

GIGA TRONICS INC
Form 10-K
May 29, 2003

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UNITED STATES
SECURITIES AND EXCHANGE
COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the fiscal year ended March 29, 2003, or

() TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 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)

(I.R.S. 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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

None

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, No par value

(Title of class)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

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Yes

No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b of the Act). Yes No

The aggregate market value of voting stock held by non-affiliates of the Registrant calculated on the closing average bid and asked prices as of May 21, 2003 was \$5,180,254. For purposes of this determination only, directors and officers of the Registrant have been assumed to be affiliates. There were a total of 4,693,080 shares of the Registrant's Common Stock outstanding as of May 21, 2003.

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents have been incorporated by reference into the parts indicated:

<u>PART OF FORM 10-K</u>	<u>DOCUMENT</u>
PART III Items 10, 11, 12 and 13	Registrant's PROXY STATEMENT for its 2003 annual meeting of shareholders to be filed no later than 120 days after the close of the fiscal year ended March 29, 2003.

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PART I

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 discussed under Certain Factors Which May Adversely Affect Future Operations Or An Investment In Giga-tronics in Item 1 below and in Item 7, Management's Discussion and Analysis.

ITEM 1. BUSINESS

General

Giga-tronics Incorporated (Giga-tronics) includes operations of Giga-tronics Instrument Division, ASCOR, Inc. (ASCOR), DYMATiX, which is a joint venture of Viking Semiconductor Equipment, Inc. (Viking) and Ultracision, Inc. (Ultracision), and Microsource, Inc. (Microsource).

Giga-tronics designs, manufactures and markets through its Giga-tronics Instrument Division, 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. These products are used primarily in the design, production, repair and maintenance of commercial telecommunications, radar, and electronic warfare.

Giga-tronics was incorporated on March 5, 1980, and its principal executive offices are located at 4650 Norris Canyon Road, San Ramon, California, and its telephone number at that location is (925) 328-4650.

Effective July 23, 1996, Giga-tronics acquired ASCOR. ASCOR, located in Fremont, California, designs, manufactures, and markets a line of switching and connecting devices that link together many specific purpose instruments that comprise a portion of automatic test systems. ASCOR offers a family of switching and interface test adapters as standard VXI configured products, as well as complete system integration services to the Automatic Test Equipment market.

Effective June 27, 1997, Giga-tronics completed a merger with Viking by issuing approximately 420,000 shares of the Company's common stock in exchange for all of the common stock of Viking. Viking, which is now located in Fremont, California, manufactures and markets a line of optical inspection equipment used to manufacture and test semiconductor devices. Products include die attachments, automatic die sorters, tape and reel equipment, and wafer inspection equipment.

Effective December 2, 1997, Giga-tronics completed a merger with Ultracision by issuing approximately 517,000 shares of the Company's common stock in exchange for all of the common stock of Ultracision. Ultracision was a manufacturer of automation equipment for the test and inspection of silicon wafers. Ultracision also produced a line of probers for the testing and inspection of silicon devices.

Effective May 18, 1998, Giga-tronics acquired Microsource. All the outstanding shares of Microsource were exchanged for \$1,500,000 plus contingent payments based on earnings from Microsource from 1998 to 2000, which amounts were nominal. Microsource located in Santa Rosa, California develops and manufactures a broad line of YIG (Yttrium, Iron, Garnet) tuned oscillators, filters and microwave synthesizers, which are used by its customers in manufacturing a wide variety of microwave instruments or devices.

Giga-tronics intends to broaden its product lines and expand its market, both by internal development of new products and through the acquisition of other business entities. From time to time, the Company considers a variety of acquisition opportunities.

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Industry Segments

The Company manufactures products used in test, measurement and handling. The Company operates primarily in four operating segments, Giga-tronics Instrument Division, ASCOR Inc., Microsource Inc. and DYMATiX (formerly the Semiconductor Equipment Group).

Products and Markets

Giga-tronics Instrument Division

The Giga-tronics Instrument Division segment produces signal sources, generators and sweepers, and power measurement instruments for use in the microwave and RF frequency range (10 kHz to 75 GHz). Within each product line are a number of different models and options allowing customers to select frequency range and specialized capabilities, features and functions. The end-user markets for these products can be divided into three broad segments: commercial telecommunications, radar and electronic warfare. This segment's instruments are used in the design, production, repair and maintenance and calibration of other manufacturers' products, from discrete components to complex systems.

ASCOR Inc.

The ASCOR Inc. segment produces switch modules, and interface adapters that operate with a bandwidth from direct current (DC) to 18 GHz. This segment's switch modules may be incorporated within its customer's automated test equipment. The end-user markets for these products are primarily related to electronic warfare, though the VXI architecture may become more accepted by the telecommunications market.

DYMATiX (formerly the Semiconductor Equipment Group)

The DYMATiX segment manufactures and markets a line of optical inspection equipment used in the testing of semiconductor devices. Products include die attachments, automatic die sorters, tape and reel equipment, and wafer inspection equipment. Until recently, DYMATiX manufactured automation equipment for the test inspection and robotic handling of silicon wafers in addition to a line of probers for the testing and inspection of silicon devices.

Microsource Inc.

The Microsource segment develops and manufactures a broad line of YIG (Yttrium, Iron, Garnet) tuned oscillators, filters and microwave synthesizers, which are used by its customers in manufacturing a wide variety of microwave instruments or devices.

Sources and Availability of Raw Materials and Components

Substantially all of the components required by Giga-tronics to make its assemblies are available from more than one source. The Company occasionally uses sole source arrangements to obtain leading-edge technology, favorable pricing or supply terms, but not in any material volume. In the Company's opinion, the loss of any sole source arrangement it has would not be material to its operations.

Although extended delays in receipt of components from its suppliers could result in longer product delivery schedules for the Company, the Company believes that its protection against this possibility stems from its practice of dealing with well-established suppliers and maintaining good relationships with such suppliers.

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Patents and Licenses

The Company's competitive position is largely dependent upon its ability to provide performance specifications for its instruments and systems that (a) easily, effectively and reliably meet customers' needs and (b) selectively surpass competitors' specifications in competing products. Patents may occasionally provide some short-term protection of proprietary designs. However, because of the rapid progress of technological development in the Company's industry, such protection is most often, although not always, short-lived. Therefore, although we occasionally pursue patent coverage, we place major emphasis on the development of new products with superior performance specifications and the upgrading of existing products toward this same end. This is reflected in a substantial allocation of budget to project development costs.

The Company's products are based on its own designs, which in turn derive from its own engineering abilities. If the Company's new product engineering efforts fall behind, its competitive position weakens. Conversely, effective product development greatly enhances its competitive status.

The Company presently holds 22 patents. None of these is critical to the Company's ongoing business, and the Company does not actively maintain them.

The Company is not dependent on trademarks, licenses or franchises. We do utilize certain software licenses in some functional aspects to some of our products. Such licenses are readily available, non-exclusive and are obtained at either no cost or for a relatively small fee.

Seasonal Nature of Business

The business of the Company is not seasonal.

Working Capital Practices

The Company generally strives to maintain at least 60 days worth of inventory and generally sells to customers on 30 day payment terms. Typically, the Company receives payment terms of 30 days. The Company believes that these practices are consistent with typical industry practices.

Importance of Limited Number of Customers

Commercial business accounted for 61% of net sales in fiscal 2003, 83% in fiscal 2002, and 89% in fiscal 2001. The Company is a leading supplier of microwave and radio frequency (RF) test instruments to various U.S. Government defense agencies, as well as to their prime contractors. Management anticipates sales to U.S. Government agencies will remain significant in fiscal 2004. Defense-related agencies accounted for 39% of net sales in fiscal 2003, 17% in fiscal 2002, and 11% in fiscal 2001. Prior to the current year, where the defense business has improved, sales to the defense industry in general and direct sales to the United States and foreign government agencies in particular had declined. Any decline of defense orders could have a negative effect on the business, operating results, financial condition and cash flows of Giga-tronics.

During fiscal 2003, a Japanese distributor of the Company, Midoriya, accounted for less than 10% of the Company's revenues and a negligible amount outstanding in accounts receivable. During 2002 and 2001, Midoriya accounted for 16% and 10% of the Company's consolidated sales, respectively. At fiscal 2002 year end, Midoriya had a negligible amount outstanding in accounts receivable while they composed about 11% of receivables at the fiscal year end of 2001.

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During fiscal 2003, the U.S. Government defense agencies and their prime contractors made up 25% of the Giga-tronics Instrument Division's 2003 revenue. During fiscal 2002 the Instrument Division had two major customer concentrations. Midoriya, the Division's Japanese distributor, accounted for 30% of the Instrument Division's fiscal 2002 revenue. The U.S. Government defense agencies and their prime contractors made up 10% of the Giga-tronics Instrument Division's 2002 revenue.

In fiscal 2003, ASCOR derived 41% of its revenues from U.S. Government defense agencies and their prime contractors and another 34% from an automated test equipment manufacturer. During fiscal 2002 ASCOR had three major customer concentrations. The U.S. Government defense agencies and their prime contractors made up 18%, an automated test equipment manufacturer comprised 30% and an international communications equipment company comprised 11% of ASCOR's fiscal 2002 revenue, respectively.

In fiscal 2003, DYMATiX derived 21% of its revenues from a major semiconductor device manufacturer and another 11% from a manufacturer of mobile electronics and transportation components. During fiscal 2002, the same manufacturer of mobile electronics and transportation components accounted for 56% of DYMATiX's revenue.

During fiscal 2003 and 2002, Microsource had two major customer concentrations. An electronic instrument manufacturer accounted for 14% and 35% of Microsource's fiscal 2003 and fiscal 2002 revenue, respectively. U.S. Government defense agencies and their prime contractors made up 62% and 35% of Microsource's 2003 and 2002 revenue, respectively.

Other than U.S. government agencies and their defense contractors, no customer accounted for 10% or more of consolidated revenues of the Company in fiscal 2003 and no customer who accounted for 10% or more of revenues of any one segment accounted for 10% or more of any other segment. Other than U.S. Government agencies and their defense contractors, the Company has no customer the loss of which would, in management's opinion, have a material adverse effect on the Company and its subsidiaries as a whole.

The Company's products are largely capital investments for its customers, and the Company's belief is that its customers have economic cycles in which capital investment budgets for the kinds of products that the Company produces expand and contract. The Company, therefore, expects that a major customer in one year will often not be a major customer in the following year. Accordingly, the Company's revenues and earnings will decline if the Company is unable to find new customers or increase its business with other existing customers to replace declining revenues from the previous year's major customers. A substantial decline in revenues from U.S. Government defense agencies and their prime contractors would also have a material adverse effect on the Company's revenues and results of operations unless replaced by revenues from the commercial sector.

Backlog of Orders

On March 29, 2003, the Company's backlog of unfilled orders was \$17,192,000 compared to \$21,387,000 at March 30, 2002. As of March 29, 2003, there were approximately \$9,077,000 in unfilled orders that were scheduled for shipment beyond a year, as compared to approximately \$13,912,000 at March 30, 2002. Orders for the Company's products include program orders from both the U.S. Government and defense contractors, with extended delivery dates. Accordingly, the backlog of orders may vary substantially from quarter to quarter and the backlog entering any single quarter may not be indicative of sales for any period.

Backlog includes only those customer orders for which a delivery schedule has been agreed upon between the Company and the customer and, in the case of U.S. Government orders, for which funding has been appropriated.

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Competition

Giga-tronics serves the broad market for electronic instrumentation with applications ranging from the design, test, calibration and maintenance of other electronic devices to providing sophisticated components for complex electronic systems to sub-systems capable of sorting and identifying high frequency communication signals. These applications cut across the commercial, industrial and military segments of the broad market. The Company has a variety of competitors. Several of its competitors are much larger than the Company and have greater resources and substantially broader product lines. Others are of comparable size with more limited product lines.

Competition from numerous existing companies is intense and potential new entrants are expected to increase. The Company's instrument, switch, oscillator and synthesizer products compete with Agilent, Anritsu, Racal, IFR and Rohde & Schwarz while the semiconductor equipment products compete with various other competitors. Many of these companies have substantially greater research and development, manufacturing, marketing, financial, technological, personnel and managerial resources than Giga-tronics. There can be no assurance that any products developed by these competitors will not gain greater market acceptance than any developed by Giga-tronics.

To compete effectively in this circumstance, the Company (a) places strong emphasis on maintaining a high degree of technical competence as it relates to the development of new products and the upgrading of existing products and (b) is highly selective in establishing technological objectives. The Company does not attempt to compete across the board, but selectively based upon its particular strengths and the competitors perceived limitations.

Specification requirements of customers in this market vary widely. The Company is able to compete by offering products that meet a customer's particular specification requirements; by being able to offer certain product specifications at lower cost resulting from the Company's past production of products with those specifications; and by being able to offer certain product specifications at a higher quality level. All of these advantages are attributable to the Company's continuing investment in research and development and in a highly trained engineering staff.

The customer's decision is most often based on the best match of its particular requirements and the supplier's operating specifications. In most cases, attracting and retaining customers does not require the Company to offer the best product with respect to each of the customer's requirements but rather to those few specifications that are most important to the customer.

Occasionally price is a competitive consideration. In that circumstance, the Company believes it has more flexibility in making pricing decisions than its larger and more structured competitors.

Sales and Marketing

Giga-tronics Instrument Division, ASCOR Inc., DYMATiX and Microsource Inc. market their products through various distributors and representatives to commercial and government customers, although not necessarily through the same distributors and representatives.

Product Development

Products of the type manufactured by Giga-tronics historically have had relatively long product life cycles. However, the electronics industry is subject to rapid technological changes at the component level. The future success of the Company is dependent on its ability to steadily incorporate advancements in component technologies into its new products.

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Product development expense was approximately \$5,644,000 in fiscal 2003, \$7,001,000 in fiscal 2002, and \$5,087,000 in fiscal 2001. Activities included the development of new products and the improvement of existing products. It is management's intention to maintain or increase expenditures for product development at levels required to sustain its competitive position. All of the Company's product development activities are internally funded and expensed as incurred.

Giga-tronics expects to continue to make significant investments in research and development. There can be no assurance that future technologies, processes or product developments will not render Giga-tronics' current product offerings obsolete or that Giga-tronics will be able to develop and introduce new products or enhancements to existing products, which satisfy customer needs, in a timely manner or achieve market acceptance. The failure to do so could adversely affect Giga-tronics' business.

Manufacturing

The assembly and testing of Giga-tronics Instrument Division microwave, RF and power measurement products are done at its San Ramon facility. The assembly and testing of ASCOR's switching and connecting devices and the assembly and testing of DYMATiX semiconductor equipment products are done at its Fremont facility. The assembly and testing of Microsource's line of YIG (Yttrium, Iron, Garnet) tuned oscillators, filters and microwave synthesizers are done at its Santa Rosa facility.

Environment

To the best of its knowledge, the Company is in compliance with all federal, state and local laws and regulations involving the protection of the environment.

Employees

As of March 29, 2003, Giga-tronics employed 174 individuals on a full time basis. Management believes that the future success of the Company depends on its ability to attract and retain skilled personnel. None of the Company's employees are represented by a labor union, and the Company considers its employee relations to be good.

Information about Foreign Operations

The Company sells to its international customers through a network of foreign technical sales representative organizations. Sales to foreign customers were approximately \$5,111,000 in fiscal 2003, \$17,105,000 in fiscal 2002, and \$22,072,000 in fiscal 2001.

The Company closed its United Kingdom (UK) research & development facility as of March 30, 2002. 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.

Certain Factors Which May Adversely Affect Future Operations Or An Investment In Giga-tronics

Business climate is volatile

Giga-tronics has a significant number of defense-related orders. If the defense market should soften, shipments in the current year could decrease more than current projected shipments with a concurrent decline 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 these orders. If this occurs, then shipments in the current year could decrease more than current projected shipments resulting in a decline in earnings.

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Giga-tronics sales are substantially dependent on the wireless industry

Giga-tronics sells directly or indirectly to customers and equipment manufacturers in the wireless industry. Currently, this industry is undergoing dramatic and rapid change. As such, the business that Giga-tronics records could decrease or existing recorded backlog could be stretched or deferred resulting in less than projected shipments. These reduced shipments may have a material adverse effect on operations.

Giga-tronics markets involve rapidly changing technology and standards

The market for electronics equipment is characterized by rapidly changing technology and evolving industry standards. Giga-tronics believes that its future success will depend in part upon its ability to develop and commercialize its existing products, develop new products and applications, and in part to develop, manufacture and successfully introduce new products and product lines with improved capabilities and to continue to enhance existing products. There can be no assurance that Giga-tronics will successfully complete the development of current or future products or that such products will achieve market acceptance.

Giga-tronics 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.

Giga-tronics common stock price is volatile

The market price of the Company's common stock could be subject to significant fluctuations in response to variations in quarterly operating results, shortfalls in revenues or earnings from levels expected by securities analysts and other factors such as announcements of technological innovations or new products by Giga-tronics or by competitors, government regulations or developments in patent or other proprietary rights. In addition, the NASDAQ National Market and other stock markets have experienced significant price fluctuations in recent periods. These fluctuations often have seemingly been unrelated to the operating performance of the specific companies whose stocks are traded. Broad market fluctuations, as well as general foreign and domestic economic conditions, may adversely affect the market price of the common stock.

Giga-tronics stock at any time has historically traded on thin volume on NASDAQ. Sales of a significant volume of stock could result in a depression of Giga-tronics share prices.

ITEM 2. PROPERTIES

As of March 29, 2003, Giga-tronics principal executive office and the Instrument Division marketing, sales and engineering offices and manufacturing facilities for its microwave and RF signal generator and power measurement products are located in approximately 47,300 square feet in San Ramon, California, which the Company occupies under a lease agreement expiring December 31, 2006.

ASCOR's marketing, sales and engineering offices and manufacturing facilities for its switching and connecting devices and the DYMATiX marketing, sales and engineering offices and manufacturing facilities for its

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automation equipment for the inspection of silicon wafers, prober line and optical inspection equipment for the manufacture and test of semiconductor devices are both located in approximately 18,756 square feet in Fremont, California, under a lease that expires on June 30, 2006.

Microsource's marketing, sales and engineering offices and manufacturing facilities for its YIG tuned oscillators, filters and microwave synthesizers are located in an approximately 33,439 square foot facility in Santa Rosa, California, which the Company occupies under a lease expiring May 25, 2013.

The Company believes that its facilities are adequate for its business activities.

ITEM 3. LEGAL PROCEEDINGS

As of March 29, 2003, the Company has no material pending legal proceedings. From time to time, Giga-tronics is involved in various disputes and litigation matters that arise in the ordinary course of business.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended March 29, 2003.

Executive Officers of the Company are listed in Part III, Item 10 of this Form 10-K.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED SHAREHOLDER MATTERS

Common Stock Market Prices

Giga-tronics' common stock is traded over the counter on NASDAQ National Market System using the symbol GIGA. The number of record holders of the Company's common stock as of March 29, 2003 was approximately 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.

	2003	High	Low	2002	High	Low
First quarter	(3/31-6/29)	\$3.700	\$2.330	(4/1-6/30)	\$5.810	\$3.200
Second quarter	(6/30-9/28)	2.220	1.000	(7/1-9/29)	3.760	2.170
Third quarter	(9/29-12/28)	1.660	0.910	(9/30-12/29)	4.160	2.320
Fourth quarter	(12/29-3/29)	1.510	1.210	(12/30-3/30)	4.630	3.450

Giga-tronics has not paid cash dividends in the past and has no plans to do so in the future, based upon its belief that the best use of its available capital is in the enhancement of its product position.

ITEM 6. SELECTED FINANCIAL DATA

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 1 to the consolidated financial statements). The impact of adopting SAB 101 was to increase earnings (loss) before the cumulative effect of the accounting change in the year ended March 31, 2001 by \$520,000, net of income taxes.

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SELECTED FINANCIAL DATA

Summary of Operations:	Year Ended				
(In thousands except per share data)	March 29, 2003	March 30, 2002	March 31, 2001	March 25, 2000	March 27, 1999
Net sales	\$ 22,281	\$ 39,036	\$ 54,159	\$ 47,577	\$ 37,636
Gross profit	5,903	11,535	19,056	15,810	11,534
Operating expenses	12,464	16,085	16,032	14,315	15,293
Interest income, net	60	63	205	59	121
Earnings (loss) before cumulative effect of accounting change and income taxes	(6,664)	(4,462)	3,461	1,633	(3,006)
Earnings (loss) before cumulative effect of accounting change	(10,762)	(2,102)	2,421	1,139	(1,858)
Cumulative effect of accounting change			(520)		
Net earnings (loss)	\$ (10,762)	\$ (2,102)	\$ 1,901	\$ 1,139	\$ (1,858)
Basic earnings (loss) per share:					
Before cumulative effect of accounting change	\$ (2.31)	\$ (0.46)	\$ 0.54	\$ 0.26	\$ (0.43)
Cumulative effect of accounting change			(0.12)		
Net earnings (loss) per share basic	(2.31)	(0.46)	0.42	0.26	(0.43)
Diluted earning (loss) per share:					
Before cumulative effect of accounting change	(2.31)	(.46)	.51	.24	(.43)
Cumulative effect of accounting change			(.11)		
Net earnings (loss) per share diluted	\$ (2.31)	\$ (0.46)	\$ 0.40	\$ 0.24	\$ (0.43)
Shares of common stock basic	4,663	4,604	4,474	4,379	4,338
Shares of common stock diluted	4,663	4,604	4,803	4,693	4,338

Financial Position:

(In thousands except ratio)	March 29, 2003	March 30, 2002	March 31, 2001	March 25, 2000	March 27, 1999
Current ratio	3.49	5.49	4.06	3.17	3.32
Working capital	\$ 13,622	\$ 23,135	\$ 22,924	\$ 21,066	\$ 18,021
Total assets	\$ 21,789	\$ 32,880	\$ 37,318	\$ 37,526	\$ 33,259
Shareholders equity	\$ 15,960	\$ 26,661	\$ 28,475	\$ 26,149	\$ 24,710

Percentage Data:

	March 29, 2003	March 30, 2002	March 31, 2001	March 25, 2000	March 27, 1999
Percent of net sales					
Gross profit	26.5%	29.6%	35.2%	33.2%	30.6%
Operating expenses	55.9	41.2	29.6	30.1	40.6
Interest income, net	0.3	0.2	0.4	0.1	0.3
Earnings (loss) before cumulative effect of accounting change and income taxes	(29.9)	(11.4)	6.4	3.4	(8.0)
Cumulative effect of accounting change			1.0		
Net earnings (loss)	(48.3)	(5.4)	3.5	2.4	(4.9)

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(In thousands except per share data)

	2003				
	First	Second	Third	Fourth	Year
Net sales	\$6,008	\$5,539	\$5,506	\$5,228	\$22,281
Gross profit	1,959	1,888	1,577	479	5,903
Operating expenses	3,644	3,159	2,719	2,942	12,464
Interest income, net	12	18	16	14	60
Loss before cumulative effect of accounting change and income taxes	1,699	1,298	1,180	2,487	6,664
Loss before cumulative effect of accounting change	1,599	1,298	5,478	2,387	10,762
Net loss	1,599	1,298	5,478	2,387	10,762
Net loss per share basic	\$ (0.34)	\$ (0.28)	\$ (1.17)	\$ (0.51)	\$ (2.31)
Net loss per share diluted	\$ (0.34)	\$ (0.28)	\$ (1.17)	\$ (0.51)	\$ (2.31)
Shares of common stock - basic	4,656	4,666	4,677	4,682	4,663
Shares of common stock - diluted	4,656	4,666	4,677	4,682	4,663

Quarterly Financial Information (Unaudited)

(In thousands except per share data)

	2002				
	First	Second	Third	Fourth	Year
Net sales	\$11,797	\$9,892	\$9,720	\$ 7,627	\$39,036
Gross profit	3,326	3,612	3,405	1,192	11,535
Operating expenses	4,332	4,060	3,824	3,869	16,085
Interest income, net	19	15	13	16	63
Loss before cumulative effect of accounting change and income taxes	(934)	(435)	(402)	(2,682)	(4,462)
Loss before cumulative effect of accounting change	(566)	(275)	(191)	(1,070)	(2,102)
Net loss	(566)	(275)	(191)	(1,070)	(2,102)
Net loss per share basic	\$ (0.12)	\$ (0.06)	\$ (0.04)	\$ (0.23)	\$ (0.46)
Net loss per share diluted	\$ (0.12)	\$ (0.06)	\$ (0.04)	\$ (0.23)	\$ (0.46)
Shares of common stock - basic	4,565	4,591	4,626	4,635	4,604
Shares of common stock - diluted	4,565	4,591	4,626	4,635	4,604

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

MANAGEMENT'S DISCUSSION AND ANALYSIS

Results of Operations for Fiscal 2003 as compared to 2002

New orders received in fiscal 2003 were \$18,086,000, a decrease of 12% from the \$20,461,000 received in fiscal 2002. New orders declined primarily due to the weakness in the commercial wireless market and major customer order cancellations during fiscal 2003 partially offset by increases in new military orders. New orders at Giga-tronics Instrument Division declined 17% to \$8,590,000 for the year. Orders at ASCOR increased 48% to \$4,866,000 primarily due to increased military orders. DYMATiX experienced a decline of 41% on new orders to \$1,738,000 for the fiscal year 2003. Orders at Microsource decreased 25% to \$2,892,000, which includes an order reversal of approximately \$750,000 due to a contract re-negotiation with a long-term customer. Backlog on March 29, 2003 was \$17,192,000 (about \$8,115,000 is expected to be shipped within one year) compared to \$21,387,000 (about \$7,475,000 was expected to be shipped within one year) on March 30, 2002. The decrease in backlog is primarily due to weak order levels at the Giga-tronics Instrument Division and Microsource offset by stronger order levels at ASCOR. Of the \$7,475,000 in orders considered shippable within one year at March 30, 2002, Giga-tronics subsequently rescheduled (and reclassified as not shippable within one year) shipments for orders of \$782,000 net and recorded cancellations of orders for \$605,000 throughout the year that ended March 29, 2003.

Net sales for fiscal 2003 were \$22,281,000, a 43% decrease from the \$39,036,000 in 2002. The reduction in sales was primarily due to fewer orders booked because of the general slowdown in the commercial wireless market. In fiscal 2003, Microsource revenues decreased 23% or \$2,349,000, on weak orders and customer stretch-outs. The Instrument Division sales decreased 57% or \$12,254,000 primarily due to weak orders. ASCOR sales increased 2% or \$62,000 primarily due to increased orders and higher backlog. Sales at DYMATiX decreased 60% or \$2,214,000 on weak orders primarily due to the reduction in capital equipment spending affecting the semiconductor manufacturing market.

Cost of sales decreased 40% in fiscal 2003 to \$16,378,000 from the \$27,501,000 in 2002. The decrease is primarily attributable to the 43% decline in sales offset with the write-off of inventory related to discontinued products.

Operating expenses decreased 23% or \$3,621,000 in fiscal 2003 over 2002 due to decreases of \$1,929,000 in Selling, general and administrative, \$335,000 in total amortization and \$1,357,000 in product development expenses. Product development costs decreased 19% or \$1,357,000 in fiscal 2003 primarily due to decreased product development expenses at the Instrument Division and Microsource offset by higher product development costs at DYMATiX related to the newest line of automation equipment. Selling, general and administrative expenses decreased 22% or \$1,929,000 for the fiscal year 2003 compared to the prior year. The decrease is a result of lower commission expense of \$581,000 on lower sales for the year coupled with \$602,000 less in administrative expenses and \$746,000 less in marketing expenses. These expense reductions were primarily personnel reductions and less rent expense on renegotiated lease terms. For fiscal year 2003 amortization of intangibles decreased 94% or \$335,000 as compared to last fiscal year. The decrease in the amortization of intangibles is primarily a result of reduced amortization of patents and licenses as well as the goodwill write-off at Microsource that occurred last year related to an impairment of this asset. Interest income in 2003 decreased from 2002 due to lower interest rates.

Giga-tronics recorded a net loss of \$10,762,000 or \$2.31 per fully diluted share for the fiscal year 2003 versus a net loss of \$2,102,000 or \$0.46 per fully diluted share in 2002. The loss for 2003 includes a one-time charge of approximately \$4,098,000 related to an increase in the allowance against the deferred tax benefit, in addition to approximately \$1,450,000 in restructuring and inventory write-offs related to discontinued products.

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Results of Operations for Fiscal 2002 as compared to 2001

New orders received in fiscal 2002 were \$20,461,000, a decrease of 65% from the \$57,830,000 received in 2001. New orders declined primarily due to the weakness in the overall wireless market and major customer order cancellations during fiscal 2002 partially offset by increases in new military orders. New orders at Giga-tronics Instrument Division declined 65% to \$10,357,000 for fiscal year 2002 after a net order cancellation of \$2,900,000. In fiscal 2002, a significant customer of the Instrument Division reduced ordering from the Company, primarily due to lower demand. The company expects the lower levels of business from this customer to continue. Orders at ASCOR declined 28% to \$3,296,000. DYMATiX experienced a decline of 55% on new orders to \$2,969,000 for the fiscal year 2002. Orders at Microsource decreased 77% to \$3,839,000, which includes \$5,120,000 order reversal for a customer that commenced liquidation proceedings. At year-end 2002, the Company's backlog of unfilled orders was \$21,387,000, compared to \$39,964,000 at the end of 2001. The decrease in backlog is primarily due to weak order levels at the Giga-tronics Instrument Division and Microsource. As of year-end 2002, there were approximately \$13,912,000 unfilled orders that were scheduled for shipment beyond a year and as of year end 2001 there were \$7,245,000 unfilled orders scheduled for shipment beyond a year. The increase in unfilled orders scheduled for shipment beyond a year is attributable primarily to Microsource's customers delaying shipments of their orders.

Net sales for 2002 were \$39,036,000, a 28% decrease from the \$54,159,000 in 2001. The reduction in sales was primarily due to fewer orders booked because of the slowdown in the commercial wireless market and stretch outs on existing orders in backlog. In fiscal 2002, Microsource revenues decreased 24% or \$3,172,000, on weak orders and customer stretch outs. Giga-tronics Instrument Division sales decreased 14% or \$3,442,000 and ASCOR sales decreased 50% or \$3,735,000 primarily due to weak orders at both of these segments. Sales at DYMATiX decreased 57% or \$4,774,000 on weak orders primarily due to customers delaying orders until their new product is released.

Cost of sales decreased 22% in fiscal 2002 to \$27,501,000 from the \$35,103,000 in 2001. The decrease is primarily attributable to the 28% decline in sales offset with higher costs for labor and material on the products shipped coupled with the write down of inventory and pre-production costs associated with the liquidation of a Microsource customer. Subsequent to year end, a telecommunications equipment customer of the Microsource Division commenced liquidation proceedings. As a result, the orders under the long term production contract with this customer were cancelled and Giga-tronics recorded a write-off of \$1,100,000 of inventory and pre-production costs.

Operating expenses increased less than 1% or \$50,000 in fiscal 2002 over 2001 due to decreases of \$1,984,000 in Selling, general and administrative and \$50,000 in total amortization offset by an increase of \$1,914,000 in product development expenses. Product development costs increased 38% or \$1,914,000 in fiscal 2002 primarily due to increased product development at DYMATiX and increased YIG product development costs at Microsource. Selling, general and administrative expenses decreased 19% or \$1,984,000 for the fiscal year 2002 compared to the prior year. The decrease was a result of lower commission expense of \$959,000 on lower sales for the year coupled with \$752,000 less in administrative expenses and \$322,000 less in marketing expenses primarily due to expense reduction measures taken during the year. These expense reductions were primarily personnel related. For fiscal year 2002 amortization of intangibles decreased 22% or \$50,000 as compared to last fiscal year. The decrease in the amortization of intangibles is primarily a result of reduced amortization of patents and licenses. The Company wrote off \$173,000 of remaining goodwill related to the Microsource acquisition as such goodwill was determined to be impaired. Interest income in 2002 decreased from 2001 due to lower interest rates.

Giga-tronics recorded a net loss of \$2,102,000, or \$0.46 per diluted share, in 2002 versus net earnings before cumulative effect of accounting change of \$2,421,000, or \$0.51 per diluted share, in 2001. The Company recorded \$520,000 for the cumulative effect of accounting change in fiscal 2001 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.

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Critical Accounting Policies

Management of Giga-tronics has identified the following as the Company's critical accounting policies:

Revenue

Revenues are recognized when there is evidence of an arrangement, delivery has occurred, the price is fixed or determinable, and collectability is reasonably assured. This generally occurs 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.

Inventory

Inventories are stated at the lower of cost or market. Cost is determined on a first-in, first-out basis. The Company periodically reviews inventory on hand to identify and write down excess and obsolete inventory based on estimated product demand.

Accounts Receivable

Accounts receivable are stated at the net realizable value. The Company has estimated an allowance for uncollectible accounts based on analysis of outstanding receivables, consideration of the age of those receivables, and the Company's historical collection experience.

Deferred Tax Assets

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 not realize benefits of these deductible differences as of March 29, 2003. Management has, therefore, established a valuation allowance against its net deferred tax assets as of March 29, 2003.

Product Development Costs

The Company incurs pre-production costs on certain long-term supply arrangements. The costs, which represent non-recurring engineering and tooling costs, are capitalized as other assets and amortized over their useful life when reimbursable by the customer. Otherwise, they are expensed as incurred.

Financial Condition and Liquidity

As of March 29, 2003, Giga-tronics had \$5,005,000 in cash and cash equivalents, compared to \$7,180,000 as of March 30, 2002. Cash used by operations amounted to \$1,996,000 in 2003 and cash provided by operations amounted to \$3,795,000 in 2002 and \$1,951,000 in 2001. Cash used by operations in 2003 is primarily attributed to the operating loss in the year offset by non-cash depreciation and amortization expenses, an increase in the deferred tax asset valuation allowance, and by the net change in operating assets and liabilities. Cash provided by operations in 2002 is attributed to accounts receivable collections, reduced inventory purchases and non-cash depreciation and amortization expenses offset by the operating loss in the year, and the net change in operating assets and liabilities. Cash provided by operations in 2001 is attributed to the operating income in the year and non-cash depreciation and amortization expenses, offset by a net change in operating assets and liabilities.

Giga-tronics had working capital at year-end of \$13,622,000 compared to \$23,135,000 in 2002 and \$22,924,000 in 2001. The Company's current ratio at March 29, 2003 was 3.5 compared to 5.5 in 2002 and 4.1 in 2001. The decrease in working capital is primarily a result of the increased allowance against the deferred income tax benefit and its operating loss in the current year.

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Additions to property and equipment were \$160,000 in 2003, compared to \$811,000 in 2002 and \$1,800,000 in 2001. Fiscal 2003 spending reflects continuing investments to support new product development, increased productivity, and improved product quality. Other cash inflows in 2003, 2002 and 2001 consist of \$61,000, \$239,000 and \$367,000, respectively, from the sale of common stock in connection with the exercise of stock options and purchases under the employee stock purchase plan.

The Company leases various facilities under various operating leases that expire through May 2013. Total future minimum lease payments under these leases amount to approximately \$6,958,000 as follows:

Fiscal years (In thousands)	
2004	\$ 1,286
2005	1,312
2006	1,325
2007	932
2008	341
Thereafter	1,762
	<hr/> \$ 6,958 <hr/>

The Company is committed to purchase certain inventory under non-cancelable purchase orders. As of March 29, 2003, total non-cancelable purchase orders were approximately \$1,142,000 through fiscal 2004 and \$187,000 beyond fiscal 2004 that are scheduled to be delivered to the Company at various dates through July 2004.

Management believes that the Company has adequate resources to meet its anticipated operating and capital expenditure needs for the foreseeable future. Giga-tronics intends to increase research and development expenditures for the purpose of broadening its product base. From time to time, Giga-tronics considers a variety of acquisition opportunities to also broaden its product lines and expand its markets. Such acquisition activity could also increase the Company's operating expenses and require the additional use of capital resources.

Outlook

The commercial wireless telecommunications market continues to be weak. All of our business segments have been impacted by the economic downturn currently affecting the test and measurement and semiconductor industries. Giga-tronics is uncertain of the duration and severity of this downturn in the markets we serve and the ultimate impact this will have on the Company. New orders in the military sector are showing strength, however new orders in many of our commercial markets have been severely impacted. In response to the current market conditions, Giga-tronics has implemented cost reductions, which include personnel reductions, pay cuts across all of the divisions for existing employees and reductions in monthly lease payments for our facilities. Giga-tronics will continue monitoring its cost structure in order to take the appropriate actions to reduce expenses and achieve profitability. Giga-tronics remains fully committed to the investment in new product development to expand our product lines and update our existing lines with additional features. While the Microsource management hopes 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 are timing delays associated with currently booked orders.

Recent Accounting Pronouncements

In August 2001, the Financial Accounting Standards Board (FASB) issued Statement No. 143, Accounting Obligations associated with the Retirement of Long-Lived Assets. SFAS No. 143 addresses financial accounting and reporting for the retirement obligation of an asset. SFAS No. 143 states that companies should recognize the asset retirement cost, at its fair value, as part of the asset cost and classify the accrued amount as a liability in the balance sheet. The asset retirement liability is then accreted to the ultimate payout as interest expense. The initial measurement of the liability would be subsequently updated for revised estimates of the discounted cash outflows. SFAS No. 143 was effective for fiscal years beginning after June 15, 2002. The Company does not expect the adoption of SFAS No. 143 will have a material effect on the Company's financial position or results of operations.

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In August 2001, the FASB issued Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Statement No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. Statement No. 144 retains the fundamental provisions in Statement No. 121 for recognizing and measuring impairment losses on long-lived assets held for use and long-lived assets to be disposed of by sale, while also resolving significant implementation issues associated with Statement No. 121. Statement No. 144 also retains the basic provisions of APB Opinion No. 30 on how to present discontinued operations in the statement of operations, but broadens that presentation to include a component of an entity (rather than a segment of a business). The Company adopted the provisions of Statement No. 144 effective March 31, 2002. The impact of adopting Statement No. 144 did not have a material effect on the Company's financial position or results of operations.

SFAS No. 145, Rescission of SFAS Statements No. 4, 44, and 64, Amendment of SFAS Statement No. 13, and Technical Corrections (SFAS 145), updates, clarifies and simplifies existing accounting pronouncements. SFAS 145 rescinds SFAS No. 4, Reporting Gains and Losses from Extinguishment of Debt. SFAS 145 amends SFAS No. 13, Accounting for Leases, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The provisions of SFAS 145 related to SFAS No.4 and SFAS No. 13 are effective for fiscal years beginning and transactions occurring after May 15, 2002, respectively. The Company does not expect the adoption of SFAS No. 145 will have a material effect on its financial position or results of operations.

In July 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, (SFAS 146), requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS 146 replaces Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). The provisions of SFAS 146 are to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The adoption of SFAS No. 146 did not have a material effect on the Company's financial position or results of operations.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45). FIN 45 requires a guarantor to (i) include disclosure of certain obligations and (ii) if applicable, at the inception of the guarantee, recognize a liability for the fair value of other certain obligations undertaken in issuing a guarantee. The disclosure provisions of the Interpretation are effective for financial statements of interim or annual reports that end after December 15, 2002. The adoption of FIN 45 required additional warranty activity disclosures for the Company. The recognition and measurement provisions of FIN 45 are effective for guarantees issued or modified after December 29, 2002. The adoption of FIN 45 did not have a material effect on the Company's financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure-An Amendment of FASB Statement No. 123. SFAS No. 148 amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for an entity that chooses to change to the fair-value-based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that statement to require prominent disclosure about the effects that accounting for stock-based employee compensation using the fair-value based method would have on reported net income and earnings per share and to require prominent disclosure about the entity's accounting policy decisions with respect to stock-based employee compensation. Certain of the disclosure requirements are required for all companies, regardless of whether the fair value method or intrinsic value method is used to account for stock-based employee compensation arrangements. The Company accounts for its stock option plan in accordance with the recognition and measurement principles of Accounting Principles Opinion No. 25, Accounting for Stock Issued to Employees. The amendments to SFAS No. 123 are effective for financial statements for fiscal years ended after December 15, 2002 and for interim periods beginning after December 15, 2002. The adoption of the disclosure requirements of SFAS No. 148 did not have a material effect on the Company's financial position or results of operations.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Financial instruments that expose the company to market risk are cash and cash equivalents. The investments are held in recognized financial instruments and have limited market risk due to the short-term maturities of the instruments.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CONSOLIDATED BALANCE SHEETS

(In thousands except share data)	March 29, 2003	March 30, 2002
Assets		
Current assets		
Cash and cash equivalents	\$ 5,005	\$ 7,180
Trade accounts receivable, net of allowance of \$353 and \$358, respectively	3,245	3,881
Inventories	10,244	11,369
Income tax refund receivable	100	701
Prepaid expenses	488	320
Deferred income taxes		4,841
	<u>19,082</u>	<u>28,292</u>
Total current assets	19,082	28,292
Property and equipment		
Leasehold improvements	674	408
Machinery and equipment	16,353	16,590
Office furniture and fixtures	1,162	1,162
	<u>18,189</u>	<u>18,160</u>
Property and equipment	18,189	18,160
Less accumulated depreciation and amortization	15,915	14,098
	<u>2,274</u>	<u>4,062</u>
Property and equipment, net	2,274	4,062
Patents and licenses		20
Other assets	433	506
	<u>21,789</u>	<u>32,880</u>
Total assets	\$ 21,789	\$ 32,880
Liabilities and shareholders equity		
Current liabilities		
Accounts payable	\$ 1,723	\$ 1,426
Accrued commissions	249	224
Accrued payroll and benefits	1,038	1,249
Accrued warranty	859	779
Customer advances	796	780
Obligations under capital lease	76	89
Other current liabilities	719	610
	<u>5,460</u>	<u>5,157</u>
Total current liabilities	5,460	5,157
Obligations under capital lease, net of current portion	10	94
Deferred income taxes		546
Deferred rent	359	422
	<u>5,829</u>	<u>6,219</u>
Total liabilities	5,829	6,219
Commitments		
Shareholders equity		
Preferred stock of no par value		
Authorized 1,000,000 shares; no shares outstanding at March 29, 2003 and March 30, 2002		

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Common stock of no par value;		
Authorized 40,000,000 shares; 4,693,080 shares at		
March 29, 2003 and 4,648,944 shares at		
March 30, 2002 issued and outstanding	12,695	12,634
Retained earnings	3,265	14,027
	<u> </u>	<u> </u>
Total shareholders' equity	15,960	26,661
	<u> </u>	<u> </u>
Total liabilities and shareholders' equity	\$ 21,789	\$ 32,880
	<u> </u>	<u> </u>

See Accompanying Notes to Consolidated Financial Statements

Table of Contents**CONSOLIDATED STATEMENTS OF OPERATIONS**

	Years ended			
	(In thousands except share data)	March 29, 2003	March 30, 2002	March 31, 2001
Net sales		\$ 22,281	\$ 39,036	\$ 54,159
Cost of sales		16,378	27,501	35,103
Gross profit		5,903	11,535	19,056
Product development		5,644	7,001	5,087
Selling, general and administrative		6,800	8,729	10,713
Amortization of intangibles		20	182	232
Goodwill impairment			173	
Operating expenses		12,464	16,085	16,032
Operating income (loss)		(6,561)	(4,550)	3,024
Other income (expense)		(163)	25	232
Interest income, net		60	63	205
Earnings (loss) before provision (benefit) for income taxes and cumulative effect of accounting change		(6,664)	(4,462)	3,461
Provision (benefit) for income taxes		4,098	(2,360)	1,040
Earnings (loss) before cumulative effect of accounting change		(10,762)	(2,102)	2,421
Cumulative effect of accounting change				(520)
Net earnings (loss)		\$(10,762)	\$ (2,102)	\$ 1,901
Basic earnings (loss) per share:				
Before cumulative effect of accounting change		\$ (2.31)	\$ (0.46)	\$ 0.54
Cumulative effect of accounting change				(0.12)
Basic earnings (loss) per share		\$ (2.31)	\$ (0.46)	\$ 0.42
Diluted earnings (loss) per share:				
Before cumulative effect of accounting change		\$ (2.31)	\$ (0.46)	\$ 0.51
Cumulative effect of accounting change				(0.11)
Diluted earnings (loss) per share		\$ (2.31)	\$ (0.46)	\$ 0.40
Weighted average basic common shares outstanding		4,663	4,604	4,474
Weighted average diluted common shares outstanding		4,663	4,604	4,803

See Accompanying Notes to Consolidated Financial Statements

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EQUITY AND COMPREHENSIVE INCOME (LOSS)**

(In thousands except share data)	Common Stock		Comprehensive Income (Loss)	Other Comprehensive Income (Loss)	Retained Earnings	Total
	Shares	Amount				
Balance at March 25, 2000	4,431,008	\$ 11,921	\$	\$	\$ 14,228	\$ 26,149
Comprehensive Income net						
Net earnings			1,901		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
Comprehensive Income net						
Net earnings			(2,102)		(2,102)	(2,102)
Stock issuance under stock option plans	106,250	239				239
Tax benefit associated with exercise of stock options		49				49
Balance at March 30, 2002	4,648,944	\$ 12,634	\$	\$	\$ 14,027	\$ 26,661
Comprehensive Income net						
Net earnings			(10,762)		(10,762)	(10,762)
Stock issuance under stock option plans	44,136	61				61
Balance at March 29, 2003	4,693,080	\$ 12,695	\$	\$	\$ 3,265	\$ 15,960

See Accompanying Notes to Consolidated Financial Statements

Table of Contents**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Years ended (In thousands)	March 29, 2003	March 30, 2002	March 31, 2001
Cash flows provided from operations:			
Net earnings (loss)	\$(10,762)	\$(2,102)	\$ 1,901
Adjustments to reconcile net earnings (loss) to net cash (used in) provided by operations:			
Provision for bad debt	(5)	96	8
Depreciation and amortization	1,954	2,216	2,120
Impairment of Goodwill		173	
Tax benefit from employee stock options		49	58
(Gain) Loss on sales of fixed assets	7	(1)	(20)
Deferred income taxes	4,295	(1,531)	(205)
Changes in operating assets and liabilities:			
Trade accounts receivable	641	3,799	1,419
Inventories	1,125	3,939	(1,072)
Prepaid expenses	(168)	229	20
Accounts payable	297	(1,921)	(718)
Accrued commissions	25	(211)	(190)
Accrued payroll and benefits	(211)	(438)	49
Accrued warranty	80	47	179
Accrued other expenses	109	62	(613)
Customer advances	16	90	(846)
Income taxes receivable/payable	601	(701)	(139)
Net cash (used in) provided by operations	(1,996)	3,795	1,951
Cash flows from investing activities:			
Proceeds from sale of property and equipment	7	13	26
Purchases of property and equipment	(160)	(708)	(1,645)
Other assets	73	603	(489)
Net cash used in investing activities	(80)	(92)	(2,108)
Cash flows from financing activities:			
Issuance of common stock	61	239	367
Payment on notes payable and other long term liabilities	(63)	(29)	(78)
Payments on capital leases	(97)	(202)	(118)
Net cash (used in) provided by financing activities	(99)	8	171
(Decrease) increase in cash and cash equivalents	(2,175)	3,711	14
Beginning cash and cash equivalents	7,180	3,469	3,455
Ending cash and cash equivalents	5,005	7,180	3,469
Supplementary disclosure of cash flow information:			
Cash paid for income taxes	\$ 6	\$ 56	\$ 988
Cash paid for interest	1	21	4
Non-cash investing and financing activities:			
Purchases under capital lease obligations		103	155

See Accompanying Notes to Consolidated Financial Statements

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 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. During March 2002 the Company closed its United Kingdom (UK) research & development facility. The Company currently 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 2003 and 2002 contained 52 weeks, while fiscal year 2001 contained 53 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 The Company records revenue in accordance with SAB 101, *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 reasonably 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 has not entered into any long-term contracts that would require revenue recognition in accordance with Statement of Position 81-1. Further, sales made to distributors do not include price protection or product return rights, except for product defects covered under warranty arrangements. The Company has no other post-shipment 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 adopted the provisions of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others*, in December 2002. For the required disclosures regarding a reconciliation of changes in the Company's product warranty liabilities, see Note 10 to the consolidated financial statements.

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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 at the beginning of fiscal year 2001. The adoption of SAB 101 resulted in the deferral of \$2,165,000 in revenue as of the beginning of the 2001 fiscal year, and subsequent recognition of the deferred sales during the year.

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 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.

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.

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. Future tax benefits are subject to a valuation allowance when management is unable to conclude that its deferred tax assets will more likely than not be realized from the results of operations.

Patents and Licenses Patents and licenses are being amortized using the straight-line method over periods of five to seven years. As of March 29, 2003 and March 30, 2002 accumulated amortization on patents and licenses was \$2,196,000 and \$2,176,000, respectively.

Goodwill The Company amortized goodwill using the straight-line method over a period of five years. In March 2002, the Company determined that the remaining goodwill balance was impaired and recorded an impairment charge on the remaining balance of \$173,000.

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, are capitalized as other assets and amortized over their useful life when reimbursable by the customer. Otherwise, they are expensed as incurred. Subsequent to fiscal 2002 year end, a telecommunications equipment customer of the Microsource division commenced liquidation proceedings. As a result, the orders under the long-term production contract with this customer were cancelled and Giga-tronics recorded a write-off of \$1,100,000 of inventory and pre-production costs in the fourth quarter of fiscal 2002. Included in other assets as of March 29, 2003 and March 30, 2002 were capitalized pre-production costs of \$341,000, and \$431,000, 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

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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. 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 29, 2003	March 30, 2002	March 31, 2001
Net earnings (loss)			
As reported	\$(10,762)	\$(2,102)	\$ 1,901
Pro-forma	(10,965)	(2,373)	1,537
Net earnings (loss) per share basic			
As reported	(2.31)	(0.46)	0.42
Pro-forma	(2.35)	(0.52)	0.34
Net earnings (loss) per share diluted			
As reported	(2.31)	(0.46)	0.40
Pro-forma	(2.35)	(0.52)	0.32

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 29, 2003	March 30, 2002	March 31, 2001
Expected life of options	4 years	4 years	4 years
Expected life of purchase rights	6 mos	6 mos	6 mos
Annualized volatility	60%	60%	60%
Risk-free interest rate	2.90 to 4.49	4.39 to 4.93	4.64 to 6.30
Dividend yield	Zero	Zero	Zero

Earnings (Loss) Per Share Basic earnings (loss) per share is 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 consist principally of cash, cash equivalents and trade accounts receivable. The Company's cash equivalents consist principally of overnight deposits and money market funds. 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 In August 2001, the Financial Accounting Standards Board (FASB) issued Statement No. 143, *Accounting Obligations associated with the Retirement of Long-Lived Assets*. SFAS No. 143 addresses financial accounting and reporting for the retirement obligation of an asset. SFAS No. 143 states that companies should recognize the asset retirement cost, at its fair value, as part of the asset cost and classify the accrued amount as a liability in the balance sheet. The asset retirement liability is then accreted to the ultimate payout as interest expense. The initial measurement of the liability would be subsequently updated for revised

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estimates of the discounted cash outflows. SFAS No. 143 was effective for fiscal years beginning after June 15, 2002. The Company does not expect the adoption of SFAS No. 143 will have a material effect on the Company's financial position or results of operations.

In August 2001, the FASB issued Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Statement No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. Statement No. 144 retains the fundamental provisions in Statement No. 121 for recognizing and measuring impairment losses on long-lived assets held for use and long-lived assets to be disposed of by sale, while also resolving significant implementation issues associated with Statement No. 121. Statement No. 144 also retains the basic provisions of APB Opinion No. 30 on how to present discontinued operations in the statement of operations, but broadens that presentation to include a component of an entity (rather than a segment of a business). The Company adopted the provisions of Statement No. 144 effective March 31, 2002. The impact of adopting Statement No. 144 did not have a material effect on the Company's financial position or results of operations.

SFAS No. 145, Rescission of SFAS Statements No. 4, 44, and 64, Amendment of SFAS Statement No. 13, and Technical Corrections (SFAS 145), updates, clarifies and simplifies existing accounting pronouncements. SFAS 145 rescinds SFAS No. 4, Reporting Gains and Losses from Extinguishment of Debt. SFAS 145 amends SFAS No. 13, Accounting for Leases, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The provisions of SFAS 145 related to SFAS No.4 and SFAS No. 13 are effective for fiscal years beginning and transactions occurring after May 15, 2002, respectively. The Company does not expect the adoption of SFAS No. 145 will have a material effect on its financial position or results of operations.

In July 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, (SFAS 146), requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS 146 replaces Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). The provisions of SFAS 146 are to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The adoption of SFAS No. 146 did not have a material effect on the Company's financial position or results of operations.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45). FIN 45 requires a guarantor to (i) include disclosure of certain obligations and (ii) if applicable, at the inception of the guarantee, recognize a liability for the fair value of other certain obligations undertaken in issuing a guarantee. The disclosure provisions of the Interpretation are effective for financial statements of interim or annual reports that end after December 15, 2002. The adoption of FIN 45 required additional warranty activity disclosures for the Company. The recognition and measurement provisions of FIN 45 are effective for guarantees issued or modified after December 29, 2002. The adoption of FIN 45 did not have a material effect on the Company's financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure-An Amendment of FASB Statement No. 123. SFAS No. 148 amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for an entity that chooses to change to the fair-value-based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that statement to require prominent disclosure about the effects that accounting for stock-based employee compensation using the fair-value based method would have on reported net income and earnings per share and to require prominent disclosure about the entity's accounting policy decisions with respect to stock-based employee compensation. Certain of the disclosure requirements are required for all companies, regardless of whether the fair value method or intrinsic value method is used to account for stock-based employee compensation arrangements. The Company accounts for its stock option plan in accordance with the recognition and measurement principles of Accounting Principles Opinion No. 25, Accounting for Stock Issued to Employees. The amendments to SFAS No. 123 are effective for financial statements for fiscal years ended after December 15,

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2002 and for interim periods beginning after December 15, 2002. The adoption of the disclosure requirements of SFAS No. 148 did not have a material effect on the Company's financial position or results of operations.

2 Cash and Cash Equivalents

Cash and cash equivalents consisted of the following at March 29, 2003 and March 30, 2002:

	Cash and Cash Equivalents	
	March 29, 2003 (In thousands)	
	Amortized Cost	Fair Value
Cash	\$ 943	\$ 943
Money market funds	4,062	4,062
	<u> </u>	<u> </u>
Cash and cash equivalents	\$ 5,005	\$ 5,005
	<u> </u>	<u> </u>

	Cash and Cash Equivalents	
	March 30, 2002 (In thousands)	
	Amortized Cost	Fair Value
Cash	\$ 1,245	\$ 1,245
Money market funds	5,935	5,935
	<u> </u>	<u> </u>
Cash and cash equivalents	\$ 7,180	\$ 7,180
	<u> </u>	<u> </u>

3 Inventories

	Years ended (In thousands)	
	March 29, 2003	March 30, 2002
Raw materials	\$ 4,669	\$ 6,157
Work-in-progress	3,427	3,852
Finished goods	1,096	683
Demonstration inventory	1,052	677
	<u> </u>	<u> </u>
	\$ 10,244	\$ 11,369
	<u> </u>	<u> </u>

4 Selling Expenses

Selling expenses consist primarily of commissions paid to various marketing agencies. Commission expense totaled \$1,039,000, \$1,620,000, and \$2,579,000 in fiscal 2003, 2002, and 2001, respectively. Advertising costs which are expensed as incurred totaled \$144,000, \$362,000, and \$579,000 for fiscal 2003, 2002, and 2001, respectively.

5 Significant Customers and Industry Segment Information

The Company has five reportable segments: Giga-tronics Instrument 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. Corporate handles the financing needs of each segment and lends funds to each segment as required.

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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. Segment net sales includes sales to external customers. Segment pre-tax loss includes an allocation for corporate expenses, amortization of goodwill, and interest expense on borrowings from Corporate. Corporate expenses are allocated to the reportable segments based principally on full time equivalent headcount. Interest expense is charged at approximately prime which is currently 5% 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 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 Instrument Division 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 2003, 2002 and 2001:

March 29, 2003 (In thousands):

	Instrument Division	ASCOR	Microsource	DYMATiX	Corporate	Total
Revenue	\$ 9,305	\$3,830	\$ 7,687	\$ 1,459	\$	\$22,281
Interest income	17	28	2		61	108
Interest expense	(36)		(460)	(258)	706	(48)
Depreciation and amortization	556	108	1,250	40		1,954
Pre-tax income (loss)	(3,477)	(473)	(999)	(2,594)	879	(6,664)
Assets	9,492	4,559	7,480	3,596	(3,338)	21,789

March 30, 2002 (In thousands):

	Instrument Division	ASCOR	Microsource	DYMATiX	Corporate	Total
Revenue	\$ 21,559	\$3,768	\$10,036	\$ 3,673	\$	\$39,036
Interest income	28	74	0	4	69	175
Interest expense	(130)	0	(561)	(234)	813	(112)
Depreciation and amortization	593	138	1,408	77		2,216
Income before taxes and accounting change	(548)	(655)	(3,011)	(1,182)	934	(4,462)
Assets	12,122	3,479	9,661	4,037	3,581	32,880

March 31, 2001 (In thousands):

	Instrument Division	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
Income before taxes and accounting change	1,193	1,436	(985)	434	1,383	3,461
Assets	15,518	4,172	11,937	5,236	455	37,318

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The Company's Giga-tronics Instrument Division, ASCOR, and Microsource segments sell to agencies of the U.S. Government and U.S. defense-related customers. In fiscal 2003, 2002, and 2001 U.S. Government and U.S. defense-related customers accounted for 39%, 17%, and 11%, of sales, respectively. During fiscal 2003, a Japanese distributor of the Company, Midoriya, accounted for less than 10% of the Company's revenues and a negligible amount outstanding in accounts receivable. During 2002 and 2001, Midoriya accounted for 16% and 10% of the Company's consolidated sales, respectively. At fiscal 2002 year end, Midoriya had a negligible amount outstanding in accounts receivable while they composed about 11% of receivables at the fiscal year end of 2001.

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Export sales accounted for 23%, 44%, and 41% of the Company's sales in fiscal 2003, 2002, and 2001, respectively. Export sales by geographical area are shown below:

Years ended (In thousands)	March 29, 2003	March 30, 2002	March 31, 2001
Americas	\$ 306	\$ 1,112	\$ 4,256
Europe	2,075	4,860	6,831
Asia	1,766	9,412	9,512
Rest of world	964	1,721	1,473
	<u>\$5,111</u>	<u>\$17,105</u>	<u>\$22,072</u>

6 Earnings (loss) per Share

Net earnings (loss) and shares used in per share computations for the years ended March 29, 2003, March 30, 2002 and March 31, 2001 are as follows:

Years ended (In thousands except per share data)	March 29, 2003	March 30, 2002	March 31, 2001
Net earnings (loss)	\$(10,762)	\$(2,102)	\$ 1,901
Weighted average:			
Common shares outstanding	4,663	4,604	4,474
Potential common shares			329
Common shares assuming dilution	4,663	4,604	4,803
Net earnings (loss) per share of common stock	\$ (2.31)	\$ (0.46)	\$ 0.42
Net earnings (loss) per share of common stock assuming dilution	\$ (2.31)	\$ (0.46)	\$ 0.40
Stock options not included in computation	528	550	57

The number of stock options not included in the computation of diluted earnings per share (EPS) for the period ended March 29, 2003 and March 30, 2002 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 period ending March 31, 2001 reflects stock options where the exercise prices were greater than the average market price of the common shares and are therefore antidilutive.

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

Years ended (In thousands)	March 29, 2003	March 30, 2002	March 31, 2001
Current:			
Federal	\$	\$ (760)	\$ 1,063
State	4	4	66
	4	(756)	1,129
Deferred:			
Federal	2,885	(1,143)	58
State	1,200	(510)	(263)
	4,085	(1,653)	(205)
Charge in lieu of taxes attributable to employer stock option plans	9	49	58
Goodwill, for initial recognition of acquired tax benefits that previously were included in the valuation allowance			58
Provision (benefit) for income taxes	\$ 4,098	\$ (2,360)	\$ 1,040

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 29, 2003	March 30, 2002
Current tax assets, net	\$ 0	\$ 4,841
Noncurrent tax asset (liabilities)	0	(546)
Net deferred taxes	\$ 0	\$ 4,295
Future state tax effect	(417)	(274)
Allowance for doubtful accounts	151	154
Fixed asset depreciation	(203)	(586)
Inventory reserves and additional costs capitalized	3,272	3,309
Accrued vacation	152	191
Accrued warranty	368	334
Other accrued liabilities	256	217
Net operating loss carryforward	7,469	5,964
Income tax credits	1,894	1,317
Valuation allowances	(12,942)	(6,331)
	\$ 0	\$ 4,295

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Years ended (In thousands except percentages)	March 29, 2003		March 30, 2002		March 31, 2001	
Statutory federal income tax (benefit)	\$(2,266)	(34.0)%	\$(1,517)	(34.0)%	\$1,176	34.0%
Beginning of year change in deferred Tax asset valuation allowance	7,176	107.8	117	2.6		
State income tax, net of federal benefit	(253)	(3.8)	(143)	(3.2)	200	5.8
Nontax deductible expenses	9	0.1	9	0.2	6	0.2
Tax credits	(577)	(8.7)	(894)	(20.0)	(297)	(8.6)
Goodwill and patent amortization			142	3.2	60	1.7
Interest income exempt from federal tax			(82)	(1.8)	(58)	(1.7)
Other	9	.1	8	.3	(47)	(1.4)
Effective income tax expense (benefit)	\$ 4,098	61.5%	\$(2,360)	(52.7)%	\$ 1,040	30.0%

The change in valuation allowance from March 30, 2002 to March 29, 2003 an increase of was \$6,611,000. The change in valuation allowance from March 31, 2001 to March 30, 2002 was a decrease of \$161,000. The change in valuation allowance from March 25, 2000 to March 31, 2001 was a decrease of \$395,000.

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. The Company is presently unable to conclude that its deferred tax assets will more likely than not be realized from the results of operations. Accordingly, the Company has provided a valuation allowance on its net deferred tax assets for the year ended March 29, 2003.

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 are allocated to goodwill and the remainder to income tax benefit. As of March 31, 2002, goodwill had been reduced by \$452,000 for the tax benefits realized from the Microsource deferred tax assets.

During the year ended March 30, 2002 and March 31, 2001, disqualifying employee stock option dispositions resulted in an income tax deduction to the Company of approximately \$122,000 and \$145,000 respectively, and a tax benefit of approximately \$49,000 and \$58,000 respectively. The tax benefit has been reflected as an increase to the Company's paid-in capital in the accompanying financial statements.

8 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 agreements 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. Holders of options may be granted stock appreciation rights (SARs), 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 29, 2003, no SARs have been granted under the option plan. As of March 29, 2003, the total number of shares of common stock available for issuance is 385,350 under the 2000 stock option plan. All outstanding options have a term of five years.

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Following is a summary of stock option activity:

	Per Share Weighted Average Fair Value Of Options Granted	Options Exercisable	Total Options Outstanding	Weighted Average Fair Value
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
Exercised			(67,275)	2.163
Forfeited			(145,437)	3.783
Granted	\$ 4.290		168,150	4.290
Outstanding as of March 30, 2002		194,437	550,174	\$ 3.838
Exercised			(12,188)	2.094
Forfeited			(113,750)	4.097
Granted	\$ 2.605		104,000	2.605
Outstanding as of March 29, 2003		269,874	528,236	\$ 3.580

Options Outstanding and Exercisable as of March 29, 2003, by Price Range

Range of Exercise Prices	Total Options Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Options Exercisable	Weighted Average Exercise Price
From \$1.22 to \$2.09	173,036	1.31	\$ 1.968	148,036	\$ 2.094
From \$2.12 to \$5.75	303,700	2.99	3.895	96,088	3.865
From \$6.13 to \$8.88	51,500	2.38	7.140	25,750	7.140
From \$1.22 to \$8.88	528,236	2.38	\$ 3.580	269,874	\$ 3.206

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 29, 2003, 67,337 shares remain available for issuance under the Purchase Plan. The weighted average fair value of the purchase rights granted in fiscal 2003 was \$1.100.

401(k) Plan The Company has established 401(k) plans which cover substantially all employees. Participants may make voluntary contributions to the plans 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 2003, 2002, and 2001 were approximately \$159,000, \$185,000, and \$208,000, respectively.

9 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 33,439 square foot facility located in Santa Rosa, California, under a twenty-year lease that commenced in July 1993 and amended in April 2003. These facilities accommodate all of the Company's present operations. The Company also has acquired equipment under capital and leases other equipment under operating leases. The future minimum lease payments for operating equipment and facility leases are shown below:

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Fiscal years (In thousands)	
<hr/>	
2004	\$1,286
2005	1,312
2006	1,325
2007	932
2008	341
Thereafter	1,762
	<hr/>
	\$6,958
	<hr/>

The aggregate rental expense was \$2,063,000, \$1,951,000, and \$1,816,000 in fiscal 2003, 2002, and 2001, respectively.

As of March 29, 2003, Property and Equipment includes equipment under capital lease of \$241,000 and related accumulated amortization of \$95,000. As of March 30, 2002, Property and Equipment includes equipment under capital lease of \$491,000 and related accumulated amortization of \$223,000. The future minimum lease payments for capital leases are shown below:

Fiscal years (In thousands)	
<hr/>	
2004	\$81
2005	10
	<hr/>
Total	91
Less interest costs	5
	<hr/>
Present value of minimum lease payments	86
Less current portion	76
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Long term portion of capital lease obligations	\$10
	<hr/>

The Company is committed to purchase certain inventory under non-cancelable purchase orders. As of March 29, 2003, total non-cancelable purchase orders were approximately \$1,142,000 through fiscal 2004 and \$187,000 beyond fiscal 2004 and were scheduled to be delivered to the Company at various dates through March 2004.

10 Warranty Obligations

The Company records a liability for estimated warranty obligations at the date products are sold. Adjustments are made as new information becomes available. The provisions of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others*, which the Company adopted in December 2002, require disclosures about the guarantees that an entity has issued, including a reconciliation of changes in the entity's product warranty liabilities. The following provides a reconciliation of changes in the Company's warranty reserve. The Company provides no other guarantees.

Years ended	March 29,	March 30,	March 31,
(In thousands)	2003	2002	2001
<hr/>			
Balance at beginning of year	\$ 779	\$ 731	\$ 553
Provision for current year sales	750	875	794
Warranty costs incurred	(670)	(827)	(616)

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Balance at end of year	<u>\$ 859</u>	<u>\$ 779</u>	<u>\$ 731</u>
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INDEPENDENT AUDITORS REPORT

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 29, 2003 and March 30, 2002, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the years in the three year period ended March 29, 2003. 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 29, 2003 and March 30, 2002, and the results of their operations and their cash flows for each of the years in the three year period ended March 29, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, effective March 26, 2000, the Company changed its method of accounting for certain equipment sales.

/s/
KPMG LLP

Mountain View, California
May 2, 2003

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES.

Not applicable.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information regarding directors of the Company is set forth under the heading "Election of Directors" of the Company's Proxy Statement for its 2003 Annual Meeting of Shareholders, incorporated herein by reference. This Proxy Statement is to be filed no later than 120 days after the close of the fiscal year ended March 29, 2003.

GIGA-TRONICS INCORPORATED
EXECUTIVE OFFICERS

Name	Age	Position
George H. Bruns, Jr.	84	Chief Executive Officer since January, 1995, Chairman of the Board and a Director of the Company. He provided seed financing for the Company in 1980 and has been a Director since inception. Mr. Bruns is General Partner of The Bruns Company, a private venture investment and management consulting firm. Mr. Bruns is Director of Testronics, Inc. of McKinney, Texas.
Mark H. Cosmez II	51	Vice President, Finance/Chief Financial Officer, Giga-tronics since October 1997. Before joining Giga-tronics, Mr. Cosmez was the Chief Financial Officer for Pacific Bell Public Communications. Prior to 1997, he was the Vice President of Finance and Chief Financial Officer for International Microcomputer Software Inc., a NASDAQ-traded software company.
Jeffrey T. Lum	57	President, ASCOR, Inc. since November 1987. Mr. Lum founded ASCOR in 1987 and has been President since inception. Before founding ASCOR, Mr. Lum was Vice President and founder of Autek Systems Corporation.
Daniel S. Markowitz	52	President, DYMATiX, a joint venture between Ultracision, Inc. and Viking Semiconductor Equipment, Inc. since January 2000. Also, President of Ultracision, Inc. and Viking Semiconductor Equipment, Inc. since April 1999. Assistant to the Chairman of Giga-tronics, Inc. from September 1998 to March 1999. Vice President, Automation Products, Ultracision, Inc. from February 1996 to August 1998. Mr. Markowitz was the General Manager of Mar Engineering from September 1993 to January 1996. Mar Engineering is a manufacturer of precision machined components for the aerospace industry.
William E. Wilson	63	President of Microsource, Inc. since April 2001. Mr. Wilson has been a director of the Company since December 1998. Before joining the Company as the President of Microsource, Inc., Mr. Wilson was the Chairman and CEO of Microwave Technology Incorporated of Fremont, CA, a producer of

Microwave Devices and Amplifiers with broad application to defense electronics, telecommunications and the test and measurement industries.

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ITEM 11. EXECUTIVE COMPENSATION

Information regarding the Company's compensation of its executive officers is set forth under the heading "Executive Compensation" of the Company's Proxy Statement for its 2003 Annual Meeting of Shareholders, incorporated herein by reference. This Proxy Statement is to be filed no later than 120 days after the close of the fiscal year ended March 29, 2003.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

Information regarding security ownership of certain beneficial owners and management is set forth under the heading "Stock Ownership of Certain Beneficial Owners and Management" of its Proxy Statement for the 2003 Annual Meeting of Shareholders, incorporated herein by reference. Information about securities authorized for issuance under equity compensation plans is set forth under the heading "Equity Compensation Plan Information" of its Proxy Statement for the 2003 Annual Meeting of Shareholders, incorporated herein by reference. This Proxy Statement is to be filed no later than 120 days after the close of the fiscal year ended March 29, 2003.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information set forth in the Proxy Statement under the section captioned "Transactions with Management and Others" is incorporated herein by reference.

ITEM 14. CONTROLS AND PROCEDURES

Within the 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in ensuring that all material information required to be included in this annual report have been made known to them in a timely fashion. There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a)(1) Financial Statements

The following financial statements and schedules are filed or incorporated by reference as a part of this report.

INDEX TO FINANCIAL STATEMENTS AND SCHEDULES

Financial Statements	Form 10K (Page No.)
Consolidated Balance Sheets - As of March 29, 2003 and March 30, 2002	19
Consolidated Statements of Operations - Years Ended March 29, 2003, March 30, 2002 and March 31, 2001	20
Consolidated Statements of Shareholders Equity and Comprehensive Income (Loss) - Years Ended March 29, 2003, March 30, 2002 and March 31, 2001	21
Consolidated Statements of Cash Flows - Years Ended March 29, 2003, March 30, 2002 and March 31, 2001	22
Notes to Consolidated Financial Statements	23 - 33
Independent Auditors Report	34
	Form 10-K (Page No.)
(a)(2) Schedules	
Report on Financial Statement Schedule and Consent of Independent Auditors	43
Schedule II - Valuation and Qualifying Accounts	44

All other schedules are not submitted because they are not applicable or not required or because the required information is included in the financial statements or notes thereto.

Except for those portions thereof incorporated by reference in this Form 10-K, the 2003 Annual Report and the Proxy Statement are not to be deemed filed as part of this report.

(a)(3) Exhibits

Reference is made to the Exhibit Index which is found on page 41 of this Annual Report on Form 10-K.

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the quarter ended March 29, 2003.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

GIGA-TRONICS INCORPORATED

By /s/ GEORGE H. BRUNS JR.

 George H. Bruns, Jr.
 Chairman of the Board and
 Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ GEORGE H. BRUNS JR _____ George H. Bruns, Jr.	Chairman of the Board and Chief Executive Officer (Principal Executive Officer)	5/27/2003 _____ (Date)
/s/ MARK H. COSMEZ II _____ Mark H. Cosmez II	Vice President, Finance, Chief Financial Officer and Secretary (Principal Accounting Officer)	5/27/2003 _____ (Date)
/s/ JAMES A. COLE _____ James A. Cole	Director	5/20/2003 _____ (Date)
/s/ KENNETH A HARVEY _____ Kenneth A. Harvey	Director	5/22/2003 _____ (Date)
/s/ ROBERT C. WILSON _____ Robert C. Wilson	Director	5/23/2003 _____ (Date)
/s/ WILLIAM E. WILSON _____ William E. Wilson	Director	5/22/2003 _____ (Date)

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**CERTIFICATIONS UNDER
SECTION 302 OF
THE SARBANES OXLEY ACT OF 2002**

I, George H. Bruns, Jr., certify that:

1. I have reviewed this annual report on Form 10-K of Giga-tronics Incorporated;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 27, 2003

/s/ GEORGE H. BRUNS JR.

George H. Bruns, Jr.
Chief Executive Officer

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**CERTIFICATIONS UNDER
SECTION 302 OF
THE SARBANES OXLEY ACT OF 2002**

I, Mark H. Cosmez II, certify that:

1. I have reviewed this annual report on Form 10-K of Giga-tronics Incorporated;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 27, 2003

/s/ MARK H. COSMEZ II

Mark H. Cosmez II
Chief Financial Officer

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GIGA-TRONICS INCORPORATED
INDEX TO EXHIBITS

3.1	Articles of Incorporation of the Registrant, as amended, previously filed as Exhibit 3.1 to Form 10-K for the fiscal year ended March 27, 1999 and incorporated herein by reference.
3.2	By-laws of Registrant, as amended, previously filed as Exhibit 3.2 to Form 10-K for the fiscal year ended March 28, 1998, and incorporated herein by reference.
4.1	Rights Agreement dated as of November 6, 1998 between Giga-tronics Incorporated and ChaseMellon Shareholder Services LLC, as previously filed on November 9, 1998 as Exhibit 4.1 to Form 8-K and incorporated herein by reference.
10.1	1990 Restated Stock Option Plan and form of Incentive Stock Option Agreement, previously filed on November 3, 1997 as Exhibit 99.1 to Form S-8 (33-39403) and incorporated herein by reference.**
10.2	Standard form Indemnification Agreement for Directors and Officers, previously filed on June 21, 1999, as Exhibit 10.2 to Form 10-K for the fiscal year ended March 27, 1999 and incorporated herein by reference.**
10.3	Lease between Giga-tronics Incorporated and Calfront Associates for 4650 Norris Canyon Road, San Ramon, CA, dated December 6, 1993, previously filed as Exhibit 10.12 to Form 10-K for the fiscal year ended March 26, 1994 and incorporated herein by reference.
10.4	Employee Stock Purchase Plan, previously filed on August 29, 1997, as Exhibit 99.1 to Form S-8 (33-34719), and incorporated herein by reference.**
10.8	2000 Stock Option Plan and form of Incentive Stock Option Agreement, previously filed on September 8, 2000 as Exhibit 99.1 to Form S-8 (33-45476) and incorporated herein by reference.**
21*	Significant Subsidiaries.
23.1*	Report on Financial Statement Schedule and Consent of Independent Auditors. (See page 43 of this Annual Report on Form 10-K.)
99.1*	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 Chief Executive Officer.
99.2*	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 Chief Financial Officer.

* Attached as exhibits to this Form 10-K.

** Management contract or compensatory plan or arrangement.

ed reasonable indemnity to the Indenture Trustee to institute that proceeding in its own name as trustee, and

(3)

the Indenture Trustee has failed to institute any proceeding, and has not received from the registered owners of a majority in aggregate principal amount of the outstanding Senior Debt Securities of all series in respect of which an event of default under the Indenture exists, considered as one class, a direction inconsistent with that request, within 60 days after that notice, request and offer. (Indenture, Section 807).

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However, these limitations do not apply to a suit instituted by a registered owner of a Senior Debt Security for the enforcement of payment of the principal of or premium, if any, or interest on that Senior Debt Security on or after the applicable due date specified in that Senior Debt Security. (Indenture, Section 808).

FPL Group Capital is required to deliver to the Indenture Trustee an annual statement as to its compliance with all conditions and covenants under the Indenture. (Indenture, Section 606).

Modification and Waiver. Without the consent of any registered owner of Senior Debt Securities, FPL Group Capital and the Indenture Trustee may amend or supplement the Indenture for any of the following purposes:

- (1) to provide for the assumption by any permitted successor to FPL Group Capital of FPL Group Capital's obligations under the Indenture and the Senior Debt Securities in the case of a merger or consolidation or a conveyance, transfer or lease of its assets substantially as an entirety,

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- (2) to add covenants of FPL Group Capital or to surrender any right or power conferred upon FPL Group Capital by the Indenture,
- (3) to add any additional events of default,
- (4) to change, eliminate or add any provision of the Indenture, provided that if that change, elimination or addition will materially adversely affect the interests of the registered owners of Senior Debt Securities of any series or tranche, that change, elimination or addition will become effective with respect to that series or tranche only
 - (a) when the required consent of the registered owners of Senior Debt Securities of that series or tranche has been obtained, or
 - (b) when no Senior Debt Securities of that series or tranche remain outstanding under the Indenture,
- (5) to provide collateral security for all but not a part of the Senior Debt Securities,
- (6) to establish the form or terms of Senior Debt Securities of any other series or tranche,
- (7) to provide for the authentication and delivery of bearer securities and the related coupons and for other matters relating to those bearer securities,
- (8) to accept the appointment of a successor Indenture Trustee with respect to the Senior Debt Securities of one or more series and to change any of the provisions of the Indenture as necessary to provide for the administration of the trusts under the Indenture by more than one trustee,
- (9) to add procedures to permit the use of a non-certificated system of registration for the Senior Debt Securities of all or any series or tranche,
- (10) to change any place where
 - (a) the principal of and premium, if any, and interest on all or any series or tranche of Senior Debt Securities are payable,
 - (b) all or any series or tranche of Senior Debt Securities may be transferred or exchanged, and
 - (c) notices and demands to or upon FPL Group Capital in respect of Senior Debt Securities and the Indenture may be served, or
- (11) to cure any ambiguity or inconsistency or to add or change any other provisions with respect to matters and questions arising under the Indenture, provided those changes or additions may not materially adversely affect the interests of the registered owners of Senior Debt Securities of any series or tranche. (Indenture, Section 1201).

The registered owners of a majority in aggregate principal amount of the Senior Debt Securities of all series then outstanding may waive compliance by FPL Group Capital with certain restrictive provisions of the Indenture. (Indenture, Section 607). The registered owners of a majority in principal amount of the outstanding Senior Debt Securities of any series may waive any past default under the Indenture with respect to that series, except a default in the payment of principal, premium, if any, or interest and a default with respect to certain restrictive covenants or provisions of the Indenture that cannot be modified or amended without the consent of the registered owner of each outstanding

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Senior Debt Security of that series affected. (Indenture, Section 813).

In addition to any amendments described above, if the Trust Indenture Act of 1939 is amended after the date of the Indenture in a way that requires changes to the Indenture or in a way that permits changes to, or the elimination of, provisions that were previously required by the Trust Indenture Act of 1939, the Indenture will be deemed to be amended to conform to that amendment of the Trust Indenture Act of 1939 or to make those changes,

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additions or eliminations. FPL Group Capital and the Indenture Trustee may, without the consent of any registered owners, enter into supplemental indentures to make that amendment. (Indenture, Section 1201).

Except for any amendments described above, the consent of the registered owners of a majority in aggregate principal amount of the Senior Debt Securities of all series then outstanding, considered as one class, is required for all other modifications to the Indenture. However, if less than all of the series of Senior Debt Securities outstanding are directly affected by a proposed supplemental indenture, then the consent only of the registered owners of a majority in aggregate principal amount of outstanding Senior Debt Securities of all directly affected series, considered as one class, is required. But, if FPL Group Capital issues any series of Senior Debt Securities in more than one tranche and if the proposed supplemental indenture directly affects the rights of the registered owners of Senior Debt Securities of less than all of those tranches, then the consent only of the registered owners of a majority in aggregate principal amount of the outstanding Senior Debt Securities of all directly affected tranches, considered as one class, will be required. However, none of those amendments or modifications may:

- (1) change the dates on which the principal of or interest on a Senior Debt Security is due without the consent of the registered owner of that Senior Debt Security,
- (2) reduce any Senior Debt Security's principal amount or rate of interest (or the amount of any installment of that interest) or change the method of calculating that rate without the consent of the registered owner of that Senior Debt Security,
- (3) reduce any premium payable upon the redemption of a Senior Debt Security without the consent of the registered owner of that Senior Debt Security,
- (4) change the currency (or other property) in which a Senior Debt Security is payable without the consent of the registered owner of that Senior Debt Security,
- (5) impair the right to sue to enforce payments on any Senior Debt Security on or after the date that it states that the payment is due (or, in the case of redemption, on or after the redemption date) without the consent of the registered owner of that Senior Debt Security,
- (6) reduce the percentage in principal amount of the outstanding Senior Debt Security of any series or tranche whose owners must consent to an amendment, supplement or waiver without the consent of the registered owner of each outstanding Senior Debt Security of that series or tranche,
- (7) reduce the requirements for quorum or voting of any series or tranche without the consent of the registered owner of each outstanding Senior Debt Security of that series or tranche, or
- (8) modify certain of the provisions of the Indenture relating to supplemental indentures, waivers of certain covenants and waivers of past defaults with respect to the Senior Debt Securities of any series or tranche, without the consent of the registered owner of each outstanding Senior Debt Security affected by the modification.

A supplemental indenture that changes or eliminates any provision of the Indenture that has expressly been included only for the benefit of one or more particular series or tranches of Senior Debt Securities, or that modifies the rights of the registered owners of Senior Debt Securities of that series or tranche with respect to that provision, will not affect the rights under the Indenture of the registered owners of the Senior Debt Securities of any other series or tranche. (Indenture, Section 1202).

The Indenture provides that, in order to determine whether the registered owners of the required principal amount of the outstanding Senior Debt Securities have given any request, demand, authorization, direction, notice, consent or waiver under the Indenture, or whether a quorum is present at the meeting of the registered owners of Senior Debt Securities, Senior Debt Securities owned by FPL Group Capital or any other obligor upon the Senior Debt Securities or any affiliate of FPL Group Capital or of that other obligor (unless FPL Group Capital, that affiliate or that obligor owns all Senior Debt Securities outstanding under the Indenture, determined without regard to this provision) will be disregarded and deemed not to be outstanding. (Indenture, Section 101).

If FPL Group Capital solicits any action under the Indenture from registered owners of Senior Debt Securities, FPL Group Capital may, at its option, by signing a written request to the Indenture Trustee, fix in advance a record date for determining the registered owners of Senior Debt Securities entitled to take that action. However, FPL Group Capital will not be obligated to do this. If FPL Group Capital fixes such a record date, that action may be taken before or after that record date, but only the registered owners of record at the close of business on that record date will be deemed to be registered owners of Senior Debt Securities for the purposes of determining whether registered owners of the required proportion of the outstanding Senior Debt Securities have authorized that action. For these purposes, the outstanding Senior Debt Securities will be computed as of the record date. Any action of a registered owner of any Senior Debt Security under the Indenture will bind every future registered owner of that Senior Debt Security, or any Senior Debt Security replacing that Senior Debt Security, with respect to anything that the Indenture Trustee or FPL Group Capital do, fail to do, or allow to be done in reliance on that action, whether or not that action is noted upon that Senior Debt Security. (Indenture, Section 104).

Resignation and Removal of Indenture Trustee. The Indenture Trustee may resign at any time with respect to any series of Senior Debt Securities by giving written notice of its resignation to FPL Group Capital. Also, the registered owners of a majority in principal amount of the outstanding Senior Debt Securities of one or more series of Senior Debt Securities may remove the Indenture Trustee at any time with respect to the Senior Debt Securities of that series, by delivering an instrument evidencing this action to the Indenture Trustee and FPL Group Capital. The resignation or removal of the Indenture Trustee and the appointment of a successor trustee will not become effective until a successor trustee accepts its appointment.

Except with respect to an Indenture Trustee appointed by the registered owners of Senior Debt Securities, the Indenture Trustee will be deemed to have resigned and the successor will be deemed to have been appointed as trustee in accordance with the Indenture if:

- (1) no event of default under the Indenture or event that, after notice or lapse of time, or both, would become an event of default under the Indenture exists, and
- (2) FPL Group Capital has delivered to the Indenture Trustee a resolution of its Board of Directors appointing a successor trustee and that successor trustee has accepted that appointment in accordance with the terms of the Indenture. (Indenture, Section 910).

Notices. Notices to registered owners of Senior Debt Securities will be sent by mail to the addresses of those registered owners as they appear in the security register for those Senior Debt Securities. (Indenture, Section 106).

Title. FPL Group Capital, the Indenture Trustee, and any agent of FPL Group Capital or the Indenture Trustee, may treat the person in whose name a Senior Debt Security is registered as the absolute owner of that Senior Debt Security, whether or not that Senior Debt Security is overdue, for the purpose of making payments and for all other purposes, regardless of any notice to the contrary. (Indenture, Section 308).

Governing Law. The Indenture and the Senior Debt Securities will be governed by, and construed in accordance with, the laws of the State of New York, without regard to New York's conflict of law principles, except to the extent that the law of any other jurisdiction is mandatorily applicable. (Indenture, Section 112).

DESCRIPTION OF THE FPL GROUP GUARANTEE OF THE FPL GROUP CAPITAL SENIOR DEBT SECURITIES

General. This section briefly summarizes some of the provisions of the Guarantee Agreement, dated as of June 1, 1999, between FPL Group and The Bank of New York, as Guarantee Trustee. The Guarantee Agreement was executed for the benefit of the Indenture Trustee, which holds the Guarantee Agreement for the benefit of registered owners of the Senior Debt Securities covered by the Guarantee Agreement. This summary does not contain a complete description of the Guarantee Agreement. You should read this summary together with the Guarantee Agreement for a complete understanding of all the provisions. The Guarantee Agreement has been previously filed with the SEC and is an exhibit to the registration statement filed with the SEC of which this prospectus is a part. In addition, the Guarantee Agreement is qualified as an indenture under the Trust Indenture Act

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of 1939 and is therefore subject to the provisions of the Trust Indenture Act of 1939. You should read the Trust Indenture Act of 1939 for a complete understanding of its provisions.

Under the Guarantee Agreement, FPL Group absolutely, irrevocably and unconditionally guarantees the prompt and full payment, when due and payable (including upon acceleration or redemption), of the principal, interest and premium, if any, on the Senior Debt Securities that are covered by the Guarantee Agreement to the registered owners of those Senior Debt Securities, according to the terms of those Senior Debt Securities and the Indenture. Pursuant to the Guarantee Agreement, all of the Senior Debt Securities are covered by the Guarantee Agreement except Senior Debt Securities that by their terms are expressly not entitled to the benefit of the Guarantee Agreement. All of the Offered Senior Debt Securities will be covered by the Guarantee Agreement. This guarantee is referred to in this prospectus as the "Guarantee." FPL Group is only required to make these payments if FPL Group Capital fails to pay or provide for punctual payment of any of those amounts on or before the expiration of any applicable grace periods. (Guarantee Agreement, Section 5.01). In the Guarantee Agreement, FPL Group has waived its right to require the Guarantee Trustee, the Indenture Trustee or the registered owners of Senior Debt Securities covered by the Guarantee Agreement to exhaust their remedies against FPL Group Capital prior to bringing suit against FPL Group. (Guarantee Agreement, Section 5.06).

The Guarantee is a guarantee of payment when due (i.e., the guaranteed party may institute a legal proceeding directly against FPL Group to enforce its rights under the Guarantee Agreement without first instituting a legal proceeding against any other person or entity). The Guarantee is not a guarantee of collection. (Guarantee Agreement, Section 5.01).

Except as otherwise stated in the related prospectus supplement, the covenants in the Guarantee Agreement would not give registered owners of the Senior Debt Securities covered by the Guarantee Agreement protection in the event of a highly-leveraged transaction involving FPL Group.

Security and Ranking. The Guarantee is an unsecured obligation of FPL Group and will rank equally and ratably with all other unsecured and unsubordinated indebtedness of FPL Group. The Guarantee will rank senior to the Preferred Trust Securities Guarantee, the Subordinated Guarantee and the FPL Group Junior Subordinated Debentures (each as defined below) and FPL Group's guarantee of FPL Group Capital's preferred stock. There is no limit on the amount of other indebtedness, including guarantees, that FPL Group may incur or issue.

FPL Group is a holding company that derives substantially all of its income from its operating subsidiaries. Therefore, the Guarantee is effectively subordinated to all indebtedness and other liabilities, including trade payables, debt and preferred stock, incurred or issued by FPL Group's subsidiaries. Neither the Indenture nor the Guarantee Agreement places any limit on the amount of liabilities, including debt or preferred stock, that FPL Group's subsidiaries may issue, guarantee or otherwise incur.

Events of Default. An event of default under the Guarantee Agreement will occur upon the failure of FPL Group to perform any of its payment obligations under the Guarantee Agreement. (Guarantee Agreement, Section 1.01). The registered owners of a majority of the aggregate principal amount of the outstanding Senior Debt Securities covered by the Guarantee Agreement have the right to:

- (1) direct the time, method and place of conducting any proceeding for any remedy available to the Guarantee Trustee under the Guarantee Agreement, or
- (2) direct the exercise of any trust or power conferred upon the Guarantee Trustee under the Guarantee Agreement. (Guarantee Agreement, Section 3.01).

The Guarantee Trustee must give notice of any event of default under the Guarantee Agreement known to the Guarantee Trustee to the registered owners of Senior Debt Securities covered by the Guarantee Agreement within 90 days after the occurrence of that event of default, in the manner and to the extent provided in subsection (c) of Section 313 of the Trust Indenture Act of 1939, unless such event of default has been cured or waived prior to the giving of such notice. (Guarantee Agreement, Section 2.07). The registered owners of all outstanding Senior Debt Securities may waive any past event of default and its consequences. (Guarantee Agreement, Section 2.06).

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The Guarantee Trustee, the Indenture Trustee and the registered owners of Senior Debt Securities covered by the Guarantee Agreement have all of the rights and remedies available under applicable law and may sue to enforce the terms of the Guarantee Agreement and to recover damages for the breach of the Guarantee Agreement. The remedies of each of the Guarantee Trustee, the Indenture Trustee and the registered owners of Senior Debt Securities covered by the Guarantee Agreement, to the extent permitted by law, are cumulative and in addition to any other remedy now or hereafter existing at law or in equity. At the option of any of the Guarantee Trustee, the Indenture Trustee or the registered owners of Senior Debt Securities covered by the Guarantee Agreement, that person or entity may join FPL Group in any lawsuit commenced by that person or entity against FPL Group Capital with respect to any obligations under the Guarantee Agreement. Also, that person or entity may recover against FPL Group in that lawsuit, or in any independent lawsuit against FPL Group, without first asserting, prosecuting or exhausting any remedy or claim against FPL Group Capital. (Guarantee Agreement, Section 5.06).

FPL Group is required to deliver to the Guarantee Trustee an annual statement as to its compliance with all conditions under the Guarantee Agreement. (Guarantee Agreement, Section 2.04).

Modification. FPL Group and the Guarantee Trustee may, without the consent of any registered owner of Senior Debt Securities covered by the Guarantee Agreement, agree to any changes to the Guarantee Agreement that do not materially adversely affect the rights of registered owners. The Guarantee Agreement also may be amended with the prior approval of the registered owners of a majority in aggregate principal amount of all outstanding Senior Debt Securities covered by the Guarantee Agreement. However, the right of any registered owner of Senior Debt Securities covered by the Guarantee Agreement to receive payment under the Guarantee Agreement on the due date of the Senior Debt Securities held by that registered owner, or to institute suit for the enforcement of that payment on or after that due date, may not be impaired or affected without the consent of that registered owner. (Guarantee Agreement, Section 6.01).

Termination of the Guarantee Agreement. The Guarantee Agreement will terminate and be of no further force and effect upon full payment of all Senior Debt Securities covered by the Guarantee Agreement. (Guarantee Agreement, Section 5.05).

Governing Law. The Guarantee Agreement will be governed by and construed in accordance with the laws of the State of New York, without regard to conflict of laws principles thereunder, except to the extent that the law of any other jurisdiction is mandatorily applicable. (Guarantee Agreement, Section 5.07).

DESCRIPTION OF FPL GROUP SENIOR DEBT SECURITIES

FPL Group will issue its debt securities (other than the FPL Group Junior Subordinated Debentures (as defined below under "Description of the FPL Group and FPL Group Capital Junior Subordinated Debentures and the FPL Group Subordinated Guarantee")), in one or more series, under an Indenture, between FPL Group and The Bank of New York, as trustee. The terms of any offered debt securities will be described in a supplement to this prospectus.

DESCRIPTION OF FPL GROUP COMMON STOCK

General. The following statements describing FPL Group's common stock are not intended to be a complete description. For additional information, please see FPL Group's Restated Articles of Incorporation, as amended ("Charter"), and its bylaws, which set forth the terms of the common stock. Please also see the Mortgage and Deed of Trust, dated as of January 1, 1944, between Florida Power & Light Company and Deutsche Bank Trust Company Americas, as trustee, as amended and supplemented (the "Mortgage"), which contains restrictions which may limit the ability of Florida Power & Light Company to pay dividends to FPL Group. Each of these documents has been previously filed with the SEC and they are exhibits to the registration statement filed with the SEC of which this prospectus is a part. Reference is also made to the laws of the State of Florida.

FPL Group's authorized capital stock consists of 800,000,000 shares of common stock, \$.01 par value, and 100,000,000 shares of serial preferred stock, \$.01 par value. As of March 31, 2007, 406,415,900 shares of common stock were issued and outstanding and no shares of serial preferred stock were issued and outstanding. The FPL Group common stock has no preemptive, subscription or conversion rights, and there are no redemption or sinking fund provisions applicable thereto. The outstanding shares of common stock are, and when issued the shares offered

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hereby will be, fully paid and nonassessable. In some cases, the issuance of preferred stock could make it difficult for another company to acquire FPL Group and make it harder to remove current management. See "Description of Preferred Stock and FPL Group Guarantee of FPL Group Capital Preferred Stock FPL Group Preferred Stock" below.

All outstanding FPL Group common stock is listed on the NYSE and trades under the symbol "FPL." The registrar and transfer agent for the FPL Group common stock is Computershare Investor Services, LLC.

A number of provisions that are in FPL Group's Charter and bylaws will make it difficult for another company to acquire FPL Group and for a holder of FPL Group common stock to receive any related takeover premium for its shares. See " Voting Rights and Non-Cumulative Voting" and "Description of Preferred Stock and FPL Group Guarantee of FPL Group Capital Preferred Stock FPL Group Preferred Stock" below.

Dividend Rights. Each share of common stock is entitled to participate equally with respect to dividends declared on the common stock out of funds legally available for the payment thereof.

FPL Group's Charter does not limit the dividends that can be paid on the common stock. However, as a practical matter, the ability of FPL Group to pay dividends on the common stock is dependent upon, among other things, dividends paid to it by its subsidiaries, including Florida Power & Light Company. Florida Power & Light Company's ability to pay dividends is limited by restrictions contained in the Mortgage. However, these restrictions do not currently limit Florida Power & Light Company's ability to pay dividends to FPL Group from its retained earnings.

FPL Group Capital has issued junior subordinated debentures in connection with preferred trust securities previously issued by FPL Group Capital Trust I, which junior subordinated debentures are guaranteed by FPL Group. FPL Group Capital has the right, from time to time, to defer the payment of interest on its outstanding junior subordinated debentures for a deferral period of up to 20 consecutive quarters. FPL Group Capital has also issued two series of junior subordinated debentures not in connection with preferred trust securities, which junior subordinated debentures are guaranteed by FPL Group. FPL Group Capital has the right, from time to time, to defer the payment of interest on these outstanding junior subordinated debentures on one or more occasions for up to 10 consecutive years. FPL Group, Florida Power & Light Company and/or FPL Group Capital may issue, from time to time, additional junior subordinated debentures. FPL Group, Florida Power & Light Company and/or FPL Group Capital may have similar rights to defer the payment of interest on those additional junior subordinated debentures. If FPL Group Capital and/or FPL Group exercises any such right to defer the payment of interest, FPL Group would not be able to pay dividends on its common stock or preferred stock during the periods when such payments are delayed with certain limited exceptions. If Florida Power & Light Company exercises any such right to defer the payment of interest, it would not be able to pay dividends to any holder of its common stock or preferred stock, including FPL Group, during the periods when such payments are delayed with certain limited exceptions. In addition, FPL Group, FPL Group Capital and Florida Power & Light Company may issue other securities in the future that have a similar right to delay interest or distribution payments and similar dividend restrictions in the event of the exercise of such rights.

In addition, FPL Group may issue one or more series of its serial preferred stock, \$.01 par value, without the approval of its shareholders. Each series may have terms that differ from those of any other series and may provide for dividend, liquidation, voting and other rights that are superior or prior to those of FPL Group's common stock.

Voting Rights and Non-Cumulative Voting. In general, the holders of FPL Group common stock are entitled to one vote per share for the election of directors and for other corporate purposes. The Charter:

- (1) permits the shareholders to remove a director only for cause and only by the affirmative vote of 75% in voting power of the outstanding shares of common stock and other outstanding voting stock, voting as a class;
- (2) provides that a vacancy on the Board of Directors may be filled only by the remaining directors;

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- (3) permits shareholders to take action only at an annual meeting, or a special meeting duly called by certain officers, the Board of Directors or the holders of a majority in voting power of the outstanding shares of voting stock entitled to vote on the matter;
- (4) requires the affirmative vote of 75% in voting power of the outstanding shares of voting stock to approve certain Business Combinations (as defined below) with an Interested Shareholder (as defined below) or its affiliate, unless approved by a majority of the Continuing Directors (as defined below) or, in certain cases, unless certain minimum price and procedural requirements are met; and
- (5) requires the affirmative vote of 75% in voting power of the outstanding shares of voting stock to amend the bylaws or to amend certain provisions of the Charter including those provisions discussed in (1) through (4) above.

Such provisions may have significant effects on the ability of the shareholders to change the composition of an incumbent Board of Directors or to benefit from certain transactions which are opposed by an incumbent Board of Directors.

The term "Interested Shareholder" is defined in the Charter to include a security holder who owns 10% or more in voting power of the outstanding shares of voting stock, and the term "Continuing Director" is defined in the Charter to include any director who is not an affiliate of an Interested Shareholder. The above provisions dealing with Business Combinations involving FPL Group and an Interested Shareholder may discriminate against a security holder who becomes an Interested Shareholder by reason of the beneficial ownership of such amount of common or other voting stock. The term "Business Combination" is defined in the Charter to include:

- (1) any merger or consolidation of FPL Group or any direct or indirect majority-owned subsidiary with (a) an Interested Shareholder or (b) any other corporation which is, or after such merger or consolidation would be, an affiliate of an Interested Shareholder;
- (2) any sale, lease, exchange, mortgage, pledge, transfer or other disposition in one transaction or a series of transactions to or with any Interested Shareholder or any affiliate of an Interested Shareholder of assets of FPL Group or any direct or indirect majority-owned subsidiary having an aggregate fair market value of \$10,000,000 or more;
- (3) the issuance or transfer by FPL Group or any direct or indirect majority-owned subsidiary in one transaction or a series of transactions of any securities of FPL Group or any subsidiary to any Interested Shareholder or any affiliate of any Interested Shareholder in exchange for cash, securities or other property, or a combination thereof, having an aggregate fair market value of \$10,000,000 or more;
- (4) the adoption of any plan or proposal for the liquidation or dissolution of FPL Group proposed by or on behalf of an Interested Shareholder or an affiliate of an Interested Shareholder; or
- (5) any reclassification of securities, including any reverse stock split, or recapitalization, of FPL Group, or any merger or consolidation of FPL Group with any of its direct or indirect majority-owned subsidiaries or any other transaction which has the direct or indirect effect of increasing the proportionate share of the outstanding shares of any class of equity or convertible securities of FPL Group or any direct or indirect wholly-owned subsidiary which is directly or indirectly owned by any Interested Shareholder or any affiliate of any Interested Shareholder.

The holders of common stock do not have cumulative voting rights, and therefore the holders of more than 50% of a quorum (majority) of the outstanding shares of common stock can elect all of FPL Group's directors. Unless otherwise provided in the Charter or the bylaws or in accordance with applicable law, the affirmative vote of a majority of the total number of shares represented at a meeting and entitled to vote is required for shareholder action on a matter. Voting rights for the election of directors or otherwise, if any, for any series of the serial preferred stock, will be established by the Board of Directors when such series is issued. See "Description of Preferred Stock and FPL Group Guarantee of FPL Group Capital Preferred Stock FPL Group Preferred Stock" below.

Liquidation Rights. After satisfaction of creditors and payments due the holders of serial preferred stock, if any, the holders of common stock are entitled to share ratably in the distribution of all remaining assets. See "Description of Preferred Stock and FPL Group Guarantee of FPL Group Capital Preferred Stock" below.

DESCRIPTION OF PREFERRED STOCK AND FPL GROUP GUARANTEE OF FPL GROUP CAPITAL PREFERRED STOCK

General. The following statements describing FPL Group's preferred stock and FPL Group Capital's preferred stock are not intended to be a complete description. For additional information, please see FPL Group's Charter and its bylaws, and FPL Group Capital's Articles of Incorporation, as amended ("FPL Group Capital's Charter"), and its bylaws, respectively. You should read this summary together with the articles of amendment to FPL Group's Charter or FPL Group Capital's Charter, as applicable, which will describe the terms of any preferred stock to be offered hereby, for a complete understanding of all the provisions. With respect to the FPL Group preferred stock and the guarantee of the FPL Group Capital preferred stock, please also see the Mortgage, which contains restrictions which may limit the ability of Florida Power & Light Company to pay dividends to FPL Group. Each of these documents has been previously filed with the SEC and each is an exhibit to the registration statement filed with the SEC of which this prospectus is a part. Reference is also made to the laws of the State of Florida.

FPL Group Preferred Stock. FPL Group may issue one or more series of its serial preferred stock, \$.01 par value, without the approval of its shareholders.

Some terms of a series of preferred stock may differ from those of another series. A prospectus supplement will describe the terms of any preferred stock being offered. These terms will also be described in articles of amendment to FPL Group's Charter, which will establish the terms of the preferred stock being offered. These terms will include any of the following that apply to that series:

- (1) the title of that series of preferred stock,
- (2) the number of shares in the series,
- (3) the dividend rate, or how such rate will be determined, and the dividend payment dates for the series,
- (4) whether the series will be listed on a securities exchange,
- (5) the date or dates on which the series of preferred stock may be redeemed at the option of FPL Group and any restrictions on such redemptions,
- (6) any sinking fund or other provisions that would obligate FPL Group to repurchase, redeem or retire the series of preferred stock,
- (7) the amount payable on the series of preferred stock in case of the liquidation, dissolution or winding up of FPL Group and any additional amount, or method of determining such amount, payable in case any such event is voluntary,
- (8) any rights to convert the shares of the series of preferred stock into shares of another series or into shares of any other class of capital stock,
- (9) the voting rights, if any, and
- (10) any other terms that are not inconsistent with the provisions of FPL Group's Charter.

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In some cases, the issuance of preferred stock could make it difficult for another company to acquire FPL Group and make it harder to remove current management. See also "Description of FPL Group Common Stock."

If FPL Group Capital or FPL Group exercises a right to defer the payment of interest on junior subordinated debentures, including those junior subordinated debentures issued in connection with preferred trust

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securities, FPL Group will not be able to pay dividends on its common or preferred stock during the periods such payments are delayed with certain limited exceptions. If the trusts formed by Florida Power & Light Company issue preferred trust securities and Florida Power & Light Company exercises a right to defer the payment of interest on junior subordinated debentures issued in connection with preferred trust securities, Florida Power & Light Company will not be able to pay dividends on its common stock or preferred stock during the periods when such payments are delayed with certain limited exceptions. In addition, FPL Group, FPL Group Capital and Florida Power & Light Company may issue other securities in the future that have a similar right to delay interest or distribution payments and similar dividend restrictions in the event of the exercise of such rights. See "Description of FPL Group Common Stock Dividend Rights" in this prospectus.

Shares of preferred stock offered hereby by FPL Group will, when issued, be fully paid and non-assessable.

FPL Group Capital Preferred Stock. FPL Group Capital may issue one or more series of serial preferred stock, \$.01 par value, without the approval of its shareholders. The preferred stock of FPL Group Capital will be fully and unconditionally guaranteed by FPL Group as described below.

Some terms of a series of preferred stock may differ from those of another series. A prospectus supplement will describe the terms of any preferred stock being offered. These terms will also be described in articles of amendment to FPL Group Capital's Charter, which will establish the terms of the preferred stock being offered. These terms will include any of the following that apply to that series:

- (1) the title of that series of preferred stock,
- (2) the number of shares in the series,
- (3) the dividend rate, or how such rate will be determined, and the dividend payment dates for the series,
- (4) whether the series will be listed on a securities exchange,
- (5) the date or dates on which the series of preferred stock may be redeemed at the option of FPL Group Capital and any restrictions on such redemptions,
- (6) any sinking fund or other provisions that would obligate FPL Group Capital to repurchase, redeem or retire the series of preferred stock,
- (7) the amount payable on the series of preferred stock in case of the liquidation, dissolution or winding up of FPL Group Capital and any additional amount, or method of determining such amount, payable in case any such event is voluntary,
- (8) any rights to convert the shares of the series of preferred stock into shares of another series or into shares of any other class of capital stock,
- (9) the voting rights, if any, and
- (10) any other terms that are not inconsistent with the provisions of FPL Group Capital's Charter.

If FPL Group Capital exercises a right to defer the payment of interest on junior subordinated debentures, including those junior subordinated debentures issued in connection with preferred trust securities, FPL Group Capital will not be able to pay dividends on its common or preferred stock during the periods such payments are delayed with certain limited exceptions. In addition, FPL Group Capital may issue other securities in the future that have a similar right to delay interest or distribution payments and similar dividend restrictions in the event of the exercise of such rights. See "Description of FPL Group Common Stock Dividend Rights" in this prospectus.

Shares of preferred stock offered hereby by FPL Group Capital will, when issued, be fully paid and non-assessable.

FPL Group Guarantee of FPL Group Capital Preferred Stock. FPL Group will fully, unconditionally and irrevocably guarantee the payment of accumulated and unpaid dividends, and payments due on liquidation or redemption, as and when due, regardless of any defense, right of set-off or counterclaim that FPL Group Capital may have or assert. FPL Group's guarantee of FPL Group Capital's preferred stock will be an unsecured obligation of FPL Group and will rank (1) subordinate and junior in right of payment to all other liabilities of FPL Group (except those made pari passu or subordinate by their terms), (2) equal in right of payment with the most senior preferred or preference stock that may be issued by FPL Group and with any other guarantee that may be entered into by FPL Group in respect of any preferred or preference stock of any affiliate of FPL Group, and (3) senior to FPL Group's common stock. A prospectus supplement will describe the terms of FPL Group's guarantee of FPL Group Capital's preferred stock. The description will not necessarily be complete, and reference will be made to the preferred stock guarantee agreement.

FPL Group is a holding company that derives substantially all of its income from its operating subsidiaries. Therefore, the FPL Group guarantee of FPL Group Capital preferred stock will be effectively subordinated to all indebtedness and other liabilities, including trade payables, debt and preferred stock, incurred or issued by FPL Group's subsidiaries. FPL Group's guarantee of FPL Group Capital preferred stock does not place any limit on the amount of liabilities, including debt or preferred stock, that FPL Group's subsidiaries may issue, guarantee or otherwise incur.

DESCRIPTION OF STOCK PURCHASE CONTRACTS AND STOCK PURCHASE UNITS

FPL Group may issue stock purchase contracts, including contracts that obligate holders to purchase from FPL Group, and FPL Group to sell to these holders, a specified number of shares of common stock or preferred stock at a future date or dates. The consideration per share of common stock or preferred stock may be fixed at the time the stock purchase contracts are issued or may be determined by reference to a specific formula set forth in the stock purchase contracts. The stock purchase contracts may be issued separately or as a part of stock purchase units consisting of a stock purchase contract and either debt securities of FPL Group Capital, debt securities of FPL Group, preferred trust securities of one or more FPL Group subsidiary trusts or other subsidiary entities (including, but not limited to, Preferred Trust Securities (as defined herein)), or debt securities of third parties including, but not limited to, U.S. Treasury securities, that would secure the holders' obligations to purchase the common stock or preferred stock under the stock purchase contracts. The stock purchase contracts may require FPL Group to make periodic payments to the holders of some or all of the stock purchase units or vice versa, and such payments may be unsecured or prefunded on some basis. The stock purchase contracts may require holders to secure their obligations under these stock purchase contracts in a specified manner.

A prospectus supplement will describe the terms of any stock purchase contracts or stock purchase units being offered. The description in the prospectus supplement will not necessarily be complete, and reference will be made to the stock purchase contracts.

DESCRIPTION OF PREFERRED TRUST SECURITIES

General. The Trust may issue preferred trust securities and common trust securities under the Trust Agreement. The terms of the agreements pursuant to which the preferred trust securities of FPL Group Capital Trust will be issued is herein referred to as the "FPL Group Capital Trust Agreement," and the Trust Agreement pursuant to which preferred trust securities of FPL Group Trust will be issued is herein referred to as the "FPL Group Trust Agreement;" each of these agreements is referred to in this prospectus as the "Trust Agreement." The terms of the FPL Group Capital Trust Agreement and the FPL Group Trust Agreement are substantially the same. The preferred trust securities and common trust securities issued by the Trust are referred to in this prospectus as "Preferred Trust Securities" and "Common Trust Securities," respectively, and collectively as "Trust Securities." These Trust Securities will represent undivided beneficial interests in the assets of the Trust. In connection with the issuance of Trust Securities by FPL Group Capital Trust, the related FPL Group Capital Junior Subordinated Debentures (as defined below under "Description of the FPL Group and FPL Group Capital Junior Subordinated Debentures and the FPL Group Subordinated Guarantee") will be held by FPL Group Capital Trust, and in connection with the issuance of Trust Securities by FPL Group Trust, the related FPL Group Junior Subordinated Debentures (as defined below under "Description of the FPL Group and FPL Group Capital Junior Subordinated Debentures and the FPL Group Subordinated Guarantee") will be held by FPL Group Trust. This section briefly summarizes some of the

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provisions of the Trust Agreement. This summary does not contain a complete description of the Trust Agreement. You should read this summary together with the Trust Agreement for a complete understanding of all the provisions. The form of the Trust Agreement has been previously filed with the SEC and is an exhibit to the registration statement filed with the SEC of which this prospectus is a part. In addition, each Trust Agreement will be qualified as an indenture under the Trust Indenture Act of 1939 and is therefore subject to the provisions of the Trust Indenture Act of 1939. You should read the Trust Indenture Act of 1939 for a complete understanding of its provisions.

In this section, any discussion of FPL Group Capital Trust, FPL Group Trust, Preferred Trust Securities and Common Trust Securities relate only to the applicable Trust. Holders of Preferred Trust Securities of FPL Group Capital Trust II, FPL Group Capital Trust III, FPL Group Trust I and FPL Group Trust II will be entitled to any of the benefits and protections contained in the Trust Agreement applicable to the particular Trust which issued the relevant Trust Securities and not with respect to any other Trust.

The Preferred Trust Securities and Common Trust Securities issued by the Trust will be substantially the same except that, if there is an event of default under the Trust Agreement, as described below, that results from an event of default under the Subordinated Indenture (as such term is defined below under "Description of the FPL Group and FPL Group Capital Junior Subordinated Debentures and the FPL Group Subordinated Guarantee General"), the right of FPL Group, as holder of the Common Trust Securities, to payment of distributions and upon liquidation or redemption will be subordinated to the rights of the holders of the Preferred Trust Securities. (Trust Agreement, Section 4.03). All of the Common Trust Securities will be owned by FPL Group. (Trust Agreement, Section 5.10).

FPL Group will fully and unconditionally guarantee payments due on the Preferred Trust Securities issued by the Trust through a combination of the following:

- (1) with respect to the Preferred Trust Securities issued by FPL Group Capital Trust only, FPL Group's guarantee of FPL Group Capital's payment obligations under the FPL Group Capital Junior Subordinated Debentures (referred to in this prospectus as the "Subordinated Guarantee");
- (2) with respect to the Preferred Trust Securities issued by FPL Group Trust only, FPL Group's obligations under the FPL Group Junior Subordinated Debentures;
- (3) the rights of holders of Preferred Trust Securities to enforce those obligations in (1) and (2) above, as applicable;
- (4) FPL Group's agreement to pay the expenses of the Trust; and
- (5) FPL Group's guarantee of payments due on the Preferred Trust Securities to the extent of the Trust's legally available assets (referred to in this prospectus as the "Preferred Trust Securities Guarantee").

No single one of the applicable documents listed above standing alone or operating in conjunction with fewer than all of the other applicable documents constitutes the guarantee by FPL Group. It is only the combined operation of these documents that has the effect of providing a full and unconditional, but subordinated, guarantee as to payment by FPL Group of the Preferred Trust Securities.

FPL Group Capital Trust will use the proceeds from its sale of the Trust Securities to purchase FPL Group Capital Junior Subordinated Debentures, and FPL Group Trust will use the proceeds from its sale of the Trust Securities to purchase FPL Group Junior Subordinated Debentures. (Trust Agreement, Section 2.05). The FPL Group Capital Junior Subordinated Debentures will be guaranteed by FPL Group pursuant to the Subordinated Guarantee described below and issued under an Indenture, dated as of March 1, 2004, among FPL Group Capital, FPL Group and The Bank of New York, as trustee, or another subordinated indenture among FPL Group Capital, FPL Group and The Bank of New York as specified in the related prospectus supplement. The FPL Group Junior Subordinated Debentures will be issued under a subordinated indenture between FPL Group and The Bank of New York, as trustee. In connection with the issuance of Trust Securities, the Junior Subordinated Debentures (as defined below under "Description of the FPL Group and FPL Group Capital Junior Subordinated Debentures and

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the FPL Group Subordinated Guarantee") will be held in trust for the benefit of holders of the applicable Preferred Trust Securities and Common Trust Securities. (Trust Agreement, Section 2.09).

A prospectus supplement relating to the Preferred Trust Securities will include specific terms of those securities and of the Junior Subordinated Debentures issued in connection therewith. For a description of some specific terms that will affect both the Preferred Trust Securities and the Junior Subordinated Debentures, and holders' rights under each, see "Description of the FPL Group and FPL Group Capital Junior Subordinated Debentures and the FPL Group Subordinated Guarantee" below.

Distributions. The only income of the Trust available for distribution to the holders of Preferred Trust Securities will be payments on the applicable Junior Subordinated Debentures. (Trust Agreement, Section 8.01). If neither FPL Group Capital nor FPL Group makes interest payments on the FPL Group Capital Junior Subordinated Debentures, or if FPL Group does not make interest payments on the FPL Group Junior Subordinated Debentures, as the case may be, the Trust will not have funds available to pay distributions on Preferred Trust Securities. The payment of distributions, if and to the extent the Trust has sufficient funds available for the payment of such distributions, is guaranteed on a limited basis by FPL Group as described under "Description of the Preferred Trust Securities Guarantee."

Unless otherwise provided in the related prospectus supplement, the issuer of the Junior Subordinated Debentures may have the option to defer the payment of interest from time to time on the Junior Subordinated Debentures for one or more periods, in which case, if the Junior Subordinated Debentures were issued in connection with Preferred Trust Securities, distributions on the Preferred Trust Securities would be deferred during any such period. Unless otherwise provided in the related prospectus supplement, distributions would, however, continue to accumulate. (Trust Agreement, Section 4.01). During any optional deferral period, or for so long as an "Event of Default" under the Subordinated Indenture resulting from a payment default or a payment default under the Preferred Trust Securities Guarantee has occurred and is continuing, neither FPL Group nor FPL Group Capital, with respect to deferral of the payment of interest on the FPL Group Capital Junior Subordinated Debentures, nor FPL Group, with respect to the deferral of the payment of interest on the FPL Group Junior Subordinated Debentures, may:

- (1) declare or pay any dividend or distribution on its capital stock;
- (2) redeem, purchase, acquire or make a liquidation payment with respect to any of its capital stock;
- (3) pay any principal, interest or premium on, or repay, repurchase or redeem any debt securities that are equal or junior in right of payment with the Junior Subordinated Debentures or the Subordinated Guarantee (as the case may be); or
- (4) make any payments with respect to any guarantee of debt securities if such guarantee is equal or junior in right of payment to the Junior Subordinated Debentures or the Subordinated Guarantee (as the case may be),

other than

- (1) purchases, redemptions or other acquisitions of its capital stock in connection with any employment contract, benefit plan or other similar arrangement with or for the benefit of employees, officers, directors or agents or a stock purchase or dividend reinvestment plan, or the satisfaction of its obligations pursuant to any contract or security outstanding on the date that the payment of interest is deferred requiring it to purchase, redeem or acquire its capital stock;
- (2) any payment, repayment, redemption, purchase, acquisition or declaration of dividend listed as restricted payments in clauses (1) and (2) above as a result of a reclassification of its capital stock or the exchange or conversion of all or a portion of one class or series of its capital stock for another class or series of its capital stock;

- (3) the purchase of fractional interests in shares of its capital stock pursuant to the conversion or exchange provisions of its capital stock or the security being converted or exchanged, or in connection with the settlement of stock purchase contracts;
- (4) dividends or distributions paid or made in its capital stock (or rights to acquire its capital stock), or repurchases, redemptions or acquisitions of capital stock in connection with the issuance or exchange of capital stock (or of securities convertible into or exchangeable for shares of its capital stock) and distributions in connection with the settlement of stock purchase contracts;
- (5) redemptions, exchanges or repurchases of, or with respect to, any rights outstanding under a shareholder rights plan or the declaration or payment thereunder of a dividend or distribution of or with respect to rights in the future;
- (6) payments under any preferred trust securities guarantee or guarantee of subordinated debentures executed and delivered by FPL Group concurrently with the issuance by a trust of any preferred trust securities, so long as the amount of payments made on any preferred trust securities or subordinated debentures (as the case may be) is paid on all preferred trust securities or subordinated debentures (as the case may be) then outstanding on a pro rata basis in proportion to the full distributions to which each series of preferred trust securities or subordinated debentures (as the case may be) is then entitled if paid in full;
- (7) payments under any guarantee of junior subordinated debentures executed and delivered by FPL Group (including a FPL Group Subordinated Guarantee), so long as the amount of payments made on any junior subordinated debentures is paid on all junior subordinated debentures then outstanding on a pro rata basis in proportion to the full payment to which each series of junior subordinated debentures is then entitled if paid in full;
- (8) dividends or distributions by FPL Group Capital on its capital stock to the extent owned by FPL Group; or
- (9) redemptions, purchases, acquisitions or liquidation payments by FPL Group Capital with respect to its capital stock to the extent owned by FPL Group.

The exceptions in (8) and (9) above are not applicable to an optional deferral period on the FPL Group Junior Subordinated Debentures.

Unless otherwise provided in the related prospectus supplement, before an optional deferral period ends, FPL Group Capital or FPL Group, as the case may be, may further defer the payment of interest. Unless otherwise provided in the related prospectus supplement, no optional deferral period may exceed the period of time specified in that prospectus supplement. After any optional deferral period and the payment of all amounts then due, FPL Group Capital or FPL Group, as the case may be, may select a new optional deferral period. No interest period may be deferred beyond the maturity of the Junior Subordinated Debentures.

Redemption. Whenever Junior Subordinated Debentures are repaid, whether at maturity or earlier redemption, the Property Trustee will apply the proceeds to redeem a like amount of Preferred Trust Securities and Common Trust Securities. (Trust Agreement, Section 4.02(a)).

Preferred Trust Securities will be redeemed at the redemption price plus accrued and unpaid distributions with the proceeds from the contemporaneous redemption or repayment of Junior Subordinated Debentures. Redemptions of the Preferred Trust Securities will be made on a redemption date only if the Trust has funds available for the payment of the redemption price plus accrued and unpaid distributions. (Trust Agreement, Section 4.02(c)).

Holders of Preferred Trust Securities will be given not less than 30 nor more than 60 days' notice of any redemption. (Trust Agreement, Section 4.02(b)). On or before the redemption date, the Trust will irrevocably deposit with the paying agent for Preferred Trust Securities sufficient funds and will give the paying agent irrevocable instructions and authority to pay the redemption price plus accrued and unpaid distributions to the

holders upon surrender of their Preferred Trust Securities. Distributions payable on or before a redemption date will be payable to the holders on the record date for the distribution payment. If notice is given and funds are deposited as required, then on the redemption date all rights of holders of the Preferred Trust Securities called for redemption will cease, except the right of the holders to receive the redemption price plus accrued and unpaid distributions, and the Preferred Trust Securities will cease to be outstanding. No interest will accrue on amounts payable on the redemption date. In the event that any date fixed for redemption of Preferred Trust Securities is not a business day, then payment will be made on the next business day, except that, if such business day falls in the next calendar year, then payment will be made on the immediately preceding business day. No interest will be payable because of any such delay. If payment of Preferred Trust Securities called for redemption is improperly withheld or refused and not paid either by the Trust or by FPL Group pursuant to the Preferred Trust Securities Guarantee, distributions on such Preferred Trust Securities will continue to accrue to the date of payment. In that event, the actual payment date will be considered the date fixed for redemption for purposes of calculating the redemption price plus accrued and unpaid distributions. (Trust Agreement, Section 4.02(d)).

Subject to applicable law, including United States federal securities laws, FPL Group or its affiliates may at any time and from time to time purchase outstanding Preferred Trust Securities by tender, in the open market or by private agreement.

If Preferred Trust Securities are partially redeemed on a redemption date, a corresponding percentage of the Common Trust Securities will be redeemed. The particular Preferred Trust Securities to be redeemed will be selected not more than 60 days prior to the redemption date by the Property Trustee by such method as the Property Trustee shall deem fair, taking into account the denominations in which they were issued. The Property Trustee will promptly notify the Preferred Trust Security registrar in writing of the Preferred Trust Securities selected for redemption and, where applicable, the partial amount to be redeemed. (Trust Agreement, Section 4.02(f)).

Subordination of Common Trust Securities. Payment of distributions on, and the redemption price, plus accrued and unpaid distributions, of, the Preferred Trust Securities and Common Trust Securities shall be made pro rata based on the liquidation preference amount of such securities. However, if on any distribution payment date or redemption date an event of default under the Trust Agreement resulting from an event of default under the related Subordinated Indenture has occurred and is continuing, no payment on any Common Trust Security shall be made until all payments due on the Preferred Trust Securities have been made. In that case, funds available to the Property Trustee shall first be applied to the payment in full of all distributions on, or the redemption price plus accrued and unpaid distributions of, Preferred Trust Securities then due and payable. (Trust Agreement, Section 4.03(a)).

If an event of default under the Trust Agreement results from an event of default under the related Subordinated Indenture, the holder of Common Trust Securities cannot take action with respect to the Trust Agreement default until the effect of all defaults with respect to the Preferred Trust Securities has been cured, waived or otherwise eliminated. Until the event of default under the Trust Agreement with respect to Preferred Trust Securities has been cured, waived or otherwise eliminated, the Property Trustee shall, to the fullest extent permitted by law, act solely on behalf of the holders of Preferred Trust Securities and not the holder of the Common Trust Securities, and only the holders of Preferred Trust Securities will have the right to direct the Property Trustee to act on their behalf. (Trust Agreement, Section 4.03(b)).

Liquidation Distribution upon Dissolution. The Trust will be dissolved and liquidated by the Property Trustee on the first to occur of:

- (1) the expiration of the term of the Trust;
- (2) the bankruptcy, dissolution or liquidation of FPL Group;
- (3) the redemption of all of the Preferred Trust Securities of the Trust;
- (4) the entry of an order for dissolution of the Trust by a court of competent jurisdiction; or
- (5) at any time, at the election of FPL Group. (Trust Agreement, Sections 9.01 and 9.02).

If a dissolution of the Trust occurs, the Trust will be liquidated by the Property Trustee as expeditiously as the Property Trustee determines to be appropriate. If a dissolution of the Trust occurs other than by redemption of all the Preferred Trust Securities, the Property Trustee will provide for the satisfaction of liabilities of creditors, if any, and distribute to each holder of the Preferred Trust Securities and Common Trust Securities a proportionate amount of Junior Subordinated Debentures. If a distribution of Junior Subordinated Debentures is determined by the Property Trustee not to be practical, holders of Preferred Trust Securities will be entitled to receive, out of the assets of the Trust after adequate provision for the satisfaction of liabilities of creditors, if any, an amount equal to the aggregate liquidation preference of the Preferred Trust Securities plus accrued and unpaid distributions thereon to the date of payment. If this liquidation distribution can be paid only in part because the Trust has insufficient assets available to pay in full the aggregate liquidation distribution, then the amounts payable by the Trust on the Preferred Trust Securities shall be paid on a pro rata basis. FPL Group, as holder of the Common Trust Securities, will be entitled to receive distributions upon any dissolution pro rata with the holders of the Preferred Trust Securities, except that if an event of default (or event that, with the lapse of time or giving of notice, would become such an event of default) has occurred and is continuing under the related Subordinated Indenture, the Preferred Trust Securities will have a preference over the Common Trust Securities. (Trust Agreement, Section 9.04).

Events of Default; Notice. Any one of the following events will be an event of default under the Trust Agreement whether it shall be voluntary or involuntary or be effected by operation of law or pursuant to any judgment, decree or order of any court or any order, rule or regulation of any administrative or governmental body:

- (1) the occurrence of an event of default as described in the related Subordinated Indenture;
- (2) default by the Trust in the payment of any distribution when it becomes due and payable, and continuation of that default for a period of 30 days;
- (3) default by the Trust in the payment of any redemption price, plus accrued and unpaid distributions, of any Preferred Trust Security or Common Trust Security when it becomes due and payable;
- (4) default in the performance, or breach, in any material respect, of any covenant or warranty of the trustees in the Trust Agreement which is not dealt with above, and continuation of that default or breach for a period of 90 days after written notice to the Trust, the defaulting trustee under the Trust Agreement and FPL Group by the holders of Preferred Trust Securities having at least 33% of the total liquidation preference amount of the outstanding Preferred Trust Securities. However, the holders of Preferred Trust Securities will be deemed to have agreed to an extension of the 90 day period if corrective action is initiated by any of the trustees within such period and is diligently pursued in good faith; or
- (5) the occurrence of certain events of bankruptcy or insolvency with respect to the Trust. (Trust Agreement, Section 1.01).

Within 90 days after the occurrence of any default known to the Property Trustee, the Property Trustee shall transmit to the holders of Preferred Trust Securities, FPL Group and the Administrative Trustees notice of any such default, unless that default shall have been cured or waived. (Trust Agreement, Section 8.02).

A holder of Preferred Trust Securities may directly institute a proceeding to enforce payment when due to the holder of the Preferred Trust Securities of the principal of or interest on Junior Subordinated Debentures having a principal amount equal to the aggregate liquidation preference amount of the holder's Preferred Trust Securities. The holders of Preferred Trust Securities have no other rights to exercise directly any other remedies available to the holder of the Junior Subordinated Debentures unless the trustees under the Trust Agreement fail to do so. (Trust Agreement, Section 6.01(a)).

Removal of Trustees. Unless an event of default under the related Subordinated Indenture has occurred and is continuing, the holder of the Common Trust Securities may remove any trustee under the Trust Agreement at any time. If an event of default under the Subordinated Indenture has occurred and is continuing, the holders of a majority of the total liquidation preference amount of the outstanding Preferred Trust Securities may remove the Property Trustee or the Delaware Trustee, or both of them. The holder of the Common Trust Securities may remove

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any Administrative Trustee at any time. Any resignation or removal of a trustee under the Trust Agreement will take effect only on the acceptance of appointment by the successor trustee. (Trust Agreement, Section 8.10).

Holders of Preferred Trust Securities will have no right to appoint or remove the Administrative Trustees of the Trust, who may be appointed, removed or replaced solely by FPL Group as the holder of the Common Trust Securities. (Trust Agreement, Section 8.10).

Voting Rights. Except as provided below and under "Description of the Preferred Trust Securities Guarantee Modification and Assignment," and as otherwise required by law or the Trust Agreement, the holders of Preferred Trust Securities will have no voting rights.

While Junior Subordinated Debentures are held by the Property Trustee, the Property Trustee shall not:

- (1) direct the time, method and place to conduct any proceeding for any remedy available to the Subordinated Indenture Trustee (as such term is defined below under "Description of the FPL Group and FPL Group Capital Junior Subordinated Debentures and the FPL Group Subordinated Guarantee General"), or execute any trust or power conferred on the Subordinated Indenture Trustee with respect to the Junior Subordinated Debentures;
- (2) waive any past default under the related Subordinated Indenture;
- (3) exercise any right to rescind or annul a declaration that the principal of all the Junior Subordinated Debentures will be due and payable; or
- (4) consent to any amendment, modification or termination of the related Subordinated Indenture or the Junior Subordinated Debentures, where that consent will be required,

without, in each case, obtaining the prior approval of the holders of Preferred Trust Securities having at least a majority of the aggregate liquidation preference amount of all outstanding Preferred Trust Securities of the Trust. Where a consent of each holder of Junior Subordinated Debentures affected is required, no consent shall be given by the Property Trustee without the prior consent of each holder of the Preferred Trust Securities affected. The Property Trustee shall not revoke any action previously authorized or approved by a vote of the holders of Preferred Trust Securities, except pursuant to the subsequent vote of the holders of Preferred Trust Securities. (Trust Agreement, Section 6.01(b)). If the Property Trustee fails to enforce its rights, as holder, under the Junior Subordinated Debentures or the Trust Agreement, a holder of the Preferred Trust Securities may institute a legal proceeding directly against FPL Group or FPL Group Capital, as the case may be, to enforce the Property Trustee's rights under the Junior Subordinated Debentures or the Trust Agreement without first instituting any legal proceeding against the Property Trustee or anyone else. (Trust Agreement, Section 6.01(a)). The Property Trustee shall notify all holders of Preferred Trust Securities of any notice of default received from the Subordinated Indenture Trustee. The Property Trustee shall not take any action approved by the consent of the holders of Preferred Trust Securities without an opinion of counsel experienced in those matters to the effect that the Trust will be classified as a grantor trust and not as an association taxable as a corporation for United States federal income tax purposes on account of that action. (Trust Agreement, Section 6.01(b)).

Holders of Preferred Trust Securities may give any required approval at a meeting convened for such purpose or by written consent without prior notice. (Trust Agreement, Section 6.06). The Administrative Trustees will give notice of any meeting at which holders of Preferred Trust Securities are entitled to vote. (Trust Agreement, Section 6.02).

No vote or consent of the holders of Preferred Trust Securities will be required for the Trust to redeem and cancel Preferred Trust Securities in accordance with the Trust Agreement.

Notwithstanding that holders of Preferred Trust Securities are entitled to vote or consent under any of the circumstances described above, any Preferred Trust Securities that are owned by FPL Group Capital, FPL Group, any Administrative Trustee or any affiliate of any of them, shall be treated as if they were not outstanding for purposes of such vote or consent. (Trust Agreement, Section 1.01).

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Amendments. The Trust Agreement may be amended from time to time by a majority of its Administrative Trustees and FPL Group, without the consent of any holders of Preferred Trust Securities or the other trustees under the Trust Agreement in order to:

- (1) cure any ambiguity; correct or supplement any provision that may be inconsistent with any other provision of the Trust Agreement or amendment to the Trust Agreement; or make any other provisions with respect to matters or questions arising under the Trust Agreement;
- (2) change the name of the Trust; or
- (3) modify, eliminate or add to any provisions of the Trust Agreement to the extent necessary to ensure that the Trust will not be classified for United States federal income tax purposes other than as a grantor trust (and not an association taxable as a corporation) at any time that any Preferred Trust Securities and Common Trust Securities are outstanding or to ensure the Trust's exemption from the status of an "investment company" under the Investment Company Act of 1940.

No amendment described above may materially adversely affect the interests of any holder of Preferred Trust Securities or Common Trust Securities without the applicable consents required pursuant to the following two paragraphs. Any of the amendments of the Trust Agreement described in paragraph (1) above shall become effective when notice of the amendment is given to the holders of Preferred Trust Securities and Common Trust Securities in accordance with the provisions of the Trust Agreement. (Trust Agreement, Section 10.03(a)).

Except as provided below, any provision of the Trust Agreement may be amended by the Administrative Trustees and FPL Group with:

- (1) the consent of holders of Preferred Trust Securities and Common Trust Securities representing not less than a majority in aggregate liquidation preference amount of the Preferred Trust Securities and Common Trust Securities then outstanding; and
- (2) receipt by the trustees of an opinion of counsel to the effect that such amendment or the exercise of any power granted to the trustees in accordance with the amendment will not affect the Trust's status as a grantor trust for federal income tax purposes (and not an association taxable as a corporation) or affect the Trust's exemption from the status of an "investment company" under the Investment Company Act of 1940. (Trust Agreement, Section 10.03(b)).

Each affected holder of Preferred Trust Securities must consent to any amendment to the Trust Agreement that:

- (1) adversely changes the amount or timing of any distribution with respect to Preferred Trust Securities or otherwise adversely affects the amount of any distribution required to be made in respect of Preferred Trust Securities as of a specified date;
- (2) restricts the right of a holder of Preferred Trust Securities to institute suit for the enforcement of any such payment on or after that date; or
- (3) modify the provisions described in clauses (1) and (2) above. (Trust Agreement, Section 10.03(c)).

Form, Exchange and Transfer. Preferred Trust Securities may be exchanged for other Preferred Trust Securities in any authorized denomination and of like tenor and aggregate liquidation preference. (Trust Agreement, Section 5.04).

Subject to the terms of the Trust Agreement, Preferred Trust Securities may be presented for exchange as provided above or for registration of transfer, duly endorsed or accompanied by a duly executed instrument of transfer, at the office of the Preferred Trust Security registrar. The Administrative Trustees may designate FPL Group or FPL Group Capital or any affiliate of either of them, as the Preferred Trust Security registrar. The Property Trustee will initially act as the Preferred Trust Security registrar and transfer agent. (Trust Agreement, Section 5.08). No service charge will be made for any registration of transfer or exchange of Preferred Trust

Securities, but the Preferred Trust Security registrar may require payment of a sum sufficient to cover any tax or other governmental charge payable in connection with the transfer or exchange. A transfer or exchange will be made when the Preferred Trust Security registrar and Administrative Trustees are satisfied with the documents of title and identity of the person making the request. (Trust Agreement, Section 5.04). The Administrative Trustees may at any time designate another transfer agent and registrar or rescind the designation of any transfer agent and registrar or approve a change in the office through which any transfer agent and registrar acts, except that FPL Group will, or will cause the Preferred Trust Security registrar to, maintain an office or agency in The City of New York where Preferred Trust Securities may be transferred or exchanged. (Trust Agreement, Sections 2.07(a) and 5.08).

The Trust will not be required to:

- (1) issue, register the transfer of, or exchange any Preferred Trust Securities during the period beginning at the opening of business 15 calendar days before the mailing of a notice of redemption of any Preferred Trust Securities called for redemption and ending at the close of business on the day the notice is mailed; or
- (2) register the transfer of or exchange any Preferred Trust Securities so selected for redemption, in whole or in part, except the unredeemed portion of any Preferred Trust Securities being redeemed in part. (Trust Agreement, Section 5.04).

Payment on Preferred Trust Securities and Paying Agent. Unless otherwise stated in a prospectus supplement, payments in respect of the Preferred Trust Securities will be made on the applicable distribution dates by check mailed to the address of the holder entitled thereto as such address appears on the Preferred Trust Security register. (Trust Agreement, Section 4.04). The paying agent shall initially be the Property Trustee and any co-paying agent chosen by the Property Trustee that is acceptable to the Administrative Trustees, FPL Group and, in the case of Preferred Trust Securities issued by FPL Group Capital Trust, FPL Group Capital. The paying agent may resign upon 30 days' written notice to the Administrative Trustees, the Property Trustee, FPL Group and, in the case of Preferred Trust Securities issued by FPL Group Capital Trust, FPL Group Capital. In the event that the Property Trustee shall no longer be the paying agent, the Administrative Trustees shall appoint a successor, which shall be a bank, trust company or affiliate of FPL Group reasonably acceptable to the Property Trustee, FPL Group, and, in the case of Preferred Trust Securities issued by FPL Group Capital Trust, FPL Group Capital, to act as paying agent. (Trust Agreement, Section 5.09).

Duties of the Trustees. The Delaware Trustee will act as the resident trustee in the State of Delaware and will have no other significant duties. The Property Trustee will hold the Junior Subordinated Debentures on behalf of the Trust and will maintain a payment account with respect to the Preferred Trust Securities and Common Trust Securities, and will also act as trustee under the Trust Agreement for the purposes of the Trust Indenture Act of 1939. (Trust Agreement, Sections 2.06 and 2.07(b)).

The Administrative Trustees of the Trust are authorized and directed to conduct the affairs of the Trust and to operate the Trust so that

- (1) the Trust will not be deemed to be an "investment company" required to be registered under the Investment Company Act of 1940,
- (2) the Trust will not be taxed as a corporation, and
- (3) in the case of FPL Group Capital Trust, the FPL Group Capital Junior Subordinated Debentures will be treated as indebtedness of FPL Group Capital for United States federal income tax purposes and, in the case of FPL Group Trust, the FPL Group Junior Subordinated Debentures will be treated as indebtedness of FPL Group for United States federal income tax purposes.

In this regard, FPL Group and the Administrative Trustees are authorized to take any action, not inconsistent with applicable law, the certificate of trust or the Trust Agreement, that FPL Group and the Administrative Trustees determine in their discretion to be necessary or desirable for those purposes, as long as the

action does not materially adversely affect the interests of the holders of the Preferred Trust Securities. (Trust Agreement, Section 2.07(d)).

Miscellaneous. Holders of the Preferred Trust Securities have no preemptive or similar rights. (Trust Agreement, Section 5.13).

Notices. Notices to holders of Preferred Trust Securities will be sent by mail to the addresses of those holders as they appear in the security register for those Preferred Trust Securities. (Trust Agreement, Section 6.02).

Title. The Property Trustee, the Delaware Trustee, the Administrative Trustees, and the Preferred Trust Security registrar and transfer agent, and any agent of the Property Trustee, the Delaware Trustee, the Administrative Trustees, or the Preferred Trust Security registrar and transfer agent, may treat the person in whose name a Preferred Trust Security is registered as the absolute owner of that Preferred Trust Security for the purpose of receiving distributions and all other purposes, regardless of any notice to the contrary. (Trust Agreement, Section 5.06).

Governing Law. The Trust Agreement, the Preferred Trust Securities and the Common Trust Securities will be governed by and construed in accordance with the laws of the State of Delaware, without regard to conflict of laws principles thereunder, except to the extent that the law of any other jurisdiction is mandatorily applicable. (Trust Agreement, Section 10.05).

DESCRIPTION OF THE PREFERRED TRUST SECURITIES GUARANTEE

General. This section briefly summarizes some of the provisions of the Preferred Trust Securities Guarantee Agreements that FPL Group will execute and deliver for the benefit of the holders of the Preferred Trust Securities issued by FPL Group Capital Trust and FPL Group Trust. The terms of these agreements are substantially the same, and they are referred to in this prospectus as the "Preferred Trust Securities Guarantee Agreement." This summary does not contain a complete description of the Preferred Trust Securities Guarantee Agreement. You should read this summary together with the Preferred Trust Securities Guarantee Agreement for a complete understanding of all the provisions. The form of the Preferred Trust Securities Guarantee Agreement has been previously filed with the SEC and is an exhibit to the registration statement filed with the SEC of which this prospectus is a part. In addition, the Preferred Trust Securities Guarantee Agreement will be qualified as an indenture under the Trust Indenture Act of 1939 and is therefore subject to the provisions of the Trust Indenture Act of 1939. You should read the Trust Indenture Act of 1939 for a complete understanding of its provisions.

The Bank of New York will act as Preferred Trust Securities Guarantee Trustee under the Preferred Trust Securities Guarantee Agreement and will hold the Preferred Trust Securities Guarantee for the benefit of the holders of the Preferred Trust Securities.

General Terms of the Preferred Trust Securities Guarantee. FPL Group will absolutely, irrevocably and unconditionally agree to make the guarantee payments listed below in full to the holders of the Preferred Trust Securities if they are not made by the Trust, as and when due, regardless of any defense, right of set-off or counterclaim that the Trust may have or assert. (Preferred Trust Securities Guarantee Agreement, Section 5.01). The following payments will be subject to the Preferred Trust Securities Guarantee (without duplication):

- (1) any accrued and unpaid distributions required to be paid on Preferred Trust Securities, to the extent the Trust has funds in the payment account maintained by the Property Trustee legally available for these payments at such time;
- (2) the redemption price, plus all accrued and unpaid distributions to the redemption date, for any Preferred Trust Securities called for redemption by the Trust, to the extent the Trust has funds in the payment account maintained by the Property Trustee legally available for these payments at such time; and
- (3) upon a voluntary or involuntary dissolution, winding-up or termination of the Trust (except in connection with the distribution of Junior Subordinated Debentures to the holders in exchange for Preferred Trust Securities as provided in the Trust Agreement or upon a redemption of all of the

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Preferred Trust Securities upon maturity or redemption of the Junior Subordinated Debentures as provided in the Trust Agreement), the lesser of:

- (a) the aggregate of the liquidation preference amount and all accrued and unpaid distributions on Preferred Trust Securities to the date of payment, to the extent the Trust has funds in the payment account maintained by the Property Trustee legally available for these payments at such time; and
- (b) the amount of assets of the Trust remaining available for distribution to holders of Preferred Trust Securities in liquidation of the Trust after satisfaction of liabilities to creditors of the Trust as required by applicable law.

(Preferred Trust Securities Guarantee Agreement, Section 1.01). FPL Group's obligation to make a guarantee payment may be satisfied by either making a direct payment of the required amounts by FPL Group to the holders of Preferred Trust Securities or causing the Trust to pay such amounts to those holders. (Preferred Trust Securities Guarantee Agreement, Section 5.01).

The Preferred Trust Securities Guarantee will be a guarantee, subject to certain subordination provisions, as to payment with respect to the Preferred Trust Securities, but will not apply to any payment of distributions if and to the extent that the Trust does not have funds legally available to make those payments. (Preferred Trust Securities Guarantee Agreement, Sections 1.01 and 5.05). If neither FPL Group Capital nor FPL Group makes interest payments on the FPL Group Capital Junior Subordinated Debentures held by a Trust and if FPL Group does not make interest payments on the FPL Group Junior Subordinated Debentures held by a Trust, in each case the applicable Trust will not have funds available to pay distributions on the Preferred Trust Securities.

FPL Group will fully and unconditionally guarantee payments due on the Preferred Trust Securities issued by the Trust through a combination of the following:

- (1) with respect to the Preferred Trust Securities issued by FPL Group Capital Trust only, the Subordinated Guarantee;
- (2) with respect to the Preferred Trust Securities issued by FPL Group Trust only, FPL Group's obligations under the FPL Group Junior Subordinated Debentures;
- (3) the rights of holders of Preferred Trust Securities to enforce those obligations in (1) and (2) above, as applicable;
- (4) FPL Group's agreement to pay the expenses of the Trust; and
- (5) the Preferred Trust Securities Guarantee.

No single one of the applicable documents listed above standing alone or operating in conjunction with fewer than all of the other applicable documents constitutes the guarantee by FPL Group. It is only the combined operation of these documents that has the effect of providing a full and unconditional, but subordinated, guarantee as to payment by FPL Group of the Preferred Trust Securities.

Except as otherwise stated in the related prospectus supplement, the covenants in the Preferred Trust Securities Guarantee Agreement would not give holders of the Preferred Trust Securities protection in the event of a highly-leveraged transaction involving FPL Group.

Security and Ranking. The Preferred Trust Securities Guarantee will be an unsecured obligation of FPL Group and will rank:

- (1) subordinate and junior in right of payment to all other liabilities of FPL Group, including the Subordinated Guarantee and the Senior Debt Securities Guarantee (except those made *pari passu* or subordinate by their terms);

- (2) equal in right of payment with the most senior preferred or preference stock that may be issued by FPL Group and with any guarantee that may be entered into by FPL Group in respect of any preferred or preference stock of any affiliate of FPL Group; and
- (3) senior to FPL Group common stock. (Preferred Trust Securities Guarantee Agreement, Section 6.01).

The Preferred Trust Securities Guarantee Agreement does not limit the amount of other indebtedness, including guarantees, that FPL Group may issue or incur or the amount of preferred or preference stock it may issue.

The Trust Agreement provides that by accepting Preferred Trust Securities, a holder agrees to the subordination provisions and other terms of the Preferred Trust Securities Guarantee. (Trust Agreement, Section 5.02).

The Preferred Trust Securities Guarantee will be a guarantee of payment and not of collection, that is, the guaranteed party may institute a legal proceeding directly against FPL Group to enforce its rights under the Preferred Trust Securities Guarantee without first instituting a legal proceeding against anyone else. (Preferred Trust Securities Guarantee Agreement, Sections 5.04 and 5.05).

FPL Group is a holding company that derives substantially all of its income from its operating subsidiaries. Therefore, the Preferred Trust Securities Guarantee will be effectively subordinated to all indebtedness and other liabilities, including trade payables, debt and preferred stock, incurred or issued by FPL Group's subsidiaries. Neither the Subordinated Indenture nor the Preferred Trust Securities Guarantee Agreement places any limit on the amount of liabilities, including debt or preferred stock, that FPL Group's subsidiaries may issue, guarantee or otherwise incur.

Events of Default. An event of default under the Preferred Trust Securities Guarantee Agreement will occur upon failure of FPL Group to perform any of its payment obligations under the Preferred Trust Securities Guarantee Agreement, which failure has not been cured within 90 days of receipt of notice thereof. (Preferred Trust Securities Guarantee Agreement, Section 1.01). Upon an event of default, the holders of the Preferred Trust Securities having a majority of the aggregate liquidation preference of the Preferred Trust Securities have the right to:

- (1) direct the time, method and place of conducting any proceeding for any remedy available to the Preferred Trust Securities Guarantee Trustee under the Preferred Trust Securities Guarantee Agreement, or
- (2) direct the exercise of any trust or power conferred upon the Preferred Trust Securities Guarantee Trustee under the Preferred Trust Securities Guarantee Agreement. (Preferred Trust Securities Guarantee Agreement, Section 5.04).

Any holder of the Preferred Trust Securities may enforce the Preferred Trust Securities Guarantee, or institute a legal proceeding directly against FPL Group to enforce the Preferred Trust Securities Guarantee Trustee's rights under the Preferred Trust Securities Guarantee Agreement without first instituting a legal proceeding against the Trust, the Preferred Trust Securities Guarantee Trustee or anyone else. (Preferred Trust Securities Guarantee Agreement, Section 5.04). The holders of the Preferred Trust Securities having a majority of the aggregate liquidation preference of the Preferred Trust Securities may waive any past event of default and its consequences. (Preferred Trust Securities Guarantee Agreement, Section 2.06).

FPL Group will be required to deliver to the Preferred Trust Securities Guarantee Trustee an annual statement as to its compliance with all conditions under the Preferred Trust Securities Guarantee Agreement. (Preferred Trust Securities Guarantee Agreement, Section 2.04).

Modification and Assignment. No consent of holders of Preferred Trust Securities is required for changes to the Preferred Trust Securities Guarantee Agreement that do not materially adversely affect their rights. Except as provided below, changes to the Preferred Trust Securities Guarantee Agreement that materially adversely affect the rights of Preferred Trust Securities require the prior approval of the holders of Preferred Trust Securities having at least a majority of the aggregate liquidation preference amount of the outstanding Preferred Trust Securities. Each

affected holder of Preferred Trust Securities must consent to any amendment to the Preferred Trust Securities Guarantee Agreement that impairs the right of such holder to receive guarantee payments under the Preferred Trust Securities Guarantee Agreement or to institute suit for enforcement of any such payment. (Preferred Trust Securities Guarantee Agreement, Section 8.01).

All guarantees and agreements contained in the Preferred Trust Securities Guarantee Agreement will bind the successors, assigns, receivers, trustees and representatives of FPL Group and will inure to the benefit of the holders of the Preferred Trust Securities then outstanding. (Preferred Trust Securities Guarantee Agreement, Section 8.02).

Termination of the Preferred Trust Securities Guarantee. The Preferred Trust Securities Guarantee Agreement will terminate and be of no further force and effect upon:

- (1) full payment of the redemption price, plus accrued and unpaid distributions to the redemption date, for all the Preferred Trust Securities;
- (2) the distribution of Junior Subordinated Debentures to holders of the Preferred Trust Securities in exchange for all of the Preferred Trust Securities; or
- (3) full payment of the amounts payable upon liquidation of the Trust.

However, the Preferred Trust Securities Guarantee will continue to be effective or will be reinstated, as the case may be, if at any time, as result of the subordination provisions or any mistake or any judicial proceeding or otherwise, any holder of Preferred Trust Securities must return any sums paid under the Preferred Trust Securities or the Preferred Trust Securities Guarantee. (Preferred Trust Securities Guarantee Agreement, Section 7.01).

Governing Law. The Preferred Trust Securities Guarantee Agreement provides that it is to be governed by and construed in accordance with the laws of the State of New York, without regard to conflict of laws principles thereunder, except to the extent that the law of any other jurisdiction is mandatorily applicable. (Preferred Trust Securities Guarantee Agreement, Section 8.06).

DESCRIPTION OF THE FPL GROUP AND FPL GROUP CAPITAL JUNIOR SUBORDINATED DEBENTURES AND THE FPL GROUP SUBORDINATED GUARANTEE

General. The junior subordinated debentures issued by FPL Group Capital are referred to in this prospectus as the "FPL Group Capital Junior Subordinated Debentures." The junior subordinated debentures issued by FPL Group are referred to in this prospectus as the "FPL Group Junior Subordinated Debentures," and, together with the FPL Group Capital Junior Subordinated Debentures, are referred to as the "Junior Subordinated Debentures." The FPL Group Capital Junior Subordinated Debentures will be issued by FPL Group Capital in one or more series under an Indenture, dated as of March 1, 2004, among FPL Group Capital, FPL Group and The Bank of New York, as trustee, an Indenture, dated as of September 1, 2006, among FPL Group Capital, FPL Group and The Bank of New York, as trustee, or another subordinated indenture among FPL Group Capital, FPL Group and The Bank of New York as specified in the related prospectus supplement. The indenture or indentures pursuant to which FPL Group Capital Junior Subordinated Debentures may be issued, as it may be amended from time to time, is referred to in this prospectus as the "FPL Group Capital Subordinated Indenture." The indenture or indentures pursuant to which FPL Group Junior Subordinated Debentures may be issued, as it may be amended from time to time, is referred to in this prospectus as the "FPL Group Subordinated Indenture." The FPL Group Junior Subordinated Debentures will be issued by FPL Group in one or more series under an indenture or indentures between FPL Group and The Bank of New York, as trustee. In connection with the issuance of Trust Securities, the Property Trustee will hold the FPL Group Capital Junior Subordinated Debentures on behalf of FPL Group Capital Trust, or the FPL Group Junior Subordinated Debentures on behalf of FPL Group Trust, as the case may be, as trust assets. Each of the FPL Group Capital Subordinated Indenture and the FPL Group Subordinated Indenture, as each may be amended and supplemented from time to time, is referred to in this prospectus as the "Subordinated Indenture." The Bank of New York, as trustee under each Subordinated Indenture, is referred to in this prospectus as the "Subordinated Indenture Trustee." The Subordinated Indenture provides for the issuance from time to time of subordinated debt in an unlimited amount. The Junior Subordinated Debentures and all other subordinated debt

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issued previously or hereafter under the Subordinated Indenture are collectively referred to in this prospectus as the "Subordinated Indenture Securities."

This section briefly summarizes some of the terms of the Junior Subordinated Debentures, the Subordinated Guarantee applicable to the FPL Group Capital Junior Subordinated Debentures, and some of the provisions of the Subordinated Indenture. This summary does not contain a complete description of the Junior Subordinated Debentures, the Subordinated Guarantee or the Subordinated Indenture. You should read this summary together with the Subordinated Indenture and the officer's certificates or other documents establishing the Junior Subordinated Debentures and the Subordinated Guarantee for a complete understanding of all the provisions and for the definitions of some terms used in this summary. The Subordinated Indenture (which, in the case of the FPL Group Capital Subordinated Indenture, contains the Subordinated Guarantee), the forms of officer's certificate that may be used to establish a series of Junior Subordinated Debentures and the forms of the Junior Subordinated Debentures have been previously filed with the SEC, and are exhibits to the registration statement. In addition, each Subordinated Indenture will be qualified under the Trust Indenture Act of 1939 and is therefore subject to the provisions of the Trust Indenture Act of 1939. You should read the Trust Indenture Act of 1939 for a complete understanding of its provisions.

Each issue of the FPL Group Capital Junior Subordinated Debentures and the FPL Group Junior Subordinated Debentures will constitute a separate series under the respective Subordinated Indenture. In connection with the issuance of Trust Securities, the aggregate principal amount of each series will be limited to the sum of the aggregate liquidation preference amount of the related Preferred Trust Securities and the consideration paid by FPL Group for the related Common Trust Securities.

All FPL Group Capital Junior Subordinated Debentures of one series need not be issued at the same time, and a series may be re-opened for issuances of additional FPL Group Capital Junior Subordinated Debentures of such series. This means that FPL Group Capital may from time to time, without notice to, or the consent of the existing holders of the FPL Group Capital Junior Subordinated Debentures of a particular series, create and issue additional FPL Group Capital Junior Subordinated Debentures of such series. Such additional FPL Group Capital Junior Subordinated Debentures will have the same terms as the FPL Group Capital Junior Subordinated Debentures of such series in all respects (except for the payment of interest accruing prior to the issue date of the additional FPL Group Capital Junior Subordinated Debentures or except for the first payments of interest following the issue date of the additional FPL Group Capital Junior Subordinated Debentures) so that the additional FPL Group Capital Junior Subordinated Debentures may be consolidated and form a single series with the FPL Group Capital Junior Subordinated Debentures of such series.

Similarly, all FPL Group Junior Subordinated Debentures of one series need not be issued at the same time, and a series may be re-opened for issuances of additional FPL Group Junior Subordinated Debentures of such series, in the manner described in the paragraph above with respect to FPL Group Capital Junior Subordinated Debentures.

The FPL Group Capital Junior Subordinated Debentures will be unsecured, subordinated obligations of FPL Group Capital which rank junior to all of FPL Group Capital's Senior Indebtedness. The FPL Group Junior Subordinated Debentures will be unsecured, subordinated obligations of FPL Group which rank junior to all of FPL Group's Senior Indebtedness. The term "Senior Indebtedness" with respect to FPL Group Capital or FPL Group, as the case may be, will be defined in the related prospectus supplement. All Junior Subordinated Debentures issued under a particular Subordinated Indenture will rank equally and ratably with all other Junior Subordinated Debentures issued under that Subordinated Indenture, except to the extent that FPL Group Capital or FPL Group, as the case may be, elects to provide security with respect to any series of Junior Subordinated Debentures without providing that security to all outstanding Junior Subordinated Debentures as allowed under the respective Subordinated Indenture. Junior Subordinated Debentures issued under a particular Subordinated Indenture may rank senior to, pari passu with, or junior to, Junior Subordinated Debentures issued by the same issuer under another Subordinated Indenture. The FPL Group Capital Junior Subordinated Debentures will be unconditionally guaranteed by FPL Group as to payment of principal, and any interest and premium, pursuant to a Subordinated Guarantee of FPL Group, included in the Subordinated Indenture for such FPL Group Capital Junior Subordinated Debentures, which Subordinated Guarantee ranks junior to all of FPL Group's Senior Indebtedness, and may rank senior to, pari passu with, or junior to, FPL Group's obligations under a separate Subordinated Guarantee. See " Subordinated Guarantee" below.

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Although the FPL Group Capital Junior Subordinated Debentures and the FPL Group Junior Subordinated Debentures are discussed together in this section of the prospectus, FPL Group will have no obligation with respect to the FPL Group Capital Junior Subordinated Debentures except in connection with the Subordinated Guarantee and FPL Group Capital will have no obligation with respect to the FPL Group Junior Subordinated Debentures.

Each series of Junior Subordinated Debentures that may be issued under each Subordinated Indenture may have different terms. FPL Group Capital or FPL Group, as the case may be, will include some or all of the following information about a specific series of Junior Subordinated Debentures in the prospectus supplement relating to those Junior Subordinated Debentures:

- (1) the title of those Junior Subordinated Debentures,
- (2) any limit upon the aggregate principal amount of those Junior Subordinated Debentures,
- (3) the date(s) on which the principal will be paid,
- (4) the rate(s) of interest on those Junior Subordinated Debentures, or how the rate(s) of interest will be determined, the date(s) from which interest will accrue, the dates on which interest will be paid and the record date for any interest payable on any interest payment date,
- (5) the person to whom interest will be paid on any interest payment date, if other than the person in whose name those Junior Subordinated Debentures are registered at the close of business on the record date for that interest payment,
- (6) the place(s) at which or methods by which payments will be made on those Junior Subordinated Debentures and the place(s) at which or methods by which the registered owners of those Junior Subordinated Debentures may transfer or exchange those Junior Subordinated Debentures and serve notices and demands to or upon FPL Group Capital or FPL Group, as the case may be,
- (7) the security registrar and any paying agent or agents for those Junior Subordinated Debentures,
- (8) any date(s) on which, the price(s) at which and the terms and conditions upon which those Junior Subordinated Debentures may be redeemed at the option of the issuer, in whole or in part, and any restrictions on those redemptions,
- (9) any sinking fund or other provisions or options held by the registered owners of those Junior Subordinated Debentures that would obligate the issuer to repurchase or redeem those Junior Subordinated Debentures,
- (10) the denominations in which those Junior Subordinated Debentures may be issued, if other than denominations of \$25 and any integral multiple of \$25,
- (11) the currency or currencies in which the principal of or premium, if any, or interest on those Junior Subordinated Debentures may be paid (if other than in U.S. dollars),
- (12) if FPL Group Capital, or FPL Group, as the case may be, or a registered owner may elect to pay, or receive, principal of or premium, if any, or interest on those Junior Subordinated Debentures in a currency other than that in which those Junior Subordinated Debentures are stated to be payable, the terms and conditions upon which that election may be made,
- (13) if the principal of or premium, if any, or interest on those Junior Subordinated Debentures may be paid in securities or other property, the type and amount of those securities or other property and the terms and conditions upon which FPL Group Capital, or FPL Group, as the case may be, or a registered owner may elect to pay or receive those payments,

(14)

if the amount payable in respect of principal of or premium, if any, or interest on those Junior Subordinated Debentures may be determined by reference to an index or other fact or event

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ascertainable outside of the Subordinated Indenture, the manner in which those amounts will be determined,

- (15) the portion of the principal amount of the Junior Subordinated Debentures that will be paid by the issuer upon declaration of acceleration of the maturity of those Junior Subordinated Debentures, if other than the entire principal amount of those Junior Subordinated Debentures,
- (16) any events of default with respect to those Junior Subordinated Debentures and any covenants of FPL Group Capital, or FPL Group, as the case may be, for the benefit of the registered owners of those Junior Subordinated Debentures, other than those specified in the Subordinated Indenture,
- (17) the terms, if any, pursuant to which those Junior Subordinated Debentures may be exchanged for shares of capital stock or other securities of any other entity,
- (18) a definition of "Eligible Obligations" under the Subordinated Indenture with respect to the Junior Subordinated Debentures denominated in a currency other than U.S. dollars, and any other provisions for the reinstatement of the issuer's indebtedness in respect of those Junior Subordinated Debentures after their satisfaction and discharge,
- (19) if those Junior Subordinated Debentures will be issued in global form, necessary information relating to the issuance of those Junior Subordinated Debentures in global form,
- (20) if those Junior Subordinated Debentures will be issued as bearer securities, necessary information relating to the issuance of those Junior Subordinated Debentures as bearer securities,
- (21) any limits on the rights of the registered owners of those Junior Subordinated Debentures to transfer or exchange those Junior Subordinated Debentures or to register their transfer, and any related service charges,
- (22) any exceptions to the provisions governing payments due on legal holidays or any variations in the definition of business day with respect to those Junior Subordinated Debentures,
- (23) any collateral security, assurance, or guarantee for those Junior Subordinated Debentures (including, with respect to the FPL Group Capital Junior Subordinated Debentures, any security, assurance of guarantee in addition to, or any exceptions to, the Subordinated Guarantee described under " Subordinated Guarantee of FPL Group Capital Junior Subordinated Debentures" below),
- (24) the designation of the trust to which the Junior Subordinated Debentures are to be issued, if the Junior Subordinated Debentures are issued in connection with the issuance of Trust Securities,
- (25) the terms relating to any additional interest that may be payable as a result of any tax, assessment or governmental charges, and
- (26) any other terms of those Junior Subordinated Debentures that are not inconsistent with the provisions of the Subordinated Indenture. (Subordinated Indenture, Section 301).

Except as otherwise stated in the related prospectus supplement, the covenants in the Subordinated Indenture would not give registered owners of Junior Subordinated Debentures protection in the event of a highly-leveraged transaction involving FPL Group Capital, in the case of the FPL Group Capital Junior Subordinated Debentures, or FPL Group.

Subordination. The Junior Subordinated Debentures will be subordinate and junior in right of payment to all Senior Indebtedness of FPL Group Capital, or FPL Group, as the case may be. (FPL Group Capital Subordinated Indenture, Article Fifteen; FPL Group Subordinated

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Indenture, Article Fourteen). No payment of the principal (including redemption and sinking fund payments) of, or interest, or premium, if any, on the Junior Subordinated Debentures may be made by FPL Group Capital, or FPL Group, as the case may be, until all holders of Senior

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Indebtedness of FPL Group Capital, or FPL Group, as the case may be, have been paid in full (or provision has been made for such payment), if any of the following occurs:

- (1) certain events of bankruptcy, insolvency or reorganization of FPL Group Capital or FPL Group, as the case may be;
- (2) any Senior Indebtedness of FPL Group Capital, or of FPL Group, as the case may be, is not paid when due (after the expiration of any applicable grace period) and that default continues without waiver; or
- (3) any other default has occurred and continues without waiver (after the expiration of any applicable grace period) pursuant to which the holders of Senior Indebtedness of FPL Group Capital, or FPL Group, as the case may be, are permitted to accelerate the maturity of such Senior Indebtedness. (FPL Group Capital Subordinated Indenture, Section 1502; FPL Group Subordinated Indenture, Section 1402).

Upon any distribution of assets of FPL Group Capital, or of FPL Group, as the case may be, to creditors in connection with any insolvency, bankruptcy or similar proceeding, all principal of, and premium, if any, and interest due or to become due on all Senior Indebtedness of FPL Group Capital, or of FPL Group, as the case may be, must be paid in full before the holders of the Junior Subordinated Debentures are entitled to receive or retain any payment from such distribution. (FPL Group Capital Subordinated Indenture, Section 1502; FPL Group Subordinated Indenture, Section 1402).

FPL Group Capital is a holding company that derives substantially all of its income from its operating subsidiaries. Therefore, FPL Group Capital Subordinated Indenture Securities will be effectively subordinated to all indebtedness and other liabilities, including trade payables, debt and preferred stock, incurred or issued by FPL Group Capital's subsidiaries. The FPL Group Capital Subordinated Indenture does not place any limit on the amount of liabilities including debt or preferred stock, that FPL Group Capital's subsidiaries may issue, guarantee or otherwise incur.

FPL Group is a holding company that derives substantially all of its income from its operating subsidiaries. Therefore, FPL Group Subordinated Indenture Securities will be effectively subordinated to all indebtedness and other liabilities, including trade payables, debt and preferred stock, incurred or issued by FPL Group's subsidiaries. The FPL Group Subordinated Indenture does not place any limit on the amount of liabilities including debt or preferred stock, that FPL Group's subsidiaries may issue, guarantee or otherwise incur.

Subordinated Guarantee of FPL Group Capital Junior Subordinated Debentures. Pursuant to the Subordinated Guarantee, FPL Group will unconditionally and irrevocably guarantee the payment of principal of and any interest and premium, if any, on the FPL Group Capital Junior Subordinated Debentures, when due and payable, whether at the stated maturity date, by declaration of acceleration, call for redemption or otherwise, in accordance with the terms of such FPL Group Capital Junior Subordinated Debentures and the FPL Group Capital Subordinated Indenture. The Subordinated Guarantee will remain in effect until the entire principal of and any premium, if any, and interest on the FPL Group Capital Junior Subordinated Debentures has been paid in full or otherwise discharged in accordance with the provisions of the FPL Group Capital Subordinated Indenture. (FPL Group Capital Subordinated Indenture, Article Fourteen).

The Subordinated Guarantee will be subordinate and junior in right of payment to all Senior Indebtedness of FPL Group. (FPL Group Capital Subordinated Indenture, Section 1402). No payment of the principal (including redemption and sinking fund payments) of, or interest, or premium, if any, on, the FPL Group Capital Junior Subordinated Debentures may be made by FPL Group under the Subordinated Guarantee until all holders of Senior Indebtedness of FPL Group have been paid in full (or provision has been made for such payment), if any of the following occurs:

- (1) certain events of bankruptcy, insolvency or reorganization of FPL Group;
- (2) any Senior Indebtedness of FPL Group is not paid when due (after the expiration of any applicable grace period) and that default continues without waiver; or

(3)

any other default has occurred and continues without waiver (after the expiration of any applicable grace period) pursuant to which the holders of Senior Indebtedness of FPL Group are permitted to accelerate the maturity of such Senior Indebtedness. (FPL Group Capital Subordinated Indenture, Section 1403).

Upon any distribution of assets of FPL Group to creditors in connection with any insolvency, bankruptcy or similar proceeding, all principal of, and premium, if any, and interest due or to become due on all Senior Indebtedness of FPL Group must be paid in full before the holders of the FPL Group Capital Junior Subordinated Debentures are entitled to receive or retain any payment from such distribution. (FPL Group Capital Subordinated Indenture, Section 1403).

FPL Group is a holding company that derives substantially all of its income from its operating subsidiaries. Therefore, the Subordinated Guarantee is effectively subordinated to all indebtedness and other liabilities, including trade payables, debt and preferred stock, incurred or issued by FPL Group's subsidiaries. The FPL Group Capital Subordinated Indenture does not place any limit on the amount of liabilities, including debt or preferred stock, that FPL Group's subsidiaries may issue, guarantee or otherwise incur.

Payment and Paying Agents. Except as stated in the related prospectus supplement, on each interest payment date FPL Group Capital, or FPL Group, as the case may be, will pay interest on each Junior Subordinated Debenture to the person in whose name that Junior Subordinated Debenture is registered as of the close of business on the record date relating to that interest payment date. However, on the date that the Junior Subordinated Debentures mature, FPL Group Capital, or FPL Group, as the case may be, will pay the interest to the person to whom it pays the principal. Also, if FPL Group Capital, or FPL Group, as the case may be, has defaulted in the payment of interest on any Junior Subordinated Debenture, it may pay that defaulted interest to the registered owner of that Junior Subordinated Debenture:

(1)

as of the close of business on a date that the Subordinated Indenture Trustee selects, which may not be more than 15 days or less than 10 days before the date that FPL Group Capital, or FPL Group, as the case may be, proposes to pay the defaulted interest, or

(2)

in any other lawful manner that does not violate the requirements of any securities exchange on which that Junior Subordinated Debenture is listed and that the Subordinated Indenture Trustee believes is acceptable. (Subordinated Indenture, Section 307).

Unless otherwise stated in the related prospectus supplement, the principal, premium, if any, and interest on the Junior Subordinated Debentures at maturity will be payable when such Junior Subordinated Debentures are presented at the main corporate trust office of The Bank of New York, as paying agent, in The City of New York. FPL Group Capital and/or FPL Group with respect to the FPL Group Capital Junior Subordinated Debentures and FPL Group with respect to the FPL Group Junior Subordinated Debentures may change the place of payment on the Junior Subordinated Debentures, appoint one or more additional paying agents, including itself, and remove any paying agent. (Subordinated Indenture, Section 602).

Transfer and Exchange. Unless otherwise stated in the related prospectus supplement, Junior Subordinated Debentures may be transferred or exchanged at the main corporate trust office of The Bank of New York, as security registrar, in The City of New York. FPL Group Capital, or FPL Group, as the case may be, may change the place for transfer and exchange of the Junior Subordinated Debentures and may designate one or more additional places for that transfer and exchange.

Except as otherwise stated in the related prospectus supplement, there will be no service charge for any transfer or exchange of the Junior Subordinated Debentures. However, FPL Group Capital, or FPL Group, as the case may be, may require payment of any tax or other governmental charge in connection with any transfer or exchange of the Junior Subordinated Debentures.

FPL Group Capital, or FPL Group, as the case may be, will not be required to transfer or exchange any Junior Subordinated Debenture selected for redemption. Also, FPL Group Capital, or FPL Group, as the case may be, will not be required to transfer or exchange any Junior Subordinated Debenture during a period of 15 days before selection of Junior Subordinated Debentures to be redeemed. (Subordinated Indenture, Section 305).

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Unless otherwise stated in the related prospectus supplement, if Junior Subordinated Debentures are issued in connection with the issuance of Trust Securities and are subsequently distributed to holders of Preferred Trust Securities in a dissolution of the Trust, the Junior Subordinated Debentures will be issued in fully registered certificated form in the denominations and integral multiples thereof in which the Preferred Trust Securities have been issued, and they may be transferred or exchanged as described above. (Trust Agreement, Section 9.04).

Defeasance. FPL Group Capital and FPL Group may, at any time, elect to have all of their obligations discharged with respect to all or a portion of any Subordinated Indenture Securities (including the FPL Group Capital Junior Subordinated Debentures). FPL Group may, at any time, elect to have all of its obligations discharged with respect to all or a portion of any Subordinated Indenture Securities (including the FPL Group Junior Subordinated Debentures). To do so, FPL Group Capital or FPL Group, with respect to FPL Group Capital Junior Subordinated Debentures, or FPL Group with respect to the FPL Group Junior Subordinated Debentures, must irrevocably deposit with the Subordinated Indenture Trustee or any paying agent, in trust:

- (1) money in an amount that will be sufficient to pay all or that portion of the principal, premium, if any, and interest due and to become due on those Subordinated Indenture Securities, on or prior to their maturity, or
- (2) in the case of a deposit made prior to the maturity of that series of Subordinated Indenture Securities,
 - (a) direct obligations of, or obligations unconditionally guaranteed by, the United States and entitled to the benefit of its full faith and credit that do not contain provisions permitting their redemption or other prepayment at the option of their issuer, and
 - (b) certificates, depositary receipts or other instruments that evidence a direct ownership interest in those obligations or in any specific interest or principal payments due in respect of those obligations that do not contain provisions permitting their redemption or other prepayment at the option of their issuer, the principal of and the interest on which, when due, without any regard to reinvestment of that principal or interest, will provide money that, together with any money deposited with or held by the Subordinated Indenture Trustee, will be sufficient to pay all or that portion of the principal, premium, if any, and interest due and to become due on those Subordinated Indenture Securities, on or prior to their maturity, or
- (3) a combination of (1) and (2) that will be sufficient to pay all or that portion of the principal, premium, if any, and interest due and to become due on those Subordinated Indenture Securities, on or prior to their maturity. (Subordinated Indenture, Section 701).

Option to Defer Interest Payments. Unless otherwise provided in a related prospectus supplement, FPL Group Capital, or FPL Group, as the case may be, may have the option to defer the payment of interest from time to time on the Junior Subordinated Debentures for one or more periods. As a consequence, if the Junior Subordinated Debentures are issued in connection with Preferred Trust Securities, distributions on the Preferred Trust Securities would be deferred during any optional deferral period. Interest would, however, continue to accrue on the Junior Subordinated Debentures. Unless otherwise provided in a related prospectus supplement, during any optional deferral period, or for so long as an "Event of Default" under the Subordinated Indenture resulting from a payment default (or a payment default under the Preferred Trust Securities Guarantee if the Junior Subordinated Debentures are issued in connection with Preferred Trust Securities) has occurred and is continuing, neither FPL Group nor FPL Group Capital, with respect to FPL Group Capital Junior Subordinated Debentures, or FPL Group, with respect to FPL Group Junior Subordinated Debentures may:

- (1) declare or pay any dividend or distribution on its capital stock;
- (2) redeem, purchase, acquire or make a liquidation payment with respect to any of its capital stock;
- (3) pay any principal, interest or premium on, or repay, repurchase or redeem any debt securities that are equal or junior in right of payment with the Junior Subordinated Debentures or, in the case of FPL Group Capital Junior Subordinated Debentures issued in connection with Preferred Trust Securities, the Subordinated Guarantee (as the case may be); or

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- (4) make any payments with respect to any guarantee of debt securities if such guarantee is equal or junior in right of payment to the Junior Subordinated Debentures or the Subordinated Guarantee if the Junior Subordinated Debentures are issued in connection with Preferred Trust Securities (as the case may be),

other than

- (1) purchases, redemptions or other acquisitions of its capital stock in connection with any employment contract, benefit plan or other similar arrangement with or for the benefit of employees, officers, directors or agents or a stock purchase or dividend reinvestment plan, or the satisfaction of its obligations pursuant to any contract or security outstanding on the date that the payment of interest is deferred requiring it to purchase, redeem or acquire its capital stock;
- (2) any payment, repayment, redemption, purchase, acquisition or declaration of dividend listed as restricted payments in clauses (1) and (2) above as a result of a reclassification of its capital stock or the exchange or conversion of all or a portion of one class or series of its capital stock for another class or series of its capital stock;
- (3) the purchase of fractional interests in shares of its capital stock pursuant to the conversion or exchange provisions of its capital stock or the security being converted or exchanged, or in connection with the settlement of stock purchase contracts;
- (4) dividends or distributions paid or made in its capital stock (or rights to acquire its capital stock), or repurchases, redemptions or acquisitions of capital stock in connection with the issuance or exchange of capital stock (or of securities convertible into or exchangeable for shares of its capital stock) and distributions in connection with the settlement of stock purchase contracts;
- (5) redemptions, exchanges or repurchases of, or with respect to, any rights outstanding under a shareholder rights plan or the declaration or payment thereunder of a dividend or distribution of or with respect to rights in the future;
- (6) payments under any preferred trust securities guarantee or guarantee of subordinated debentures executed and delivered by FPL Group concurrently with the issuance by a trust of any preferred trust securities, so long as the amount of payments made on any preferred trust securities or subordinated debentures (as the case may be) is paid on all preferred trust securities or subordinated debentures (as the case may be) then outstanding on a pro rata basis in proportion to the full distributions to which each series of preferred trust securities or subordinated debentures (as the case may be) is then entitled if paid in full;
- (7) payments under any guarantee of junior subordinated debentures executed and delivered by FPL Group (including a FPL Group Subordinated Guarantee), so long as the amount of payments made on any junior subordinated debentures is paid on all junior subordinated debentures then outstanding on a pro rata basis in proportion to the full payment to which each series of junior subordinated debentures is then entitled if paid in full;
- (8) dividends or distributions by FPL Group Capital on its capital stock to the extent owned by FPL Group; or
- (9) redemptions, purchases, acquisitions or liquidation payments by FPL Group Capital with respect to its capital stock to the extent owned by FPL Group. (Subordinated Indenture, Section 608).

The exceptions in (8) and (9) above are not applicable to an optional deferral period on the FPL Group Junior Subordinated Debentures.

Unless otherwise provided in a related prospectus supplement, before an optional deferral period ends, FPL Group Capital, or FPL Group, as the case may be, may further defer the payment of interest. Unless otherwise provided in the related prospectus supplement, no optional deferral period may exceed the period of time specified in that prospectus supplement. After any optional deferral period and the payment of all amounts then due, FPL

Group Capital, or FPL Group, as the case may be, may select a new optional deferral period. No interest period may be deferred beyond the maturity of the Junior Subordinated Debentures. If the Junior Subordinated Debentures are issued in connection with Preferred Trust Securities, FPL Group Capital, or FPL Group, as the case may be, will give the Trust and the Subordinated Indenture Trustee notice of its election of an optional deferral period prior to the earlier of (i) one business day before the record date for the distribution on the Preferred Trust Securities which would occur if FPL Group Capital, or FPL Group, as the case may be, did not make the election to defer or (ii) the date the Administrative Trustees are required to give notice to any securities exchange or any other applicable self-regulatory organization of the record date for such a distribution. The Property Trustee shall send notice of that election to the holders of Preferred Trust Securities.

Additional Interest. If the Junior Subordinated Debentures are issued in connection with the issuance of Trust Securities and if the Trust is required to pay any taxes, duties, assessments or governmental charges imposed by the United States or any other taxing authority on income derived from the interest payments on the Junior Subordinated Debentures, then, so long as any Preferred Trust Securities remain outstanding, FPL Group Capital, or FPL Group, as the case may be, will pay as interest on the Junior Subordinated Debentures any additional interest that may be necessary in order that the net amounts received and retained by the Trust after the payment of those taxes, duties, assessments or governmental charges will be the same as the Trust would have had in the absence of such payment. (Subordinated Indenture, Section 313).

Redemption. The redemption terms of the Junior Subordinated Debentures, if any, will be set forth in a prospectus supplement. Unless set forth differently in a prospectus supplement, and except with respect to Junior Subordinated Debentures redeemable at the option of the holder, Junior Subordinated Debentures will be redeemable upon notice between 30 and 60 days prior to the redemption date. If less than all of the Junior Subordinated Debentures of any series or any tranche thereof are to be redeemed, the Subordinated Indenture Trustee will select the Junior Subordinated Debentures to be redeemed. In the absence of any provision for selection, the Subordinated Indenture Trustee will choose a method of random selection as it deems fair and appropriate. (Subordinated Indenture, Sections 403 and 404).

Junior Subordinated Debentures selected for redemption will cease to bear interest on the redemption date. The paying agent will pay the redemption price and any accrued interest once the Junior Subordinated Debentures are surrendered for redemption. (Subordinated Indenture, Section 405). If only part of a Junior Subordinated Debenture is redeemed, the Subordinated Indenture Trustee will deliver a new Junior Subordinated Debenture of the same series for the remaining portion without charge. (Subordinated Indenture, Section 406).

Any redemption at the option of FPL Group Capital, or FPL Group, as the case may be, may be conditional upon the receipt by the paying agent, on or prior to the date fixed for redemption, of money sufficient to pay the redemption price. If the paying agent has not received such money by the date fixed for redemption, neither FPL Group Capital nor FPL Group, in the case of FPL Group Capital Junior Subordinated Debentures, nor FPL Group, in the case of FPL Group Junior Subordinated Debentures, will be required to redeem such Junior Subordinated Debentures. (Subordinated Indenture, Section 404).

If the Junior Subordinated Debentures are issued in connection with the issuance of Trust Securities, for so long as the Trust is the holder of all of the related Junior Subordinated Debentures the proceeds of any redemption of Junior Subordinated Debentures will be used by the Trust to redeem Preferred Trust Securities and Common Trust Securities in accordance with their terms. (Trust Agreement, Section 4.02(a)).

Subject to applicable law, including United States federal securities laws, FPL Group or its affiliates, including FPL Group Capital, may at any time and from time to time purchase outstanding Junior Subordinated Debentures by tender, in the open market or by private agreement.

Consolidation, Merger, and Sale of Assets. Under the FPL Group Capital Subordinated Indenture, neither FPL Group Capital nor FPL Group may, and under the FPL Group Subordinated Indenture, FPL Group may not, consolidate with or merge into any other entity or convey, transfer or lease its properties and assets substantially as an entirety to any entity, unless:

- (1) the entity formed by that consolidation, or the entity into which FPL Group Capital or FPL Group, as the case may be, in the case of the FPL Group Capital Subordinated Indenture, or FPL Group, in the

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case of the FPL Group Subordinated Indenture, is merged, or the entity that acquires or leases FPL Group Capital's or FPL Group's, as the case may be, in the case of the FPL Group Capital Subordinated Indenture, or FPL Group's, in the case of the FPL Group Subordinated Indenture, property and assets, is an entity organized and existing under the laws of the United States, any state or the District of Columbia and that entity expressly assumes FPL Group Capital's or FPL Group's, as the case may be, in the case of the FPL Group Capital Subordinated Indenture, or FPL Group's, in the case of the FPL Group Subordinated Indenture, obligations on all Subordinated Indenture Securities and under the Subordinated Indenture,

- (2) immediately after giving effect to the transaction, no event of default under the Subordinated Indenture and no event that, after notice or lapse of time or both, would become an event of default under the Subordinated Indenture exists, and
- (3) FPL Group Capital or FPL Group, as the case may be, in the case of the FPL Group Capital Subordinated Indenture, or FPL Group, in the case of the FPL Group Subordinated Indenture, delivers an officer's certificate and an opinion of counsel to the Subordinated Indenture Trustee, as provided in the Subordinated Indenture. (Subordinated Indenture, Section 1101).

The Subordinated Indenture does not prevent or restrict:

- (1) any consolidation or merger after the consummation of which FPL Group Capital or FPL Group, in the case of the FPL Group Capital Subordinated Indenture, or FPL Group, in the case of the FPL Group Subordinated Indenture, would be the surviving or resulting entity;
- (2) in the case of the FPL Group Capital Subordinated Indenture, any consolidation of FPL Group Capital with FPL Group or any other entity all of the outstanding voting securities of which are owned, directly or indirectly, by FPL Group, or any merger of any such entity into any other of such entities, or any conveyance or other transfer, or lease, of properties or assets by any thereof to any other thereof;
- (3) any conveyance or other transfer, or lease, of any part of the properties or assets of FPL Group Capital or FPL Group, in the case of the FPL Group Capital Subordinated Indenture, or FPL Group, in the case of the FPL Group Subordinated Indenture, which does not constitute the entirety, or substantially the entirety, thereof; or
- (4) the approval by FPL Group Capital or FPL Group, in the case of the FPL Group Capital Subordinated Indenture, or FPL Group, in the case of the FPL Group Subordinated Indenture, of or the consent by FPL Group Capital or FPL Group, in the case of the FPL Group Capital Subordinated Indenture, or FPL Group, in the case of the FPL Group Subordinated Indenture, to any consolidation or merger to which any direct or indirect subsidiary or affiliate of FPL Group may be a party, or any conveyance, transfer or lease by any such subsidiary or affiliate of any or all of its properties or assets. (Subordinated Indenture, Section 1103).

Events of Default. Each of the following is an event of default under the Subordinated Indenture with respect to the Subordinated Indenture Securities of any series:

- (1) failure to pay interest on the Subordinated Indenture Securities of that series within 30 days after it is due (provided, however, that a failure to pay interest during a valid optional deferral period will not constitute an event of default),
- (2) failure to pay principal or premium, if any, on the Subordinated Indenture Securities of that series when it is due,
- (3) failure to comply with any other covenant in the Subordinated Indenture, other than a covenant that does not relate to that series of Subordinated Indenture Securities, that continues for 90 days after FPL Group Capital and FPL Group, in the case of the FPL Group Capital Subordinated Indenture, or FPL Group, in the case of the FPL Group Subordinated Indenture, receive written notice of such failure to

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comply from the Subordinated Indenture Trustee, or FPL Group Capital, in the case of the FPL Group Capital Subordinated Indenture, FPL Group and the Subordinated Indenture Trustee receive written notice of such failure to comply from the registered owners of at least 33% in principal amount of the Subordinated Indenture Securities of that series,

- (4) certain events of bankruptcy, insolvency or reorganization of FPL Group Capital or FPL Group in the case of the FPL Group Capital Subordinated Indenture, or FPL Group in the case of the FPL Group Subordinated Indenture,
- (5) with certain exceptions, the Subordinated Guarantee ceases to be effective, is found by a judicial proceeding to be unenforceable or invalid or is denied or disaffirmed by FPL Group, and
- (6) any other event of default specified with respect to the Subordinated Indenture Securities of that series. (Subordinated Indenture, Section 801).

In the case of the third event of default listed above, the Subordinated Indenture Trustee may extend the grace period. In addition, if holders of a particular series have given a notice of default, then holders of at least the same percentage of Junior Subordinated Debentures of that series, together with the Subordinated Indenture Trustee, may also extend the grace period. The grace period will be automatically extended if FPL Group Capital or FPL Group, in the case of the FPL Group Capital Subordinated Indenture, or FPL Group, in the case of the FPL Group Subordinated Indenture, has initiated and is diligently pursuing corrective action in good faith. (Subordinated Indenture, Section 801). An event of default with respect to the Subordinated Indenture Securities of a particular series will not necessarily constitute an event of default with respect to Subordinated Indenture Securities of any other series issued under the Subordinated Indenture.

Remedies. If an event of default applicable to the Subordinated Indenture Securities of one or more series, but not applicable to all outstanding Subordinated Indenture Securities, exists, then either the Subordinated Indenture Trustee or the registered owners of at least 33% in aggregate principal amount of the Subordinated Indenture Securities of each of the affected series may declare the principal of and accrued but unpaid interest on all the Subordinated Indenture Securities of that series to be due and payable immediately. (Subordinated Indenture, Section 802).

If the event of default is applicable to all outstanding Subordinated Indenture Securities, then only the Subordinated Indenture Trustee or the registered owners of at least 33% in aggregate principal amount of all outstanding Subordinated Indenture Securities of all series, voting as one class, and not the registered owners of any one series, may make a declaration of acceleration. (Subordinated Indenture, Section 802). However, the event of default giving rise to the declaration relating to any series of Subordinated Indenture Securities will be automatically waived, and that declaration and its consequences will be automatically rescinded and annulled, if, at any time after that declaration and before a judgment or decree for payment of the money due has been obtained:

- (1) FPL Group Capital or FPL Group in the case of the FPL Group Capital Subordinated Indenture, or FPL Group in the case of the FPL Group Subordinated Indenture, deposits with the Subordinated Indenture Trustee a sum sufficient to pay:
 - (a) all overdue interest on all Subordinated Indenture Securities of that series,
 - (b) the principal of and any premium on any Subordinated Indenture Securities of that series that have become due for reasons other than that declaration, and interest that is then due,
 - (c) interest on overdue interest for that series, and
 - (d) all amounts due to the Subordinated Indenture Trustee under the Subordinated Indenture, and
- (2) any other event of default with respect to the Subordinated Indenture Securities of that series has been cured or waived as provided in the Subordinated Indenture. (Subordinated Indenture, Section 802).

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Other than its obligations and duties in case of an event of default under the Subordinated Indenture, the Subordinated Indenture Trustee is not obligated to exercise any of its rights or powers under the Subordinated Indenture at the request or direction of any of the registered owners of the Subordinated Indenture Securities, unless those registered owners offer reasonable indemnity to the Subordinated Indenture Trustee. (Subordinated Indenture, Section 903). If they provide this reasonable indemnity, the registered owners of a majority in principal amount of any series of Subordinated Indenture Securities will have the right to direct the time, method and place of conducting any proceeding for any remedy available to the Subordinated Indenture Trustee, or exercising any trust or power conferred on the Subordinated Indenture Trustee, with respect to the Subordinated Indenture Securities of that series. However, if an event of default under the Subordinated Indenture relates to more than one series of Subordinated Indenture Securities, only the registered owners of a majority in aggregate principal amount of all affected series of Subordinated Indenture Securities, considered as one class, will have the right to make that direction. Also, the direction must not violate any law or the Subordinated Indenture, and may not expose the Subordinated Indenture Trustee to personal liability in circumstances where its indemnity would not, in the Subordinated Indenture Trustee's sole discretion, be adequate. (Subordinated Indenture, Section 812).

No registered owner of Subordinated Indenture Securities of any series will have any right to institute any proceeding under the Subordinated Indenture, or exercise any remedy under the Subordinated Indenture, unless:

- (1) that registered owner has previously given to the Subordinated Indenture Trustee written notice of a continuing event of default with respect to the Subordinated Indenture Securities of that series,
- (2) the registered owners of a majority in aggregate principal amount of the outstanding Subordinated Indenture Securities of all series in respect of which an event of default under the Subordinated Indenture exists, considered as one class, have made written request to the Subordinated Indenture Trustee, and have offered reasonable indemnity to the Subordinated Indenture Trustee to institute that proceeding in its own name as trustee, and
- (3) the Subordinated Indenture Trustee has failed to institute any proceeding, and has not received from the registered owners of a majority in aggregate principal amount of the outstanding Subordinated Indenture Securities of all series in respect of which an event of default under the Subordinated Indenture exists, considered as one class, a direction inconsistent with that request, within 60 days after that notice, request and offer. (Subordinated Indenture, Section 807).

However, these limitations do not apply to a suit instituted by a registered owner of a Subordinated Indenture Security for the enforcement of payment of the principal of or any premium, if any, or interest on that Subordinated Indenture Security on or after the applicable due date specified in that Subordinated Indenture Security. (Subordinated Indenture, Section 808).

Each of FPL Group Capital and FPL Group in the case of the FPL Group Capital Subordinated Indenture, and FPL Group in the case of the FPL Group Subordinated Indenture, is required to deliver to the Subordinated Indenture Trustee an annual statement as to its compliance with all conditions and covenants applicable to it under the Subordinated Indenture. (Subordinated Indenture, Section 606).

Enforcement of Certain Rights by Holders of Preferred Trust Securities. If the Junior Subordinated Debentures were issued in connection with the issuance of Trust Securities and if there is an event of default with respect to Junior Subordinated Debentures held by the Trust, then the holders of Preferred Trust Securities issued by the Trust will rely on the Property Trustee or the Subordinated Indenture Trustee, acting for the benefit of the Property Trustee, to enforce the Property Trustee's rights against FPL Group Capital and FPL Group in the case of the FPL Group Capital Subordinated Indenture, or FPL Group in the case of the FPL Group Subordinated Indenture, as a holder of the Junior Subordinated Debentures. However, in such a situation, a holder of Preferred Trust Securities may enforce the Subordinated Indenture directly against FPL Group Capital in the case of the FPL Group Capital Subordinated Indenture, or FPL Group, in the case of the FPL Group Subordinated Indenture, to the same extent, and upon the same conditions, as if the holder of Preferred Trust Securities held a principal amount of Junior Subordinated Debentures equal to the aggregate liquidation amount of its Preferred Trust Securities. (Subordinated Indenture, Section 610).

Subject to their right to bring suit to enforce their right to payment, the holders of Preferred Trust Securities would not be able to institute any proceeding with respect to the Subordinated Indenture unless the Subordinated Indenture Trustee has failed to do so for 60 days after a request of the holders of at least a majority of the aggregate liquidation amount of outstanding Preferred Trust Securities. Upon such failure, the holders of a majority of the aggregate liquidation amount of the outstanding Preferred Trust Securities would have the right to directly institute proceedings for enforcement of all other rights of the Subordinated Indenture Trustee against FPL Group Capital in the case of the FPL Group Capital Subordinated Indenture, or FPL Group in the case of the FPL Group Subordinated Indenture, to the fullest extent permitted by law. (Subordinated Indenture, Sections 807, 808 and 812).

Modification and Waiver. Without the consent of any registered owner of Subordinated Indenture Securities, FPL Group, the Subordinated Indenture Trustee and, in the case of the FPL Group Capital Subordinated Indenture, FPL Group Capital, may amend or supplement the Subordinated Indenture for any of the following purposes:

- (1) to provide for the assumption by any permitted successor to FPL Group Capital or FPL Group of FPL Group Capital's or FPL Group's, in the case of the FPL Group Capital Subordinated Indenture, or by any permitted successor to FPL Group of FPL Group's, in the case of the FPL Group Subordinated Indenture, obligations with respect to the Subordinated Indenture and the Subordinated Indenture Securities in the case of a merger or consolidation or a conveyance, transfer or lease of its properties and assets substantially as an entirety,
- (2) to add covenants of FPL Group Capital or FPL Group in the case of the FPL Group Capital Subordinated Indenture, or FPL Group in the case of the FPL Group Subordinated Indenture, or to surrender any right or power conferred upon FPL Group Capital, in the case of the FPL Group Capital Subordinated Indenture, or FPL Group by the Subordinated Indenture,
- (3) to add any additional events of default,
- (4) to change, eliminate or add any provision of the Subordinated Indenture, provided that if that change, elimination or addition will materially adversely affect the interests of the registered owners of Subordinated Indenture Securities of any series or tranche, that change, elimination or addition will become effective with respect to that series or tranche only
 - (a) when the required consent of the registered owners of Subordinated Indenture Securities of that series or tranche has been obtained, or
 - (b) when no Subordinated Indenture Securities of that series or tranche remain outstanding under the Subordinated Indenture,
- (5) to provide collateral security for all but not a part of the Subordinated Indenture Securities,
- (6) to establish the form or terms of Subordinated Indenture Securities of any other series or tranche,
- (7) to provide for the authentication and delivery of bearer securities and the related coupons and for other matters relating to those bearer securities,
- (8) to accept the appointment of a successor Subordinated Indenture Trustee or co-trustee with respect to the Subordinated Indenture Securities of one or more series and to change any of the provisions of the Subordinated Indenture as necessary to provide for the administration of the trusts under the Subordinated Indenture by more than one trustee,
- (9) to add procedures to permit the use of a non-certificated system of registration for the Subordinated Indenture Securities of all or any series or tranche,

(10)

to change any place where

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- (a) the principal of and premium, if any, and interest on all or any series or tranche of Subordinated Indenture Securities are payable,
 - (b) all or any series or tranche of Subordinated Indenture Securities may be transferred or exchanged, and
 - (c) notices and demands to or upon FPL Group Capital or FPL Group in the case of the FPL Group Capital Subordinated Indenture, or FPL Group in the case of the FPL Group Subordinated Indenture, in respect of Subordinated Indenture Securities and the Subordinated Indenture may be served, or
- (11) to cure any ambiguity or inconsistency or to add or change any other provisions with respect to matters and questions arising under the Subordinated Indenture, provided those changes or additions may not materially adversely affect the interests of the registered owners of Subordinated Indenture Securities of any series or tranche. (Subordinated Indenture, Section 1201).

The registered owners of a majority in aggregate principal amount of the Subordinated Indenture Securities of all series then outstanding may waive compliance by FPL Group Capital or FPL Group in the case of the FPL Group Capital Subordinated Indenture, or by FPL Group in the case of the FPL Group Subordinated Indenture, with certain restrictive provisions of the Subordinated Indenture. (Subordinated Indenture, Section 607). The registered owners of a majority in principal amount of the outstanding Subordinated Indenture Securities of any series may waive any past default under the Subordinated Indenture with respect to that series, except a default in the payment of principal, premium, if any, or interest and a default with respect to certain restrictive covenants or provisions of the Subordinated Indenture that cannot be modified or amended without the consent of the registered owner of each outstanding Subordinated Indenture Security of that series affected. (Subordinated Indenture, Section 813). If the Trust holds Subordinated Indenture Securities of any series, the Trust may not waive compliance, or any default in compliance, by FPL Group Capital or FPL Group with any covenant or term contained in, or any past default under, the Subordinated Indenture or the Subordinated Indenture Securities of such series, without the approval of at least a majority (or such greater percentage required by the Trust Agreement) in aggregate liquidation preference amount of the outstanding Preferred Trust Securities. (Subordinated Indenture, Sections 607 and 813).

In addition to any amendments described above, if the Trust Indenture Act of 1939 is amended after the date of either Subordinated Indenture in a way that requires changes to the Subordinated Indenture or in a way that permits changes to, or the elimination of, provisions that were previously required by the Trust Indenture Act of 1939, the Subordinated Indenture will be deemed to be amended to conform to that amendment of the Trust Indenture Act of 1939 or to make those changes, additions or eliminations. FPL Group Capital and FPL Group in the case of the FPL Group Capital Subordinated Indenture, or FPL Group in the case of the FPL Group Subordinated Indenture, and the Subordinated Indenture Trustee may, without the consent of any registered owners, enter into supplemental indentures to make that amendment. (Subordinated Indenture, Section 1201).

Except for any amendments described above, the consent of the registered owners of a majority in aggregate principal amount of the Subordinated Indenture Securities of all series then outstanding, considered as one class, is required for all other modifications to the Subordinated Indenture. However, if less than all of the series of Subordinated Indenture Securities outstanding are directly affected by a proposed supplemental indenture, then the consent only of the registered owners of a majority in aggregate principal amount of outstanding Subordinated Indenture Securities of all directly affected series, considered as one class, is required. But, if FPL Group Capital or FPL Group, as the case may be, issues any series of Subordinated Indenture Securities in more than one tranche and if the proposed supplemental indenture directly affects the rights of the registered owners of Subordinated Indenture Securities of less than all of those tranches, then the consent only of the registered owners of a majority in aggregate principal amount of the outstanding Subordinated Indenture Securities of all directly affected tranches, considered as one class, will be required. However, none of those amendments or modifications may:

- (1) change the dates on which the principal of or interest (except as described above under " Option to Defer Interest Payments") on a Subordinated Indenture Security is due without the consent of the registered owner of that Subordinated Indenture Security,

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- (2) reduce any Subordinated Indenture Security's principal amount or rate of interest (or the amount of any installment of that interest) or change the method of calculating that rate without the consent of the registered owner of that Subordinated Indenture Security,
- (3) reduce any premium payable upon the redemption of a Subordinated Indenture Security without the consent of the registered owner of that Subordinated Indenture Security,
- (4) change the currency (or other property) in which a Subordinated Indenture Security is payable without the consent of the registered owner of that Subordinated Indenture Security,
- (5) impair the right to sue to enforce payments on any Subordinated Indenture Security on or after the date that it states that the payment is due (or, in the case of redemption, on or after the redemption date) without the consent of the registered owner of that Subordinated Indenture Security,
- (6) in the case of FPL Group Capital Subordinated Indenture, impair the right to receive payments under the Subordinated Guarantee or to institute suit for enforcement of any such payment under the Subordinated Guarantee,
- (7) reduce the percentage in principal amount of the outstanding Subordinated Indenture Securities of any series or tranche whose owners must consent to an amendment, supplement or waiver without the consent of the registered owner of each outstanding Subordinated Indenture Security of that series or tranche,
- (8) reduce the requirements for quorum or voting of any series or tranche without the consent of the registered owner of each outstanding Subordinated Indenture Security of that series or tranche, or
- (9) modify certain of the provisions of the Subordinated Indenture relating to supplemental indentures, waivers of certain covenants and waivers of past defaults with respect to the Subordinated Indenture Securities of any series or tranche, without the consent of the registered owner of each outstanding Subordinated Indenture Security affected by the modification.

A supplemental indenture that changes or eliminates any provision of the Subordinated Indenture that has expressly been included only for the benefit of one or more particular series or tranches of Subordinated Indenture Securities, or that modifies the rights of the registered owners of Subordinated Indenture Securities of that series or tranche with respect to that provision, will not affect the rights under the Subordinated Indenture of the registered owners of the Subordinated Indenture Securities of any other series or tranche. If Junior Subordinated Debentures were issued in connection with the issuance of Trust Securities, so long as any Preferred Trust Securities are outstanding, the Subordinated Indenture Trustee may not consent to any supplemental indenture without the prior consent of the holders of a majority in aggregate liquidation preference of all outstanding Preferred Trust Securities affected or, in the case of changes described in clauses (1) through (9) immediately above, 100% in aggregate liquidation preference of all such outstanding Preferred Trust Securities affected. (Subordinated Indenture, Section 1202).

Each Subordinated Indenture provides that, in order to determine whether the registered owners of the required principal amount of the outstanding Subordinated Indenture Securities have given any request, demand, authorization, direction, notice, consent or waiver under the Subordinated Indenture, or whether a quorum is present at the meeting of the registered owners of Subordinated Indenture Securities, (a) in the case of the FPL Group Capital Subordinated Indenture, Subordinated Indenture Securities owned by FPL Group Capital, FPL Group or any other obligor upon the Subordinated Indenture Securities or any affiliate of FPL Group Capital, FPL Group or of that other obligor (unless FPL Group Capital, FPL Group, that affiliate or that obligor owns all Subordinated Indenture Securities outstanding under the Subordinated Indenture, determined without regard to this provision) and (b) in the case of the FPL Group Subordinated Indenture, Subordinated Indenture Securities owned by FPL Group or any other obligor upon the Subordinated Indenture Securities or any affiliate of FPL Group or of that other obligor (unless FPL Group, that affiliate or that obligor owns all Subordinated Indenture Securities outstanding under the Subordinated Indenture, determined without regard to this provision), will be disregarded and deemed not to be outstanding. (Subordinated Indenture, Section 101).

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If FPL Group Capital, in the case of the FPL Group Capital Subordinated Indenture, or FPL Group solicits any action under the Subordinated Indenture from registered owners of Subordinated Indenture Securities, each of FPL Group Capital or FPL Group in the case of the FPL Group Capital Subordinated Indenture, or FPL Group in the case of the FPL Group Subordinated Indenture, may, at its option, by signing a written request to the Subordinated Indenture Trustee, fix in advance a record date for determining the registered owners of Subordinated Indenture Securities entitled to take that action. However, neither FPL Group Capital nor FPL Group will be obligated to do this. If FPL Group Capital or FPL Group in the case of the FPL Group Capital Subordinated Indenture, or FPL Group in the case of the FPL Group Subordinated Indenture, as the case may be, fixes such a record date, that action may be taken before or after that record date, but only the registered owners of record at the close of business on that record date will be deemed to be registered owners of Subordinated Indenture Securities for the purposes of determining whether registered owners of the required proportion of the outstanding Subordinated Indenture Securities have authorized that action. For these purposes, the outstanding Subordinated Indenture Securities will be computed as of the record date. Any action of a registered owner of any Subordinated Indenture Security under the Subordinated Indenture will bind every future registered owner of that Subordinated Indenture Security, or any Subordinated Indenture Security replacing that Subordinated Indenture Security, with respect to anything that the Subordinated Indenture Trustee, FPL Group Capital or FPL Group in the case of the FPL Group Capital Subordinated Indenture, or FPL Group in the case of the FPL Group Subordinated Indenture, do, fail to do, or allow to be done in reliance on that action, whether or not that action is noted upon that Subordinated Indenture Security. (Subordinated Indenture, Section 104).

Resignation and Removal of Subordinated Indenture Trustee. The Subordinated Indenture Trustee may resign at any time with respect to any series of Subordinated Indenture Securities by giving written notice of its resignation to FPL Group Capital and FPL Group in the case of the FPL Group Capital Subordinated Indenture, or FPL Group in the case of the FPL Group Subordinated Indenture. Also, the registered owners of a majority in principal amount of the outstanding Subordinated Indenture Securities of one or more series of Subordinated Indenture Securities may remove the Subordinated Indenture Trustee at any time with respect to the Subordinated Indenture Securities of that series, by delivering an instrument evidencing this action to the Subordinated Indenture Trustee, FPL Group Capital and FPL Group in the case of the FPL Group Capital Subordinated Indenture, and to FPL Group in the case of the FPL Group Subordinated Indenture. However, if Junior Subordinated Debentures were issued in connection with the issuance of Trust Securities, so long as any Preferred Trust Securities remain outstanding, the Trust cannot deliver an instrument evidencing this action without the consent of the holders of a majority in aggregate liquidation preference of Preferred Trust Securities outstanding. (Subordinated Indenture, Section 910). The resignation or removal of the Subordinated Indenture Trustee and the appointment of a successor trustee will not become effective until a successor trustee accepts its appointment.

Except with respect to a Subordinated Indenture Trustee appointed by the registered owners of Subordinated Indenture Securities, the Subordinated Indenture Trustee will be deemed to have resigned and the successor will be deemed to have been appointed as trustee in accordance with the Subordinated Indenture if:

- (1) no event of default under the Subordinated Indenture or event that, after notice or lapse of time, or both, would become an event of default under the Subordinated Indenture exists, and
- (2) FPL Group Capital and FPL Group in the case of the FPL Group Capital Subordinated Indenture, or FPL Group in the case of the FPL Group Subordinated Indenture, have delivered to the Subordinated Indenture Trustee resolutions of their Boards of Directors appointing a successor trustee and that successor trustee has accepted that appointment in accordance with the terms of the Subordinated Indenture. (Subordinated Indenture, Section 910).

Notices. Notices to registered owners of Subordinated Indenture Securities will be sent by mail to the addresses of those registered owners as they appear in the security register for those Subordinated Indenture Securities. (Subordinated Indenture, Section 106).

Title. The person in whose name a Subordinated Indenture Security is registered may be treated as the absolute owner of that Subordinated Indenture Security, whether or not that Subordinated Indenture Security is overdue, for the purpose of making payments and for all other purposes, regardless of any notice to the contrary. (Subordinated Indenture, Section 308).

Governing Law. The Subordinated Indenture and the Subordinated Indenture Securities will be governed by, and construed in accordance with, the laws of the State of New York, without regard to New York's conflict of law principles, except to the extent that the law of any other jurisdiction is mandatorily applicable. (Subordinated Indenture, Section 112).

INFORMATION CONCERNING THE TRUSTEES

FPL Group and its subsidiaries, including FPL Group Capital, also maintain various banking and trust relationships with The Bank of New York. In addition to acting as Subordinated Indenture Trustee, security registrar and paying agent under the FPL Group Capital Subordinated Indenture, The Bank of New York acts, or would act, as (i) Indenture Trustee, security registrar and paying agent under the Indenture described under "Description of FPL Group Capital Senior Debt Securities" above, (ii) Guarantee Trustee under the Guarantee Agreement described under "Description of the FPL Group Capital Senior Debt Securities Guarantee" above, (iii) purchase contract agent under a purchase contract agreement described under "Description of FPL Group Stock Purchase Contracts and Stock Purchase Units" above, (iv) Preferred Trust Securities Guarantee Trustee under the Preferred Trust Securities Guarantee Agreement described under "Description of the Preferred Trust Securities Guarantee" above, (v) Property Trustee under the Trust Agreement and (vi) Subordinated Indenture Trustee, security registrar and paying agent under the FPL Group Subordinated Indenture. In addition, The Bank of New York acts as preferred trust securities trustee and property trustee with respect to FPL Group Capital Trust I's preferred trust securities. The Bank of New York (Delaware) acts as the Delaware Trustee under the Trust Agreement and as Delaware trustee under the Trust Agreement entered into in connection with FPL Group Capital Trust I's preferred trust securities.

PLAN OF DISTRIBUTION

FPL Group, FPL Group Capital and the Trust may sell the securities offered pursuant to this prospectus ("Offered Securities"):

- (1) through underwriters or dealers,
- (2) through agents, or
- (3) directly to one or more purchasers.

Through Underwriters or Dealers. If FPL Group, FPL Group Capital and/or the Trust uses underwriters in the sale of the Offered Securities, the underwriters will acquire the Offered Securities for their own account. The underwriters may resell the Offered Securities in one or more transactions, including negotiated transactions, at a fixed public offering price or at varying prices determined at the time of sale. The underwriters may sell the Offered Securities directly or through underwriting syndicates represented by managing underwriters. Unless otherwise stated in the prospectus supplement relating to the Offered Securities, the obligations of the underwriters to purchase those Offered Securities will be subject to certain conditions, and the underwriters will be obligated to purchase all of those Offered Securities if they purchase any of them. If FPL Group, FPL Group Capital and/or the Trust uses a dealer in the sale, FPL Group, FPL Group Capital and/or the Trust will sell the Offered Securities to the dealer as principal. The dealer may then resell those Offered Securities at varying prices determined at the time of resale.

Any initial public offering price and any discounts or concessions allowed or reallocated or paid to dealers may be changed from time to time.

Through Agents. FPL Group, FPL Group Capital and/or the Trust may designate one or more agents to sell the Offered Securities. Unless otherwise stated in a prospectus supplement, the agents will agree to use their best efforts to solicit purchases for the period of their appointment.

Directly. FPL Group, FPL Group Capital and/or the Trust may sell the Offered Securities directly to one or more purchasers. In this case, no underwriters, dealers or agents would be involved.

General Information. A prospectus supplement will state the name of any underwriter, dealer or agent and the amount of any compensation, underwriting discounts or concessions paid, allowed or reallocated to them. A

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prospectus supplement will also state the proceeds to FPL Group, FPL Group Capital and/or the Trust from the sale of the Offered Securities, any initial public offering price and other terms of the offering of those Offered Securities.

FPL Group, FPL Group Capital and/or the Trust may authorize underwriters, dealers or agents to solicit offers by certain institutions to purchase the Offered Securities from FPL Group, FPL Group Capital and/or the Trust at the public offering price and on the terms described in the related prospectus supplement pursuant to delayed delivery contracts providing for payment and delivery on a specified date in the future.

The Offered Securities may also be offered and sold, if so indicated in the applicable prospectus supplement, in connection with a remarketing upon their purchase, in accordance with a redemption or repayment pursuant to their terms, or otherwise, by one or more firms, which are referred to herein as the "remarketing firms," acting as principals for their own accounts or as our agent or the applicable trust's agents, as applicable. Any remarketing firm will be identified and the terms of its agreement, if any, with FPL Group, FPL Group Capital and/or the Trust and its compensation will be described in the applicable prospectus supplement. Remarketing firms may be deemed to be underwriters, as that term is defined in the Securities Act of 1933, in connection with the securities remarketed thereby.

FPL Group, FPL Group Capital and/or the Trust may enter into derivative transactions with third parties, or sell securities not covered by this prospectus to third parties in privately negotiated transactions. If the applicable prospectus supplement indicates, in connection with those derivatives, the third parties may sell securities covered by this prospectus and the applicable prospectus supplement, including in short sale transactions. If so, the third party may use securities pledged by FPL Group, FPL Group Capital and/or the Trust or borrowed from any of them or others to settle those sales or to close out any related open borrowings of securities, and may use securities received from FPL Group, FPL Group Capital and/or the Trust in settlement of those derivatives to close out any related open borrowings of securities. The third party in such sale transactions will be an underwriter and, if not identified in this prospectus, will be identified in the applicable prospectus supplement.

FPL Group, FPL Group Capital and/or the Trust may have agreements to indemnify underwriters, dealers and agents against, or to contribute to payments which the underwriters, dealers and agents may be required to make in respect of, certain civil liabilities, including liabilities under the Securities Act of 1933.

EXPERTS

The consolidated financial statements and management's report on the effectiveness of internal control over financial reporting incorporated in this prospectus by reference from FPL Group's Annual Report on Form 10-K for the year ended December 31, 2006, have been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their reports, which are incorporated herein by reference, and have been so incorporated in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

LEGAL OPINIONS

Squire, Sanders & Dempsey L.L.P., Miami, Florida, and Thelen Reid Brown Raysman & Steiner LLP, New York, New York, co-counsel to FPL Group, FPL Group Capital and the Trust, will pass upon the legality of the Offered Securities for FPL Group, FPL Group Capital and the Trust. Hunton & Williams LLP, New York, New York, will pass upon the legality of the Offered Securities for any underwriter, dealer or agent. Certain matters of Delaware law relating to the validity of the Preferred Trust Securities, the enforceability of the Trust Agreement and the creation of the Trust will be passed upon by Morris, James, Hitchens & Williams LLP, special Delaware counsel to FPL Group, FPL Group Capital and the Trust. Thelen Reid Brown Raysman & Steiner LLP and Hunton & Williams LLP may rely as to all matters of Florida law upon the opinion of Squire, Sanders & Dempsey L.L.P., and on the opinion of Morris, James, Hitchens & Williams LLP, as to matters involving the law of the State of Delaware in connection with the Preferred Trust Securities. Squire, Sanders & Dempsey L.L.P. may rely as to all matters of New York law upon the opinion of Thelen Reid Brown Raysman & Steiner LLP, and on the opinion of Morris, James, Hitchens & Williams LLP, as to matters involving the law of the State of Delaware in connection with the Preferred Trust Securities.

You should rely only on the information incorporated by reference or provided in this prospectus or any prospectus supplement or in any written communication from FPL Group, FPL Group Capital or the Trust specifying the final terms of a particular offering of securities. Neither FPL Group, FPL Group Capital nor the Trust has authorized anyone else to provide you with additional or different information. Neither FPL Group, FPL Group Capital nor the Trust is making an offer of these securities in any jurisdiction where the offer is not permitted. You should not assume that the information in this prospectus or any prospectus supplement is accurate as of any date other than the date on the front of those documents or that the information incorporated by reference is accurate as of any date other than the date of the document incorporated by reference.

\$350,000,000

Series F Junior Subordinated Debentures due 2069

**The Series F Junior Subordinated Debentures will
be Fully and Unconditionally Guaranteed by
FPL GROUP, INC.**

PROSPECTUS SUPPLEMENT
March 12, 2009

Banc of America Securities LLC

Citi

Morgan Stanley

UBS Investment Bank

Wachovia Securities

Raymond James

RBC Capital Markets

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