

Giga-tronics

2 0 0 1 A N N U A L R E P O R T



C O R P O R A T E P R O F I L E

Giga-tronics provides instruments, systems, subsystems and components for inclusion in, and for the maintenance of, a wide range of communications equipment and facilities. We serve a broad market spanning commercial, military and industry users.

Instrument Division supplies RF and microwave frequency synthesizers and power measurement instruments in bench top, rack mount and VXIbus configurations for use in cellular, PCS, radar, electronic warfare, satellite and telecommunications systems test applications.

Microsource is a vertically integrated designer and manufacturer of leading-edge microwave circuits, components, and sub-systems. Its product line includes a broad range of YIG based signal sources and peripheral devices such as oscillators, filters, multipliers, band reject and band pass filters, and broad band signal synthesizers.

ASCOR designs and manufactures ATE instrumentation and switching equipment in the VXI and PXI formats for terrestrial and satellite related communications, commercial aircraft, military flight systems and automatic test systems.

DYMATIX designs and manufactures automation and test equipment for the semiconductor and memory media industries. Key products include, automatic die sorting systems, automatic tape and reel equipment, robotic wafer/disk handling and inspection equipment, and wafer test probers.

FINANCIAL HIGHLIGHTS

(In thousands except per share data and ratio)

	March 31, 2001	March 25, 2000	March 27, 1999
New orders	\$ 57,830	\$ 64,013	\$ 36,786
Net sales	54,159	47,577	37,636
Operating income	3,024	1,495	(3,759)
Pre-tax earnings	3,461	1,633	(3,006)
Net earnings	1,901	1,139	(1,858)
Backlog	39,964	34,128	17,692
Earnings per share - basic	0.42	0.26	(.43)
Earnings per share - diluted	0.40	0.24	(.43)
Current ratio	4.06	3.17	3.32
Working capital	22,924	21,066	18,021
Shareholders' equity	28,475	26,149	24,710
Total assets	37,318	37,526	33,259
Equity per share	6.27	5.90	5.66

T O O U R S H A R E H O L D E R S



Performance for the fiscal year ended March 31, 2001 showed substantial improvement over the prior year.

Sales of \$54,159,000 were up 14% while earnings of \$1,901,000 were up 67%.

Earnings of \$.40 per fully diluted share compared with \$.24 per fully diluted share a year ago.

Backlog of approximately \$40,000,000 (about \$32,700,000 shippable in 12 months) was up 17% from the \$34,100,000 (\$23,900,000 shippable within 12 months) of a year earlier.

Manufacturing margins increased 21% to \$19,056,000 compared to \$15,810,000 for the prior year.

Giga-tronics financial condition continued strong with no debt, \$3,469,000 in cash and liquid investments and a back-up unused \$7,000,000 line of credit. Current ratio was 4.06 up from 3.17 a year earlier.

Shareholders equity increased to \$28,475,000 or 6.27 per share from \$26,149,000 or 5.90 per share last year. Tangible book value was 6.18 per share up from 5.75 a share a year ago.

In November 2000, we established a research and development facility in England. This was done because of the availability of power measurement engineers in the United Kingdom at a time when that kind of technical talent was virtually unavailable in California. This is currently a very small facility, but has thus far well served our original purpose.

R & D expenses for FY 2001 were \$5,087,000 or 9.4% of sales, up from \$4,180,000 or 8.8% of sales for the prior year.

There were several significant management changes shortly after year end and in the early months of FY 2002.

Claudio Mariotta became President and General Manager of the Instrument Division as of April 1st replacing Jim Koehn who retired at year end. Mr. Mariotta had been with the organization for 3 years as Vice President Engineering and Vice President Operations. He has had more than 30 years of technology based business experience with such companies as SSE Telecom and the Farinon Division of Harris Corporation.

On April 16, 2001, William Wilson became President and General Manager of Microsource Division replacing Robert Smith who retired at that time. Bill had been and continues as a Director of Giga-tronics Inc. He brings many years of very applicable experience to this challenging job having served as CEO of Microwave Technology, Inc., President of Amplica, Inc., Business Director of Hybrid Microcircuits at Rockwell/Collins Radio and on Technical Staff at Sandia Laboratories.

On June 4, John Regazzi joined Giga-tronics Instrument Division as VP for Engineering. Mr. Regazzi comes to us from Hewlett Packard/Agilent where he spent 24 years in senior technical management and product planning positions.

On July 1, 2001, Carlos Blanco was named National Sales and Marketing Manager of the Instrument Division. He had previously served as International Manager for Europe, South America, and Mexico. Prior to joining Giga-tronics in November 1999, Mr. Blanco was Director of Latin American Sales for IFR Systems Inc. and Marconi Instruments Inc.

On June 25, Scott Weiss joined Microsource Division as VP of Sales and Marketing. Mr. Weiss has served in sales and marketing positions at companies such as TrueTime, Inc. and Internet Commerce.

Because we believe it is important to understand the breadth and depth of the market we serve, we have reproduced on the following two pages the spectrum analysis and market outline that appeared in last year's annual report. Giga-tronics serves many segments of this broad market with equipment essential to the manufacture, calibration, maintenance and operation of these communications systems.

Through the fourth quarter of FY 2001 and the first quarter of FY 2002, this market has softened substantially due in part to the general economic slowdown and in part to an imbalance in the build-out of many of the large wireless communication systems. We will undoubtedly feel the effects of this through the first part of this year. Fortunately, we now have experienced senior managers aggressively addressing this challenge.

Sincerely,



A handwritten signature in black ink that reads "G H Bruns Jr." The signature is written in a cursive, flowing style.

George H. Bruns, Jr.
Chairman and Chief Executive Officer

F R E Q U E N C Y S P E C T R U M

FIXED & MOBILE SERVICES	10 KHZ - 500	
MARITIME COMM & NAV	10 KHZ - 3000	
BROADCAST, AM TO TVRO	500 KHZ - 4000	
AERO COMM & NAV	40 KHZ - 3700	
CB	27	
PAGING	30 - 50	
LOW BAND LAND MOBILE	30 - 50	
CT1	40 - 50	
Wireless Local Loop	66 - 88, 132 - 520	
SCA PAGING	90 - 108	
HIGH BAND LAND MOBILE	150 - 170	
PAGING	150 - 175	
TETRA, Wireless Local Loop	380 - 512	
UHF LAND MOBILE	450 - 500	
IMTS PAGING	450 - 500	
UHF TV	500 - 800	
CELLULAR	800 - 900	
CELLULAR TRUNKING SMR	800 - 950	
Wireless Local Loop	800	
ISM	800 - 1000	
PCN spread spectrum	900	
CT2	1000	1GHz
Narrowband GPS	930 - 931	
GPS	970 - 1210, 1220 - 1400, 1420 - 1540	
Wireless Local Loop	1500	
GPS	1550 - 1580, 1590 - 1640, 1650 - 1680	
LEO	1600	
DECT, Wireless Local Loop	1800	
PCS	1850 - 1990	
Wireless Local Loop	1900	
PCS	2130 - 2150, 2180 - 2200	
ISM	2200 - 2700	
Wireless Local Loop	2300 - 2310	
PCS, Big LEO sat/mobile downlink	2400 - 2500	
Bluetooth	2400	
Wireless Local Loop	2400	2.5 GHz
TV RELAY AND MMDS-IFTS	1700 - 2700	
MMDS	2500 - 2700	
Wireless Local Loop	2700	
MILITARY	2700 - 2900	
RADAR, AERO. COMM & NAV	2700 - 3000	
MARITIME COMM & NAV	2900 - 3000	
Wireless Local Loop	3500	
AERO. COMM & NAV	3600 - 3700	
TVRO	3950 - 4000	
Fixed Satellite, Mobile, space to earth	4660 - 4685	5 GHz
Big LEO, forward link	5000 - 5150	
Private Land Mobile	5150 - 5650	
WLL, unlicensed high speed data, ISM, Govt	5150 - 5350, 5725 - 5825	
Big LEO	5925 - 6425	
Big LEO, return link	6425 - 7125	8 GHz
Govt, space research, satellite	7075 - 8500	
RADAR	9000 - 10500	
Mobile Satellite	11.7 - 12.2 GHz	
DBS	12.2 - 12.7	
RADAR	13.4 - 14 GHz	
Fixed - Satellite, earth to space	14 - 15.7 GHz	
RADAR	15 - 17.7 GHz	20 GHz
Fixed - Mobile, Video	21.4 - 22.5 GHz	
LMDS	27.5 - 28.35 GHz	
LMDS	29.1 - 29.25 GHz	
Big LEO	29.75 - 30 GHz	
Microwave point to point	38 GHz	40 GHz
European LMDS	41 - 42 GHz	
ISM	61 GHz	
Vehicle Radar	77 GHz	
Air to Air secure communications	94 GHz	110 GHz

CB	Citizens Band
EMC	Electro-magnetic Compatibility
TETRA	Trans Euro. Trunked Radio
GSM	Global Sytem/Mobile Comm.
UHF	Ultra High Frequency
IMTS	Improved Mobile Telephone Service
ISM	Industrial Scientific & Medical Band
PCN	Public Communications Network
GPS	Global Positioning System
DECT	Digital European Cordless Telephone
PCS	Personal Comm. System
WLL	Wireless Local Loop
MMDS	Multi-channel, Multi-point Distribution Service
TVRO	TV Receive Only
LEO	Low Earth Orbit
LMDS	Local Multi-point Distribution Service
CDMA	Code Division Multiple Access
TDMA	Time Division Multiple Access
LAN	Local Area Network
WAN	Wide Area Network
DBS	Direct Broadcast Service

B R E A D T H O F M A R K E T S

The allocation of frequency spectrum on the preceding page, ranging from 10 kilohertz to 110 gigahertz, indicates the real breadth of the wireless communications market and the wide range of specific applications of this technology.

We tend to think of wireless communication principally in terms of voice and data transmission. Certainly this is a large and growing segment of this market and includes such sub-segments as cellular, internet, point to point, point to multipoint, LMDS, back-haul, fixed and mobile services, satellite up and down links, GPS, LAN, WAN and others.

At the same time, however, the civilian aviation and the commercial aviation segments of this market use wireless communication not only in voice and data transmission, but in the application of radar to the very vital function of air traffic control. Commercial aircraft in flight use storm warning radar to detect and avoid storm cells for reasons of both safety and passenger comfort. Forward looking radar provides terrain warning in mountainous country. Ground control radar is used to direct and control aircraft traffic on runways and taxiways of very large airports where visual surveillance is difficult. There are potential applications for in-flight close proximity warning.

The military uses radar in a wide range of navigation, missile identification and weapons control applications. Ground forces are now equipped with very sophisticated wireless communications and wireless weapons control systems. With the current emphasis by the armed services on COTS (commercial off-the-shelf) procurement there is little difference between commercial and military procurement.

Then there is the "every-day" private user market including Global Positioning Systems, the home use walk around telephone, CB (citizen band) users, ham radio, even the remote control door locks on your car.

All of the foregoing segments of this very large and diverse market utilize the same fundamental technologies and have very similar needs for instruments and test systems that calibrate and maintain the various elements of these communications systems. Therefore, they are all extremely important markets to Giga-tronics.

U S E R S O F G I G A - T R O N I C S P R O D U C T S

Tektronix	ShinEtsu
PEI Electronic	Hughes
Amkor	Raytheon
Spectrian Loral	Northrop Grumman
Denso	Harris Aerospace
Agilent	Nokia
Management Technologies	Rohde & Schwarz
RCAF (Canadian Airforce)	BAE Systems
Boeing	U.S. Navy
Qualcomm	U.S. Army
Phillips	Marine Corps
BEI	US Air Force
Sanders	Ericsson
Motorola	Siemens
Lockheed Martin	Kyocera
Alcatel	Teradyne
Grumman	Delphi
Conexant	Nortel
Korean Army	French Navy
Canadian Military	Australian Military
Mitsubishi	St. Judes Hospital
Lucent	Unisys
Seoul University	Spectrian
Dallas Semiconductor	MEMC

I N S T R U M E N T S

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Microwave Signal Generators, RF Signal Generators, Peak Power Meters, Universal Power Meters, VXI Signal Generators and VXI Universal Power Meters.

Claudio Mariotta is the President and General Manager of this Division, having previously served as Vice President of Operations and as Vice President of Engineering. Before coming to Giga-tronics he had served as Executive Vice President of SSE Telecom and as Vice President of Engineering at the Microwave Division of Harris Corporation.



Claudio S. Mariotta
President, Giga-tronics Instrument Division



M I C R O S O U R C E

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YIG Oscillators, YIG based microwave and millimeter wave products, free running and phase locked oscillators in narrow and wide band configurations, band pass and band reject filters, narrow and wide band frequency synthesizers and highly integrated front-end modules for applications in test & measurement, wireless communications and defense electronics.

Bill Wilson is the President and General Manager of Microsource. He is also a Director of Giga-tronics Incorporated. His prior experience includes Chairman and CEO of Microwave Technology, Inc., President of Amplica Inc./COMSAT, Business Director Hybrid Microcircuits of Rockwell International/Collins Radio and on technical staff of Sandia Laboratories and Rome Air Development Center.

William E. Wilson
President, Microsource, Inc.



A S C O R

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Counters, Volt meters, A to D Converters, D to A Converters, Electronic and Optical Switches, GPIB, VXI, PXI and USB Platforms.

Jeffrey T. Lum is the President and founder of ASCOR. Previously he was the Vice President and founder of Autek Systems. He holds several patents derived from this technology.

Jeffrey T. Lum
President, ASCOR, Inc.



D Y M A T I X

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Die sorting systems, Wafer/Disk handling systems and Wafer probers.

Dan Markowitz is the President of DYMATiX. He has extensive prior experience as General Manager of MAR Engineering, as a Director of Material, Relocation Project Manager and Group Contracts Manager while with various Allied Signal divisions, as well as a Plant Manager, Director of Contracts, Program Manager, Cost Control/Estimating Manager and Purchasing Manager with Bendix Electrodynamics Division.



Daniel S. Markowitz
President, DYMATiX



FINANCIAL REPORT

“Giga-tronics continues to maintain a strong financial position with a current ratio of over 4 and almost \$23 million in working capital.”



Mark H. Cosmez, II
Vice President, Finance
Chief Financial Officer & Secretary

F I N A N C I A L R E P O R T

15	MANAGEMENT'S DISCUSSION AND ANALYSIS
17	CONSOLIDATED BALANCE SHEETS
18	CONSOLIDATED STATEMENTS OF OPERATIONS
19	CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
20	CONSOLIDATED STATEMENTS OF CASH FLOWS
21	NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
29	INDEPENDENT AUDITOR'S REPORT
30	SELECTED FINANCIAL DATA
32	CORPORATE INFORMATION

MANAGEMENT'S DISCUSSION AND ANALYSIS

Results of Operations for Fiscal 2001 as Compared to 2000

During the fourth quarter of fiscal 2001, the Company adopted SAB 101, *Revenue Recognition in Financial Statements*. The Company recorded a net cumulative effect adjustment related to this change in accounting of \$520,000, effective March 26, 2000. The adoption of SAB 101 resulted in the deferral of \$2,165,000 in sales as of the beginning of the 2001 fiscal year, and subsequent recognition of the deferred sales during the year.

New orders received in 2001 were \$57,830,000, a decrease of 10% from \$64,013,000 in 2000. This decrease was attributable primarily to the non recurrence of a three year contract for about \$14,100,000 recorded at the end of fiscal 2000. At year end 2001, the Company's backlog of unfilled orders was \$39,964,000, compared to \$34,128,000 at the end of 2000. As of year end 2001, there were approximately \$7,245,000 unfilled orders that were scheduled for shipment beyond a year and as of year end 2000 there were \$10,201,000 unfilled orders scheduled for shipment beyond a year. Primarily, the increase in backlog is attributable to strong order levels at Microsource and at the Giga-tronics Instruments division.

Net sales for 2001 were \$54,159,000, a 14% increase from \$47,577,000 in 2000. Sales for the fiscal year 2001, without the SAB 101 adjustment, would have been \$51,994,000, or over a 9% increase in revenue as compared to the \$47,577,000 of the prior year. In fiscal 2001, Microsource decreased revenues 12% or \$1,861,000, while Giga-tronics Instruments increased 35% or \$6,485,000, in sales and ASCOR improved 12% or \$798,000, in sales. DYMATIX (formerly the Semiconductor Equipment Group) improved 16% or \$1,160,000. DYMATIX sales for the fiscal year 2001, without the SAB 101 adjustment, would have declined over 14% or \$1,005,000.

Cost of sales increased 11% in 2001 to \$35,103,000 from \$31,767,000 in 2000. Cost of sales for the fiscal year 2001, without the SAB 101 adjustment, would have been \$33,681,000, or over a 6% increase in cost of sales as compared to the prior year. The increase in fiscal 2001 is attributable to increased shipments of products during the fiscal year coupled with higher costs for labor and material for the products shipped.

Operating expenses increased 12% in 2001 over 2000. Product development costs increased \$907,000 in fiscal 2001 to \$5,087,000. This was principally due to increased development of new products at the Instruments division and at Microsource. Selling, general and administrative expenses increased \$1,058,000 to \$10,713,000 in 2001 due to higher commissions on higher revenues coupled with higher personnel and promotional expenses at the Instruments division. Amortization of intangibles decreased \$248,000 to \$232,000 principally, as a result of reduced amortization of patents and licenses.

Other income increased in fiscal 2001 primarily due to increased sublease rent from the facilities leased in Santa Rosa. Net interest income in 2001 increased from 2000 due to higher average cash available for investment. The average cash improvement resulted principally from higher cash levels in the middle of the year. The provision for income taxes in 2001 was \$1,040,000, or 30%, of the pre-tax earnings.

Giga-tronics recorded net earnings before cumulative effect of accounting change of \$2,421,000, or \$0.51 per diluted share, in 2001 versus \$1,139,000, or \$0.24 per diluted share, in 2000. The improvement in 2001 earnings was due to the Company's higher sales levels in 2001 as compared to 2000. The Company recorded \$520,000 for the cumulative effect of accounting change as a result of the implementation of SAB 101. As a result, Giga-tronics recorded net earnings of \$1,901,000, or \$0.40 per diluted share, in 2001 versus \$1,139,000, or \$0.24 per diluted share, in 2000.

Results of Operations for Fiscal 2000 as compared to 1999

New orders received in 2000 were \$64,013,000, an increase of 74% from \$36,786,000 in 1999. At year end 2000, the Company's backlog of unfilled orders was \$34,128,000, compared to \$17,692,000 at the end of 1999. As of year end 2000, there were approximately \$10,201,000 unfilled orders that were scheduled for shipment beyond a year and as of year end 1999 there were no unfilled orders scheduled for shipment beyond a year. Primarily, the increase in backlog is attributable to strong order levels at Microsource and at the Giga-tronics Instruments division.

Net sales for 2000 were \$47,577,000, a 26% increase from \$37,636,000 in 1999. Every segment of the business improved revenue during the fiscal year. In fiscal 2000, Microsource increased revenues 68% or \$6,085,000, DYMATIX (formerly the Semiconductor Equipment Group) improved 43% or \$2,180,000, in revenue, while Giga-tronics Instruments increased 8% or \$1,455,000, in sales and ASCOR improved 3% or \$221,000, in sales.

Cost of sales increased 22% in 2000 to \$31,767,000 from \$26,102,000 in 1999. The increase in fiscal 2000 is attributable to increased shipments of products during the fiscal year coupled with higher costs for labor and material for the products shipped.

Operating expenses declined 6% in 2000 over 1999. Product development costs declined \$1,133,000 in fiscal 2000 to \$4,180,000 as the development of new products returned to previous levels. Selling, general and administrative expenses increased \$237,000 to \$9,655,000 in 2000 due to higher commissions on higher revenues. Amortization of intangibles decreased \$82,000 to \$480,000 as a result of reduced amortization of patents and licenses.

Other income decreased in fiscal 2000 primarily due to the fiscal 1999 gain from the sale of a surplus building following facilities consolidation at DYMATIX for which there was no corresponding sale in fiscal 2000. Net interest income in 2000 decreased 51% from 1999 due to lower average cash available for investment. The average cash decline resulted principally from low cash level at the beginning of the year. The provision for income taxes in 2000 was \$494,000, or 30%, of the pre-tax earnings.

Giga-tronics recorded net earnings of \$1,139,000, or \$0.24 per diluted share, in 2000 versus a loss of \$1,858,000, or \$0.43 per diluted share, in 1999. The improvement in 2000 earnings was due to the Company's higher sales levels in 2000 as compared to 1999.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Condition and Liquidity

As of March 31, 2001, Giga-tronics had \$3,469,000 in cash and cash equivalents, compared to \$3,455,000 as of March 25, 2000 and \$2,286,000 as of March 27, 1999. Cash provided by operations amounted to \$1,951,000 in 2001 and \$2,644,000 in 2000, compared to cash used by operations of \$2,365,000 in 1999. Cash provided by operations in 2001 is attributed to operating income in the year primarily offset by cash paid for income taxes of \$988,000 and the net change in operating assets and liabilities. Cash provided by operations in 2000 is attributed to operating income in the year. In 1999, losses by operations were the significant reason for the increase in use of cash by operations.

Giga-tronics continues to maintain a strong financial position, with working capital at year end of \$22,924,000 compared to \$21,066,000 in 2000 and \$18,021,000 in 1999. The Company's current ratio of 4.1 increased from the 2000 and 1999 current ratio of 3.2 and 3.3, respectively. The increase in working capital is primarily a result of the increased operations of the Company.

Additions to property and equipment were \$1,800,000 in 2001, compared to \$1,361,000 in 2000 and \$953,000 in 1999. Fiscal 2001 spending reflects continuing investments to support new product development, increased productivity, and improved product quality. Other cash inflows in 2001 consists of \$367,000 of common stock in connection with the exercise of stock options. Other cash inflows in 2000 were \$174,000 of common stock in connection with the exercise of stock options.

Management believes that the Company has adequate resources to meet its operating and capital expenditure needs for the foreseeable future. The Company has a seven million dollar unsecured line of credit, none of which has been used. The Company may continue to increase product development expenditures in the near term for the purpose of broadening its product base. It is the Company's intention to broaden its product lines and expand its market, both by internal development of new products and through the acquisition of other business entities.

Factors That May Affect Future Results Of Operations

BUSINESS CLIMATE MAY BECOME VOLATILE

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 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 under the contract. If this occurs, then shipments in the current year could fall short of plan resulting in a decline in earnings.

GIGA-TRONICS ACQUISITIONS MAY NOT BE EFFECTIVELY INTEGRATED AND THEIR INTEGRATION MAY BE COSTLY

As part of its business strategy, Giga-tronics intends to broaden its product lines and expand its markets, in part through the acquisition of other business entities. Giga-tronics is subject to various risks in connection with 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 management to maximize the financial and strategic position of the Company by the successful incorporation of acquired technology and rights into its 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 harm the Company or that any such acquisition will be successful in enhancing the Company's business. The Company currently contemplates that future acquisitions may involve the issuance of additional shares of common stock. Any such issuance may result in dilution to all Giga-tronics shareholders, and sales of such shares in significant volume by the shareholders of acquired companies may depress the price of its common stock.

FORWARD LOOKING STATEMENTS

Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Annual Report to Shareholders contain forward-looking statements that involve risks and uncertainties. The actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed herein and in the Company's 2001 Report 10-K under "Item 1. Business" and "Certain Factors Which May Affect Future Operation Or An Investment In Giga-tronics" as filed with the Securities and Exchange Commission.

CONSOLIDATED BALANCE SHEETS

(In thousands except share data)	<u>March 31, 2001</u>	<u>March 25, 2000</u>
Assets		
Current assets		
Cash and cash equivalents	\$ 3,469	\$ 3,455
Trade accounts receivable, net of allowance of \$262 and \$254 respectively	7,767	9,194
Inventories, net	15,185	14,113
Prepaid expenses	424	444
Deferred income taxes	3,560	3,570
Total current assets	30,405	30,776
Property and equipment		
Leasehold improvements	398	382
Machinery and equipment	16,123	14,673
Office furniture and fixtures	1,142	1,023
Property and equipment, gross cost	17,663	16,078
Less accumulated depreciation and amortization	12,357	10,678
Property and equipment, net	5,306	5,400
Patents and licenses	36	112
Goodwill, net	339	564
Other assets	1,232	674
Total assets	\$ 37,318	\$ 37,526
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable	\$ 3,347	\$ 4,065
Accrued commissions	435	625
Accrued payroll and benefits	1,687	1,638
Accrued warranty	732	553
Customer advances	690	1,536
Obligation under capital lease	167	118
Other current liabilities	423	1,175
Total current liabilities	7,481	9,710
Obligations under capital lease, net of current portion	115	127
Deferred income taxes	796	1,011
Deferred rent	451	529
Total liabilities	8,843	11,377
Shareholders' equity		
Preferred stock of no par value		
Authorized 1,000,000 shares; no shares outstanding at March 31, 2001 and March 25, 2000	—	—
Common stock of no par value;		
Authorized 40,000,000 shares; 4,542,694 shares at March 31, 2001 and 4,431,008 shares at March 25, 2000 issued and outstanding	12,346	11,921
Retained earnings	16,129	14,228
Total shareholders' equity	28,475	26,149
Total liabilities and shareholders' equity	\$ 37,318	\$ 37,526

See Accompanying Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF OPERATIONS

Years ended (In thousands except per share data)	March 31, 2001	March 25, 2000	March 27, 1999
Net sales	\$ 54,159	\$ 47,577	\$ 37,636
Cost of sales	<u>35,103</u>	<u>31,767</u>	<u>26,102</u>
Gross profit	19,056	15,810	11,534
Product development	5,087	4,180	5,313
Selling, general and administrative	10,713	9,655	9,418
Amortization of intangibles	<u>232</u>	<u>480</u>	<u>562</u>
Operating expenses	<u>16,032</u>	<u>14,315</u>	<u>15,293</u>
Operating income (loss)	3,024	1,495	(3,759)
Other income (expense)	232	79	632
Interest income, net	<u>205</u>	<u>59</u>	<u>121</u>
Earnings (loss) before provision (benefit) for income taxes and cumulative effect of accounting change	3,461	1,633	(3,006)
Provision (benefit) for income taxes	<u>1,040</u>	<u>494</u>	<u>(1,148)</u>
Earnings (loss) before cumulative effect of accounting change	2,421	1,139	(1,858)
Cumulative effect of accounting change	<u>520</u>	<u>—</u>	<u>—</u>
Net earnings (loss)	<u>\$ 1,901</u>	<u>\$ 1,139</u>	<u>\$ (1,858)</u>
Basic earnings (loss) per share:			
Before cumulative effect of accounting change	\$ <u>0.54</u>	\$ <u>0.26</u>	\$ <u>(0.43)</u>
Cumulative effect of accounting change	<u>(0.12)</u>	<u>—</u>	<u>—</u>
Basic earnings (loss) per share	<u>\$ 0.42</u>	<u>\$ 0.26</u>	<u>\$ (0.43)</u>
Diluted earnings (loss) per share:			
Before cumulative effect of accounting change	\$ <u>0.51</u>	\$ <u>0.24</u>	\$ <u>(0.43)</u>
Cumulative effect of accounting change	<u>(0.11)</u>	<u>—</u>	<u>—</u>
Diluted earnings (loss) per share	<u>\$ 0.40</u>	<u>\$ 0.24</u>	<u>\$ (0.43)</u>
Weighted average basic common shares outstanding	4,474	4,379	4,338
Weighted average diluted common shares outstanding	4,803	4,693	4,338
Pro forma amounts assuming accounting change is applied retroactively:			
(Unaudited)			
Net income (loss)	<u>\$ 2,421</u>	<u>\$ 623</u>	<u>\$ (1,404)</u>
Net income (loss) per share – Basic	<u>\$ 0.54</u>	<u>\$ 0.14</u>	<u>\$ (0.32)</u>
Net income (loss) per share – Diluted	<u>\$ 0.51</u>	<u>\$ 0.13</u>	<u>\$ (0.32)</u>

See Accompanying Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In thousands except share data)

	Common Stock		Comprehensive Income (Loss)	Other Comprehensive Income (Loss)	Retained Earnings	Total
	Shares	Amount				
Balance at March 28, 1998	4,326,299	\$ 11,532	\$ —	\$ (18)	\$ 14,947	\$ 26,461
Comprehensive Income						
Net loss	—	—	(1,858)	—	(1,858)	(1,858)
Unrealized gain on investments, net of income tax benefit of \$10	—	—	<u>18</u>	18	—	18
Comprehensive loss	—	—	<u>(1,840)</u>	—	—	—
Stock issuance under stock option plans	35,603	89	—	—	—	89
Balance at March 27, 1999	4,361,902	\$ 11,621	\$ —	\$ —	\$ 13,089	\$ 24,710
Comprehensive Income – net						
Net earnings	—	—	<u>1,139</u>	—	1,139	1,139
Stock issuance under stock Option plans	69,106	174	—	—	—	174
Tax benefit associated with exercise of stock options	—	126	—	—	—	126
Balance at March 25, 2000	4,431,008	\$ 11,921	\$ —	\$ —	\$ 14,228	\$ 26,149
Comprehensive Income – net						
Net earnings	—	—	<u>1,901</u>	—	1,901	1,901
Stock issuance under stock option plans	111,686	367	—	—	—	367
Tax benefit associated with exercise of stock options	—	58	—	—	—	58
Balance at March 31, 2001	4,542,694	\$ 12,346	\$ —	\$ —	\$ 16,129	\$ 28,475

See Accompanying Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended (In thousands)	March 31, 2001	March 25, 2000	March 27, 1999
Cash flows provided from operations:			
Net earnings (loss)	\$ 1,901	\$ 1,139	\$(1,858)
Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operations:			
Provision for bad debt	8	(182)	142
Depreciation and amortization	2,120	2,111	2,208
Tax benefit from employee stock options	58	126	—
Tax benefit of pre acquisition NOL utilization	—	394	—
Gain on sales of fixed assets	(20)	(20)	(521)
Deferred income taxes	(205)	(81)	(443)
Changes in operating assets and liabilities:			
Trade accounts receivable	1,419	(2,578)	1,738
Inventories	(1,072)	(864)	(1,710)
Prepaid expenses	20	(61)	74
Accounts payable	(718)	1,043	(622)
Accrued commissions	(190)	256	(180)
Accrued payroll and benefits	49	292	67
Accrued warranty	179	86	(269)
Accrued other expenses	(613)	535	(209)
Customer advances	(846)	(112)	(968)
Income taxes receivable/payable	(139)	560	186
Net cash provided by (used in) operations	1,951	2,644	(2,365)
Cash flows from investing activities:			
Purchases of investments	—	—	(2,268)
Maturities of investments	—	—	8,010
Proceeds from sale of property and equipment	26	7	1,291
Additions to property and equipment	(1,645)	(1,311)	(953)
Payment for purchase of Microsource, including transaction costs	—	(8)	(605)
Advances to Microsource	—	—	(940)
Other assets	(489)	(565)	(17)
Net cash provided by (used in) investing activities	(2,108)	(1,877)	4,518
Cash flows from financing activities:			
Issuance of common stock	367	174	89
Payment on line of credit	—	—	(1,500)
Payment on notes payable and other long term liabilities	(78)	(45)	(2,497)
Payments on capital lease and other long term obligations	(118)	(127)	(170)
Net cash provided by (used in) financing activities	171	2	(4,078)
Increase (decrease) in cash and cash equivalents	14	769	(1,925)
Beginning cash and cash equivalents	3,455	2,686	4,611
Ending cash and cash equivalents	3,469	3,455	2,686
Supplementary disclosure of cash flow information:			
Cash paid for income taxes	\$ 988	\$ 86	\$ 7
Cash paid for interest	—	—	—
Non-cash investing and financing activities:			
Purchases under capital lease obligations	155	50	—

See Accompanying Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 Business Combinations

On May 18, 1998, Giga-tronics Incorporated acquired Microsource, Inc. (Microsource) of Santa Rosa, California. Microsource develops and manufactures a broad line of YIG (Yttrium, Iron, Garnet) tuned oscillators, filters, and microwave synthesizers. The acquisition was accounted for using the purchase method of accounting, and accordingly, the results of operations of Microsource have been included in the Company's consolidated financial statements from May 18, 1998. The purchase price consisted of \$1,500,000 plus contingent payments based upon future net income of Microsource during the two fiscal years after the effective time of the merger.

The purchase price was subsequently adjusted to give effect to the contingent payment of \$8,000, net paid to Microsource shareholders based on the subsidiary's fiscal year 2000 operating results. In addition, the purchase price allocation was adjusted to give effect in fiscal year 2000 to the recognition of deferred tax assets of \$394,000 for which no value was assigned at the date of the acquisition.

2 Summary of Significant Accounting Policies

The Company The accompanying consolidated financial statements include the accounts of Giga-tronics and its wholly owned subsidiaries. Giga-tronics and its subsidiary companies design, manufacture and market 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. The Company also manufactures and markets a line of test, measurement, and handling equipment used in the manufacturing of semiconductor devices. The Company's products are sold worldwide to customers in the test and measurement and semiconductor industries. The Company has a United Kingdom (UK) research & development facility for the Instruments division. Otherwise the Company has no other foreign-based operations or material amounts of identifiable assets in foreign countries. Its gross margins on foreign and domestic sales are similar, and all non-U.S. sales are made in U.S. dollars.

Principles of Consolidation The consolidated financial statements include the accounts of Giga-tronics and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that effect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fiscal Year The Company's financial reporting year consists of either a 52 week or 53 week period ending on the last Saturday of the month of March. Fiscal year 2001 contained 53 weeks while fiscal years 2000 and 1999 each contained 52 weeks.

Reclassifications Certain reclassifications, none of which affected net income (loss), have been made to prior year balances in order to conform to the current year presentation.

Revenue Recognition Revenues are recognized when there is evidence of an arrangement, delivery has occurred, the price is fixed and determinable, and collectibility is reasonably assured. Revenue to customers is recorded when products are shipped and the risk of loss has passed. Upon shipment, the Company also provides for the estimated cost that may be incurred for product warranties. Revenue related to products shipped subject to customers' evaluation is recognized upon final acceptance.

During the fourth quarter of fiscal 2001, the Company adopted Staff Accounting Bulletin (SAB) 101, *Revenue Recognition in Financial Statements*, effective March 26, 2000. Prior to the adoption of SAB 101, the Company recognized revenue on sales with final customer acceptance upon delivery and provided for the estimated costs of installation obligations at the time the revenue was recognized. The Company recorded a cumulative effect adjustment related to this change in accounting of \$520,000, net of income taxes. The adoption of SAB 101 resulted in the deferral of \$2,165,000 in sales as of the beginning of the 2001 fiscal year, and subsequent recognition of the deferred sales during the year.

Pro forma effect of SAB 101 assuming accounting change is applied retroactively is as follows:

Years ended (In thousands except per share data) (Unaudited)	March 31, 2001	March 25, 2000	March 27, 1999
Net Sales	\$ 54,159	\$ 45,412	\$ 39,120
Cost of Sales	<u>35,103</u>	<u>30,345</u>	<u>26,938</u>
Gross Profit	19,056	15,067	12,182
Operating Expense	<u>16,032</u>	<u>14,315</u>	<u>15,293</u>
Operating Income (loss)	3,024	752	(3,111)
Interest and other income	<u>437</u>	<u>138</u>	<u>753</u>
Earnings (loss) before taxes	3,461	890	(2,358)
Provision (benefit) for income taxes	<u>1,040</u>	<u>267</u>	<u>(954)</u>
Net income (loss)	<u>\$ 2,421</u>	<u>\$ 623</u>	<u>\$ (1,404)</u>
Net income (loss) per share – Basic	<u>\$ 0.54</u>	<u>\$ 0.14</u>	<u>\$ (0.32)</u>
Net income (loss) per share – Diluted	<u>\$ 0.51</u>	<u>\$ 0.13</u>	<u>\$ (0.32)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Cash Equivalents The Company considers all highly liquid debt instruments with remaining maturity dates of 90 days or less from date of purchase to be cash equivalents.

Inventories Inventories are stated at the lower of cost or market. Cost is determined on a first-in, first-out basis.

Property and Equipment Property and equipment are stated at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of the respective assets, which range from three to ten years for machinery and equipment and office fixtures. Leasehold improvements and assets acquired under capital leases are amortized using the straight-line method over the shorter of the estimated useful lives of the respective assets or the lease term. Recoverability of property and equipment is measured by comparison of its carrying amount, including the unamortized portion of goodwill allocated to property and equipment, to future cash flows the property and equipment are expected to generate. The Company assesses the recoverability of enterprise level goodwill by determining whether the unamortized goodwill balance can be recovered through undiscounted future cash flows of the acquired operation. To date, the Company has made no adjustments to the carrying value of its property and equipment or goodwill due to asset impairment.

Deferred Rent Rent expense is recognized in an amount equal to the minimum guaranteed base rent plus future rental increases amortized on the straight-line basis over the terms of the leases, including free rent periods. Included in other long-term liabilities is the excess of rent expense over required rental payments.

Income Taxes Income taxes are accounted for using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Patents and Licenses Patents and licenses are being amortized using the straight-line method over periods of five to seven years. As of March 31, 2001 and March 25, 2000 accumulated amortization on patents and licenses was \$2,160,000 and \$2,084,000, respectively.

Goodwill Goodwill is being amortized using the straight-line method over a period of five years. As of March 31, 2001 and March 25, 2000 accumulated amortization on goodwill was \$1,881,000 and \$1,725,000 respectively.

Pre-production costs The Company incurs pre-production costs on certain long-term supply arrangements. The costs, which represent non-recurring engineering and tooling costs owned by the Company, are capitalized as part of other assets and amortized over their useful life when reimbursable by the customer. Otherwise, they are expensed as incurred. Included in other assets as of March 31, 2001 and March 25, 2000 are capitalized design and development costs of \$1,133,000 and \$579,000, respectively.

Product Development Costs Product development costs are charged to operations in the year incurred.

Software Development Costs Development costs included in the research and development of new products and enhancements to existing products are expensed as incurred until technological feasibility in the form of a working model has been established. To date, completion of software development has been concurrent with the establishment of technological feasibility, and accordingly, no costs have been capitalized.

Stock-based Compensation The Company uses the intrinsic value method to account for employee stock-based compensation.

Earnings (Loss) Per Share Basic earnings (loss) per share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share incorporate the incremental shares issuable upon the assumed exercise of stock options using the treasury method. Antidilutive options are not included in the computation of diluted earnings per share.

Financial Instruments and Concentration of Credit Risk Financial instruments, which potentially subject the Company to credit risk as of March 31, 2001, consist principally of cash, cash equivalents and trade accounts receivable. The Company's cash equivalents consist principally of money market funds and certificates of deposits. Cash and cash equivalents are held in recognized depository institutions. Concentration of credit risk in trade accounts receivable results primarily from sales to major customers. The Company individually evaluates the creditworthiness of its customers and generally does not require collateral or other security.

Fair Market Value of Financial Instruments The carrying amount for the Company's cash equivalents, trade accounts receivable and accounts payable approximates fair market value because of the short maturity of these financial instruments.

Recent Accounting Pronouncements The Financial Accounting Standards Board (FASB) issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the Balance Sheet and measure those instruments at fair value. For a derivative not designated as a hedging instrument, changes in the fair value of the derivative are recognized in earnings in the period of change. The Company must adopt SFAS No. 133 in the first quarter of fiscal 2002. Management does not believe the adoption of SFAS No. 133 will have a material effect on the financial position or operations of the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3 Cash and Cash Equivalents

Cash and cash equivalents consisted of the following at March 31, 2001 and March 25, 2000:

March 31, 2001 (In thousands)	Cash and Cash Equivalents	
	Amortized Cost	Fair Value
Cash	\$ 3,469	\$ 3,469
Total	<u>\$ 3,469</u>	<u>\$ 3,469</u>

March 25, 2000 (In thousands)	Cash and Cash Equivalents	
	Amortized Cost	Fair Value
Cash	\$ 1,067	\$ 1,067
Money market funds	1,933	1,933
Other marketable securities	455	455
Total	<u>\$ 3,455</u>	<u>\$ 3,455</u>

4 Inventories

Years ended (In thousands)	March 31, 2001	March 25, 2000
Raw materials	\$ 8,432	\$ 8,095
Work-in-progress	4,833	5,167
Finished goods	1,020	294
Loaned inventory	900	557
	<u>\$ 15,185</u>	<u>\$ 14,113</u>

5 Selling Expenses

Selling expenses consist primarily of commissions paid to various marketing agencies. Commission expense totaled \$2,579,000, \$2,360,000, and \$2,051,000 in fiscal 2001, 2000, and 1999, respectively. Advertising costs which are expensed as incurred totaled \$579,000, \$511,000, and \$558,000 for fiscal 2001, 2000, and 1999, respectively.

6 Significant Customers and Industry Segment Information

The Company has five reportable segments: Giga-tronics Instruments division, ASCOR, Microsource, DYMATIX, 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 or devices. DYMATIX, which includes Viking Semiconductor Equipment, Inc. and Ultracision, Inc., manufactures and markets optical inspection equipment used to test semiconductor devices and automation equipment for the test and inspection of silicon wafers. Corporate handles the financing needs of each segment and lends funds to each segment as required.

The accounting policies for the segments are the same as those described in the "Summary of Significant Accounting Policies." The Company evaluates the performance of its segments and allocates resources to them based on earnings before income taxes (pre-tax income (loss)). Segment net sales includes sales to external customers. Segment pre-tax loss includes an allocation for corporate expenses, amortization of goodwill, and interest expense from borrowings from Corporate. Corporate expenses are allocated to the reportable segments based principally on full time equivalent headcount. Interest expense is charged at prime which is currently 9% for cash required by each segment. Goodwill associated with acquisitions are recorded as assets of the individual segments. Assets include accounts receivable, inventories, equipment, cash, deferred income taxes, prepaid expenses, goodwill and other long-term assets. The Company accounts for inter-segment sales and transfers at terms that allow a reasonable profit to the seller. During the periods reported there were no significant inter-segment sales or transfers.

The Company's reportable operating segments are strategic business units that offer different products and services. They are managed separately because each business utilizes different technology and requires different marketing strategies. All of the businesses except for Giga-tronics Instruments were acquired. The Company's chief operating decision maker is considered to be the Company's Chief Executive Officer ("CEO"). The CEO reviews financial information presented on a consolidated basis accompanied by disaggregated information about revenues and pre-tax income by operating segment. The tables below present information for the fiscal years ended in 2001, 2000 and 1999:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2001 (In thousands):	Giga-tronics Instruments	ASCOR	Microsource	DYMATIX	Corporate	Total
Revenue	\$ 25,001	\$ 7,503	\$ 13,208	\$ 8,447	\$ —	\$ 54,159
Interest income	25	93	6	3	109	236
Interest expense	(196)	(4)	(744)	(354)	1,267	(31)
Depreciation and amortization	604	148	1,270	98	—	2,120
Pre-tax income	1,193	1,436	(985)	434	1,383	3,461
Assets	15,518	4,172	11,937	5,236	455	37,318

March 25, 2000 (In thousands):	Giga-tronics Instruments	ASCOR	Microsource	DYMATIX	Corporate	Total
Revenue	\$ 18,516	\$ 6,705	\$ 15,069	\$ 7,287	\$ —	\$ 47,577
Interest income	—	34	1	—	70	105
Interest expense	(25)	(15)	(634)	(329)	957	(46)
Depreciation and amortization	699	153	1,164	95	—	2,111
Pre-tax income	361	53	132	168	919	1,633
Assets	13,546	5,299	11,874	5,396	1,411	37,526

March 27, 1999 (In thousands):	Giga-tronics Instruments	ASCOR	Microsource	DYMATIX	Corporate	Total
Revenue	\$ 17,061	\$ 6,484	\$ 8,984	\$ 5,107	\$ —	\$ 37,636
Interest income	35	10	—	2	120	167
Interest expense	—	31	455	287	(727)	46
Depreciation and amortization	924	152	1,004	128	—	2,208
Pre-tax income (loss)	(805)	546	(777)	(2,791)	821	(3,006)
Assets	10,130	4,426	11,495	5,763	1,445	33,259

The Company's Giga-tronics Instruments, ASCOR, and Microsource segments sell to agencies of the U.S. Government and U.S. defense-related customers. In fiscal 2001, 2000, and 1999 U.S. Government and U.S. defense-related customers accounted for 11%, 16%, and 24%, of sales, respectively. In addition during 2001, a Japanese distributor of the Company, Midoriya, accounted for 10% of the Company's consolidated sales and 11% of accounts receivable as of year end.

Export sales accounted for 41%, 30%, and 20% of the Company's sales in fiscal 2001, 2000, and 1999, respectively. Export sales by geographical area are shown below:

Years ended (In thousands)	March 31, 2001	March 25, 2000	March 27, 1999
Americas	\$ 4,256	\$ 1,989	\$ 445
Europe	6,831	6,448	3,446
Asia	9,512	4,981	3,371
Rest of world	1,473	1,050	403
	<u>\$ 22,072</u>	<u>\$ 14,468</u>	<u>\$ 7,665</u>

7 Earnings (loss) per Share

Shares used in per share computations for the years ended March 31, 2001, March 25, 2000, and March 27, 1999 are as follows:

Years ended (In thousands except per share data)	March 31, 2001	March 25, 2000	March 27, 1999
Net earnings (loss)	<u>\$ 1,901</u>	<u>\$ 1,139</u>	<u>\$ (1,858)</u>
Weighted average:			
Common shares outstanding	4,474	4,379	4,338
Common share equivalents	329	314	—
Common shares assuming dilution	<u>4,803</u>	<u>4,693</u>	<u>4,338</u>
Net earnings per share of common stock	<u>\$ 0.42</u>	<u>\$ 0.26</u>	<u>\$ (0.43)</u>
Net earnings per share of common stock assuming dilution	<u>\$ 0.40</u>	<u>\$ 0.24</u>	<u>\$ (0.43)</u>
Stock options not included in computation	<u>57</u>	<u>24</u>	<u>537</u>

The number of stock options not included in the computation of diluted earnings per share (EPS) for the period ended March 27, 1999 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 periods ending March 31, 2001 and March 25, 2000 reflects stock options where the exercise prices were greater than the average market price of the common shares and are therefore antidilutive.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8 Income Taxes

Following are the components of the provision (benefit) for income taxes:

Years ended (In thousands)	March 31, 2001	March 25, 2000	March 27, 1999
Current:			
Federal	\$ 1,063	\$ 46	\$ (720)
State	66	7	4
	<u>1,129</u>	<u>53</u>	<u>(716)</u>
Deferred:			
Federal	58	(180)	(205)
State	(263)	100	(227)
	<u>(205)</u>	<u>(80)</u>	<u>(432)</u>
Charge in lieu of taxes attributable to employer stock option plans	58	127	—
Goodwill, for initial recognition of acquired tax benefits that previously were included in the valuation reserve	58	394	—
	<u>58</u>	<u>394</u>	<u>—</u>
Provision (benefit) for income taxes	\$ 1,040	\$ 494	\$ (1,148)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities are as follows:

Years ended (In thousands)	March 31, 2001	March 25, 2000
Current tax assets, net	\$ 3,560	\$ 3,570
Noncurrent tax asset (liabilities), net	(796)	(1,011)
Net deferred taxes	<u>\$ 2,764</u>	<u>\$ 2,559</u>
Future state tax effect	(182)	(188)
Allowance for doubtful accounts	112	196
Fixed asset depreciation	(855)	(1,116)
Inventory reserves and additional costs capitalized	2,529	2,747
Deferred revenue	—	19
Accrued vacation	284	268
Accrued warranty	314	237
Other accrued liabilities	212	330
Net operating loss carryforward	6,056	6,452
Income tax credits	786	501
Valuation allowances	(6,492)	(6,887)
	<u>\$ 2,764</u>	<u>\$ 2,559</u>

Years ended (In thousands except percentages)	March 31, 2001		March 25, 2000		March 27, 1999	
Statutory federal income tax (benefit)	\$ 1,176	34.0%	\$ 555	34.0%	\$(1,022)	34.0%
Beginning of year change in deferred						
Tax asset valuation allowance	—	—	(55)	(3.4)	—	—
State income tax, net of federal benefit	200	5.8	57	3.5	(146)	4.9
Nontax deductible expenses	6	0.2	6	0.4	14	(0.4)
Tax credits	(297)	(8.6)	(98)	(6.0)	(58)	1.9
Goodwill and patent amortization	60	1.7	88	5.4	84	(2.8)
Interest income exempt from federal tax	(58)	(1.7)	(51)	(3.1)	(19)	.6
Other	(47)	(1.4)	(8)	(.5)	(1)	—
Effective income tax (benefit)	\$ 1,040	30.0%	\$ 494	30.3%	\$(1,148)	38.2%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The change in valuation allowance from March 25, 2000 to March 31, 2001 was \$395,000. The change in valuation allowance from March 27, 1999 to March 25, 2000 was \$860,000. The change in valuation allowance from March 28, 1998 to March 27, 1999 was \$7,648,000.

The Company has recorded a valuation allowance to reflect the estimated amount of deferred tax assets, which may not be realized. The ultimate realization of deferred tax assets is dependent upon generation of future taxable income during the periods in which those temporary differences become deductible. Management considers projected future taxable income and tax planning strategies in making this assessment. Based on the 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 realize benefits of these deductible differences, net of valuation allowances as of March 31, 2001.

During the year ended March 27, 1999, the Company acquired approximately \$7,600,000 of deferred tax assets in the acquisition of Microsource, which was fully offset by a valuation allowance. Subsequent recognition of tax benefits relating to the valuation allowance for deferred tax assets of Microsource will be allocated to goodwill and the remainder to income tax benefit. As of March 31, 2001, goodwill has been reduced by \$452,000 for the tax benefits realized from the Microsource deferred tax assets.

During the years ended March 31, 2001 and March 25, 2000, disqualifying employee stock option dispositions resulted in an income tax deduction to the Company of approximately \$145,000 and \$269,000, respectively, and a tax benefit of approximately \$58,000 and \$127,000, respectively. The tax benefit has been reflected as an increase to the Company's paid-in capital in the accompanying Statement of Shareholders' Equity.

9 Stock Options and Employee Benefit Plans

Stock Option Plan The Company established a 1990 Stock Option Plan which provided for the granting of options for up to 700,000 shares of common stock. The 1990 Plan expired during the 2001 fiscal year. The Company subsequently established the 2000 Stock Option Plan which provides for the granting of options for up to 700,000 shares of common stock at 100% of fair market value at the date of grant, with each grant requiring approval by the Board of Directors of the Company. Options granted vest in one or more installments as set forth in the relevant option agreement and must be exercised while the grantee is employed by the Company or within a certain period after termination of employment. Options granted to employees shall not have terms in excess of 10 years from the grant date. During December 1998, the Company offered options holders the opportunity to have outstanding options repriced to current fair value, with the related vesting period starting over. The Company cancelled and reissued (repriced) 405,250 options pursuant to the repricing. Holders of options may be granted stock appreciation rights (SAR's), which entitle them to surrender outstanding options for a cash distribution under certain changes in ownership of the Company, as defined in the stock option plan. As of March 31, 2001, no SAR's have been granted under the option plan. As of March 31, 2001, the total number of shares of common stock available for issuance is 540,800 under the 2000 stock option plan. All outstanding options have a term of five years.

Following is a summary of stock option activity:

	Per Share Weighted Average Fair Value of Options Granted	Options Exercisable	Shares	Weighted Average Exercise Price
Outstanding as of March 28, 1998		106,682	390,670	\$ 7.268
Exercised			(1,400)	2.660
Forfeited			(561,456)	6.399
Granted	\$ 2.914		807,750	2.818
Outstanding as of March 27, 1999		48,814	635,564	2.391
Exercised			(28,204)	2.515
Forfeited			(168,875)	2.118
Granted	\$ 2.613		115,500	2.613
Outstanding as of March 25, 2000		131,424	553,985	2.514
Exercised			(84,212)	2.247
Forfeited			(89,737)	4.786
Granted	\$ 6.407		214,700	6.407
Outstanding as of March 31, 2001		143,988	594,736	\$ 3.610

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In accordance with SFAS No. 123, "Accounting for Stock-Based Compensation", the Company is required to disclose the effects on net earnings and earnings per share as if it had elected to use the fair value method to account for employee stock-based compensation plans. Had the Company recorded a charge for the fair value of options granted consistent with SFAS No. 123, net earnings (loss) and net earnings (loss) per share would have been changed to the pro-forma (unaudited) amounts shown below:

Years ended (In thousands except per share data)	March 31, 2001	March 25, 2000	March 27, 1999
Net earnings (loss)			
As reported	\$ 1,901	\$ 1,139	\$ (1,858)
Pro-forma	1,537	872	(2,234)
Net earnings (loss) per share – basic			
As reported	0.42	0.26	(0.43)
Pro-forma	0.34	0.20	(0.52)
Net earnings (loss) per share – diluted			
As reported	0.40	0.24	(0.43)
Pro-forma	\$ 0.32	\$ 0.19	\$ (0.52)

For purposes of computing pro-forma (unaudited) consolidated net earnings (loss), the fair value of each option grant and Employee Stock Purchase Plan purchase right is estimated on the date of grant using the Black Scholes option pricing model. The assumptions used to value the option grants and purchase rights are stated below:

Years ended	March 31, 2001	March 25, 2000	March 27, 1999
Expected life of options	4 years	4 years	4 years
Expected life of purchase rights	6 mos	6 mos	6 mos
Volatility	60%	60%	60%
Risk-free interest rate	4.64 to 6.30	5.08 to 5.97	4.53 to 5.66
Dividend yield	Zero	Zero	Zero

Options Outstanding and Exercisable as of March 25, 2001, by Price Range

Range of Exercise Prices	Number of Options Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Options Exercisable	Weighted Average Exercise Price
\$2.09	286,536	2.69	\$ 2.094	113,238	\$ 2.094
From \$2.12 to \$5.09	182,200	3.77	3.658	30,750	2.895
From \$6.13 to \$8.88	126,000	4.54	6.990	—	—
From \$2.09 to \$8.88	<u>594,736</u>	<u>3.41</u>	<u>\$ 3.610</u>	<u>143,988</u>	<u>\$ 2.26</u>

Employee Stock Purchase Plan Under the Company's Employee Stock Purchase Plan (the Purchase Plan), employees meeting specific employment qualifications are eligible to participate and can purchase shares semi-annually through payroll deductions at the lower of 85% of the fair market value of the stock at the commencement or end of the offering period. The Purchase Plan permits eligible employees to purchase common stock through payroll deductions for up to 10% of qualified compensation. As of March 31, 2001, 18,260 shares remain available for issuance under the Purchase Plan. The weighted average fair value of the purchase rights granted in fiscal 2001 was \$6.471.

401(k) Plan The Company has established 401(k) plans which cover substantially all employees. Participants may make voluntary contributions to the plan up to 20% of their defined compensation. The Company is required to match a percentage of the participants' contributions in accordance with the plan. Participants vest ratably in Company contributions over a four-year period. Company contributions to the plans for fiscal 2001, 2000, and 1999 were approximately \$208,000, \$151,000, and \$153,000, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10 Commitments

The Company leases a 47,300 square foot facility located in San Ramon, California, under a twelve-year lease (as amended) that commenced in April 1994. The Company leases a 18,756 square foot facility located in Fremont, California, under a seven-year lease that commenced in July 1999. The Company leases a 20,400 square foot facility located in Santa Clara, California, under a seven-year lease that commenced in July 1995. The Company leases a 49,090 square foot facility located in Santa Rosa, California, under a twenty-year lease that commenced in July 1993. These facilities accommodate all of the Company's present operations. The Company also has acquired equipment under capital and operating leases. The future minimum lease payments for operating equipment and facility leases are shown below:

Fiscal years (In thousands)	
2002	\$ 1,717
2003	1,581
2004	1,535
2005	875
2006	886
Thereafter	6,241
	<u>\$ 12,835</u>

The aggregate rental expense was \$1,816,000, \$1,812,000, and \$1,462,000 in fiscal 2001, 2000, and 1999, respectively.

As of March 31, 2001, Property and Equipment includes equipment under capital lease of \$283,000 and related accumulated amortization of \$162,000. As of March 25, 2000, Property and Equipment includes equipment under capital lease of \$313,000 and related accumulated amortization of \$99,000. As of March 27, 1999, Property and Equipment includes equipment under capital lease of \$502,000 and related accumulated amortization of \$111,000. The future minimum lease payments for capital equipment leases are shown below.

Fiscal years (In thousands)	
2002	\$ 182
2003	70
2004	57
Total	<u>309</u>
Less interest costs	<u>27</u>
Present value of minimum lease payments	282
Less current portion	<u>167</u>
Long term portion of capital lease obligations	<u>\$ 115</u>

11 Line of Credit

The Company has an agreement with a bank for an unsecured revolving line of credit loan for \$7,000,000 with interest payable at prime rate or at LIBOR plus 1½ percent. As of March 31, 2001, this credit line has not been utilized by the Company and expires July 31, 2001.

I N D E P E N D E N T A U D I T O R S ' R E P O R T

The Board of Directors and Shareholders
Giga-tronics Incorporated:

We have audited the accompanying consolidated balance sheets of Giga-tronics Incorporated and subsidiaries as of March 31, 2001 and March 25, 2000, and the related consolidated statements of operations, shareholders' equity and cash flows for years ended March 31, 2001, March 25, 2000, and March 27, 1999. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Giga-tronics Incorporated and subsidiaries as of March 31, 2001 and March 25, 2000, and the results of their operations and their cash flows for the years ended March 31, 2001, March 25, 2000, and March 27, 1999, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, effective March 26, 2000, the Company changed its method of accounting for certain equipment sales.

KPMG LLP

KPMG LLP
Mountain View, California
May 4, 2001

S E L E C T E D F I N A N C I A L D A T A

Summary of Operations:

(In thousands except per share data)	March 31, 2001	March 25, 2000	March 27, 1999	March 28, 1998	March 29, 1997
Net sales	\$ 54,159	\$ 47,577	\$ 37,636	\$ 36,813	\$ 38,031
Gross profit	19,056	15,810	11,534	15,789	14,627
Operating expenses	16,032	14,315	15,293	15,172	13,096
Interest income, net	205	59	121	457	533
Earnings (loss) before cumulative effect of accounting change and income taxes	3,461	1,633	(3,006)	1,096	2,048
Earnings (loss) before cumulative effect of accounting change	2,421	1,139	(1,858)	767	1,509
Net earnings (loss)	1,901	1,139	(1,858)	767	1,509
Net earnings (loss) per share – basic	\$ 0.42	\$ 0.26	\$ (0.43)	\$ 0.18	\$ 0.35
Net earnings (loss) per share – diluted	\$ 0.40	\$ 0.24	\$ (0.43)	\$ 0.18	\$ 0.34

Financial Position:

(In thousands except ratio)	March 31, 2001	March 25, 2000	March 27, 1999	March 28, 1998	March 29, 1997
Current ratio	4.06	3.17	3.32	5.06	4.32
Working capital	\$ 22,924	\$ 21,066	\$ 18,021	\$ 23,484	\$ 22,692
Total assets	37,318	37,526	33,259	32,672	33,618
Shareholders' equity	\$ 28,475	\$ 26,149	\$ 24,710	\$ 26,461	\$ 25,654
Shares of common stock – basic	4,474	4,379	4,338	4,319	4,300
Shares of common stock – diluted	4,803	4,693	4,338	4,377	4,376

Percentage Data:

	March 31, 2001	March 25, 2000	March 27, 1999	March 28, 1998	March 29, 1997
Percent of net sales					
Gross profit	35.2	33.2	30.6	42.9	38.5
Operating expenses	29.6	30.1	40.6	41.2	34.4
Interest income, net	0.4	0.1	0.3	1.2	1.4
Earnings (loss) before cumulative effect of accounting change and income taxes	6.4	3.4	(8.0)	3.0	5.4
Net earnings (loss)	3.5	2.4	(4.9)	2.1	4.0

Common Stock Market Prices

Giga-tronics' common stock is traded over the counter on NASDAQ/NMS National Market System using the symbol "GIGA". The number of record holders of the Company's common stock as of March 31, 2001 was close to 1,400. The table below shows the high and low closing bid quotations for the common stock during the indicated fiscal periods. These quotations reflect inter-dealer prices without retail mark-ups, mark-downs, or commission and may not reflect actual transactions.

	2001	High	Low	2000	High	Low
First quarter	(3/26-6/24)	12 ⁷ / ₈	6 ³ / ₈	(3/28-6/26)	3	1 ³ / ₄
Second quarter	(6/25-9/30)	10	6 ²⁵ / ₃₂	(6/27-9/25)	3 ⁵ / ₁₆	1 ¹³ / ₁₆
Third quarter	(10/1-12/30)	7 ⁵ / ₁₆	4 ¹³ / ₁₆	(9/26-12/25)	7 ¹ / ₂	2 ¹ / ₂
Fourth quarter	(12/31-3/31)	8 ³ / ₁₆	4 ⁷ / ₈	(12/26-3/25)	22	6 ¹ / ₂

S E L E C T E D F I N A N C I A L D A T A

Effective March 26, 2000, the Company changed its method of accounting for revenue recognition to conform with the guidance provided by SAB 101 (see Note 2). The Company's unaudited financial results for the quarters ended June 24, September 30 and December 30, 2000 have been restated to apply SAB 101 retroactively to the beginning of fiscal 2001. The impact in 2001 of adopting SAB 101 was to increase net income before the cumulative effect of the accounting change by \$520,000, net of income taxes.

Quarterly Financial Information (Unaudited)

(In thousands except per share data)

	2001				
	First	Second	Third	Fourth	Year
Net sales	\$ 13,637	\$ 13,642	\$ 11,368	\$ 15,512	\$ 54,159
Gross profit	4,963	4,814	4,068	5,211	19,056
Operating expenses	3,775	4,298	3,883	4,076	16,032
Interest income, net	33	36	96	40	205
Earnings before cumulative effect of accounting change and income taxes	1,253	666	322	1,220	3,461
Earnings before cumulative effect of accounting change	877	465	225	854	2,421
Net earnings	357	465	225	854	1,901
Net earnings per share – basic	\$ 0.08	\$ 0.10	\$ 0.05	\$ 0.19	\$ 0.42
Net earnings per share – diluted	\$ 0.07	\$ 0.10	\$ 0.05	\$ 0.18	\$ 0.40
Equivalent shares of common stock - basic	4,437	4,460	4,488	4,511	4,474
Equivalent shares of common stock - diluted	4,817	4,796	4,777	4,801	4,803

The results of operations and statements of financial position as previously reported in the Company's interim 2001 financial statements filed on Form 10-Q have been revised to retroactively reflect on a pro-forma basis the application of SAB 101 effective March 26, 2000.

	For the three months ended					
	June 24, 2000		September 30, 2000		December 30, 2000	
	As Reported	Revised	As Reported	Revised	As Reported	Revised
Net sales	\$ 12,161	\$ 13,637	\$ 14,058	\$ 13,642	\$ 11,810	\$ 11,368
Gross profit	4,436	4,963	4,946	4,814	4,266	4,068
Operating expenses	3,775	3,775	4,298	4,298	3,883	3,883
Interest income, net	33	33	36	36	96	96
Earnings before cumulative effect of accounting change and income taxes	726	1,253	798	666	520	322
Earnings before cumulative effect of accounting change	508	877	557	465	363	224
Net earnings	508	357	557	465	363	224

Quarterly Financial Information (Unaudited)

(In thousands except per share data)

	2000				
	First	Second	Third	Fourth	Year
Net sales	\$ 11,505	\$ 11,834	\$ 11,314	\$ 12,924	\$ 47,577
Gross profit	3,451	3,948	3,990	4,421	15,810
Operating expenses	3,315	3,638	3,568	3,794	14,315
Interest income, net	(1)	3	22	35	59
Earnings before income taxes	162	324	460	687	1,633
Net earnings	112	227	322	478	1,139
Net earnings per share – basic	\$ 0.03	\$ 0.05	\$ 0.07	\$ 0.11	\$ 0.26
Net earnings per share – diluted	\$ 0.03	\$ 0.05	\$ 0.07	\$ 0.10	\$ 0.24
Equivalent shares of common stock - basic	4,362	4,368	4,383	4,402	4,379
Equivalent shares of common stock - diluted	4,372	4,483	4,611	4,846	4,693

C O R P O R A T E I N F O R M A T I O N

D I R E C T O R S

George H. Bruns, Jr.
Chairman and
Chief Executive Officer

James A. Cole^{1,2}
General Partner, Windward Ventures
General Partner, Spectra Enterprises

Robert C. Wilson^{1,2}
Chairman
Wilson & Chambers

William E. Wilson^{1,2}
President
Microsource, Inc.

¹ Member, Compensation Committee

² Member, Audit Committee

E X E C U T I V E O F F I C E R S

George H. Bruns, Jr.
Chairman and
Chief Executive Officer

Mark H. Cosmez II
Vice President, Finance/
Chief Financial Officer & Secretary

Claudio S. Mariotta
President, Giga-tronics Instrument Division

Jeffrey T. Lum
President, ASCOR, Inc.

Daniel S. Markowitz
President, DYMATIX
(Ultracision, Inc. and Viking Semiconductor Equipment, Inc.)

William E. Wilson
President, Microsource, Inc.

H E A D Q U A R T E R S

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Chairman and Chief Executive Officer
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INDEPENDENT AUDITORS

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500 East Middlefield Road
Mountain View, CA 94043
www.kpmg.com

ANNUAL MEETING

The Company's Annual Meeting of Shareholders will be held at 9:30 a.m. on August 30, 2001 at Giga-tronics' offices located at 4650 Norris Canyon Road, San Ramon, CA 94583.

FORM 10-K

A copy of the Company's Annual Report on Form 10-K for 2001, filed with the Securities and Exchange Commission, may be obtained by shareholders without charge by a written request to:

Company Secretary
4650 Norris Canyon Road
San Ramon, CA 94583

Giga-tronics Incorporated

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