DIGITAL POWER CORP
Form 10QSB
May 15, 2007

U.S. 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 March 31, 2007

|_| 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 incorporation or organization)	(IRS Employer Identification No.)

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 |X| No |_|

Number of shares of common stock outstanding as of May 8, 2007: 6,610,708

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DIGITAL POWER CORPORATION

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS OF MARCH 31, 2007

IN U.S. DOLLARS

UNAUDITED

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[LOGO GRAPHIC OMITTED]

The Board of Directors
Digital Power Corporation

Re: Review of unaudited interim consolidated financial statements for the three-month period ended March 31, 2007

We have reviewed the accompanying consolidated balance sheet of Digital Power Corporation ("the Company") and its subsidiaries as of March 31, 2007, and the related consolidated statements of income and cash flows for the three-month periods ended March 31, 2007 and 2006, and the statement of changes in shareholders' equity for the three-month period ended March 31, 2007. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, 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 consolidated interim financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

Tel-Aviv, Israel
May 14 , 2007

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

DIGITAL POWER CORPORATION

CONSOLIDATED BALANCE SHEET

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

	March 31, 2007
	Unaudited
CURRENT ASSETS:	
Cash and cash equivalents	$ 1,225
Restricted cash	104
Trade receivables, net of allowance for doubtful accounts of $ 124	1,781
Prepaid expenses and other receivables	187
Inventories	1,917
Total current assets	5,214
PROPERTY AND EQUIPMENT, NET	161
Total assets	$ 5,375
LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable	$ 602
Related parties - trade payables	900
Deferred revenues	11
Other current liabilities	328
Total current liabilities	1,841
SHAREHOLDERS' EQUITY:	

Share capital:	
Series A redeemable, convertible Preferred shares, no par value: 500,000 shares authorized, 0 shares issued and outstanding at March 31, 2007	--
Preferred shares, no par value: 1,500,000 shares authorized, 0 shares issued and outstanding at March 31, 2007	--
Common shares, no par value: 30,000,000 shares authorized; 6,610,708 shares issued and outstanding at March 31, 2007	--
Additional paid-in capital	13,792
Accumulated deficit	(10,428)
Accumulated other comprehensive income	170
Total shareholders' equity	3,534
Total liabilities and shareholders' equity	$ 5,375

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

DIGITAL POWER CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

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

	Three months ended March 31, 2007	Three months ended March 31, 2006
	Unaudited	
Revenues	$ 2,742	$ 2,708
Cost of revenues	1,967	1,926
Gross profit	775	782
Operating expenses:		
Engineering and product development	221	138
Selling and marketing	229	302
General and administrative	300	304
Total operating expenses	750	744
Operating income	25	38
Financial income (expenses), net	16	(1)
Net income	$ 41	$ 37

Basic and diluted net earnings per share	$ 0.006	$ 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 Number	Common shares Amount	Additional paid-in capital	Accumulated deficit	Accumul othe comprehe inco
Balance as of January 1, 2007	6,610,708	$-	$ 13,768	$ (10,463)	$
Stock compensation related to options granted to Telkoor's employees	--	--	12	--	
Stock compensation related to options granted to employees	--	--	12	--	
Comprehensive income:					
Net income	--	--	--	41	
Foreign currency translation adjustments	--	--	--	--	
Cumulative impact of change in accounting for uncertainties in income taxes	--	--	--	(6)	
Total other comprehensive income					
Balance as of March 31, 2007 (unaudited)	6,610,708	$ --	$ 13,792	$ (10,428)	$

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

	Three months ended March 31, 2007	Three months ended March 31, 2006
	Unaudited	
Cash flows from operating activities:		
Net income	$ 41	$ 37
Adjustments required to reconcile net income to net cash used in operating activities:		
Depreciation	19	20
Stock compensation related to options granted to employees	12	2
Stock compensation related to options granted to Telkoor's employees	12	8
Decrease in trade receivables, net	426	95
Increase in prepaid expenses and other receivables	(47)	(37)
Increase in inventories	(317)	(128)
Decrease in accounts payable and related parties-trade payables	(203)	(44)
Decrease in deferred revenues and other current liabilities	(195)	(85)
Net cash used in operating activities	(252)	(132)
Cash flows from investing activities:		
Restricted cash	--	(1)
Purchase of property and equipment	(18)	(2)
Net cash used in investing activities	(18)	(3)
Cash flows from financing activities:		
Exercise of options of a director	--	140
Net cash provided by financing activities	--	140
Effect of exchange rate changes on cash and cash equivalents	1	5
Increase (decrease) in cash and cash equivalents	(269)	10
Cash and cash equivalents at the beginning of the period	1,494	1,409
Cash and cash equivalents at the end of the period	$ 1,225	$ 1,419

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

DIGITAL POWER CORPORATION

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, 2006, 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, 2007, and for the three months ended March 31, 2007 and 2006 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, 2006. The results of operations for the three months ended March 31, 2007, are not necessarily indicative of the results for the entire fiscal year ending December 31, 2007.

b. Accounting for stock-based compensation:

The Company has several stock-based employee compensation plans, which are described more fully in Note 5. Prior to January 1, 2006, the Company accounted for those plans under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), and related Interpretations, as permitted by FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). 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.

Under that transition method, compensation cost recognized in the first quarter of 2006 includes compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). On December 31, 2005, the Company accelerated all of its unvested outstanding employees' stock options, and therefore, no compensation costs were included for share-based payments granted prior to January 1, 2006 in the first quarter of 2006.

DIGITAL POWER CORPORATION

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company and its subsidiaries 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.

c. FIN 48 - Uncertainty in income taxes:

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement 109" ("FIN 48"). FIN 48 establishes a single model to address accounting for uncertain tax positions. FIN 48 clarified the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted the provisions of FIN 48 effective January 1, 2007. As a result of the implementation of FIN 48, the Company recorded an increase of $ 6 associated with the liability for unrecognized tax benefits, which was accounted for as an increase to the accumulated deficit balance as of January 1, 2007.

NOTE 3:- INVENTORIES

	March 31, 2007
	Unaudited
Raw materials, parts and supplies	$ 289
Work in progress	474
Finished products	1,154
	$ 1,917

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 subsidiaries.

2. As of March 31, 2007, 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 2,272,200 of the Company's Common shares. As of March 31, 2007, an aggregate of 668,715 of the Company's options are still available for future grant.

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

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:

	Three months ended March 31, 2007			
	Amount of options	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value*)
Outstanding at the beginning of the period	901,225	$1.12	6.63	
Granted	80,000	$1.70		
Forfieted	(20,035)	$1.12		
Outstanding at the end of the period	961,190	$1.17	6.67	255,120
Exercisable options at the end of the period	772,440	$1.08	6.00	246,045

*) Calculation of aggregate intrinsic value is based on the share price of the Company's Common stock as of March 31, 2007 ($1.27 pershare).

Grants for the three months ended March 31, 2006:

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.

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

	Three months ended March 31, 2007
	Unaudited
Expected volatility	102-118%
Divided Yield	0%
Expected life of up to (in years)	5-7
Risk free interest rate	4.47-5.03%

The fair value of options granted during the first quarter of 2007 was $ 1.39.

As of March 31, 2007, there was $ 185 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 4 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 March 31, 2007, the outstanding Common shares held by the ESOT amount to 167,504 shares.

NOTE 5:- NET EARNINGS PER SHARE

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

1. Numerator:

	Three months ended March 31,

	2007	2006
Net income available to Common stockholders	$ 41	$ 37

2. Denominator:

Denominator for basic net earnings per share of weighted average number of Common stock	6,610,708	6,261,859
Effect of dilutive securities:		
Employee stock options	346,182	192,912
Convertible note	--	235,849
Denominator for diluted net earnings per share of Common stock	6,956,890	6,690,620

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:

	Three months ended March 31, 2007 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$ 1,203	$ 1,539	$ --	$ 2,742
Intersegment revenues	36	--	(36)	--
Total revenues	$ 1,239	$ 1,539	$ (36)	$ 2,742
Depreciation expense	$ 5	$ 14	$ --	$ 19
Operating income (loss)	$ (57)	$ 82	$ --	$ 25
Financial income, net				$ 16
Net income (loss)	$ (47)	$ 88	$ --	$ 41
Expenditures for				

segment assets as of March 31, 2007	$ --	$ 18	$ --	$ 18
Identifiable assets as of March 31, 2007	$ 2,340	$ 3,035	$ --	$ 5,375

DIGITAL POWER CORPORATION

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

	Three months ended March 31, 2006 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$ 1,423	$ 1,285	$ --	$ 2,708
Intersegment revenues	210	--	(210)	--
Total revenues	$ 1,633	$ 1,285	$ (210)	$ 2,708
Depreciation expense	$ 5	$ 15	$ --	$ 20
Operating income	$ 9	$ 29	$ --	$ 38
Financial expenses, net				(1)
Net income	$ 12	$ 25	$ --	$ 37
Expenditures for segment assets as of March 31, 2006	$ --	$ 2	$ --	$ 2
Identifiable assets as of March 31, 2006	$ 2,459	$ 3,042	$ --	$ 5,501

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 China and other risks factors detailed in the Company's Form 10-KSB for the year ended December 31, 2006. 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, selling and distributing switching power supplies to the industrial, telecommunication, data communication, medical and military industries. Revenues are generated from sales to distributors and OEMs in North America and Europe.

We have continued our efforts to increase sales to existing and new customers, and continue our strategy to manufacture our products in the Far East. While we believe our revenues have increased to a sufficient amount to offset our expenses, we may be subject to net losses in an individual quarter. We believe that our cash will be sufficient to fund those 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 the Company has a wholly-owned subsidiary, Digital Power Limited ("DPL"), located in Salisbury, England.

THREE MONTHS ENDED MARCH 31, 2007, COMPARED TO MARCH 31, 2006

REVENUES
Total revenues increased by 1.3% to $2,742,000 for the first quarter ended March 31, 2007, from $2,708,000 for the first quarter ended March 31, 2006.

Revenues from the domestic operations of DPC decreased by 15.5% to $1,203,000 for the first quarter ended March 31, 2007, from $1,423,000 for the first quarter ended March 31, 2006. Revenues from the Company's European operations of DPL increased 19.8% to $1,539,000 for the first quarter ended March 31, 2007, from $1,285,000 for the first quarter ended March 31, 2006.

GROSS MARGINS
Gross margins were 28.3% for the three months ended March 31, 2007, compared to 28.9% for the three months ended March 31, 2006.

ENGINEERING AND PRODUCT DEVELOPMENT
Engineering and product development expenses were 8.1% of revenues for the three months ended March 31, 2007, and 5.1 % for the three months ended March 31, 2006. The increase is mainly due to product safety expenses and contract services.

SELLING AND MARKETING
Selling and marketing expenses were 8.4% of revenues for the three months ended March 31, 2007, compared to 11.2% for the three months ended March 31, 2006.

Actual dollar expenditures decreased by $73,000 mainly due to headcount reduction.

GENERAL AND ADMINISTRATIVE

General and administrative expenses were 10.9% of revenues for the three months ended March 31, 2007 compared to 11.2% for the three months ended March 31, 2006. In actual dollars, general and administrative expenses remained approximately at the same level.

FINANCIAL INCOME

Net financial income was $16,000 for the three months ended March 31, 2007, compared to net financial expense of $1,000 for the three months ended March 31, 2006. Financial income is mainly from interest received from the exchange rate fluctuation of the Company's United Kingdom's operations of DPL.

NET INCOME

Net income for the three months ended March 31, 2007, was $41,000 compared to net income of $37,000 for the three months ended March 31, 2006.

LIQUIDITY AND CAPITAL RESOURCES

On March 31, 2007, the Company had cash, cash equivalent and a short-term bank deposit of $1,225,000 and working capital of $3,373,000. This compares with cash and cash equivalent of $1,419,000 and working capital of $2,653,000 at March 31, 2006. The increase in working capital is mainly due to increase in inventory, decrease in accounts payable and deferred revenues.

Cash used in operating activities for the Company totaled $252,000 for the three months ended March 31, 2007, compared to cash used of $132,000 for the three months ended March 31, 2006. Cash used in investing activities was $18,000 for the three months ended March 31, 2007, compared to cash used of $3,000 for the three months ended March 31, 2006. Net cash provided by financing activities was $140,000 for the three months ended March 31, 2006.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. CHANGES IN SECURITIES

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

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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:

Jonathan Wax,
Chief Executive Officer
(Principal Executive Officer)

Date:

Leo Yen,
Chief Financial Officer
(Principal Financial Officer)