GIGA TRONICS INC
Form 10QSB
November 03, 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 September 25, 2004 or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT for the transition period from___________________ to___________________
-

Commission File No. 0-12719

GIGA-TRONICS INCORPORATED

(Exact name of Registrant as specified in its charter)

California	94-2656341
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
4650 Norris Canyon Road, San Ramon, CA	94583
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number: (925) 328-4650

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

Yes x No o

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

Common stock outstanding as of November 1, 2004: 4,724,896 shares

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

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ITEM 1

CONDENSED CONSOLIDATED BALANCE SHEETS

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

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

See accompanying notes to unaudited condensed consolidated financial statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS

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

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

See accompanying notes to unaudited condensed consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

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

Supplementary disclosure of cash flow information:

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

See accompanying notes to unaudited condensed consolidated financial statements.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The condensed consolidated financial statements included herein have been prepared by Giga-tronics (the Company), pursuant to the rules and regulations of the Securities and Exchange Commission. The consolidated results of operations for the interim periods shown in this report are not necessarily indicative of results to be expected for the fiscal year. In the opinion of management, the information contained herein reflects all adjustments necessary to make the consolidated results of operations for the interim periods a fair statement of such operations. For further information, refer to the consolidated financial statements and footnotes thereto, included in the Annual Report on Form 10-K, filed with the Securities and Exchange Commission for the year ended March 27, 2004.

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

(2) Discontinued Operations

In the first quarter of 2004, Giga-tronics decided to discontinue the operations at its Dymatix division due to the substantial losses incurred over the last two years. In the fourth quarter of fiscal 2004, Giga-tronics consummated the sale of its Dymatix division and recognized a gain of $53,000 in connection with the sale. The purchase price was $300,000. The Company received a $50,000 cash payment from the buyer and a $250,000 note receivable with $50,000 due in May and quarterly installments of $25,000 due beginning in July 2004. The Company agreed to reschedule the payment due in May 2004 to August 2004 and, to date, has not received payments due. Accordingly, the Company considers the note receivable to be impaired and has established an allowance for credit loss of $50,000 in the current period through a charge to discontinued operations. Additionally, the related interest receivable totaling $9,000 was reversed through a charge to discontinued operations and interest is no longer accrued on the impaired note receivable.

(3) Revenue Recognition

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

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

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(4) Inventories

(In thousands)	September 25, 2004	March 27, 2004
Raw materials	$ 3,980	$ 4,036
Work-in-progress	1,928	1,915
Finished goods	415	724
Demonstration inventory	385	245
Total inventory	$ 6,708	$ 6,920

(5) Earnings (Loss) Per Share

Basic earnings (loss) per share is calculated by dividing net income or loss by the weighted average common shares outstanding during the period. Diluted earnings per share reflects the net incremental shares that would be issued if dilutive outstanding stock options were exercised, using the treasury stock method. In the case of a net loss, it is assumed that no incremental shares would be issued because they would be antidilutive. In addition, certain options are considered antidilutive because the options exercise price was above the average market price during the period. The shares used in per share computations are as follows (in thousands except per share data):

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

The number of stock options not included in the computation of diluted earnings per share (EPS) for the three month and six month periods ended September 25, 2004 reflects stock options where the exercise prices were greater than the average market price of the common shares and are, therefore, antidilutive. The number of stock options not included in the computation of diluted EPS for the three month and six month periods ended September 27, 2003 are a result of the Company s loss from continuing operations and, therefore, the options are antidilutive. The weighted average exercise price of excluded options was $3.30 and $3.37 as of September 25, 2004 and September 27, 2003, respectively.

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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		Six Months Ended	
(In thousands except per share data)	**September 25, 2004**	**September 27, 2003**	**September 25, 2004**	**September 27, 2003**
Net income (loss), as reported	$ 24	$ (483)	$ 381	$ (4,115)
Deduct				
Stock-based compensation expense included in reported net income (loss)				
Add				
Total stock-based employee compensation determined under fair value based method for all awards, net of related tax effect	(63)	(49)	(129)	(97)
Pro forma net income (loss)	$ (39)	$ (532)	$ 252	$ (4,212)
Net income (loss) per share - basic				
As reported	$ 0.01	$ (0.10)	$ 0.08	$ (0.88)
Pro forma	(0.01)	(0.11)	0.05	(0.90)
Net income (loss) per share - diluted				
As reported	0.01	(0.10)	0.08	(0.88)
Pro forma	(0.01)	(0.11)	0.05	(0.90)

(7) Significant Customers and Industry Segment Information

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

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Information on reportable segments is as follows:

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

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

(8) Warranty Obligations

The Company s warranty policy generally provides three years for Fast Switching Microwave Synthesizers and Universal Power Meters and one year for all other products. The Company s policy is to accrue the estimated cost of warranty coverage at the time the sale is recorded. The estimated cost of warranty coverage is based on the Company s actual historical experience with its current products or similar products. For new products, the required reserve is based on historical experience of similar products until such time as sufficient historical data has been collected on the new product. The Company records a liability for estimated warranty obligations at the date products are sold. Adjustments are made as new information becomes available.

The following provides a reconciliation of changes in the Company s warranty reserve. The Company provides no other guarantees.

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

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

Results of Operations

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

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

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

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

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

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

Fiscal 2005 second quarter net sales from continuing operations were $5,379,000, a 5% increase from the $5,135,000 in the second quarter of 2004. The increase in sales was primarily due