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DIGITAL POWER CORP  
Form 10QSB  
August 08, 2003

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

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended June 30, 2003

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  
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(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  No

Number of shares of common stock outstanding as of August 7, 2003: 5,410,680.

DIGITAL POWER CORPORATION

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS OF JUNE 30, 2003

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IN U.S. DOLLARS

UNAUDITED

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The Board of Directors  
Digital Power Corporation  
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Re: Review report of unaudited interim consolidated financial statements as  
of and for the six months and three months ended June 30, 2003  
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We have reviewed the accompanying consolidated balance sheet of Digital Power Corporation ("the Company") and its subsidiary as of June 30, 2003, and the related interim consolidated statements of operations for the six months and three months ended June 30, 2003 and the statements of changes in shareholders' equity for the six months ended June 30, 2003 and consolidated statements of cash flows for the six months and three months ended June 30, 2003, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the

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Company's management. The interim consolidated financial statements of the Company and its subsidiaries for the six months and three months ended June 30, 2002 were reviewed by other accountants, whose report dated August 13, 2002, stated that they were not aware of any material modification that should be made to those statements for them to be in conformity with accounting principles generally accepted in the United States.

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

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with accounting principles generally accepted in the United States.

Tel-Aviv, Israel  
August 5, 2003

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

### DIGITAL POWER CORPORATION

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#### CONSOLIDATED BALANCE SHEETS

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U.S. dollars in thousands

|   | June 30,  |       |
|---|-----------|-------|
|   | 2003      | 2002  |
|   | Unaudited |       |
| <b>ASSETS</b>   |           |       |
| <b>CURRENT ASSETS:</b>  |           |       |
| Cash and cash equivalents   | \$ 1,357  | \$ 1, |
| Restricted short-term bank deposit  | -         |       |
| Trade receivables, net of doubtful accounts of \$29, \$284 and \$39 at June 30, 2003 and 2002 and December 31, 2002, respectively | 1,368     | 1,    |
| Deferred income taxes   | 307       |       |
| Other current assets  | 126       |       |
| Inventories   | 1,621     | 1,    |
|   | 4,779     | 4,    |
| Total current assets  |           |       |
| -----   |           |       |

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|                             |          |       |
|-----------------------------|----------|-------|
| OTHER LONG-TERM ASSETS      | 30       |       |
| PROPERTY AND EQUIPMENT, NET | 341      |       |
| Total assets                | \$ 5,150 | \$ 5, |

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

DIGITAL POWER CORPORATION

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands, except share data

|  | June 30,  |      |
|--|-----------|------|
|  | 2003      | 2002 |
|  | Unaudited |      |
| LIABILITIES AND SHAREHOLDERS' EQUITY   |           |      |
| CURRENT LIABILITIES:   |           |      |
| Short-term bank credit   | \$ -      | \$   |
| Current maturities of capital lease obligations and long-term loan from a bank     | 8         |      |
| Accounts payable   | 1,014     | 1,   |
| Other current liabilities  | 629       | 1,   |
| Total current liabilities  | 1,651     | 2,   |
| LONG-TERM LIABILITIES:   |           |      |
| Capital lease obligations and long-term loan from a bank net of current maturities | 4         |      |
| Other long-term liabilities  | -         |      |
| Total long-term liabilities  | 4         |      |

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### SHAREHOLDERS' EQUITY:

|  |          |       |
|--|----------|-------|
| Series A Redeemable, Convertible Preferred shares no par value: 500,000 shares authorized, 0 shares issued and outstanding at June 30, 2003 and June 30, 2002 and December 31, 2002                | -        |       |
| Preferred shares, no par value: 1,500,000 shares authorized, 0 shares issued and outstanding at June 30, 2003, June 30, 2002 and December 31, 2002   | -        |       |
| Common shares, no par value: 10,000,000 shares authorized; 5,410,680, 4,510,680 and 4,510,680 shares issued and outstanding at June 30, 2003 and June 30, 2002 and December 31, 2002, respectively | 11,636   | 11,   |
| Additional paid-in capital   | 837      |       |
| Accumulated deficit  | (8,862)  | (8,   |
| Accumulated other comprehensive loss   | (116)    | (     |
|  | -----    | ----- |
| Total shareholders' equity   | 3,495    | 2,    |
|  | -----    | ----- |
| Total liabilities and shareholders' equity   | \$ 5,150 | \$ 5, |
|  | =====    | ===== |

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

### DIGITAL POWER CORPORATION

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### CONSOLIDATED STATEMENTS OF OPERATIONS

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

|                                     | Six months ended<br>June 30, |          | Three months ended<br>June 30, |          |
|-------------------------------------|------------------------------|----------|--------------------------------|----------|
|                                     | 2003                         | 2002     | 2003                           | 2002     |
|                                     | -----<br>Unaudited<br>-----  |          |                                |          |
| Revenues                            | \$ 3,729                     | \$ 4,541 | \$ 1,596                       | \$ 1,596 |
| Cost of revenues                    | 2,704                        | 3,285    | 1,166                          | 1,166    |
|                                     | -----                        | -----    | -----                          | -----    |
| Gross profit                        | 1,025                        | 1,256    | 430                            | 430      |
|                                     | -----                        | -----    | -----                          | -----    |
| Operating expenses:                 |                              |          |                                |          |
| Engineering and product development | 273                          | 373      | 128                            | 128      |

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|   |           |           |           |       |
|---|-----------|-----------|-----------|-------|
| Selling and marketing                       | 518       | 522       | 259       |       |
| General and administrative                  | 647       | 528       | 337       |       |
|   | -----     | -----     | -----     | ----- |
| Total operating expenses                    | 1,438     | 1,423     | 724       |       |
|   | -----     | -----     | -----     | ----- |
| Operating loss                              | (413)     | (167)     | (294)     |       |
| Capital gain from disposal of a subsidiary  | -         | -         | -         |       |
| Financial income, net                       | 7         | 12        | 11        |       |
| Other income                                | -         | 5         | -         |       |
|   | -----     | -----     | -----     | ----- |
| Loss before taxes on income (tax benefit)   | (406)     | (150)     | (283)     |       |
| Taxes on income (tax benefit)               | (26)      | 40        | (18)      |       |
|   | -----     | -----     | -----     | ----- |
| Net income (loss)                           | \$ (380)  | \$ (190)  | \$ (265)  | \$    |
|   | =====     | =====     | =====     | ===== |
| Basic and diluted earnings (loss) per share | \$ (0.08) | \$ (0.04) | \$ (0.05) | \$    |
|   | =====     | =====     | =====     | ===== |

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 DATA

|   | Common shares |          | Additional      | Accumulated | Accumulated other comprehensive |
|---|---------------|----------|-----------------|-------------|---------------------------------|
|   | Number        | Amount   | paid-in capital | deficit     | loss                            |
|   | -----         | -----    | -----           | -----       | -----                           |
| Balance as of January 1, 2002   | 4,510,680     | \$11,036 | \$ 733          | \$ (8,772)  | \$ (312)                        |
| Stock compensation related to warrants issued to bank for financing transaction | -             | -        | 20              | -           | -                               |
| Stock compensation related to   |               |          |                 |             |                                 |

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|  |           |          |        |            |          |
|--|-----------|----------|--------|------------|----------|
| options granted to consultants and service providers | -         | -        | 84     | -          | -        |
| Comprehensive income:                                |           |          |        |            |          |
| Net income   | -         | -        | -      | 290        | -        |
| Foreign currency translation adjustments             | -         | -        | -      | -          | 160      |
| Total comprehensive income                           |           |          |        |            |          |
| Balance as of December 31, 2002                      | 4,510,680 | 11,036   | 837    | (8,482)    | (152)    |
| Issuance of Common shares                            | 900,000   | 600      | -      | -          | -        |
| Comprehensive loss:                                  |           |          |        |            |          |
| Net loss   | -         | -        | -      | (380)      | -        |
| Foreign currency translation adjustments             | -         | -        | -      | -          | 36       |
| Total comprehensive loss                             |           |          |        |            |          |
| Balance as of June 30, 2003 (unaudited)              | 5,410,680 | \$11,636 | \$ 837 | \$ (8,862) | \$ (116) |

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<br>June 30 |          | Three months ended<br>June 30 |      |
|---|-----------------------------|----------|-------------------------------|------|
|   | 2003                        | 2002     | 2003                          | 2002 |
|   | Unaudited                   |          |                               |      |
| Cash flows from operating activities:   |                             |          |                               |      |
| Net income (loss)   | \$ (380)                    | \$ (190) | \$ (265)                      | \$ 6 |
| Adjustments required to reconcile net income (loss) to net cash provided by (used in) operating activities: |                             |          |                               |      |
| Depreciation and amortization   | 71                          | 159      | 34                            | 74   |
| Capital gain from disposal of a subsidiary  | -                           | -        | -                             | -    |
| Compensation related to options granted to consultants and service providers                                | -                           | -        | -                             | -    |

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|  |         |         |          |         |
|--|---------|---------|----------|---------|
| Decrease (increase) in trade receivables                 | 632     | 216     | 428      | (44)    |
| Decrease (increase) in deferred income taxes, net        | 342     | -       | -        | -       |
| Decrease in other current assets                         | 9       | 6       | 23       | 29      |
| Decrease (increase) in inventories                       | (152)   | 415     | (155)    | 34      |
| Decrease in other long-term assets                       | -       | 6       | -        | 2       |
| Increase (decrease) in accounts payable                  | (344)   | (118)   | (166)    | 49      |
| Increase (decrease) in other current liabilities         | (350)   | (69)    | (137)    | (9)     |
| Other  | -       | 3       | -        | 3       |
| <hr/>  |         |         |          |         |
| Net cash provided by (used in) operating activities      | (172)   | 428     | (238)    | 144     |
| <hr/>  |         |         |          |         |
| Cash flows from investing activities:                    |         |         |          |         |
| Restricted short-term bank deposit                       | 600     | -       | 600      | -       |
| Purchase of property and equipment                       | (42)    | 58)     | (23)     | (55)    |
| Proceeds from disposal of a subsidiary                   | -       | -       | -        | -       |
| Investment in long term loan                             | -       | -       | -        | -       |
| Proceeds from long-term loan                             | 13      | -       | 7        | -       |
| <hr/>  |         |         |          |         |
| Net cash provided by (used in) investing activities      | 571     | (58)    | 584      | (55)    |
| <hr/>  |         |         |          |         |
| Cash flows from financing activities:                    |         |         |          |         |
| Proceeds from short term bank credit                     | 40      | -       | -        | -       |
| Proceeds from issuance of Common shares                  | 600     | -       | 600      | -       |
| Proceeds from long-term loan from a bank                 | 12      | -       | 12       | -       |
| Payments made on short-term bank credit                  | (290)   | (652)   | (290)    | (552)   |
| Principal payments on capital lease obligations          | (27)    | (16)    | (17)     | (4)     |
| <hr/>  |         |         |          |         |
| Net cash provided by (used in) financing activities      | 335     | (668)   | 305      | (556)   |
| <hr/>  |         |         |          |         |
| Effect of exchange rate changes on cash                  | 7       | 77      | 22       | 107     |
| <hr/>  |         |         |          |         |
| Increase (decrease) in cash and cash equivalents         | 741     | (221)   | 673      | (360)   |
| Cash and cash equivalents at the beginning of the period | 616     | 1,243   | 684      | 1,382   |
| <hr/>  |         |         |          |         |
| Cash and cash equivalents at the end of the period       | \$1,357 | \$1,022 | \$ 1,357 | \$1,022 |
| <hr/>  |         |         |          |         |
| Supplemental disclosure of cash flows activities:        |         |         |          |         |
| Cash paid during the period for interest                 | \$ 8    | \$ 17   | \$ 3     | \$ 3    |
| <hr/>  |         |         |          |         |

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

DIGITAL POWER CORPORATION



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### NOTE 1:- GENERAL

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

### NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

- a. The significant accounting policies applied in the annual financial statements of the Company as of December 31, 2002, 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, 2003 and for the six months ended June 30, 2003 and 2002 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, 2002. The results of operations for the six months ended June 30, 2003 are not necessarily indicative of the results for the entire fiscal year ending December 31, 2003.

- 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.

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

### NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (cont.)

Under Statement of Financial Accounting Standard No. 123 "Accounting for Stock Based compensation ("SFAS No. 123") SFAS No. 123, pro forma information regarding net earnings (loss) and

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net earnings (loss) per share is required and has been determined as if the Company had accounted for its employee options under the fair value method of that statement. The fair value for these options was estimated at the date of grant using a Black-Scholes Option Valuation Model, with the following weighted-average assumptions for June 30, 2003 and 2002 and December 31, 2002. Expected volatility of 45.6% ranging from 55.0% - 125.9% and 33.8% respectively, risk-free interest rates of 1.5%, ranging from 4.23% to 5.6% 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 income (loss) and earnings (loss) per share as if the fair value method had been applied to all outstanding and unvested awards in each period:

|  | Six months ended<br>June 30, |          |
|--|------------------------------|----------|
|  | 2003                         | 2002     |
|  | Unaudited                    |          |
| Net income (loss), as reported   | \$ (380)                     | \$ (19)  |
| Deduct: Total stock-based compensation<br>expense determined under fair value<br>method for all awards, net of related<br>tax effect | (31)                         | (3)      |
| Pro forma net loss   | \$ (411)                     | \$ (22)  |
| Basic and diluted net earnings (loss) per<br>share, as reported  | \$ (0.08)                    | \$ (0.0) |
| Basic and diluted net loss per share, pro<br>forma   | \$ (0.08)                    | \$ (0.0) |

### NOTE 3:- SHARE CAPITAL

- a. On March 31, 2003, the Company entered into an agreement to sell 900,000 shares of Common stock to Telkoor Telecom Ltd. in consideration for \$600. As part of the transaction, Telkoor Telecom Ltd.'s warrant to purchase 900,000 shares was cancelled.
- b. On April 3, 2003, the Company issued the 900,000 shares to

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Telkoor and received the total consideration of \$600.

NOTE 4:- PENDING LITIGATION

A claim was filed against the Company by one of its former customers in the amount of \$300.

Company's management believes that the fundamental allegations in the complaint are false and intends to vigorously defend itself.

At this point, management and the Company's legal counsel are of the opinion that it is not possible to predict the likelihood of an unfavorable outcome or the range of a potential verdict against the Company.

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, 2003 |          |      |
|---|--------------------------------|----------|------|
|   | DPC                            | DPL      | Elim |
| Revenues  | \$ 1,863                       | \$ 1,866 | \$   |
| Intersegment revenues                               | 410                            | -        |      |
| Total revenues                                      | \$ 2,273                       | \$ 1,866 | \$   |
| Depreciation expenses                               | \$ 17                          | \$ 54    | \$   |
| Operating loss                                      | \$ (265)                       | \$ (148) | \$   |
| Financial income, net                               |                                |          |      |
| Loss before tax benefit                             |                                |          |      |
| Tax benefit   | \$ -                           | \$ 26    | \$   |
| Net loss  | \$ (277)                       | \$ (103) | \$   |
| Expenditures for segment assets as of June 30, 2003 | \$ 12                          | \$ 30    | \$   |
| Identifiable assets as of June 30, 2003             | \$ 1,992                       | \$ 2,851 | \$   |

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## DIGITAL POWER CORPORATION

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

|   | Six months ended June 30, 2002   |          |       |
|---|----------------------------------|----------|-------|
|   | DPC                              | DPL      | Elimi |
| Revenues  | \$ 2,585                         | \$ 1,956 | \$    |
| Intersegment revenues   | 213                              | -        |       |
| Total revenues  | \$ 2,798                         | \$ 1,956 | \$    |
| Depreciation expenses   | \$ 104                           | \$ 55    | \$    |
| Operating loss  | \$ (289)                         | \$ 122   |       |
| Financial income, net   |                                  |          |       |
| Other income  |                                  |          |       |
| Loss before taxes on income   |                                  |          |       |
| Taxes on income   | \$ -                             | \$ 40    | \$    |
| Net income (loss)   | \$ (289)                         | \$ 99    | \$    |
| Expenditures for segment assets for the<br>three months ended June 30, 2002 | \$ 44                            | \$ 14    | \$    |
| Identifiable assets as of June 30, 2002                                     | \$ 2,842                         | \$ 2,703 | \$    |
|   | Three months ended June 30, 2002 |          |       |
|   | DPC                              | DPL      | Elimi |
| Revenues  | \$ 869                           | \$ 727   | \$    |
| Intersegment revenues   | 207                              | -        |       |
| Total revenues  | \$ 1,076                         | \$ 727   | \$    |
| Depreciation expenses   | \$ 9                             | \$ 25    | \$    |

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|   |          |          |    |
|---|----------|----------|----|
| Operating loss  | \$ (155) | \$ (139) | \$ |
| Financial income, net   |          |          |    |
| Loss before tax benefit   |          |          |    |
| Tax benefit   | \$ -     | \$ 18    | \$ |
| Net loss  | \$ (160) | \$ (105) | \$ |
| Expenditures for segment assets for the<br>three months ended June 30, 2003 | \$ 12    | \$ 2     | \$ |
| Identifiable assets as of June 30, 2003                                     | \$ 1,992 | \$ 2,851 | \$ |

DIGITAL POWER CORPORATION

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

|                             | Three months ended June 30, 2003 |          |       |
|-----------------------------|----------------------------------|----------|-------|
|                             | DPC                              | DPL      | Elimi |
| Revenues                    | \$ 1,325                         | \$ 1,033 | \$    |
| Intersegment revenues       | 115                              | -        |       |
| Total revenues              | \$ 1,440                         | \$ 1,033 | \$    |
| Depreciation expenses       | \$ 45                            | \$ 29    | \$    |
| Operating loss              | \$ (72)                          | \$ 62    |       |
| Financial income, net       |                                  |          |       |
| Other income                |                                  |          |       |
| Loss before taxes on income |                                  |          |       |
| Taxes on income             | -                                | \$ 14    |       |
| Net income (loss)           | \$ (63)                          | \$ 69    | \$    |

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|   |          |          |       |
|---|----------|----------|-------|
| Expenditures for segment assets for the<br>three months ended June 30, 2002 | \$ 40    | \$ 14    | \$    |
|   | =====    | =====    | ===== |
| Identifiable assets as of June 30, 2002                                     | \$ 2,842 | \$ 2,703 | \$    |
|   | =====    | =====    | ===== |

### DIGITAL POWER CORPORATION

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

|  | Year ended December 31 |          |       |
|--|------------------------|----------|-------|
|  | DPC                    | DPL      | Elim  |
|  | -----                  | -----    | ----- |
| Revenues   | \$ 4,348               | \$ 4,427 | \$    |
| Intersegment revenues                                      | 383                    | -        |       |
|  | -----                  | -----    | ----- |
| Total revenues   | \$ 4,731               | \$ 4,427 | \$    |
|  | =====                  | =====    | ===== |
| Operating income (loss)                                    | \$ (761)               | \$ 235   | \$    |
|  | =====                  | =====    | ===== |
| Capital gain from disposal of a<br>subsidiary              | \$ 280                 | \$ -     | \$    |
|  | =====                  | =====    | ===== |
| Financial income, net                                      |                        |          |       |
| Loss before tax benefit                                    |                        |          |       |
| Tax benefit  | \$ 649                 | \$ (119) | \$    |
|  | =====                  | =====    | ===== |
| Net income   | \$ 151                 | \$ 139   | \$    |
|  | =====                  | =====    | ===== |
| Additional information:                                    |                        |          |       |
| Depreciation expenses                                      | \$ 184                 | \$ 114   | \$    |
|  | =====                  | =====    | ===== |
| Expenditures for segment assets as of<br>December 31, 2002 | \$ 13                  | \$ 24    | \$    |
|  | =====                  | =====    | ===== |
| Identifiable assets as of December 31,<br>2002             | \$ 2,292               | \$ 2,898 | \$    |
|  | =====                  | =====    | ===== |

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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 computer and other electronic equipment industries, competition in the power supply industry, dependence on manufacturers in Mexico and China and other risks factors detailed in the Company's Form 10-KSB for the year ended December 31, 2002. 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.

THREE AND SIX MONTHS PERIODS ENDED JUNE 30, 2003, COMPARED TO JUNE 30, 2002

#### REVENUES

Total revenues decreased by 32.3% to \$1,596,000 for the three months ended June 30, 2003, from \$2,358,000 for the second quarter ended June 30, 2002. Revenues from the Company's United Kingdom's operations of Digital Power Ltd. decreased 22.2% to \$727,000 for the second quarter ended June 30, 2003, from \$934,000 for the second quarter ended June 30, 2002. Revenues attributed to the United States operations decreased by 39.0% to \$869,000 for the second quarter ended June 30, 2003, from \$1,424,000 for the second quarter ended June 31, 2002.

For the six months ended June 30, 2003, revenues decreased by 17.9% to \$3,729,000 from \$4,541,000 for the six months ended June 30, 2002. Revenues from the Company's United Kingdom's operations of Digital Power Ltd. decreased 4.6% to \$1,866,000 for the six months ended June 30, 2003 from \$1,956,000 for the six months ended June 30, 2002. Revenues attributed to the United States operations decreased by 27.9% to \$1,863,000 for the six months ended June 30, 2003, from \$2,585,000 for the six months ended June 30, 2002. The decrease in revenues is partially due to the time necessary to implement new products into the customers design cycle throughout the market and due to rescheduling of deliveries by customers in the United Kingdom.

In June 2003, the Company entered into an agreement to supply approximately US\$1,637,000 of power supplies to a foreign customer for military purposes. Subject to the provision in the agreement, the management believes that it will recognize the majority of the revenue from this agreement in 2004. The Company can not give any assurances that it will receive future purchases from this customer or of this quantity.

#### GROSS MARGINS

Gross margins were 26.9% for the three months ended June 30, 2003, compared to 30.6% for the three months ended June 30, 2002. Gross margins were 27.5% for the six months ended June 30, 2003, compared to 27.7% for the six months ended June 30, 2002. The decrease in gross margins can be primarily attributed to the fixed cost and the decrease in revenues.

#### ENGINEERING AND PRODUCT DEVELOPMENT

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Engineering and product development expenses were 8.0% of revenues for the three months ended June 30, 2003, and 7.8% for the three months ended June 30, 2002. Engineering and product development expenses were 7.3 % of revenues for the six months ended June 30, 2003, compared to 8.2% for the six months ended June 30, 2002. Actual dollar expenditures were down by 30.1% for the three months ended June 30, 2003 and 26.8 % for the six month ended June 30, 2003. The decrease was mainly due to the reduced salaries as a result of lay offs.

### SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses were 37.3% of revenues for the three months ended June 30, 2003, compared to 23.2% for the three months ended June 30, 2002. Selling, general and administrative expenses were 31.2 % of revenues for the six months ended June 30, 2003, compared to 23.1% for the six months ended June 30, 2002. In actual dollar, these expenses were up by 8.8% for the three months ended June 30, 2003 and 11.0% for the six month ended June 30, 2003. The increase selling, general and administrative expenses can be attributed mainly to the hiring of the Company's CFO, the additional legal expenses and one time expenses related to a lay off.

### FINANCIAL INCOME (EXPENSES)

Interest income was \$11,000 for the three months ended June 30, 2003, compared to \$20,000 for the three months ended June 30, 2002. Interest income, was \$7,000 for the six months ended June 30, 2003 compared to \$12,000 for the six months ended June 30, 2002.

### LOSS BEFORE INCOME TAXES

For the three months ended June 30, 2003, the Company had loss before income taxes of \$283,000 compared to income before income taxes of \$20,000 for the three months ended June 30, 2002. For the six months ended June 30, 2003, the Company had a loss before tax benefits \$406,000 compared to loss before income taxes of \$150,000 for the six months ended June 30, 2002.

### INCOME TAX

For the three months ended June 30, 2003, net tax benefit was \$18,000 compared to provision for income tax of \$14,000 for the three months ended June 30, 2002. For the six months ended June 30, 2003 tax benefit was \$26,000 compared to provision for income tax of \$40,000 for the six months ended June 30, 2002. The tax benefit was from decrease of tax provision from the United Kingdom's operation.

### NET LOSS

Net loss for the three months ended June 30, 2003, was \$265,000 compared to net income of \$6,000 for the three months ended June 30, 2002. Net loss for the six months ended June 30, 2003, was \$380,000, compared to a net loss of \$190,000 for the six months ended June 30, 2002. Net loss increase mainly due to the reduced revenue.

### LIQUIDITY AND CAPITAL RESOURCES

On June 30, 2003, the Company had cash of \$1,357,000 and working capital of \$3,128,000. This compares with cash of \$1,022,000 and working capital of \$1,848,000 at June 30, 2002. The increase in working capital was mainly due to increase in deferred tax asset of \$307,000, increase of \$335,000 in cash, decrease in accounts payable and other current liabilities of \$1,272,000 which was partially offset by a decrease in trade receivables and other current assets of \$700,000.

Cash used in operating activities of the Company totaled \$172,000 for the six months ended June 30, 2003 compared to cash provided in operating activities for the Company of \$428,000 for the six months ended June, 2002. Cash provided by investing activities was \$571,000 for the six months ended June 30, 2003, compared to cash used in investing activities of \$58,000 for the six months



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ended June 30, 2002. Net cash provided by financing activities was \$335,000 for the six months ended June 30, 2002, compared to the net cash used in financing activities of \$668,000 for the six months ended June 30, 2002.

The Company renewed its line of credit with Silicon Valley Bank ("SVB") on June 5, 2003. The Company can borrow up to \$1,200,000 if it maintains certain ratios and is in compliance with other covenants. The rate for this line of credit is Silicon Valley Bank's prime rate plus 1.75%. The Company also has a \$483,000 line of credit with Lloyds TSB Bank in the UK bearing interest of 1.75% per annum over Lloyds TSB Bank's base rate.

On March 31, 2003, the Company entered into an agreement to sell 900,000 shares of Common stock to Telkooor Telecom Ltd. in consideration for \$600,000. As part of the transaction, Telkooor Telecom Ltd.'s warrant to purchase 900,000 shares was cancelled. On April 3, 2003, the Company issued the 900,000 shares to Telkooor and received the total consideration of \$600,000.

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 debt or equity, which may dilute the shareholder equity.

### ITEM 3. CONTROLS AND PROCEDURES

The Company's Chief Executive Officer and Chief Financial Officer of the Company evaluated the disclosure controls and procedures of the Company as of the end of the period covered by this report and have determined that such controls and procedures are effective.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

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

### ITEM 2. CHANGES IN SECURITIES

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 AND REPORTS ON FORM 8-K

(a) Exhibits

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- 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

### (a) Reports on Form 8-K

The Company filed the following reports

| Date of Report<br>----- | Date of Event<br>----- | Item reported<br>-----                         |
|-------------------------|------------------------|--|
| May 19, 2003            | May 12, 2003           | Press release announcing first quarter results |

### 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)

Dated: August 7, 2003

/s/ David Amitai  
-----  
David Amitai  
Chief Executive Officer  
(Principal Executive  
Officer)

Dated: August 7, 2003

/s/ Haim Yatim  
-----  
Haim Yatim  
Chief Financial Officer  
(Principal Financial  
Officer)