GIGA TRONICS INC
Form 10QSB
November 03, 2006

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

(Mark One)

þ **QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

for the quarterly period ended September 30, 2006

o **TRANSITION REPORT UNDER SECTION 13 OR 15 (d) OF THE EXCHANGE ACT**

for the transition period from __________ to __________

Commission File No. 0-12719

GIGA-TRONICS INCORPORATED

(Exact name of small business issuer 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)
Issuer s telephone number: (925) 328-4650
N/A
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

Yes o No þ

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 3, 2006: 4,809,021 shares

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

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Part I FINANCIAL INFORMATION
Item 1

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands except share data) (Unaudited)	September 30, 2006	March 25, 2006
Assets		
Current assets		
Cash and cash equivalents	$ 3,286	$ 3,412
Notes receivable		3
Trade accounts receivable, net	1,557	3,435
Inventories	5,767	4,813
Prepaid expenses and other assets	260	219
Total current assets	10,870	11,882
Property and equipment, net	375	337
Other assets	103	127
Total assets	$ 11,348	$ 12,346
Liabilities and shareholders equity		
Current liabilities		
Accounts payable	$ 1,019	$ 870
Accrued commissions	117	171
Accrued payroll and benefits	733	781
Accrued warranty	190	250
Customer advances	997	521
Other current liabilities	379	433
Total current liabilities	3,435	3,026
Deferred rent	173	222
Total liabilities	3,608	3,248
Shareholders equity		
Preferred stock of no par value; Authorized 1,000,000 shares; no shares outstanding at September 30, 2006 and March 25, 2006		
Common stock of no par value; Authorized 40,000,000 shares; 4,809,021 shares at September 30, 2006 and March 25, 2006 issued and outstanding	13,075	13,003
Accumulated deficit	(5,335)	(3,905)
Total shareholders equity	7,740	9,098
Total liabilities and shareholders equity	$ 11,348	$ 12,346

See accompanying notes to unaudited condensed consolidated financial statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands except per share data) (Unaudited)	Three Months Ended September 30, 2006	Three Months Ended September 24, 2005	Six Months Ended September 30, 2006	Six Months Ended September 24, 2005
Net sales	$ 3,934	$ 3,614	$ 7,320	$ 9,397
Cost of sales	2,077	2,391	4,264	5,529
Gross profit	1,857	1,223	3,056	3,868
Product development	938	1,043	1,899	2,009
Selling, general and administrative	1,368	1,331	2,665	2,784
Operating expenses	2,306	2,374	4,564	4,793
Operating loss	(449)	(1,151)	(1,508)	(925)
Interest income, net	37	9	66	14
Loss from continuing operations before income taxes	(412)	(1,142)	(1,442)	(911)
Provision for income taxes	1		1	4
Loss from continuing operations	(413)	(1,142)	(1,443)	(915)
Income from discontinued operations, net of income taxes	10	5	13	11
Net loss	$ (403)	$ (1,137)	$ (1,430)	$ (904)
Basic net loss per share:				
From continuing operations	$ (0.08)	$ (0.24)	$ (0.30)	$ (0.19)
On discontinued operations	(0.00)	(0.00)	(0.00)	(0.00)
Basic net loss per share	$ (0.08)	$ (0.24)	$ (0.30)	$ (0.19)
Diluted net loss per share:				
From continuing operations	$ (0.08)	$ (0.24)	$ (0.30)	$ (0.19)
On discontinued operations	(0.00)	(0.00)	(0.00)	(0.00)
Diluted net loss per share	$ (0.08)	$ (0.24)	$ (0.30)	$ (0.19)
Shares used in per share calculation:				
Basic	4,809	4,778	4,809	4,755

Dilutive	4,809	4,778	4,809	4,755

See accompanying notes to unaudited condensed consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) (Unaudited)	Six Months Ended September 30, 2006	Six Months Ended September 24, 2005
Cash flows provided from operations:		
Net loss	$ (1,430)	$ (904)
Adjustments to reconcile net loss to net cash provided by operations:		
Depreciation and amortization	124	266
Deferred rent	(49)	(42)
Equity based compensation	72	
Changes in operating assets and liabilities	1,319	1,677
Net cash provided by operations	36	997
Cash flows from investing activities:		
Proceeds from sales of equipment	2	
Purchases of property and equipment	(164)	(66)
Net cash used in investing activities	(162)	(66)
Cash flows from financing activities:		
Issuance of common stock		247
(Decrease) increase in cash and cash equivalents	(126)	1,178
Cash and cash equivalents at beginning of period	3,412	2,540
Cash and cash equivalents at end of period	$ 3,286	$ 3,718

Supplementary disclosure of cash flow information:

(1) Cash paid for income taxes was $1 for the six month period ended September 30, 2006. Cash paid for income taxes was $4 for the six month period ended September 24, 2005.

See accompanying notes to unaudited condensed consolidated financial statements.

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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 25, 2006.

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. During the six month period ended September 30, 2006, the Company has received payments of previously reserved receivables and has recorded $13,000 as income on discontinued operations.

(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.

(4) Inventories

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 overhead must be recognized as an expense in the

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period in which they are incurred. The Company adopted FAS 151 effective March 26, 2006, which did not have a material impact on the Company s financial statements and related disclosures.

(In thousands)		September 30, 2006		March 25, 2006
Raw materials	$	3,301	$	3,025
Work-in-progress		1,835		1,309
Finished goods		368		246
Demonstration inventory		263		233
Total inventory	$	5,767	$	4,813

(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 number of stock options not included in the computation of diluted earnings per share (EPS) for the three and six month periods ended September 30, 2006 and September 24, 2005 are a result of the Company s loss from continuing operations and, therefore, the options are antidilutive. Due to the Company s net loss, there were no shares considered to be potentially issuable for the three and six month periods ended September 30, 2006 and September 24, 2005. Stock options not included in the computation or earnings per share totaled 698 and 537 with a weighted average exercise price of excluded options of $2.03 and $3.03 as of September 30, 2006 and September 24, 2005, respectively.

(6) Stock Based Compensation

The Company established a 2005 Equity Incentive Plan which provided for the granting of options for up to 700,000 shares of Common Stock. Effective March 26, 2006, the Company adopted Statement of Financial Accounting Standards No. 123(R), *Share Based Payment* (SFAS 123(R)), using the modified prospective application transition method, which requires recognizing expense for options granted prior to the adoption date equal to the fair value of the unvested amounts over their remaining vesting period, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 *Accounting for Stock Based Compensation,* and compensation cost for all share based payments granted subsequent to January 1, 2006, based on the grant date fair values estimated in accordance with the provisions of SFAS 123(R). There were 328,900 option grants made in the six month period ended September 30, 2006 and no grants were made in the same period in the prior year.

Results for prior periods have not been restated. Prior to March 26, 2006, the Company accounted for these plans under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations (APB 25). No stock-based compensation cost is reflected in net income prior to March 26, 2006, as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

As a result of adopting SFAS 123(R), the Company s loss before provision for income taxes and net income for the three and six month periods ended September 30, 2006 was $68,000 and $72,000, respectively, higher than if the Company had continued to account for share-based compensation under APB 25. Basic and diluted loss per share for the quarter ended September 30, 2006 would have been $0.07 without the adoption of SFAS 123(R) compared to $0.08 as reported. Basic and diluted loss per share for the six months ended September 30, 2006 would have been $0.28 without the adoption of SFAS 123(R) compared to $0.30 as reported.

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SFAS 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as a cash flow from financing in the statement of cash flows. These excess tax benefits were not significant for the Company for the three and six month periods ended September 30, 2006.

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 option-pricing model and the following weighted average assumptions:

	Three Months Ended September 30, 2006
Dividend yield	None
Expected volatility	72.80%
Risk-free interest rate	4.97%
Expected term (years)	5

The computation of expected volatility used in the Black-Scholes option-pricing model is based on the historical volatility of our share price. The expected term is estimated based on a review of historical employee exercise behavior with respect to option grants.

A summary of the changes in stock options outstanding for the six months ended September 30, 2006 is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at March 25, 2006	438,975	$ 2.57	2.7	$ 122,173
Granted	328,900	1.64		
Exercised				
Forfeited/Expired	69,475	3.59		
Outstanding at September 30, 2006	698,400	$ 2.03	3.6	$ 2,000
Exercisable at September 30, 2006	161,250	$ 2.33	2.2	$ 1,500

The weighted average grant date fair value of options granted during the six month period ended September 30, 2006 was $1.64. There was no intrinsic value of options exercised during the six month period ended September 30, 2006. As of September 30, 2006, there was $419,000 of total unrecognized compensation cost related to nonvested options granted under the plans. That cost is expected to be recognized over a weighted average period of one year. The total fair value of options vested during the three and six month periods ended September 30, 2006 were $16,000 and $25,000. No cash was received from stock option exercises for the three and six month periods ended September 30, 2006.

The following table illustrates the pro forma effect on net income and earnings per share if the fair value recognition provisions of SFAS 123 had been applied to the Company s stock option plans for the three month and six month periods ended September 24, 2005.

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

(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.

Information on reportable segments is as follows:

	Three Months Ended			
(In thousands)	September 30, 2006		September 24, 2005	
	Net Sales	Pre-tax Income (loss)	Net Sales	Pre-tax Income (loss)
Giga-tronics Instrument	$ 1,606	$ (615)	$ 1,428	$ (724)
ASCOR	885	(122)	914	(221)
Microsource	1,443	77	1,272	(417)
Corporate		248		220
Total	$ 3,934	$ (412)	$ 3,614	$ (1,142)

	Six Months Ended			
(In thousands)	September 30, 2006		September 24, 2005	
		Pre-tax		Pre-tax

	Net Sales	Income (loss)	Net Sales	Income (loss)
Giga-tronics Instrument	$ 3,376	$ (1,253)	$ 4,306	$ (675)
ASCOR	1,487	(401)	2,191	(189)
Microsource	2,457	(370)	2,900	(521)
Corporate		582		474
Total	$ 7,320	$ (1,442)	$ 9,397	$ (911)

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(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 30, 2006	Three Months Ended September 24, 2005	Six Months Ended September 30, 2006	Six Months Ended September 24, 2005
Balance at beginning of period	$ 244	$ 345	$ 250	$ 378
(Reduction) provision, net	(26)	59	16	134
Warranty costs incurred	(28)	(101)	(76)	(209)
Balance at end of period	$ 190	$ 303	$ 190	$ 303

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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 25, 2006 Part I, under the heading Certain Factors Which May Adversely Affect Future Operations or an Investment in Giga-tronics , and Part II, under the heading Management s Discussion and Analysis of Financial Conditions and Results of Operations .

Overview

Giga-tronics produces instruments, subsystems and sophisticated microwave components that have broad applications in both defense electronics and wireless telecommunications. In 2006, our business consisted of four operating and reporting segments: Instrument Division, ASCOR, Microsource and Corporate.

Our business is highly dependent on government spending in the defense electronics sector and on the wireless telecommunications market. While the Company has seen some improvement in its international defense business, domestic spending remains sporadic. The commercial business environment has shown some improvement; however, commercial orders for the year declined slightly due to delays in new product introductions.

The Company continues to monitor costs, including reductions in personnel and other expenses, to more appropriately align costs with revenues. The Company s employees have been on salary reductions over the last three years. Recently, the Company has reversed a portion of the prior salary reductions and anticipates reinstating previous salary levels contingent on the Company s financial condition stabilizing.

The Company released the 2400B synthesizer (part of the 2400 family of products) during the 2006 fiscal year. These products are being accepted by the market and management believes there is significant room for growth. This release demonstrates the Company s commitment to new product development.

In an effort to improve results and make optimal use of its resources, Giga-tronics intends to take additional steps to restructure the company. The Company will continue to consolidate operations and functions among its divisions as the Company has done with sales and marketing. Further integration of product development efforts should enable Giga-tronics to achieve a better return on its substantial investment in research and development (R&D). New development programs will focus more on commercial products to reduce the Company s dependence on the domestic defense sector. Giga-tronics will look for any available opportunities to operate more efficiently and with greater focus on customer needs. The Company hopes to accomplish these changes in a business-like manner that is not overly disruptive to its very talented work force yet is decisive enough to yield meaningful improvements to the bottom line.

While the management at Microsource estimates that prospects for new orders will improve in this fiscal year, its short-term growth will be limited as to customer delivery schedules associated with this new business.

Results of Operations

New orders received from continuing operations in the second quarter of fiscal 2007 increased 215% to $5,812,000 from the $1,847,000 received in the second quarter of fiscal 2006. Orders received for the first half of fiscal 2007 increased 19% to $8,745,000 from $7,340,000 for the first half of fiscal 2006.