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DIGITAL POWER CORP  
Form 10QSB  
November 14, 2003

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

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934 for the quarterly period ended September 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  
-----

(State or other jurisdiction of  
incorporation or organization)

94-1721931  
-----

(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 November 11, 2003: 5,410,680

DIGITAL POWER CORPORATION

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS OF SEPTEMBER 30, 2003

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IN U.S. DOLLARS

UNAUDITED

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[GRAPHIC OMITTED]  
ERNST & YOUNG

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The Board of Directors  
Digital Power Corporation  
-----

Re: Review report of unaudited interim consolidated financial statements as of and for the nine months and three months ended September 30, 2003  
-----

We have reviewed the accompanying consolidated balance sheets of Digital Power Corporation ("the Company") and its subsidiary as of September 30, 2003 and 2002, and the related interim consolidated statements of operations and statements of cash flows for the nine months and three months ended September 30, 2003 and 2002 and the statements of changes in shareholders' equity for the nine months ended September 30, 2003. These financial statements are the responsibility of the Company's management.

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We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, which will be performed for the full year with the objective of expressing 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.

/s/ Kost Forer & Gabbay

Tel-Aviv, Israel  
November 11, 2003

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KOST FORER & GABBAY  
A Member of Ernst & Young Global

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DIGITAL POWER CORPORATION

CONSOLIDATED BALANCE SHEETS

-----  
U.S. dollars in thousands

|  | September 30,               |        |
|--|-----------------------------|--------|
|  | 2003                        | 2002   |
|  | -----<br>Unaudited<br>----- |        |
| ASSETS   |                             |        |
| CURRENT ASSETS:  |                             |        |
| Cash and cash equivalents  | \$ 1,302                    | \$ 210 |
| Restricted short-term bank deposit   | -                           | 600    |
| Trade receivables, net of doubtful accounts of \$49,<br>\$269 and \$39 at September 30, 2003 and 2002<br>and December 31, 2002, respectively | 1,241                       | 2,265  |
| Deferred income taxes  | 62                          | -      |
| Other current assets   | 173                         | 114    |
| Inventories  | 1,653                       | 1,572  |
|  | -----                       | -----  |
| Total current assets   | 4,431                       | 4,761  |
| -----  |                             |        |
| OTHER LONG-TERM ASSETS   | 24                          | 77     |
|  | -----                       | -----  |

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|                             |          |          |
|-----------------------------|----------|----------|
| PROPERTY AND EQUIPMENT, NET | 330      | 400      |
|                             | -----    | -----    |
| Total assets                | \$ 4,785 | \$ 5,238 |
| -----                       | =====    | =====    |

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

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DIGITAL POWER CORPORATION

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands, except share data

|  | September 30, |         |
|--|---------------|---------|
|  | 2003          | 2002    |
|  | Unaudited     |         |
|  | -----         | -----   |
| LIABILITIES AND SHAREHOLDERS' EQUITY   |               |         |
| CURRENT LIABILITIES:   |               |         |
| Short-term bank credit   | \$ -          | \$ 145  |
| Current maturities of capital lease obligation and long-term loan from a bank  | 10            | 36      |
| Accounts payable   | 902           | 1,297   |
| Other current liabilities  | 563           | 1,043   |
|  | -----         | -----   |
| Total current liabilities  | 1,475         | 2,521   |
| -----  | -----         | -----   |
| SHAREHOLDERS' EQUITY:  |               |         |
| Series A Redeemable, Convertible Preferred shares no par value: 500,000 shares authorized, 0 shares issued and outstanding at September 30, 2003 and 2002 and December 31, 2002                | -             | -       |
| Preferred shares, no par value: 1,500,000 shares authorized, 0 shares issued and outstanding at September 30, 2003 and 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 September 30, 2003 and 2002 and December 31, 2002, respectively | 11,036        | 11,036  |
| Additional paid-in capital   | 1,437         | 733     |
| Accumulated deficit  | (9,056)       | (8,858) |
| Accumulated other comprehensive loss   | (107)         | (194)   |
|  | -----         | -----   |

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|  |          |          |
|--|----------|----------|
| Total shareholders' equity                 | 3,310    | 2,717    |
|  | -----    | -----    |
| Total liabilities and shareholders' equity | \$ 4,785 | \$ 5,238 |
|  | =====    | =====    |

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DIGITAL POWER CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

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

|  | Nine months ended<br>September 30, |           | Three months end<br>September 30, |           |
|--|------------------------------------|-----------|-----------------------------------|-----------|
|  | 2003                               | 2002      | 2003                              | 2002      |
|  | -----<br>Unaudited<br>-----        |           |                                   |           |
| Revenues   | \$ 5,338                           | \$ 6,772  | \$ 1,609                          | \$ 2,000  |
| Cost of revenues                                   | 3,883                              | 4,873     | 1,179                             | 1,179     |
|  | -----                              | -----     | -----                             | -----     |
| Gross profit                                       | 1,455                              | 1,899     | 430                               | 821       |
|  | -----                              | -----     | -----                             | -----     |
| Operating expenses:                                |                                    |           |                                   |           |
| Engineering and product development                | 384                                | 600       | 111                               | 111       |
| Selling and marketing                              | 784                                | 761       | 266                               | 266       |
| General and administrative                         | 946                                | 866       | 299                               | 299       |
|  | -----                              | -----     | -----                             | -----     |
| Total operating expenses                           | 2,114                              | 2,227     | 676                               | 676       |
|  | -----                              | -----     | -----                             | -----     |
| Operating loss                                     | (659)                              | (328)     | (246)                             | (246)     |
| Capital gain from disposal of a subsidiary         | -                                  | 280       | -                                 | -         |
| Financial income (expenses), net                   | 12                                 | 11        | 5                                 | 5         |
|  | -----                              | -----     | -----                             | -----     |
| Income (loss) before tax benefit (taxes on income) | (647)                              | (37)      | (241)                             | (241)     |
| Tax benefit (taxes on income)                      | 73                                 | (49)      | 47                                | 47        |
|  | -----                              | -----     | -----                             | -----     |
| Net income (loss)                                  | \$ (574)                           | \$ (86)   | \$ (194)                          | \$ (194)  |
|  | =====                              | =====     | =====                             | =====     |
| Basic and diluted earnings (loss) per share        | \$ (0.11)                          | \$ (0.02) | \$ (0.04)                         | \$ (0.04) |
|  | =====                              | =====     | =====                             | =====     |

Weighted average number of shares

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|   |           |           |           |           |
|---|-----------|-----------|-----------|-----------|
| used in computing basic and diluted earnings (loss) per share | 5,110,680 | 4,510,680 | 5,410,680 | 4,510,680 |
|   | =====     | =====     | =====     | =====     |

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

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DIGITAL POWER CORPORATION

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands, except share data

|  | Common shares |           | Additional      | Accumulated | Acco  |
|--|---------------|-----------|-----------------|-------------|-------|
|  | Number        | Amount    | paid-in capital | deficit     | comp  |
|  | -----         | -----     | -----           | -----       | ----- |
| Balance as of January 1, 2002  | 4,510,680     | \$ 11,036 | \$ 733          | \$ (8,772)  | \$    |
| Stock compensation related to warrants issued to bank for financing transaction    | -             | -         | 20              | -           |       |
| Stock compensation related to options granted to consultants and service providers | -             | -         | 84              | -           |       |
| Comprehensive income:  |               |           |                 |             |       |
| Net income   | -             | -         | -               | 290         |       |
| Foreign currency translation adjustments   | -             | -         | -               | -           |       |
| Total comprehensive income   |               |           |                 |             |       |
| Balance as of December 31, 2002  | 4,510,680     | 11,036    | 837             | (8,482)     |       |
| Issuance of Common shares  | 900,000       | -         | 600             | -           |       |
| Comprehensive loss:  |               |           |                 |             |       |
| Net loss   | -             | -         | -               | (574)       |       |
| Foreign currency translation adjustments   | -             | -         | -               | -           |       |
| Total comprehensive loss   |               |           |                 |             |       |
| Balance as of September 30, 2003 (unaudited)                                       | 5,410,680     | \$ 11,036 | \$ 1,437        | \$ (9,056)  | \$    |
|  | =====         | =====     | =====           | =====       | ===== |

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

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DIGITAL POWER CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

|  | Nine months ended<br>September 30, |         | Three months ended<br>September 30, |    |
|--|------------------------------------|---------|-------------------------------------|----|
|  | 2003                               | 2002    | 2003                                |    |
|  | Unaudited                          |         |                                     |    |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                                    |         |                                     |    |
| Net income (loss)  | \$ (574)                           | \$ (86) | \$ (194)                            | \$ |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |                                    |         |                                     |    |
| Depreciation and amortization  | 102                                | 217     | 31                                  |    |
| Capital gain from disposal of a subsidiary   | -                                  | (280)   | -                                   |    |
| Compensation related to options granted to consultants and service providers                       | 758                                | -       | -                                   |    |
| Decrease (increase) in trade receivables   | 588                                | (61)    | 126                                 |    |
| Deferred income taxes, net   | (37)                               | 52      | 246                                 |    |
| Decrease (increase) in other current assets  | (182)                              | 27      | (46)                                |    |
| Decrease (increase) in inventories   | -                                  | 426     | (30)                                |    |
| Decrease (increase) in other long-term assets  | -                                  | (114)   | -                                   |    |
| Decrease in accounts payable   | (457)                              | (244)   | (113)                               |    |
| Increase (decrease) in other current liabilities   | (415)                              | 69      | (65)                                |    |
| Other  | -                                  | -       | -                                   |    |
| Net cash provided by (used in) operating activities  | (217)                              | 6       | (45)                                |    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                                    |         |                                     |    |
| Restricted short-term bank deposit   | 600                                | (600)   | -                                   |    |
| Purchase of property and equipment   | (62)                               | (27)    | (20)                                |    |
| Proceeds from disposal of a subsidiary   | -                                  | (11)    | -                                   |    |
| Investment in long-term loan   | -                                  | -       | -                                   |    |
| Proceeds from long-term loan   | 19                                 | -       | 6                                   |    |
| Net cash provided by (used in) investing activities  | 557                                | (638)   | (14)                                |    |
| <b>Cash flows from financing activities:</b>   |                                    |         |                                     |    |
| Proceeds from short-term bank credit   | 40                                 | 145     | -                                   |    |
| Proceeds from issuance of Common shares  | 600                                | -       | -                                   |    |
| Proceeds from long-term loan from a bank   | 12                                 | -       | -                                   |    |
| Payments made on short term bank credit  | (290)                              | (652)   | -                                   |    |
| Principal payments on capital lease obligations and long-term loan                                 | (29)                               | (12)    | (2)                                 |    |

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|  |          |         |          |    |
|--|----------|---------|----------|----|
| Net cash provided by (used in) financing activities      | 333      | (519)   | (2)      |    |
| Effect of exchange rate changes on cash                  | 13       | 118     | 6        |    |
| Increase (decrease) in cash and cash equivalents         | 686      | (1,033) | (55)     |    |
| Cash and cash equivalents at the beginning of the period | 616      | 1,243   | 1,357    | 1  |
| Cash and cash equivalents at the end of the period       | \$ 1,302 | \$ 210  | \$ 1,302 | \$ |
| 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

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DIGITAL POWER CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In U.S. dollars

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 interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States for interim financial information. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine months period ended September 30, 2003 are not



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necessarily indicative of the results that may be expected for the year ended December 31, 2003.

b. Accounting for stock-based compensation:

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

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

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DIGITAL POWER CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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In U.S. dollars

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 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 September 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%, 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:

| Nine months ended<br>September 30, |       |
|------------------------------------|-------|
| -----                              | ----- |
| 2003                               | 2002  |
| -----                              | ----- |

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|   | Unaudited |         |
|---|-----------|---------|
|   | -----     |         |
| Net income (loss), as reported  | \$ (574)  | \$ (8)  |
| Deduct: Total stock-based compensation expense determined under fair value method for all awards, net of related tax effect | (48)      | (6)     |
|   | -----     | -----   |
| Pro forma net loss  | \$ (622)  | \$ (15) |
|   | =====     | =====   |
| Basic and diluted net earnings (loss) per share, as reported  | \$ (0.11) | \$ (0.) |
|   | =====     | =====   |
| Basic and diluted net loss per share, pro forma   | \$ (0.12) | \$ (0.) |
|   | =====     | =====   |

NOTE 3:- SHARE CAPITAL

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

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DIGITAL POWER CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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In U.S. dollars

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 currently 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").

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

|  | Nine months ended September 30, |          |      |
|--|---------------------------------|----------|------|
|  | DPC                             | DPL      | Elim |
| Revenues   | \$ 2,718                        | \$ 2,620 | \$   |
| Intersegment revenues                                    | 535                             | -        |      |
|  | \$ 3,253                        | \$ 2,620 | \$   |
| Depreciation expenses                                    | \$ 25                           | \$ 77    | \$   |
| Operating loss   | \$ (441)                        | \$ (218) | \$   |
| Financial income, net                                    |                                 |          |      |
| Loss before tax benefit                                  |                                 |          |      |
| Tax benefit  | \$ -                            | \$ 73    | \$   |
| Net loss   | \$ (450)                        | \$ (124) | \$   |
| Expenditures for segment assets at<br>September 30, 2003 | \$ 12                           | \$ 50    | \$   |
| Identifiable assets at September 30,<br>2003             | \$ 1,956                        | \$ 2,767 | \$   |

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### DIGITAL POWER CORPORATION

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In U.S. dollars

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

|                       | Nine months ended September 30, |          |      |
|-----------------------|---------------------------------|----------|------|
|                       | DPC                             | DPL      | Elim |
| Revenues              | \$ 3,384                        | \$ 3,388 | \$   |
| Intersegment revenues | 258                             | -        |      |

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|  |          |          |    |
|--|----------|----------|----|
| Total revenues   | \$ 3,642 | \$ 3,388 | \$ |
| Depreciation expenses                                    | \$ 133   | \$ 84    | \$ |
| Operating loss   | \$ (136) | \$ (192) | \$ |
| Capital gain from disposal<br>of a subsidiary            | \$ 280   | \$ -     | \$ |
| Financial income, net                                    |          |          |    |
| Loss before taxes on income                              |          |          |    |
| Taxes on income  | \$ -     | \$ (49)  | \$ |
| Net income (loss)  | \$ (123) | \$ 37    | \$ |
| Expenditures for segment assets at<br>September 30, 2002 | \$ 13    | \$ 14    | \$ |
| Identifiable assets at September 30,<br>2002             | \$ 2,107 | \$ 3,131 | \$ |

|  | Three months ended September 30 |         |      |
|--|---------------------------------|---------|------|
|  | DPC                             | DPL     | Elim |
| Revenues   | \$ 855                          | \$ 754  | \$   |
| Intersegment revenues  | 125                             | -       |      |
| Total revenues   | \$ 980                          | \$ 754  | \$   |
| Depreciation expenses  | \$ 8                            | \$ 23   | \$   |
| Operating loss   | \$ (176)                        | \$ (70) | \$   |
| Financial income, net  |                                 |         |      |
| Loss before tax benefit  |                                 |         |      |
| Tax benefit  | \$ -                            | \$ 47   | \$   |
| Net loss   | \$ (173)                        | \$ (21) | \$   |
| Expenditures for segment assets for the<br>three months ended September 30, 2003 | \$ 2                            | \$ 18   | \$   |

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|  |          |          |       |
|--|----------|----------|-------|
| Identifiable assets at September 30,<br>2003 | \$ 1,956 | \$ 2,767 | \$    |
|  | =====    | =====    | ===== |

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DIGITAL POWER CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In U.S. dollars

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

|  | Three months ended September 30 |          |       |
|--|---------------------------------|----------|-------|
|  | DPC                             | DPL      | Elim  |
|  | -----                           | -----    | ----- |
| Revenues   | \$ 799                          | \$ 1,431 | \$    |
| Intersegment revenues  | 44                              | -        |       |
|  | -----                           | -----    | ----- |
| Total revenues   | \$ 843                          | \$ 1,431 | \$    |
|  | =====                           | =====    | ===== |
| Depreciation expenses  | \$ 29                           | \$ 29    | \$    |
|  | =====                           | =====    | ===== |
| Operating loss   | \$ -                            | \$ -     | \$    |
|  | =====                           | =====    | ===== |
| Capital gain from disposal<br>of a subsidiary                                    | \$ 280                          | \$ -     | \$    |
|  | =====                           | =====    | ===== |
| Financial expense, net   |                                 |          |       |
| Income before taxes on income  |                                 |          |       |
| Taxes on income  | \$ -                            | \$ (9)   | \$    |
|  | =====                           | =====    | ===== |
| Net income (loss)  | \$ 105                          | \$ (1)   | \$    |
|  | =====                           | =====    | ===== |
| Expenditures for segment assets for the<br>three months ended September 30, 2002 | \$ -                            | \$ -     | \$    |
|  | =====                           | =====    | ===== |
| Identifiable assets at September 30,<br>2002                                     | \$ 2,107                        | \$ 3,131 | \$    |
|  | =====                           | =====    | ===== |

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DIGITAL POWER CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In U.S. dollars

NOTE 5:- SEGMENTS, MAJOR 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 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 December 31, 2002 | \$ 13                  | \$ 24    | \$   |
| Identifiable assets as of December 31, 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 telecommunication, datacom, test and measurement 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 NINE MONTH PERIODS ENDED SEPTEMBER 30, 2003, COMPARED TO SEPTEMBER 30, 2002

#### REVENUES

Revenues decreased by 27.8% to \$1,609,000 for the three months ended September 30, 2003, from \$2,230,000 for the three months ended September 30, 2002.

Revenues from the domestic operation of DPC increased 7.0% to \$855,000 for the three months ended September 30, 2003, from \$799,000 for the three months ended September 30, 2002. Revenues from the Company's United Kingdom's operations of DPL decreased 47.3% to \$754,000 for the three months ended September 30, 2003, from \$1,431,000 for the three months ended September 30, 2002.

For the nine months ended September 30, 2003, revenues decreased by 21.2% to \$5,338,000 from \$6,772,000 for the nine months ended September 30, 2002.

Revenues from the domestic operation of DPC decreased 19.7% to \$2,718,000 for the nine months ended September 30, 2003, from \$3,384,000 for the nine months ended September 30, 2002. Revenues from the Company's United Kingdom's operations of DPL decreased 22.7% to \$2,620,000 for the nine months ended September 30, 2003, from \$3,388,000 for the nine months ended September 30, 2002.

The decrease in revenues for the nine months ended September 30, 2003 from September 30, 2002 is due to continued softness in the Company's market. In addition, where the Company has been successful in designed in products, sales have been slower than anticipated.

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#### GROSS MARGINS

Gross margins were 26.7% for the three months ended September 30, 2003, compared to 28.8% for the three months ended September 30, 2002. For the nine months ended September 30, 2003, gross margin was 27.3% compared to 28.0% for the nine months ended September 30, 2002. The decrease in gross margins can be primarily attributed to fixed cost and the decrease in revenues.

#### ENGINEERING AND PRODUCT DEVELOPMENT

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Engineering and product development expenses were 6.9% of revenues for the three months ended September 30, 2003, and 10.2% for the three months ended September 30, 2002. Engineering and product development expenses were 7.2% of revenues for the nine months ended September 30, 2003, compared to 8.9% for the nine months ended September 30, 2002. Actual dollar expenditures were down by 51.1% for the three months ended September 30, 2003 and 36.0% for the nine month ended September 30, 2003. The decrease was mainly due to the reduced salary expenses.

### SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses were 35.1% of revenues for the three months ended September 30, 2003, compared to 26.1% for the three months ended September 30, 2002. Selling, general and administrative expenses were 32.4% of revenues for the nine months ended September 30, 2003, compared to 24.0% for the nine months ended September 30, 2002. In actual dollars, for the three months ended September 30, 2003, selling, general and administrative expenses decreased by 2.8% compared to the three months ended September 30, 2002. For the nine month ended September 30, 2003, the actual dollars spent on selling, general and administrative expenses increased by 6.3% compared to the same period last year. The increase in selling, general and administrative expenses can be attributed mainly to the recognition of the CFO's salary for the full nine months ended September 30, 2003, additional legal expenses and one time expenses related to a lay off.

### INCOME (LOSS) BEFORE TAX BENEFIT (TAXES ON IINCOME)

For the three months ended September 30, 2003, the Company had a loss before tax benefit of \$241,000 compared to an income before taxes on income of \$113,000 for the three months ended September 30, 2002. For the nine months ended September 30, 2003, the Company had a loss before tax benefit of \$647,000 compared to a loss before taxes on income of \$37,000 for the nine months ended September 30, 2002. The loss increase is mainly due to the decrease in revenue in the nine months ended September 30, 2003 and one time capital gain of \$280,000 recorded in the nine months ended September 30, 2002 as a result of the disposal of the Mexican subsidiary, Poder Digital, S.A. de C.V.

### INCOME TAXES

For the three months ended September 30, 2003, net tax benefit was \$47,000 compared to provision for income taxes of \$9,000 for the three months ended September 30, 2002. For the nine months ended September 30, 2003 tax benefit was \$73,000 compared to provision for income taxes of \$49,000 for the nine months

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ended September 30, 2002. The tax benefit was mainly comprised of deferred income taxes due to carrying back losses to prior profitable years in the Company's United Kingdom's operations.

### NET INCOME (LOSS)

Net loss for the three months ended September 30, 2003, was \$194,000 compared to net income of \$104,000 for the three months ended September 30, 2002. Net loss for the nine months ended September 30, 2003, was \$574,000 compared to net loss of \$86,000 for the nine months ended September 30, 2002.

### LIQUIDITY AND CAPITAL RESOURCES



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On September 30, 2003, the Company had cash and cash equivalents of \$1,302,000, and working capital of \$2,956,000. This compares to cash and cash equivalents of \$210,000, short term deposit of \$600,000 and working capital of \$2,240,000 at September 30, 2002. Cash used by operating activities for the Company totaled \$217,000 compared to cash provided by operating activities of \$6,000 for the nine months ended September 30, 2003 and 2002 respectively.

Cash provided by investing activities was \$557,000 for the nine months ended September 30, 2003, compared to cash used in investing activities of \$638,000 for the nine months ended September 30, 2002.

Net cash provided by financing activities was \$333,000 for the nine months ended September 30, 2003, compared to cash used in financing activities of \$519,000 for the nine months ended September 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 \$500,000 line of credit with Lloyds TSB Bank in the UK bearing interest of 1.75% per annum over Lloyds TSB Bank's base rate.

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 evaluated the disclosure controls and procedures (pursuant to Exchange Act Rule 13a-15) 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

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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

At the annual meeting of the shareholders held on Monday, August 4, 2003 at the Company's corporate headquarters, located at 41920 Christy Street, Fremont, California 94538, a quorum of shareholders voted to elect the following persons

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as Directors of the Company:

| Name              | Votes For | Withheld |
|-------------------|-----------|----------|
| ----              | -----     | -----    |
| Ben- Zion Diamont | 5,086,012 | 22,262   |
| David Amitai      | 5,086,012 | 22,262   |
| Mark Thum         | 5,088,312 | 19,962   |
| Yeheskel Manea    | 5,085,012 | 23,262   |
| Youal Menipaz     | 5,085,012 | 23,262   |
| Amos Kohn         | 5,087,312 | 20,962   |

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                                   |
|----------------|----------------|---|
| -----          | -----          | -----   |
| August 8, 2003 | August 7, 2003 | Press release announcing second quarter results |

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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

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(Registrant)

Dated: 11/11/2003

/s/ David Amitai

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David Amitai  
Chief Executive Officer  
(Principal Executive Officer)

Dated: 11/11/2003

/s/ Haim Yatim

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Haim Yatim

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Chief Financial Officer  
(Principal Financial and Accounting  
Officer)