GIGA TRONICS INC
Form 10QSB
February 01, 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 December 24, 2005

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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

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

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

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 February 1, 2006: 4,809,021 shares

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

GIGA-TRONICS INCORPORATED

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Item 1

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands except share data)	December 24, 2005	March 26, 2005
(Unaudited)		
Assets		
Current assets		
Cash and cash equivalents	$ 2,537	$ 2,540
Notes receivable, net		7
Trade accounts receivable, net	3,324	3,145
Inventories	5,875	6,257
Prepaid expenses	247	227
Total current assets	11,983	12,176
Property and equipment, net	384	674
Other assets	68	111
Total assets	$ 12,435	$ 12,961
Liabilities and shareholders equity		
Current liabilities		
Accounts payable	$ 1,086	$ 1,075
Accrued commissions	182	200
Accrued payroll and benefits	625	720
Accrued warranty	264	378
Customer advances	454	2
Other current liabilities	395	464
Total current liabilities	3,006	2,839
Deferred rent	245	310
Total liabilities	3,251	3,149
Shareholders equity		
Preferred stock of no par value;		
Authorized 1,000,000 shares; no shares outstanding at December 24, 2005 and March 26, 2005		
Common stock of no par value;		
Authorized 40,000,000 shares; 4,809,021 shares at December 24, 2005 and 4,728,646 shares at March 26, 2005 issued and outstanding	13,002	12,756
Accumulated deficit	(3,818)	(2,944)
Total shareholders equity	9,184	9,812
Total liabilities and shareholders equity	$ 12,435	$ 12,961

See accompanying notes to unaudited condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands except per share data)	Three Months Ended December 24, 2005	Three Months Ended December 25, 2004	Nine Months Ended December 24, 2005	Nine Months Ended December 25, 2004
(Unaudited)				
Net sales	$ 5,537	$ 5,130	$ 14,934	$ 16,209
Cost of sales	3,203	2,755	8,732	8,934
Gross profit	2,334	2,375	6,202	7,275
Product development	883	812	2,892	2,465
Selling, general and administrative	1,434	1,398	4,218	4,182
Operating expenses	2,317	2,210	7,110	6,647
Operating income (loss)	17	165	(908)	628
Other expense		(2)		(2)
Interest income (expense), net	10	(2)	24	1
Income (loss) from continuing operations before income taxes	27	161	(884)	627
Provision for income taxes			4	4
Income (loss) from continuing operations	27	161	(888)	623
Income (loss) on discontinued operations, net of income taxes	3	(133)	14	(214)
Net income (loss)	$ 30	$ 28	$ (874)	$ 409
Basic net income (loss) per share:				
From continuing operations	$ 0.01	$ 0.04	$ (0.18)	$ 0.13
On discontinued operations	0.00	(0.03)	0.00	(0.04)
Basic net income (loss) per share	$ 0.01	$ 0.01	$ (0.18)	$ 0.09
Diluted net income (loss) per share:				
From continuing operations	$ 0.01	$ 0.04	$ (0.18)	$ 0.13
On discontinued operations	0.00	(0.03)	0.00	(0.04)
Diluted net income (loss) per share	$ 0.01	$ 0.01	$ (0.18)	$ 0.09

Shares used in per share calculation:				
Basic	4,809	4,725	4,773	4,725
Dilutive	4,917	4,734	4,773	4,734

See accompanying notes to unaudited condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) (Unaudited)	Nine Months Ended December 24, 2005	Nine Months Ended December 25, 2004
Cash flows used in operations:		
Net (loss) income	$ (874)	$ 409
Adjustments to reconcile net (loss) income to net cash used in operations:		
Depreciation and amortization	367	526
Loss on disposal or sale of equipment		4
Changes in operating assets and liabilities	335	(956)
Net cash used in operations	(172)	(17)
Cash flows from investing activities:		
Purchases of property and equipment	(77)	(40)
Net cash used in investing activities	(77)	(40)
Cash flows from financing activities:		
Issuance of common stock	246	
Payments on capital lease		(10)
Net cash provided by (used in) financing activities	246	(10)
Decrease in cash and cash equivalents	(3)	(67)
Cash and cash equivalents at beginning of period	2,540	2,752
Cash and cash equivalents at end of period	$ 2,537	$ 2,685

Supplementary disclosure of cash flow information:

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

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 Incorporated (the Company or Giga-tronics), 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 (consisting of normal recurring adjustments) 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 to 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 December 24, 2005, the note receivable continued 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.

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(4) Inventories

(In thousands)	December 24, 2005	March 26, 2005
Raw materials	$ 3,670	$ 3,702
Work-in-progress	1,665	1,925
Finished goods	287	393
Demonstration inventory	253	237
Total inventory	$ 5,875	$ 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 (EPS) 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		Nine Months Ended	
(In thousands except per share data)	December 24, 2005	December 25, 2004	December 24, 2005	December 25, 2004
Net income (loss)	$ 30	$ 28	$ (874)	409
Weighted average:				
Common shares outstanding	4,809	4,725	4,773	4,725
Potential common shares	108	9		9
Common shares assuming dilution	4,917	4,734	4,773	4,734
Net earnings (loss) per share of common stock	$ 0.01	$ 0.01	$ (0.18)	$ 0.09
Net earnings (loss) per share of common stock assuming dilution	$ 0.01	$ 0.01	$ (0.18)	$ 0.09
Stock options not included in computation	81	479	494	479

The number of stock options not included in the computation of diluted EPS for the three month period ended December 24, 2005 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 nine month period ended December 24, 2005 is 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 nine month periods ended December 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 $5.10 and $3.29 as of December 24, 2005 and December 25, 2004, respectively.

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(6) Stock Based Compensation

The Company accounts for stock-based employee compensation using the intrinsic value method under Accounting Principles Board Opinion (APB) 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 (SFAS) 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.

(In thousands except per share data)	Three Months Ended December 24, 2005	Three Months Ended December 25, 2004	Nine Months Ended December 24, 2005	Nine Months Ended December 25, 2004
Net income (loss), as reported	$ 30	$ 28	$ (874)	$ 409
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	(26)	(57)	(97)	(186)
Pro forma net income (loss)	$ 4	$ (29)	$ (971)	$ 223
Net income (loss) per share basic				
As reported	$ 0.01	$ 0.01	$ (0.18)	$ 0.09
Pro forma	0.00	(0.01)	(0.20)	0.05
Net income (loss) per share diluted				
As reported	$ 0.01	$ 0.01	$ (0.18)	$ 0.09
Pro forma	0.00	(0.01)	(0.20)	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.

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Information on reportable segments is as follows:

(In thousands)	Three Months Ended December 24, 2005 Net Sales	Three Months Ended December 24, 2005 Pre-tax Income (loss)	Three Months Ended December 25, 2004 Net Sales	Three Months Ended December 25, 2004 Pre-tax Income (loss)
Giga-tronics Instrument	$ 2,960	$ (63)	$ 3,061	$ 142
ASCOR	797	(244)	965	57
Microsource	1,780	31	1,104	(271)
Corporate		303		233
Total	$ 5,537	$ 27	$ 5,130	$ 161

(In thousands)	Nine Months Ended December 24, 2005 Net Sales	Nine Months Ended December 24, 2005 Pre-tax Income (loss)	Nine Months Ended December 25, 2004 Net Sales	Nine Months Ended December 25, 2004 Pre-tax Income (loss)
Giga-tronics Instrument	$ 7,266	$ (738)	$ 9,719	$ 522
ASCOR	2,988	(433)	2,817	(48)
Microsource	4,680	(490)	3,673	(674)
Corporate		777		827
Total	$ 14,934	$ (884)	$ 16,209	$ 627

(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 December 24, 2005	Three Months Ended December 25, 2004	Nine Months Ended December 24, 2005	Nine Months Ended December 25, 2004
Balance at beginning of quarter	$ 303	$ 488	$ 378	$ 548
Provision for current quarter sales	(18)	72	116	156
Warranty costs incurred	(21)	(86)	(230)	(230)
Balance at end of quarter	$ 264	$ 474	$ 264	$ 474

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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 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 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.

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. 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 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 third quarter of fiscal 2006, the net profit from discontinued operations was $3,000, compared to a net loss of $133,000 for the same period in fiscal 2005.

Results of Operations

New orders received from continuing operations in the third quarter of fiscal 2006 decreased 1% to $3,995,000 from the $4,032,000 received in the third quarter of fiscal 2005.

New Orders

	Three Months Ended			Nine Months Ended		
(Dollars in thousands)	December 24, 2005	% change	December 25, 2004	December 24, 2005	% change	December 25, 2004
Instrument Division	$3,047	14%	$ 2,677	$ 7,178	(20%)	$ 8,955
ASCOR	462	(51%)	934	2,697	1%	2,666
Microsource	486	15%	421	1,460	151%	(2,869)
Total	$3,995	(1%)	$ 4,032	$11,335	30%	$ 8,752

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Increases in military and commercial demand improved Instrument Division orders in the third quarter of fiscal 2006. Orders at ASCOR decreased in the third quarter primarily due to a decrease in military demand for its products. Orders at Microsource increased for the third quarter primarily due to an increase in military demand for its products. Orders at the Instrument Division for the nine months decreased principally due to the decline in the commercial wireless market. Orders at Microsource for the nine months 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.

	Three Months Ended		
(Dollars in thousands)	December 24, 2005	% Change	December 25, 2004
Backlog of unfilled orders	$12,193	37%	$ 8,898
Backlog of unfilled orders shippable within one year	6,343	(10%)	7,047
Previous fiscal year end (FYE) quarter backlog reclassified during year as shippable later than one year	1	(99%)	191
Net cancellations during year of previous FYE one-year backlog		(100%)	7

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

Allocation of Net sales by Segment

	Three Months Ended			Nine Months Ended		
(Dollars in thousands)	December 24, 2005	% change	December 25, 2004	December 24, 2005	% change	December 25, 2004
Instrument Division	$2,960	(3%)	$ 3,061	$ 7,266	(25%)	$ 9,719
ASCOR	797	(17%)	965	2,988	6%	2,817
Microsource	1,780	61%	1,104	4,680	27%	3,673
Total	$5,537	8%	$ 5,130	$14,934	(8%)	$ 16,209

Fiscal 2006 third quarter net sales from continuing operations were $5,537,000, an 8% increase from $5,130,000 in the third quarter of 2005. The increase in sales was primarily due to the increase in military and commercial business at Microsource offset by weakness in the military sector at ASCOR and to lower shipment levels at the Instrument Division due to the decline in the military shipments offset by the increase in the commercial shipments. For the nine months ended December 24, 2005 sales decreased 8% to $14,934,000 from the $16,209,000 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 offset by improvement in the military shipments at ASCOR coupled with the improvement in customer delivery requirements at Microsource.

Cost of Sales

	Three Months Ended			Nine Months Ended		
(Dollars in thousands)	December 24, 2005	% change	December 25, 2004	December 24, 2005	% change	December 25, 2004
Cost of sales	$3,203	16%	$ 2,755	$8,732	(2%)	$ 8,934

In the third quarter of fiscal 2006, cost of sales from continuing operations increased 16% to $3,203,000 from $2,755,000 for the same period last year. The increase is principally due to an increase in the material content of products shipped. For the nine months ended December 24, 2005, the cost of sales from continuing operations declined 2% to $8,732,000 from $8,934,000 for the similar period ending December 25, 2004. The decline was primarily attributable to lower shipment levels, partially offset by higher material cost of products shipped.

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Operating Expenses

(Dollars in thousands)	Three Months Ended December 24, 2005	% change	December 25, 2004	Nine Months Ended December 24, 2005	% change	December 25, 2004
Product development	$ 883	9%	$ 812	$2,892	17%	$ 2,465
Selling, general and administrative	1,434	3%	1,398	4,218	1%	4,182
Total	$2,317	5%	$ 2,210	$7,110	7%	$ 6,647

Operating expenses from continuing operations increased 5% or $107,000 in the third quarter of fiscal 2006 over 2005 due to an increase of $71,000 in product development costs and an increase of $36,000 in selling, general and administrative expenses. Product development costs from continuing operations increased 9% or $71,000 in the third quarter of fiscal 2006 primarily due to increased research and development designed to expand product lines and update existing lines company-wide. Selling, general and administrative expenses from continuing operations increased 3% or $36,000 for the third quarter of fiscal year 2006 compared to the same period in the prior year. The increase is a result of higher marketing expenses of $48,000 and higher administrative expenses of $30,000, offset by lower commission expenses of $42,000.

Operating expenses from continuing operations increased 7% or $463,000 for the nine months ended December 24, 2005 over the same period for the prior year due to an increase of $427,000 in product development costs and an increase of $36,000 in selling, general and administrative expenses. Product development costs from continuing operations increased 17% or $427,000 for the nine months ended December 24, 2005 primarily due to increased research and development designed to expand product lines and update existing lines company-wide. Selling, general and administrative expenses from continuing operations increased 1% or $36,000 for the nine months ended December 24, 2005 as compared to the same period in the prior year. The increase is a result of higher administrative expenses of $62,000, offset by lower marketing expenses of $18,000 and lower commission expenses of $8,000 on lower commissionable sales for the nine month period.

Pre-tax income from continuing operations for the three month period ended December 24, 2005 was $27,000 as compared to $161,000 for the same period last year. The pre-tax loss from continuing operations for the nine month period ended December 24, 2005 was $884,000 as compared to pre-tax income from continuing operations of $627,000 for the same period last year. Giga-tronics recorded a net profit of $30,000 or $0.01 per fully diluted share for the third quarter of fiscal 2006 versus a net profit of $28,000 or $0.01 per fully diluted share in the same period last year. Giga-tronics recorded a net loss of $874,000 or $0.18 per fully diluted share for the nine months ended December 24, 2005 versus a net profit of $409,000 or $0.09 per fully diluted share in the same period last year.

Profit from discontinued operations for the nine month period ended December 24, 2005 totaled $14,000. Loss from discontinued operations for the nine month period ended December 25, 2004 totaled $214,000. The Company discontinued and subsequently sold its Dymatix Division in the fourth quarter of fiscal 2004. The loss recorded for the nine-month period ended December 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 to the Interim Consolidated Financial Statements Discontinued Operations.

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Financial Condition and Liquidity

As of December 24, 2005, Giga-tronics had $2,537,000 in cash and cash equivalents, compared to $2,540,000 as of March 26, 2005.

Working capital at the end of the third quarter of fiscal 2006 was $8,977,000 compared to $9,054,000 at the end of the same period last year. The decrease in working capital at the end of the third quarter of 2006 versus 2005 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 December 24, 2005 was 4.0 compared to 3.5 on December 25, 2004.

Cash used in operations amounted to $172,000 for the nine month period ended December 24, 2005. Cash used by operations was $17,000 in the same period of fiscal 2005. Cash used in operations for the first nine months 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 in operations in the nine month period ended December 25, 2004 is primarily attributed to the net change in operating assets and liabilities offset by the operating profit for the nine month period of 2004.

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 nine month periods ended December 24, 2005.

From time to time, Giga-tronics considers a variety of acquisition opportunities to 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 $77,000 for the nine months ended December 24, 2005 compared to $40,000 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 December 24, 2005. Management has, therefore, established a valuation allowance against its net deferred tax assets as of December 24, 2005.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 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 shared-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 amounts on the expense previously calculated and reported in the pro forma disclosures that had been required by FAS 123. FAS 123(R)

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is effective for the first reporting period beginning after December 15, 2005. Management has not completed its evaluation of the effect that FAS 123 (R) will have but believes that the effect will be consistent with the application disclosed in its 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.

On June 7, 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections a replacement of APB Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements*. Under the provisions of SFAS No. 154, voluntary changes in accounting principles are applied retrospectively to prior periods financial statements unless it would be impractical to do so. SFAS No. 154 supersedes APB Opinion No. 20, which required that most voluntary changes in accounting principles be recognized by including in the current period s net income the cumulative effect of the change. SFAS No. 154 also makes a distinction between retrospective application of a change in accounting principle and the restatement of financial statements to reflect the correction of an error. The provisions of SFAS No. 154 are effective for accounting changes made in fiscal years beginning after December 15, 2005. Management of the Company does not expect the adoption of this standard to have a material impact on its financial position or results of operations.

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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 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 and dispute over performance. Other risks and uncertainties involve the ability to satisfy requirements related to the Sarbanes-Oxley Act and other regulation on internal control, civil disturbances or terrorist threats or acts, or apprehension about the possible future occurrences of acts of this type, the involvement of the United Sates in war or other hostilities, restrictive covenants in or changes to the credit ratings on our current or future debt that could increase our financing costs or affect our ability to borrow, make payments on debt or pay dividends, the ability to collect receivables, and other risks and unforeseen events. 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.

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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 was no change in the Company s internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect our internal control over financial reporting.

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Part II OTHER INFORMATION
Item 1
Legal Proceedings
As of February 1, 2006, 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 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.

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SIGNATURES

In accordance with the requirements of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GIGA-TRONICS INCORPORATED
(Registrant)

By:

Date: February 1, 2006 /s/ GEORGE H. BRUNS, JR.

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

Date: February 1, 2006 /s/ MARK H. COSMEZ II

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

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Exhibit Index

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