GIGA TRONICS INC
Form 10QSB
November 03, 2004

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended September 25, 2004 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 x 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, 2004: 4,724,896 shares

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

GIGA-TRONICS INCORPORATED

INDEX

Table of Contents

ITEM 1

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands except share data) (Unaudited)	September 25, 2004	March 27, 2004
Assets		
Current assets		
Cash and cash equivalents	$ 2,214	$ 2,752
Notes receivable	202	253
Trade accounts receivable, net	3,133	1,959
Inventories	6,708	6,920
Prepaid expenses	225	271
Total current assets	12,482	12,155
Property and equipment, net	918	1,251
Other assets	138	327
Total assets	$ 13,538	$ 13,733
Liabilities and shareholders equity		
Current liabilities		
Accounts payable	$ 941	$ 1,686
Accrued commissions	362	293
Accrued payroll and benefits	906	889
Accrued warranty	488	548
Customer advances	406	58
Obligations under capital lease		10
Other current liabilities	512	674
Total current liabilities	3,615	4,158
Deferred rent	346	379
Total liabilities	3,961	4,537
Shareholders equity		
Preferred stock of no par value; Authorized 1,000,000 shares; no shares outstanding at September 25, 2004 and March 27, 2004		

Common stock of no par value; Authorized 40,000,000 shares; 4,724,896 shares at September 25, 2004 and 4,724,896 shares at March 27, 2004 issued and outstanding	12,752	12,752
Accumulated deficit	(3,175)	(3,556)
Total shareholders equity	9,577	9,196
Total liabilities and shareholders equity	$ 13,538	$ 13,733

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands except per share data) (Unaudited)	Three Months Ended September 25, 2004	Three Months Ended September 27, 2003	Six Months Ended September 25, 2004	Six Months Ended September 27, 2003
Net sales	$5,379	$ 5,135	$11,079	$ 10,374
Cost of sales	3,050	3,220	6,179	7,096
Gross profit	2,329	1,915	4,900	3,278
Product development	809	865	1,653	1,853
Selling, general and administrative	1,371	1,420	2,784	3,064
Operating expenses	2,180	2,285	4,437	4,917
Operating income (loss)	149	(370)	463	(1,639)
Interest (expense) income, net	(1)	13	3	10
Income (loss) from continuing operations before income taxes	148	(357)	466	(1,629)
Provision for income taxes			4	4
Income (loss) from continuing operations	148	(357)	462	(1,633)
Loss on discontinued operations, net of income taxes	(124)	(126)	(81)	(2,482)
Net income (loss)	$ 24	$ (483)	$ 381	$ (4,115)
Basic net income (loss) per share:				
From continuing operations	$ 0.03	$ (0.08)	$ 0.10	$ (0.35)
On discontinued operations	(0.02)	(0.02)	(0.02)	(0.53)
Basic net income (loss) per share	$ 0.01	$ (0.10)	$ 0.08	$ (0.88)
Diluted net income (loss) per share:				
From continuing operations	$ 0.03	$ (0.08)	$ 0.10	$ (0.35)
On discontinued operations	(0.02)	(0.02)	(0.02)	(0.53)
Diluted net income (loss) per share	$ 0.01	$ (0.10)	$ 0.08	$ (0.88)

Shares used in per share calculation:				
Basic	4,725	4,696	4,725	4,695
Dilutive	4,732	4,696	4,734	4,695

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) (Unaudited)	Six Months Ended September 25, 2004	Six Months Ended September 27, 2003
Cash flows provided from operations:		
Net income (loss)	$ 381	$ (4,115)
Adjustments to reconcile net income (loss) to net cash used in operations:		
Depreciation and amortization	552	615
Loss on disposal or sale of equipment		(4)
Changes in operating assets and liabilities	(1,398)	2,751
Net cash used in operations	(465)	(753)
Cash flows from investing activities:		
Purchases of property and equipment	(30)	(30)
Other assets		49
Net cash (used in) provided by investing activities	(30)	19
Cash flows from financing activities:		
Issuance of common stock		11
Payments on capital lease and other long term obligations	(43)	(150)
Net cash used in financing activities	(43)	(139)
Decrease in cash and cash equivalents	(538)	(873)
Cash and cash equivalents at beginning of period	2,752	5,005
Cash and cash equivalents at end of period	$ 2,214	$ 4,132

Supplementary disclosure of cash flow information:

(1) Cash paid for income taxes was $4 for the six month periods ended September 25, 2004 and September 27, 2003.

See accompanying notes to unaudited condensed consolidated financial statements.

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 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 27, 2004.

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

(2) Discontinued Operations

In the first quarter of 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 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 purchase 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 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. Accordingly, the Company considers the note receivable to be impaired and has established an allowance for credit loss of $50,000 in the current period through a charge to discontinued operations. Additionally, the related interest receivable totaling $9,000 was reversed through a charge to discontinued operations and interest is no longer accrued on the impaired note receivable.

(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 three years for Fast Switching Microwave Synthesizers and Universal Power Meters 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 thousands)	September 25, 2004	March 27, 2004
Raw materials	$ 3,980	$ 4,036
Work-in-progress	1,928	1,915
Finished goods	415	724
Demonstration inventory	385	245
Total inventory	$ 6,708	$ 6,920

(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):

	Three Months Ended		Six Months Ended	
(In thousands except per share data)	September 25, 2004	September 27, 2003	September 25, 2004	September 27, 2003
Net income (loss)	$ 24	$ (483)	$ 381	$ (4,115)
Weighted average:				
Common shares outstanding	4,725	4,696	4,725	4,695
Potential common shares	7		9	
Common shares assuming dilution	4,732	4,696	4,734	4,695
Net earnings (loss) per share of common stock	0.01	(0.10)	0.08	(0.88)
Net earnings (loss) per share of common stock assuming dilution	0.01	(0.10)	0.08	(0.88)
Stock options not included in computation	486	571	486	571

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 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 number of stock options not included in the computation of diluted EPS for the three month and six month periods ended September 27, 2003 are a result of the Company s loss from continuing operations and, therefore, the options are antidilutive. The weighted average exercise price of excluded options was $3.30 and $3.37 as of September 25, 2004 and September 27, 2003, respectively.

Table of Contents

(6) Stock Based Compensation

During the first quarter of fiscal year 2004, the Company adopted SFAS No. 148 (SFAS 148), *Accounting for Stock-Based Compensation Transition and Disclosure an Amendment of FAS 123.* 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 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 25, 2004**	**September 27, 2003**	**September 25, 2004**	**September 27, 2003**
Net income (loss), as reported	$ 24	$ (483)	$ 381	$ (4,115)
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	(63)	(49)	(129)	(97)
Pro forma net income (loss)	$ (39)	$ (532)	$ 252	$ (4,212)
Net income (loss) per share - basic				
As reported	$ 0.01	$ (0.10)	$ 0.08	$ (0.88)
Pro forma	(0.01)	(0.11)	0.05	(0.90)
Net income (loss) per share - diluted				
As reported	0.01	(0.10)	0.08	(0.88)
Pro forma	(0.01)	(0.11)	0.05	(0.90)

(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.

Table of Contents

Information on reportable segments is as follows:

	Three Months Ended			
	September 25, 2004		September 27, 2003	
(In thousands)	Net Sales	Pre-tax Income (loss)	Net Sales	Pre-tax Income (loss)
Giga-tronics Instrument	$3,137	$ 176	$2,381	$ (440)
ASCOR	1,068	8	1,046	55
Microsource	1,174	(426)	1,708	(150)
Corporate		390		178
Total	$5,379	$ 148	$5,135	$ (357)

	Six Months Ended			
	September 25, 2004		September 27, 2003	
(In thousands)	Net Sales	Pre-tax Income (loss)	Net Sales	Pre-tax Income (loss)
Giga-tronics Instrument	$ 6,658	$ 380	$ 4,488	$(1,252)
ASCOR	1,852	(105)	2,440	(139)
Microsource	2,569	(403)	3,446	(569)
Corporate		594		331
Total	$11,079	$ 466	$10,374	$(1,629)

(8) Warranty Obligations

The Company s warranty policy generally provides three years for Fast Switching Microwave Synthesizers and Universal Power Meters and one year for all other products. The Company s policy is to accrue the estimated cost of warranty coverage at the time the sale is recorded. 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. The Company records a liability 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.

	Three Months Ended		Six Months Ended	
(In thousands)	**September 25, 2004**	**September 27, 2003**	**September 25, 2004**	**September 27, 2003**
Balance at beginning of quarter	$512	$ 805	$ 548	$ 859
Provision for current quarter sales	56	95	84	269
Warranty costs incurred	(80)	(116)	(144)	(344)
Balance at end of quarter	$488	$ 784	$ 488	$ 784

9

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-K for the fiscal year ended March 27, 2004 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 commercial business environment remains challenging; however Giga-tronics is showing improvements in new orders. Inquiries for Giga-tronics products were also higher as the Company recently introduced the 2400M Modulation Series microwave synthesizer. New orders in the military sector are showing indications of increased strength, but 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.

Cost reductions, including personnel reductions and renegotiated lease terms, are on track and have positioned Giga-tronics to take advantage of any potential opportunities in our market. If new orders should decrease or are canceled, cash may be used faster than currently anticipated. Management would anticipate further cost and expense reductions in this circumstance. While the management at Microsource anticipates that prospects for new orders will improve results for the new fiscal year, its short-term growth will be less than previously anticipated as there continue to be timing delays associated with currently booked orders.

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 2005, the net loss from discontinued operations was $124,000, compared to a net loss of $126,000 for the same period in fiscal 2004. For the first six months of fiscal 2005, the net loss for discontinued operations was $81,000 as compared to a net loss of $2,482,000 for the same period a year ago. With the sale of Dymatix that occurred in the fourth quarter of fiscal 2004, Giga-tronics will be able to focus on its core business in order to release new products to market more quickly.

Results of Operations

New orders received from continuing operations in the second quarter of fiscal 2005 decreased 68% to $1,253,000 from the $3,930,000 received in the second quarter of fiscal 2004. As discussed below, the decline in orders is principally due to the renegotiation of a long term contract with an existing customer, whereby the Company reversed its recorded backlog for deliveries beyond 12 months by $4,854,000. Exclusive of this reversal, orders received for the second quarter increased 55% to $6,107,000 from $3,930,000 a year ago and orders received for the first half of fiscal 2005 increased 42% to $9,574,000 from $6,748,000 for the first half of fiscal 2004. New orders increased primarily due to strengthening in our commercial wireless business coupled with increases in new commercial and military orders.

Table of Contents

	New Orders					
	Three Months Ended			Six Months Ended		
(Dollars in thousands)	**September 25, 2004**	**% change**	**September 27, 2003**	**September 25, 2004**	**% change**	**September 27, 2003**
Instrument Division	$ 3,791	51%	$ 2,519	$ 6,278	34%	$ 4,697
ASCOR	924	62%	572	1,732	74%	998
Microsource	(3,462)	(513%)	839	(3,290)	(412%)	1,053
Total	$ 1,253	(68%)	$ 3,930	$ 4,720	(30%)	$ 6,748

Improvement in the military and government business at the Instrument Division helped to increase new orders in the second quarter of FY 2005. Orders at ASCOR increased in the second quarter primarily due to an increase in commercial demand for their products. As discussed below, orders at Microsource decreased primarily due to the renegotiation of a long term contract with an existing customer, whereby the Microsource reversed its recorded backlog for deliveries beyond 12 months by $4,854,000; the decrease was offset in part by an increase in commercial orders.

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

	Three Months Ended		
(Dollars in thousands)	**September 25, 2004**	**% Change**	**September 27, 2003**
Backlog of unfilled orders	$9,996	(24%)	$ 13,111
Backlog of unfilled orders shippable within one year	7,435	37%	5,438
Previous fiscal year end (FYE) quarter backlog reclassified during year as shippable later than one year	333	15%	289
Net cancellations during year of previous FYE one-year backlog		(100%)	29

Backlog at the end of the second quarter 2005 has declined as compared to the end of the same period last year. This decline is a result of the following reversal offset by commercial orders received during the quarter. During July 2004, Microsource renegotiated a long-term contract with an existing customer. As a result, the customer s firm purchase commitment quantities have been significantly reduced and management reversed its recorded backlog for deliveries beyond 12 months by approximately $4,854,000.

Fiscal 2005 second quarter net sales from continuing operations were $5,379,000, a 5% increase from the $5,135,000 in the second quarter of 2004. The increase in sales was primarily due to higher order levels at the Instrument Division due to the improvement in the commercial wireless market offset by weakness in the military market at ASCOR coupled with weakness in the military sector and customer extension of delivery dates at Microsource. For the six months ended September 25, 2004 sales improved 7% to $11,079,000 from the $10,374,000 for the same period in the prior year. The increase in sales was primarily due to higher order levels at the Instrument Division due to the strength in the commercial market as well as the military and government market coupled with limited improvement in the commercial market at ASCOR partially offset by weakness in the military sector and customer extension of delivery dates at Microsource.

Table of Contents

Allocation of Net sales by segment

(Dollars in thousands)	Three Months Ended			Six Months Ended		
	September 25, 2004	% change	September 27, 2003	September 25, 2004	% change	September 27, 2003
Instrument Division	$3,137	32%	$ 2,381	$ 6,658	48%	$ 4,448
ASCOR	1,068	2%	1,046	1,852	(24%)	2,440
Microsource	1,174	(31%)	1,708	2,569	(25%)	3,446
Total	$5,379	5%	$ 5,135	$11,079	7%	$ 10,374

In the second quarter of fiscal 2005, cost of sales from continuing operations decreased 5% to $3,050,000 from $3,220,000 for the same period last year. For the six months ended September 25, 2004, the cost of sales from continuing operations declined 13% to $6,179,000 from $7,096,000 for the similar period ending September 27, 2004. Both of these declines are primarily attributable to the cost reductions in both personnel and the level of fixed manufacturing costs.

Operating expense and Cost of sales

(Dollars in thousands)	Three Months Ended			Six Months Ended		
	September 25, 2004	% change	September 27, 2003	September 25, 2004	% change	September 27, 2003
Cost of sales	$3,050	(5%)	$ 3,220	$ 6,179	(13%)	$ 7,096
Product development	809	(7%)	865	1,653	(11%)	1,853
Selling, general and administrative	1,371	(4%)	1,420	2,784	(9%)	3,064
Total	$5,230	(5%)	$ 5,505	$10,616	(12%)	$ 12,013

Operating expenses from continuing operations decreased 5% or $105,000 in the second quarter of fiscal 2005 over 2004 due to decreases of $49,000 in selling, general and administrative and $56,000 in product development expenses. Product development costs from continuing operations decreased 7% or $56,000 in the fiscal 2005 second quarter primarily due to decreased product development expenses company-wide on personnel cost reductions and a more streamlined product development focus. Selling, general and administrative expenses from continuing operations decreased 4% or $49,000 for the second quarter of fiscal year 2005 compared to the same period in the prior year. The decrease is a result of $117,000 less in marketing and administrative expenses offset by higher commission expense of $68,000 on higher commissionable sales for the quarter. These expense reductions were primarily personnel reductions and rent reductions due to renegotiated lease terms.

Operating expenses from continuing operations decreased 10% or $480,000 for the six months ended September 25, 2004 over the same period for prior year due to decreases of $280,000 in selling, general and administrative and $200,000 in product development expenses. Product development costs from continuing operations decreased 11% or $200,000 for the six months ended September 25, 2004 primarily due to decreased product development expenses company-wide on personnel cost reductions and a more streamlined product development focus. Selling, general and administrative expenses from continuing operations decreased 9% or $280,000 for the first half of fiscal year 2005 compared to the same period in the prior year. The decrease is a result of $272,000 less in marketing and administrative expenses coupled with lower commission expense of $8,000. These expense reductions were primarily personnel reductions and rent reductions due to renegotiated lease terms.

The pre-tax profit from continuing operations for the three and six months periods ended September 25, 2004 were $148,000 and $462,000, respectively. The pre-tax loss from continuing operations for the three and six months periods ended September 27, 2003 were $357,000 and $1,633,000, respectively. Giga-tronics recorded a net profit of $24,000 or $0.01 per fully diluted share for the second quarter of fiscal year 2005 versus a net loss of $483,000 or $0.10 per fully diluted share in the same period last year. Giga-tronics recorded a net profit of $381,000 or $0.08 per fully diluted share for the first half of fiscal 2005 versus a net loss of $4,115,000 or $0.88 per fully diluted share in the same period last year.

Loss from discontinued operations for the six-month period ended September 25, 2004 and September 27, 2003 totaled $81,000 and $2,482,000. The Company discontinued and subsequently sold its Dymatix division in the fourth quarter of 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 25, 2004, Giga-tronics had $2,214,000 in cash and cash equivalents, compared to $2,752,000 as of March 27, 2004.

Working capital at the end of the second quarter of fiscal 2005 was $8,867,000 compared to $10,104,000 in the same period last year. The decrease in working capital at the end of the second quarter of 2005 versus 2004 was primarily due to decreases in cash partially offset by a decrease in accrued warranty.

The Company s current ratio (current assets divided by current liabilities) at September 25, 2004 was 3.5 compared to 3.6 on September 27, 2003.

Cash used by operations amounted to $465,000 in the first half of fiscal 2005 and $753,000 in the same period of fiscal 2004. Cash used by operations in the first half of fiscal 2005 is primarily attributed to the operating profit in the quarter offset by net change in operating assets and liabilities. Cash used by operations in first half of fiscal 2004 was primarily attributed to the operating loss in the year offset by a decrease in inventory.

Based on current operations, management believes that cash and cash equivalents remain adequate to meet anticipated operating needs for the next two years. However, this estimate is based on projections that may or may not be realized, and therefore actual cash usage could be greater than projected. To operate beyond that term would require the Company to earn additional cash from operations, obtain a line of credit or obtain additional funds from other sources. On June 1, 2004, the Company obtained a secured revolving line of credit for $2,500,000, with interest payable at prime rate plus 1 1/2%. 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 25, 2004.

Additions to property and equipment were $30,000 in the first half of fiscal 2005 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.

Recent Accounting Pronouncements

In December 2003, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 104 (SAB No. 104), Revenue Recognition, which codifies, revises and rescinds certain sections of SAB No. 101, Revenue Recognition, in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No 104 did not have a material effect on the Company s consolidated results of operations, consolidated financial position or consolidated cash flows.

In December 2003, the FASB issued Interpretation No. 46 (FIN 46R)(revised December 2003), Consolidation of variable Interest Entities, an interpretation of accounting Research Bulletin No.51 (ARB 51), which addresses how a business enterprise should evaluate whether it has a controlling interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46 (FIN 46), which was issued in January 2003. Before concluding that it is appropriate to apply the ARB 51 Voting interest consolidation model to an entity, an enterprise must first evaluate its involvement with all entities. There is no grandfathering of existing entities, Public companies must apply either FIN 46 or Fin 46R immediately to entities created after December 15, 2003 and no later than the end of the first reporting period that ends after March 15, 2004 to entities considered to be special purpose entities. The adoption of FIN 46R had no effect on the Company s consolidated financial position, results of operations, or cash flows.

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 acquired Microsource, Inc. in fiscal 1999 in a transaction accounted for as a purchase. 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, 2004, 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 7, 2004.

The vote for the nominated Directors was as follows:

Nominee	In Favor	Withheld
George H. Bruns, Jr.	4,284,571	106,635
James A. Cole	4,280,721	110,485
Kenneth A. Harvey	4,280,721	110,485
Robert C. Wilson	4,280,721	110,485
William E. Wilson	4,253,364	137,842

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, 2004

/s/ GEORGE H. BRUNS, JR.

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

Date: November 1, 2004

/s/ MARK H. COSMEZ II

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

17