

DIGITAL POWER CORP

FORM 10QSB

(Quarterly Report of Financial Condition)

Filed 8/12/1999 For Period Ending 6/30/1999

Address	41920 CHRISTY ST FREMONT, California 94538
Telephone	510-657-2635
CIK	0000896493
Industry	Electronic Instr. & Controls
Sector	Technology
Fiscal Year	12/31

U.S. Securities and Exchange Commission

Washington, D.C. 20549

FORM 10-QSB

☒ **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE**

ACT OF 1934 for the quarterly period ended June 30, 1999

☐ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE**

ACT OF 1934 for the transition period from _____ to _____

COMMISSION FILE NUMBER 1-12711

DIGITAL POWER CORPORATION

(Exact name of small business issuer as specified in its charter)

California
(State or other jurisdiction of
incorporation or organization)

94-1721931
(IRS Employer Identification No.)

41920 Christy Street, Fremont, CA 94538-3158
(Address of principal executive offices)

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

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Number of shares of common stock outstanding as of June 30, 1999: 2,771,435

DIGITAL POWER CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEET
JUNE 30, 1999

ASSETS	

CURRENT ASSETS:	
Cash	\$ 1,090,292
Accounts receivable - trade, net of allowance for doubtful accounts of \$320,000	3,134,013
Income tax refund receivable	176,729
Other receivables	151,987
Inventory, net	4,409,544
Prepaid expenses and deposits	100,003
Deferred income taxes	385,605

Total current assets	9,448,173
PROPERTY AND EQUIPMENT, net	1,287,852
EXCESS OF PURCHASE PRICE OVER NET ASSETS ACQUIRED net amortization of \$249,320	1,202,870
DEPOSITS	83,218

TOTAL ASSETS	\$ 12,022,113
=====	
LIABILITIES AND STOCKHOLDERS' EQUITY	

CURRENT LIABILITIES:	
Notes payable	\$ 1,529,637
Current portion of long-term debt	97,930
Current portion of capital lease obligations	56,754
Accounts payable	1,561,727
Accrued liabilities	1,283,123

Total current liabilities	4,529,171
LONG-TERM DEBT, less current portion	40,986
CAPITAL LEASE OBLIGATIONS, less current position	100,896
OTHER LONG-TERM LIABILITIES	25,000
DEFERRED INCOME TAXES	26,000

Total liabilities	4,722,053

COMMITMENTS AND CONTINGENCIES	-
STOCKHOLDERS' EQUITY:	
Preferred stock issuable in series, no par value, 2,000,000 shares authorized; no shares issued and outstanding	-
Common Stock, no par value, 10,000,000 shares authorized; 2,771,435 shares issued and outstanding	9,012,679
Warrants	60,776
Additional paid-in capital	218,334
Accumulated deficit	(1,954,564)
Unearned employee stock ownership plan shares	(138,916)
Accumulated other comprehensive income	101,751

Total stockholders' equity	7,300,060

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 12,022,113
=====	

See accompanying notes to these condensed consolidated financial statements.

DIGITAL POWER CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	1999 ----	1998 ----	1999 ----	1998 ----
REVENUES	\$ 4,332,948	\$ 4,575,030	\$ 7,549,411	\$ 9,630,361
COST OF GOODS SOLD	3,279,891	3,535,150	5,763,266	7,070,504
Gross Margin	1,053,057	1,039,880	1,786,145	2,559,857
OPERATING EXPENSES				
Engineering and product development	210,516	271,223	431,282	541,119
Marketing and selling	317,978	369,636	597,984	714,115
General and administrative	363,582	388,775	715,474	694,827
Total operating expenses	892,076	1,029,634	1,744,740	1,950,061
INCOME FROM OPERATIONS	160,981	10,246	41,405	609,796
OTHER INCOME (EXPENSES):				
Interest income	3,474	109	7,508	1,989
Interest expense	(46,775)	(67,841)	(98,888)	(115,075)
Translation loss	(3,679)	(11,439)	(6,260)	(14,960)
Other income (expense)	(46,980)	(79,171)	(97,640)	(128,046)
INCOME (LOSS) BEFORE INCOME TAXES	114,001	(68,925)	(56,235)	481,750
PROVISION (BENEFIT) FOR INCOME TAXES	53,500	(73,342)	38,800	182,900
NET INCOME (LOSS)	60,501	4,417	(95,035)	298,850
Other comprehensive income (loss): Foreign currency translation adjustment	(85,562)	(12,573)	(169,677)	70,094
COMPREHENSIVE INCOME (LOSS)	\$ (25,061)	\$ (8,156)	\$ (264,712)	\$ 368,944
NET INCOME (LOSS) PER SHARE				
BASIC	\$ 0.02	\$ *	\$ (0.03)	\$ 0.11
DILUTED	\$ 0.02	\$ *	\$ (0.03)	\$ 0.09
	*Less than \$0.01			

See accompanying notes to these condensed consolidated financial statements.

DIGITAL POWER CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	SIX MONTHS ENDED JUNE 30,	
	1999	1998
Cash Flows from Operating Activities:		
Net income (loss)	\$ (95,035)	\$ 298,850
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization		
Deferred income taxes	267,816	179,325
Compensation recognized upon issuance of stock or stock options		(15,234)
Contribution to ESOP		48,032
Foreign currency translation adjustment	46,003	47,560
Changes in operating assets and liabilities:	6,260	14,960
Cash - restricted		(600,000)
Accounts receivable	426,025	509,305
Other receivables	(48,945)	(9,075)
Income Tax Refund Receivable	215,917	
Inventory	454,976	(1,090,776)
Prepaid expenses	(44,739)	(89,422)
Deposits	(42,427)	(13,641)
Accounts payable	314,872	(1,089,267)
Accrued liabilities	(341,975)	953,080
Other long-term liabilities	19,957	
Net adjustments	1,273,740	(1,155,153)
Net cash provided by (used in) operating activities	1,178,705	(856,303)
Cash Flows from Investing Activities:		
Acquisition of Gresham Power Electronics		(2,974,411)
Purchases of property and equipment	(37,234)	(46,695)
Proceeds from sale of asset		8,528
Net cash used in investing activities	(37,234)	(3,012,578)
Cash Flows from Financing Activities:		
Proceeds from exercise of stock options including related tax benefits		61,150
Payments on long-term debt	(46,002)	(47,560)
Payments on capital lease obligations	(19,637)	(5,918)
Proceeds from line of credit		1,750,000
Principal payments on notes payable	(677,209)	
Net cash provided by (used in) financing activities	(742,848)	1,757,672
Effect of Exchange Rate Changes on Cash	(175,938)	55,134
Net increase (decrease) in cash and cash equivalents	222,685	(2,056,075)
Cash and cash equivalents, beginning of period	867,607	2,205,282
Cash and cash equivalents, end of period	\$ 1,090,292	\$ 149,207
Supplemental Cash Flow Information:		
Cash payments for:		
Interest	\$ 99,807	\$ 108,877
Income taxes	\$ 36,957	\$ 288,850

See accompanying notes to these condensed consolidated financial statements.

DIGITAL POWER CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 1999

(UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. For further information, refer to the financial statements and footnotes thereto included in the Company's annual report on Form 10-KSB for the fiscal year ended December 31, 1998.

In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments consisting only of normal recurring accruals considered necessary to present fairly the Company's financial position at June 30, 1999, the results of operations for the three month and six month periods ended June 30, 1999 and 1998, and cash flows for the six months ended June 30, 1999 and 1998. The results for the period ended June 30, 1999, are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 1999.

NOTE 2 - EARNINGS PER SHARE

The following represents the calculation of earnings per share:

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	1999	1998	1999	1998
BASIC				
Net Income (loss)	\$ 60,501	\$ 4,417	\$ (95,035)	\$ 298,850
Less - preferred stock dividends	-	-	-	-
Net income (loss) applicable to common shareholder	\$ 60,501	\$ 4,417	\$ (95,035)	\$ 298,850
Weighted average number of common shares	2,771,435	2,704,377	2,771,435	2,701,566
Basic earnings (loss) per share	\$ 0.02	\$ *	\$ (0.03)	\$ 0.11
DILUTED				
Net income (loss) applicable to common shareholders	\$ 60,501	\$ 4,417	\$ (95,035)	\$ 298,850
Preferred stock dividend	-	-	-	-
Net income (loss) available to common shareholders plus assumed conversion	\$ 60,501	\$ 4,417	\$ (95,035)	\$ 298,850
Weighted average number of common shares	2,771,435	2,704,377	2,771,435	2,701,566
Common stock equivalent shares representing shares issuable upon exercise of stock options	65,150	367,409	65,350	386,347
Common stock equivalent shares representing shares issuable upon exercise of warrants	--	65,468	--	116,228
Weighted average number of shares used in calculation of diluted income (loss) per share	2,836,585	3,137,254	2,836,785	3,204,141
Diluted earnings (loss) per share	\$ 0.02	\$ *	\$ (0.03)	\$ 0.09
* Less than \$0.01				

NOTE 3 - SEGMENT REPORTING

The company has identified its segments based upon its geographic operations. These segments are represented by each of the Company's individual legal entities: Digital Power Corporation (DPC), Poder Digital, S.A. de C.V. (PD) and Digital Power Limited (DPL). Segment information is as follows:

For the Three Months Ended June 30, 1999

	DPC	PD	DPL	Eliminations	Totals
Revenues	\$ 2,501,309	\$ 9,625	\$ 1,822,014	\$ --	\$ 4,332,948
Intersegment Revenues	\$ 56,071	\$ 693,257	\$ --	\$ (749,328)	\$ --
Interest Income	\$ 31,705	\$ 169	\$ --	\$ (28,400)	\$ 3,474
Interest Expense	\$ 32,985	\$ 2,591	\$ 39,599	\$ (28,400)	\$ 46,775
Income Tax Expense(Benefit)	\$ --	\$ --	\$ 53,500	\$ --	\$ 53,500
Income (loss)	\$ (24,772)	\$ (14,844)	\$ 100,117	\$ --	\$ 60,501

For the Three Months Ended June 30, 1998

	DPC	PD	DPL	Eliminations	Totals
Revenues	\$ 2,845,907	\$ 3,540	\$ 1,725,583	\$ --	\$ 4,575,030
Intersegment Revenues	\$ --	\$ 401,039	\$ --	\$ (401,039)	\$ --
Interest Income	\$ 109	\$ --	\$ --	\$ --	\$ 109
Interest Expense	\$ 43,787	\$ 917	\$ 23,137	\$ --	\$ 67,841
Income Tax Expense (Benefit)	\$ (78,400)	\$ --	\$ 5,058	\$ --	\$ (73,342)
Income (loss)	\$ 278,441	\$ (274,536)	\$ 512	\$ --	\$ 4,417

For the Six Months Ended June 30, 1999

	DPC	PD	DPL	Eliminations	Totals
Revenues	\$ 4,433,282	\$ 9,652	\$ 3,106,477	\$ --	\$ 7,549,411
Intersegment Revenues	\$ 100,910	\$ 1,040,449	\$ --	\$ (1,141,359)	\$ --
Interest Income	\$ 62,397	\$ 1,599	\$ --	\$ (56,488)	\$ 7,508
Interest Expense	\$ 68,179	\$ 3,189	\$ 84,008	\$ (56,488)	\$ 98,888
Income Tax Expense (Benefit)	\$ --	\$ --	\$ 38,800	\$ --	\$ 38,800
Income (loss)	\$ (95,169)	\$ (16,224)	\$ 16,358	\$ --	\$ (95,035)

For the Six Months Ended June 30, 1998

	DPC	PD	DPL	Eliminations	Totals
Revenues	\$ 6,105,715	\$ 19,196	\$ 3,505,450	\$ --	\$ 9,630,361
Intersegment Revenues	\$ --	\$ 880,296	\$ --	\$ (880,296)	\$ --
Interest Income	\$ 1,989	\$ --	\$ --	\$ --	\$ 1,989
Interest Expense	\$ 77,387	\$ 1,379	\$ 36,309	\$ --	\$ 115,075
Income Tax Expense (Benefit)	\$ 126,800		\$ 56,100	\$ --	\$ 182,900
Income (loss)	\$ 572,409	\$ (440,368)	\$ 166,809	\$ --	\$ 298,850

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

With the exception of historical facts stated herein, the matters discussed in this report are "forward looking" statements that involve risks and uncertainties that could cause actual results to differ materially from projected results. Such "forward looking" statements include, but are not necessarily limited to, statements regarding anticipated levels of future revenues and earnings from operations of the Company. Factors that could cause actual results to differ materially include, in addition to other factors identified in this report, a high degree of customer concentration, dependence on the computer and other electronic equipment industry, competition in the power supply industry, dependence on the Guadalajara, Mexico facility, and other risks factors detailed in the Company's Securities and Exchange Commission ("SEC") filings including the risk factors set forth in Company's Registration Statement on Form SB-2, SEC File No. 333-14199, and "Certain Considerations" section in the Company's Form 10-KSB for the year ended December 31, 1998. Readers of this report are cautioned not to put undue reliance on "forward looking" statements which are, by their nature, uncertain as reliable indicators of future performance. The Company disclaims any intent or obligation to publicly update these "forward looking" statements, whether as a result of new information, future events, or otherwise.

THREE AND SIX MONTH PERIODS ENDED JUNE 30, 1999, COMPARED TO JUNE 30, 1998

REVENUES

Revenues decreased by 5.3% to \$4,332,948 for the three months ended June 30, 1999, from \$4,575,030 for the three months ended June 30, 1998. Revenues from the Company's United Kingdom's operations of Digital Power Ltd. increased 5.6% to \$1,822,014 for the second quarter ended June 30, 1999, from \$1,725,583 for the second quarter ended June 30, 1998. Revenues attributed to the United States operations decreased by 11.9% from the same quarter during the prior year. The decrease in revenues can be attributed primarily from discontinued purchases from one large customer who began buying a lower priced product from a competitor. This customer resumed placing orders with the Company during the first quarter of 1999.

For the six months ended June 30, 1999, revenues decreased by 21.6% to \$7,549,411 from \$9,630,361 for the six months ended June 30, 1998. The decrease in revenues during the six months ended June 30, 1999, can be attributed primarily to the reduction in purchases from the one large customer as stated in the quarterly review discussion above. For the six months ended June 30, 1999, Digital Power Ltd. contributed \$3,106,477 to the Company's revenues compared to \$3,505,450 for the six months ended June 30, 1998.

GROSS MARGINS

Gross margins were 24.3% for the three months ended June 30, 1999, compared to 22.7% for the three months ended June 30, 1998. The improvement in gross margins can primarily be attributed to favorable product mix.

Gross margins were 23.7% for the six months ended June 30, 1999, compared to 26.6% for the six months ended June 30, 1998. The decrease in gross margins can primarily be attributed to reduced shipment level of higher margin products.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses were 15.7% of revenues for the three months ended June 30, 1999, compared to 16.6% for the three months ended June 30, 1998. Selling, general and administrative expenses were 17.4% of revenues for the six months ended June 30, 1999, compared to 14.6% for the six months ended June 30, 1998. The continued cost constraints implemented by the Company resulted in actual dollar reductions in these expenses of \$76,851 for the quarter and \$95,484 for the six months ended June 30, 1999.

ENGINEERING AND PRODUCT DEVELOPMENT

Engineering and product development expenses were 4.9% of revenues for the three months ended June 30, 1999, and 5.9% for the three months ended June 30, 1998. Engineering and product development expenses were 5.7% of revenues for the six months ended June 30, 1999, compared to 5.6% for the six months ended June 30, 1998. Actual dollar expenditures decreased \$60,707 and \$109,837 respectively for the quarter and six months ended June 30, 1999.

INTEREST EXPENSE

Interest expense, net of interest income, was \$43,301 for the three months ended June 30, 1999, compared to \$67,732 for the three months ended June 30, 1998. Interest expense, net of interest income, was \$91,380 for the six months ended June 30, 1999, compared to \$113,086 for the six months ended June 30, 1998. The decrease in interest expense is related primarily to payments made to reduce notes payable.

INCOME (LOSS) BEFORE INCOME TAXES

For the three months ended June 30, 1999, the Company had an income before income taxes of \$114,001 compared to a loss before income taxes of \$68,925 for the three months ended June 30, 1998. For the six months ended June 30, 1999, the Company had a loss before income taxes of \$56,235 compared to income of \$481,750 for the six months ended June 30, 1998.

INCOME TAX

The provision for income tax increased from a tax benefit of \$73,342 for the three months ended June 30, 1998, to a tax expense of \$53,500 for the three months ended June 30, 1999, and decreased from \$182,900 for the six months ended June 30, 1998, to \$38,800 for the six months ended June 30, 1999.

NET INCOME

Net income for the three months ended June 30, 1999, was \$60,501 compared to \$4,417 for the three months ended June 30, 1998. Net loss for the six months ended June 30, 1999, was \$95,035, compared to net income of \$298,850 for the six months ended June 30, 1998. The increase in net income for the three month period was due to the reduction in operating and other expenses implemented to bring costs in line with revenue levels, while the decrease in net income for the six month period is primarily related to decreased revenues for the six month period, primarily related to the Company's United States operations.

LIQUIDITY AND CAPITAL RESOURCES

On June 30, 1999, the Company had cash of \$1,090,292 and working capital of \$4,919,002. This compares with cash of \$149,207 and working capital of \$5,993,382 at June 30, 1998. The decrease in working capital was due to an increase in other receivables and prepaid expenses and decrease of notes payable and accrued liabilities, offset by a decrease in accounts receivable and inventory and increase in accounts payable, resulting in an increase in cash and cash equivalents. Cash provided by (used in) operating activities for the Company totaled \$1,178,705 and (\$856,303) for the six months ended June 30, 1999 and 1998.

Cash used in investing activities was \$37,234 for the six months ended June 30, 1999, compared to \$3,012,578 for the six months ended June 30, 1998. Net cash provided by (used in) financing activities was (\$742,848) for the six months ended June 30, 1999, compared to \$1,757,672. During the six months ended June 30, 1999, the Company paid down the bank line credit of \$125,000.

IMPACT OF THE YEAR 2000 ISSUE

The Year 2000 Issue is the result of computer programs being written using two digits rather than four to define the applicable year. Any of the Company's, or its suppliers' and customers' computer programs that have date-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in system failures or miscalculations causing disruptions of operations including, among other things, a temporary inability to process transactions, send invoices, or engage in similar normal business activities.

The Company upgraded its software at a cost of less than \$10,000 and has been informed by its suppliers that such software is Year 2000 compliant. The software from these suppliers is used in major areas of the Company's operations such as for financial, sales, warehousing and administrative purposes. The Company has no internally generated software. The Company believes that all of its hardware is Year 2000 compliant. In connection with the acquisition of Gresham Power, the Company has acquired new hardware and software to address the Year 2000 Issue at a cost of approximately \$150,000 to make Gresham Power Year 2000 compliant. Gresham Power has completed the installation of this new hardware and software. After reasonable investigation, the Company has not yet identified any other Year 2000 problem but will continue to monitor the issue. However, there can be no assurances that the Year 2000 problem will not occur with respect to the Company's computer systems.

The Company has initiated formal communications with significant suppliers and large customers to determine the extent to which those third parties' failure to remedy their own Year 2000 Issues would materially effect the Company and its subsidiaries. In the event that the Company receives indications from its suppliers and large customers that the Year 2000 Issue may materially effect their ability to conduct business, the Company will seek contingency plans such as finding other vendors that are Year 2000 compliant or increase its inventory of supplies or parts in an attempt to ensure smooth operations until such vendor can remedy the problem. The Company has not received any indication from its suppliers and large customers that the Year 2000 Issue may materially effect their ability to conduct business.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDS

None.

ITEM 2. CHANGES IN SECURITIES

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

27.1 Financial Data Schedule

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DIGITAL POWER CORPORATION
(Registrant)

Date:	August 12, 1999	/s/ ROBERT O. SMITH

		Robert O. Smith
		Chief Executive Officer
		(Principal Executive Officer)
Date:	August 12, 1999	/s/ PHILIP G. SWANY

		Philip G. Swany
		Chief Financial Officer
		(Principal Financial Officer)

ARTICLE 5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE 10-QSB FOR THE PERIOD ENDED JUNE 30, 1999, FOR DIGITAL POWER CORPORATIN, AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

PERIOD TYPE	6 MOS
FISCAL YEAR END	DEC 31 1999
PERIOD END	JUN 30 1999
CASH	1,090,292
SECURITIES	0
RECEIVABLES	3,454,013
ALLOWANCES	(320,000)
INVENTORY	4,490,544
CURRENT ASSETS	9,448,173
PP&E	2,655,571
DEPRECIATION	(1,367,719)
TOTAL ASSETS	12,022,113
CURRENT LIABILITIES	4,529,171
BONDS	0
PREFERRED MANDATORY	0
PREFERRED	0
COMMON	9,012,679
OTHER SE	(1,712,619)
TOTAL LIABILITY AND EQUITY	12,022,113
SALES	7,549,411
TOTAL REVENUES	7,549,411
CGS	5,763,266
TOTAL COSTS	5,763,266
OTHER EXPENSES	1,744,740
LOSS PROVISION	0
INTEREST EXPENSE	98,888
INCOME PRETAX	(56,235)
INCOME TAX	38,800
INCOME CONTINUING	(95,035)
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET INCOME	(95,035)
EPS BASIC	(0.03)
EPS DILUTED	(0.03)

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