TAITRON COMPONENTS INC
Form 10QSB
November 14, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the quarterly period ended September 30, 2006

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from _________ to __________

Commission File Number 0-25844

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

California	95-4249240
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

28040 West Harrison Parkway, Valencia, California 91355-4162
(Address of principal executive offices)

(661) 257-6060
(Issuer's telephone number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for 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. Yes [X] No [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

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

Class	Outstanding on October 31, 2006
Class A common stock, $.001 par value	4,716,811
Class B common stock, $.001 par value	762,612

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

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements

TAITRON COMPONENTS INCORPORATED

Condensed Consolidated Balance Sheet
(Dollars in Thousands)

September 30, 2006

Assets	(Unaudited)
Current assets:	
Cash and cash equivalents	$ 2,340
Trade accounts receivable, net	1,907
Inventory, net	15,597
Prepaid expenses and other current assets	103
Total current assets	19,947
Property and equipment, net	4,440
Other assets	1,326
Total assets	$25,713
Liabilities and Shareholders' Equity	
Current liabilities:	
Trade accounts payable	$ 1,058
Accrued liabilities and other	535
Current portion of long-term debt	89
Total current liabilities	1,682
Long-term debt, less current portion (Note 3)	531
Total liabilities	2,213
Commitments and contingencies (Note 4)	
Shareholders' equity:	
Preferred stock, $.001 par value. Authorized 5,000,000 shares None issued or outstanding	--
Class A common stock, $.001 par value. Authorized 20,000,000 shares; issued and outstanding 4,716,811 shares	5
Class B common stock, $.001 par value. Authorized, issued and outstanding 762,612 shares	1
Additional paid-in capital	10,453
Accumulated other comprehensive income, net of tax	26
Retained earnings	13,015
Total shareholders' equity	23,500
Total liabilities and shareholders' equity	$25,713

See accompanying notes to condensed consolidated financial statements.

TAITRON COMPONENTS INCORPORATED

Condensed Consolidated Statements of Operations
(Dollars in Thousands, except per share amounts)

	Three months ended September 30, 2006 (Unaudited)	2005 (Unaudited)
Net sales	$ 2,892	$ 2,288
Cost of goods sold	2,027	1,625
Gross profit	865	663
Selling, general and administrative expenses	729	706
Income (loss) from operations	136	(43)
Interest income (expense), net	16	6
Other income (expense), net	21	22
Income (loss) before income taxes	173	(15)
Income tax provision	--	(8)
Net income (loss)	$ 173	$ (23)
Other comprehensive income (loss):		
Foreign currency translation adjustment	20	(14)
Comprehensive income (loss)	$ 193	$ (37)
Income (loss) per share		
Basic	$ .03	$ (.00)
Diluted	$ .03	$ (.00)
Weighted average common shares outstanding		
Basic	5,479,423	5,462,757
Diluted	5,945,423	5,462,757

See accompanying notes to condensed consolidated financial statements.

TAITRON COMPONENTS INCORPORATED

Condensed Consolidated Statements of Cash Flow
(Dollars in thousands)

	Nine months 2006 (Unaudited)
Cash flows from operating activities:	
Net income (loss)	$ 173
Adjustments to reconcile net loss to net cash provided by operating activities:	
Depreciation and amortization	149
Provision for sales returns	111
Stock-based compensation	13
Changes in assets and liabilities:	
Trade accounts receivable	(466)
Inventory, net	1,084
Prepaid expenses and other current assets	48
Other assets	(18)
Trade accounts payable	38
Accrued liabilities and other	(50)
Total adjustments	909
Net cash provided by operating activities	1,082
Cash flows from investing activities:	
Deposit on real estate purchase contract (Note 3)	(1,230)
Acquisitions of property and equipment	(161)
Net cash used in investing activities	(1,391)
Cash flows from financing activities:	
Borrowings (payments) on notes payable	620
Proceeds from exercise of stock options and issuance of stock	24
Net cash provided by (used in) financing activities	644
Impact of exchange rate changes on cash	43
Net increase (decrease) in cash and cash equivalents	378
Cash and cash equivalents, beginning of period	1,962
Cash and cash equivalents, end of period	$ 2,340
Supplemental disclosure of cash flow information:	
Cash paid for interest	$ --
Cash paid for income taxes	$ 13

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See accompanying notes to condensed consolidated financial statements.

TAITRON COMPONENTS INCORPORATED

Notes to Condensed Consolidated Financial Statements
September 30, 2006
(All amounts are unaudited)

Note 1 - Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Taitron Components Incorporated ("the Company") were prepared in accordance with accounting principles generally accepted in the United States of America and reflect all adjustments, consisting of normal recurring accruals and adjustments, which are, in the opinion of management, necessary for a fair presentation of the consolidated financial position and results of operations at and for the periods presented. Such financial statements do not include all the information or notes necessary for a complete presentation. Therefore, they should be read in conjunction with the Company's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2005, and the notes thereto, which include significant accounting policies and estimates. The results of operations for the interim periods are not necessarily indicative of results for the full year.

Note 2 - Summary of Significant Accounting Policies and Estimates

Principles of Consolidation

The unaudited condensed consolidated financial statements include the accounts of the Company and its 60% majority-owned subsidiary, Taitron Components Mexico SA de CV. All significant intercompany transactions and balances have been eliminated in consolidation.

Revenue Recognition

Revenue is typically recognized upon shipment of merchandise and sales are recorded net of discounts, rebates, and returns. Reserves for sales allowances and customer returns are established based upon historical experience and management's estimates as shipments are made. Sales returns for the quarters ended September 30, 2006 and 2005 were $15,000 and $31,000, respectively, and for the nine months ended September 30, 2006 and 2005 aggregated $111,000 and $92,000, respectively.

Allowance for Sales Returns and Doubtful Accounts

On a case-by-case basis, the Company accepts returns of products from its customers, without restocking charges, when they can demonstrate an acceptable cause for the return. Requests by a distributor to return products purchased for its own inventory generally are not included under this policy. The Company will, on a case-by-case basis, accept returns of products upon payment of a restocking fee, which is generally 15% to 30% of the net sales price. The Company will not accept returns of any products that were special-ordered by a customer or that otherwise are not generally included in inventory. The allowance for sales returns and doubtful accounts at September 30, 2006 aggregated $73,000.

Inventory

Inventory, consisting principally of products held for resale, is recorded at the lower of cost (determined using the first in-first out method) or estimated market value. Inventory is presented net of valuation allowances of $1,033,000 at September 30, 2006.

Income Taxes

The Company accounts for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the 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. Valuation allowances are recorded, when necessary, to reduce deferred tax assets to the amount expected to

be realized. The Company has fully reserved against its deferred income tax assets, as management could not determine that it was more likely than not such assets would be realized.

Per Share Data

Basic earnings per share data are based upon the weighted average number of common shares outstanding. Diluted earnings per share data are based upon the weighted average number of common shares outstanding, plus the number of common shares potentially issuable for dilutive securities such as stock options and warrants. The weighted average number of common shares outstanding for each of the three and nine month periods ended September 30, 2006 and 2005 is set forth in the following table:

	Three months ended September 30		Nine m Sep
	2006	2005	2006
Basic weighted average shares outstanding	5,479,423	5,462,757	5,477,016
Potentially dilutive stock options	466,000	616,000	473,000
Anti-dilutive stock options due to net loss in period	--	(616,000)	--
Diluted weighted average shares outstanding	5,945,423	5,462,757	5,950,016

Use of Estimates

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States. These estimates have a significant impact on the Company's valuation and reserve accounts relating to the allowance for sales returns, doubtful accounts, inventory reserves and deferred income taxes. Actual results could differ from these estimates.

Stock-Based Compensation

In March 1995, the Company established the 1995 Stock Incentive Plan (the "1995 Plan") that expired in March 2005. The 1995 Plan provided for the issuance of an aggregate 1,080,000 incentive stock options, nonstatutory options or stock appreciation rights (SAR's) to directors, officers and other employees of the Company. Under the 1995 Plan, incentive stock options were granted at prices equal to at least the fair market value of the Company's Class A common stock at the date of grant. Nonstatutory options and stock appreciation rights were granted at prices equal to at least 85% and 100%, respectively, of the fair market value of the Company's Class A common stock at the date of grant. Outstanding options and rights vest in three equal annual installments beginning one year from the date of grant and are subject to termination provisions as defined in the 1995 Plan. The 1995 Plan also provided for automatic grants of nonstatutory options to purchase 5,000 shares of Class A common stock to all members of the committee administering the 1995 Plan, upon their initial election to the committee and each year thereafter. The exercise prices of these options are equal to the fair market value of the Company's Class A common stock at the date of grant. The fair value of options is the estimated present value at grant date using the Black-Scholes option-pricing model with the following weighted average assumptions used for 2005: dividend yield of 0%; expected volatility of 35%; a risk free interest rate of approximately 5% and an expected holding period of five years.

In September 2006, the Company' 2005 Stock Incentive Plan (the "2005 Plan") was approved by state regulators, which authorizes the issuance of up to 1,000,000 shares pursuant to options or awards granted under the plan. No shares have yet been granted under the 2005 Plan.

Effective January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS 123R). SFAS 123R requires that the Company account for all stock-based compensation using a fair-value method and recognize the fair value of each award as an expense over the service period. For the year ended December 31, 2005 and earlier years, the Company accounted for employee stock-based compensation

using the intrinsic value method of APB Opinion No. 25 and followed the disclosure requirements of SFAS No. 123, as amended by SFAS 148.

The Company elected to adopt SFAS 123R using the "modified prospective application." Under that method, compensation expense includes the fair value of new awards, modified awards and any unvested awards outstanding at January 1, 2006. However, the consolidated financial statements for periods prior to the adoption of SFAS 123R have not been restated to reflect the fair value method of accounting for stock-based compensation, but rather disclosed the cost in accordance with APB 25.

The following table illustrates the effect on net loss and net loss per share as if compensation expense for all awards of stock-based employee compensation had been determined under the fair value-based method prescribed by SFAS 123 for periods prior to the adoption of SFAS 123R:

	Three months ended September 30, 2005	Nine months ended September 30, 2005
Net loss, as reported	$(23,000)	$ (160,000)
Net loss, pro forma	$(17,000)	$ (142,000)
Diluted loss, as reported	--	$ (0.03)
Diluted loss, pro forma	--	$ (0.03)

Stock option activity during the nine months ended September 30, 2006 is as follows:

	Number of Shares	Weighted Average Exercise Price
Balance at December 31, 2005	526,166	$ 1.78
Exercised	(16,666)	$ 1.41
Forfeitures	(1,000)	$ 2.08
Balance at September 30, 2006 (Unaudited)	508,500	$ 1.80

The weighted average fair value of options granted in the three months and nine months periods ended September 30, 2006 and 2005 was $0, as there were no options granted during these periods.

At September 30, 2006, the range of individual weighted average exercise prices was $1.29 to $2.17. The remaining contractual life of outstanding options is 90 days after termination of employment of option holder. At September 30, 2006, the approximate number of options exercisable was 466,000 and the weighted average exercise price of those exercisable options was $1.80.

Note 3 - Long-Term Debt

	September 30, 2006
Bank loan payable in fixed monthly principal installments of $7,381, plus interest at the rate of one year LIBOR + 1.8% per annum, due September 20, 2013	620,000
Less current portion	(89,000)
Long-term debt, less current portion	531,000

On September 21, 2006, the Company borrowed $620,000 in connection with its deposit on a real estate purchase contract related to the acquisition of approximately 4,500 square feet of office space (consisting of 2 separate units on same floor) in Shanghai, China with a total purchase price of $1,230,000. The overall office building project is under construction and is estimated to be completed in March 2007. The investment will be used as rental property for lease to others and for the Company's project design and engineering center.

Note 4 - Commitments and Contingencies

Effective July 1, 2006, the European Union ("EU") began restricting the distribution of products within the EU containing certain substances, including lead. At the present time, much of the Company's inventory contains substances prohibited by the RoHS directive and management believes it is likely that the Company will not be able to distribute non-RoHS compliant products to most customers who intend to sell their finished goods in the EU after the effective date. Therefore, the non-RoHS compliant products may become obsolete and unsaleable and, as a result, have to be written off. However, Management believes the demand from our customers requiring only the RoHS compliant products has already been experienced during the periods leading up to the directive's restriction date.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

The following discussion should be read in conjunction with the condensed consolidated financial statements, including the related notes, appearing in Item 1 of this report as well as our most recent annual report on Form 10-KSB for the year ended December 31, 2005. Also, several of the matters discussed in this document contain forward-looking statements that involve risks and uncertainties. Forward-looking statements usually are denoted by words or phrases such as "believes," "expects," "projects," "estimates," "anticipates," "will likely result" or similar expressions. We wish to caution readers that all forward-looking statements are necessarily speculative and not to place undue reliance on forward-looking statements, which speak only as of the date made, and to advise readers that actual results could vary due to a variety of risks and uncertainties. Factors associated with the forward looking statements that could cause the forward looking statements to be inaccurate and could otherwise impact our future results are set forth in detail in our most recent annual report on Form 10-KSB. In addition to the other information contained in this document, readers should carefully consider the information contained in our most recent annual report on Form 10-KSB under the heading "Cautionary Statements and Risk Factors."

References to "Taitron," "the Company," "we," "our" and "us" refer to Taitron Components Incorporated and its majority-owned subsidiary, unless the context otherwise requires.

Critical Accounting Policies and Estimates

Use Of Estimates - Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare its condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States. These estimates have a significant impact on the Company's valuation and reserve accounts relating to the allowance for sales returns, doubtful accounts, inventory reserves and deferred income taxes. Actual results could differ from these estimates.

Revenue Recognition - Revenue is recognized upon shipment of the merchandise, which is when legal transfer of title occurs. Reserves for sales allowances and customer returns are established based upon historical experience and our estimates of future returns. Sales returns for the quarters ended

September 30, 2006 and 2005 were $15,000 and $31,000, respectively, and for the nine months ended September 30, 2006 and 2005 aggregated $111,000 and $92,000, respectively. The allowance for sales returns and doubtful accounts at September 30, 2006 aggregated $73,000.

Inventory - Inventory, consisting principally of products held for resale, is recorded at the lower of cost (determined using the first in-first out method) or estimated market value. We had inventory balances in the amount of $15,597,000 at September 30, 2006, which is presented net of valuation allowances of $1,033,000. We evaluate inventories to identify excess, high-cost, slow-moving or other factors rendering inventories as unmarketable at normal profit margins. Due to the large number of transactions and the complexity of managing and maintaining a large inventory of product offerings, estimates are made regarding adjustments to the cost of inventories. Based on our assumptions about future demand and market conditions, inventories are carried at the lower of cost or estimated market value. If our assumptions about future demand change, or market conditions are less favorable than those projected, additional write-downs of inventories may be required. In any case, actual amounts could be different from those estimated.

Impact of Governmental Regulation - Our worldwide operations are subject to local laws and regulations. As such, of particular interest is the European Union ("EU") directive relating to the Restriction of Certain Hazardous Substance ("RoHS"). Effective July 1, 2006, the European Union ("EU") began restricting the distribution of products within the EU containing certain substances, including lead. At the present time, much of the Company's inventory contains substances prohibited by the RoHS directive and management believes it is likely that the Company will not be able to distribute non-RoHS compliant products to most customers who intend to sell their finished goods in the EU after the effective date. Therefore, the non-RoHS compliant products may become obsolete and unsaleable and, as a result, have to be written off. However, we believe the demand from our customers requiring only the RoHS compliant products has already been experienced during the periods leading up to the directive's restriction date.

Deferred Taxes - We review the nature of each component of our deferred income taxes for reasonableness. If determined that it is more likely than not that we will not realize all or part of our net deferred tax assets in the future, we record a valuation allowance against the deferred tax assets, which allowance will be charged to income tax expense in the period of such determination. We also consider the scheduled reversal of deferred tax liabilities, tax planning strategies and future taxable income in assessing the realizability of deferred tax assets. We also consider the weight of both positive and negative evidence in determining whether a valuation allowance is needed. Based upon recent operating results and the difficulty of estimating future market conditions, we have fully reserved against our net deferred tax assets.

Selected Recent Accounting Policies

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Current Year Misstatements. SAB No. 108 requires analysis of misstatements using both an income statement (rollover) approach and a balance sheet (iron curtain) approach in assessing materiality and provides for a one-time cumulative effect transition adjustment. SAB No. 108 is effective for our fiscal year 2006 annual consolidated financial statements. We are currently assessing the potential impact that the adoption of SAB No. 108 will have on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective for us beginning January 1, 2008. We are currently assessing the potential impact that the adoption of SFAS No. 157 will have on our consolidated financial statements.

In June 2006, the FASB issued FIN No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 requires recognition of tax benefits that satisfy a greater than 50% probability threshold. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 is effective for us beginning January 1, 2007. We are currently assessing the potential impact that the adoption of FIN No. 48 will have on our financial statements.

Overview

We are a national distributor of electronic components, primarily focused on transistors, diodes and other discrete semiconductors, optoelectronic devices and passive components with a reputation of in-depth inventories and knowledge of the products we sell. Our customers consist of other electronic distributors, contract electronic manufacturers (CEMs) and original equipment manufacturers (OEMs).

We believe that demand for discrete semiconductors in the U.S. market drastically declined since 2000. This declining demand has resulted from the accelerated trend of moving the production capacity of OEM/CEM customers abroad and the consolidation of CEM customers domestically. In response, we have been refocusing our business strategy beyond the traditional role of electronic components fulfillment to the additional role of engineering and turn-key services for our existing OEM and CEM customers by outsourcing their product design and

manufacturing work offshore. We formed some strategic business partnerships with a few customers and are providing them with original design and manufacturing (ODM) services for their multi-year turn-key projects.

Our core strategy of electronic components fulfillment, however, consists of carrying a substantial quantity and variety of products in inventory to meet the rapid delivery requirements of our customers. This strategy allows us to fill customer orders immediately from stock on hand. Although we believe better market conditions may return, we are focused on lowering our inventory balances and increasing our cash holdings. Our long-term strategy is to rely not only on our core strategy of component fulfillment service, but also the value-added engineering and turn-key services. In accordance with Generally Accepted

Accounting Principles, we classify inventory as a current asset. However, if all or a substantial portion of the inventory was required to be immediately liquidated, the inventory would not be as readily marketable or liquid as other items included or classified as a current asset, such as cash. We cannot assure you that demand in the discrete semiconductor market will increase and that market conditions will improve. Therefore, it is possible that further declines in our carrying values of inventory may result.

Results of Operations

Third quarter of 2006 versus Third quarter of 2005.

Net sales in the third quarter of 2006 totaled $2,892,000 versus $2,288,000 in the comparable period for 2005, an increase of 26.4% over the same period last year. The sales increase was attributed to growth in our ODM products by $465,000 comparing the third quarter of 2006 over the same period last year.

Gross profit for the third quarter of 2006 was $865,000 versus $663,000 in the comparable period for 2005, and gross margin percentage of net sales was 29% in both periods. The increase was primarily attributed to the impact from our ODM products.

Selling, general and administrative ("SG&A") expenses in the third quarter of 2006 totaled $729,000 versus $706,000 in the comparable period for 2005. As a percentage of net sales, SG&A expenses were 25.2% in the third quarter of 2006 compared to 30.9% in the third quarter for 2005. The increase of $23,000 was primarily attributable to personnel related expenses from our engineering center in China and higher trade commissions to our sales representatives for ODM products.

Interest income, net of interest expense, was $16,000 for the third quarter of 2006 versus $6,000 in the comparable period for 2005. The change is due to earning interest on cash investments in 2006 after repaying all debt obligations in 2005.

Income tax provision was $0 for the third quarter of 2006 and $8,000 in the comparable period for 2005, as we do not expect significant taxable income for fiscal year 2006.

Net income was $173,000 for the third quarter of 2006 versus a loss of $23,000 in the comparable period for 2005, an increase of $196,000.

Effective January 1, 2006, we adopted SFAS 123(R) and such had a $3,000 financial impact to our SG&A for the third quarter of 2006.

Nine Months Ended September 30, 2006 versus Nine Months Ended September 30, 2005.

Net sales in the nine months ended September 30, 2006 was $7,877,000 versus $6,332,000 in the comparable period for 2005, an increase of 24.4% over the same period last year. The sales increase was attributed to growth in our ODM products by $1,452,000 comparing the nine months ended September 30, 2006 over the same period last year.

Gross profit for the nine months ended September 30, 2006 was $2,208,000 versus $1,750,000 in the comparable period for 2005, and gross margin percentage of net sales was 28% for both periods. The dollar increase was primarily attributed to the impact from our ODM products.

Selling, general and administrative ("SG&A") expenses in the nine months ended September 30, 2006 totaled $2,069,000 versus $1,952,000 in the comparable period for 2005. As a percentage of net sales, SG&A expenses were 26.3% in the nine months ended September 30, 2006 compared to 30.8% in the comparable period for 2005. The increase of $117,000 was primarily attributable to personnel related expenses from our engineering center in China and higher trade commissions to our sales representatives for ODM products.

Interest income, net of interest expense, was $53,000 for the nine months ended September 30, 2006 versus interest expense, net of interest income, of $11,000 in the comparable period for 2005. The change is due to earning interest on cash investments in 2006 after repaying all debt obligations in 2005.

Income tax provision was $4,000 for the nine months ended September 30, 2006 versus $8,000 in the comparable period for 2005, as we do not expect significant taxable income for fiscal year 2006.

Net income was $173,000 for the nine months ended September 30, 2006 versus net losses of $160,000 in the comparable period for 2005, an increase of $333,000 resulting from the reasons discussed above.

Effective January 1, 2006, we adopted SFAS 123(R) and such had a $13,000 financial impact to our SG&A for the nine months ended September 30, 2006.

Liquidity and Capital Resources

We have satisfied our liquidity requirements principally through cash generated from operations and short-term commercial loans. A summary of our cash flows resulting from our operating, investing and financing activities for the nine months ended September 30, 2006 and 2005 are as follows:

	Nine months ended September 30,	
(Dollars in thousands)	2006	2005
	(Unaudited)	(Unaudited)
Operating activities	$ 1,082	$ 1,275
Investing activities	(1,391)	(3)
Financing activities	644	(1,324)

Cash provided by operating activities for the nine months ended September 30, 2006 was $1,082,000 versus $1,275,000 during the comparable period in 2005. The decrease was primarily attributed to inventory decreasing by $1,084,000 for the nine months ended September 30, 2006, versus inventory decreasing by $1,250,000 during the comparable period in 2005.

Cash used in investing activities for the nine months ended September 30, 2006 and 2005 was $1,391,000 and $3,000, respectively. The increase was primarily attributed to the deposit of $1,230,000 for the real estate purchase contract of office space in Shanghai, China in the third quarter of 2006 (see Note 3) and $125,000 for upgrading our computer server equipment and Oracle ERP software in the third quarter of 2006.

Cash provided by financing activities for the nine months ended September 30, 2006 was $644,000 versus $1,324,000 used in, during the comparable period in 2005. The increase was primarily attributed to the borrowing of $620,000 for the deposit on real estate purchase contract for office space in Shanghai, China (see Note 3) and repayments on notes payable of $1,326,000 in the nine months ended September 30, 2005.

Inventory is included in current assets; however, it will take over one year for the inventory to turn. Hence, inventory would not be as readily marketable or liquid as other items included in current assets, such as cash.

We believe that funds generated from operations, in addition to existing cash balances are likely to be sufficient to finance our working capital and capital expenditure requirements for the foreseeable future. If these funds are not sufficient, we may secure new sources of short-term commercial loans, asset-based lending on accounts receivables or issue debt or equity securities.

Item 3. Controls and Procedures.

The Company's management, including its Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) as of the end of the reporting period covered by this quarterly report. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer has concluded that, as of the end of the period covered by this quarterly report, the Company's disclosure controls and procedures are effective such that material information required to be disclosed by the Company (including its consolidated subsidiary) in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified by the Securities and Exchange Commission's rules and forms relating to the Company.

During the quarterly period covered by this report, there have been no changes to the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

There were no issuances or sales of our securities by us during the quarter ended September 30, 2006 that were not registered under the Securities Act.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

a. Certification Pursuant to Section 302 of the Sarbanes-Oxley

Act of 2002.

b. Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TAITRON COMPONENTS INCORPORATED

Date: November 14, 2006

By: /s/ Stewart Wang

Stewart Wang
Chief Executive Officer, President,
Chief Financial Officer and Director
(Principal Executive, Financial and
Accounting Officer)