DIGITAL POWER CORP
Form 10QSB
August 16, 2004

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 June 30, 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 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 August 10, 2004: 6,136,859

ITEM 1. FINANCIAL STATEMENTS

DIGITAL POWER CORPORATION

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS OF JUNE 30, 2004

IN U.S. DOLLARS

UNAUDITED

INDEX



- - - - - - - -

DIGITAL POWER CORPORATION

CONSOLIDATED BALANCE SHEET

U.S. dollars in thousands

| | June 30, 2004 |
|---|---|
| | Unaudited |
| ASSETS | |
| CURRENT ASSETS: | |
| Cash and cash equivalents | $ 1,124 |
| Restricted cash | 296 |
| Trade receivables, net of allowance for doubtful accounts of $ 62 at June 30, 2004 | 1,491 |
| Prepaid expenses and other current assets | 257 |
| Inventories | 1,643 |
| Total current assets | 4,811 |

| | |
|---|---|
| LONG-TERM LEASE DEPOSITS | 18 |
| PROPERTY AND EQUIPMENT, NET | 284 |
| Total assets | $ 5,113 |

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

CONSOLIDATED BALANCE SHEET

U.S. dollars in thousands, except share and per 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 June 30, 2004
Preferred shares, no par value: 1,500,000 shares authorized, 0 shares issued and outstanding a
30, 2004
Common shares, no par value: 10,000,000 shares authorized; 5,931,941 shares issued and outstan
at June 30, 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.

CONSOLIDATED STATEMENTS OF OPERATIONS

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

| | Six months ended June 30, 2004 | Six months ended June 30, 2003 | |
|---|---|---|---|
| | Unaudited | | |
| Revenues | $ 3,968 | $ 3,729 | $ |
| Cost of revenues | 3,004 | 2,704 | |
| Gross profit | 964 | 1,025 | |
| Operating expenses: | | | |
| Engineering and product development | 292 | 273 | |
| Selling and marketing | 622 | 518 | |
| General and administrative | 555 | 647 | |
| Total operating expenses | 1,469 | 1,438 | |
| Operating loss | (505) | (413) | |
| Financial income (expenses), net | 2 | 7 | |
| Loss before income taxes | (503) | (406) | |
| Income taxes | - | (26) | |

| | | | |
|---|---|---|---|
| Net loss | $ (503) | $ (380) | $ |
| Basic and diluted net loss per share | $ (0.09) | $ (0.08) | $ |
| Weighted average number of shares used in computing basic and diluted loss per share | 5,692,013 | 4,960,680 | 5, |

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

DIGITAL POWER CORPORATION
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

| | Common shares Number | Common shares Amount | Additional paid-in capital | Deferred stock compensation | paid-in Accumulated deficit | Addition other comprehe income ( |
|---|---|---|---|---|---|---|
| Balance as of January 1, 2004 | 5,410,680 | $11,036 | $ 1,437 | $ - | $ (9,445) | $ ( |
| Issuance of Common shares, net | 511,261 | - | 493 | - | - | |
| Deferred stock compensation related to options granted to an employee | - | - | 25 | (25) | - | |
| Amortization of deferred stock compensation related to options granted to an employee | - | - | - | 9 | - | |
| Exercise of options | 10,000 | - | 7 | - | - | |
| Comprehensive loss: | | | | | | |
| Net loss | - | - | - | - | (503) | |
| Foreign currency translation adjustments | - | - | - | - | - | 1 |
| Total other comprehensive loss | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Balance as of June 30, 2004 (Unaudited) | 5,931,941 | $11,036 | $ 1,962 | $ (16) | $ (9,948) | $ |

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

| | Six months ended June 30, 2004 | Six months ended June 30, 2003 | |
|---|---|---|---|
| | Unaudited | | |
| Cash flows from operating activities: | | | |
| Net loss | $ (503) | $ (380) | $ |
| Adjustments required to reconcile net loss to net cash used in operating activities: | | | |
| Depreciation | 50 | 71 | |
| Compensation related to options granted to an employee | 9 | - | |
| Decrease in deferred income taxes | - | 342 | |
| Decrease in trade receivables | 139 | 632 | |
| Decrease (increase) in prepaid expenses and other current assets | (121) | 9 | |
| Decrease (increase) in inventories | 55 | (152) | |
| Increase (decrease) in accounts payable | 130 | (344) | |
| Decrease in other current liabilities | (176) | (350) | |
| Net cash used in operating activities | (417) | (172) | |
| Cash flows from investing activities: | | | |
| Restricted short-term bank deposit | - | 600 | |
| Purchase of property and equipment | (12) | (42) | |
| Proceeds from long-term loan | - | 13 | |
| Net cash provided by (used in) investing activities | (12) | 571 | |
| Cash flows from financing activities: | | | |
| Proceeds from short-term bank credit | - | 40 | |
| Proceeds from issuance of Common shares | - | 600 | |

| | | | |
|---|---|---|---|
| Proceeds from long-term loan from a bank | - | 12 | |
| Payments made on short-term bank credit | - | (290) | |
| Principal payments on capital lease obligations | - | (27) | |
| Issuance of shares pursuant to an investment by Telkoor Telecom Ltd. | 493 | - | |
| Exercise of options granted to an employee | 7 | - | |
| Net cash provided by financing activities | 500 | 335 | |
| Effect of exchange rate changes on cash and cash equivalents | 3 | 7 | |
| Increase (decrease) in cash and cash equivalents | 74 | 741 | |
| Cash and cash equivalents at the beginning of the period | 1,050 | 616 | 1 |
| Cash and cash equivalents at the end of the period | $ 1,124 | $ 1,357 | $ 1 |
| Supplemental disclosure of cash flows activities: | | | |
| Cash paid during the period for interest | $ - | $ 8 | $ |

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

U.S. dollars in thousands

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 June 30, 2004 and for the six months ended June 30, 2004 and 2003 are unaudiated 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 six months ended June 30, 2004 are not necessarily indicative of the results for the entire fiscal year ending December 31, 2004.

b. Accounting for stock-based compensation:

The Company and its subsidiary has 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.

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company and its subsidiary apply Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" ("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.

Under SFAS No. 123, proforma information regarding net loss and 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 June 30, 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:

| | 2 |
|---|---|
| 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 | $ |
| Loss per share: | |
| Basic and diluted net loss, as reported | $ |
| Pro forma basic and diluted net loss | $ |

U.S. dollars in thousands

NOTE 3:- SHARE CAPITAL

a. On January 12, 2004, the Company entered into an agreement to sell 290,023 shares of Common Stock to Telkoor Telecom Ltd. in consideration of $ 246, net of issuance expenses.

b. On June 16, 2004, the Company entered into an agreement to sell 221,238 shares of Common stock to Telkoor Ltd., in consideration of $ 247, net of issuance expenses. Additionally, under the abovementioned agreement, Telkoor may purchase additional shares of Common stock for an aggregate consideration of $ 250, prior to or on December 31, 2004, as determined in the agreement.

NOTE 4:- LEGAL PROCEEDINGS

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

In April 2004, the Company signed a settlement agreement with Tek-Tron according to which the Company agreed to pay a total of $ 90 in two installments. As of June 30, 2004, the Company paid $ 75. Under the settlement agreement, Tek-Tron shall have the right to receive the inventory from the Company and to compel arbitration limited to the sum of $ 50, in case the parties do not agree on a resolution regarding the inventory list. The inventory list is currently disputed among the parties and no resolution has been reached regarding the inventory list.

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:

| | Six months ended June 30, 2004 | | |
|---|---|---|---|
| | DPC | DPL | Elimi |
| Revenues | $ 1,855 | $ 2,113 | $ |
| Intersegment revenues | 417 | - | |
| Total revenues | $ 2,272 | $ 2,113 | $ |
| Depreciation expense | $ 15 | $ 35 | $ |
| Operating loss | $ (359) | $ (146) | $ |
| Financial income, net | | | |
| Net loss | $ (353) | $ (150) | $ |
| Expenditures for segment assets as of June 30, 2004 | $ 8 | $ 4 | $ |
| Identifiable assets as of June 30, 2004 | $ 2,072 | $ 3,041 | $ |

U.S. dollars in thousands

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

| | Six months ended June 30, 2003 | | |
|---|---|---|---|
| | DPC | DPL | Elimi |
| Revenues | $ 1,863 | $ 1,866 | $ |
| Intersegment revenues | 410 | - | |

| | | | |
|---|---|---|---|
| Total revenues | $ 2,273 | $ 1,866 | $ |
| Depreciation expenses | $ 17 | $ 54 | $ |
| Operating loss | $ (265) | $ (148) | $ |
| Financial expenses, net | | | |
| Loss before tax benefit | | | |
| Tax benefit | $ - | $ 26 | $ |
| Net loss | $ (273) | $ (107) | $ |
| Expenditures for segment assets as of June 30, 2003 | $ 12 | $ 30 | $ |
| Identifiable assets as of June 30, 2003 | $ 1,992 | $ 2,851 | $ |

| | Three months ended June 30, 200 | | |
|---|---|---|---|
| | DPC | DPL | Elimi |
| Revenues | $ 1,071 | $ 1,068 | $ |
| Intersegment revenues | 279 | - | |
| Total revenues | $ 1,350 | $ 1,068 | $ |
| Depreciation expense | $ 8 | $ 17 | $ |
| Operating loss | $ (126) | $ (95) | $ |
| Financial expenses, net | | | |
| Net loss | $ (116) | $ (135) | $ |
| Expenditures for segment assets as of June 30, 2004 | $ 8 | $ - | $ |
| Identifiable assets as of June 30, 2004 | $ 2,072 | $ 3,041 | $ |

U.S. dollars in thousands

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

| | Three months ended June 30, 200 | | |
|---|---|---|---|
| | DPC | DPL | Elimi |
| Revenues | $ 869 | $ 727 | $ |
| Intersegment revenues | 207 | - | |
| Total revenues | $ 1,076 | $ 727 | $ |
| Depreciation expenses | $ 9 | $ 25 | $ |
| Operating loss | $ (155) | $ (139) | $ |
| Financial income, net | | | |
| Loss before tax benefit | | | |
| Tax benefit | $ - | $ 18 | $ |
| Net loss | $ (160) | $ (105) | $ |
| Expenditures for segment assets for the three months ended June 30, 2003 | $ 12 | $ 2 | $ |
| Identifiable assets as of June 30, 2003 | $ 1,992 | $ 2,851 | $ |

U.S. dollars in thousands

NOTE 6:- SUBSEQUENT EVENTS

In July 2004, the Company issued 204,918 shares of Common stock to a new investor, in consideration of $250. Additionally, under the agreement between the Company and the investor, the investor may purchase additional shares of Common stock for an aggregate consideration of $250 prior to or on December 31, 2004, as determined in the agreement.

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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.

In June 2004, we raised $247,000 through the sale of 221,238 shares of common stock at $1.13 per share net of issuance expenses. In July 2004, we raised an additional $250,000 through the sale of 204,918 shares of common stock at $1.22 per share. We intend to use the additional financing as working capital to implement our business plan.

THREE AND SIX MONTHS ENDED JUNE 30, 2004, COMPARED TO JUNE 30, 2003

REVENUES

Total revenues increased by 34.0% to $2,139,000 for the three months ended June 30, 2004, from $1,596,000 for the three months ended June 30, 2003.

Revenues from the domestic operations of DPC increased 23.2% to $1,071,000 for the second quarter ended June 30, 2004, from $869,000 for the second quarter ended June 30, 2003. Revenues from the Company's European operations of DPL increased 47.0% to $1,068,000 for the second quarter ended June 30, 2004, from $727,000 for the second quarter ended June 30, 2003. The revenue increase in the second quarter of 2004 is mainly due to increase in sales of our new products and military products.

For the six months ended June 30, 2004, revenues increased by 6.4% to $3,968,000 from $3,729,000 for the six months ended June 30, 2003. Revenues attributed to the domestic operations of DPC were $1,855,000 for the six months ended June 30, 2004, approximately at the same level of $1,863,000 for the same period last year. Revenues from the Company's European operations of DPL increased 13.3% to $2,113,000 for the six months ended June 31, 2004, from $1,866,000 for the six months ended June 30, 2003. The increase in revenue from the Company's European operations of DPL is mainly due to higher sales of our new products and military products.

GROSS MARGINS

Gross margins were 24.7% for the three months ended June 30, 2004, compared to 26.9% for the three months ended June 30, 2003. The decrease in gross margins can be primarily attributed to the shift in product mix. Gross margins were 24.3% for the six months ended June 30, 2004 compared to 27.5% for the six months ended June 30, 2003. The decrease in gross margins can be primarily attributed to the shifting in product mix.

ENGINEERING AND PRODUCT DEVELOPMENT

Engineering and product development expenses were 7.2% of revenues for the three months ended June 30, 2004, and 8.0% for the three months ended June 30, 2003. In actual dollars, engineering and product development increased by $27,000. Engineering and product development expenses were 7.4% of revenues for the six months ended June 30, 2004, compared to 7.3% of revenues for the six months ended June 30, 2003

SELLING AND MARKETING

Selling and marketing expenses were 14.9% of revenues for the three months ended June 30, 2004, compared to 16.2% for the three months ended June 30, 2003. In absolute dollars, the selling and marketing expenditures increased by $60,000 mainly due to increase in travel and advertising expenses as part of our efforts to increase sales in the future. Selling and marketing expenses were 15.7% of revenues for the six months ended June 30, 2004, compared to 13.9% for the six months ended June 30, 2003. The increase in selling and marketing were primarily due to new hires and increase in advertising and travel expenses.

GENERAL AND ADMINISTRATIVE

General and administrative expenses were 12.9% of revenues for the three months ended June 30, 2004, compared to 21.1% for the three months ended June 30, 2003. In actual dollars, general and administrative expenditures decreased by $62,000

mainly due to reduction in executive compensation costs. General and administrative expenses were 14.0% of revenues for the six months ended June 30, 2004, compared to 17.4% for the six months ended June 30, 2003. In actual dollars, general and administrative expenses decreased by $92,000, primarily due to reduction in executive compensation costs.

FINANCIAL INCOME

Financial expense net was $30,000 for the three months ended June 30, 2004, compared to financial income net of $11,000 for the three months ended June 30, 2003. The financial expense resulted mainly from the exchange rate fluctuation. Financial income was $2,000 for the six months ended June 30, 2004, compare to $7,000 for the six months ended June 30, 2003.

LOSS BEFORE INCOME TAXES

For the three months ended June 30, 2004, the Company had a loss before income taxes of $251,000 compared to a loss before income taxes of $283,000 for the three months ended June 2003. The loss decrease is mainly due to the increase in revenues. Loss before income taxes for the six months ended June 30, 2004 increased to $503,000 compared to $406,000 for the six months ended June 30, 2003. The loss increase is mainly due to the reduction in gross margin.

TAX BENEFIT
The tax benefit of $18,000 for the second quarter of 2003 was from the Company's European operations of DPL.

NET LOSS
Net loss for the three months ended June 30, 2004, was $251,000 compared to net loss of $265,000 for the three months ended June 30, 2003. Net loss for the six months ended June 30, 2004 was $503,000, compared to a net loss of $380,000 for the six months ended June 30, 2003. Net loss increased mainly due to lower gross margin.

LIQUIDITY AND CAPITAL RESOURCES
On June 30, 2004, the Company had cash, cash equivalents $1,124,000 and working capital of $2,739,000. This compares with cash and cash equivalents of $1,357,000 and working capital of $3,128,000 at June 30, 2003. The decrease in working capital is mainly due to operating losses offset partially by the Telkoor Telecom Ltd.'s investments of $493,000 during the six months ended June 30, 2004.

Cash used in operating activities for the Company totaled $283,000 for the three months ended June 30, 2004, compared to $238,000 for the three months ended June 30, 2003. Cash used in investing activities was $8,000 for the three months ended June 30, 2004, compared to cash provided by investing activities of $584,000 for the three months ended June 30, 2003. Net cash provided by financing activities was $254,000 for the three months ended June 30, 2004, compared to net cash provided by financing activities of $305,000 for the three months ended June 30, 2003.

The Company has an available 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 June 30, 2004, the Company has not utilized its line of credit.

The Company's subsidiary has a $271,000 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. The Company's subsidiary has not utilized its line of credit.

Subsequent to the quarter end, we sold 204,918 shares of Common stock to Fortron/Source Corp. for the aggregate consideration of $250,000. Under the agreements with Telkoor Telecom in June 2004 and with Fortron/Source Corp. in July 2004, Fortron/Source Corp. and Telkoor Telecom Ltd. may purchase additional shares of Common stock for an aggregate consideration of $250,000 each prior to or on December 31, 2004.

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 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

On April 2, 2003, a claim was filed against the Company by Tek-Tron Enterprises Inc. in the state court of Pennsylvania, specifically, the Court of Common Pleas of Bucks County, as Case No. 0302116-24-1. Tek-Tron Enterprises, Inc was 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.

In April 2004, the Company signed a settlement agreement with Tek-Tron according to which the Company agreed to pay a total of $90,000 in installments and return certain disputed property in exchange for a full release. As of June 30, 2004, the Company paid $75,000 with an additional payment of $15,000 is due in September 2004. Additionally, under the settlement agreement, Tek-Tron has the ability to seek arbitration limited to the sum of $50,000 in case the parties do not agree on a resolution regarding the returned property. Tek-Tron has notified the Company it believes that the disputed property contains missing or damaged items. The Company continues to work on reaching a resolution over the returned property which is the Company's liability limited to a maximum of $50,000 under the settlement agreement.

### ITEM 2. CHANGES IN SECURITIES

On June 25, 2004, the Company sold 221,238 shares of common stock at $1.13 per share to Telkoor Telecom Ltd. On July 8, 2004, the Company sold 204,918 shares of common stock at $1.22 per share to Fortron/Source Corp. Under the terms of the stock purchase agreement, the investors may invest an additional $250,000 each on or before December 31, 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.

The Company did not repurchase any of its shares during the quarter.

### 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 AND REPORTS ON FORM 8-K

(a) 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 |

(b) Reports on Form 8-K

The Company filed the following reports

| Date of Report | Date of Event | Item reported |
|---|---|---|
| May 20, 2004 | May 13, 2004 | Financial Results for First Quarter |
| July 14, 2004 | June 25, 2004 | Investment by Telkoor Telkoor Ltd. and Fortron/Source Corp. |

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: 8/16/2004

/s/ Jonathan Wax

Jonathan Wax
Chief Executive Officer
(Principal Executive Officer)

Date: 8/16/2004

/s/ Uzi Sasson

Uzi Sasson
Chief Financial Officer
(Principal Financial Officer)