DIGITAL POWER CORP
Form 10-Q
November 05, 2010

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

FORM 10-Q

þ Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2010

¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from ________ to ________ .

Commission file number 1-12711

DIGITAL POWER CORPORATION
(Exact name of registrant as specified in its charter)

California (State or other jurisdiction of incorporation or organization)	94-1721931 (I.R.S. Employer Identification Number)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes ¨ No ¨

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	þ

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

At November 5, 2010, the registrant had outstanding 6,678,968 shares of common stock.

DIGITAL POWER CORPORATION

TABLE OF CONTENTS

DIGITAL POWER CORPORATION AND SUBSIDIARY

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS OF SEPTEMBER 30, 2010

IN U.S. DOLLARS

UNAUDITED

INDEX

- - - - - - - -

The Board of Directors
Digital Power Corporation

Re: Review of unaudited interim consolidated financial statements
for the three and nine-month periods ended September 30, 2010

We have reviewed the accompanying interim consolidated balance sheet of Digital Power Corporation ("the Company") and its subsidiary as of September 30, 2010, and the related interim consolidated statements of operations and cash flows for the three and nine-month periods ended September 30, 2010 and 2009, and the interim statement of changes in shareholders' equity for the nine-month period ended September 30, 2010. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the interim consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

Tel-Aviv, Israel	KOST FORER GABBAY & KASIERER
November 5, 2010	A Member of Ernst & Young Global

DIGITAL POWER CORPORATION AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

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

	September 30, 2010 Unaudited	December 31, 2009
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 2,398	$ 2,967
Restricted cash	83	84
Trade receivables (net of allowance for doubtful accounts of $ 111 and $ 127 at September 30, 2010 and December 31, 2009, respectively)	2,585	1,522
Prepaid expenses and other receivables	165	243
Inventories (Note 3)	1,890	1,056
Total current assets	7,121	5,872
PROPERTY AND EQUIPMENT, NET	236	231
TECHNOLOGY, NET (Note 4)	479	-
LONG-TERM DEPOSITS	42	41
Total assets	$ 7,878	$ 6,144
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 1,158	$ 891
Related parties - trade payables	1,031	531
Advances from customers and deferred revenue	1,012	471
Other current liabilities	644	492
Total current liabilities	3,845	2,385
SHAREHOLDERS' EQUITY:		
Share capital -		
Series A Redeemable, Convertible Preferred shares, no par value - 500,000 shares authorized at September 30, 2010 and December 31, 2009; 0 shares issued and outstanding at September 30, 2010 and December 31, 2009	-	-
Preferred shares, no par value - 1,500,000 shares authorized at September 30, 2010 and December 31, 2009; 0 shares issued and outstanding at September 30, 2010 and December 31, 2009	-	-
Common shares, no par value - 30,000,000 shares authorized at September 30, 2010 and December 31, 2009; 6,678,968 and 6,626,468 shares issued and outstanding at September 30, 2010 and December 31, 2009, respectively	-	-

Additional paid-in capital	14,150	14,042
Accumulated deficit	(9,658)	(9,932)
Accumulated other comprehensive loss	(459)	(351)
Total shareholders' equity	4,033	3,759
Total liabilities and shareholders' equity	$ 7,878	$ 6,144

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

DIGITAL POWER CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Nine months ended September 30, 2010	Nine months ended September 30, 2009	Three months ended September 30, 2010	Three months ended September 30, 2009
	Unaudited			
Revenues	$ 7,324	$ 6,224	$ 3,186	$ 1,708
Cost of revenues	4,624	4,071	2,036	1,196
Gross profit	2,700	2,153	1,150	512
Operating expenses:				
Engineering and product development	429	405	161	136
Selling and marketing	857	834	253	250
General and administrative	1,084	1,022	354	357
Total operating expenses	2,370	2,261	768	743
Operating income (loss)	330	(108)	382	(231)
Financial income (expense), net	(56)	(46)	(79)	26
Net income (loss)	$ 274	$ (154)	$ 303	$ (205)
Basic net earnings (loss) per share	$ 0.041	$ (0.023)	$ 0.045	$ (0.031)
Diluted net earnings (loss) per share	$ 0.040	$ (0.023)	$ 0.045	$ (0.031)

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

DIGITAL POWER CORPORATION AND SUBSIDIARY

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands, except share data

	Common shares Number	Additional paid-in capital	Accumulated deficit	Other accumulated comprehensive loss	Total comprehensive loss	Total shareholders' equity
Balance as of January 1, 2010	6,626,468	$ 14,042	$ (9,932)	$ (351)	-	$ 3,759
Stock compensation related to options granted to Telkoor's employees and other non-employee consultant	-	1	-	-	-	1
Stock compensation related to options granted to employees	-	61	-	-	-	61
Exercise of options granted to employees	52,500	46	-	-	-	46
Comprehensive income:						
Net income	-	-	274	-	274	274
Foreign currency translation adjustments	-	-	-	(108)	(108)	(108)
Total comprehensive income						
					$ 166	
Balance as of September 30, 2010 (unaudited)	6,678,968	$ 14,150	$ (9,658)	$ (459)		$ 4,033

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

DIGITAL POWER CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Nine months ended September 30, 2010	2009
	Unaudited	
Cash flows from operating activities:		
Net income (loss)	$ 274	$ (154)
Adjustments required to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	38	56
Stock compensation related to options granted to employees	61	57
Stock compensation related to options granted to Telkoor's employees and other non-employee consultant	1	14
Decrease (increase) in trade receivables, net	(1,066)	612
Decrease (increase) in prepaid expenses and other accounts receivable	77	(73)
Decrease (increase) in inventories	(829)	459
Increase (decrease) in accounts payable and related parties- trade payables	762	(1,154)
Increase in deferred revenues	526	129
Increase in other current liabilities	149	54
Net cash used in operating activities	(7)	-
Cash flows from investing activities:		
Purchase of property and equipment	(49)	(53)
Purchase of technology	(471)	-
Net cash used in investing activities	(520)	(53)
Cash flows from financing activities:		
Proceeds from exercise of options	46	12
Net cash provided by financing activities	46	12
Effect of exchange rate changes on cash and cash equivalents	(88)	108
Increase (decrease) in cash and cash equivalents	(569)	67
Cash and cash equivalents at the beginning of the period	2,967	2,476
Cash and cash equivalents at the end of the period	$ 2,398	$ 2,543
Supplemental disclosure of non-cash activities:		

Reclassification of inventory to fixed assets	$	-	$	74

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

DIGITAL POWER CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL

a. Digital Power Corporation (the "Company" or "DPC") was incorporated in 1969, under the General Corporation Law of the State of California. The Company and Digital Power Limited ("DPL"), a wholly owned subsidiary located in the United Kingdom, are currently engaged in the design, manufacture and sale of high-grade switching power supplies and solutions. The Company also provides static frequency and AC/DC switching converters, including distributed power systems. The Company has two reportable geographic segments - North America (sales through DPC) and Europe (sales through DPL).

b. The Company depends on Telkoor Telecom Ltd. ("Telkoor"), a major shareholder of the Company and one of DPC's third party subcontractors, for some of its products know-how, and for its manufacturing capabilities in the production of some of the products that DPC sells. If Telkoor is unable or unwilling to continue manufacturing the Company's products in required volumes on a timely basis, that could lead to loss of sales, and adversely affect the Company's operating results and cash position. The Company also depends on Telkoor's intellectual property and ability to transfer production of some of Digital Power’s product line to third party manufacturers. Failure to obtain new products in a timely manner or delay in delivery of product to customers will have an adverse effect on the Company's ability to meet its customers' expectations.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

a. The significant accounting policies applied in the annual financial statements of the Company as of December 31, 2009 are applied consistently in these financial statements. In addition, the following accounting policy is applied:

The accompanying unaudited consolidated financial statements as of September 30, 2010 and for the three and nine months ended September 30, 2010 and 2009 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’s Annual Report on Form 10-K for the fiscal year ended December 31, 2009. The results of operations for the nine months ended September 30, 2010 are not necessarily indicative of the results for the entire fiscal year ending December 31, 2010.

b. Accounting for stock-based compensation:

The Company has several stock-based employee compensation plans, which are described more fully in Note 5. The Company accounts for stock-based compensation in accordance with Accounting Standards Codification Statement ("ASC") 718 (formerly SFAS No. 123 (revised 2004)) “Stock compensation” (“ASC 718”).

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company and its subsidiary apply ASC 718 and ASC 505-50 (formerly EITF 96-18) “Equity-Based Payments to Non-Employees” (“ASC 505-50") to options issued to non-employees. ASC 718 requires use of an option valuation model to measure the fair value of the options at the grant date.

NOTE 3:- INVENTORIES

	September 30, 2010 Unaudited	December 31, 2009
Raw materials, parts and supplies	$ 387	$ 232
Work in progress	514	285
Finished products	989	539
	$ 1,890	$ 1,056

NOTE 4:- TECHNOLOGY, NET

On August 25, 2010, the Company and its wholly-owned subsidiary, DPL, entered into an agreement with Telkoor Power Supplies Ltd. (“TPS”), a subsidiary of Telkoor, pursuant to which, (1) TPS sold, assigned and conveyed to DPL all of its rights, title and interest in and to the intellectual property associated with the Compact Peripheral Component Interface 600 W AC/DC power supply series (the “Assets” or "IP") and (2) DPL granted to TPS an irrevocable license to sell the Assets in Israel on an exclusive basis. In consideration for the purchase of the IP, DPL has paid TPS $480. The consideration for the license provided to TPS to sell the Assets in Israel is a royalty fee of 15% of TPS's direct production costs of sales, due on a quarterly basis.

TPS will provide the Company reasonable training and technical support, if necessary, for a period of 60 months in order to enable the Company to properly and effectively use the IP to manufacture the Assets. In accordance with the agreement, the consideration for the IP may be reduced over a four year period in the event that annual sales for each fiscal year between 2011 and 2014 are less than a fixed threshold of units on an annual basis based on an offset value per unit as described in the agreement. If there is a shortfall in sale of units in one annual period and, in the subsequent period, the Company sells more than the fixed unit threshold, this difference will be offset from any reduced consideration in any annual periods between 2011and 2014.

Since the transaction was made between two related parties, an external independent valuation has been prepared in order to support the fair value of the IP purchased in accordance with ASC 820.

The useful life of the IP has been determined to be five years and the amortization method is straight line as management considers this method as the most appropriate.

- 10 -

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

NOTE 5:- ACCOUNTING FOR STOCK-BASED COMPENSATION

a. Stock option plans:

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

2. As of September 30, 2010, the Company has authorized, by three Incentive Share Option Plans, the grant of options to officers, management, other key employees and others of up to 513,000, 240,000 and 1,519,000, respectively, of the Company's common stock. As of September 30, 2010, options to purchase up to an aggregate of 762,645 shares of the Company's common stock are still available for future grant.

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

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

	Nine months ended September 30, 2010			
	Amount of options	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate Intrinsic value *)
Outstanding at the beginning of the period	825,240	$ 1.05		
Exercised	(52,500)	0.89		
Forfeited	(56,740)	1.19		
Expired	(17,000)	2.38		
Outstanding at the end of the period	699,000	$ 1.02	4.49	121
Exercisable options at the end of the period	599,750	$ 1.00	3.69	240

*) Calculation of aggregate intrinsic value is based on the share price of the Company's common stock as of September 30, 2010 ($ 1.08 per share).

DIGITAL POWER CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5:- ACCOUNTING FOR STOCK-BASED COMPENSATION (Cont.)

Under the provisions of ASC 718, the fair value of each option is estimated on the date of grant using a Black-Scholes option valuation model that uses the assumptions such as stock price on the date of the grant, exercise price, risk-free interest rate, expected volatility, expected life and expected dividend yield of the option. Expected volatility is based exclusively on historical volatility of the entity's stock as allowed by ASC 718. The Company uses historical information with respect to the employee options exercised to estimate the expected term of options granted, representing the period of time that options granted are expected to be outstanding. The risk-free interest rate of period within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

No options were granted during the first nine months of 2010.

As of September 30, 2010, there was $ 119 of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under the stock option plans. That cost is expected to be recognized over a period of the next 38 months.

b. Employee Stock Ownership Plan:

The Company has an Employee Stock Ownership Plan ("ESOP") covering eligible employees. The ESOP provides for the Employee Stock Ownership Trust ("ESOT") to distribute shares of the Company's common shares as retirement benefits to the participants. The Company has not distributed shares since 1998. As of September 30, 2010, the ESOT held 167,504 common shares.

NOTE 6:- NET INCOME (LOSS) PER SHARE

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

a. Numerator:

	Nine months ended September 30,		Three months ended September 30,	
	2010	2009	2010	2009
	Unaudited			
Net income (loss) available to common shareholders	$ 274	$ (154)	$ 303	$ (205)

b. Denominator:

Denominator for basic net earnings (loss) per share of weighted average number of common shares	6,660,996	6,615,708	6,678,968	6,615,708
Effect of dilutive securities:				
Employee stock options	126,191	96,154	106,810	42,439
	6,787,187	6,711,862	6,785,778	6,658,147

Denominator for diluted net earnings per common share	

- 12 -

DIGITAL POWER CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7:- SEGMENTS, MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION

The Company has two reportable geographic segments; see Note 1 for a brief description of the Company's business.

The following data presents the revenues, expenditures and other operating data of the Company's geographic operating segments in accordance with Statement of Financial Accounting Standard No.131, "Disclosure About Segments of an Enterprise and Related Information" ("SFAS No. 131").

	Nine months ended September 30, 2010 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$ 4,174	$ 3,150	$	$ 7,324
Intersegment revenues	59	129	(188)	-
Total revenues	$ 4,233	$ 3,279	$ (188)	$ 7,324
Depreciation expense	$ 16	$ 26	$ -	$ 42
Operating income	$ 53	$ 277	$ -	$ 330
Financial expenses, net				$ 56
Net income	$ 47	$ 227	$ -	$ 274
Expenditures for segment assets, net as of September 30, 2010	$ 42	$ 7	$ -	$ 49
Identifiable assets as of September 30, 2010	$ 3,524	$ 4,354	$ -	$ 7,878

	Nine months ended September 30, 2009 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$ 2,673	$ 3,551	$	$ 6,224
Intersegment revenues	155	23	(178)	-
Total revenues	$ 2,828	$ 3,574	$ (178)	$ 6,224
Depreciation expense	$ 23	$ 33	$ -	$ 56
Operating income (loss)	$ (354)	$ 246	$ -	$ (108)
Financial expenses, net				$ 46

Net income (loss)	$	(372)	$	218	$	-	$	(154)
Expenditures for segment assets, net as of September 30, 2009	$	13	$	40	$	-	$	53
Identifiable assets as of September 30, 2009	$	2,237	$	3,316	$	-	$	5,553

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

NOTE 7:- SEGMENTS, MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION (Cont.)

	Three months ended September 30, 2010 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$ 1,784	$ 1,402	$	$ 3,186
Intersegment revenues	29	21	(50)	-
Total revenues	$ 1,813	$ 1,423	$ (50)	$ 3,186
Depreciation expense	$ 4	$ 9	$ -	$ 13
Operating income	$ 164	$ 218	$ -	$ 382
Financial expenses, net				$ 79
Net income	$ 164	$ 139	$ -	$ 303
Expenditures for segment assets as of September 30, 2010	$ 8	$ -	$ -	$ 8
Identifiable assets as of September 30, 2010	$ 3,524	$ 4,354	$ -	$ 7,878

	Three months ended September 30, 2009 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$ 546	$ 1,162	$	$ 1,708
Intersegment revenues	4	10	(14)	-
Total revenues	$ 550	$ 1,172	$ (14)	$ 1,708
Depreciation expense (income)	$ 8	$ (14)	$ -	$ (6)
Operating income (loss)	$ (298)	$ 67	$ -	$ (231)
Financial income, net				$ 26
Net income (loss)	$ (312)	$ 107	$ -	$ (205)
Expenditures for segment assets as of September 30, 2009	$ 2	$ 14	$ -	$ 16
	$ 2,237	$ 3,316	$ -	$ 5,553

Identifiable assets as of September 30,
2009

- - - - - - - -

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

GENERAL

Digital Power Corporation is a solution-driven organization that designs, develops, manufactures and sells high-grade customized and flexible power system solutions for the most demanding applications in the medical, military, telecom and industrial markets. We are highly focused on high-grade and custom product designs for both the commercial and military/defense markets, where customers demand high density, high efficiency and ruggedized products to meet the harshest and/or military mission critical operating conditions. We are a California corporation originally formed in 1969, and our common stock trades on the NYSE Amex under the symbol "DPW". Our corporate headquarters are located in the heart of the Silicon Valley.

We also have a wholly-owned subsidiary, Digital Power Limited ("DPL"), which operates under the brand name of "Gresham Power Electronics" ("Gresham"). DPL is located in Salisbury, England, and it designs, manufactures and sells power products and system solutions mainly for the European marketplace, including power conversion, power distribution equipment, DC/AC (Direct Current/Active Current) inverters and UPS (Uninterrupted Power Supply) products. DPL's defense business has specialists in the field of naval applications of power distribution.

We believe that we are one of the first companies in the power solutions industry to introduce a product strategy based on the premise that products developed with an extremely flexible architecture enable rapid modifications to meet unique customer requirements for non-standard output voltages. The development and implementation of this strategy has resulted in broad acceptance in the telecom/industrial, and increasingly in the medical market segments for our new line of high density and high efficiency power products. These products set an industry standard for providing high-power output in package sizes that are among the smallest available for such commercial products.

We market and sell our products to many diverse market segments, including the telecom, industrial, medical and military/defense industries. Our products serve a global market, with an emphasis on North America and Europe. We offer a broad product variety, including a full custom product design and production, front-end power distribution systems, high-grade, full-featured open frame power switchers and a Compact-PCI supporting a power range of 200 to

600 watts in two form factors 3U and 6U for both commercial and military markets. We also have some of the densest and most efficient products available in the marketplace today, supporting a power range of 100 to 400 watts. In addition to developing and manufacturing full custom design products, we also sell PoE (Power over Ethernet) products and provide services and solutions based on standard design, modified-standard and value added products. Our product solution power range is scalable from 50 to 25,000 watts.

In an effort to provide short lead-times, high quality products and competitive pricing to support our markets, we have entered into production agreements with several Asia-Pacific contract manufacturers. These agreements allow us to better control production costs and ensure high quality products deliverable in a timely manner to meet our market demand.

We intend to remain an innovative leader in the development of cutting-edge custom power solutions and feature-rich products to meet any customer needs and requirements, rugged power systems to meet harsh and extreme operation environmental requirements, and high performance, high-efficiency, high-density and modular power systems. We are focusing today on developing even more high-grade custom power system solutions for numerous customers in a broadly diversified range of markets and challenging environments. Each product development is based on best of class performance criteria, including unique, advanced feature sets and a special layout to meet our customers' unique operating conditions where efficiency, size and time to market are key to their success. We are taking initiatives to develop and sell high-efficiency "green power" solutions.

RESULTS OF OPERATIONS

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010, COMPARED TO SEPTEMBER 30, 2009

Revenues

Our revenues increased by 86.5 % to $3,186,000 for the three months ended September 30, 2010, from $1,708,000 for the three months ended September 30, 2009. The increase in revenues is mainly due to higher sales of our standard and custom design commercial products and our military products. During the three months ended September 30, 2010, we generated revenues from the sale of a fully customized product solution for the medical market, as part of our earlier strategy to transition away from a dependence on standard, commodity products. In addition, during this period, we successfully delivered one of our major military projects. Revenues from sales of our commercial products during this period increased by 100.2% to $2,246,000 for the three months ended September 30, 2010, from $1,122,000 for the three months ended September 30, 2009. Revenues from sales of our military products increased by 60.4% to $940,000 for the three months ended September 30, 2010, from $586,000 for the three months ended September 30, 2009. The increase in our revenue from our military products was mainly due to the delivery of one of our major defense projects.

Revenues from our U.S. operations increased by 226.7% to $1,784,000 for the three months ended September 30, 2010, from $546,000 for the three months ended September 30, 2009. Revenues from our European operations of DPL increased by 20.7% to $1,402,000 for the three months ended September 30, 2010, from $1,162,000 for the three months ended September 30, 2009. The increase in revenues in our U.S. operations is mainly due to higher sales of our standard commercial products and to revenues from the sale of a fully customized product solution for the medical industry. The increase in revenues from our European operations is mainly attributable to the delivery of one of our major military projects in Europe.

For the nine months ended September 30, 2010, our revenues increased by 17.7% to $7,324,000, from $6,224,000 for the nine months ended September 30, 2009. Revenues from sales of our commercial products increased by 37.7% to $5,602,000 for the nine months ended September 30, 2010, from $4,069,000 for the nine months ended September 30, 2009. Revenues from our sales of military products decreased by 20.1% to $1,722,000 for the nine months ended September 30, 2010, from $2,155,000 for the nine months ended September 30, 2009. The decrease in revenues of our military products is mainly attributable to differentials in the phasing of such large capital projects.

For the nine months ended September 30, 2010, revenues from our U.S. operations increased by 56.2% to $4,174,000, from $2,673,000 for the nine months ended September 30, 2009. This increase in revenues is mainly attributable to an increase in sales of our standard commercial products and the sale of a fully customized product solution for the medical industry, as discussed above. Revenues from our European operations of DPL decreased by 11.3% to $3,150,000 for the nine months ended September 30, 2010, from $3,551,000 for the nine months ended September 30, 2009. The decrease in revenues from our European operation is mainly attributable to the decrease in sales of our military products, as explained above.

Gross Margins

Gross margins increased to 36.1% for the three months ended September 30, 2010, compared to 30.0% for the three months ended September 30, 2009. Gross margins for the nine months ended September 30, 2010 increased to 36.9% compared to gross margins of 34.6% for the nine months ended September 30, 2009. The increase in gross margins for the nine and three-month periods ended September 30, 2010 is mainly attributable to the increase in revenue with a similar level of fixed cost structure.

Engineering and Product Development

Engineering and product development expenses were $161,000, or 5.1% of revenues, for the three months ended September 30, 2010, compared to $136,000, or 8.0% of revenues, for the three months ended September 30, 2009. Engineering and product development expenses were $429,000, or 5.9% of revenues, for the nine months ended September 30, 2010, compared to $405,000, or 6.5% of revenues, for the nine months ended September 30, 2009. The increase is attributable to salary-related expenses due to the fact that during the three months ended September 30, 2009, we had a temporary decrease in salary-related expenses.

Selling and Marketing

Selling and marketing expenses were $253,000, or 7.9% of revenues, for the three months ended September 30, 2010, compared to $250,000, or 14.6% of revenues, for the three months ended September 30, 2009. Selling and marketing expenses were $857,000, or 11.7% of revenues, for the nine months ended September 30, 2010, compared to $834,000, or 13.4% of revenues, for the nine months ended September 30, 2009. The increase in selling and marketing expenses for the nine months ended September 30, 2010 was primarily due to an increase in salary expenses related to a separation agreement from a senior marketing staff member, and to an increase in other marketing expenses, partially offset by the temporary decrease in salary-related expenses during the three months ended June 30, 2010.

General and Administrative

General and administrative expenses were $354,000, or 11.1% of revenues, for the three months ended September 30, 2010, compared to $357,000, or 20.9% of revenues, for the three months ended September 30, 2009. General and administrative expenses were $1,084,000, or 14.8% of revenues, for the nine months ended September 30, 2010, compared to $1,022,000, or 16.4% of revenues, for the nine months ended September 30, 2009. The increase in general and administrative expenses during the nine months ended September 30, 2010 was mainly due to an increase in salary expenses, attributable to the hiring of a full-time Chief Financial Officer, and to an increase in general expenses, such as travel, offset by a temporary decrease in salary-related expenses during the three months ended June 30, 2010.

Financial Income (Expense)

Financial expense was $79,000 for the three months ended September 30, 2010, compared to financial income of $26,000 for the three months ended September 30, 2009. Financial expense was $56,000 for the nine months ended September 30, 2010, compared to financial expense of $46,000 for the nine months ended September 30, 2009. From time to time, we enter into forward contracts to hedge certain sales transactions which are denominated in foreign currencies. The change in financial results was due to foreign currency fluctuations during the respective periods and changes in the fair value of forward contracts.

Net Income (Loss)

For the three months ended September 30, 2010, we had a net income of $303,000 compared to a net loss of $205,000 for the three months ended September 30, 2009. Net income for the nine months ended September 30, 2010 was $274,000 compared to a net loss of $154,000 for the nine months ended September 30, 2009. The increase in the net income for the three and nine months ended September 30, 2010 is due primarily to the increase in our revenues and gross margins, partially offset by the increase in our financial expenses.

LIQUIDITY AND CAPITAL RESOURCES

On September 30, 2010, we had cash and cash equivalents of $2,398,000 and working capital of $3,276,000. This compares with cash and cash equivalents of $2,967,000 and working capital of $3,487,000 at December 31, 2009. The decrease in cash and cash equivalents is due mainly to the completion of the purchase of a technology for a consideration of $480,000, and to an increase in trade receivables and in inventories, offset by increases in accounts payable, related parties-trade payables, deferred revenues and other current liabilities. The decrease in working capital is mainly due to a decrease in cash and cash equivalents, offset partially by an increase in inventory and in trade receivables.

Net cash used in operating activities totaled $7,000 for the nine months ended September 30, 2010, compared to net cash provided by operating activities of $0 for the nine months ended September 30, 2009. The net usage of cash from operating activities was mainly due to the net income for the nine months ended September 30, 2010, and to an increase in accounts payable, related parties-trade payables, deferred revenues and other current liabilities, offset by an increase in inventories and trade receivables.

Net cash used in investing activities was $520,000 for the nine months ended September 30, 2010, compared to net cash used in investing activities of $53,000 for the nine months ended September 30, 2009. The net usage of cash from investing activities is due to the purchase of technology for a consideration of $480,000. In particular, on August 25, 2010, the Company and its wholly-owned subsidiary, DPL, entered into an agreement with Telkoor Power Supplies Ltd. (“TPS”), a subsidiary of Telkoor, pursuant to which, (1) TPS sold, assigned and conveyed to DPL all of its rights, title and interest in and to the intellectual property associated with the Compact Peripheral Component Interface 600 W AC/DC power supply series (the “Assets” or "IP") and (2) DPL granted to TPS an irrevocable license to sell the Assets in Israel on an exclusive basis. In consideration for the purchase of the IP, DPL has paid TPS $480,000. The consideration for the license provided to TPS to sell the Assets in Israel is a royalty fee of 15% of TPS's direct production costs of sales, due on a quarterly basis.

TPS will provide the Company reasonable training and technical support, if necessary, for a period of 60 months in order to enable the Company to properly and effectively use the IP to manufacture the Assets. In accordance with the agreement, the consideration for the IP may be reduced over a four year period in the event that annual sales for each fiscal year between 2011 and 2014 are less than a fixed threshold of units on an annual basis based on an offset value per unit as described in the agreement. If there is a shortfall in sale of units in one annual period and, in the subsequent period, the Company sells more than the fixed unit threshold, this difference will be offset from any reduced consideration in any annual periods between 2011 and 2014.

Since the transaction was made between two related parties, an external independent valuation has been prepared in order to support the fair value of the IP purchased in accordance with ASC 820.

The useful life of the IP has been determined to be five years and the amortization method is straight line as management considers this method the most appropriate.

Net cash provided by financing activities was $46,000 for the nine months ended September 30, 2010 and $12,000 for the nine months ended September 30, 2009, and was due to employees’ options exercised.

Our wholly-owned subsidiary, DPL, leases a 24,500 square-foot facility in Salisbury, United Kingdom, where it designs, develops, manufactures, markets and distributes commercial and military power products for the European and other international markets. Sales and service support staff for its European network of distributors are located within the building together with other functions, such as engineering, manufacturing and administration DPL’s rent expense is approximately $13,000 per month. On September 27, 2010, DPL signed a lease with the building’s owners for a rent equal to that for the lease that recently expired. The lease, which commenced on September 29, 2010, is for a period of fifteen years with an option for DPL to cancel after ten years. DPL agreed to perform certain decoration work upon commencement of the lease.

We believe we have adequate resources at this time to continue our operational and promotional efforts to increase sales and support our current operation. However, if we do not increase our sales, we may have to raise money through debt or equity, which may dilute shareholders’ equity.

CRITICAL ACCOUNTING POLICIES

In our Annual Report on Form 10-K for the year ended December 31, 2009, we identified the critical accounting policies which affect our more significant estimates and assumptions used in preparing our consolidated financial statements. The basis for developing the estimates and assumptions within our critical accounting policies is based on historical information and known current trends and factors. The estimates and assumptions are evaluated on an ongoing basis and actual results have been within our expectations. We have not changed these policies from those previously disclosed in our Annual Report.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable for a smaller reporting company.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

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

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See our disclosures under “Legal Proceedings” in our Annual Report on Form 10-K, filed March 25, 2010. There have been no material developments in those proceedings since that filing.

ITEM 1A. RISK FACTORS

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

Although we experienced an operating income and a net income during the nine months ended September 30, 2010, we experienced an operating loss and a net loss during the year ended December 31, 2009, we have historically experienced net losses and we may experience net losses in the future.

For the three months ended September 30, 2010, we had an operating income of $382,000 and a net income of $303,000; for the nine months ended September 30, 2010 we had an operating income of $330,000 and a net income of $274,000, and for the year ended December 31, 2009, we had an operating loss of $102,000 and a net loss of $148,000. Although we have actively taken steps to increase our revenue and reduce our costs, we may incur operating and net losses in the future unless we continue to increase revenues by selling current and custom design products, transitioning to production stage of our custom design products and decreasing manufacturing costs through a greater use of contract manufacturers in Asia and other strategic locations.

We depend on Telkoor to design and manufacture some of our products.

We depend on Telkoor, our largest shareholder and one of our third party subcontractors, for design and manufacturing capabilities for some of the products that we sell. If Telkoor is unable or unwilling to continue designing or manufacturing our products in required volumes and with a certain level of quality on a timely basis, that could lead to loss of sales and adversely affect our operating results and cash position. We also depend on Telkoor's intellectual property and ability to transfer production to third party manufacturers. Failure to obtain new products in a timely manner or delay in delivery of product to customers will have an adverse effect on our ability to meet our customers' expectations. In addition, we operate in highly competitive markets where our ability to sell Telkoor's products could be adversely affected by Telkoor's agreements with other companies, long lead-times and the high cost of Telkoor's products. In April 2008, for example, Telkoor signed a "Private Label" agreement with Murata Power Solutions in Canada to sell Telkoor's products under the Murata brand name, which agreement positions Murata as a direct competitor of ours with respect to the sale of Telkoor's products in North America. Also, in 2009, Telkoor's manufacturing lead-times increased, which has hindered our ability to respond to our customers' needs. Telkoor's principal offices, research and development and manufacturing facilities are located in Israel. Political, economic, and military conditions in Israel directly affect Telkoor's operations. We are also dependent upon Telkoor's terms and conditions with its contract manufacturers for some of our products, which terms and conditions may not always be in our best interest.

We are dependent upon our ability, and our contract manufacturers' ability, to timely procure electronic components.

Because of the global recession, many raw material vendors have reduced capacities, closed production lines and, in some cases, even discontinued their operations. As a result, there is a global shortage of certain electronic components, which has extended our production lead-time and our production costs. For example, in some cases, finished goods that used to be available in 12 weeks for a production purchase order are now available only after 22 weeks. Also, some materials are no longer available to support some of our products, thereby requiring us to search for cross materials or, even worse, redesign some of our products to support currently-available materials. Such redesign efforts may require certain regulatory and safety agency re-submittals, which may cause further production delays. While we have initiated actions that we believe will limit our exposure to such problems, the dynamic business conditions in many of our markets may challenge the solutions that have been put in place, and issues may recur in the future.

In addition, some of our products are manufactured, assembled and tested by third party subcontractors and contract manufacturers located in Asia. While we have had relationships with many of these third parties in the past, we cannot predict how or whether these relationships will continue in the future. In addition, changes in management, financial viability, manufacturing demand or capacity, or other factors, at these third parties could hurt our ability to have our products manufactured.

Our strategic focus on our custom power supply solution competencies and concurrent cost reduction plans may be ineffective or may limit our ability to compete.

As a result of our strategic focus on custom power system solutions, we will continue to devote significant resources to developing custom products for a large number of customers, where each product represents a uniquely tailored solution for a specific customer's requirements. A failure to meet these customer product requirements or a failure to meet production schedules and/or product quality standards may put us at risk with one or more of these customers. The loss of one or more of our significant custom power supply solution customers could have a material adverse impact on our revenues, business or financial condition.

We have also implemented a series of initiatives designed to increase efficiency and reduce costs. While we believe that these actions will reduce costs, they may not be sufficient to achieve the required operational efficiencies that will enable us to respond more quickly to changes in the market or result in the improvements in our business that we anticipate. In such event, we may be forced to take additional cost-reducing initiatives, which may negatively impact quarterly earnings and profitability as we account for severance and other related costs. In addition, there is the risk that such measures could have long-term adverse effects on our business by reducing our pool of talent, decreasing or slowing improvements in our products or services, making it more difficult for us to respond to customers, limiting our ability to increase production quickly if and when the demand for our solutions increases and limiting our ability to hire and retain key personnel. These circumstances could cause our earnings to be lower than they otherwise might be.

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

We have recently introduced a new strategy of developing multiple custom product designs. The commercial success of this new technology will depend on a number of factors, including the successful development of the custom products, our ability to meet customer requirements, our ability to meet all product criteria, successful transition from development stage to production stage, our ability to meet product cost targets generating acceptable margins, timely remediation of product performance issues, if any, identified during testing, product performance at customer locations, differentiation of our product from our competitors' products, and management of customer expectations concerning product capabilities and life cycles. If we fail to accomplish all of the above, our business could be materially and adversely affected.

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

Our success depends on our ability to attract, retain and motivate our key management personnel, including, but not limited to, our CEO and CFO, sales force, and key engineers, necessary to implement our business plan and to grow our business. Despite the adverse economic conditions at this time, and occurring over the past several years, competition for certain specific technical and management skill sets is intense. If we are unable to identify and hire the personnel that we need to succeed, or if one or more of our present key employees were to cease to be associated with us, our future results could be adversely affected.

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

We currently depend upon a few major OEMs and other customers for a significant portion of our revenues. Because of the global economic downturn, we have already experienced a reduction of orders by OEMs and a reduction or cancellation of orders, scaling back of certain activities and workforce layoffs by other customers. The loss of any of these customers, or a substantial reduction in the quantity of products that they purchase from us, would significantly reduce our revenues and net income. Furthermore, diversions in the capital spending of certain of these customers to new network elements have and could continue to lead to their reduced demand for our products, which could, in turn, have a material adverse effect on our business and results of operations. If the financial condition of one or more of our major customers should deteriorate, or if they have difficulty acquiring investment capital due to any of these or other factors, a substantial decrease in our revenues would likely result.

We are dependent on the electronic equipment industry, and accordingly will be affected by the impact on that industry by the current economic downturn.

Substantially all of our existing customers are in the electronic equipment industry, and they manufacture products that are subject to rapid technological change, obsolescence, and large fluctuations in demand. This industry is further characterized by intense competition and volatility. The OEMs serving this industry are pressured for increased product performance and lower product prices. OEMs, in turn, make similar demands on their suppliers, such as us, for increased product performance and lower prices. The current economic downturn has affected the entire supply chain, including us. Recently, certain segments of the electronic industry have experienced a significant softening in product demand. Such lower demand may affect our customers, in which case the demand for our products may decline and our growth could be adversely affected.

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

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

We outsource, and are dependent upon developer partners for, the development of some of our custom design products.

We made an operational decision to outsource some of our custom design products to numerous developer partners. This business structure will remain in place until the custom design volume justifies expanding our in house capabilities. Incomplete product designs that do not fully comply with the customer specifications and requirements might affect our ability to transition to a volume production stage of the custom designed product where the revenue goals are dependent on the high volume of custom product production. Furthermore, we rely on the design partners' ability to provide high quality prototypes of the designed product for our customer approval as a critical stage to approve production.

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

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

Our future results are dependent on our ability to establish, maintain and expand our OEM relationships and our other distribution channels.

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

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

The power supply industry, and the electronics industry as a whole, can be subject to business cycles. During periods of growth and high demand for our products, we may not have adequate supplies of inventory on hand to satisfy our customers' needs. Furthermore, during these periods of growth, our suppliers may also experience high demand and, therefore, may not have adequate levels of the components and other materials that we require to build products so that we can meet our customers' needs. Our inability to secure sufficient components to build products for our customers could negatively impact our sales and operating results. We may choose to mitigate this risk by increasing the levels of inventory for certain key components. Increased inventory levels can increase the potential risk for excess and obsolescence should our forecasts fail to materialize or if there are negative factors impacting our customers’ end markets. If we purchase too much inventory or the wrong inventory, we may have to record additional inventory reserves or write-off the inventory, which could have a material adverse effect on our gross margins and on our results of operations.

We depend on sales of our legacy products for a meaningful portion of our revenues, but these products are mature and their sales will continue to decline.

A large portion of our sales have historically been attributable to our legacy products. We expect that these products may continue to account for a meaningful percentage of our revenues for the foreseeable future. However, these sales are declining. Although we are unable to predict future prices for our legacy products, we expect that prices for these products will continue to be subject to significant downward pressure in certain markets for the reasons described above. Accordingly, our ability to maintain or increase revenues will be dependent on our ability to expand our customer base, to increase unit sales volumes of these products and to successfully, develop, introduce and sell new products such as custom design and value added products. We cannot assure you that we will be able to expand our customer base, increase unit sales volumes of existing products or develop, introduce and/or sell new products.

Our operating results may vary from quarter to quarter.

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

Failure of our information technology infrastructure to operate effectively could adversely affect our business.

We depend heavily on information technology infrastructure to achieve our business objectives. If a problem occurs that impairs this infrastructure, the resulting disruption could impede our ability to record or process orders, manufacture and ship in a timely manner, or otherwise carry on business in the normal course. Any such events could cause us to lose customers or revenue and could require us to incur significant expense to remediate.

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

Some of our products are subject to ITAR rules, which are administered by the U.S. Department of State. ITAR controls not only the export, import and trade of certain products specifically designed, modified, configured or adapted for military systems, but also the export of related technical data and defense services as well as foreign production. Any delays in obtaining the required export, import or trade licenses for products subject to ITAR rules could have a materially adverse effect on our business, financial condition, and/or operating results. In addition, changes in United States export and import laws that require us to obtain additional export and import licenses or delays in obtaining export or import licenses currently being sought could cause significant shipment delays and, if such delays are too great, could result in the cancellation of orders. Any future restrictions or charges imposed by the United States or any other country on our international sales or foreign subsidiary could have a materially adverse effect on our business, financial condition, and/or operating results. In addition, from time to time, we have entered into contracts with the Israeli Ministry of Defense which were funded with monies subject to, and we therefore were required to comply with the regulations governing, the U.S. Foreign Military Financing program. Any such future sales would be subject to such regulations.

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

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

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

Sales to customers outside of North America accounted for 59.4% of net revenues during the nine months ended September 30, 2010 and for 50.87% of net revenues in the year ended December 31, 2009, and we expect that international sales will continue to represent a material portion of our total revenues. International sales are subject to the risks of international business operations as described above, as well as generally longer payment cycles, greater difficulty collecting accounts receivable, and currency restrictions. In addition, DPL, our wholly-owned foreign subsidiary in the United Kingdom, supports our European and other international customers, distributors, and sales representatives, and therefore is also subject to local regulation. International sales are also subject to the export laws and regulations of the United States and other countries.

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

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

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

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

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

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

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

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

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

United States or abroad.

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

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

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

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

Our common stock price is volatile.

Our common stock is listed on the NYSE Amex and is thinly traded. In the past, our trading price has fluctuated widely, depending on many factors that may have little to do with our operations or business prospects. The exercise of outstanding options and warrants may adversely affect our stock price and a shareholder's percentage of ownership. As of September 30, 2010, we had outstanding exercisable options to purchase an aggregate of 599,750 shares of common stock, with a weighted average exercise price of $1.02 per share, exercisable at prices ranging from $0.48 to $2.37 per share.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. RESERVED

ITEM 5. OTHER INFORMATION

On November 3, 2010, the Company issued a press release announcing its financial results for the third quarter ended September 30, 2010. A copy of the press release is furnished as Exhibit 99.1 hereto.

ITEM 6. EXHIBITS

Exhibits

31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley of 2002
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

99.1	Press Release, dated November 3, 2010, issued by Digital Power Corporation

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: November 5, 2010

Digital Power Corporation

By: /s/ Amos Kohn
Amos Kohn
President & Chief Executive Officer
(Principal Executive Officer)

By: /s/ Assaf (Assi) Itshayek
Assaf (Assi) Itshayek
Chief Financial Officer
(Principal Financial and Accounting Officer)