day. If you vote over the Internet, you should not return a proxy card.

By Mail: You may mark, sign and date the accompanying proxy card and return it to the address provided on the proxy card.

If you sign, date and return the accompanying proxy card or vote by telephone or via the Internet, the shares of common stock represented by your proxy will be voted as you specify. If you return a signed and dated proxy card, but do not indicate how your shares of common stock should be voted, the shares of common stock represented by your proxy will be voted to elect the directors set forth under the caption Election of Directors and for ratification of the selection of Deloitte & Touche LLP as the Company s independent accountant to audit our financial statements for the fiscal year ending September 30, 2012.

Will My Shares Be Voted if I Do Not Provide Instructions to My Broker?

If you are the beneficial owner of shares held in street name by a broker or other nominee, the broker or other nominee, as the record holder of the shares, is required to vote those shares in accordance with your instructions. If you do not provide your broker or other nominee instructions as to how your shares are to be voted, your broker or other nominee will not be able to vote your shares on any of the matters discussed herein, and your shares will not be voted with respect to those matters. We urge you to provide instructions to your broker or nominee so that your vote may be counted on these important matters. You should vote your shares by following the instructions provided on the accompanying voting instructions card and return the voting instructions card to your broker or other nominee in a timely manner to ensure that your shares are voted on your behalf.

May I Revoke My Proxy or Change My Vote?

You may revoke or change your vote at any time before your proxy has been exercised by filing a written notice of revocation or a duly executed proxy bearing a later date with the Company at the Company s principal address indicated on the attached Notice of Annual Meeting of Stockholders, by submitting another timely, later-dated vote by telephone or Internet or by giving notice of revocation to the Company in open meeting. However, your presence at the annual meeting alone will not be sufficient to revoke your previously-granted proxy or vote.

How Will the Proxy Solicitation Be Conducted?

This solicitation of proxies is made by and on behalf of our Board of Directors. The cost of the solicitation of your proxy will be borne by the Company. In addition to solicitation of proxies by mail and electronically, officers and regular associates of the Company may solicit proxies in person, by telephone or by facsimile. These officers and associates will not receive any additional compensation for their participation in the solicitation process.

Table of Contents

PROPOSAL ONE: ELECTION OF DIRECTORS

You will be voting on the election of five directors at the annual meeting of stockholders. On March 17, 2011, the Board elected Robert B. Heisler, Jr. and Terrence R. Ozan as directors to fill vacancies. As required by the Company s bylaws, each of Messrs. Heisler and Ozan will serve until the 2012 annual meeting of stockholders, when each will stand for re-election.

The Company s bylaws require that the Board be divided into three classes as nearly equal in number as possible. In order to divide the classes of directors as evenly as possible, each of Messrs. Heisler and Ozan, if elected, will serve a two-year term expiring in 2014, and until his successor is elected and qualified. Each of Messrs. Asher and Kobak and Ms. Piterans, if elected, will serve a three-year term expiring in 2015, and until his or her successor is elected and qualified. At the meeting, unless you specify otherwise, the shares of common stock represented by your proxy will be voted to re-elect Anthony J. Asher, Robert B. Heisler, Jr., Bernard S. Kobak, Terrence R. Ozan and Marianne Piterans.

If for any reason any of the nominees is unable to serve as a director at the time of the election (which is not expected), the shares of common stock represented by your proxy will be voted for the election of a substitute nominee recommended by our Board of Directors, acting as our nominating committee, if the Board makes any such recommendation.

The following table sets forth information regarding our directors:

Name	Age	Position(s) Held in TFS Financial Corporation	Director Since	Term of Office Expires
Nominees for Director				
Anthony J. Asher	73	Director	2008	2012
Robert B. Heisler, Jr.	63	Director	2011	2012
Bernard S. Kobak	83	Director, Officer	1993	2012
Terrence R. Ozan	65	Director	2011	2012
Marianne Piterans	57	Director of Human Resources and Director	2006	2012
Directors Continuing in Office				
Martin J. Cohen	58	Director	2006	2013
Robert A. Fiala	58	Director	2005	2013
William C. Mulligan	58	Director	2007	2014
Paul W. Stefanik	87	Director	1993	2014
Ben S. Stefanski III(1)	39	Director	2010	2013
Marc A. Stefanski	57	Chairman of the Board, President, Chief Executive Officer and Director	1987	2013

(1) Ben S. Stefanski III is the nephew of Marc A. Stefanski.

Our Board of Directors recommends that stockholders vote FOR the nominees for election set forth above.

Business Experience of Each Nominee for Director

Anthony J. Asher is the Chairman of Weston, Inc., a real estate ownership firm that is one of the largest industrial property owners in the Cleveland, Ohio area, and which Mr. Asher founded in 1971. Mr. Asher also founded one of the largest title agencies in the Cleveland area. This experience, combined with his background as an entrepreneur, provides invaluable skills used in his service on the Board and the Audit and Compensation Committees.

Table of Contents

Robert B. Heisler, Jr. retired as the Dean of Kent State University s Business School in October of 2011, a position he held since 2008. Prior to that appointment, he served as a Special Advisor to the University President. Mr. Heisler retired as Chairman of KeyBank, N.A. in 2007 after 37 years in the banking industry. Prior to his role as Chairman, Mr. Heisler served as Senior Managing Director of Key Capital Partners and held various positions throughout the organization, overseeing investment banking, brokerage, asset management, private banking and investment research. Mr. Heisler is a director of FirstEnergy Corp. and Myers Industries and holds leadership positions in many Northeast Ohio community organizations. Mr. Heisler s extensive business and banking experience enhance the risk management and oversight functions of the Board and are important to his service on the Board and the Enterprise Risk Management Committee.

Bernard S. Kobak joined Third Federal Savings and Loan in 1958 and has served as Executive Vice President since 1963. Mr. Kobak s many years of service in various areas of Third Federal Savings and Loan bring knowledge of the financial, operational and regulatory challenges that the Company faces.

Terrence R. Ozan serves on the board of directors of Capgemini, Cohesant Inc. and a privately held chemical manufacturer and supplier. Mr. Ozan served as Chief Executive Officer of North American operations and was an executive member of the Capgemini Global Management Committee prior to his retirement in 2003. Prior to the formation of Capgemini in 2000, Mr. Ozan was the Chief Executive Officer of worldwide consulting services for Ernst & Young and served on various boards and governance committees. In his nearly 30 year career at Ernst & Young, Mr. Ozan also directed many different domestic business units of the organization. Mr. Ozan s extensive business and banking experience enhance the risk management and oversight functions of the Board and are important to his service on the Board and the Enterprise Risk Management Committee.

Marianne Piterans is Director of Human Resources, Training, Security and Administrative Services for Third Federal Savings and Loan. Prior to joining Third Federal Savings and Loan in 1992, Ms. Piterans served as Senior Vice President of Society National Bank, where she worked for 20 years. Ms. Piterans brings a strong knowledge of the employees and communities served by the Company, which provides a unique perspective to the Board.

Business Experience of Each Continuing Director

Martin J. Cohen has been a managing partner of H & M Management Company, a real estate management company, since 1975 and is manager and part owner of eight apartment complexes. He has managed and owned other commercial and single family properties. Mr. Cohen also has previous financial-related experience in the banking industry and has maintained leadership positions in various trade and community organizations. These skills provide a useful resource in his service on the Board and the Audit Committee.

Robert A. Fiala is president of the architecture firm ThenDesign, which he founded in 1989. He is also a member of the Willoughby, Ohio, City Council, where he currently serves as Council Vice President. Mr. Fiala is a current and past board member of several local nonprofit institutions. Mr. Fiala s management and business experience in operating his own company and his extensive civic and community responsibilities bring extensive knowledge and business acumen, as well as knowledge of the local community served by the Company, to his service on the Board and the Compensation Committee.

William C. Mulligan has served as a managing director of Primus Capital Funds, a private equity firm, since 1987. Mr. Mulligan joined Primus Capital Funds in 1985 from McKinsey & Company, Inc., an international management consulting firm. Mr. Mulligan serves as a director of several private companies and one public company, Universal Electronics, Inc. Mr. Mulligan s exposure to a wide range of companies and strategic acquisitions provides extensive business, financial and risk management skills that are important to his service on the Board and the Audit and Compensation Committees.

Paul W. Stefanik worked for Third Federal Savings and Loan for 30 years prior to his retirement in 1993. In 1987, Mr. Stefanik was appointed Executive Vice President of Branch Administration, a position he held until his

Table of Contents

retirement. Mr. Stefanik s many years of service in various areas of Third Federal Savings and Loan bring knowledge of the financial, operational and regulatory challenges faced by the Company and are important to his service on the Board and the Audit Committee.

Ben S. Stefanski III is currently Director of Direct Sales at Patagonia, Inc., a $320 million outdoor retail company. Mr. Stefanski has been employed by Patagonia, Inc. since 2001 and has led a number of teams, including Patagonia, Inc. s call centers and inventory groups. Mr. Stefanski has previously served on the board of the Third Federal Foundation. He is the nephew of Marc A. Stefanski and grandson of Ben and Gerome Stefanski, the founders of Third Federal Savings and Loan. Mr. Stefanski provides a retail business perspective that is important to his service on the Board and the Enterprise Risk Management Committee.

Marc A. Stefanski joined Third Federal Savings and Loan in 1982 and was elected Chairman of the Board and Chief Executive Officer in 1988, succeeding his father in these positions. He was elected President of Third Federal Savings and Loan and the Company in 2000. Mr. Stefanski s parents, Ben and Gerome Stefanski, founded Third Federal Savings and Loan in 1938. Mr. Stefanski s values, leadership skills, extensive experience overseeing the growth of Third Federal Savings and Loan and the Company and extensive knowledge of the industry, the Company and the community are considered valuable assets to the Board.

CORPORATE GOVERNANCE

Meetings of the Board of Directors

During the fiscal year ended September 30, 2011, our Board of Directors met 12 times and the board of directors of Third Federal Savings and Loan, which consists of the same directors as our Board of Directors, met 12 times. During the fiscal year ended September 30, 2011 or such period during the fiscal year as an individual may have served as a director, no director attended fewer than 75% of the total number of meetings of our Board of Directors and the total number of meetings held by all committees on which the director served. The Company anticipates that all of its directors will attend the annual meeting of stockholders. All directors serving at the time of last year s annual meeting attended that meeting, except for Mr. Mulligan, who was unable to attend. Our Board of Directors has established various standing committees, including an Audit Committee, Compensation Committee, Executive Committee and Enterprise Risk Management Committee. The full Board of Directors acts as the Company s nominating committee.

Independent Directors

A majority of our Board of Directors and all members of the Audit Committee, Compensation Committee and Enterprise Risk Management Committee are independent, as affirmatively determined by our Board of Directors consistent with the criteria established by the NASDAQ Stock Market.

Our Board of Directors conducts an annual review of director independence for all current nominees for election as directors and all continuing directors. In connection with this review, our Board of Directors considers all relevant facts and circumstances relating to relationships that each director, his or her immediate family members and their related interests had with the Company and its subsidiaries.

As a result of this review, our Board of Directors affirmatively determined that nominees Asher, Heisler and Ozan and continuing directors Cohen, Fiala, Mulligan, Stefanik and Stefanski III are independent. Our Board of Directors determined that nominees Kobak and Piterans and continuing director Stefanski are not independent because they are associates of the Company.

Board Leadership Structure and Risk Oversight

Pursuant to the Company s bylaws, the Board of Directors is responsible for the selection of a Chairman of the Board and a President of the Company, and may further designate the Chairman of the Board as an officer.

Mr. Stefanski currently serves as our Chairman of the Board, President, and Chief Executive Officer. The Board of Directors believes that this structure provides the optimal leadership model for us. Combining the Chairman of the Board and President and Chief Executive Officer roles fosters accountability, effective decision-making and alignment between interests of the Board of Directors and management. Mr. Stefanski also is able to use the in-depth focus and perspective gained in his executive function to assist our Board of Directors in addressing both internal and external issues affecting the Company. This structure also allows a single person to act as a spokesperson for the Company and to represent and speak on our behalf to our customers, employees and regulators. It also best leverages Mr. Stefanski s unique attributes and heritage as his family s name and history are an important part of our brand image.

While the Board of Directors does not have a lead independent director, we feel that having a majority of independent directors, a discrete and independent committee system and periodic meetings of non-management directors in executive session permits the Board to maintain effective oversight of the Company s management. Nevertheless, the Board of Directors periodically reviews its leadership structure to ensure that it meets the Company s needs. In fiscal year 2011, the Board met in this capacity to approve a director succession plan and a management succession plan.

Our Board of Directors assists in monitoring the risks inherent in the Company s business model and internal operations, including risk relating to changes in interest rates, risk relating to the Company s investments, risk relating to the Company s lending activities and risks arising from the Company s compensation policies and practices.

Because a majority of the Company s assets and liabilities are monetary in nature, the Company s most significant form of risk, and thus the risk most important to manage, is interest rate risk. In general, our assets, consisting primarily of mortgage loans, have longer maturities than our liabilities, consisting primarily of deposits. As a result, a principal part of our business strategy is to manage interest rate risk and limit the exposure of our net interest income to changes in market interest rates. Accordingly, the Board of Directors has established risk management guidelines and an Asset/Liability Management Committee consisting of members of management. This committee is responsible for evaluating the interest rate risk inherent in our assets and liabilities, for determining the level of risk that is appropriate, given our business strategy, operating environment, capital, liquidity and performance objectives, and for managing this risk consistent with the guidelines approved by the Board of Directors. The committee meets quarterly, and more frequently if necessary, and provides reports of its proceedings to the Board of Directors.

The Company is also exposed to risk from the assets in which it invests. As part of its risk oversight, the Board of Directors is responsible for establishing and overseeing the Company s investment policy, which is reviewed at least annually by management, and any changes to the policy are subject to approval by the Board of Directors. This policy dictates that investment decisions be made based on the safety of the investment, liquidity requirements, potential returns, the ability to provide collateral for pledging requirements, and consistency with our interest rate risk management strategy. Third Federal Savings and Loan also maintains an Investment Committee made up of members of management, which oversees investing activities and strategies and policies. The committee meets quarterly, or more frequently as necessary, and provides reports of its proceedings to the Board s Executive Committee.

A third category of risk to which the Company is exposed is risk from its lending activities. As part of its risk oversight, the Board of Directors has established underwriting standards and loan origination procedures, including loan approval limits. The Board of Directors has delegated authority to its Executive Committee to review and assign lending authority to certain individuals of the Company to consider and approve loans within their designated authority.

Pursuant to a memorandum of understanding entered into between the Company and its former primary regulator, the Office of Thrift Supervision, the Board of Directors engaged Promontory Financial Group, LLC (Promontory) to review and assess the Company s risk management organization, structure, programs and

Table of Contents

practices. The review and assessment focused on credit risk, market, interest rate, liquidity and operational risk, including compliance risk. The Board considered and directed that management implement the recommendations presented by Promontory to decrease the Company s exposure to these areas of risk.

On April 28, 2011, the Board of Directors formed an Enterprise Risk Management Committee to oversee the Company s risk management processes and delegated to it responsibilities with respect to risk management oversight, including responsibilities with respect to interest rate, investing and lending risk. Although it does not directly supervise the Company s Investment Committee or Asset/Liability Management Committee, the Enterprise Risk Management Committee is responsible for the regular review of their guidelines, policies and deliberations. The Committee also reviews the Company s strategies, policies and practices to identify, assess, report and manage risk exposures and considers similar risk assessments presented to it by the Company s internal management risk committee.

On a more general level, the Audit Committee is also involved in the risk management process, as it annually reviews and approves the processes used by our internal audit department in developing our annual risk assessment, discusses any areas of high risk identified during an audit, inquires into significant risks facing the Company, and independently discusses with management the Company s policies with respect to risk assessment and risk management.

As part of our bonus program, the Compensation Committee has negative discretion to reduce the amount payable from the incentive pool based on certain measures, including interest rate risk and credit risk. In addition, the Company uses only non-commissioned associates to gather loan applications and underwrite and process loan requests. These measures are designed to reduce incentives for employees to cause the Company to take undue risk.

Our management has assessed our compensation policies and practices and has concluded that they are not reasonably likely to have a material adverse effect on the Company.

Executive Session

The non-management directors of our Board of Directors meet periodically in executive session.

Committee Membership and Roles

The following table provides details with respect to committee membership and roles as of September 30, 2011:

	Audit(1)	**Compensation**	**Executive**	**Risk Management**	**Nominating**
William C. Mulligan	þ(2)(3)	þ	þ		þ
Anthony J. Asher	þ	þ			þ
Martin J. Cohen	þ				þ
Paul W. Stefanik	þ				þ
Robert A. Fiala		þ(2)			þ
Marc A. Stefanski			þ(2)		þ
Bernard S. Kobak			þ		þ
Robert B. Heisler, Jr.				þ(2)	þ
Terrence R. Ozan				þ	þ
Ben S. Stefanski III				þ	þ
Marianne Piterans					þ

(1) - The Audit Committee also serves as our Qualified Legal Compliance Committee.

(2) - Committee chairperson.

(3) - Mr. Mulligan also serves as our audit committee financial expert.

8

Table of Contents

Audit Committee

The Audit Committee consists of Messrs. Mulligan (Chairman), Asher, Cohen and Stefanik. The Audit Committee is responsible for providing oversight relating to our financial statements and financial reporting process, systems of internal accounting and financial controls, internal audit function, annual independent audit and the compliance and ethics programs established by management and our Board of Directors. The Audit Committee also serves as our Qualified Legal Compliance Committee. Each member of the Audit Committee is independent in accordance with the listing standards of the NASDAQ Stock Market and under Rule 10A-3(b)(1) under the Securities Exchange Act of 1934, as amended. Our Board of Directors has determined that Mr. Mulligan is an audit committee financial expert as that term is defined by the rules and regulations of the Securities and Exchange Commission. The Audit Committee met nine times during the fiscal year ended September 30, 2011.

A current copy of the Audit Committee s charter is available on the Company s web site, www.thirdfederal.com, under Investor Relations and a written copy is available to stockholders upon written request to the Company, to the attention of Investor Relations at 7007 Broadway Avenue, Cleveland, Ohio 44105.

Compensation Committee

The members of the Compensation Committee of the Board of Directors (the Committee) are Messrs. Fiala (Chairman), Asher and Mulligan. All three members of the Committee served on the Committee throughout the fiscal year ended September 30, 2011, during which the Committee held five meetings.

The Committee is responsible for assisting our Board of Directors in the following primary areas:

- Reviewing and approving the goals and objectives relevant to the compensation of the Chief Executive Officer and the Company s other executive officers and ensuring those goals are aligned with the Company s short- and long-term objectives;
- Reviewing, at least annually, the structure and compensation opportunities available under the Company s executive and associate compensation plans in light of the Company s goals and objectives;
- Evaluating the risks arising from the Company s compensation policies and practices to determine whether they are reasonably likely to have a material adverse effect on the Company;
- Reviewing and approving salary, annual and long-term incentive compensation targets, performance objectives and payments for the executive officers of the Company;
- Evaluating, at least annually, the performance of the executive officers in light of the Company s strategic plan and the goals and objectives of the Company s executive compensation plans and establishing future compensation levels based upon this evaluation;
- Reviewing and approving grants and awards to the executive officers and other participants under equity-based compensation plans, based on achievement of pre-determined goals and objectives;
- Reviewing and approving compensation for members of our Board of Directors and any of its committees; and
- Reviewing and approving any employment agreement or severance agreement to be made with any existing or prospective executive officer of the Company.

The Committee engages a compensation consultant to assist in the design of the Company s compensation program and the review of its effectiveness.

Table of Contents

A copy of the Committee s charter is available on the Company s web site, www.thirdfederal.com, under Investor Relations and a written copy is available to stockholders upon written request to the Company, to the attention of Investor Relations at 7007 Broadway Avenue, Cleveland, Ohio 44105.

Executive Committee

The Executive Committee, which currently consists of Messrs. Stefanski (Chairman), Kobak and Mulligan, possesses the power of our Board of Directors during intervals between meetings of our Board of Directors in order to address various items, including approval of various policies and guidelines and significant agreements and contracts. The Executive Committee does not possess the power to fill vacancies on our Board of Directors or any Board of Directors committees. The Executive Committee held 13 meetings during the fiscal year ended September 30, 2011.

Enterprise Risk Management Committee

The Enterprise Risk Management Committee consists of Messrs. Heisler (Chairman), Ozan and Stefanski III. The Enterprise Risk Management Committee is responsible for providing oversight and monitoring relating to our risk management practices, procedures and tolerances. The Enterprise Risk Management Committee was formed April 28, 2011 and met once during the fiscal year ended September 30, 2011.

A copy of the committee s charter is available on the Company s website, www.thirdfederal.com, under Investor Relations and a written copy is available to stockholders upon written request to the Company, to the attention of Investor Relations at 7007 Broadway Avenue, Cleveland, Ohio 44105.

Nominating Committee

Our Board of Directors has determined that the Company is a Controlled company, as defined by the NASDAQ Stock Market, because Third Federal Savings and Loan Association of Cleveland, MHC currently owns more than 50% of our common stock. Therefore, the full Board of Directors acts as our nominating committee and does not have a separate nominating committee charter. The Board of Directors met twice in this capacity during the fiscal year ended September 30, 2011. In that capacity, our Board of Directors elected Messrs. Heisler and Ozan to fill open Board positions in March 2011 and recommended a slate of nominees for election by stockholders at the Company s 2012 annual meeting of stockholders.

As set forth in our Policy and Procedures for Stockholder Recommendations for Director Candidates (the Policy), our Board of Directors will consider suggestions forwarded by stockholders to the Secretary of the Company concerning qualified candidates for election as directors. To recommend a prospective nominee for our Board of Directors consideration, a stockholder may submit the candidate s name, qualifications and other pertinent information required by the Policy to the Company s Secretary at the following address: 7007 Broadway Avenue, Cleveland, Ohio 44105. To be timely, the submission must be received by the Secretary at least 150 days prior to the anniversary date of the proxy statement relating to the preceding year s annual meeting of stockholders.

Under our bylaws, no nomination for director, except one made by the Board of Directors, will be voted upon unless the nomination is made in writing and delivered to the Company s Secretary at least 30 days prior to the date of the annual meeting. Upon delivery, a nomination will be posted in a conspicuous place in each office of the Company. Ballots bearing the names of all persons nominated by the Board of Directors and by stockholders will be provided for use at the annual meeting. If the Board of Directors fails or refuses to act in regard to nominations for directors at least 20 days prior to the annual meeting, nominations for directors may be made at the annual meeting by any holders of shares of common stock entitled to vote, and will be voted upon.

Our Board of Directors has recommended for election each of the nominees identified in Proposal One: Election of Directors on page 4.

Table of Contents

A current copy of our Policy and Procedures for Stockholder Recommendations for Director Candidates is available on the Company s web site, www.thirdfederal.com, under Investor Relations and a written copy is available to stockholders upon written request to the Company, to the attention of Investor Relations at 7007 Broadway Avenue, Cleveland, Ohio 44105.

Our Board of Directors has not established specific minimum qualifications that a candidate must have in order to be recommended for election to our Board of Directors. However, in determining qualifications for new directors, our Board of Directors will consider a potential member s qualification as independent under the NASDAQ Stock Market listing standards, as well as his or her age, skill and experience in the context of the needs of the Board of Directors. Our Board of Directors does not have a specific policy with regard to its consideration of diversity of its directors, although diversity is one of many factors taken into account when considering potential candidates to serve on the Board of Directors.

When evaluating a candidate, the Board of Directors considers those attributes most likely to serve the interests of the Company and its stockholders. Those characteristics will ideally reflect a balance of professional and personal backgrounds that contribute to the Board of Directors performance of its functions in the highly competitive and closely regulated business in which the Company operates. If the Board of Directors believes that a potential candidate may be an appropriate nominee to the Board, the Board seeks to learn more about the candidate s qualifications, background and interest in serving on the Board, and the candidate has the opportunity to learn more about us, the Board and its governance practices.

Code of Conduct and Code of Ethics

The Company has adopted policies governing the activities of both the Company and Third Federal Savings and Loan, including a code of conduct and a code of ethics for senior financial officers. The code of conduct applies to all associates and directors, and addresses conflicts of interest, the treatment of confidential information, general associate conduct and compliance with applicable laws, rules and regulations. The code of ethics for senior financial officers applies to the Chief Executive Officer, the Chief Financial Officer and the Chief Accounting Officer, and addresses adherence to standards of integrity and professionalism when conducting and reporting the Company s financial affairs. In addition, the codes are designed to deter wrongdoing and to promote honest and ethical conduct, full and accurate disclosure and compliance with all applicable laws, rules and regulations. The codes are posted on the Company s web site, www.thirdfederal.com, under Investor Relations. Any waiver of any provision of either code granted to an executive officer or director may be made only by our Board of Directors. There were no waivers granted during fiscal year 2011.

REPORT OF THE AUDIT COMMITTEE

The Audit Committee reviews the Company s financial reporting practices on behalf of our Board of Directors. Management is responsible for the financial statements and the reporting process, including the system of internal controls. The Company s independent accountant is responsible for expressing an opinion on the conformity of those audited financial statements with accounting principles generally accepted in the United States of America.

The Audit Committee has:

Reviewed and discussed with management the audited financial statements of the Company contained in its Annual Report on Form 10-K for the fiscal year ended September 30, 2011;

	Discussed with the Company s independent accountant the matters required to be discussed pursuant to Statement of Auditing Standards No. 61, as amended (AICPA, Pr	(25,581)
Total shareholders' equity	668	1,720
Total liabilities and shareholders' equity	$9,060	$9,074

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands except per share data)	**Three Months Ended**	
	June 24,	**June 25,**
	2017	**2016**
Net sales	$1,991	$3,442
Cost of sales	1,525	2,517
Gross margin	466	925
Operating expenses:		
Engineering	452	530
Selling, general and administrative	1,171	1,305
Total operating expenses	1,623	1,835
Operating loss	(1,157)	(910)
Gain on sale of product line	—	802
Gain/(loss) on adjustment of warrant liability to fair value	—	46
Interest expense:		
Interest expense, net	(79)	(29)
Interest expense from accretion of loan discount	(22)	(11)
Total interest expense, net	(101)	(40)
Loss before income taxes	(1,258)	(102)
Provision for income taxes	—	—
Net loss	$(1,258)	$(102)
Loss per common share - basic	$(0.13)	$(0.01)
Loss per common share - diluted	$(0.13)	$(0.01)
Weighted average common shares used in per share calculation:		
Basic	9,715	9,550
Diluted	9,715	9,550

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

5

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)	Three Months Ended June 24, 2017	June 25, 2016
Cash flows from operating activities:		
Net loss	$(1,258)	$(102)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	247	91
Share based compensation	46	72
Adjustment of warrant liability to fair value	—	(46)
Capitalized software development costs	—	(334)
Estimated equity forward	46	—
Accretion of discounts on debt	22	11
Change in deferred rent	451	(32)
Gain on sale of product line	—	(802)
Changes in operating assets and liabilities:		
Trade accounts receivable	206	304
Inventories	(178)	(553)
Prepaid expenses and other assets	75	63
Accounts payable	(441)	(173)
Accrued payroll and benefits	(156)	81
Deferred revenue	(167)	1,101
Other current liabilities	—	(270)
Net cash used in operating activities	(1,107)	(589)
Cash flows from investing activities:		
Cash received from sale of product lines	—	1,225
Purchases of property and equipment	(620)	(30)
Net cash (used in) provided by investing activities	(620)	1,195
Cash flows from financing activities:		
Principal payments on capital leases	(13)	(11)
Proceeds from borrowings, net of issuance costs	1,456	—
Repayments of debt	—	(130)
Net cash provided by (used in) financing activities	1,443	(141)
(Decrease)/Increase in cash and cash-equivalents	(284)	465
Beginning cash and cash-equivalents	1,421	1,331
Ending cash and cash-equivalents	$1,137	$1,796
Supplementary disclosure of cash flow information:		
Cash paid for income taxes	$—	$—
Cash paid for interest	$39	$23

Supplementary disclosure of noncash investing and financing activities:		
Common stock issued in connection with debt issuance	**$** 156	**$** —
Fully depreciated equipment disposal	$ 377	$ 67

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

6

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Organization and Significant Accounting Policies

The condensed consolidated financial statements included herein have been prepared by Giga-tronics Incorporated (the "Company"), pursuant to the rules and regulations of the Securities and Exchange Commission. The consolidated results of operations for the interim periods shown in this report are not necessarily indicative of results to be expected for the fiscal year. In the opinion of management, the information contained herein reflects all adjustments (consisting of normal recurring entries) necessary to make the consolidated results of operations for the interim periods a fair statement of such operations. For further information, refer to the consolidated financial statements and footnotes thereto, included in the Annual Report on Form 10-K, filed with the Securities and Exchange Commission for the year ended March 25, 2017.

Principles of Consolidation The consolidated financial statements include the accounts of Giga-tronics and its wholly-owned subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation.

Derivatives The Company accounts for certain of its warrants and embedded debt features as derivatives. Changes in fair values are reported in earnings as gain or loss on adjustment of these instruments to fair value.

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

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

New Accounting Standards In November 2015, the FASB issued ASU 2015-17 – *Income Taxes (Topic 740): "Balance Sheet Classification of Deferred Taxes".* Topic 740 is effective for public business entities for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. For all other entities, the amendments are effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. The amendments may be applied prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. The amendments in ASU 2015-17 eliminates the current requirement for organizations to present deferred tax liabilities and assets as current and noncurrent in a classified balance sheet. Instead, organizations will be required to classify all deferred tax assets and liabilities as noncurrent. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09 ("ASU 2016-09"), *Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.* ASU 2016-09 simplifies several aspects of the accounting for employee share-based payments, including accounting for income taxes, forfeitures, statutory tax withholding requirements, and classification on the statement of cash flows. The amendments in this ASU are effective for annual periods beginning after December 15, 2016, with early adoption permitted. The Company adopted this standard in the first quarter ended June, 24, 2017, the adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In May 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-09 ("ASU 2017-09"), *Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting*. ASU 2017-09 was issued to provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The amendments in this ASU are effective for annual periods beginning after December 15, 2017. The Company does not expect that the standard will have a material effect on its consolidated financial statements and will apply this guidance to applicable transactions after the adoption date.

In February 2016, the FASB issued ASU 2016-02 ("ASU 2016-02"), Leases. ASU 2016-02 requires that lessees recognize assets and liabilities for the rights and obligations for leases with a lease term of more than one year. The amendments in this ASU are effective for annual periods ending after December 15, 2018. Early adoption is permitted. The Company is currently evaluating the impact of the adoption of ASU 2016-02 on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09 ("ASU 2014-09"), Revenue from Contracts with Customers. ASU 2014-09 establishes a broad principle that would require an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this principle, an entity identifies the contract with a customer, identifies the separate performance obligations in the contract, determines the transaction price, allocates the transaction price to the separate performance obligations and recognizes revenue when each separate performance obligation is satisfied. ASU 2014-09 was further updated in March, April, May, and December 2016 to provide clarification on a number of specific issues as well as requiring additional disclosures. ASU 2014-09 may be applied either retrospectively or through the use of a modified-retrospective method. The full retrospective method requires companies to recast each prior reporting period presented as if the new guidance had always existed. Under the modified retrospective method, companies would recognize the cumulative effect of initially applying the standard as an adjustment to opening retained earnings at the date of initial application. On July 9, 2015, the FASB approved a one year deferral of the effective date of ASU 2014-09 to annual reporting periods beginning after December 15, 2017. The Company has not yet completed its evaluation of the impact of ASU 2014-09 on its past and future revenue recognition and related disclosure.

(2) Going Concern and Management’s Plan

The Company incurred net losses of $1.3 million and $102,000 in the first quarter of fiscal 2018 and fiscal 2017, respectively. These losses have contributed to an accumulated deficit of $26.8 million as of June 24, 2017. The Company used cash flow in operations totaling $1.1 million and $589,000 in the first quarter of fiscal 2018 and 2017, respectively.

The Company has experienced delays in the development of features, receipt of orders, and shipments for the new Advanced Signal Generator (“ASG”). These delays have contributed, in part to a decrease in working capital. The new ASG product has shipped to several customers, but potential delays in the development of features, longer than anticipated sales cycles, or uncertainty as to the Company’s ability to efficiently manufacture the ASG, could significantly contribute to additional future losses and decreases in working capital.

To help fund operations, the Company relies on advances under the line of credit with Bridge Bank which expires on May 6, 2019. The agreement includes a subjective acceleration clause, which allows for amounts due under the facility to become immediately due in the event of a material adverse change in the Company’s business condition (financial or otherwise), operations, properties or prospects, or ability to repay the credit based on the lender’s judgement. As of June 24, 2017, the line of credit had a balance of $582,000.

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

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

On April 27, 2017, the Company entered into a new loan agreement with PFG. Under the terms of the agreement, PFG made a term loan to the Company in the principal amount of $1,500,000, with funding occurring on April 28, 2017. The loan has a two-year term, with interest only payments for the term of the loan. However, as of June 24, 2017, the Company was not in compliance with certain revenue and shareholders’ equity covenants. On August 2, 2017, the Company and PFG entered into a short-term forbearance arrangement (through the end of August) with respect to such noncompliance. No assurance can be given that the Company will be able to comply with the terms of the forbearance agreement that the parties agreed on, or that PFG will agree to a further extension of forbearance at the end of the initial forbearance period. The default interest rate associated with the forbearance agreement is 6%. The Company will most likely be required to raise additional capital to rectify the noncompliance. No assurance can be given that the Company will be able to raise sufficient capital on timely basis.

In July 2016, Microsource received a $1.9 million non-recurring engineering order associated with redesigning a component of its high performance YIG filter used on an aircraft platform. The Company delivered NRE services for approximately $314,000 during the first quarter of fiscal 2018 and we expect to continue such services over the next nine to twelve months.

In March 2017 and July 2017, Microsource received two orders totaling $875,000 associated with its high performance YIG filter used on an aircraft platform; we expect to start shipping the filters in the second quarter of fiscal 2018.

In July 2017, the Giga-tronics Division received a $1.7 million order from the United States Navy for the Real-Time Threat Emulation Systems ("TEmS") which the Company expects to ship in fiscal 2018.

With the elimination of Giga-tronics Switch, Power Meter, Amplifier, and Signal Generator legacy product lines resulting from the Asset Purchase Agreements with Spanawave and Astronics, (see Note 9, Sale of Product Lines), the Company has been able to reduce expenses, while providing additional cash for operations from the proceeds of the sales. The Company is also expecting longer term reductions in overhead costs by the relocating of its operations into a smaller facility beginning in the first quarter of fiscal 2018.

In the first quarter of fiscal 2016, the Company's Microsource business unit also finalized a multiyear $10.0 million YIG production order ("YIG Production Order"). The Company started shipping the YIG Production Order in the second quarter of fiscal 2017, and we expect to ship the remainder through fiscal 2020.

To assist with the upfront purchases of inventory required for future product deliveries, the Company entered into advance payment arrangements with certain customers, whereby the customers reimburse the Company for raw material purchases prior to the shipment of the finished products. In the first quarter of fiscal 2018, the Company entered into advance payment arrangements totaling $160,000. The Company will continue to seek similar terms in future agreements with these customers and other customers.

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

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

The Company's historical operating results and forecasting uncertainties indicate that substantial doubt exists related to the Company's ability to continue as a going concern. Forecasting uncertainties exist with respect to the ASG product line due to the potential longer than anticipated sales cycles as well as with potential delays in the refinement of certain features, and/or the Company's ability to efficiently manufacture it in a timely manner. The accompanying Consolidated Financial Statements have been prepared assuming that the Company will continue as a going concern and do not include any adjustments that might result if the Company were unable to do so.

(3) Revenue Recognition

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

a. It is commensurate with either of the following:

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

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

b. It relates solely to past performance.

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

Milestones for revenue recognition are agreed upon with the customer prior to the start of the contract and some milestones will be tied to product shipping while others will be tied to design review. In fiscal 2015 the Company's Microsource business unit received a $6.5 million order from a major aerospace company for non-recurring engineering services to develop a variant of its high performance fast tuning YIG filters for an aircraft platform and to deliver a limited number of flight-qualified prototype hardware units (the "NRE Order") which is being accounted for on a milestone basis. The Company considered factors such as estimated completion dates and product acceptance of the order prior to accounting for the NRE Order as milestone revenue. There was no revenue recognized during the three-month period ended June 24, 2017 as the Company had delivered all milestones associated with this contract.

During the three-month period ended June 25, 2016, revenue recognized on a milestone basis were $145,000.

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

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

The Company provides for estimated costs that may be incurred for product warranties at the time of shipment. The Company's warranty policy generally provides twelve to eighteen months depending on the customer. The estimated cost of warranty coverage is based on the Company's actual historical experience with its current products or similar products. For new products, 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.

(4) Inventories

Inventories net of inventory reserves totaling $3.4 million at June 24, 2017 and March 25, 2017, respectively consisted of the following:

(In thousands)	**June 24, 2017**	**March 25, 2017**
Raw materials	$1,411	$1,775
Work-in-progress	2,931	2,155
Finished goods	239	473
Demonstration inventory	408	408
Total	$4,989	$4,811

9

(5) Software Development Costs

On September 3, 2015, the Company entered a software development agreement with a major aerospace and defense company whereby the aerospace company developed and licensed its simulation software to the Company. The simulation software (also called Open Loop Simulator or OLS technology) is currently the aerospace company's intellectual property. The OLS technology generates threat simulations and enables various hardware to generate signals for performing threat analysis on systems under test. The Company licenses the OLS software as a bundled or integrated solution with its Advanced Signal Generator system.

The Company paid the aerospace company software development costs and fees for OLS of $1.2 million in the aggregate (this includes an amendment to the software development agreement for additional features and functionality), which was paid in monthly installments as the work was performed by the aerospace company through the third quarter of fiscal 2017. The OLS technology is a perpetual license agreement that may be terminated by the Company at any time as long as the Company provides a notice to the aerospace company and pays for the development costs incurred through the notice termination date. The Company is also obligated to pay royalties to the aerospace company on net sales of its Advanced Signal Generator product sold with the OLS software equal to seven percent of net sales price of each ASG system sold and subject to certain minimums. The Company expenses research and development costs as they are incurred. Development costs of computer software to be sold, leased, or otherwise marketed are subject to capitalization beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers.

As of June 24, 2017 and March 25, 2017, capitalized software costs were $582,000 and $733,000, respectively. The Company began amortizing the costs of capitalized software to cost of sales in third quarter of fiscal 2017 using the straight-line methodology over an estimated three-year amortization period. During the fourth quarter of fiscal 2017, the Company changed its estimated amortization period from three years to two years due to the longer than anticipated procurement cycle associated with the ASG TEmS product line. The Company also amortized capitalized software costs using the estimated percentage of revenue approach (which was greater than straight-line amortization) in the fourth quarter of fiscal 2017. During the first quarter of fiscal 2018, the Company had no revenues associated with its ASG TEmS product line and therefore amortized capitalized software costs on a straight-line basis. Amortization of capitalized software costs recorded during the first quarter of fiscal 2018 were $151,000. There was no amortization recorded in the first quarter of fiscal 2017 as the Company had not yet released its ASG TEmS units.

(6) Accounts Receivable Line of Credit

On June 1, 2015 the Company entered into a $2.5 million Revolving Accounts Receivable Line of Credit agreement with Bridge Bank. The agreement provides for a maximum borrowing capacity of $2.5 million of which $2.0 million is subject to a borrowing base calculation and $500,000 is non-formula based. On May 23, 2017, the Company renewed this credit line (which expired on May 7, 2017) through May 6, 2019.

The loan agreement is secured by all assets of the Company including intellectual property and general intangibles and provides for a borrowing capacity equal to 80% of eligible accounts receivable. The loan matures on May 6, 2019 and bears an interest rate, equal to 1.5% over the bank’s prime rate of interest (which was 4.25% at June 24, 2017 resulting in an interest rate of 5.75%). Interest is payable monthly with principal due upon maturity. The Company paid an annual commitment fee of $12,500 in May 2017. The loan agreement contains financial and non-financial covenants that are customary for this type of lending and includes a covenant to maintain an asset coverage ratio of at least 150% (defined as unrestricted cash and cash equivalents maintained with Bridge Bank, plus eligible accounts receivable aged less than 90 days from the invoice date, divided by the total amount of outstanding principal of all obligations under the loan agreement). While the Company maintained the asset coverage ratio, the Company was in a cross default at June 24, 2017, as a result of the PFG noncompliance described in Note 7 below.

The line of credit requires a lockbox arrangement, which provides for receipts to be swept daily to reduce borrowings outstanding at the discretion of Bridge Bank. This arrangement, combined with the existence of the subjective acceleration clause in the line of credit agreement, necessitates the line of credit be classified as a current liability on the balance sheet. The acceleration clause allows for amounts due under the facility to become immediately due in the event of a material adverse change in the Company’s business condition (financial or otherwise), operations, properties or prospects, or ability to repay the credit based on the lender's judgment. As of June 24, 2017, the Company’s total outstanding borrowings under the Bridge Bank line of credit were $582,000.

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

On April 27, 2017, the Company entered into a new loan agreement with PFG (Partners For Growth V, L.P.). Under the terms of the agreement, PFG made a term loan to Giga-tronics in the principal amount of $1,500,000, with funding occurring on April 28, 2017.

The loan has a two-year term, with interest only payments for the term of the loan. The principal amount of the loan plus any accrued interest will be due upon maturity. The loan bears interest at an aggregate per annum rate equal to 16% per annum, fixed, which is comprised of cash interest reflecting a 9.5% per annum rate and deferred interest reflecting a 6.5% per annum rate. The Company will pay the cash interest monthly and will accrue deferred interest on the unpaid principal balance. The deferred interest will be due and payable upon maturity. In addition, the Company agreed to pay PFG a charge of up to $100,000 due and payable upon maturity (the “back-end fee”), $76,000 of which was earned on April 27, 2017, and $24,000 of which is earned at the rate of $1,000 per month on the first day of each month if the loan principal (of any amount) is outstanding during any day of the prior month. If the Company meets or exceeds certain revenue and net income minimums in fiscal 2018, the amount could be reduced by 25 percent. To stay in compliance with the loan terms, the Company must meet certain financial covenants associated with minimum quarterly revenues and monthly minimum shareholders’ equity. The lender can accelerate the maturity of the loan in case of a default. The Company can prepay the loan before maturity at any time without fee or penalty.

In connection with its loan to the Company, PFG will receive up to 250,000 shares of common stock, 190,000 of which was earned on April 27, 2017 and 60,000 of which is earned at the rate of 2,500 per month on the first day of each month if the loan principal (of any amount) is outstanding during any day of the prior month.

The Company has pledged all its assets as collateral for the loan made by PFG, including all its accounts, inventory, equipment, deposit accounts, intellectual property and all other personal property. The PFG loan is subordinate to the Bridge Bank line of credit (see Note 6, Accounts Receivable Line of Credit).

The requirement to issue 60,000 shares of the Company's common stock over the term of the loan is an embedded derivative (an embedded equity forward). The Company evaluated the embedded derivative in accordance with ASC 815-15-25. The embedded derivative is not clearly and closely related to the debt host instrument and therefore has been separately measured at fair value, with subsequent changes in fair value recognized in the Condensed Consolidated Statements of Operations.

The proceeds received upon issuing the loan was allocated to: i) common stock, for the fair value of the 190,000 shares of common stock initially issued to the lender; ii) the fair value of the embedded derivative; and iii) the loan host instrument. Upon issuance of the loan, the Company recognized $1,576,000 of principal payable to PFG, representing the stated principal balance of $1,500,000 plus the initial back-end fee of $76,000. The initial carrying value of the loan was recognized net of debt discount aggregating approximately $326,000, which is comprised of the following:

Fees paid to the lender and third parties	$44,000
Backend fee	76,000
Estimated fair value of embedded equity forward	49,000
Fair value of 190,000 shares of common stock issued to lender	157,000
Aggregate discount amount	$326,000

The bifurcated embedded derivative and the debt discount are presented net with the related loan balance in the Condensed Consolidated Balance Sheets. The debt discount is amortized to interest expense over the loan's term using the effective interest method.

The Company amortized approximately $22,000 to interest expense in the quarter ended June 24, 2017. Additionally, the Company recognized a loss of approximately $500 in the in the quarter ended June 24, 2017 due to the estimated increase in fair value of the embedded equity forward.

PFG's ability to call the debt on default (contingent put) and its ability to assess interest rate at a default rate (contingent interest) are embedded derivatives which the Company evaluated. The fair value of these embedded features were determined to be immaterial and were not bifurcated from the debt host for accounting purposes.

As of June 24, 2017, the Company was not in compliance with certain financial covenants associated with the PFG loan. On August 2, 2017, the Company and PFG entered into a short-term forbearance arrangement (through the end of August) with respect to such noncompliance. No assurance can be given that the Company will be able to comply with the terms of the forbearance agreement that the parties agreed on, or that PFG will agree to a further extension of forbearance at the end of the initial forbearance period. There is a 6% default rate associated with the forbearance agreement. The Company will most likely be required to raise additional capital to rectify the noncompliance. No assurance can be given that the Company will be able to raise sufficient capital on timely basis.

On March 13, 2014, the Company entered into a three year, $2.0 million term loan agreement with PFG under which the Company received $1.0 million on March 14, 2014 ("First Draw"). Interest on the initial $1.0 million term loan was fixed at 9.75%. On June 16, 2014, the Company amended its loan agreement with PFG (the "Amendment"). Under the terms of the Amendment, PFG made a revolving credit line available to Giga-tronics in the amount of $500,000, and the Company borrowed the entire amount on June 17, 2014. The revolving line had a thirty-three month term. The Amendment reduced the future amount potentially available for the Company to borrow under the PFG Loan agreement from $1.0 million to $500,000. The interest on the PFG revolving credit line was fixed, calculated on a daily basis at a rate of 12.50% per annum. The Company as of June 24, 2017, and March 25, 2017 had fully repaid both the $1.0 million term loan and the $500,000 revolving credit line.

In connection with the March 2014 loan agreement, the Company issued warrants convertible into shares of the Company's common stock, of which 180,000 were exercisable upon receipt of the initial $1.0 million from the First Draw, and 80,000 became exercisable with the First Amendment. Each warrant issued under the loan agreement has a term of five years and an exercise price of $1.42 which was equal to the average NASDAQ closing price of the Company's common stock for the ten trading days prior to the First Draw.

If the warrants are not exercised before expiration on March 31, 2019, the Company would be required to pay PFG $150,000 and $67,000 as settlement for warrants associated with the First Draw and the Amendment, respectively. The warrants could be settled for cash at an earlier date in the event of any acquisition or other change in control of the Company, future public issuance of Company securities or liquidation (or substantially similar event) of the Company. The Company currently has no definitive plans for any of the aforementioned events, and as a result, the cash payment date is estimated to be the expiration date unless warrants are exercised before then. The warrants have the characteristics of both debt and equity and are accounted for as a derivative liability measured at fair value each reporting period with the change in fair value recorded in earnings.

As of June 24, 2017, and March 25, 2017, the estimated fair values of the derivative liabilities associated with the warrants issued in connection with the First Draw and Amendment were $133,000 and $89,000, respectively, for a combined value of $222,000, respectively. There was no change in the fair value of the warrant liability in the first quarter ended June 24, 2017. The change in the fair value of the warrant liability totaled $46,000 for the first quarter ended June 25, 2016 and is reported in the accompanying statement of operations as a gain on adjustment of derivative liability to fair value. There was no accretion recorded in the first quarter ended June 24, 2017 in connection with the March 2014 loan agreement as the loan was paid in full. For the quarter ended June 25, 2016, the Company recorded accretion of discount expense associated with the warrants issued with the PFG Loan of $11,000.

(8) Fair Value

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

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

- *Level 1* —Valuations are based on quoted prices in active markets for identical assets or liabilities and readily accessible by us at the reporting date. Examples of assets and liabilities utilizing Level 1 inputs are certain money market funds, U.S. Treasuries and trading securities with quoted prices on active markets.
- *Level 2* —Valuations based on inputs other than the quoted prices in active markets that are observable either directly or indirectly in active markets. Examples of assets and liabilities utilizing Level 2 inputs are U.S. government agency bonds, corporate bonds, commercial paper, certificates of deposit and over-the- counter derivatives.
- *Level 3* —Valuations based on unobservable inputs in which there are little or no market data, which require us to develop our own assumptions.

Fair value measurements discussed herein are based upon certain market assumptions and pertinent information available to management as of and during the three month period ended June 24, 2017. The carrying values of cash and cash equivalents, trade accounts receivable, line of credit, term debt and accounts payable approximate their fair values given their short-term nature. As of June 24, 2017, the carrying value of the outstanding PFG loan approximates the estimated aggregate fair value, since the embedded equity forward is recognized at fair value and classified with the loan host. The fair value estimate of the embedded equity forward is based on the closing price of the Company's common stock on the measurement date, the risk-free rate, the date of expiration, and any expected cash distributions of the underlying asset before expiration. The estimated fair value of the embedded equity forward represents a Level 2 measurement.

Derivatives The Company does not use derivative instruments to hedge exposures to cash flow, market, or foreign currency risks. The Company evaluates all of its financial instruments, including notes payable, to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. The Company accounts for certain of its warrants as derivatives. Changes in fair values are reported in earnings as gain or loss on adjustment of warrant liability to fair value.

Embedded derivatives must be separately measured from the host contract if all the requirements for bifurcation are met. The assessment of the conditions surrounding the bifurcation of embedded derivatives depends on the nature of the host contract. Bifurcated embedded derivatives are recognized at fair value, with changes in fair value recognized in the statement of operations each period. Bifurcated embedded derivatives are classified with the related host contract in the Company's balance sheet.

The Company's derivative warrant liability is measured at fair value on a recurring basis and is categorized as Level 3 in the fair value hierarchy. The derivative warrant liability is valued using a Monte Carlo simulation model, which used the following assumptions as of June 24, 2017: (i) the remaining expected life of 1.7 years, (ii) the Company's historical volatility rate of 101.1%, (iii) risk-free interest rate of 1.26%, and (iv) a discount rate of thirty percent.

The aforementioned derivative warrant liability and equity forward are the Company's only asset and liability recognized and measured at fair value on a recurring or non-recurring basis and are follows:

Fair Value Measurements as of June 24, 2017

(In Thousands):

	Level 1	**Level 2**	**Level 3**
Warrant liability	$ —	$ —	$ 222
Equity forward	—	46	—

Total	$ —	$ 46	$ 222

Fair Value Measurements as of March 25, 2017

(In Thousands):

	Level 1	**Level 2**	**Level 3**
Warrant liability	$ —	$ —	$ 222
Total	$ —	$ —	$ 222

There were no transfers between Level 1, Level 2 or Level 3 for the quarter ended June 24, 2017.

The table below summarizes changes in gains and losses recorded in earnings for Level 3 assets and liabilities that are still held at June 24, 2017:

(In thousands)	**Quarter Ended June 24, 2017**	**Quarter Ended June 25, 2016**
Warrant liability at beginning of year	$ 222	$ 353
Gains on adjustment of warrant liability to fair value	—	(46)
Losses on adjustment of warrant liability to fair value	—	—
Warrant liability at end of period	$ 222	$ 307

There were no assets measured at fair value on a recurring basis and there were no assets or liabilities measured on a non-recurring basis at June 24, 2017 and March 25, 2017.

The following table presents quantitative information about recurring Level 3 fair value measurements at June 24, 2017 and March 25, 2017:

June 24, 2017	**Valuation Technique(s)**	**Unobservable Input**	
Warrant liability	Monte Carlo	Discount rate	30%

March 25, 2017	**Valuation Techniques(s)**	**Unobservable Input**	
Warrant liability	Monte Carlo	Discount rate	24%

The discount rate of thirty percent at June 24, 2017, and twenty four percent at March 25, 2017 is management's estimate of the cost of capital given the Company's credit worthiness. A significant increase in the discount rate would significantly decrease the fair value, but the magnitude of this decrease would be less significant in a scenario where the Company's stock price is significantly higher than the exercise price since the holder's option to take a cash payment at maturity represents a smaller component of the total fair value when the Company's stock price is higher. The Monte Carlo simulation model simulated the Company's stock price through the maturity date of March 31, 2019. At the end of the simulated period, the value of the warrant was determined based on the greater of (1) the net share settlement value, (2) the net exercise value, or (3) the fixed cash put value.

(9) Sale of Product Lines

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

(In thousands)	Quarter Ended June 25, 2016
Cash received from Astronics	$ 850
Cash paid to buy out future commission obligation	(170)
Employee severance	(97)
Legal fees	(13)
Commissions	(46)
Warranty Liability released	278
Net gain recognized in the quarter	$ 802

In calculating the gain included in the accompanying consolidated financial statements, the Company released $278,000 of deferred warranty obligations related to the Switch asset. Pursuant to the terms of the agreement, Astronics assumed all the warranty obligations for the Switch product line, including the products sold prior to the asset being transferred to Astronics. The deferred warranty obligation was previously included in other current liabilities in the consolidated financial statements. The Company also had a previous agreement with a consultant supporting the Switch product line, which included a three percent commission on the sales of the Switch product line for a period of 4 years ending in January 2020. The agreement allowed for a buyout of future commissions associated with the Switch product, which the Company exercised in connection with the Astronics sales in June 2016 which resulted in a payment by the Company during June of $170,000. Astronics also purchased approximately $500,000 of related materials inventory from Giga-tronics between July and August of 2016.

The Company had no revenues or gross margin associated with the Switch product line in the first quarter ended June 24, 2017. The Switch product line accounted for $1.1 million in revenue for the fiscal quarter ended June 25, 2016. The Switch product line’s gross margin on revenues was $437,000 for the fiscal quarter ended June 25, 2016. While the Company is able to distinguish revenue and gross margin information related to the sale of the Switch product line, the Company is unable to present meaningful information about results of operation and cash flows from the Switch product line.

On December 15, 2015, the Company entered into an Asset Purchase Agreement with Spanawave Corporation, whereby Spanawave agreed to purchase the Giga-tronics' Division product lines for its Power Meters, Amplifiers, and Legacy Signal Generators for $1.5 million. The agreement provided for the transfer of these product lines to Spanawave sequentially in six phases beginning with certain sensor and amplifier products. The Company had transferred the Power Meters and Amplifiers in phases one through five, the Company still holds the right to phase 6 (Legacy Signal Generators). During the second quarter ended September 24, 2016, the Company and Spanawave became engaged in a dispute, including litigation initiated by Spanawave and an arbitration proceeding initiated by Spanawave's affiliate Liberty Test Equipment, Inc., as to whether the Company has fulfilled all the requirements to close phases one through five and become entitled to the $375,000 received by the Company during the first quarter of fiscal 2017 (see below).

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

During fiscal 2017, the Company received $750,000 from Spanawave under the agreement. Of this amount, the Company returned $375,000 to Spanawave on July 28, 2016 resulting from the dispute regarding the status of phases one through five. The remaining $375,000 is included in deferred liability related to asset sales in the consolidated balance sheet. In addition, in June 2016, the Company received approximately $275,000 in exchange for raw material purchases. The purchase price of the raw materials approximated its carrying value, therefore no gain or loss was recognized. The parties are currently attempting to resolve this dispute. No gain has been recognized in connection with this product line sale because of the aforementioned dispute. These product lines accounted for approximately $95,000 and $275,000 in revenue during the fiscal quarter ended June 24, 2017, and June 25, 2016, respectively. For the fiscal quarter ended June 24, 2017, gross margin was immaterial. There was no margin associated with the revenue derived in the first quarter of fiscal 2017 as the revenues were primarily related to inventory transfer at book value. While the Company is able to distinguish revenue and gross margin information related to the sale of these product lines, the Company is unable to present meaningful information about results of operation and cash flows from these product lines.

(10) Loss Per Share

Basic loss per share (EPS) is calculated by dividing net income or loss by the weighted average common shares outstanding during the period. Diluted EPS reflects the net incremental shares that would be issued if unvested restricted shares became vested and dilutive outstanding stock options were exercised, using the treasury stock method. In the case of a net loss, it is assumed that no incremental shares would be issued because they would be antidilutive. 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 June 24, 2017**	**June 25, 2016**
Net loss	$(1,258)	$(102)
Weighted average:		
Common shares outstanding	9,715	9,550
Potential common shares	—	—
Common shares assuming dilution	9,715	9,550
Loss per common share – basic	$(0.13)	$(0.01)
Loss per common share – diluted	$(0.13)	$(0.01)
Stock options not included in computation that could potentially dilute EPS in the future	1,104	1,529
Restricted stock awards not included in computation that could potentially dilute EPS in the future	350	—
Issuable shares for interest on loan	55	—
Convertible preferred stock not included in computation that could potentially dilute EPS in the future	1,853	1,853
Warrants not included in computation that could potentially dilute EPS in the future	3,737	3,737

The stock options, restricted stock, convertible preferred stocks and warrants not included in the computation of diluted earnings per share (EPS) for the three month period ended June 24, 2017 and June 25, 2016 is a result of the Company's net loss and, therefore, the effect of these instruments would be anti-dilutive.

(11) Share Based Compensation

The Company has established the 2005 Equity Incentive Plan, which provide for the granting of options and restricted stock for up to 2,850,000 shares of common stock at 100% of fair market value at the date of grant, with each grant requiring approval by the Board of Directors of the Company. The 2005 Plan has been extended to be effective until 2025. Option grants under the 2000 Stock Option Plan are no longer available. Options granted generally vest in one or more installments in a four or five year period and must be exercised while the grantee is employed by the Company or within a certain period after termination of employment. Options granted to employees shall not have terms in excess of 10 years from the grant date. Holders of options may be granted stock appreciation rights (SARs), which entitle them to surrender outstanding awards for a cash distribution under certain changes in ownership of the Company, as defined in the stock option plan. As of June 24, 2017, no SAR's have been granted under the option plan. As of June 24, 2017, the total number of shares of common stock available for issuance was 934,677. All outstanding options have a ten year life from the date of grant. The Company records compensation cost associated with share-based compensation equivalent to the estimated fair value of the awards over the requisite service period.

Stock Options

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

	Three Months Ended	
	June 24, 2017	June 25, 2016
Dividend yield	—	—
Expected volatility	—	98.95 %
Risk-free interest rate	—	1.38 %
Expected term (years)	—	8.36

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

A summary of the changes in stock options outstanding for the three-month period ended June 24, 2017 and the year ended March 25, 2017 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Terms (Years)	Aggregate Intrinsic Value
Outstanding at March 26, 2016	1,592,200	$ 1.52	6.8	$ 69
Granted	148,000	0.97		
Exercised	—	—		
Forfeited / Expired	635,700	1.57		
Outstanding at March 25, 2017	1,104,500	$ 1.41	6.1	$ 3
Granted	—	—		
Exercised	—	—		
Forfeited / Expired	—	—		
Outstanding at June 24, 2017	1,104,500	$ 1.41	6.1	$ 3
Exercisable at June 24, 2017	812,050	$ 1.45	5.2	$ —
At June 24, 2017 expected to vest in the future	1,006,157	$ 1.42	5.7	$ —

As of June 24, 2017, there was $156,000 of total unrecognized compensation cost related to non-vested options. That cost is expected to be recognized over a weighted average period of 3.06 years and will be adjusted for subsequent changes in estimated forfeitures. There were 29,500 options that vested during the quarter ended June 24, 2017, and 28,500 options that vested during the quarter ended June 25, 2016. The total fair value of options vested during each of the quarters ended June 24, 2017 and June 25, 2016 was $33,000 and $1,000 respectively. There were no options exercised in the three-month period ended June 24, 2017 and June 25, 2016. Share based compensation cost related to stock options recognized in operating results for the three months ended June 24, 2017 and June 25, 2016 totaled $37,000 and $72,000, respectively.

Restricted Stock

The Company granted 350,450 restricted awards during the first quarter of fiscal 2018. No restricted awards were granted during the first quarter of fiscal 2017. No restricted awards vested during the first quarter of fiscal 2018 and 2017. The restricted stock awards are considered fixed awards as the number of shares and fair value at the grant date is amortized over the requisite service period net of estimated forfeitures. As of June 24, 2017, there was $204,000 of total unrecognized compensation cost related to non-vested awards. That cost is expected to be recognized over a weighted average period of 1.98 years and will be adjusted for subsequent changes in estimated forfeitures. Compensation cost recognized for the restricted and unrestricted stock awards during the first quarter of 2018 was $9,000. There was no compensation recognized for the restricted and unrestricted stock awards during the first quarter of fiscal 2017.

A summary of the changes in non-vested restricted stock awards outstanding for the three-month period ended June 24, 2017 and the fiscal year ended March 25, 2017 is as follows:

	Shares	Weighted Average Fair Value
Non-Vested at March 26, 2016	—	$ —
Granted	44,500	0.66
Vested	44,500	0.66
Forfeited or cancelled	—	—
Non-Vested at March 25, 2017	—	$ —
Granted	350,450	
Vested	—	
Forfeited or cancelled	—	—
Non-Vested at June 24, 2017	350,450	$ —

(12) Significant Customer and Industry Segment Information

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

The Giga-tronics Division historically produces a broad line of test and measurement equipment used primarily for the design, production, repair and maintenance of products in aerospace, telecommunications, RADAR, and electronic warfare.
Microsource primarily develops and manufactures YIG RADAR filters used in fighter jet aircraft for two prime contractors.

The tables below present information for the three month periods ended June 24, 2017 and June 25, 2016:

(In thousands)	**Three Month Periods Ended At June 24, 2017**	**June 24, 2017**		**Three Month Periods Ended At June 25, 2016**	**June 25, 2016**	
	Assets	**Net Sales**	**Net Income (Loss)**	**Assets**	**Net Sales**	**Net Income (Loss)**
Giga-tronics Division	$6,153	$297	$(1,849)	$8,233	$2,125	$ (554)
Microsource	2,907	1,694	591	3,887	1,317	452
Total	$9,060	$1,991	$(1,258)	$12,120	$3,442	$ (102)

During the first quarter of fiscal 2018, one customer accounted for 43% of the Company's consolidated revenues and was included in the Microsource segment. A second customer accounted for 37% and was also included in the Microsource segment. During the first quarter of fiscal 2017, one customer accounted for 30% of the Company's consolidated revenues and was included in the Microsource segment. A second customer accounted for 22% and was included in the Giga-tronics Division. A third customer accounted for 17% of the Company's consolidated revenue and was also included in the Giga-tronics Division.

(13) Income Taxes

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

The Company recorded no tax expense for the three months ended June 24, 2017 and June 25, 2016. The effective tax rate for the three months ended June 24, 2017 and June 25, 2016 was 0% respectively, primarily due to a valuation allowance recorded against the net deferred tax asset balance.

As of June 24, 2017, the Company had recorded $120,000 for unrecognized tax benefits related to uncertain tax positions. The unrecognized tax benefit is netted against the non-current deferred tax asset on the Consolidated

Balance Sheet. The Company does not expect the liability for unrecognized tax benefits to change materially within the next 12 months. The Company does have a California Franchise Tax Board audit that is currently in process. The Company is working with the California Franchise Tax Board to resolve all audit issues and does not believe any material taxes, penalties and fees are due. However, as a result of the on-going examination, the Company recorded an estimated associated tax liability of $45,000 in the first quarter of fiscal 2015.

(14) Warranty Obligations

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

(In thousands)	**Three Months Ended June 24, 2017**	**Three Months Ended June 25, 2016**
Balance at beginning of period	$ 123	$ 60
Provision, net	1	112
Warranty costs incurred	(33)	(112)
Balance at end of period	$ 91	$ 60

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

On November 10, 2011, the Company received $2,199,000 in cash proceeds from Alara Capital AVI II, LLC, a Delaware limited liability company (the "Investor"), an investment vehicle sponsored by Active Value Investors, LLC, under a Securities Purchase Agreement entered into on October 31, 2011. Under the terms of the Securities Purchase Agreement, the Company issued 9,997 shares of its Series B Convertible Voting Perpetual Preferred Stock ("Series B Preferred Stock") to the Investor at a price of $220 per share. The Company has recorded $2.0 million as Series B Preferred Stock on the consolidated balance sheet which is net of stock offering costs of approximately $202,000 and represents the value attributable to both the convertible preferred stock and warrants issued to the Investor. After considering the value of the warrants, the effective conversion price of the preferred stock was greater than the common stock price on date of issue and therefore no beneficial conversion feature was present.

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

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

Each share of Series B, Series C and Series D Preferred Stock is convertible into one hundred shares of the Company’s common stock. In connection with the preferred stock issuance described above, the Company issued to the investor warrants to purchase a total of 1,017,405 common shares at an exercise price of $1.43 per share. These warrants were exercised in February 2015, and May 2015. The Company received funds from Alara in separate closings dated February 16, 2015 and February 23, 2015. Alara exercised a total of 1,002,818 of its existing Series C and Series D warrants to purchase common shares, all of which had an exercise price of $1.43 per share for total cash proceeds of $1,434,000, which was recorded net of $42,000 of stock issuance costs. As part of the consideration for this exercise, the Company sold to Alara two new warrants to purchase an additional 898,634 and 194,437 common shares at an exercise price of $1.78 and $1.76 per share, respectively, for a total purchase price of $137,000 or $0.125 per share. The new warrants have a term of five years and may be paid in cash or through a cashless net share settlement. The Company and Alara amended the remaining 14,587 warrants as part of the February closings. On May 14, 2015, Alara exercised the remaining 14,587 warrants by acquiring 7,216 of shares of the Company’s common stock through a cashless net share settlement.

The table below present information for the periods ended June 24, 2017 and March 25, 2017:

Preferred Stock

As of June 24, 2017 and March 25, 2017

	Designated Shares	Shares Issued	Shares Outstanding	Liquidation Preference (in thousands)
Series B	10,000.00	9,997.00	9,997.00	$ 2,309
Series C	3,500.00	3,424.65	3,424.65	500
Series D	6,000.00	5,111.86	5,111.86	731
Total	19,500.00	18,533.51	18,533.51	$ 3,540

(16) Private Placement Offering

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

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 25, 2017 Part I, under the heading "Risk Factors", and Part II, under the heading "Management's Discussion and Analysis of Financial Conditions and Results of Operations".

Company Overview

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

The Giga-tronics Division over the past thirty-five years has produced a broad line of test and measurement equipment used primarily for the design, production, repair and maintenance of products in aerospace, telecommunications, RADAR, and electronic warfare. Giga-tronics has recently completed a move within the test and measurement market from its legacy products to the newly developed ASG product. As part of this evolution certain legacy product lines were sold to raise additional capital. For example, we sold our SCPM product line to Teradyne in 2013, and in December of 2015, Giga-tronics sold its Power Meters, Amplifiers, and Legacy Signal Generators to Spanawave (see Note 9, Sale of Product Lines). In June of 2016, Giga-tronics sold its Switch product line to Astronics (see Note 9, Sale of Product Lines). With the sales of these legacy product lines, the Giga-tronics Division is solely focused on the ASG product in the test and measurement equipment market.

Microsource primarily develops and manufactures YIG RADAR filters used in fighter jet aircraft for two prime contractors. The Microsource YIG RADAR filters provide us with long term production and development contracts with strong gross margins.

The ASG has the potential to significantly grow product sales and achieve strong gross margins. However, Giga-tronics has experienced significant delays developing, manufacturing and receiving ASG customer orders. The ASG is the most technically complex and advanced product Giga-tronics has developed and manufactured, and we have experienced delays in bringing the product to market and efficiently manufacturing it. It is also priced significantly higher than any other Giga-tronics product, and we have experienced longer than anticipated procurement cycles in the electronic warfare market it services. The delays in the development and manufacturing of the ASG, along with the longer than anticipated procurement cycles, have significantly contributed to the increased operating losses in the first fiscal quarter of 2018 and prior years. Giga-tronics could experience similar losses in the current fiscal year if there are further delays in ASG features currently being developed, manufacturing efficiencies are not achieved, and customer orders are delayed. To bring the ASG to its full potential, Giga-tronics may be required to seek additional working capital, however, there are no assurances that such working capital will be available, or on terms acceptable to the Company.

Significant Orders

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

In July 2016, Microsource received a $1.9 million non-recurring engineering order associated with redesigning a component of its high performance YIG filter used on an aircraft platform. Of this NRE service order, we delivered approximately $884,000 in services during the first quarter ended June 24, 2017, and we expect to continue such services over the next nine to twelve months.

In March 2017, Microsource received a $404,000 YIG RADAR filter order from one of our customers. We expect to fulfil this order starting in the second quarter of fiscal 2018.

Also in July 2017, Microsource received an additional $471,000 YIG RADAR filter order from one of our customers. We expect to fulfil this order in fiscal 2018. This order is not reflected in the orders and backlog numbers reported below as it was received after June 24, 2017.

In July 2017, the Giga-tronics Division received a follow on $1.7 million order from the United States Navy for our Real-Time Threat Emulation System (TEmS) which is a combination of the ASG hardware platform, along with software developed and licensed to the Company from a major Aerospace and Defense Company. We expect to fulfil this order in the second quarter of fiscal 2018. This order is not reflected in the orders and backlog numbers reported below as it was received after June 24, 2017.

In June 2016, the Giga-tronics Division received a $3.3 million order from the United States Navy for our Real-Time Threat Emulation System (TEmS) which is a combination of the ASG hardware platform, along with software developed and licensed to the Company from a major Aerospace and Defense Company. The complete order included ASG blades, along with engineering services to integrate the Real-Time TEmS product with additional third party hardware and software for the customer. We fulfilled the Navy order during the fourth quarter of fiscal 2017. An additional order for $542,000 was received in July 2016 from the United States Navy for our ASG hardware only platform. We also fulfilled the $542,000 order in fiscal 2017.

18

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

Critical Accounting Policies

Please refer to the section of the Company’s Annual Report on Form 10-K for the year ended March 25, 2017 entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations —Critical Accounting Policies” for a discussion of our critical accounting policies. During the three months ended June 24, 2017, there were no material changes to these policies other than as disclosed in Note 1 Organization and Significant Accounting Policies.

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

Results of Operations

New orders received by segment are as follows:

NEW ORDERS

(Dollars in thousands)	**Three Month Periods Ended June 24, 2017**	**June 25, 2016**	**% change**
Giga-tronics Division	$—	$4,729	(100)%
Microsource	17	4,543	(100)%
Total	$17	$9,272	(100)%

New orders received in the first quarter of fiscal 2018 decreased nearly 100% to $17,000 from $9.3 million received in the first quarter of fiscal 2017. Both the Giga-tronics Division and Microsource segment saw decreases in orders in the first quarter of fiscal 2018. The Giga-tronics Division had no new ASG orders in the first quarter of fiscal 2018, the Company fulfilled the $3.3 million order from the US Navy associated with the Company's ASG in fiscal 2017. The Microsource business unit saw a decrease in the first quarter of fiscal 2018 as we fulfilled the $4.5 million YIG purchase order in fiscal 2017. The timing of receipt of expected large YIG filter contracts varies from period to period.

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

BACKLOG

(Dollars in thousands)	**June 24, 2017**	**June 25, 2016**	**% change**
Backlog of unfilled orders at end of period:			
Giga-tronics Division	$444	$3,861	(89)%
Microsource	8,924	14,506	(38)%
Total	$9,368	$18,367	(49)%
Backlog of unfilled orders shippable within one year:			
Giga-tronics Division	$444	$3,861	(89)%
Microsource	4,058	5,668	(28)%
Total	$4,502	$9,529	(53)%

Backlog at the end of the first quarter of fiscal 2018 decreased 49% compared to the end of the same period last year. The Giga-tronics ASG backlog at June 24, 2017 was $444,000, a $3.4 million decrease; the decrease in the backlog was due to the fulfilment of the Navy ASG order. Microsource saw a 38% decrease in backlog in the first quarter of fiscal 2018. The decrease is primarily due to the fulfilment of the $4.5 million YIG production Order. The minimal level of new orders and the decrease in backlog could have a material adverse effect on the Company's revenues, financial condition and ability to continue as a going concern.

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

ALLOCATION OF NET SALES

(Dollars in thousands)	Three Month Periods Ended June 24, 2017	June 25, 2016	% Change
Giga-tronics Division	$297	$2,125	(86)%
Microsource	1,694	1,317	29 %
Total	$1,991	$3,442	(42)%

Fiscal 2018 first quarter net sales were $2.0 million, a 42% decrease from the $3.4 million in the first quarter of fiscal 2017. Sales at Microsource increased 29% primarily due to an increase in YIG RADAR filter shipments and completion of certain related nonrecurring engineering (NRE) services. Net sales for the Company's Giga-tronics business unit were $297,000, an 86% decrease from $2.1 million in the first quarter of fiscal 2017. The decrease was primarily due to lower legacy product sales mainly due to recent product line divestitures as well as a decrease in the ASG product shipments. Sales for the Company's Advanced Signal Generator ("ASG") were $200,000 in the first quarter of fiscal 2018 compared to $674,000 in the first quarter of fiscal 2017.

Gross margins was as follows for the periods shown:

GROSS MARGIN

(Dollars in thousands)	Three Month Periods Ended June 24, 2017	June 25, 2016	% change
Total	$466	$925	65 %

Gross margin decreased in the first quarter of fiscal 2018 to $466,000 from $925,000 for the first quarter of fiscal 2017. The lower gross margin was primarily due to the lower net sales.

Operating expenses were as follows for the periods shown:

OPERATING EXPENSES

(Dollars in thousands)	Three Month Periods Ended June 24, 2017	June 25, 2016	% change
Engineering	$452	$530	(15)%
Selling, general and administrative	1,171	1,305	(10)%
Total	$1,623	$1,835	(12)%

Operating expenses decreased 12% or $212,000 in the first quarter of fiscal 2018 over fiscal 2017. Engineering expenses decreased $78,000, primarily due to a decrease in personnel related expenses as a result of the sale of the Switch and Legacy product lines. Selling, general and administrative decreased by $134,000 primarily due to a non-recurring severance charge associated with an officer departure which was included in the first quarter of fiscal 2017.

Gain on Sale of Product Line

On June 20, 2016, the Company entered into an Asset Purchase agreement for the sale of its Switch product line to Astronics. Upon signing the agreement, Astronics paid $850,000 to the Company for the intellectual property of the product line. The Company recognized a net gain of $802,000 in the first quarter ended June 25, 2016 after related expenses were subtracted from the sales price. The gain is included in the accompanying consolidated financial statements. During the three-month periods ended June 24, 2017, there was no revenue associated with Switch sales. During the three-month period ended June 25, 2016, net Switch sales were $1.1 million (see Note 9, Sale of Product Lines).

Derivative Liability

There was no gains or losses recorded in the first quarter of fiscal 2018. The Company recorded a gain of $46,000 in the first quarter of fiscal 2017 related to revaluation of the derivative liability associated with warrants issued with the PFG Loan (see Note 7, Term Loans, Revolving Line of Credit and Warrants).

Net Interest Expense

Net interest expense in the first quarter of fiscal 2018 was $102,000, an increase of $62,000 over the first quarter of fiscal 2017. Interest expense increased primarily due to the new loan with PFG, as well as additional interest accrued as a result of the Company’s noncompliance with certain PFG loan covenants. For the first quarter of fiscal 2018, interest expense includes $22,000 of accretion of discounts on the new PFG loan compared to $11,000 recorded in the first quarter of fiscal 2017.

Net Loss

Net loss was for the first quarter of fiscal 2018 was $1.3 million compared to a net loss of $102,000 recorded in the first quarter of fiscal 2017. The increase in net loss was primarily due to the $802,000 gain recorded associated with the sale of the Switch product line in the first quarter of fiscal 2017 as discussed above and lower sales.

Financial Condition and Liquidity

As of June 24, 2017, Giga-tronics had $1.1 million in cash and cash equivalents, compared to $1.4 million as of March 25, 2017. The Company had negative working capital at June 24, 2017 compared to $620,000 at March 25, 2017. The current ratio (current assets divided by current liabilities) at June 24, 2017 was 0.95 compared to 1.09 at March 25, 2017. The decrease in working capital is primarily due to declining revenues resulting in net losses in the recent periods.

The Company will need additional financing to continue to fund operations; such financing may not be available on terms favorable to the Company if at all, which raises substantial doubt about our ability to continue as a going concern as of the date of this report. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. If adequate funds are not available, the Company may be required to delay, reduce the scope of, or eliminate some of its operations. The Company plans to meet its capital requirements primarily through issuances of equity securities, future partnerships, debt financing or possible product line sales. Failure to generate revenue or raise additional capital would adversely affect our ability to achieve our intended business objectives. No assurance can be given that the Company will be able to meet its capital requirements through these means or otherwise.

Cash used in operating activities was $1.1 million for the three-month period ended June 24, 2017. Cash used in operating activities in the first quarter of fiscal 2018 resulted primarily from our net loss of $1.3 million, a decrease of

$441,000 in accounts payable, a decrease of $206,000 in accounts receivable and a decrease of $167,000 in deferred revenues. These were partially offset by non-cash charges of $247,000 for depreciation and amortization and an increase of $451,000 in deferred rent.

Cash used in operating activities was $589,000 for the three-month period ended June 25, 2016. Cash used in operating activities in the first quarter of fiscal 2017 resulted primarily from our net loss of $102,000, an increase in inventories of $553,000, and partially offset by an increase in deferred revenue of $1.1 million due to advance payment arrangements for raw materials. These uses of cash were partially offset by a decrease to accounts payable of $173,000.

Cash used in investing activities for the three-month period ended June 24, 2017 was $620,000, primarily for leasehold improvements in conjunction with the Company's relocation to Dublin, California.

Cash provided by investing activities was $1.2 million for the three-month period ended June 25, 2016. Cash provided by investing activities in the first quarter of fiscal 2017 resulted primarily from a cash payment from Astronics of $850,000 pertaining to the sale of our Switch product line as well as a cash payment from Spanawave of $375,000 pertaining to the sale of our legacy product lines. The cash payments were offset by additions to property and equipment of $30,000 in the first quarter of fiscal 2017. The additions in the first quarter ended fiscal 2017 were associated with equipment required to manufacture the ASG.

Cash provided by financing activities for the quarter ended June 24, 2017 was $1.4 million, primarily due to proceeds from the new term loan with PFG.

Cash used in financing activities for the quarter ended June 25, 2016 was $141,000, primarily due to the repayment of the Company's term loan with PFG.

The Company incurred net losses of $1.2 million and $102,000 in the first quarter of fiscal 2018 and fiscal 2017, respectively. These losses have contributed to an accumulated deficit of $26.8 million as of June 24, 2017.

The Company has experienced delays in the development of features, orders, and shipments for the new Advanced Signal Generator ("ASG"). These delays have contributed, in part to a decrease in working capital. The new ASG product has shipped to several customers, but potential delays in the development of features, longer than anticipated sales cycles, or the uncertainty as to our ability to efficiently manufacture the ASG, could significantly contribute to additional future losses and decreases in working capital.

To help fund operations, the Company relies on advances under the line of credit with Bridge Bank. The line of credit expires on May 6, 2019. The agreement includes a subjective acceleration clause, which allows for amounts due under the facility to become immediately due in the event of a material adverse change in the Company's business condition (financial or otherwise), operations, properties or prospects, or ability to repay the credit based on the lender's judgement. As of June 24, 2017, the line of credit had a balance of $582,000.

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

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

On April 27, 2017, the Company entered into a new loan agreement with PFG. Under the terms of the agreement, PFG made a term loan to the Company in the principal amount of $1,500,000, with funding occurring on April 28, 2017. The loan has a two-year term, with interest only payments for the term of the loan. However, as of June 24, 2017, the Company was not in compliance with certain revenue and shareholders' equity covenants. On August 2, 2017, the Company and PFG entered into a short-term forbearance arrangement (through the end of August) with respect to such noncompliance. No assurance can be given that the Company will be able to comply with the terms of the forbearance agreement that the parties agreed on, or that PFG will agree to a further extension of forbearance at the end of the initial forbearance period. The Company will most likely be required to raise additional capital to rectify the noncompliance. No assurance can be given that the Company will be able to raise sufficient capital on timely basis.

In July 2016, Microsource received a $1.9 million non-recurring engineering order associated with redesigning a component of its high performance YIG filter used on an aircraft platform. The Company delivered NRE services for approximately $314,000 during the first quarter of fiscal 2018 and we expect to continue such services over the next nine to twelve months.

In March 2017 and July 2017, Microsource received two orders totaling $875,000 associated with its high performance YIG filter used on an aircraft platform; we expect to start shipping the filters in the second quarter of fiscal 2018.

In July 2017, the Giga-tronics Division received a $1.7 million order from the United States Navy for the Real-Time Threat Emulation Systems ("TEmS") which the Company expects to ship in fiscal 2018.

With the elimination of Giga-tronics Switch, Power Meter, Amplifier, and Signal Generator legacy product lines resulting from the Asset Purchase Agreements with Spanawave and Astronics, (see Note 9, Sale of Product Lines), the Company has been able to reduce expenses, while providing additional cash for operations from the proceeds of the sales. The Company is also expecting longer term reductions in overhead costs by the relocating of its operations into a smaller facility beginning in the first quarter of fiscal 2018.

In the first quarter of fiscal 2016, the Company's Microsource business unit also finalized a multiyear $10.0 million YIG production order ("YIG Production Order"). The Company started shipping the YIG Production Order in the second quarter of fiscal 2017, and we expect to ship the remainder through fiscal 2020.

To assist with the upfront purchases of inventory required for future product deliveries, the Company entered into advance payment arrangements with certain customers, whereby the customers reimburse the Company for raw material purchases prior to the shipment of the finished products. In the first quarter of fiscal 2018, the Company entered into advance payment arrangements totaling $160,000. The Company will continue to seek similar terms in future agreements with these customers and other customers.

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

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

The Company’s historical operating results and forecasting uncertainties indicate that substantial doubt exists related to the Company’s ability to continue as a going concern. Forecasting uncertainties exist with respect to the ASG product line due to the potential longer than anticipated sales cycles as well as with potential delays in the refinement of certain features, and/or the Company’s ability to efficiently manufacture it in a timely manner. The accompanying Consolidated Financial Statements have been prepared assuming that the Company will continue as a going concern and do not include any adjustments that might result if the Company were unable to do so.

ITEM 3 - QUANTITATI VE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4 - CONTROLS AND PROCEDURES

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Co-Chief Executive Officers and Principal Accounting & Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of June 24, 2017, which is the end of the fiscal quarter covered by this report. Based upon that evaluation, the Co-Chief Executive Officers and Principle Accounting & Financial Officer concluded that the Company's disclosure controls and procedures are effective to provide reasonable assurances that (i) the information the Company is required to disclose in the reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time period required by the Commission’s rules and forms, and (ii) such information is accumulated and communicated to our management, including our Co-Chief Executive Officers and Principal Accounting & Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

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

II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

As of June 24, 2017, 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.

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

ITEM 1A – RISK FACTORS

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 24, 2017, except (i) with respect to the matter reported in Item 3, Defaults Upon Senior Securities, below and (ii) a continuing decrease in the Company's cash flow and liquidity, which increases the level of doubt as to the Company's ability to continue as a going concern.

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

None.

ITEM 3 – DEFAULTS UPON SENIOR SECURITIES

On April 27, 2017, the Company entered into a new loan agreement with PFG. Under the terms of the agreement, PFG made a term loan to the Company in the principal amount of $1,500,000. As of June 24, 2017, the Company was not in compliance with certain revenue and shareholders' equity covenants. On August 2, 2017, the Company and PFG entered into a short-term forbearance arrangement (through the end of August) with respect to such noncompliance. No assurance can be given that the Company will be able to comply with the terms of the forbearance agreement that the parties agreed on or that PFG will agree to a further extension of forbearance at the end of the initial forbearance period. The Company will most likely be required to raise additional capital to rectify the noncompliance. No assurance can be given that the Company will be able to raise sufficient capital on timely basis.

ITEM 4 – MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5 – OTHER INFORMATION

None.

ITEM 6 – EXHIBITS

31.1	Certification of Co-Chief Executive Officers pursuant to Section 302 of Sarbanes-Oxley Act.
31.2	Certification of Principal Accounting & Financial Officer pursuant to Section 302 of Sarbanes-Oxley Act.
32.1	Certification of Co-Chief Executive Officers pursuant to Section 906 of Sarbanes-Oxley Act.
32.2	Certification of Principal Accounting& Financial Officer pursuant to Section 906 of Sarbanes-Oxley Act.
101.INS**	XBRL Instance
101.SCH**	XBRL Taxonomy Extension Schema
101.CAL**	XBRL Taxonomy Extension Calculation
101.DEF**	XBRL Taxonomy Extension Definition
101.LAB**	XBRL Taxonomy Extension Labels
101.PRE**	XBRL Taxonomy Extension Presentation

SIGNATURES

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

	GIGA-TRONICS INCORPORATED (Registrant)
	By:
Date: August 4, 2017	/s/ John R. Regazzi John R. Regazzi Co-Chief Executive Officer (Principal Executive Officer)
Date: August 4, 2017	/s/ Suresh Nair Suresh Nair Co-Chief Executive Officer
Date: August 4, 2017	/s/ Temi Oduozor Temi Oduozor Corporate Controller & Principal Accounting & Officer

25