GIGA TRONICS INC
Form 10QSB
November 03, 2005

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-QSB

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended September 24, 2005 or**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT for the transition period from ____________________ to**

Commission File No. 0-12719
GIGA-TRONICS INCORPORATED
(Exact name of Registrant as specified in its charter)

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

Registrant s telephone number: (925) 328-4650

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

Yes þ No o

State the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practicable date:

Common stock outstanding as of November 1, 2005: 4,809,021 shares

Transitional Small Business Disclosure Format (Check one) Yes o No þ

GIGA-TRONICS INCORPORATED
INDEX

Table of Contents

Item 1

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands except share data)		September 24, 2005		March 26, 2005
(Unaudited)				
Assets				
Current assets				
Cash and cash equivalents	$	3,718	$	2,540
Notes receivable				7
Trade accounts receivable, net		1,645		3,145
Inventories		6,520		6,257
Prepaid expenses		247		227
Total current assets		12,130		12,176
Property and equipment, net		474		674
Other assets		85		111
Total assets	$	12,689	$	12,961
Liabilities and shareholders equity				
Current liabilities				
Accounts payable	$	1,128	$	1,075
Accrued commissions		253		200
Accrued payroll and benefits		737		720
Accrued warranty		303		378
Customer advances		461		2
Other current liabilities		385		464
Total current liabilities		3,267		2,839
Deferred rent		268		310
Total liabilities		3,535		3,149
Shareholders equity				
Preferred stock of no par value;				
Authorized 1,000,000 shares; no shares outstanding at September 24, 2005 and March 26, 2005				
Common stock of no par value;				
Authorized 40,000,000 shares; 4,809,021 shares at September 24, 2005 and 4,728,646 shares at March 26, 2005 issued and outstanding		13,002		12,756
Accumulated deficit		(3,848)		(2,944)
Total shareholders equity		9,154		9,812
Total liabilities and shareholders equity	$	12,689	$	12,961

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands except per share data)	Three Months Ended September 24, 2005	Three Months Ended September 25, 2004	Six Months Ended September 24, 2005	Six Months Ended September 25, 2004
(Unaudited)				
Net sales	$ 3,614	$ 5,379	$ 9,397	$ 11,079
Cost of sales	2,391	3,050	5,529	6,179
Gross profit	1,223	2,329	3,868	4,900
Product development	1,043	809	2,009	1,653
Selling, general and administrative	1,331	1,371	2,784	2,784
Operating expenses	2,374	2,180	4,793	4,437
Operating (loss) income	(1,151)	149	(925)	463
Interest income (expense), net	9	(1)	14	3
(Loss) income from continuing operations before income taxes	(1,142)	148	(911)	466
Provision for income taxes			4	4
(Loss) income from continuing operations	(1,142)	148	(915)	462
Income (loss) on discontinued operations, net of income taxes	5	(124)	11	(81)
Net (loss) income	$ (1,137)	$ 24	$ (904)	$ 381
Basic net (loss) income per share:				
From continuing operations	$ (0.24)	$ 0.03	$ (0.19)	$ 0.10
On discontinued operations	(0.00)	(0.02)	(0.00)	(0.02)
Basic net (loss) income per share	$ (0.24)	$ 0.01	$ (0.19)	$ 0.08
Diluted net (loss) income per share:				
From continuing operations	$ (0.24)	$ 0.03	$ (0.19)	$ 0.10
On discontinued operations	(0.00)	(0.02)	(0.00)	(0.02)
Diluted net (loss) income per share	$ (0.24)	$ 0.01	$ (0.19)	$ 0.08
Shares used in per share calculation:				
Basic	4,778	4,725	4,755	4,725

Dilutive	4,778	4,732	4,755	4,734

See accompanying notes to unaudited condensed consolidated financial statements.

4

Table of Contents

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) (Unaudited)	Six Months Ended September 24, 2005	September 25, 2004
Cash flows provided from operations:		
Net (loss) income	$ (904)	$ 381
Adjustments to reconcile net (loss) income to net cash provided by (used in) operations:		
Depreciation and amortization	266	363
Changes in operating assets and liabilities	1,636	(1,242)
Net cash provided by (used in) operations	998	(498)
Cash flows from investing activities:		
Purchases of property and equipment	(66)	(30)
Net cash used in investing activities	(66)	(30)
Cash flows from financing activities:		
Issuance of common stock	246	
Payments on capital lease and other long-term obligations		(10)
Net cash provided by (used in) financing activities	246	(10)
Increase (decrease) in cash and cash equivalents	1,178	(538)
Cash and cash equivalents at beginning of period	2,540	2,752
Cash and cash equivalents at end of period	$ 3,718	$ 2,214

Supplementary disclosure of cash flow information:

(1) Cash paid for income taxes was $4 for the six month periods ended September 24, 2005 and September 25, 2004.

See accompanying notes to unaudited condensed consolidated financial statements.

5

Table of Contents

GIGA-TRONICS INCORPORATED
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The condensed consolidated financial statements included herein have been prepared by Giga-tronics (the Company), pursuant to the rules and regulations of the Securities and Exchange Commission. The consolidated results of operations for the interim periods shown in this report are not necessarily indicative of results to be expected for the fiscal year. In the opinion of management, the information contained herein reflects all adjustments (consisting of only normal recurring accruals) necessary to make the consolidated results of operations for the interim periods a fair statement of such operations. For further information, refer to the consolidated financial statements and footnotes thereto, included in the Annual Report on Form 10-KSB, filed with the Securities and Exchange Commission for the year ended March 26, 2005.

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

(2) Discontinued Operations

In the first quarter of fiscal 2004, Giga-tronics discontinued the operations at its Dymatix Division due to the substantial losses incurred over the previous two years. In the fourth quarter of fiscal 2004, Giga-tronics consummated the sale of its Dymatix Division and recognized a gain of $53,000 in connection with the sale. The sales price was $300,000. The Company received a $50,000 cash payment from the buyer and a $250,000 note receivable with $50,000 due in May 2004 and quarterly installments of $25,000 due beginning in July 2004. The Company agreed to reschedule the payment due in May 2004 to August 2004 and, to date, has not received payments due. The note is secured by collateral and in management s opinion the value of this collateral deteriorated during fiscal 2005. Accordingly, the Company considers the note receivable to be impaired and has recorded a provision for loss of $250,000 through discontinued operations in the 2005 fiscal year. At September 24, 2005, the note receivable continues to be considered impaired.

(3) Revenue Recognition

The Company records revenue in accordance with SAB 101 and 104, *Revenue Recognition in Financial Statements.* As such, revenue is recorded when there is evidence of an arrangement, delivery has occurred, the price is fixed and determinable, and collectability is assured. This occurs when products are shipped, unless the arrangement involves acceptance terms. If the arrangement involves acceptance terms, the Company defers revenue until product acceptance is received.

The Company provides for estimated costs that may be incurred for product warranties at the time of shipment. The Company s warranty policy generally provides four years for the 2400 family of Microwave Synthesizers and one year for all other products. The estimated cost of warranty coverage is based on the Company s actual historical experience with its current products or similar products.

Table of Contents

(4) Inventories

(In thousands)	September 24, 2005	March 26, 2005
Raw materials	$ 3,672	$ 3,702
Work-in-progress	2,104	1,925
Finished goods	559	393
Demonstration inventory	275	237
Total inventory	$ 6,520	$ 6,257

(5) Earnings (Loss) Per Share

Basic earnings (loss) per share is calculated by dividing net income or loss by the weighted average common shares outstanding during the period. Diluted earnings per share reflects the net incremental shares that would be issued if dilutive outstanding stock options were exercised, using the treasury stock method. In the case of a net loss, it is assumed that no incremental shares would be issued because they would be antidilutive. In addition, certain options are considered antidilutive because the options exercise price was above the average market price during the period. The shares used in per share computations are as follows (in thousands except per share data):

(In thousands except per share data)	Three Months Ended September 24, 2005	Three Months Ended September 25, 2004	Six Months Ended September 24, 2005	Six Months Ended September 25, 2004
Net (loss) income	$ (1,137)	$ 24	$ (904)	$ 381
Weighted average:				
Common shares outstanding	4,778	4,725	4,755	4,725
Potential common shares		7		9
Common shares assuming dilution	4,778	4,732	4,755	4,734
Net (loss) income per share of common stock	(0.24)	0.01	(0.19)	0.08
Net (loss) income per share of common stock assuming dilution	(0.24)	0.01	(0.19)	0.08
Stock options not included in computation	537	486	537	486

The number of stock options not included in the computation of diluted earnings per share (EPS) for the three month and six month periods ended September 24, 2005 are a result of the Company s loss from continuing operations and, therefore, the options are antidilutive. The number of stock options not included in the computation of diluted EPS for the three month and six month periods ended September 25, 2004 reflects stock options where the exercise prices were greater than the average market price of the common shares and are, therefore, antidilutive. The weighted average exercise price of excluded options was $3.03 and $3.30 as of September 24, 2005 and September 25, 2004, respectively.

Table of Contents

(6) Stock Based Compensation

The Company accounts for stock-based employee compensation using the intrinsic value method under Accounting Principles Board Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees,* and related interpretations and complies with the disclosure provisions of Statement of Financial Accounting Standards No. 123 (SFAS 123), *Accounting for Stock-Based Compensation.* The following table illustrates the effect on net income (loss) and earnings (loss) per share as if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation:

	Three Months Ended		Six Months Ended	
(In thousands except per share data)	September 24, 2005	September 25, 2004	September 24, 2005	September 25, 2004
Net (loss) income, as reported	$ (1,137)	$ 24	$ (904)	$ 381
Deduct				
Stock-based compensation expense included in reported net income (loss)				
Add				
Total stock-based employee compensation determined under fair value based method for all awards, net of related tax effect	(29)	(63)	(71)	(129)
Pro forma net (loss) income	$ (1,166)	$ (39)	$ (975)	$ 252
Net (loss) income per share basic				
As reported	$ (0.24)	$ 0.01	$ (0.19)	$ 0.08
Pro forma	(0.24)	(0.01)	(0.21)	0.05
Net (loss) income per share diluted				
As reported	(0.24)	0.01	(0.19)	0.08
Pro forma	(0.24)	(0.01)	(0.21)	0.05

(7) Significant Customers and Industry Segment Information

The Company has four reportable segments: Giga-tronics Instrument Division, ASCOR, Microsource and Corporate. Giga-tronics Instrument Division produces a broad line of test and measurement equipment used in the development, test and maintenance of wireless communications products and systems, flight navigational equipment, electronic defense systems and automatic testing systems. ASCOR designs, manufactures, and markets a line of switching devices that link together many specific purpose instruments that comprise automatic test systems. Microsource develops and manufactures a broad line of YIG (Yttrium, Iron, Garnet) tuned oscillators, filters and microwave synthesizers, which are used in a wide variety of microwave instruments and devices. Corporate handles the financing needs of each segment and lends funds to each segment as required and are eliminated in consolidation.

Table of Contents

Information on reportable segments is as follows:

(In thousands)	Three Months Ended September 24, 2005 Net Sales	Pre-tax Income (loss)	September 25, 2004 Net Sales	Pre-tax Income (loss)
Giga-tronics Instrument	$ 1,428	$ (724)	$ 3,137	$ 176
ASCOR	914	(221)	1,068	8
Microsource	1,272	(417)	1,174	(426)
Corporate		220		390
Total	$ 3,614	$ (1,142)	$ 5,379	$ 148

(In thousands)	Six Months Ended September 24, 2005 Net Sales	Pre-tax Income (loss)	September 25, 2004 Net Sales	Pre-tax Income (loss)
Giga-tronics Instrument	$ 4,306	$ (675)	$ 6,658	$ 380
ASCOR	2,191	(189)	1,852	(105)
Microsource	2,900	(521)	2,569	(403)
Corporate		474		594
Total	$ 9,397	$ (911)	$ 11,079	$ 466

(8) Warranty Obligations

The Company s warranty policy generally provides four years for the 2400 family of Microwave Synthesizers and one year for all other products. The Company records a liability for estimated warranty obligations at the date products are sold. 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.

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

(In thousands)	Three Months Ended September 24, 2005	September 25, 2004	Six Months Ended September 24, 2005	September 25, 2004
Balance at beginning of period	$ 345	$ 512	$ 378	$ 548
Provision for current period sales	59	56	134	84
Warranty costs incurred	(101)	(80)	(209)	(144)
Balance at end of period	$ 303	$ 488	$ 303	$ 488

Table of Contents

Item 2

MANAGEMENT S DISCUSSION AND ANALYSIS OF OPERATIONS AND FINANCIAL CONDITION

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-KSB for the fiscal year ended March 26, 2005 Part I, under the heading Certain Factors Which May Adversely Affect Future Operations or an Investment in Giga-tronics , and Part II, under the heading Management s Discussion and Analysis of Financial Conditions and Results of Operations .

Overview

The business environment remains challenging; this quarter Giga-tronics is showing a significant decline in new orders. However, inquiries for Giga-tronics products remain high as the Company recently introduced the 2400M Modulation Series microwave synthesizer. New orders in the military sector are showing indications of weakness and it is still too early to determine if the commercial wireless telecommunications market has rebounded. Giga-tronics intends to continue research and development in key growth areas in order to expand product lines and update existing lines with features our customers are demanding.

The Company s cost reduction programs, including reductions in personnel and new lease terms, are on track and have positioned Giga-tronics to take advantage of opportunities in our market. However, the Company s employees have been on salary reductions over the last three years and the Company anticipates reinstating prior salary levels in fiscal 2006 once the financial condition of the Company stabilizes.

The Company has released the 2400M synthesizer during the 2005 fiscal year. These products are being accepted by the marketplace and management believes there is significant room for growth. This release demonstrates the Company s commitment to new product development. Giga-tronics intends to continue research and development in key growth areas in order to expand product lines and update existing lines with additional features.

While Microsource received a large long-term order from Boeing during fiscal 2005, the management at Microsource anticipates that prospects for new orders will be moderate for the new fiscal year.

In the first quarter of fiscal 2004, Giga-tronics decided to discontinue the operations at its Dymatix division due to the substantial losses incurred over the last two years. In the second quarter of fiscal 2006, the net profit from discontinued operations was $5,000, compared to a net loss of $124,000 for the same period in fiscal 2005.

Results of Operations

New orders received from continuing operations in the second quarter of fiscal 2006 increased 47% to $1,847,000 from the $1,253,000 received in the second quarter of fiscal 2005. The $1,253,000 included a significant order reversal of $4,854,000 during the second quarter of fiscal 2005. Orders received for the first half of fiscal 2006 increased 56% to $7,340,000 from $4,720,000 for the first half of fiscal 2005. This increase in orders is due to the reversal in the second quarter of fiscal 2005 of $4,854,000.

Table of Contents

New Orders

(Dollars in thousands)	Three Months Ended September 24, 2005	% change	September 25, 2004	Six Months Ended September 24, 2005	% change	September 25, 2004
Instrument Division	$ 1,376	(64%)	$ 3,791	$ 4,131	(34%)	$ 6,278
ASCOR	320	(65%)	924	2,235	29%	1,732
Microsource	151		(3,462)	974		(3,290)
Total	$ 1,847	47%	$ 1,253	$ 7,340	56%	$ 4,720

Orders at the Instrument Division decreased in the second quarter primarily due to a decrease in military demand for their products. Orders at ASCOR decreased in the second quarter primarily due to a decrease in commercial demand for their products. Orders at Microsource increased primarily due to the renegotiation of a long term contract with an existing customer, whereby Microsource reversed its recorded backlog for deliveries beyond 12 months by $4,854,000 during the second quarter of fiscal 2005.

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

(Dollars in thousands)	Three Months Ended September 24, 2005	% Change	September 25, 2004
Backlog of unfilled orders	$ 13,735	37%	$ 9,996
Backlog of unfilled orders shippable within one year	7,014	(6%)	7,435
Previous fiscal year (FY) quarter end backlog reclassified during year as shippable later than one year	186	(44%)	333
Net cancellations during year of previous FY quarter end one-year backlog			

Backlog at the end of the second quarter 2006 increased 37% as compared to the end of the same period last year.

Allocation of Net Sales by Segment

(Dollars in thousands)	Three Months Ended September 24, 2005	% change	September 25, 2004	Six Months Ended September 24, 2005	% change	September 25, 2004
Instrument Division	$ 1,428	(55%)	$ 3,137	$ 4,306	(35%)	$ 6,658
ASCOR	914	(14%)	1,068	2,191	18%	1,852
Microsource	1,272	8%	1,174	2,900	13%	2,569
Total	$ 3,614	(33%)	$ 5,379	$ 9,397	(15%)	$ 11,079

Fiscal 2006 second quarter net sales from continuing operations were $3,614,000, a 33% decrease from the $5,379,000 in the second quarter of 2005. The decrease in sales was primarily due to lower order levels at the Instrument Division due to the weakness in military related orders and delayed delivery requirements coupled with the weakness in the commercial market at ASCOR offset with the limited improvement in customer delivery requirements at Microsource. For the six months ended September 24, 2005 sales declined 15% to $9,397,000 from $11,079,000 for the same period in the prior year. The decrease in sales was primarily due to lower order levels at the Instrument Division due to the weakness in the commercial market as well as the military and government market coupled with decreased orders in the commercial market at ASCOR partially offset by the improvement in customer delivery requirements at Microsource.

Cost of Sales

	Three Months Ended			Six Months Ended		
(Dollars in thousands)	September 24, 2005	% change	September 25, 2004	September 24, 2005	% change	September 25, 2004
Cost of sales	$ 2,391	(22%)	$ 3,050	$ 5,529	(11%)	$ 6,179

In the second quarter of fiscal 2006, cost of sales from continuing operations decreased 22% to $2,391,000 from $3,050,000 for the same period last year. For the six months ended September 24, 2005, the cost of sales from continuing operations declined 11% to $5,529,000 from $6,179,000 for the similar period ending September 25, 2004. Both of these declines are primarily attributable to the lower material and labor costs associated with reduced shipment levels.

11

Table of Contents

Operating Expenses

(Dollars in thousands)	Three Months Ended September 24, 2005	% change	September 25, 2004	Six Months Ended September 24, 2005	% change	September 25, 2004
Product development	$ 1,043	29%	$ 809	$ 2,009	22%	$ 1,653
Selling, general and administrative	1,331	(3%)	1,371	2,784	0%	2,784
Total	$ 2,374	9%	$ 2,180	$ 4,793	8%	$ 4,437

Operating expenses from continuing operations increased 9% or $194,000 in the second quarter of fiscal 2006 over 2005 due to an increase of $234,000 in product development costs and a decrease of $40,000 in selling, general and administrative expenses. Product development costs from continuing operations increased 29% or $234,000 in the second quarter of fiscal 2006 primarily due to increased product development expenses company-wide as Giga-tronics continues research and development in order to expand product lines and update its existing lines. Selling, general and administrative expenses from continuing operations decreased 3% or $40,000 for the second quarter of fiscal year 2006 compared to the same period in the prior year. The decrease is a result of lower commission expenses of $99,000 on lower commissionable sales for the quarter, offset by higher administrative expenses of $55,000 and higher marketing expenses of $4,000.

Operating expenses from continuing operations increased 8% or $356,000 for the six months ended September 24, 2005 over the same period for the prior year due to an increase of $356,000 in product development costs. Product development costs from continuing operations increased 22% or $356,000 for the six months ended September 25, 2004 primarily due to increased product development expenses company-wide as Giga-tronics continued research and development in order to expand product lines and update its existing lines. Selling, general and administrative expenses from continuing operations remained flat for the first half of fiscal 2006 compared to the same period in the prior year. This is a result of higher commission expenses of $34,000 and higher administrative expenses of $32,000 offset by lower marketing expense of $66,000.

The pre-tax loss from continuing operations for the three and six months periods ended September 24, 2005 were $1,142,000 and $911,000, respectively. The pre-tax profit from continuing operations for the three and six months periods ended September 25, 2004 were $148,000 and $466,000, respectively. Giga-tronics recorded a net loss of $1,137,000 or $0.24 per fully diluted share for the second quarter of fiscal 2006 versus a net profit of $24,000 or $0.01 per fully diluted share in the same period last year. Giga-tronics recorded a net loss of $904,000 or $0.19 per fully diluted share for the first half of fiscal 2006 versus a net profit of $381,000 or $0.08 per fully diluted share in the same period last year.

Profit from discontinued operations for the six-month period ended September 24, 2005 totaled $11,000. Loss from discontinued operations for the six-month period ended September 25, 2004 totaled $81,000. The Company discontinued and subsequently sold its Dymatix division in the fourth quarter of fiscal 2004. The loss recorded for the six-month period ended September 25, 2004 reflects changes in estimated expense related to the discontinuation of the Dymatix division and a reserve for impairment established by management as discussed in Footnote 2 the Interim Consolidated Financial Statement Discontinued Operations.

Financial Condition and Liquidity

As of September 24, 2005, Giga-tronics had $3,718,000 in cash and cash equivalents, compared to $2,540,000 as of March 26, 2005.

Working capital at the end of the second quarter of fiscal 2006 was $8,863,000 compared to $8,867,000 in the same period last year.

The Company s current ratio (current assets divided by current liabilities) at September 24, 2005 was 3.7 compared to 3.5 on September 25, 2004.

Table of Contents

Cash provided by operations amounted to $1,040,000 in the first half of fiscal 2006. Cash used by operations amounted to $465,000 in the same period of fiscal 2005. Cash provided by operations in the first half of fiscal 2006 is primarily attributed to the net change in operating assets and liabilities offset by the operating loss in the year. Cash used by operations in the first half of fiscal 2005 is primarily attributed to the net change in operating assets and liabilities offset by the operating profit in the quarter.

On June 20, 2005, the Company renewed its secured revolving line of credit for $2,500,000, with interest payable at prime rate plus 1%. The borrowing under this line of credit is based on the Company s accounts receivable and inventory and is secured by all of the assets of the Company. The Company had no borrowing under this line of credit during the three and six month periods ended September 24, 2005.

From time to time, Giga-tronics considers a variety of acquisition opportunities to also broaden its product lines and expand its market. Such acquisition activity could also increase the Company s operating expenses and require the additional use of capital resources. The Company also intends to maintain research and development expenditures for the purpose of broadening its product line.

Additions to property and equipment were $66,000 in the first half of fiscal 2006 compared to $30,000 for the same period last year. The low level of capital equipment spending reflects the overall decline in business activity and increased productivity.

Future tax benefits are subject to a valuation allowance when management is unable to conclude that its deferred tax assets will more likely than not be realized from the results of operations. The ultimate realization of deferred tax assets is dependent upon generation of future taxable income during the periods in which those temporary differences become deductible. Management considers projected future taxable income and tax planning strategies in making this assessment. Based on historical taxable income and projections for future taxable income over the periods in which the deferred tax assets become deductible, management believes it more likely than not that the Company will not realize benefits of these deductible differences as of September 24, 2005. Management has, therefore, established a valuation allowance against its net deferred tax assets as of September 24, 2005.

Recent Accounting Pronouncements

In December 2004 the FASB issued Statement Number 123 (revised 2004) (FAS 123 (R)), Share-Based Payments. FAS 123 (R) requires all entities to recognize compensation expense in an amount equal to the fair value of share-based payments, such as stock options, granted to employees. The Company is required to apply FAS 123 (R) on a modified prospective method. Under this method, the Company is required to record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that remain outstanding at the date of adoption. In addition, the Company may elect to adopt FAS 123 (R) by restating previously issued financial statements, basing the expense on that previously reported in their pro forma disclosures required by FAS 123. FAS 123 (R) is effective in the first reporting period beginning after December 15, 2005, March 26, 2006 for the Company. Management has not completed its evaluation of the effect that FAS 123 (R) will have, but believes that the effect will be consistent with its previous pro forma disclosures.

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs* (FAS 151). FAS 151 requires that abnormal amounts of idle facility expense, freight, handling costs and spoilage be recognized as current-period charges. Further, FAS 151 requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. Unallocated overheads must be recognized as an expense in the period in which they are incurred. FAS 151 is effective for inventory costs incurred beginning in the first quarter of fiscal 2007. We are currently evaluating the effect of FAS 151 on our financial statements and related disclosures.

Table of Contents

FORWARD-LOOKING STATEMENTS

Certain statements contained in this section of the report, including statements regarding sales under OVERVIEW and statements under FINANCIAL CONDITION AND LIQUIDITY , are forward-looking. While Giga-tronics believes that these statements are accurate, Giga-tronics business is dependent upon general economic conditions and various conditions specific to the test and measurement, wireless and semiconductor industries. Future trends and these factors could cause actual results to differ materially from the forward-looking statements that we have made. In particular: Giga-tronics core business is test and measurement, as well as components for the wireless communications market, which continues to be soft. The Company s commercial product backlog has a number of risks and uncertainties such as the cancellation or deferral of orders, dispute over performance and our ability to collect amounts due. If the commercial market should decline further, then shipments in the current year could fall short of plan resulting in a decline in earnings. Also, Giga-tronics has a significant number of defense-related orders. While Giga-tronics has seen some improvement in the defense sector, it is not significant enough to offset the decline in the commercial sector. If the defense market should decline, shipments in the current year could be less than anticipated and cause a decrease in earnings.

The market for electronics equipment is characterized by rapidly changing technology and evolving industry standards. Giga-tronics believes that its future success will depend, in part, upon its ability to develop and commercialize its existing products, develop new products and applications and in part to develop, manufacture and successfully introduce new products and product lines with improved capabilities and continue enhancing existing products. There can be no assurance that Giga-tronics will successfully complete the development of current or future products or that such products will achieve market acceptance. Giga-tronics may also experience difficulty obtaining critical parts or components required in the manufacturing of our products, resulting in an inability to fulfill orders in a timely manner, which may have a negative impact on earnings. Also, the Company may not timely ramp manufacturing capacity to meet order demand and quickly adapt cost structures to changing market conditions.

As part of its business strategy, Giga-tronics has in the past broadened its product lines and expanded its markets, in part through the acquisition of other business entities, and it may do so in the future. The Company is subject to various risks in connection with past and any future acquisitions. Such risks include, among other things, the difficulty of assimilating the operations and personnel of the acquired companies, the potential disruption of the Company s business, the inability of the Company s management to maximize the financial and strategic position of the Company by the successful incorporation of acquired technology and rights into the Company s product offerings, the maintenance of uniform standards, controls, procedures and policies, and the potential loss of key employees of acquired companies. No assurance can be given that any acquisition by Giga-tronics will or will not occur, that if an acquisition does occur, that it will not materially and adversely affect the Company or that any such acquisition will be successful in enhancing the Company s business. Giga-tronics currently contemplates that future acquisitions may involve the issuance of additional shares of the Company s common stock. Any such issuance may result in dilution to all shareholders of the Company, and sales of such shares in significant volume by the shareholders of acquired companies may depress the price of the Company s common stock.

Table of Contents

Item 3

Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of the Company s management, including the Company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures provide reasonable assurances that the information the Company is required to disclose in the reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time period required by the Commission s rules and forms. 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 controls over financial reporting.

Table of Contents

Part II OTHER INFORMATION
Item 1
Legal Proceedings
As of November 1, 2005, Giga-tronics has no material pending legal proceedings. From time to time, Giga-tronics is involved in various disputes and litigation matters that arise in the ordinary course of business.
Item 4
Submission of matters to a vote of security holders
Annual Meeting of stockholders was held on September 13, 2005.

(1) The vote for the nominated Directors was as follows:

Nominee	In Favor	Withheld
George H. Bruns, Jr.	4,140,426	165,930
James A. Cole	4,137,946	168,410
Kenneth A. Harvey	4,141,946	164,410
Robert C. Wilson	4,110,464	195,892
William E. Wilson	4,113,564	192,792

(2) Other matters voted upon at the meeting were as follows:

(a) Adoption of The 2005 Equity Incentive Plan was approved as follows:

	No. of Votes on Proposal	Percent of Votes Cast
For	2,388,624	88.06%
Against	295,979	10.91%
Abstain	27,928	1.03%
Quorum	2,712,531	100.00%

Broker non-voted Shares = 1,593,825

(b) Ratification of the selection of Perry-Smith LLP as independent public accountants for the fiscal year 2006 was approved as follows:

	No. of Votes on Proposal	Percent of Votes Cast
For	4,276,295	99.30%
Against	23,855	0.55%
Abstain	6,206	0.15%
Quorum	4,306,356	100.00%

Broker non-voted Shares = 0
Outstanding shares on Record Date = 4,734,646

Table of Contents

Item 6
Exhibits
Exhibits

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

31.2 Certification of Chief Financial Officer pursuant to Section 302 of Sarbanes-Oxley Act.

32.1 Certification of Chief Executive Officer pursuant to Section 906 of Sarbanes-Oxley Act.

32.2 Certification of Chief Financial Officer pursuant to Section 906 of Sarbanes-Oxley Act.

Table of Contents

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: November 1, 2005

/s/ GEORGE H. BRUNS, JR.

George H. Bruns, Jr.
Chairman and Chief Executive Officer
(Principal Executive Officer)

Date: November 1, 2005

/s/ MARK H. COSMEZ II

Mark H. Cosmez II
Vice President, Finance
Chief Financial Officer and Secretary
(Principal Accounting Officer)

18