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DIGITAL POWER CORP
Form 10QSB
May 17, 2004

U.S. Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-QSB

- QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended March 31, 2004
- TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from _____ to _____

COMMISSION FILE NUMBER 1-12711

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

California 94-1721931

(State or other jurisdiction of (IRS Employer Identification No.)
incorporation or organization)

41920 Christy Street, Fremont CA 94538-3158

(Address of principal executive offices)

(510) 657-2635

(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 No

Number of shares of common stock outstanding as of May 1, 2004: 5,700,703.

ITEM 1. FINANCIAL STATEMENTS

DIGITAL POWER CORPORATION

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INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS OF MARCH 31, 2004

IN U.S. DOLLARS

UNAUDITED

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[GRAPHIC OMITTED]

The Board of Directors
Digital Power Corporation

Re: Review report of unaudited interim consolidated financial
statements
as of and for the three-month period ended March 31, 2004

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We have reviewed the accompanying consolidated balance sheet of Digital Power Corporation ("the Company") and its subsidiary as of March 31, 2004, and the related consolidated statements of operations, and cash flows for the three-month period ended March 31, 2004 and 2003 and changes in shareholders' equity for the three month period ended March 31, 2004 in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the Company's management.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with auditing standards generally accepted in the United States, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements at March 31, 2004, and the three-month period then ended in order for them to be in conformity with accounting principles generally accepted in the United States.

Tel-Aviv, Israel
May 11, 2004

s/KOST FORER GABBAY & KASIERER
KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

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DIGITAL POWER CORPORATION

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

ASSETS

CURRENT ASSETS:

Cash and cash equivalents

Restricted cash

Trade receivables, net of allowance for doubtful accounts of \$ 44 at March 31, 2004

Prepaid expenses and other current assets

Inventories

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Total current assets

LEASE DEPOSITS

PROPERTY AND EQUIPMENT, NET

Total assets

The accompanying notes are an integral part of the consolidated financial statements.

The financial statements included in this report include additional information not otherwise required by regulations of the Securities and Exchange Commission. The Company is providing this additional information in connection with Telkooor Telecom Ltd. filings with the securities agencies in Israel.

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CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands, except share data

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:

Accounts payable
Other current liabilities

Total current liabilities

SHAREHOLDERS' EQUITY:

Series A redeemable, convertible preferred shares no par value: 500,000 shares authorized, 0 s
issued and outstanding at March 31, 2004
Preferred shares, no par value: 1,500,000 shares authorized, 0 shares issued and outstanding a
March 31, 2004

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Common shares, no par value: 10,000,000 shares authorized; 5,700,703 shares issued and outstanding at March 31, 2004

Additional paid-in capital
Deferred stock compensation
Accumulated deficit
Accumulated other comprehensive income

Total shareholders' equity

Total liabilities and shareholders' equity

The accompanying notes are an integral part of the consolidated financial statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

	Th
	----- 2004 -----
Revenues	\$ 1,82
Cost of revenues	1,39

Gross profit	43

Operating expenses:	
Engineering and product development	13
Selling and marketing	30
General and administrative	28

Total operating expenses	72

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Operating loss	(28)
Financial income (expenses), net	3
Loss before tax benefit	(25)
Tax benefit	
Net loss	\$ (25)
Basic and diluted loss per share	\$ (0.0)
Weighted average number of shares used in computing basic and diluted loss per share	5,663,28

The accompanying notes are an integral part of the consolidated financial statements.

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DIGITAL POWER CORPORATION
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE DATA

	Common shares	Additional	Deferred	Accumulated	Accumulated	
	Number	Amount	paid-in capital	stock compensation	deficit	other comprehensive Loss
Balance as of January 1, 2004	5,410,680	\$11,036	\$ 1,437	\$ -	\$ (9,445)	\$ -
Issuance of Common shares, net	290,023	-	246	-	-	-
Deferred stock compensation related to options granted to an employee	-	-	25	(25)	-	-
Amortization of deferred stock compensation related to options granted to an employee	-	-	-	6	-	-
Comprehensive loss:						
Net loss						
Foreign currency translation adjustments	-	-	-	-	(252)	-
	-	-	-	-	-	-

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Total other comprehensive loss

Balance as of March 31, 2004 (Unaudited)	5,700,703	\$11,036	\$ 1,708	\$	(19)	\$	(9,697)
	=====	=====	=====	=====	=====	=====	=====

The accompanying notes are an integral part of the consolidated financial statements.

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DIGITAL POWER CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	2004
Cash flows from operating activities:	
Net loss	\$ (25)
Adjustments required to reconcile net loss to net cash provided by (used in) operating activities:	
Depreciation	2
Compensation related to options granted to an employee	
Decrease in deferred income taxes	
Decrease in trade receivables	12
Increase in prepaid expenses and other current assets	(10)
Decrease in inventories	2
Decrease in accounts payables	(19)
Increase (decrease) in other current liabilities	23
Net cash provided by (used in) operating activities	(13)
Cash flows from investing activities:	
Purchase of property and equipment	(
Proceeds from long-term loan	
Net cash used in investing activities	(
Cash flows from financing activities:	
Proceeds from short-term bank credit	
Principal payments on capital lease obligations	
Issuance of shares pursuant to an investment by Telkoor Telecom Ltd.	24

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Net cash provided by financing activities	24
Effect of exchange rate changes on cash and cash equivalents	
Increase in cash and cash equivalents	11
Cash and cash equivalents at the beginning of the period	1,05
Cash and cash equivalents at the end of the period	\$ 1,16
Supplemental disclosure of cash flows activities:	
Cash paid during the period for interest	\$

The accompanying notes are an integral part of the consolidated financial statements.

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NOTE 1:- GENERAL

Digital Power Corporation ("the Company" or "DPC") was incorporated in 1969, under the General Corporation Law of the state of California. The Company has a wholly-owned subsidiary, Digital Power Limited ("DPL"), located in the United Kingdom. The Company and its subsidiary are currently engaged in the design, manufacture and sale of switching power supplies and converters. The Company has two reportable geographic segments - North America (sales through DPC) and Europe (sales through DPL).

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

- a. The significant accounting policies applied in the annual financial statements of the Company as of December 31, 2003, are applied consistently in these financial statements. In addition the following accounting policy is applied:

The accompanying unaudited consolidated financial statements as of March 31, 2004 and for the three months ended March 31, 2004 and 2003 are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods. The condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, together with management's discussion and analysis of the financial condition and results of operations, contained in the Company Annual Report on Form 10-KSB for the fiscal year ended December 31, 2003. The results of operations for the three months ended March 31, 2004 are not necessarily indicative of the results for the entire fiscal year ending December 31, 2004.

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b. Accounting for stock-based compensation:

The Company and its subsidiary have elected to follow Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB No. 25") in accounting for its employee stock option plans. Under APB No. 25, when the exercise price of the Company's share options is less than the market price of the underlying shares on the date of grant, compensation expense is recognized.

The Company and its subsidiary apply SFAS No. 123, and Emerging Issues Task Force No. 96-18 "Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" ("EITF 96-18"), with respect to options issued to non-employees SFAS No. 123 requires use of an option valuation model to measure the fair value of the options at the grant date.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Under Statement of Financial Accounting Standard No. 123 "Accounting for Stock Based compensation ("SFAS No. 123") SFAS No. 123, proforma information regarding net earnings (loss) and net earnings (loss) per share is required and has been determined as if the Company had accounted for its employee options under the fair value method of that statement. The fair value for these options was estimated at the date of grant using a Black-Scholes Option Valuation Model, with the following weighted-average assumptions for March 31, 2004 and 2003. Expected volatility of 113% and 46% respectively, risk-free interest rates of 4.7% and 1.5%, respectively, dividend yield of 0% for each period, and a weighted-average expected life of the option of 4 years for each period. Stock compensation, for pro-forma purposes, is amortized over the vesting period.

The following table illustrates the effect on net loss and loss per share as if the fair value method had been applied to all outstanding and unvested awards in each period:

Net loss available to Ordinary shares - as reported	\$
Deduct - stock-based employee compensation - intrinsic value	
Add - stock-based employee compensation -fair value	

Pro forma net loss

Earning per share:

2

\$

\$
=====

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Basic and diluted net loss, as reported

\$

Pro forma basic and diluted net loss

\$

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NOTE 3:- SHARE CAPITAL

On January 12, 2004, the Company entered into an agreement to sell 290,023 shares of Common Stock to Telkooor Telecom Ltd. in consideration of \$246, net of issuance expenses. Additionally under the abovementioned agreement, Telkooor may purchase additional shares of Common Stock for an aggregate consideration of \$250 prior to or on June 30, 2004, as determined in the agreement.

NOTE 4:- PENDING LITIGATION

On April 2, 2003, a claim was filed against the Company by Tek-Tron Enterprises Inc. in state court of Pennsylvania, specifically, the Court of Common Pleas of Bucks County, at Case No. 0302116-24-1. Tek-Tron Enterprises Inc. is seeking damages of approximately \$300,000. This case is a complaint for breaking of contract and conversion of parts and infrastructure owned by Tek-Tron Enterprises Inc. located in the Company's former subsidiary, Poder Digital S.A.'s, Mexico manufacturing plant. The Company accrued \$ 102,000 including expenses related to the lawsuit.

NOTE 5:- SEGMENTS, MAJOR CUSTOMERS AND GEOGRAPHICAL INFORMATION

The Company has two reportable geographic segments, see Note 1 for a brief description of the Company's business. The data is presented in accordance with Statement of Financial Accounting Standard No.131, "Disclosure About Segments of an Enterprise and Related Information" ("SFAS No. 131").

The following data presents the revenues, expenditures and other operating data of the Company's geographic operating segments:

	Three months ended March 31, 200		
	DPC	DPL	Elimi
	-----	-----	-----
Revenues	\$ 784	\$ 1,045	\$
Intersegment revenues	138	-	
	-----	-----	-----
Total revenues	\$ 922	\$ 1,045	\$
	=====	=====	=====
Depreciation expense	\$ 7	\$ 18	\$
	=====	=====	=====

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Operating loss	\$ (233)	\$ (51)	\$
Financial income, net			
Net loss	\$ (237)	\$ (15)	\$
Expenditures for segment assets as of March 31, 2004	\$ -	\$ 4	\$
Identifiable assets as of March 31, 2004	\$ 2,242	\$ 2,972	\$

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NOTE 5:- SEGMENTS CUSTOMERS AND GEOGRAPHICAL INFORMATION (Cont.)

	Three months ended March 31, 20		
	DPC	DPL	Elimi
Revenues	\$ 994	\$ 1,139	\$
Intersegment revenues	203	-	
Total revenues	\$ 1,197	\$ 1,139	\$
Depreciation expenses	\$ 8	\$ 29	\$
Operating loss	\$ (109)	\$ (10)	\$
Financial expenses, net			
Loss before tax benefit			
Tax benefit	\$ -	\$ 8	\$
Net income (loss)	\$ (117)	\$ 2	\$
Expenditures for segment assets as of March 31, 2003	\$ -	\$ 19	\$

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Identifiable assets as of				
March 31, 2003	\$	2,145	\$	2,853
		=====		=====

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

With the exception of historical facts stated herein, the matters discussed in this report are "forward looking" statements that involve risks and uncertainties that could cause actual results to differ materially from projected results. Such "forward looking" statements include, but are not necessarily limited to, statements regarding anticipated levels of future revenues and earnings from operations of the Company. Factors that could cause actual results to differ materially include, in addition to other factors identified in this report, dependence on the electronic equipment industry, competition in the power supply industry, dependence on manufacturers in Mexico, China and other risks factors detailed in the Company's Form 10-KSB for the year ended December 31, 2003. Readers of this report are cautioned not to put undue reliance on "forward looking" statements which are, by their nature, uncertain as reliable indicators of future performance. The Company disclaims any intent or obligation to publicly update these "forward looking" statements, whether as a result of new information, future events, or otherwise.

GENERAL

We are engaged in the business of designing, developing, manufacturing, marketing and selling switching power supplies to telecommunications, data communication, test and measurement equipment, office and factory automation and instrumentation equipment manufacturers. Revenues are generated from sales to distributors, OEMs in the telecommunication, data communication, test and measurements equipment, office and factory automation and instrumentation manufacturers' equipment in North America, Europe, and the United Kingdom.

We have continued our efforts to increase sales to existing and new customers, and continue our strategy to manufacture our product in the Far East. Until revenues increase to a sufficient amount to offset our expenses, we anticipate that we will continue to experience net losses for the near future. We believe that our cash will be sufficient to fund those losses.

The Company entered into a securities purchase agreement on January 12, 2004 to sell 290,023 shares of Common stock to Telkoor Telecom Ltd. for the aggregate consideration of \$250,000. Telkoor may purchase additional shares of Common stock for an aggregate consideration of \$250,000 prior to or on June 30, 2004, as determined in the agreement.

On January 19, 2004, the Company hired Jonathan Wax as president and CEO.

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THREE MONTHS ENDED MARCH 31, 2004, COMPARED TO MARCH 31, 2003

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REVENUES

Total revenues decreased by 14.3% to \$1,829,000 for the first quarter ended March 31, 2004, from \$2,133,000 for the first quarter ended March 31, 2003. Revenues from the domestic operation of DPC decreased 21.1% to \$784,000 for the first quarter ended March 31, 2004, from \$994,000 for the first quarter ended March 31, 2003. Revenues from the Company's European operations of DPL decreased 8.3% to \$1,045,000 for the first quarter ended March 31, 2004, from \$1,139,000 for the first quarter ended March 31, 2003. The revenue decrease in the first quarter of 2004 is mainly due to a reduction in sales of our mature products and slower than anticipated ramp up in sales of our new products.

GROSS MARGINS

Gross margins were 23.8% for the three months ended March 31, 2004, compared to 27.9% for the three months ended March 31, 2003. The decrease in gross margins can be primarily attributed to the shift in product mix, fixed cost and decrease in revenues.

ENGINEERING AND PRODUCT DEVELOPMENT

Engineering and product development expenses were 7.5% of revenues for the three months ended March 31, 2004 and 6.8 % for the three months ended March 31, 2003. Actual dollar expenditures remained at approximately the same level.

SELLING AND MARKETING

Selling and marketing expenses were 16.6 % of revenues for the three months ended March 31, 2004, compared to 12.1% for the three months ended March 31, 2003. The increase in sales and marketing expenses were primarily due to new hires as part of our efforts to increase sales in the future.

GENERAL AND ADMINISTRATIVE

General and administrative expenses were 15.3% of revenues for the three months ended March 31, 2004, compared to 14.5% for the three months ended March 31, 2003. In actual dollars, general and administrative expenditures decreased by \$30,000, which was mainly due to recovery of bad debt allowance.

FINANCIAL INCOME AND OTHER EXPENSES

Financial income net was \$32,000 for the three months ended March 31, 2004, compared to financial expenses net of \$4,000 for the three months ended March 31, 2003. The financial income resulted mainly from a favorable exchange rate.

LOSS BEFORE INCOME TAXES

For the three months ended March 31, 2004, the Company had a loss before income taxes of \$252,000 compared to a loss before income taxes of \$123,000 for the three months ended March 31, 2003. The loss increase is mainly due to the decrease in revenues and gross margin.

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TAX BENEFIT

The tax benefit of \$8,000 for the first quarter of 2003 was from DPL. No tax benefit was recorded for the first quarter of 2004.

NET LOSS

Net loss for the three months ended March 31, 2004, was \$252,000 compared to net loss of \$115,000 for the three months ended March 31, 2003. The net loss increase is mainly due to the decrease in revenues and gross margin. The Company intends to reduce costs by transitioning the manufacture of our newer commercial product lines to the Far East.

LIQUIDITY AND CAPITAL RESOURCES

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On March 31, 2004, the Company had cash, cash equivalent and a short-term bank deposit of \$1,164,000 and working capital of \$2,727,000. This compares with cash and cash equivalent of \$684,000 and working capital of \$2,701,000 at March 31, 2003. The increase in working capital is mainly from the Telkoor Telecom investment of \$246,000, offset partially by the operating loss.

Cash used in operating activities for the Company totaled \$134,000 for the three months ended March 31, 2004, compared to cash provided of \$66,000 for the three months ended March 31, 2003. Cash used in investing activities was \$4,000 for the three months ended March 31, 2004, compared to \$13,000 for the three months ended March 31, 2003. Net cash provided by financing activities was \$246,000 for the three months ended March 31, 2004, compared to the net cash provided of \$30,000 for the three months ended March 31, 2003.

The Company has available a line of credit with Silicon Valley Bank ("SVB"). The Company can borrow up to \$1,200,000 against eligible accounts receivable and other financial covenants. The rate for this line of credit would be at Silicon Valley Bank's prime rate plus 1.75%. In order to utilize the line of credit, the Company is required to maintain certain ratios and be in compliance with other covenants. As of March 31, 2004, the Company has not utilized its line of credit.

The Company's subsidiary has a \$548,000 line of credit with Lloyds TSB Bank. Borrowing under this line of credit bears interest of 1.75% per annum over the bank's base rate. As of March 31, 2004, there is no outstanding balance on this line of credit.

The Company believes it has adequate resources at this time to continue its promotional efforts to increase sales in the electronic industry market. However, if the Company does not meet those goals, it may have to raise money through debts or equity, which may dilute shareholder's equity.

ITEM 3. CONTROLS AND PROCEDURES

The Company's management with the participation of the Company's principal executive and financial officers evaluated the effectiveness of the Company's disclosure controls and procedures (as defined Rule 13a-15(e) of the Exchange Act) as of the end of the period covered by this report. The Company's

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disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act are recorded, processed, summarized and reported on a timely basis. Based upon their evaluation, the Company's principal executive and financial officers concluded that the Company's disclosure controls and procedures are effective to accumulate and communicate to the Company's management as appropriate to allow timely decisions regarding disclosure.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time the Company is subject to exposure to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to any such current actions will not materially affect the financial position or results of operations of the Company.

ITEM 2. CHANGES IN SECURITIES

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On January 12, 2004, the Company sold 290,023 shares of common stock for \$0.862 per share to Telkoor Telecom Ltd. Under the terms of the stock purchase agreement, Telkoor may invest an additional \$250,000 on or before June 30, 2004. The purchase price per share for the additional investment is the average closing price of the Company's common stock twenty (20) trading days prior to notice of intent to invest. There was no broker or placement agent in this transaction.

The sales and issuance of common stock was made by us in reliance upon the exemptions from registration provided under Section 4(2) and 4(6) of the Securities Act of 1933, as amended, and Rule 506 of Regulation D, promulgated by the SEC under federal securities laws and comparable exemptions for sales to "accredited" investors under state securities laws. The offers and sales were made to accredited investors as defined in Rule 501(a) under the Securities Act, no general solicitation was made by us or any person acting on our behalf; the securities sold were subject to transfer restrictions, and the certificates for those shares contained an appropriate legend stating that they had not been registered under the Securities Act and may not be offered or sold absent registration or pursuant to an exemption there from.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

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ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

- (a) Exhibits

- 3(ii) Bylaws as Amended
- 31.1 Certification of the CEO under the Sarbanes-Oxley Act
- 31.2 Certification of the CFO under the Sarbanes-Oxley Act
- 32 Certification of the CEO & CFO under the Sarbanes-Oxley Act

- (b) Reports on Form 8-K

The Company filed the following reports:

Date of Report -----	Date of Event -----	Item reported -----
March 17, 2004	March 11, 2004	Press release announcing fourth quarter results, Mark Thum's resignation from the Board and elimination of Executive CEO position

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January 14, 2004

January 11, 2004

Press release announcing securities purchase agreement with Telkooor Telecom Ltd.

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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.

DIGITAL POWER CORPORATION
(Registrant)

Date: May 12, 2004

/s/ JONATHAN WAX

Jonathan Wax
Chief Executive Officer
(Principal Executive Officer)

Date: May 12, 2004

/s/ HAIM YATIM

Haim Yatim
Chief Financial Officer
(Principal Financial and
Accounting Officer)