DIGITAL POWER CORP
Form 10-Q
November 14, 2016
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2016

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

48430 Lakeview Blvd

Fremont, CA 94538-3158

(Address of principal executive offices)

(510) 657-2635

(Registrant's telephone number, including area code)

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 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

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

At November 11, 2016, the registrant had outstanding 6,775,971 shares of common stock.

DIGITAL POWER CORPORATION

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DIGITAL POWER CORPORATION AND ITS SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	September 30, 2016 Unaudited	**December 31, 2015**
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 1,292	$ 1,241
Trade receivables	1,110	1,240
Related parties – trade receivables	-	77
Prepaid expenses and other accounts receivable	239	187
Inventories (Note 3)	1,186	1,542
Total current assets	3,827	4,287
PROPERTY AND EQUIPMENT, NET	615	709
INVESTMENT IN TELKOOR	-	90
LONG-TERM DEPOSITS	13	13
Total Non- current assets	628	812
Total assets	$ 4,455	$ 5,099

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

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DIGITAL POWER CORPORATION AND ITS SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	September 30, 2016 Unaudited	**December 31, 2015**
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 757	$ 937
Advances from customers and deferred revenue	94	211
Other current liabilities	434	480
Total current liabilities	1,285	1,628
SHAREHOLDERS' EQUITY:		
Share capital -		
Series A Redeemable Convertible Preferred shares, no par value - 500,000 shares authorized; 0 shares issued and outstanding at September 30, 2016 and December 31, 2015	-	-
Preferred shares, no par value - 1,500,000 shares authorized; 0 shares issued and outstanding at September 30, 2016 and December 31, 2015	-	-
Common shares, no par value - 30,000,000 shares authorized; 6,775,971 shares issued and outstanding as of September 30, 2016 and December 31, 2015	-	-
Additional paid-in capital	15,094	14,965
Accumulated deficit	(11,201)	(11,036)
Accumulated other comprehensive loss	(723)	(458)
Total shareholders' equity	3,170	3,471
Total liabilities and shareholders' equity	$ 4,455	$ 5,099

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

DIGITAL POWER CORPORATION AND ITS SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Nine months ended		**Three months ended**	
	September 30,		**September 30,**	
	2016	**2015**	**2016**	**2015**
	Unaudited			
Revenues	$5,603	$5,462	$1,826	$1,415
Cost of revenues	3,526	3,468	1,123	935
Gross profit	2,077	1,994	703	480
Operating expenses:				
Engineering and product development	511	663	147	203
Selling and marketing	723	835	235	316
General and administrative	1,115	1,279	404	378
Total operating expenses	2,349	2,777	786	897
Operating income (loss)	(272)	(783)	(83)	(417)
Financial income (expense), net	85	18	23	21
Impairment of investment	-	(106)	-	-
Income (Loss) before income taxes	(187)	(871)	(60)	(396)
Income taxes	22	-	22	-
Net (loss) income	$(165)	$(871)	$(38)	$(396)
Basic net income (loss) per share	$(0.02)	$(0.129)	$(0.01)	$(0.059)
Diluted net income (loss) per share	$(0.02)	$(0.129)	$(0.01)	$(0.059)

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

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DIGITAL POWER CORPORATION AND ITS SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

U.S. dollars in thousands

	Nine months ended		Three months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	Unaudited			
Net (loss) income	$(165)	$(871)	$(38)	$(396)
Other Comprehensive income, net of tax:				
Change in net foreign currency translation adjustment	(265)	(55)	(55)	(82)
Other comprehensive income	(265)	(55)	(55)	(82)
Total comprehensive income (loss):	$(430)	$(926)	$(93)	$(478)

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

DIGITAL POWER CORPORATION AND ITS 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 income (loss)	Total shareholders equity
Balance as of January 1, 2016	6,775,971	$ 14,965	$ (11,036)	$ (458)	$ 3,471
Stock compensation related to options granted to employees	-	129	-	-	129
Comprehensive loss: Net loss	-	-	(165)	-	(165)
Foreign currency translation adjustments	-	-	-	(265)	(265)
Balance as of September 30, 2016	6,775,971	$ 15,094	$ (11,201)	$ (723)	$ 3,170
Balance as of January 1, 2015	6,775,971	$ 14,739	$ (9,940)	$ (358)	$ 4,441
Stock compensation related to options granted to employees	-	181	-	-	181
Comprehensive loss:					
Net loss	-	-	(871)	-	(871)
Foreign currency translation adjustments	-	-	-	(55)	(55)
Balance as of September 30, 2015	6,775,971	$ 14,920	$ (10,811)	$ (413)	$ 3,696

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

DIGITAL POWER CORPORATION AND ITS SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Nine months ended September 30,	
	2016	**2015**
	Unaudited	
Cash flows from operating activities:		
Net loss	$(165)	$(871)
Adjustments required to reconcile net income to net cash provided by operating activities:		
Depreciation	123	108
Amortization of intangible asset	-	66
Stock compensation related to options granted to employees	129	181
Impairment of investment in Telkoor	-	106
Write down of inventory		44
Decrease (Increase) in trade receivables, net	82	560
Decrease (Increase) in prepaid expenses and other accounts receivable	(60)	(53)
Decrease (increase) in inventories	243	(339)
Decrease in accounts payable and related parties- trade payables	(101)	(236)
Increase (decrease) in deferred revenues and other current liabilities	(113)	(161)
Net cash provided by operating activities	138	(595)
Cash flows from investing activities:		
Purchase of property and equipment	(78)	(130)
Sale of investment	90	
Net cash from(used) n investing activities	12	(130)
Cash flows from financing activities:	-	-
Effect of exchange rate changes on cash and cash equivalents	(99)	(20)

Increase (Decrease) in cash and cash equivalents	51	(745)
Cash and cash equivalents at the beginning of the period	1,241	2,110
Cash and cash equivalents at the end of the period	$1,292	$1,365

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

DIGITAL POWER CORPORATION AND SUBSIDIARY

NOTES TO INTERIM 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 switching power supplies and converters. The Company has two reportable geographic segments - North America (sales through DPC) and Europe (sales through DPL).

b. In January 2016, Telkoor Telecom Ltd. (“Telkoor”) sold its entire commercial assets to Advice Ltd. (“Advice”). Consequently, the Company depends on Advice for design, to retain product technology up-to-date and manufacturing capabilities for certain of the products that the Company sells. If Advice is unable or unwilling to continue designing or manufacturing the Company's 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 the Company's operating results and cash position. The Company also depends on Advice'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 products to customers will have an adverse effect on the Company's ability to meet its customers’ expectations. In addition, the Company operates in highly competitive markets where the ability to sell Advice’s products could be adversely affected by Advice's agreements with other companies, long lead-times and the high cost of Advice’s products. In 2010, the Company purchased specific IP from Telkoor in order to reduce its dependency on Telkoor with respect to a certain line of products.

c. On September 5, 2016, the Company entered into a Securities Purchase Agreement (the “Agreement”) with Philou Ventures, LLC, a Wyoming limited liability company (the “Purchaser”), and Telkoor Telecom Ltd., an Israeli company (the “Seller”) pursuant to which the Purchaser purchased all of the Seller’s 2,714,610 shares of the common stock in the Company, constituting approximately 40.06% of the Company’s outstanding shares of common stock. In consideration for such shares, the Purchaser paid Seller $1.5 million.

Pursuant to the Agreement, the Company entered into a Rescission Agreement with the Seller in order to resolve all financial issues between the parties, including the repurchase by the Seller of 1,136,666 shares of common stock in

Seller beneficially owned by the Company for their book value.

The closing of the transactions under the Agreement and the Rescission Agreement occurred on September 22, 2016.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited consolidated financial statements as of September 30, 2016 and for the three and nine months ended September 30, 2016 and 2015 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, 2015. The results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results for the entire fiscal year ending December 31, 2016.

The significant accounting policies applied in the annual financial statements of the Company as of December 31, 2015 are applied consistently in these financial statements.

DIGITAL POWER CORPORATION AND SUBSIDIARY

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

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NOTE 3:- INVENTORIES

	September 30, 2016 Unaudited	December 31, 2015
Raw materials, parts and supplies	$ 219	$ 336
Work in progress	213	191
Finished products	754	1,015
	$ 1,186	$ 1,542

NOTE 4:- ACCOUNTING FOR STOCK-BASED COMPENSATION

Share Option Plan

1. Under the Company's Digital Power 2012 (as amended) ("Incentive Share Option Plan"), options may be granted to employees, officers, consultants, service providers and directors of the Company or its subsidiary.

2. As of September 30, 2016, the Company had authorized according to the Incentive Share Option Plan, the grant of options to officers, management, other key employees and others of up to 1,372,630 options for the Company's common shares. The maximum term of the options is ten years from date of grant. As of September 30, 2016, an aggregate of 812,630 shares of the Company's common stock were 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.

4. 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, 2016			
	Amount of options	**Weighted average exercise price**	**Weighted average remaining contractual term (years)**	**Aggregate intrinsic value (*)** In thousands
Outstanding at the beginning of the period	1,146,000	$ 1.52	6.74	$ -
Expire	40,000	$ 1.16		
Forfeited	105,000	$ 1.38		
Outstanding at the end of the period	1,001,000	$ 1.55	6.05	$ 7
Exercisable options at the end of the period	756,000	$ 1.56	5.50	$ 3

(*) Calculation of aggregate intrinsic value is based upon the share price of the Company's common stock as of September 30, 2016 $0.77 per share.

DIGITAL POWER CORPORATION AND ITS SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4:- 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-Sholes 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 the 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 2016.

The total employee's equity-based compensation expense related to all of the Company’s equity-based awards recognized for the three and nine months ended September 30, 2016 and 2015 is comprised as follows:

	Nine months ended September 30, 2016 Unaudited	September 30, 2015 Unaudited	Three months ended September 30, 2016 Unaudited	September 30, 2015 Unaudited
Cost of goods sold	5	4	1	1
Sales and marketing expenses	3	8	1	2
Research and development	13	14	5	3
General and administrative	108	155	35	38
Total employees equity-based compensation expense	129	181	42	44

As of September 30, 2016, there was $274 of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under the share option plans. That cost is expected to be recognized over a period of the next 1.66 years.

DIGITAL POWER CORPORATION AND SUBSIDIARY

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5:- INCOME (LOSS) PER SHARE

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

	Nine months ended		Three months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	Unaudited			
Denominator for basic net income per share of weighted average number of common shares	6,775,971	6,775,971	6,775,971	6,775,971
Effect of dilutive securities:				
Employee stock options	--	-	--	-
Denominator for diluted net income per common share	6,775,971	6,775,971	6,775,971	6,775,971
Basic net income (loss) per share	$(0.02)	$(0.129)	$(0.01)	$(0.059)
Diluted net income (loss) per share	$(0.02)	$(0.129)	$(0.01)	$(0.059)

NOTE 6:- INVESTMENT IN TELKOOR

On June 16, 2011 the Company acquired 1,136,666 shares of Telkoor, the Company's major shareholder at the time, and an Israeli company listed in the Tel Aviv stock exchange (at such time), which represented 8.8% of the outstanding shares of Telkoor. As a result of this transaction, an existing manufacturing agreement between the Company and Telkoor was updated and extended.

The Company recorded an impairment of its investment in Telkoor of $0 for the nine months ended September 30, 2016 compared to $106,000 for the nine months ended September 30, 2015 and $110,0000 for the year ended December 31, 2015.

On September 22, 2016, the Company sold such shares to Telkoor for $90,000. (see Note 1)

Equity securities that do not have readily determinable fair values (i.e. non-marketable equity securities) and are not required to be accounted for under the equity method are typically carried at cost (i.e., cost method investments), as described in ASC 325-20. The Company has classified its investment in Telkoor's shares using the cost method in accordance with ASC 325-20 "Investments in Other". Paragraphs 320-10-35-17 through 35-35 discuss the methodology for determining impairment and evaluate whether the impairment is other than temporary and therefore should be recognized.

DIGITAL POWER CORPORATION AND SUBSIDIARY

NOTES TO INTERIM 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 ASC 218 "Segment Reporting" ("ASC 218").

	Nine months ended September 30, 2016 (unaudited)			
	DPC	**DPL**	**Eliminations**	**Total**
Revenues	$3,408	$2,195	$ -	$5,603
Intersegment revenues	89	-	(89)	-
Total revenues	$3,497	$2,195	$ (89)	$5,603
Depreciation and amortization expense	$57	$66	$ -	$123
Operating income (loss)	$(147)	$(125)	$ -	$(272)
Impairment of investment	-	-		-
Financial expense, net	(12)	97		85
Tax	-	22		22
Net income (loss)	$(159)	$(6)	$ -	$(165)
Expenditures for segment assets, as of September 30, 2016	$23	$51	$ -	$74

Total assets as of September 30, 2016	$2,084	$2,371	$ -	$4,455

	Nine months ended September 30, 2015 (unaudited)			
	DPC	**DPL**	**Eliminations**	**Total**
Revenues	$2,795	$2,667	$ -	$5,462
Intersegment revenues	277	-	(277)	-
Total revenues	$3,072	$2,667	$ (277)	$5,462
Depreciation and amortization expense	$56	$118	$ -	$174
Operating income (loss)	$(845)	$62	$ -	$(783)
Impairment of investment		(106)		(106)
Financial expense, net	(4)	22		18
Net income (loss)	$(849)	$(22)	$ -	$(871)
Expenditures for segment assets, as of September 30, 2015	$54	$76	$ -	$130
Total assets as of September 30, 2015	$2,252	$2,930	$ -	$5,182

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	Three months ended September 30, 2016 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$1,248	$578	$ -	$1,826
Intersegment revenues	27	-	(27)	-
Total revenues	$1,275	$578	$ (27)	$1,826
Depreciation and amortization expense	$19	$21	$ -	$40
Operating income (loss)	$34	$(117)	$ -	$(83)
Impairment of investment	-	-		-
Financial income (expense), net	(2)	25		23
Tax	-	22		22
Net income (loss)	$32	$(70)	$ -	$(38)
Expenditures for segment assets, as of September 30, 2016	$-	$4	$ -	$4
Total assets as of September 30, 2016	$2,084	$2,371	$ -	$4,455

	Three months ended September 30, 2015 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$808	$607	$ -	$1,415
Intersegment revenues	155	-	(155)	-
Total revenues	$963	$607	$ (155)	$1,415
Depreciation and amortization expense	$19	$36	$ -	$55
Operating income (loss)	$(316)	$(101)	$ -	$(417)
Impairment of investment	-	-		-
Financial expense, net	(4)	25		21
Net income (loss)	$(320)	$(76)	$ -	$(396)
Expenditures for segment assets, as of September 30, 2015	$4	$21	$ -	$25
Total assets as of September 30, 2015	$2,252	$2,930	$ -	$5,182

DIGITAL POWER CORPORATION AND SUBSIDIARY

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

Major customer data as a percentage of total revenues:

The following table sets forth the customers that represented 10% or more of the Company's total revenues in the period of nine months ended September 30, 2016.

	Total Revenues by Major Customer (in thousands)	Percentage of Total Company Revenues
Customer A	1,176	21 %

Revenue from customer A was attributable to DPC.

NOTE 8:- SUBSEQUENT EVENTS

On October 21, 2016, the Company entered into a 12% Convertible Secured Note ("Convertible Note"), a warrant to purchase 265,000 shares of common stock each at an exercise price of $0.80 ("$0.80 Warrant"), a warrant to purchase 265,000 shares of common stock each at an exercise price of $0.90 ("$0.90 Warrant" and together with the $0.80 Warrant collectively "Warrants") and a registration rights agreement with an accredited investor (the "Investor").

The Convertible Note is in the principal amount of $530,000 and was sold for $500,000, bears interest at 12% simple interest on the principal amount, is secured by all the assets of the Company, and is due on October 20, 2019. Interest only payments are due on a quarterly basis and the principal may be converted into shares of the Company's common stock at $0.55 per share. Subject to certain beneficial ownership limitations, the Investor may convert the principal amount of the Convertible Note at any time into common stock. The conversion price of the Convertible Note is subject to adjustment for customary stock splits, stock dividends, combinations or similar events.

Upon 30 days' notice, the Company has the right to prepay the Convertible Note. In addition, provided that the closing price for a share of the Company's common stock exceeds $3.00 per share for 30 consecutive trading days, the Company has the right to force the holder thereof to convert the principal amount into shares of common stock at the conversion rate.

On November 3, 2016, subject to shareholder approval at the Company's next annual general meeting of shareholders to be held on December 28, 2016, the Company's Board approved the 2016 Stock Incentive Plan (the "2016 Stock Incentive Plan"), under which options to acquire up to 4,000,000 shares of common stock may be granted to the Company's directors, officers, employees and consultants. The 2016 Stock Incentive Plan is in addition to the Company's current 2012 Stock Option Plan, as amended (the "2012 Plan"), which provides for the issuance of a maximum of 1,372,630 shares of the Company's common stock to be offered to the Company's directors, officers, employees, and consultants. As of November 4, 2016, 522,500 options, net of cancellations, to purchase shares of Common Stock were granted under the 2012 Plan. If the 2016 Stock Incentive Plan is approved by the Company's Shareholders, then 4,850,130 options shall be available for future issuance under the 2012 Plan and the 2016 Stock Incentive Plan.

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

We are 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 the commercial, medical 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 MKT under the symbol "DPW". Our corporate headquarters are located in the heart of the Silicon Valley.

Our wholly-owned UK-based subsidiary, Digital Power Limited ("DPL"), located in Salisbury, England, operates under the brand name of "Gresham Power Electronics" ("Gresham"). DPL 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. Our European defense business is specialized in the field of naval power distribution products.

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 input and output voltages. We continue to sell products with flexible configurations to customers serving diversified applications in telecom, industrial and medical market segments. We believe our high density and high efficiency power products have set an industry standard for providing high-power output in a small packaging sizes.

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, standard and modified-standard products. Our unique high-speed switching power rectifiers include but are not limited to defense and commercial custom power products, ruggedized custom military products, Datacom and server power supplies, front-end, open-frame, enclosed, CompactPCI, Capacitor Charger for laser charging, Desktop/Wall-mount Adaptors, Power over Ethernet (POE) and other product solutions. Our product power range is from 10 watts to 75,000 watts.

In an effort to provide high quality products, better control our manufacturing costs and sell our products at competitive pricing to support our markets, we have entered into several contract manufacturing agreements with several manufacturers both domestically and in Asia, primarily China. To comply with the US International Traffic in Arms Regulations (“ITAR”) regulations, we manufacture our military products by a domestic manufacturer that complies with US ITAR regulations and is certified to perform such manufacturing services.

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 environment conditions, and high efficiency, high-density and scalable power systems.

RESULTS OF OPERATIONS

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2016 COMPARED TO THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2015

Revenues

Our revenues increased by $411,000, or 29.0%, to $1,826,000 for the three months ended September 30, 2016, from $1,415,000 for the three months ended September 30, 2015. The increase in revenue is mostly attributable to a rising sales volume of commercial and military products in North America. We had one customer that accounted for more than 10% of the consolidated revenues for the nine months ended September 30, 2016.

Revenues from our U.S. operations increased by 54.5% to $1,248,000 for the three months ended September 30, 2016, from $808,000 for the three months ended September 30, 2015. Revenues from our European operations of DPL decreased by 4.8% to $578,000 for the three months ended September 30, 2016, from $607,000 for the three months ended September 30, 2015.

For the nine months ended September 30, 2016, our revenues increased by 2.6% to $5,603,000 from $5,462,000 for the nine months ended September 30, 2015. The increase in revenues was attributable primarily to the increase in revenue from our U.S operations offset by a decrease of shipments of military products of DPL.

Gross Margins

Gross margins increased to 38.5% for the three months ended September 30, 2016 compared to 33.9% for the three months ended September 30, 2015. Gross margins for the nine months ended September 30, 2016 increased slightly to 37.1% compared to gross margins of 36.5% for the nine months ended September 30, 2015. The increase in gross margins for the last quarter was mainly attributable to the increase in profitability of our commercial products sold by our U.S operations.

Engineering and Product Development

Engineering and product development expenses decreased by $56,000 to $147,000 for the three months ended September 30, 2016 from $203,000 for the three months ended September 30, 2015.

Engineering and product development expenses were $511,000 for the nine months ended September 30, 2016 as compared to $663,000 for the nine months ended September 30, 2015. The overall decrease in our engineering and product development expenses for the comparative nine month period was primarily related to the completion of custom product development efforts for medical and broadband applications, which decreased the amount of outside contracted engineering services incurred by our U.S operations.

Selling and Marketing

Selling and marketing expenses were $235,000 and $723,000, respectively, for the three and nine months ended September 30, 2016 as compared to $316,000 and $835,000, respectively, for the three and nine months ended September 30, 2015. The decrease in sales and marketing expenses for the three and nine month periods of 2016 versus the 2015 comparable periods was primarily the result of a reduction in sales staff.

General and Administrative

General and administrative expenses were $404,000 and $1,115,000, respectively, for the three and nine months ended September 30, 2016 as compared to $378,000 and $1,279,000, respectively, for the three and nine months ended September 30, 2015. The decrease in our general and administrative expenses for the comparative nine months period was mainly due to the resignation of our former CFO and lower stock option expenses. The increase in the expenses for the three months ended September 30, 2016 was mainly due to increases in legal costs related to the Securities Purchase Agreement with Philou Ventures, LLC.

Impairment of investment

The Company did not record an impairment of its investment in Telkoor for the nine months ended September 30, 2016 compared to an impairment of $106,000 for the nine months ended September 30, 2015.

Financial Income (Expenses), net

Financial income, net was $23,000 and $85,000, respectively, for the three and nine months ended September 30, 2016 compared to $21,000 and $18,000 for the three and nine months ended September 30, 2015. Financial income is primarily related to foreign currency exchange gains from the impact of the weakening British Pound on DPL cash and receivables that are linked to the USD.

Operating Loss

The Company recorded an operating loss of $83,000 for the three months ended September 30, 2016 compared to operating loss of $417,000 for the three months ended September 30, 2015. The decrease in operating loss was achieved by increased sales in North America and lower operating expenses. For the nine months ended September 30, 2016, the Company recorded an operating loss of $272,000 compared to operating loss of $783,000 for the nine months ended September 30, 2015. The decrease in operating loss is primarily related to a decrease in operating expenses.

Net Income (Loss)

The Company recorded a net loss of $38,000 for the three months ended September 30, 2016 compared to a net loss of $396,000 for the three months ended September 30, 2015 as a result of the aforementioned changes. For the nine months ended September 30, 2016, the Company recorded a net loss of $165,000 compared to net loss of $871,000 for the nine months ended September 30, 2015 that included a $106,000 impairment of investment.

Other comprehensive income (loss)

Other comprehensive loss was $55,000 and $265,000, respectively, for the three and nine months ended September 30, 2016 as compared to other comprehensive income of $82,000 and $55,000, respectively, for the three and nine months ended September 30, 2015. The significant other comprehensive loss for the three and nine month periods ended September 30, 2016, which decreased our equity reflects the impact of the weakening of the British Pound on the equity of our UK-based subsidiary DPL following the referendum in the UK on membership in the European Union.

LIQUIDITY AND CAPITAL RESOURCES

On September 30, 2016, we had cash and cash equivalents of $1,292,000. This compares with cash and cash equivalents of $1,241,000 at December 31, 2015. The increase in cash and cash equivalents was primarily due to the net cash provided from operating activities.

Net cash provided by operating activities totaled $138,000 for the nine months ended September 30, 2016, compared to net cash used by operating activities of $595,000 for the nine months ended September 30, 2015. In the 2016 period, the increase in net cash provided from operating activities compared to the 2015 period was mainly due to a decrease in losses and a decrease in inventories.

Net cash provided from investing activities was $12,000 for the nine months ended September 30, 2016 compared to net cash used in investing activities of $130,000 for the nine months ended September 30, 2015. The investing activities for both periods represented purchases of property and equipment net of retirements, and for the 2016 period includes $90,000 received from sale of the investment in Telkoor.

There were no financing activities in the three and nine months ended September 30, 2016 and September 30, 2015.

We believe that cash provided by operating activities as well as our cash and cash equivalents will be sufficient to meet our anticipated cash needs for at least the next 12 months.

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 offerings, which may dilute shareholders' equity.

CRITICAL ACCOUNTING POLICIES

In our Annual Report on Form 10-K for the year ended December 31, 2015, 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

We have established disclosure controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms and is accumulated and communicated to management, including the principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure.

Our principal executive officer and principal financial officer, with the assistance of other members of the Company's management, have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report. Based upon such evaluation, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures are effective as of the end of the period covered by this quarterly report.

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

None

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.

We generated an operating and net loss during the three and nine months ended September 30, 2016 and September 30, 2015, we have historically experienced operating and net losses, and we may experience such losses in the future.

For the nine months ended September 30, 2016, we had an operating loss of $272,000 and a net loss of $165,000 compared to an operating loss of $1,003,000 and a net loss of $1,096,000 for the year ended December 31, 2015. Although we have actively taken steps to increase our revenue and reduce manufacturing and operating costs, we may incur operating and net losses in the future unless we increase revenues by selling current and custom design products and continue seeking manufacturing cost reductions through contract manufacturers.

We depend on Advice Electronics Ltd. ("Advice") to maintain the technology used to manufacture our products and to manufacture some of our products. We also depend on the right to manufacture certain products subject to royalty payments with Advice.

In January 2016, Telkoor sold its entire commercial assets to Advice (formerly owned by Telkoor) which included without limitation product IP, manufacturing rights, customer base, inventory, staff and technological capabilities. Following such transaction, we entered into a manufacturing and distribution agreement with Advice. This agreement allows us to manufacture certain Advice products through August 2017 against royalty payments. From August 2017 through December 2020, subject to Advice's consent, we will be allowed to continue distributing and selling certain Advice products while keeping product branding under our brand, after which we will be entitled to distribute the products under DPC branding until December 2020.

We depend on Advice to design and retain product technology up to date and for manufacturing capabilities for certain of the products that we sell. If Advice 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 Advice'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 products 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 Advice's products could be adversely affected by Advice's agreements with third parties, long lead-times and the high cost of Advice's products. Also, in 2012, Telkoor's products manufacturing lead-times increased, which hindered our ability to respond to our customers' needs in timely manner. Advice's principal offices, research and development and manufacturing facilities are located in Israel. Political, economic, and military conditions in Israel directly affect Advice operations. We are also dependent upon Advice’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. In 2010, we purchased certain IP from Telkoor in order to reduce our dependency on Telkoor with respect to a certain line of products. We also entered into a Manufacturing Rights Agreement with Advice in 2016, pursuant to which we were granted the non-exclusive right to directly place purchase orders for certain products from a third party manufacturer in consideration for payment of royalties to Advice. This agreement currently accounts for a significant portion of our sales. In the event this agreement is terminated for any reason, it would materially affect our profitability and cash position.

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

Because of the global economy, 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. 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 domestically and 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 manufacture our products.

If we fail to meet NYSE Mkt continued listing standards, our common stock will be delisted from NYSE Mkt which could adversely affect the price and liquidity of our common stock

The listing of our common stock on the NYSE MKT is contingent on our compliance with the NYSE MKT's conditions for continued listing. On December 18, 2015, we were notified by the NYSE MKT that we were no longer in compliance with the NYSE MKT continued listing standards because our last reported stockholders' equity was below continued listing standards. The NYSE MKT requires that a listed company's stockholders' equity be $4.0 million or more if it has reported losses from continuing operations and/or net losses in three of its four most recent fiscal years, and that stockholder equity be no less than $6 million if it has net losses in their five most recent fiscal years.

Following submission of our plan demonstrating how we intend to regain compliance with the continued listing standards, we were notified on March 9, 2016 that the NYSE MKT granted us a listing extension on the basis of our plan until June 19, 2017. We are subject to periodic review by NYSE MKT staff during the extension period. Failure to make progress consistent with the plan or to regain compliance with the continued listing standards by the end of the extension period could result in our common stock being delisted from the NYSE MKT.

There is no assurance that we will be able to regain compliance with the abovementioned standard or any other applicable NYSE MKT listing standard. Upon such an occurrence, trading of our common stock will be suspended by the NYSE MKT and we may be delisted by the NYSE MKT. In the event our common stock is no longer listed for trading on the NYSE MKT, our trading volume and share price may decrease and we may experience further difficulties in raising capital which could materially affect our operations and financial results.

We Will Need to Raise Additional Capital to Increase our Stockholders' Equity and to Fund our Operations in Furtherance of Our Business Plan.

We will need to quickly raise additional capital in order to increase our stockholders' equity in order to meet the NYSE MKT continued listing standards and to fund our operations in furtherance of our business plan. The proposed financing may include shares of common stock, shares of preferred stock, warrants to purchase shares of common stock or preferred stock, debt securities, units consisting of the forgoing securities, equity investments from strategic development partners or some combination of each. Any additional equity financings may be financially dilutive to, and will be dilutive from an ownership perspective to our stockholders, and such dilution may be significant based upon the size of such financing. Additionally, we cannot assure that such funding will be available on a timely basis, in needed quantities, or on terms favorable to us, if at all.

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 supply solutions, we will continue to devote significant resources to developing and manufacturing custom power supply solutions for a large number of customers, where each product represents a uniquely tailored solution for a specific customer's requirements. 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. Moreover, changes in market conditions and strategic changes at the direction of our customers may affect their decision to continue to purchase from us. The loss of one or more of our significant custom power supply solution customers could have a material adverse impact on our revenues, and 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, including those involving our personnel, 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.

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 President and CEO, our V.P. of Finance, marketing and sales personnel, and key engineers necessary to implement our business plan and to grow our business. 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. Mr. Kohn continues to serve in his role as our President and CEO. However, Mr. Kohn’s employment agreement expired on December 31, 2010. We have been in discussions with Mr. Kohn regarding a new employment agreement and have agreed to terms of a new employment subject to entering into a definitive agreement.

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. If our major OEM customers will reduce or cancel their orders scaling back some of their activities, our revenues and net income would be significantly reduced. 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 of current economic conditions.

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. Such demands may adversely affect our ability to successfully compete in certain markets or our ability to sustain our gross margins.

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 contract 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 manufacturer' representative OEM relationships and our other relationships.

We market and sell our products through domestic and international OEM relationships and other distribution channels, such as manufacturers' representatives and distributors. Our future results are dependent on our ability to establish, maintain and expand our relationships with OEMs as well as with manufacturer' representatives and distributors to sell our products. 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.

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

A relatively 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 our 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 International Traffic In Arms Regulation ("ITAR"), which are interpreted, enforced and administered by the U.S. Department of State. ITAR regulation 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 regulation and rules could have a material 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 governed by the U.S. Foreign Military Financing program ("FMF"). Any such future sales would be subject to these regulations. Failure to comply with ITAR or FMF rules could have a material adverse effect on our financial condition, and/or operating results.

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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 43% of net revenues in the first nine months of 2016 and 58.1% of net revenues in the year ended December 31, 2015, 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 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 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 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 MKT LLC. 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, 2016, we had outstanding options to purchase an aggregate of 1,001,000 shares of common stock, with a weighted average exercise price of $1.55 per share, exercisable at prices ranging from $0.65 to $1.79 per share.

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

On October 21, 2016, the Company entered into a 12% Convertible Secured Note, a warrant to purchase 265,000 shares of common stock each at an exercise price of $0.80, and a warrant to purchase 265,000 shares of common stock each at an exercise price of $0.90 with an accredited investor. The sale of the 12% Convertible Secured Note and the warrants were exempt from registration under the Securities Act of 1933, as amended, pursuant to an exemption under Section 4(a)(2) of the Securities Act and Regulation D promulgated thereunder. No commission was paid in connection with the placement.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None

ITEM 5. OTHER INFORMATION

On November 14, 2016, the Company issued a press release announcing its financial results for the third quarter ended September 30, 2016. A copy of the press release is furnished as Exhibit 99.1 hereto.

ITEM 6. EXHIBITS

Exhibits

3.1	Amended and Restated Articles of Incorporation of Digital Power Corporation (1)
3.2	Amendment to Articles of Incorporation (1)
3.3	Amendment to Articles of Incorporation (2)
3.3	Bylaws of Digital Power Corporation (1)
3.4	Securities Purchase Agreement, dated as of September 4, 2016 by and among the Company, Philou Ventures, LLC, and Telkoor Telecom Ltd. (3)
3.5	Rescission Agreement, dated as of September 4, 2016 by and among the Company and Telkoor Telecom Ltd. (3)
31.1	Certification of Chief Executive Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certific Certification of Chief Financial Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.1	Press Release, dated November 15, 2016, issued by Digital Power Corporation
101.INS**	XBRL Instance
101.SCH**	XBRL Taxonomy Extension Schema
101.CAL**	XBRL Taxonomy Extension Calculation
101.DEF**	XBRL Taxonomy Extension Definition
101.LAB**	XBRL Taxonomy Extension Labels
101.PRE**	XBRL Taxonomy Extension Presentation
(1)	Previously filed with the Commission on October 16, 1996 as an exhibit to the Company's Registration Statement on Form SB-2.
(2)	Previously filed with the Commission as Exhibit 3.1 to the Company's Form 8-K filed December 9, 2013

(3)	Previously filed with the Commission as an exhibit to the Company's Form 8-K filed September 7, 2016
**	XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

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 14, 2016

Digital Power Corporation

By: /s/ Uri Friedlander
Uri Friedlander
Vice President of Finance
(Principal Accounting Officer)

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