GIGA TRONICS INC
Form 10QSB
August 04, 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 June 24, 2006

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

Commission File No. 0-12719

GIGA-TRONICS INCORPORATED

(Exact name of small business issuer as specified in its charter)

California	94-2656341
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

4650 Norris Canyon Road, San Ramon, CA 94583
(Address of principal executive offices)
Issuer s telephone number: (925) 328-4650
N/A
(Former name, former address an former fiscal year, if changed since last report)

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

Yes þ No o

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

Yes o No þ

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

Common stock outstanding as of August 3, 2006: 4,809,021 shares

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

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Item 1

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands except share data) (Unaudited)	June 24, 2006	March 25, 2006
Assets		
Current assets		
Cash and cash equivalents	$ 3,726	$ 3,412
Notes receivable	14	3
Trade accounts receivable, net	1,734	3,435
Inventories	5,066	4,813
Prepaid expenses and other assets	255	219
Total current assets	10,795	11,882
Property and equipment, net	412	337
Other assets	113	127
Total assets	$ 11,320	$ 12,346
Liabilities and shareholders equity		
Current liabilities		
Accounts payable	$ 1,099	$ 870
Accrued commissions	108	171
Accrued payroll and benefits	742	781
Accrued warranty	244	250
Customer advances	465	521
Other current liabilities	389	433
Total current liabilities	3,047	3,026
Deferred rent	198	222
Total liabilities	3,245	3,248
Shareholders equity		
Preferred stock of no par value;		
Authorized 1,000,000 shares; no shares outstanding at June 24, 2006 and March 25, 2006		
Common stock of no par value;		
Authorized 40,000,000 shares; 4,809,021 shares at June 24, 2006 and March 25, 2006 issued and outstanding	13,007	13,003
Accumulated deficit	(4,932)	(3,905)
Total shareholders equity	8,075	9,098
Total liabilities and shareholders equity	$ 11,320	$ 12,346

See accompanying notes to unaudited condensed consolidated financial statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands except per share data) (Unaudited)	Three Months Ended June 24, 2006	June 25, 2005
Net sales	$ 3,386	$ 5,783
Cost of sales	2,187	3,138
Gross profit	1,199	2,645
Product development	961	966
Selling, general and administrative	1,297	1,453
Operating expenses	2,258	2,419
Operating (loss) income	(1,059)	226
Interest income, net	29	5
(Loss) income from continuing operations before income taxes	(1,030)	231
Provision for income taxes		4
(Loss) income from continuing operations	(1,030)	227
Income on discontinued operations, net of income taxes	3	6
Net (loss) income	$ (1,027)	$ 233
Basic net (loss) income per share:		
From continuing operations	$ (0.21)	$ 0.05
On discontinued operations	(0.00)	0.00
Basic net (loss) income per share	$ (0.21)	$ 0.05
Diluted net (loss) income per share:		
From continuing operations	$ (0.21)	$ 0.05
On discontinued operations	(0.00)	0.00
Diluted net (loss) income per share	$ (0.21)	$ 0.05
Shares used in per share calculation:		
Basic	4,809	4,731
Dilutive	4,809	4,912

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 24, 2006	June 25, 2005
Cash flows from operations:		
Net (loss) income	$ (1,027)	$ 233
Adjustments to reconcile net (loss) income to net cash provided by operations:		
Depreciation and amortization	69	141
Equity based compensation	4	
Changes in operating assets and liabilities	1,436	(195)
Net cash provided by operations	482	179
Cash flows from investing activities:		
Proceeds from sale of equipment	2	
Purchases of property and equipment	(146)	(49)
Net cash used in investing activities	(144)	(49)
Cash flows from financing activities:		
Issuance of common stock		15
Payments on capital lease obligations	(24)	(18)
Net cash used in financing activities	(24)	(3)
Increase in cash and cash equivalents	314	127
Cash and cash equivalents at beginning of period	3,412	2,540
Cash and cash equivalents at end of period	$ 3,726	$ 2,667

Supplementary disclosure of cash flow information:

(1) No cash was paid for income taxes and interest in the three month periods ended June 24, 2006 and June 25, 2005.

See accompanying notes to unaudited condensed consolidated financial statements.

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GIGA-TRONICS INCORPORATED
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The condensed consolidated financial statements included herein have been prepared by Giga-tronics (the Company), pursuant to the rules and regulations of the Securities and Exchange Commission. The consolidated results of operations for the interim periods shown in this report are not necessarily indicative of results to be expected for the fiscal year. In the opinion of management, the information contained herein reflects all adjustments (consisting of normal recurring entries) necessary to make the consolidated results of operations for the interim periods a fair statement of such operations. For further information, refer to the consolidated financial statements and footnotes thereto, included in the Annual Report on Form 10-KSB, filed with the Securities and Exchange Commission for the year ended March 25, 2006.

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

(2) Discontinued Operations

In the first quarter of 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 this collateral deteriorated during fiscal 2005. Accordingly, the Company considers the note receivable to be impaired and has recorded a provision of loss of $250,000 through discontinued operations in the 2005 fiscal year.

(3) Revenue Recognition

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

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

(4) Inventories

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs* (FAS 151). FAS 151 requires that abnormal amounts of idle facility expense, freight, handling costs and spoilage be recognized as current-period charges. Further, FAS 151 requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. Unallocated overheads must be recognized as an expense in the period in which they are incurred. The Company adopted FAS 151 effective March 26, 2006, which did not have a material impact on the Company s financial statements and related disclosures.

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(In thousands)	June 24, 2006	March 25, 2006
Raw materials	$ 3,007	$ 3,025
Work-in-progress	1,589	1,309
Finished goods	244	246
Demonstration inventory	226	233
Total inventory	$ 5,066	$ 4,813

(5) Earnings 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 (loss) 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 June 24, 2006	June 25, 2005
Net (loss) income	$ (1,027)	$ 233
Weighted average:		
Common shares outstanding	4,809	4,731
Potential common shares		181
Common shares assuming dilution	4,809	4,912
Net (loss) income per share of common stock	$ (0.21)	$ 0.05
Net (loss) income per share of common stock assuming dilution	(0.21)	0.05
Stock options not included in computation	467	124

The number of stock options not included in the computation of diluted EPS for the three month period ended June 24, 2006 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 period ended June 25, 2005 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 $2.46 and $5.32 as of June 24, 2006 and June 25, 2005, respectively.

(6) Stock Based Compensation

The Company established a 2005 Equity Incentive Plan which provided for the granting of options for up to 700,000 shares of Common Stock. Effective March 26, 2006, the Company adopted Statement of Financial Accounting Standards No. 123(R), *Share Based Payment* (SFAS 123(R)), using the modified prospective application transition method, which requires recognizing expense for options granted prior to the adoption date equal to the fair value of the unvested amounts over their remaining vesting period, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 *Accounting for Stock Based Compensation,* and compensation cost for all share based payments granted subsequent to January 1, 2006, based on the grant date fair values estimated in accordance with the provisions of SFAS 123(R). There were 60,000 grants made in the first quarter of fiscal 2007 and no grants in the same quarter for fiscal 2006. Results for prior periods have not been restated. Prior to March 26, 2006, the Company accounted for these plans under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations (APB 25). No stock-based compensation cost is reflected in net income prior to March 26, 2006, as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

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As a result of adopting SFAS 123(R), the Company s loss before provision for income taxes and net income for the three months ended June 24, 2006 was $4,000 higher than if the Company had continued to account for share-based compensation under APB 25. Basic and diluted loss per share for the quarter ended June 24, 2006 would have been $0.21 without the adoption of SFAS 123(R) compared to $0.21 as reported.

SFAS 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as a cash flow from financing in the statement of cash flows. These excess tax benefits were not significant for the Company, for the three months ended June 24, 2006.

In calculating compensation related to stock option grants, the fair value of each stock option is estimated on the date of grant using the Black-Scholes option-pricing model and the following weighted average assumptions:

	Three Months Ended June 24, 2006
Dividend yield	None
Expected volatility	.51%
Risk-free interest rate	4.73%
Expected term (years)	5

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

A summary of the changes in stock options outstanding for the three months ended June 24, 2006 is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at March 25, 2006	438,975	$ 2.57	2.7	$ 122,173
Granted	60,000	2.65		
Exercised				
Forfeited/Expired	32,250	4.31		
Outstanding at June 24, 2006	466,725	$ 2.46	2.9	$ 5,800
Exercisable at June 24, 2006	185,350	$ 2.48	2.1	$ 4,350

The weighted average grant date fair value of options granted during the three month period ended June 24, 2006 was $2.65. There was no intrinsic value of options exercised during the three month period ended June 24, 2006.

As of June 24, 2006, there was $40,000 of total unrecognized compensation cost related to nonvested options granted under the plans. That cost is expected to be recognized over a weighted average period of one year. The total fair value of options vested during the three month period ended June 24, 2006 was $1,600. No cash was received from stock option exercises for the three month period ended June 24, 2006.

The following table illustrates the pro forma effect on net income and earnings per share if the fair value recognition provisions of SFAS 123 had been applied to the Company s stock option plans for the quarter ended June 25, 2005.

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(In thousands except per share data)		Three Months Ended June 25, 2005
Net income, as reported	$	233
Deduct:		
Stock-based compensation expense included in reported net income		
Add:		
Total stock-based employee compensation determined under fair value based method for all awards, net of related tax effect		(42)
Pro forma net income	$	191
Net income per share basic:		
As reported	$	0.05
Pro forma		0.04
Net income per share diluted:		
As reported		0.05
Pro forma		0.04

(7) Industry Segment Information

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

Information on reportable segments is as follows:

(In thousands)	Three Months Ended June 24, 2006 Net Sales		June 24, 2006 Pre-tax Income (loss)	June 25, 2005 Net Sales		June 25, 2005 Pre-tax Income (loss)
Instrument Division	$ 1,770	$	(638)	$ 2,878	$	49
ASCOR	602		(279)	1,277		32
Microsource	1,014		(447)	1,628		(104)
Corporate			334			254
Total	$ 3,386	$	(1,030)	$ 5,783	$	231

(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 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.

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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 24, 2006	June 25, 2005
Balance at beginning of quarter	$ 250	$ 378
Provision for current quarter sales	42	75
Warranty costs incurred and adjustments	(48)	(108)
Balance at end of quarter	$ 244	$ 345

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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

Giga-tronics produces instruments, subsystems and sophisticated microwave components that have broad applications in both defense electronics and wireless telecommunications. In 2005, our business consisted of four operating and reporting segments: Instrument Division, ASCOR, Microsource and Corporate.

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

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

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

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

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

Results of Operations

New orders received from continuing operations in the first quarter of fiscal 2007 decreased 47% to $2,933,000 from the $5,493,000 received in the first quarter of fiscal 2006. New orders decreased primarily due to a decline in new military orders.

New Orders

(Dollars in thousands)	Three Months Ended June 24, 2006	% change	June 25, 2005
Instrument Division	$ 1,898	(31%)	$ 2,755
ASCOR	671	(65%)	1,915
Microsource	364	(56%)	823
Total new orders	$ 2,933	(47%)	$ 5,493

All three divisions experienced a decrease in new orders due to a decrease in military demand in the first quarter of fiscal 2007 as compared to the first quarter of fiscal 2006.

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

(Dollars in thousands)	Three Months Ended June 24, 2006	% change	June 25, 2005
Backlog of unfilled orders	$9,876	(36%)	$15,502
Backlog of unfilled orders shippable within one year	5,756	(30%)	8,216
Previous fiscal year (FY) quarter end backlog reclassified during quarter as shippable later than one year	64	392%	13
Net cancellations during quarter of previous FY quarter end one year backlog	38	100%	

Backlog at the end of the first quarter 2007 decreased 36% from the same quarter end last year primarily due to the decline in orders discussed above.

The allocation of net sales was as follows for the periods shown:

Allocation of Net Sales

(Dollars in thousands)	Three Months Ended June 24, 2006	% change	June 25, 2005
Instrument Division	$ 1,770	(39%)	$ 2,878
ASCOR	602	(53%)	1,277
Microsource	1,014	(38%)	1,628
Total net sales	$ 3,386	(42%)	$ 5,783

Fiscal 2007 first quarter net sales from continuing operations were $3,386,000, a 42% decrease from the $5,783,000 in the first quarter of fiscal 2006. The decrease in sales for all three divisions was primarily due to lower deliveries in the commercial market. Sales at the Instrument Division declined 39% or $1,108,000, ASCOR sales decreased 53% or $675,000 and sales at Microsource decreased 38% or $614,000 during the first quarter of fiscal 2007 versus the first quarter of fiscal 2006.

Cost of sales were as follows for the periods shown:

Cost of Sales

Three Months Ended

(Dollars in thousands)	June 24, 2006	% change	June 25, 2005
Cost of sales	$2,187	(30%)	$ 3,138

In the first quarter of fiscal 2007, cost of sales decreased 30% to $2,187,000 from $3,138,000 for the same period last year. This decline is primarily attributable to the reduced shipment levels, partially offset by a relatively higher percentage of fixed costs associated with this lower shipment level.

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Operating expenses were as follows for the periods shown:

Operating Expenses

(Dollars in thousands)	June 24, 2006	% change	June 25, 2005
	Three Months Ended		
Product development	$ 961	(1%)	$ 966
Selling, general and administrative	1,297	(11%)	1,453
Total operating expenses	$ 2,258	(7%)	$ 2,419

Operating expenses decreased 7% or $161,000 in the first quarter of fiscal 2007 over fiscal 2006 due to decreases of $156,000 in selling, general and administrative expenses and $5,000 in product development expenses. Product development costs remained flat for the three months ended June 24, 2006 as compared to the same period in the prior year. Selling, general and administrative expenses decreased 11% or $156,000 for the first quarter of fiscal year 2007 compared to the prior year. The decrease is a result of $249,000 less in commission expense offset by higher marketing expenses of $63,000 and higher administrative expenses of $30,000.

Giga-tronics recorded a net loss of $1,027,000 or $0.21 per fully diluted share for the first quarter of fiscal 2007 versus a net profit of $233,000 or $0.05 per fully diluted share in the same period last year. A $4,000 provision for income taxes was incurred in the first quarter of fiscal 2006.

Financial Condition and Liquidity

As of June 24, 2006, Giga-tronics had $3,726,000 in cash and cash equivalents, compared to $3,412,000 as of March 25, 2006.

Working capital for the first quarter end of fiscal 2007 was $7,748,000 compared to $9,673,000 at the same quarter end last year. The decrease in working capital at the first quarter end of fiscal 2007 versus fiscal 2006 was primarily due to a decrease in trade accounts receivable and inventories partially offset by an increase in cash.

The Company s current ratio (current assets divided by current liabilities) at June 24, 2006 was 3.54 compared to 4.0 on June 25, 2005.

Cash provided by operations amounted to $482,000 in the first quarter of fiscal 2007. Cash provided by operations amounted to $179,000 in the first quarter of fiscal 2006. Cash provided by operations in the first quarter of fiscal 2007 is primarily attributed to the decrease in trade accounts receivable and inventories offset by the operating loss in the quarter. Cash provided by operations in the first quarter of fiscal 2006 is primarily attributed to the operating profit in the quarter and the net change in operating assets and liabilities.

Additions to property and equipment were $146,000 in the first quarter of 2007 compared to $49,000 for the same period last year. The increase in capital equipment spending in fiscal 2007 was due to an upgrade of capital equipment enabling the manufacture of new products being released.

On June 19, 2006, 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 borrowings under this line of credit during the period ended June 24, 2006. From time to time, Giga-tronics considers a variety of acquisition opportunities to also broaden its product lines and expand its market. Such acquisition activity could also increase the Company s operating expenses and require the additional use of capital resources. The Company also intends to maintain research and development expenditures for the purpose of broadening its product line.

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

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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 June 24, 2006. Management has, therefore, established a valuation allowance against its net deferred tax assets as of June 24, 2006.

Recent Accounting Pronouncements

On November 10, 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. FAS 123R-3 *Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards* (FSP 123R-3). The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and consolidated statements of cash flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share Based Payment* (SFAS 123R). The Company is currently evaluating the available transition alternatives of FSP 123R-3. The Company does not believe the adoption of this FSP 123R-3 will have a material impact on its 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 continue 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. 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.

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.

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Part II OTHER INFORMATION

Item 1

Legal Proceedings

As of August 3, 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

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: August 3, 2006	/s/ JOHN R. REGAZZI
	John R. Regazzi President and Chief Executive Officer (Principal Executive Officer)
Date: August 3, 2006	/s/ MARK H. COSMEZ II
	Mark H. Cosmez II Vice President, Finance/ Chief Financial Officer and Secretary (Principal Accounting Officer)

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Exhibit Index

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