DIGITAL POWER CORP
Form 10-Q
November 14, 2008

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x **Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2008

o **Transition report pursuant to 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 incorporation or organization)	*(I.R.S. Employer Identification Number)*

41324 Christy Street
Fremont, CA 94538-3158
(Address of principal executive offices)

(510) 657-2635
(Issuer's telephone number)

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.
Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated file	¨	Smaller reporting company	x

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

At November 7, 2008, the registrant had outstanding 6,615,708 shares of common stock.

DIGITAL POWER CORPORATION

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PART I -- FINANCIAL INFORMATION

ITEM 1. **FINANCIAL STATEMENTS**

DIGITAL POWER CORPORATION
CONSOLIDATED BALANCE SHEET

U.S. dollars in thousands (except share and per share data)

		September 30, 2008 Unaudited
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$	2,388
Restricted cash		96
Trade receivables, net of allowance for doubtful accounts of $ 103		2,058
Prepaid expenses and other accounts receivable		142
Inventories		1,591
Total current assets		6,275
PROPERTY AND EQUIPMENT, NET		186
LONG-TERM DEPOSITS		41
Total assets	$	6,502
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$	973
Related parties - trade payables		651
Deferred revenues		243
Other current liabilities		628
Total current liabilities		2,495
SHAREHOLDERS' EQUITY:		
Share capital -		
Series A redeemable, convertible Preferred shares, no par value - 500,000 shares authorized, 0 shares issued and outstanding at September 30, 2008		-
Preferred shares, no par value - 1,500,000 shares authorized, 0 shares issued and outstanding at September 30, 2008		-
Common shares, no par value - 30,000,000 shares authorized; 6,615,708 shares issued and outstanding at September 30, 2008		-
Additional paid-in capital		13,969
Accumulated deficit		(9,926)
Accumulated other comprehensive loss		(36)

Total shareholders' equity		4,007
Total liabilities and shareholders' equity	$	6,502

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

DIGITAL POWER CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands, except per share data

	Nine months ended September 30,		Three months ended September 30,	
	2008	2007	2008	2007
	Unaudited			
Revenues	$ 9,341	$ 8,306	$ 2,825	$ 3,028
Cost of revenues	6,594	6,177	1,761	2,238
Gross profit	2,747	2,129	1,064	790
Operating expenses:				
Engineering and product development	460	587	158	185
Selling and marketing	702	716	242	238
General and administrative	1,243	979	364	345
Total operating expenses	2,405	2,282	764	768
Operating income (loss)	342	(153)	300	22
Financial income, net	74	36	62	7
Income (loss) before income taxes	416	(117)	362	29
Income taxes	-	(3)	-	(12)
Net income (loss)	$ 416	$ (114)	$ 362	$ 41
Basic net earnings (loss) per share	$ 0.063	$ (0.017)	$ 0.055	$ 0.006
Diluted net earnings (loss) per share	$ 0.062	$ (0.017)	$ 0.054	$ 0.006

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

DIGITAL POWER CORPORATION
STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands, except share data

	Common shares		Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive loss	Total other comprehensive income	Total shareholders' equity
	Number	Amount					
Balance as of January 1, 2008	6,615,708	$ -	$ 13,885	$ (10,342)	$ 200		$ 3,743
Stock compensation related to options granted to Telkoor's employees	-	-	41	-	-		41
Stock compensation related to options granted to employees	-	-	43	-	-		43
Comprehensive loss:							
Net income	-	-	-	416	-	$ 416	416
Foreign currency translation adjustments	-	-	-	-	(236)	(236)	(236)
Total other comprehensive income						$ 180	
Balance as of September 30, 2008 (unaudited)	6,615,708	$ -	$ 13,969	$ (9,926)	$ (36)		$ 4,007

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

DIGITAL POWER CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Nine months ended September 30,	
	2008	**2007**
	Unaudited	
Cash flows from operating activities:		
Net income (loss)	$ 416	$ (114)
Adjustments required to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	69	58
Stock compensation related to options granted to employees	43	41
Stock compensation related to options granted to Telkoor's employees	41	41
Decrease in trade receivables, net	618	479
Increase in prepaid expenses and other accounts receivable	(39)	(17)
Decrease (increase) in inventories	14	(389)
Increase (decrease) in accounts payable and related parties- trade payables	(463)	359
Increase (decrease) in deferred revenues and other current liabilities	460	(126)
Net cash provided by operating activities	1,159	332
Cash flows from investing activities:		
Purchase of property and equipment	(64)	(31)
Net cash used in investing activities	(64)	(31)
Effect of exchange rate changes on cash and cash equivalents	(150)	53
Increase in cash and cash equivalents	945	354
Cash and cash equivalents at the beginning of the period	1,443	1,494
Cash and cash equivalents at the end of the period	$ 2,388	$ 1,848
Supplemental disclosure of non-cash activities:		
Adjustments on account of change in accounting for uncertainties in income taxes	$ -	$ 6

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

DIGITAL POWER CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

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, sale and distribution 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, 2007, are applied consistently in these financial statements. In addition, the following accounting policy is applied:

The accompanying unaudited consolidated financial statements as of September 30, 2008, and for the nine months ended September 30, 2008 and 2007 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, 2007. The results of operations for the nine months ended September 30, 2008, are not necessarily indicative of the results for the entire fiscal year ending December 31, 2008.

b. Accounting for stock-based compensation:

The Company has several stock-based employee compensation plans, which are described more fully in Note 4. Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement No. 123(R), "Share-Based Payment" ("SFAS 123(R)"), using the modified-prospective-transition method.

The Company and its subsidiary apply SFAS 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 123 requires use of an option valuation model to measure the fair value of the options at the grant date.

DIGITAL POWER CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

NOTE 3:- INVENTORIES

		September 30, 2008 Unaudited
Raw materials, parts and supplies	$	297
Work in progress		239
Finished products		1,055
	$	1,591

NOTE 4:- ACCOUNTING FOR STOCK BASED COMPENSATION

a. Share option plans:

1. Under the Company's stock option plans, options may be granted to employees, officers, consultants, service providers and directors of the Company or its subsidiary.

2. As of September 30, 2008, the Company has authorized, by several Incentive Share Option Plans, the grant of options to officers, management, other key employees and others of up to 2,272,000 of the Company's Common shares. As of September 30, 2008, an aggregate of 895,870 of the Company's options are still available for future grant.

3. The options granted generally become fully exercisable after four years and expire no later than 10 years from the approval date of the option plan under the terms of grant. Any options that are forfeited or cancelled before expiration become available for future grants.

A summary of the Company's employee share option activity (except options to consultants and service providers) and related information is as follows:

	Nine months ended September 30, 2008			
	Amount of options	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value *)
Outstanding at the beginning of the period	930,190	$ 1.15		
Granted	100,000	0.83		
Forfeited	(220,000)	1.29		
Expired	(31,155)	$ 2.31		
Outstanding at the end of the period	779,035	$ 1.03	5.82	7

Exercisable options at the end of the period	577,535	$	1.01	4.78	7

*) Calculation of aggregate intrinsic value is based on the share price of the Company's Common stock as of September 30, 2008 ($0.71 per share).

DIGITAL POWER CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 4:- ACCOUNTING FOR STOCK BASED COMPENSATION (Cont.)

Under the provisions of SFAS 123(R), the fair value of each option is estimated on the date of grant using a Black-Scholes option valuation model that uses the assumptions such as stock price on the date of the grant, exercise price, risk-free interest rate, expected volatility, expected life and expected dividend yield of the option. Because Black-Scholes option valuation models incorporate various judgmental assumptions for inputs, as described above. Expected volatility is based exclusively on historical volatility of the entity's stock as allowed by SFAS 123(R). The Company uses historical information with respect to the employee options exercised to estimate the expected term of options granted, representing the period of time that options granted are expected to be outstanding The risk-free interest rate of period within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

Grants for the nine months ended September 30, 2008:

Under the provisions of SFAS 123(R), the fair value of each option is estimated on the date of grant using a Black-Scholes option valuation model that uses the assumptions noted in the following table. Because Black-Scholes option valuation models incorporate various judgmental assumptions for inputs, those assumptions are disclosed. Expected volatility is based exclusively on historical volatility of the entity's stock as allowed by SFAS 123(R). The Company uses historical information with respect to the employee options exercised to estimate the expected term of options granted, representing the period of time that options granted are expected to be outstanding. The risk-free interest rate of period within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	Nine months ended September 30, 2008 Unaudited
Expected volatility	100.7%-101.7%
Divided Yield	0%
Expected life of up to (in years)	10
Risk free interest rate	3.85%

As of September 30, 2008, there was $ 169 of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under the plan. That cost is expected to be recognized over a period of two years.

b. Employee Stock Ownership Plan:

The Company has an Employee Stock Ownership Plan ("ESOP") covering eligible employees. The ESOP provides for the Employee Stock Ownership Trust ("ESOT") to distribute shares of the Company's Common shares as retirement benefits to the participants. The Company has not distributed shares since 1998. As of September 30, 2008, the outstanding Common shares held by the ESOT amount to 167,504 shares.

DIGITAL POWER CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 5:- NET EARNINGS (LOSS) PER SHARE

The following table sets forth the computation of the basic and diluted net earnings (loss) per share:

1.	Numerator:			
	Nine months ended September 30,		**Three months ended September 30,**	
	2008	**2007**	**2008**	**2007**
	Unaudited			
Net income (loss) available to Common shareholders	$ 416	$ (114)	$ 362	$ 41
2.	Denominator:			
Denominator for basic net earnings per share of weighted average number of Common shares	6,615,708	6,610,708	6,615,708	6,610,708
Effect of dilutive securities:				
Employee stock options	96,154	-	42,439	284,418
Denominator for diluted net earnings per Common share	6,711,862	6,610,708	6,658,147	6,895,126

DIGITAL POWER CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 6:- SEGMENTS, MAJOR CUSTOMERS AND GEOGRAPHIC 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:

	Nine months ended September 30, 2008 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$ 3,947	$ 5,394	$	$ $9,341
Intersegment revenues	234	5	(239)	
Total revenues	$ 4,181	$ 5,399	$ (239)	$ 9,341
Depreciation expense	$ 23	$ 46	$ -	$ 69
Operating income (loss)	$ (125)	$ 467	$ -	$ 342
Financial income, net				$ 74
Net income (loss)	$ (108)	$ 524	$ -	$ 416
Expenditures for segment assets, net as of September 30, 2008	$ 4	$ 86	$ -	$ 90
Identifiable assets as of September 30, 2008	$ 2,623	$ 3,879	$ -	$ 6,502

DIGITAL POWER CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 6:- SEGMENTS, MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION (Cont.)

	Nine months ended September 30, 2007 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$ 3,886	$ 4,420	$ -	$ 8,306
Intersegment revenues	118	-	(118)	-
Total revenues	$ 4,004	$ 4,420	$ (118)	$ 8,306
Depreciation expense	$ 13	$ 45	$ -	$ 58
Operating income (loss)	$ (247)	$ 94	$ -	$ (153)
Financial income, net and income taxes				39
Net income (loss)	$ (218)	$ 104	$ -	$ (114)
Expenditures for segment assets as of September 30, 2007	$ -	$ 31	$ -	$ 31
Identifiable assets as of September 30, 2007	$ 2,680	$ 3,351	$ -	$ 6,031

	Three months ended September 30, 2008 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$ 1,536	$ 1,289	$ -	$ 2,825
Intersegment revenues	114	5	(119)	-
Total revenues	$ 1,650	$ 1,294	$ (119)	$ 2,825
Depreciation expense	$ 8	$ 15	$ -	$ 23
Operating income	$ 147	$ 154	$ -	$ 301
Financial income, net				$ 61
Net income	$ 148	$ 214	$ -	$ 362
Expenditures for segment assets as of September 30, 2008	$ 4	$ 55	$ -	$ 59
	$ 2,623	$ 3,879	$ -	$ 6,502

Identifiable assets as of
September 30, 2008

DIGITAL POWER CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 6:- SEGMENTS, MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION (Cont.)

	Three months ended September 30, 2007 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$ 1,572	$ 1,456	$ -	$ 3,028
Intersegment revenues	30	-	(30)	-
Total revenues	$ 1,602	$ 1,456	$ (30)	$ 3,028
Depreciation expense	$ 4	$ 20	$ -	$ 24
Operating income (loss)	$ (17)	$ 39	$ -	$ 22
Financial income, net and income taxes				19
Net income (loss)	$ (7)	$ 48	$ -	$ 41
Expenditures for segment assets as of September 30, 2007	$ -	$ 6	$ -	$ 6
Identifiable assets as of September 30, 2007	$ 2,680	$ 3,351	$ -	$ 6,031

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report contains forward-looking statements regarding future events and our future results that are subject to the safe harbors created under the Securities Act of 1933 and the Securities Exchange Act of 1934. All statements other than statements of historical facts are statements that could be deemed forward-looking statements. These statements are based on our expectations, beliefs, forecasts, intentions and future strategies and are signified by the words "expects," "anticipates," "intends," "believes" or similar language. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our business, and other characterizations of future events or circumstances are forward-looking statements. These forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, including those identified below, under “Part II, Item 1A. Risk Factors” and elsewhere in this report. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. All forward-looking statements included in this quarterly report are based on information available to us on the date of this report and speak only as of the date hereof. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events, or otherwise.

In this quarterly report, the “Company,” “we,” “us” and “our” refer to Digital Power Corporation, a California corporation, and our wholly-owned subsidiary, Digital Power Limited.

GENERAL

We are engaged in the business of designing, developing, manufacturing, marketing and selling advanced switching power supplies solutions to the telecom, datacom, industrial, medical and military industries. Revenues are generated from sales to distributors and original equipment manufacturers (OEMs) in North America and Europe.

We have continued our efforts to develop advanced power products, to increase sales to existing and new customers, and to seek to manufacture our products in Asia and other strategic locations. While we believe our revenues have increased to a sufficient amount to offset our expenses, we may be subject to net losses in any individual quarter. We believe that our cash will be sufficient to fund any losses for at least 12 months.

Our corporate office, which contains our administrative, sales, and engineering functions, is located in Fremont, California (“DPC”). In addition, we have a wholly-owned subsidiary, Digital Power Limited (“DPL”), which is located in Salisbury, United Kingdom and does business as Gresham Power Electronics. DPL designs, manufactures and sells switching power supply products for the European marketplace, including power conversion products for naval and military applications and DC/AC inverters for the telecommunications industry.

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008, COMPARED TO SEPTEMBER 30, 2007

Revenues

Total revenues for the Company decreased by 6.7% to $2,825,000 for the three months ended September 30, 2008, from $3,028,000 for the three months ended September 30, 2007. The decrease in revenues is mainly due to decrease of sales of our commercial products in Europe, partially offset by increase in sales of our military products. Revenue from the military products of the Company increased by 41.6% to $804,000 for the three months ended September 30, 2008, from $568,000 for the three months ended September 30, 2007. Revenue from the commercial products of the Company decreased by 17.9% to $2,021,000 from $2,460,000 for the three months ended September 30, 2007. The increase in military product revenues was primarily due to scheduling and lead-time requirements of customer orders.

The decrease in commercial product revenue resulted primarily from the rescheduling of shipments by two of our larger European customers, and was not reflective of a broad-based downturn in business.

Revenues from our U.S. operations decreased by 2.3% to $1,536,000 for the three months ended September 30, 2008, from $1,572,000 for the three months ended September 30, 2007. Revenues from our European operations of DPL decreased by 11.5% to $1,289,000 for the three months ended September 30, 2008, from $1,456,000 for the three months ended September 30, 2007. The decreases in our revenues from our U.S. and European operations are mainly attributed to a decrease in sales of our commercial products, partially offset by an increase in our military sales as discussed above.

For the nine months ended September 30, 2008, our revenues increased by 12.5% to $9,341,000, from $8,306,000 for the nine months ended September 30, 2007. Revenues from our commercial products increased by 11.46% to $6,889,000 for the nine months ended September 30, 2008, from $6,181,000 for the nine months ended September 30, 2007. Revenues from our military products increased by 15.39% to $2,452,000 for the nine months ended September 30, 2008, from $2,125,000 for the nine months ended September 30, 2007. The increase in revenues from our commercial products was derived particularly from increased sales of our high density product lines and products customized for particular customer applications. The increase in revenues from our military products resulted mainly from the scheduling and lead-time factors discussed above.

For the nine months ended September 30, 2008, revenues attributed to our U.S. operations increased by 1.4% to $3,942,000, from $3,886,000 for the nine months ended September 30, 2007. The increase in product revenue is mainly attributed to an increase in sales of our high density product lines and products customized for particular customer applications. Revenues from our European operations of DPL increased by 22.2% to $5,399,000 for the nine months ended September 30, 2008, from $4,420,000 for the nine months ended September 30, 2007. The increase in revenues is mainly attributed to increases in sales of our commercial products, as discussed above.

Gross Margins

Gross margins increased to 37.7% for the three months ended September 30, 2008, compared to 26.1% for the three months ended September 30, 2007. Gross margins for the nine months ended September 30, 2008 were 29.4% compared to the gross margin of 25.6% for the nine months ended September 30, 2007. The higher gross margins in 2008 were primarily attributable to the continued outsourcing of our production to Chinese contract manufacturers, cost reductions and variations in our product mix from quarter to quarter. In addition, we experienced a significant increase in revenues from some of our mature product lines, which contribute higher gross margins. Management believes that the most important factor in the substantial increase in gross margins was our strategic shift earlier in 2008 away from a dependence upon commoditized products to more integrated custom product solutions. This value-added platform of solutions, where we work in concert with our strategic customers and their partners, requires a more direct, consultative selling effort on our part. Management believes that some of this business may be of a seasonal nature and that it most likely will not signify similar increases in gross margin in the future.

Engineering and Product Development

Engineering and product development expenses were $158,000, or 5.6% of revenues, for the three months ended September 30, 2008, compared to $185,000, or 6.1% of revenues for the three months ended September 30, 2007. The decrease was primarily due to lower salary and consulting expenses, including the cessation of consulting fees. Engineering and product development expenses were $460,000, or 4.9% of revenues, for the nine months ended September 30, 2008, compared to $587,000, or 7.1% of revenues, for the nine months ended September 30, 2007. This decrease was primarily due to the increase in revenues from quarter to quarter, coupled with decreases in salary and consulting expenses described above.

Selling and Marketing

Selling and marketing expenses were $242,000, or 8.6% of revenues, for the three months ended September 30, 2008, compared to $238,000, or 7.9% of revenues, for the three months ended September 30, 2007. Selling and marketing expenses were $702,000, or 7.5% of revenues, for the nine months ended September 30, 2008, compared to $716,000, or 8.6% of revenues, for the nine months ended September 30, 2007. Selling and marketing expenses remained approximately the same level in absolute dollars between comparable periods.

General and Administrative

General and administrative expenses were $364,000, or 12.9% of revenues, for the three months ended September 30, 2008, compared to $345,000, or 11.4% or revenues, for the three months ended September 30, 2007. General and administrative expenses were $1,243,000, or 13.3% of revenues, for the nine months ended September 30, 2008, compared to $979,000, or 11.8% or revenues, for the nine months ended September 30, 2007. Expenditures increased in the first nine months of 2008 due primarily to the accrual of liabilities in relation to the separation agreement with our former President and Chief Executive Officer.

Financial Income

Financial income was $62,000 for the three months ended September 30, 2008, compared to financial income of $7,000 for the three months ended September 30, 2007. Financial income was $74,000 for the nine months ended September 30, 2008, compared to financial income of $36,000 for the nine months ended September 30, 2007. The increase in financial income was due to foreign currency fluctuations during the respective periods.

Net Income (Loss)

For the three months ended September 30, 2008, we had net income of $362,000, or 12.8% of revenues, compared to a net income of $41,000, or 1.4% of revenues, for the three months ended September 30, 2007. The increase in net income in 2008 is due to primarily a significant increase in gross margins. Net income for the nine months ended September 30, 2008 was $416,000, or 4.5% of revenues, compared to a net loss of $114,000 for the nine months ended September 30, 2007. The increase in net income in 2008 is primarily due to an increase in revenues and an increase in gross margin, partially offset by higher operating expenses.

LIQUIDITY AND CAPITAL RESOURCES

On September 30, 2008, we had cash and cash equivalents of $2,388,000 and working capital of $3,780,000. This compares with cash and cash equivalents of $1,848,000 and working capital of $3,384,000 at September 30, 2007. The increase in working capital is mainly due to an increase in cash, and decreases in accounts payable and related parties payables, offset partially by a decrease in accounts receivable and an increase in deferred revenue and other current liabilities.

Cash provided by operating activities totaled $1,162,000 for the nine months ended September 30, 2008, compared to cash provided by operating activities of $332,000 for the nine months ended September 30, 2007. The increase in cash flow from operating activities in 2008 was mainly due to an increase in net income and a decrease in trade receivables, offset partially by decreases in accounts payable and related parties trade payables.

Net cash used in investing activities was $64,000 for the nine months ended September 30, 2008, compared to net cash used in investing activities of $31,000 for the nine months ended September 30, 2007. We believe we have adequate resources at this time to continue our operational and promotional efforts to increase sales in the electronic industry market. However, if we do not meet those goals, we may have to raise money through debts or equity, which may dilute shareholder's equity.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not included for a smaller business issuer.

ITEM 4T. DISCLOSURE CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer and our Chief Financial Officer, after evaluating our disclosure controls and procedures (as defined in the rules and regulations of the Securities and Exchange Commission under the Securities Exchange Act of 1934 (the "Exchange Act")) as of the end of the period covered by this quarterly report, have concluded that as of such date, our disclosure controls and procedures were effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

Changes in Internal Controls over Financial Reporting

During the period covered by this quarterly report, there were no significant changes in our internal controls over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See our disclosures under "Legal Proceedings" in our Form 10-KSB filed March 31, 2008 and our Form 10-Q filed May 15, 2008. There have been no material developments in those proceedings since those respective filings.

ITEM 1A. RISK FACTORS

The risk factors listed in this section provide examples of risks, uncertainties and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements. Readers should be aware that the occurrence of any of the events described in these risk factors could have a material and adverse effect on our business, results of operations and financial condition. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events, or otherwise.

Although we experienced an operating profit during the nine month period ended September 30, 2008, we have historically experienced net losses and may experience net losses in the future.

For the nine months ended September 30, 2008, we had an operating profit of $300,000. We had similar operating profits for the years ended December 31, 2007 and 2006. Although we have actively taken steps to reduce our costs, we could incur losses in the future until we increase revenues through the sale of current products and decrease manufacturing costs through a greater use of contract manufacturers in Asia and other strategic locations.

If our new development efforts fail to result in products which meet our customers' needs, or if our customers fail to accept our new products, our revenues will be adversely affected.

We have recently introduced on a limited basis our high density products. The successful development, introduction and commercial success of reaching new market segments providing advanced power products and introducing new products will depend on a number of factors, including our ability to meet customer requirements, the existence of competitive products in the market, our ability to meet product cost targets generating acceptable margins, timely remediation of product performance issues, if any, identified during testing, product performance at customer locations, differentiation of our product from our competitors' products, and management of customer expectations concerning product capabilities and life cycles.

We depend upon a few major customers for a majority of our revenues, and the loss of any of these customers, or the substantial reduction in the products that they purchase from us, would significantly reduce our revenues and net income.

We currently depend upon a few major OEMs and other customers for a significant portion of our revenues and we expect to continue to derive a significant portion of our revenues from a limited number of customers in the future. The loss of any of these customers or a substantial reduction in the products that they purchase from us would significantly reduce our revenues and net income. Furthermore, diversions in the capital spending of certain of these customers to new network elements have and could continue to lead to their reduced demand for our products, which could in turn have a material adverse effect on our business and results of operation. If the financial condition of one

or more of our major customers should deteriorate, or if they have difficulty acquiring investment capital due to any of these or other factors, a substantial decrease in our revenues would likely result. Failure of our development efforts could adversely affect our operations, revenues and growth.

We are dependent on the electronic equipment and telecommunications industries.

Substantially all of our existing customers are in the electronic equipment and telecommunications industries, and they manufacture products that are subject to rapid technological change, obsolescence, and large fluctuations in demand. These industries are further characterized by intense competition. The OEMs serving these markets are pressured for increased product performance and lower product prices. OEMs, in turn, make similar demands on their suppliers, such as us, for increased product performance and lower prices. The telecommunication industry is inherently volatile. Recently, certain segments of the telecommunication and other electronic industries have experienced a significant softening in product demand. Such lower demand may affect our customers, in which case the demand for our products may decline and our growth could be adversely affected.

Revenues derived from sales of our military products are subject to military planning, strategies and funding by U.S. and European governments and could be adversely affected by changing government policies.

We in part rely on sales to customers who do business with U.S. and European governments. Reduced funding by these governments for ongoing defense procurement and research and development programs could result in cancelled or delayed contracts or lower sales of military products, all of which could adversely affect our operations, cash flow and ability to grow.

Our operating results may vary from quarter to quarter.

Our operating results have in the past been subject to quarter to quarter fluctuations, and we expect that these fluctuations will continue, and may increase in magnitude, in future periods. Demand for our products is driven by many factors, including the availability of funding for our products in customers' budgets. There is a trend for some of our customers to place large orders near the end of a quarter or fiscal year, in part to spend remaining available budget funds. Seasonal fluctuations in customer demand for our products driven by budgetary and other reasons can create corresponding fluctuations in period-to-period revenues, and we therefore cannot assure you that our results in one period are necessarily indicative of our revenues in any future period. In addition, the number and timing of large individual sales and the ability to obtain acceptances of those sales, where applicable, has been difficult for us to predict, and large individual sales have, in some cases, occurred in quarters subsequent to those we anticipated, or have not occurred at all. The loss or deferral of one or more significant sales in a quarter could harm our operating results. It is possible that in some quarters our operating results will be below the expectations of public market analysts or investors. In such events, or in the event adverse conditions prevail, the market price of our common stock may decline significantly.

We depend on Telkoor Telecom Ltd to design and manufacture many of our products.

We depend on Telkoor Telecom Ltd. ("Telkoor"), our largest shareholder and one of our third party subcontractors, for design and manufacturing capabilities for many of the products which we sell. If Telkoor is unable or unwilling to continue designing or manufacturing our products in required volumes on a timely basis, that could lead to loss of sales, and adversely affect our operating results and cash position. We also depend on Telkoor's intellectual property and ability to transfer production to third party manufacturers. Failure to obtain new products in a timely manner or delay in delivery of product to customers will have an adverse effect on our ability to meet our customers' expectations. In addition, we operate in highly competitive markets where our ability to sell Telkoor's products could be adversely affected by long lead-times and the high costs of Telkoor's products. Telkoor's principal offices, research and development and manufacturing facilities are located in Israel. . Political, economic, and military conditions in Israel directly affect Telkoor's operations. To the extent that we depend on Telkoor, we could be adversely affected by any major hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners, a significant increase in inflation, or a significant downturn in the economic or financial conditions of Israel.

Our reliance on third parties to manufacture certain aspects of our products involves risks, including delays in product shipments and reduced control over product quality.

Since we do not own significant manufacturing facilities, we must rely on, and will continue to rely on, a limited number of outside parties to manufacture parts, components, and equipment. Our reliance upon such third party contractors involve several risks, including reduced control over manufacturing costs, delivery times, reliability, quality of components, unfavorable currency exchange fluctuations, and continued inflationary pressures on many of the raw materials used in the manufacturing of our products. If we were to encounter a shortage of key manufacturing components from limited sources of supply, or experience manufacturing delays caused by reduced manufacturing capacity, inability of our contract manufacturers to procure raw materials, the loss of key assembly subcontractors, difficulties associated with the transition to our new contract manufacturers or other factors, we could experience lost revenues, increased costs, delays in, cancellations or rescheduling of orders or shipments, any of which would materially harm our business.

We face intense industry competition, price erosion and product obsolescence, which, in turn, could reduce our profitability.

We operate in an industry that is generally characterized by intense competition. We believe that the principal bases of competition in our markets are breadth of product line, quality of products, stability, reliability and reputation of the provider, along with cost. Quantity discounts, price erosion, and rapid product obsolescence due to technological improvements are therefore common in our industry as competitors strive to retain or expand market share. Product obsolescence can lead to increases in unsaleable inventory that may need to be written off and therefore could reduce our profitability. Similarly, price erosion can reduce our profitability by decreasing our revenues and our gross margins. In fact, we have seen price erosion over the last several years on most of the products we sell, and we have factored additional price erosion into our forecasts.

Sales of our mature products may continue to constitute a meaningful portion of our revenues.

A large portion of our sales have historically been attributable to our mature product line. We expect that these products may continue to account for a meaningful percentage of our revenues for the foreseeable future, but may also fluctuate from quarter to quarter. Our ability to maintain or increase revenues will be dependent on our ability to expand our customer base and maintain consistent sales of our mature products while successfully developing, introducing and selling new products.

The sale of our products is dependent on our ability to respond to rapid technological change, including evolving industry-wide standards, and may be adversely affected by the development, and acceptance by our customers, of new technologies which may compete with or reduce the demand for our products.

Rapid technological change, including evolving industry standards, could render our products obsolete. To the extent our customers adopt such new technology in place of our products, the sales of our products may be adversely affected. Such competition may also increase pricing pressure for our products and adversely affect the revenues from such products.

The sale of our products is dependent upon our ability to satisfy the proprietary requirements of our customers.

We depend upon a relatively narrow range of products for the majority of our revenue. Our success in marketing our products is dependent upon their continued acceptance by our customers. In some cases, our customers require that our products meet their own proprietary requirements. If we are unable to satisfy such requirements, or forecast and adapt to changes in such requirements, our business could be materially harmed.

If we are unable to satisfy our customers' specific product quality, certification or network requirements, our business could be disrupted and our financial condition could be harmed.

Our customers demand that our products meet stringent quality, performance and reliability standards. We have, from time to time, experienced problems in satisfying such standards. Defects or failures have in the past, and may in the future occur relating to our product quality, performance and reliability. From time to time, our customers also require us to implement specific changes to our products to allow these products to operate within their specific network configurations. If we are unable to remedy these failures or defects or if we cannot affect such required product modifications, we could experience lost revenues, increased costs, including inventory write-offs, warranty expense and costs associated with customer support, delays in or cancellations or rescheduling of orders or shipments and product returns or discounts, any of which would harm our business.

If we ship products that contain defects, the market acceptance of our products and our reputation will be harmed and our customers could seek to recover their damages from us.

Our products are complex, and despite extensive testing, may contain defects or undetected errors or failures that may become apparent only after our products have been shipped to our customers and installed in their network or after product features or new versions are released. Any such defect, error or failure could result in failure of market acceptance of our products or damage to our reputation or relations with our customers, resulting in substantial costs for us and our customers as well as the cancellation of orders, warranty costs and product returns. In addition, any defects, errors, misuse of our products or other potential problems within or out of our control that may arise from the use of our products could result in financial or other damages to our customers. Our customers could seek to have us pay for these losses. Although we maintain product liability insurance, it may not be adequate.

Our future results are dependent on our ability to establish, maintain and expand our distribution channels and our existing third-party distributor relationships.

We market and sell our products through domestic and international OEM relationships. Our future results are dependent on our ability to establish, maintain and expand third party relationships with OEM as well as other marketing and sales distribution channels. If, however, the third parties with whom we have entered into such OEM and other arrangements should fail to meet their contractual obligations, cease doing, or reduce the amount of their business with us or otherwise fail to meet their own performance objectives, customer demand for our products could be adversely affected, which would have an adverse effect on our revenues.

We may not be able to procure necessary key components for our products, or we may purchase too much inventory or the wrong inventory.

The power supply industry, and the electronics industry as a whole, can be subject to business cycles. During periods of growth, key components required to build our products may become unavailable in the timeframe required for us to meet our customers' demands. Our inability to secure sufficient components to build products for our customers could negatively impact our sales and operating results. We may choose to mitigate this risk by increasing the levels of inventory for certain key components. Increased inventory levels can increase the potential risk for excess and obsolescence should our forecasts fail to materialize or if there are negative factors impacting our customers' end markets. If we purchase too much inventory or the wrong inventory, we may have to record additional inventory reserves or write-off the inventory, which could have a material adverse effect on our gross margins and on our results of operations.

We depend on international sales for a portion of our revenues.

Sales to customers outside of North America accounted for 61.3% of net revenues during the nine months ended September 30, 2008, and we expect that international sales will continue to represent a material portion of our total revenues. International sales are subject to the risks described above as well as generally longer payment cycles, greater difficulty collecting accounts receivable, and currency restrictions. We also have a wholly-owned foreign subsidiary, Digital Power Ltd., doing business as Gresham Power Electronics, in the United Kingdom, to support European and other international customers, distributors, and sales representatives, which is subject to local regulation. In addition, international sales are subject to the export laws and regulations of the United States and other countries.

We are subject to certain governmental regulatory restrictions relating to our international sales.

Some of our products are subject to ITAR (International Trafficking and Arms Regulations), which is administered by the U.S. Department of State. ITAR controls not only the export of certain products specifically designed, modified,

configured or adapted for military systems, but also the export of related technical data and defense services as well as foreign production. We recently participated in the U.S. government's voluntary disclosure program to notify the government of potential export compliance issues that we discovered and to take corrective actions to ensure that we obtain required export licenses and to otherwise comply with ITAR. We have taken such corrective actions and believe that we now have the necessary licenses for any exports subject to the ITAR. However, if the corrective actions were to fail or be ineffective for a prolonged period of time or if the process of obtaining required export licenses for products subject to the ITAR is delayed, it could have a materially adverse effect on our business, financial condition, and/or operating results. Changes in United States export laws that require us to obtain additional export licenses or delays in obtaining export licenses currently being sought sometimes cause significant shipment delays and, if such delays are too great, could result in the cancellation of orders. Any future restrictions or charges imposed by the United States or any other country on our international sales or foreign subsidiary could have a materially adverse effect on our business, financial condition, and/or operating results. In addition, from time to time, we have entered into contracts with the Israeli Ministry of Defense which were funded with monies subject to, and we therefore were required to comply with the regulations governing, the U.S. Foreign Military Financing program.

We depend on international operations for a substantial majority of our components and products.

We purchase a substantial majority of our components from foreign manufacturers and have a substantial majority of our commercial products assembled, packaged, and tested by subcontractors located outside the United States. These activities are subject to the uncertainties associated with international business operations, including trade barriers and other restrictions, changes in trade policies, governmental regulations, currency exchange fluctuations, reduced protection for intellectual property, war and other military activities, terrorism, changes in social, political, or economic conditions, and other disruptions or delays in production or shipments, any of which could have a materially adverse effect on our business, financial condition, and/or operating results.

We are dependent upon our ability to attract, retain and motivate our key personnel.

Our success depends on our ability to attract, retain and motivate our key management personnel, including our CEO and CFO, and key engineers, necessary to implement our business plan and to grow our business. Despite the adverse economic conditions of the past several years, competition for certain specific technical and management skill sets is intense. If we are unable to identify and hire the personnel that we need to succeed, or if one or more of our present key employees were to cease to be associated with us, our future results could be adversely affected. Furthermore, we have recently experienced a number of changes in our senior management positions, both as part of restructuring initiatives and otherwise. Although we believe we have taken appropriate measures to address the impact of these changes, there is the risk that such changes could impact our business, which could negatively affect operating results.

Our limited ability to protect our proprietary information and technology may adversely affect our ability to compete, and our products could infringe upon the intellectual property rights of others, resulting in claims against us the results of which could be costly.

Many of our products consist entirely or partly of proprietary technology owned by us. Although we seek to protect our technology through a combination of copyrights, trade secret laws, contractual obligations and patents, these protections may not be sufficient to prevent the wrongful appropriation of our intellectual property, nor will they prevent our competitors from independently developing technologies that are substantially equivalent or superior to our proprietary technology. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the United States. In order to defend our proprietary rights in the technology utilized in our products from third party infringement, we may be required to institute legal proceedings. If we are unable to successfully assert and defend our proprietary rights in the technology utilized in our products, our future results could be adversely affected.

Although we attempt to avoid infringing known proprietary rights of third parties in our product development efforts, we may become subject to legal proceedings and claims for alleged infringement from time to time in the ordinary course of business. Any claims relating to the infringement of third-party proprietary rights, even if not meritorious, could result in costly litigation, divert management’s attention and resources, require us to reengineer or cease sales of our products or require us to enter into royalty or license agreements which are not advantageous to us. In addition, parties making claims may be able to obtain an injunction, which could prevent us from selling our products in the United States or abroad.

If our accounting controls and procedures are circumvented or otherwise fail to achieve their intended purposes, our business could be seriously harmed.

We evaluate our disclosure controls and procedures as of the end of each fiscal quarter, and are annually reviewing and evaluating our internal controls over financial reporting in order to comply with SEC rules relating to internal control over financial reporting adopted pursuant to the Sarbanes-Oxley Act of 2002. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. If we fail to maintain effective internal control over financial reporting or our management does not timely assess the adequacy of such internal control, we may be subject to regulatory sanctions and our reputation may decline.

Our common stock price is volatile.

Our common stock is listed on the American Stock Exchange and is thinly traded. In the past, our trading price has fluctuated widely, depending on many factors that may have little to do with our operations or business prospects. Further, the exercise of outstanding options and warrants may adversely affect our stock price and a shareholder's percentage of ownership**.** As of September 30, 2008, we had outstanding employees' options to purchase 779,035 shares of common stock, with a weighted average exercise price of $1.03, exercisable at prices ranging from $0.48 to $2.38 per share, and consultants' and service providers' options and warrants to purchase 180,000 shares of common shares, with a weighted average exercise price of $1.09, exercisable at prices ranging from $0.55 to $1.19.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

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

Exhibits

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

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.

Dated: November 14, 2008

Digital Power Corporation

By: /s/ Amos Kohn

Amos Kohn
President & Chief Executive Officer
(Principal Executive Officer)

By: /s/ Uri Friedlander

Uri Friedlander
Chief Financial Officer
(Principal Financial and Accounting Officer)