GIGA TRONICS INC
Form 10QSB
August 09, 2004

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**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 June 26, 2004 or

( ) 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 ( )

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 August 2, 2004: 4,724,896 shares

Transitional Small Business Disclosure Format (Check one) Yes ( ) No (X)

GIGA-TRONICS INCORPORATED

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Item 1

CONDENSED CONSOLIDATED BALANCE SHEETS

| (In thousands except share data) (Unaudited) | June 26, 2004 | March 27, 2004 |
|---|---|---|
| **Assets** | | |
| Current assets | | |
| Cash and cash equivalents | $ 2,376 | $ 2,752 |
| Notes receivable | 257 | 253 |
| Trade accounts receivable, net | 2,610 | 1,959 |
| Inventories | 6,875 | 6,920 |
| Prepaid expenses | 350 | 271 |
| **Total current assets** | 12,468 | 12,155 |
| Property and equipment, net | 1,089 | 1,251 |
| Other assets | 313 | 327 |
| **Total assets** | $ 13,870 | $ 13,733 |
| **Liabilities and shareholders equity** | | |
| Current liabilities | | |
| Accounts payable | $ 1,421 | $ 1,686 |
| Accrued commissions | 243 | 293 |
| Accrued payroll and benefits | 875 | 889 |
| Accrued warranty | 512 | 548 |
| Customer advances | 358 | 58 |
| Obligations under capital lease | 2 | 10 |
| Income taxes payable | 4 | |
| Other current liabilities | 539 | 674 |
| **Total current liabilities** | 3,954 | 4,158 |
| Deferred rent | 363 | 379 |
| **Total liabilities** | 4,317 | 4,537 |
| Shareholders equity | | |
| Preferred stock of no par value; | | |

| | | |
|---|---|---|
| Authorized 1,000,000 shares; no shares outstanding at June 26, 2004 and March 27, 2004 | | |
| Common stock of no par value; | | |
| Authorized 40,000,000 shares; 4,724,896 shares at June 26, 2004 and 4,724,896 shares at March 27, 2004 issued and outstanding | 12,752 | 12,752 |
| Accumulated deficit | (3,199) | (3,556) |
| **Total shareholders equity** | 9,553 | 9,196 |
| **Total liabilities and shareholders equity** | $ 13,870 | $ 13,733 |

*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 June 26, 2004 | Three Months Ended June 28, 2003 |
|---|---|---|
| **Net sales** | $5,700 | $ 5,239 |
| Cost of sales | 3,129 | 3,876 |
| **Gross profit** | 2,571 | 1,363 |
| Product development | 844 | 988 |
| Selling, general and administrative | 1,413 | 1,644 |
| Operating expenses | 2,257 | 2,632 |
| **Operating income (loss)** | 314 | (1,269) |
| Interest income, net | 4 | (3) |
| **Income (loss) from continuing operations before income taxes** | 318 | (1,272) |
| Provision for income taxes | 4 | 4 |
| **Income (loss) from continuing operations** | 314 | (1,276) |
| Income (loss) on discontinued operations, net of income taxes | 43 | (2,356) |
| **Net income (loss)** | $ 357 | $(3,632) |
| **Basic net income (loss) per share**: | | |
| From continuing operations | $ 0.07 | $ (0.27) |
| On discontinued operations | 0.01 | (0.50) |
| Basic net income (loss) per share | $ 0.08 | $ (0.77) |
| **Diluted net income (loss) per share**: | | |
| From continuing operations | $ 0.07 | $ (0.27) |
| On discontinued operations | 0.01 | (0.50) |
| Diluted net income (loss) per share | $ 0.08 | $ (0.77) |

| | | |
|---|---|---|
| Shares used in per share calculation: | | |
| Basic | 4,725 | 4,693 |
| Dilutive | 4,745 | 4,693 |

*See accompanying notes to unaudited condensed consolidated financial statements.*

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CONSOLIDATED STATEMENTS OF CASH FLOWS

| (In thousands) (Unaudited) | Three Months Ended June 26, 2004 | June 28, 2003 |
|---|---|---|
| **Cash flows provided from operations:** | | |
| Net income (loss) | $ 357 | $ (3,632) |
| Adjustments to reconcile net income (loss) to net cash used in operations: | | |
| Depreciation and amortization | 198 | 403 |
| Gain on disposal or sale of equipment | | (4) |
| Changes in operating assets and liabilities | (885) | 2,146 |
| **Net cash used in operations** | (330) | (1,087) |
| **Cash flows from investing activities:** | | |
| Purchases of property and equipment | (22) | (22) |
| Proceeds from sale of equipment | | 4 |
| Other assets | | 17 |
| **Net cash used in investing activities** | (22) | (1) |
| **Cash flows from financing activities:** | | |
| Payments on capital lease and other long term obligations | (24) | (106) |
| **Net cash used in financing activities** | (24) | (106) |
| **Decrease in cash and cash equivalents** | (376) | (1,194) |
| **Cash and cash equivalents at beginning of period** | 2,752 | 5,005 |
| **Cash and cash equivalents at end of period** | $ 2,376 | $ 3,811 |

*Supplementary disclosure of cash flow information:*

(1) No cash was paid for income taxes in the three month periods ended June 26, 2004 and June 28, 2003.

*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 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. Accordingly, the loss from discontinued operations was $2,356,000 for the first quarter of fiscal 2004.

In the fourth quarter of fiscal 2004, Giga-tronics consummated the sale of its Dymatix division. Under the terms of the sale, the Company will receive $300,000, of which $50,000 was paid at closing, $50,000 was rescheduled to be paid in July 2004, with the remaining $200,000 due in equal quarterly installments over the next two years. The buyer is currently delinquent in his installments and management is currently working with the buyer to secure payment. Management believes collection continues to be reasonably assured, as the note is collateralized by the Dymatix assets purchased, other business assets, and other personal assets of the purchaser. In addition, Giga-tronics may receive earn-out payments based on a percentage of sales on a monthly basis for two years after the closing date. The Company recognized a net gain of $53,000 in fiscal 2004, relating to this sale. With the sale of the Dymatix division, Giga-tronics will be able to focus on its core business in order to release new products more quickly to market.

**(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.

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**(4) Inventories**

| (In thousands) | June 26, 2004 | March 27, 2004 |
|---|---|---|
| Raw materials | $4,137 | $4,036 |
| Work-in-progress | 1,898 | 1,915 |
| Finished goods | 509 | 724 |
| Demonstration inventory | 331 | 245 |
| Total inventory | $6,875 | $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 | |
|---|---|---|
| (In thousands except per share data) | June 26, 2004 | June 28, 2003 |
| Net income (loss) | $ 357 | $(3,632) |
| Weighted average: | | |
| Common shares outstanding | 4,725 | 4,693 |
| Potential common shares | 20 | |
| Common shares assuming dilution | 4,745 | 4,693 |
| Net earnings (loss) per share of common stock | 0.08 | (0.77) |
| Net earnings (loss) per share of common stock assuming dilution | 0.08 | (0.77) |
| Stock options not included in computation | 448 | 525 |

The number of stock options not included in the computation of diluted earnings per share (EPS) for the three month period ended June 26, 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 period ended June 28, 2003 is 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 $3.56 and $3.57 as of June 26, 2004 and June 28, 2003, respectively.

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**(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 | |
|---|---|---|
| **(In thousands except per share data)** | **June 26, 2004** | **June 28, 2003** |
| Net income (loss), as reported | $ 357 | $ (3,632) |
| 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 | (66) | (46) |
| Pro forma net income (loss) | $ 291 | $ (3,678) |
| Net income (loss) per share basic: | | |
| As reported | $ 0.08 | $ (0.77) |
| Pro forma | 0.06 | (0.78) |
| Net income (loss) per share diluted: | | |
| As reported | 0.08 | (0.77) |
| Pro forma | 0.06 | (0.78) |

**(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 June 26, 2004 Net Sales | June 26, 2004 Pre-tax Income (loss) | June 28, 2003 Net Sales | June 28, 2003 Pre-tax Income (loss) |
|---|---|---|---|---|
| Giga-tronics Instrument | $3,521 | $ 204 | $2,107 | $ (812) |
| ASCOR | 784 | (113) | 1,394 | (194) |
| Microsource | 1,395 | 23 | 1,738 | (419) |
| Corporate | | 204 | | 153 |
| Total | $5,700 | $ 318 | $5,239 | $(1,272) |

**(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.

| (In thousands) | Three Months Ended June 26, 2004 | June 28, 2003 |
|---|---|---|
| Balance at beginning of quarter | $ 548 | $ 858 |
| Provision for current quarter sales | 28 | 175 |
| Warranty costs incurred | (64) | (228) |
| Balance at end of quarter | $ 512 | $ 805 |

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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-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 first quarter of fiscal 2005, the net profit from discontinued operations was $43,000, compared to a net loss of $2,356,000 for the same period in fiscal 2004. 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 first quarter of fiscal 2005 increased 23% to $3,467,000 from the $2,818,000 received in the first quarter of fiscal 2004. New orders increased primarily due to strengthening in our commercial wireless business coupled with increases in new military orders.

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New orders

(Dollars in thousands)

| | Three Months Ended | | |
|---|---|---|---|
| | **June 26, 2004** | **% change** | **June 28, 2003** |
| Instrument Division | $2,487 | 14% | $2,178 |
| ASCOR | 808 | 90% | 426 |
| Microsource | 172 | (20%) | 214 |
| Total | $3,467 | 23% | $2,818 |

Improvement in the commercial business at the Instrument Division helped to increase new orders in the first quarter of FY 2005. Orders at ASCOR increased in the first quarter primarily due to an increase in military demand for their products. Orders at Microsource decreased primarily due to reductions in military orders.

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

(Dollars in thousands)

| | Three Months Ended | | |
|---|---|---|---|
| | **June 26, 2004** | **% change** | **June 28, 2003** |
| Backlog of unfilled orders | $14,122 | (1%) | $14,316 |
| Backlog of unfilled orders shippable within one year | 5,839 | 3% | 5,680 |
| Previous fiscal year end (FYE) quarter backlog reclassified during year as shippable later than one year | 199 | 100% | |
| Net cancellations during year of previous FYE one-year backlog | 18 | (10%) | 20 |

Backlog at the end of the first quarter 2005 was flat compared to the same period last year. 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 will reverse its recorded backlog for deliveries beyond 12 months by approximately $4,900,000. The Company has no inventory risk or exposure associated with this reversal and as such there is no impact on the first quarter financial statements.

Fiscal 2005 first quarter net sales from continuing operations were $5,700,000, a 9% increase from the $5,239,000 in FY 2004. The increase in sales was primarily due to higher order levels at the Instrument Division due to the strength 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. Sales at the Instrument Division increased

67% or $1,414,000. ASCOR sales decreased 44% or $610,000. Sales at Microsource decreased 20% or $343,000.

Allocation of net sales, by segment

(Dollars in thousands)

| | Three Months Ended | | |
|---|---|---|---|
| | June 26, 2004 | % change | June 28, 2003 |
| Instrument Division | $3,521 | 67% | $2,107 |
| ASCOR | 784 | (44%) | 1,394 |
| Microsource | 1,395 | (20%) | 1,738 |
| | 5,700 | 9% | 5,239 |

In the first quarter of fiscal 2005, cost of sales from continuing operations decreased 20% to $3,129,000 from $3,876,000 for the same period last year. The decrease is primarily attributable to the cost reductions in both personnel and the level of fixed manufacturing costs.

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Operating Expenses and Cost of Sales

(Dollars in thousands)

| | Three Months Ended | | |
|---|---|---|---|
| | **June 26, 2004** | **% change** | **June 28, 2003** |
| Cost of sales | $3,129 | (20%) | $ 3,876 |
| Product development | 844 | (15%) | 988 |
| Selling, general and admin. | 1,413 | (14%) | 1,644 |
| Total expenses | $5,386 | (17%) | $ 6,508 |

Operating expenses from continuing operations decreased 14% or $375,000 in the first quarter of fiscal 2005 over 2004 due to decreases of $231,000 in selling, general and administrative and $144,000 in product development expenses. Product development costs from continuing operations decreased 15% or $144,000 in the fiscal 2005 first 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 14% or $231,000 for the first quarter of fiscal year 2005 compared to the prior year. The decrease is a result of $98,000 less in marketing expenses, $57,000 less in administrative expenses and lower commission expense of $76,000 on lower commissionable sales for the quarter. These expense reductions were primarily personnel reductions and rent reductions due to renegotiated lease terms. Interest income in the first quarter of 2005 increased from the same period last year due to more cash available for investment.

Giga-tronics recorded a net profit of $357,000 or $0.08 per fully diluted share for the first quarter of fiscal year 2005 versus a net loss of $3,632,000 or $0.77 per fully diluted share in the same period last year. A $4,000 provision for income taxes was incurred in the first quarter of both fiscal year 2005 and fiscal year 2004.

**Financial Condition and Liquidity**

As of June 26, 2004, Giga-tronics had $2,376,000 in cash and cash equivalents, compared to $2,752,000 as of March 27, 2004.

Working capital for the first quarter of fiscal 2005 was $8,514,000 compared to $10,363,000 in the same period last year. The decrease in working capital in the first quarter of 2005 versus 2004 was primarily due to decreases in cash partially offset by a decrease in accrued warranty and an increase in customer advances.

The Company s current ratio (current assets divided by current liabilities) at June 26, 2004 was 3.2 compared to 3.3 on June 28, 2003.

Cash used by operations amounted to $330,000 in the first quarter of fiscal 2005 and $1,087,000 in the same period of fiscal 2004. Cash used by operations in the first quarter of 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 quarter of fiscal 2004 was primarily attributed to the operating loss in the year offset by a decrease in inventory valuation.

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, 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%. 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 period ended June 26, 2004.

Additions to property and equipment were $22,000 in the first quarter of 2005 compared to $22,000 for the same period last year. Capital equipment spending reflects the overall decline in business activity and increased productivity.

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**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. 146 ( 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. 146 ( FIN 146 ), 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 grand fathering of existing entities, Public companies must apply either FIN 146 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.

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

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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.

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 reportings.

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Part II OTHER INFORMATION

Item 1

Legal Proceedings

As of August 2, 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 6

**EXHIBITS AND REPORTS ON FORM 8-K**

(a) Exhibits

10.1 Loan and Security Agreement dated June 21, 2004 between Silicon Valley Bank and Giga-tronics Incorporated.

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.

(b) Reports on Form 8-K

Form 8-K filed on May 14, 2004, reporting under Item 7, announcing the Company s results for the fiscal quarter ended March 27, 2004.

Form 8-K filed on June 24, 2004, reporting under Item 4, announcing the Company s changes in Certifying Accountant.

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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.

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| | GIGA-TRONICS INCORPORATED<br>(Registrant) |
| | By: |
| Date: August 6, 2004 | /s/ GEORGE H. BRUNS, JR.<br>George H. Bruns, Jr.<br>Chairman and Chief Executive Officer<br>(Principal Executive Officer) |
| Date: August 6, 2004 | /s/ MARK H. COSMEZ II<br>Mark H. Cosmez II<br>Vice President, Finance<br>Chief Financial Officer and Secretary<br>(Principal Accounting Officer) |