DIGITAL POWER CORP
Form 10-Q
November 20, 2012

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

FORM 10-Q

þ Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended September 30, 2012

¨ 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)

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

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

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

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

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

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

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

At August 14, 2012, the registrant had outstanding 6,863,150 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, except share data

	September 30, 2012 Unaudited	December 31, 2011
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 1, 890	$ 1,777
Trade receivables (net of allowance for doubtful accounts of $ 146 and $ 148 at September 30, 2012 and December 31, 2011, respectively)	1,754	1,845
Prepaid expenses and other receivables	143	108
Inventories (Note 3)	2,170	2,332
Total current assets	5,957	6,062
PROPERTY AND EQUIPMENT, NET	466	448
INTANGIBLE ASSET, NET	292	350
INVESTMENT IN OTHER COMPANY	781	483
LONG-TERM DEPOSITS	6	6
Total assets	$ 7,502	$ 7,349
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 640	$ 1,032
Related parties - trade payables	472	369
Advances from customers and deferred revenues	22	286
Other current liabilities	439	529
Total current liabilities	1,573	2,216
SHAREHOLDERS' EQUITY:		
Share capital -		
Series A Redeemable, Convertible Preferred shares, no par value - 500,000 shares authorized at September 30, 2012 and December 31, 2011; No shares are issued and outstanding.	-	-
Preferred shares, no par value - 1,500,000 shares authorized at September 30, 2012 and December 31, 2011; No shares are issued and outstanding.	-	-
Common shares, no par value - 30,000,000 shares authorized at September 30, 2012 and December 31, 2011; 6,863,150 shares and 6,849,654 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively	-	-
Additional paid-in capital	14,456	14,358
Accumulated deficit	(8,235)	(8,321)
Accumulated other comprehensive loss	(292)	(904)

Total shareholders' equity		5,929		5,133
Total liabilities and shareholders' equity	$	7,502	$	7,349

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 OPERATIONS

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

	Nine months ended September 30,		Three months ended September 30,	
	2012	2011	2012	2011
	Unaudited			
Revenues	$ 6,861	$ 9,174	$ 1,679	$ 3,024
Cost of revenues	4,016	5,562	1,037	1,811
Gross profit	2,845	3,612	642	1,213
Operating expenses:				
Engineering and product development	513	574	191	186
Selling and marketing	760	764	270	250
General and administrative	1,228	1,185	424	303
Total operating expenses	2,501	2,523	885	739
Operating income (loss)	344	1,089	(243)	474
Financial income (expense), net	(238)	(13)	(216)	14
Income (loss) before income taxes	106	1,076	(459)	488
Income taxes	20	49	8	39
Net income (loss)	$ 86	$ 1,027	$ (467)	$ 449
Basic net income (loss) per share	$ 0.013	$ 0.153	$ (0.068)	$ 0.067
Diluted net income (loss) per share	$ 0.012	$ 0.150	$ (0.068)	$ 0.064

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

DIGITAL POWER CORPORATION AND ITS SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

U.S. dollars in thousands

	Nine months ended September 30,		Three months ended September 30,	
	2012	2011	2012	2011
	Unaudited			
Net Income (Loss)	$86	$1,027	$(467)	$449
Other Comprehensive income, net of tax:				
Change in net unrealized gain on investment in other company	473	(405)	359	(224)
Change in net foreign currency translation adjustment	139	(31)	113	(115)
Other comprehensive income	612	(436)	472	(339)
Total comprehensive income:	698	591	5	110

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 loss	Total comprehensive Income	Total shareholders' equity
Balance as of January 1, 2012	6,849,654	$ 14,358	$ (8,321)	$ (904)	-	$ 5,133
Stock based compensation related to options granted to Telkoor's employees and other non- employee consultants	-	(3)	-	-	-	(3)
Stock based compensation related to options granted to employees	-	101	-	-	-	101
Exercise of options granted to employees	13,496		-	-	-	-
Comprehensive income:						
Net Income	-	-	86	-	86	86
Unrealized loss from investment in other company	-	-	-	473	473	473
Foreign currency translation adjustments	-	-	-	139	139	139
Total comprehensive income					$ 698	
Balance as of September 30, 2012 (unaudited)	6,863,150	$ 14,456	$ (8,235)	$ (292)		$ 5,929

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, 2012	2011
	Unaudited	
Cash flows from operating activities :		
Net income	$ 86	$ 1,027
Adjustments required to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	76	51
Amortization of intangible asset	73	74
Stock based compensation related to options granted to employees	101	57
Stock based compensation related to options granted to Telkoor's employees	(3)	20
Impairment in investment	218	-
Decrease (increase) in trade receivables, net	105	(99)
(Increase) decrease in prepaid expenses and other accounts receivable	(33)	17
Decrease in inventories	213	(77)
Decrease in accounts payable and related parties- trade payables	(299)	(117)
Decrease in deferred revenues and other current liabilities	(368)	(239)
Net cash provided by operating activities	169	714
Cash flows from investing activities :		
Purchase of securities of Telkoor	-	(1,007)
Purchase of property and equipment	(81)	(43)
Net cash used in investing activities	(81)	(1,050)
Cash flows from financing activities :		
Exercise of employees stock options	-	33
Net cash provided by financing activities	-	33
Effect of exchange rate changes on cash and cash equivalents	25	49
Increase/ (decrease) in cash and cash equivalents	113	(254)
Cash and cash equivalents at the beginning of the period	1,777	2,115
Cash and cash equivalents at the end of the period	$ 1,890	$ 1,861

The accompanying notes are an integral part of the 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. The Company depends on Telkoor Telecom Ltd. ("Telkoor"), a major shareholder of the Company and one of DPC's third party subcontractors, for design and manufacturing capabilities of some of the products which the Company sells. The Company also relies on third party contract manufacturer's (CMs) to manufacture its products. If Telkoor and these manufacturers are unable or unwilling to continue manufacturing the Company's products in required volumes on a timely basis, that could lead to loss of sales, and adversely affect the Company's operating results and cash position. The Company also depends on Telkoor's intellectual property and its willingness and ability to transfer production to third party manufacturers allowing the Company to use these production rights. Failure to obtain new products in a timely manner or delay in delivery of product to customers would have an adverse effect on the Company's ability to meet its customers' expectations.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

a. The accompanying unaudited consolidated financial statements as of September 30, 2012 and for the nine months ended September 30, 2012 and 2011 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 unaudited 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, 2011. The results of operations for the three and nine months ended September 30, 2012 are not necessarily indicative of the results for the entire fiscal year ending December 31, 2012.

The significant accounting policies applied in the annual financial statements of the Company as of December 31, 2011 are applied consistently in these financial statements. In addition, the following accounting policy is applied:

b. Investment in other company:

The Company reclassified its investment in other company shares from Available-For –Sale investment into an investment recorded at cost based on the estimated fair value in the reclassification date. Unrealized losses that are considered other than temporary are recognized as finance expenses in the income statement. In the earlier periods, this investment was recorded at market value and all differences in the market value were recognized through other comprehensive income.

c. Accounting for stock-based compensation:

The Company has several stock-based employee compensation plans, which are described more fully in Note 4. The Company accounts for stock-based compensation in accordance with Accounting Standards Codification Statement ("ASC") 718 (formerly SFAS No. 123 (revised 2004)) "Stock compensation" ("ASC 718").

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

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

NOTE 3:- INVENTORIES

	September 30, 2012 Unaudited	December 31, 2011
Raw materials, parts and supplies	$ 330	$ 239
Work in progress	483	486
Finished products	1,357	1,607
	$ 2,170	$ 2,332

NOTE 4:- ACCOUNTING FOR STOCK-BASED COMPENSATION

a. Stock option plans:

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

2. As of September 30, 2012, the Company has authorized, by way of three Incentive Share Option Plans, the grant of options to officers, management, other key employees and others of up to 513,000, 240,000 and 1,519,000 shares, respectively, of the Company's common stock. As of September 30, 2012, options to purchase up to an aggregate of 410,145 shares of the Company's common stock are still available for future grant.

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

	Nine months ended September 30, 2012			
	Amount of options	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value (*)
Outstanding at the beginning of the period	792,763	$ 1.33	6.88	$ 411
Outstanding at the end of the period	792,763	$ 1.33	6.13	$ 81
Exercisable options at the end of the period	488,513	$ 1.20	4.82	$ 78

(*) Calculation of aggregate intrinsic value is based on the share price of the Company's common stock as of September 30, 2012 ($ 1.35 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.)

a. Stock option plans (cont.):

4. 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 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 month of 2012. The fair value for options granted in the three and nine months ended September 30, 2011 is amortized over their vesting period using a straight-line recognition method and estimated at the date of grant with the following assumptions:

	Three months ended September 30, 2011 Unaudited	Nine months ended September 30, 2011 Unaudited
Dividend yield	0%	0%
Expected volatility	83%	83%
Risk-free interest rate	1.19%	1.73%
Expected life (in years)	6.25	6.25

The total employee's equity-based compensation expense related to all of the Company's equity-based awards, recognized for the nine months and three months ended September 30, 2012 is comprised as follows:

	Nine months ended		Three months ended	
	September 30, 2012 Unaudited	September 30, 2011 Unaudited	September 30, 2012 Unaudited	September 30, 2011 Unaudited
Sales and marketing expenses	5	8	2	0
General and administrative	96	49	38	(13)
Total employees equity-based compensation expense	101	57	40	(13)

The weighted-average grant-date fair value of options granted during the first nine months of 2011 was $1.16.

As of September 30, 2012, there was $ 297 of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under the stock option plans. That cost is expected to be recognized over a period of the next 35 months.

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

NOTE 4:- ACCOUNTING FOR STOCK-BASED COMPENSATION (Cont.)

b. Employee Stock Ownership Plan:

The Company has an Employee Stock Ownership Plan ("ESOP") covering eligible employees. The ESOP provides for the Employee Stock Ownership Trust ("ESOT") to distribute shares of the Company's Common shares as retirement benefits to the participants. The Company has not distributed shares since 1998. As of September 30, 2012, the ESOT held 167,504 shares of common stock.

NOTE 5:- ACQUISITION OF SHARES OF TELKOOR

On June 16, 2011 the Company has acquired 1,136,666 shares of Telkoor, a major shareholder of the Company and an Israeli company listed in the Tel Aviv stock exchange, for $0.88 (NIS 3) per share, which represents 8.8% of the outstanding shares of Telkoor. As a result of this transaction, an existing manufacturing agreement between Digital Power and Telkoor will be updated and extended. In the prior periods the investment was accounted for as available-for-sale securities. In September 2012, the investment has been accounted for under cost method as Telkoor shares do not have readily determinable fair value on the Tel Aviv Stock Exchange. The Company evaluated the fair value of the investment with assistance of a third party valuation. Other than temporary impairment loss of $218 was recognized in finance expenses in the three months ended September 30, 2012.

NOTE 6:- NET INCOME (LOSS) PER SHARE

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

1. Numerator:

	Nine months ended September 30,		Three months ended September 30,	
	2012	2011	2012	2011
	Unaudited			
Net income (loss) available to Common shareholders	$ 86	$ 1,027	$ (467)	$ 449

2. Denominator:

	Nine months ended September 30,		Three months ended September 30,	
	2012	2011	2012	2011
	Unaudited			
Denominator for basic net income (loss) per share of	6,855,501	6,713,978	6,863,150	6,731,556

weighted average number of common shares				
Effect of dilutive securities:				
Employee stock options	131,083	144,424	70,451	144,021
Denominator for diluted net income (loss) per common share	6,986,584	6,858,402	6,933,601	6,875,577

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

NOTE 7:- SEGMENTS

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 (formerly SFAS No. 131) "Segment Reporting".

	Nine months ended September 30, 2012 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$ 4,010	$ 2,851	$ -	$ 6,861
Intersegment revenues	379	56	(435)	-
Total revenues	$ 4,389	$ 2,907	$ (435)	$ 6,861
Depreciation and amortization	$ 36	$ 114	$ -	$ 150
Operating income	$ 145	$ 199	$ -	$ 344
Financial expense, net				$ (238)
Tax expense				$ (20)
Net income (loss)	$ 125	$ (39)	$ -	$ 86
Expenditures for segment assets	$ 67	$ 14	$ -	$ 81
Identifiable assets	$ 3,970	$ 3,532	$ -	$ 7,502

	Nine months ended September 30, 2011 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$ 5,046	$ 4,128	$ -	$ 9,174
Intersegment revenues	368	11	(379)	-
Total revenues	$ 5,414	$ 4,139	$ (379)	$ 9,174
Depreciation and amortization	$ 19	$ 32	$ -	$ 51
Operating income	$ 566	$ 523	$ -	$ 1,089
Financial expense, net				$ (13)
Tax expense				$ (49)
Net income	$ 518	$ 509	$ -	$ 1,027
Expenditures for segment assets	$ 21	$ 22	$ -	$ 43
Identifiable assets	$ 3,968	$ 3,208	$ -	$ 7,176

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

NOTE 7:- SEGMENTS (Cont.)

	Three months ended September 30, 2012 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$ 1,157	$ 522	$ -	$ 1,679
Intersegment revenues	89	53	(142)	-
Total revenues	$ 1,246	$ 575	$ (142)	$ 1,679
Depreciation expense	$ 13	$ 38	$ -	$ 51
Operating loss	$ (102)	$ (144)	$ -	$ (243)
Financial expenses, net				$ (216)
Tax expense				$ (8)
Net income (loss)	$ (107)	$ (360)	$ -	$ (467)
Expenditures for segment assets	$ 10	$ -	$ -	$ 10
Identifiable assets	$ 3,970	$ 3,532	$ -	$ 7,502

	Three months ended September 30, 2011 (unaudited)			
	DPC	DPL	Eliminations	Total
Revenues	$ 1,722	$ 1,302	$ -	$ 3,024
Intersegment revenues	131	6	(137)	-
Total revenues	$ 1,853	$ 1,308	$ (137)	$ 3,024
Depreciation expense	$ 10	$ 10	$ -	$ 20
Operating income	$ 246	$ 228	$ -	$ 474
Financial expenses, net				$ 14
Tax expense				$ (39)
Net income	$ 208	$ 241	$ -	$ 449
Expenditures for segment assets	$ 17	$ (1)	$ -	$ 16
Identifiable assets	$ 3,968	$ 3,208	$ -	$ 7,176

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

GENERAL

Digital Power Corporation is a solution-driven organization that designs, develops, manufactures and sells high-grade customized and flexible power system solutions for the most demanding applications in the medical, military, telecom and industrial markets. We are highly focused on high-grade and custom product designs for 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 Amex under the symbol "DPW". Our corporate headquarters are located in the heart of the Silicon Valley.

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

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

We market and sell our products to many diverse market segments, including the telecom, industrial, medical and military/defense industries. Our products serve a global market, with an emphasis on North America, Europe and the Far East. We offer a broad product variety, including a full custom product design and production, unique high-speed switching power front-end, modified-standard and value added products of Open-Frame, Compact PCI,

Micro TCA, ATCA Front-End, PoE (Power over Ethernet), Inverter, UPS, and complete custom power product solutions for commercial and military marketplaces, providing power output from 50 watts to 72,000 watts.

In an effort to provide short lead-times, high quality products and competitive pricing to support our markets, we have entered into production agreements with several contract manufacturers located in Asia, primarily China. These agreements allow us to better control production costs and ensure high quality products deliverable in a timely manner to meet market demand. However, we use domestic manufacturers to manufacture prototypes, “short production run” and our military products.

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

RESULTS OF OPERATIONS

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2012, COMPARED TO SEPTEMBER 30, 2011

Revenues

Our revenues decreased by $1.3 million, or 44%, to $1.7 million for the three months ended September 30, 2012, from $3.0 million for the three months ended September 30, 2011. The decrease in revenues was mainly due to decrease in shipment of our custom products to the commercial markets and shipments to the military markets.

Revenues from our U.S. operations decreased by $565,000 or 32.8% to $1.2 million for the three months ended September 30, 2012, from $1.7 million for the three months ended September 30, 2011. Revenues from our European operations decreased by $780,000 or 59.9% to $522,000 from $1.3 million in three months ended September 30, 2012. The decrease in revenues in our U.S. operations was attributable to decreased sales of custom products to the commercial market while the decrease in the revenues from European operations was primarily due to decreased sales to military market.

For the nine months ended September 30, 2012, our revenues decreased by 25.2% to $6.8 million from $9.2 million for the nine months ended September 30, 2011. The decrease in the revenues was attributable to end of life of certain military products of our European operations and lower demand due in the domestic operations.

For the nine months ended September 30, 2012, revenues from our U.S. operations decreased by $1.0 million or 20.5% to $4.0 million from $5.0 for the nine months ended September 30, 2011. Revenues from our European operations decreased by $1.3 million or 30.9% to $2.9 million from $4.1 million.

Gross Margins

Gross margins decreased to 38.2% for the three months ended September 30, 2012, compared to 40.8% for the three months ended September 30, 2011. Gross margins for the nine months ended September 30, 2012 increased to 41.5% compared to the gross margins of 39.0% for the nine months ended September 30, 2011. The decrease in the margin for the three months ended September 30, 2012 as compared to the same period in 2011 was due to lower sales. The increase in gross margins for the nine months ended September 30, 2012 was mainly due to lower pricing offered by suppliers and improved product mix.

Engineering and Product Development

Engineering and product development expenses were $191,000 for the three months ended September 30, 2012, compared to $186,000 for the three months ended September 30, 2011. Engineering and product development expenses were $513,000 for the nine months ended September 30, 2012 as compared to $388,000, for the nine months ended June 30, 2011. The overall increase in our engineering and product development expenses was mainly due to increased spending on consulting costs related to additional custom products.

Selling and Marketing

Selling and marketing expenses were $270,000 for the three months ended September 30, 2012 as compared to $250,000 for the three months ended September 30, 2011. Selling and marketing expenses were $760,000 for the nine months ended September 30, 2012 as compared to $514,000 for the nine months ended September 30, 2011. The increase in the absolute dollars of selling and marketing expenses was primarily due to higher expense in marketing headcount.

General and Administrative

General and administrative expenses were $424,000 for the three months ended September 30, 2012 as compared to $303,000 for the three months ended September 30, 2011. General and administrative expenses were $1.2 million for the nine months ended September 30, 2012 as compared to $882,000 for the nine months ended September 30, 2011. The increase in general and administrative expenses during the three and nine months ended September 30, 2012 was mainly due higher legal and consulting fees.

Financial Income (Expense)

Financial expense was $216,000 for the three months ended September 30, 2012 compared to financial income of $14,000 for the three months ended September 30, 2011. Financial expense was $238,000 for the nine months ended September 30, 2012 compared to financial expense of $13,000 for the nine months ended September 30, 2011. The change in financial results was primarily due to impairment of investment in Telkoor stock which is recorded on fair value.

LIQUIDITY AND CAPITAL RESOURCES

On September 30, 2012, we had cash and cash equivalents of $1.9 million and working capital of $4.4 million. This compared with cash and cash equivalents of $1.8 million and working capital of $3.8 million at December 31, 2011. The increase in cash and cash equivalents and working capital was due mainly to net cash provided by operating activities of $170,000.

Net cash used in investing activities was $81,000 for the nine months ended September 30, 2012 compared to $1,034,000 for the nine months ended September 30, 2011. The net usage of cash for investing activities in 2011 was due mainly to a purchase of available for sale securities of Telkoor.

Net cash provided by financing activities was $33,000 for the nine months ended September 30, 2011 due to a employees' options exercised. There were no cash flows from financing activities for the nine months ended September 30, 2012.

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

CRITICAL ACCOUNTING POLICIES

In our Annual Report on Form 10-K for the year ended December 31, 2011, 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.

The Company reclassified its investment in Telkoor's shares from Available-For –Sale investment into an investment recorded at cost based on the estimated fair value in the reclassification date. Unrealized losses that are considered other than temporary are recognized as finance expenses in the income statement. In the earlier periods, this investment was recorded at market value and all differences in the market value were recognized through other comprehensive income.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable for a smaller reporting company.

ITEM 4T. 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 changes in our internal control over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See our disclosures under “Legal Proceedings” in our Annual Report on Form 10-K, filed April 3, 2012. There have been no material developments in those proceedings since that filing.

ITEM 1A. RISK FACTORS

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

Although we generated operating income and a net income during the nine months ended September 30, 2012, we experienced an operating loss and a net loss during the three months ended September 30, 2012, we have historically experienced net losses and we may experience net losses in the future.

For the nine months ended September 30, 2012, we had an operating income of $344,000 and a net income of $86,000 compared to an operating loss of $459,000 and a net loss of $467,000 for the three months ended September 30, 2012. 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 continue to increase revenues by selling current and custom design products, and continue seeking manufacturing cost reductions through offshore strategic agreements with contract manufacturers.

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

We depend on Telkoor, our largest shareholder and one of our third party subcontractors, for design and manufacturing capabilities for some of the products that we sell. If Telkoor is unable or unwilling to continue designing or manufacturing our products in required volumes and with a certain level of quality on a timely basis, that could lead to loss of sales and adversely affect our operating results and cash position. We also depend on Telkoor's intellectual property and ability to transfer production to third party manufacturers. Failure to obtain new products in a timely manner or delay in delivery of 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 Telkoor's products could be adversely affected by Telkoor's agreements with other companies, long lead-times and the high cost of Telkoor's products. For example, in April 2008 Telkoor signed a "private label" agreement with Murata Power Solutions ("MPS") in Canada to manufacture and sell Telkoor's products under the Murata brand name, an agreement which positioned Murata as a direct competitor to us with respect to selling Telkoor's products in North America.

Also, in 2010, Telkoor's manufacturing lead-times increased, which has hindered our ability to respond to our customers' needs. Telkoor's principal offices, research and development and manufacturing facilities are located in Israel. Political, economic, and military conditions in Israel directly affect Telkoor's operations. We are also dependent upon Telkoor's terms and conditions with its contract manufacturers for some of our products, which terms and conditions may not always be in our best interest. In 2010, the Company purchased a certain IP from Telkoor in order to reduce its dependency on Telkoor with respect to a certain line of products.

Beginning in 2010, Telkoor made the decision to not offer Digital Power manufacturing rights on their newer technology, which prevents us from cost-reducing these products. This requires us to buy finished goods directly from Telkoor which, in turn, affects our ability to sell these products at competitive prices.

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

Affected by the 2009 global recession and the recent tsunami and nuclear crises in Japan, many of our raw material vendors have reduced capacities, closed production lines and, in some cases, even discontinued their operations. As a result, there is a global shortage of certain electronic components, which has extended our production lead-time and our production costs. For example, in some cases, finished goods that used to be available in 12 weeks for a production purchase order are now available only after 22 weeks. Also, some materials are no longer available to support some of our products, thereby requiring us to search for cross materials or, even worse, redesign some of our products to support currently-available materials. Such redesign efforts may require certain regulatory and safety agency re-submittals, which may cause further production delays. While we have initiated actions that we believe will limit our exposure to such problems, the dynamic business conditions in many of our markets may challenge the solutions that have been put in place, and issues may recur in the future.

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

products manufactured.

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

As a result of our strategic focus on custom power 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. A failure to meet these customer product requirements or a failure to meet production schedules and/or product quality standards may put us at risk with one or more of these customers. The loss of one or more of our significant custom power supply solution customers could have a material adverse impact on our revenues, business or financial condition.

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

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

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

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

Our success depends on our ability to attract, retain and motivate our key management personnel, including, but not limited to, our CEO, CFO, marketing & sales, and key engineers, necessary to implement our business plan and to grow our business. Despite the adverse economic conditions at this time, and those occurring over the past several years, competition for certain specific technical and management skill sets is intense. If we are unable to identify and hire the personnel that we need to succeed, or if one or more of our present key employees were to cease to be associated with us, our future results could be adversely affected. Our CEO, Amos Kohn, also currently serves as our CFO on an interim basis until the Company appoints a new CFO. Mr. Kohn will continue to serve in his role as our CEO.

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

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

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

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

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

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

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

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

We operate in an industry that is generally characterized by intense competition. We believe that the principal bases of competition in our markets are breadth of product line, quality of products, stability, reliability and reputation of the provider, along with cost. Quantity discounts, price erosion, and rapid product obsolescence due to technological improvements are therefore common in our industry as competitors strive to retain or expand market share. Product obsolescence can lead to increases in un-saleable 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 manufacturers' representative OEM relationships and our other distributors.

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 manufacturers' 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.

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

A 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 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") rules, which are interpreted, enforced and administered by the U.S. Department of State. These regulations implement the provisions of the Arms Export Control Act, the goal of which is to safeguard U.S. national security and further U.S. foreign policy objectives. ITAR controls not only the export, import and trade of certain products specifically designed, modified, configured or adapted for military systems, but also the export of related technical data and defense services as well as foreign production. Any delays in obtaining the required export, import or trade licenses for products subject to ITAR rules could have a materially adverse effect on our business, financial condition, and/or operating results. In addition, changes in United States export and import laws that require us to obtain additional export and import licenses or delays in obtaining export or import licenses currently being sought could cause significant shipment delays and, if such delays are too great, could result in the cancellation of orders. Any future restrictions or charges imposed by the United States or any other country on our international sales or foreign subsidiary could have a materially adverse

effect on our business, financial condition, and/or operating results. In addition, from time to time, we have entered into contracts with the Israeli Ministry of Defense which were funded with monies subject to, and we therefore were required to comply with the regulations governing, the U.S. Foreign Military Financing program. Any such future sales would be subject to such regulations.

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

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

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

Sales to customers outside of North America accounted for 44.9% of net revenues during the nine months ended September 30, 2012, 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.

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

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

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

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

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

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

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

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

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

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

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

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

Our products are complex, and despite extensive testing, may contain defects or undetected errors or failures that may become apparent only after our products have been shipped to our customers and installed in their network or after product features or new versions are released. Any such defect, error or failure could result in failure of market acceptance of our products or damage to our reputation or relations with our customers, resulting in substantial costs for us and for 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.

If Telkoor's share market value will continue to decrease it may have a material adverse effect on our results of operations.

During the second quarter of 2011, we invested in our major shareholder – Telkoor Telecom Ltd. (a publicly traded company in Israel) through our wholly own subsidiary, DPL. This strategic investment was classified as an available-for-sale security and was recorded in our financial statements at the market value. Under United States generally accepted accounting principles ("U.S. GAAP"), unrealized losses are reflected as "accumulated other comprehensive loss" in the equity, unless there is deemed to be a permanent decrease in market value. During the three months ended September 30, 2012, we reclassified this investment and recorded it at cost or fair value, whichever is lower. Based on the fair value analysis, we recorded a other than temporary impairment loss of $218,000 during the three months ended September 30, 2012. We have recorded this loss under Finance expense on the income statement.

Our common stock price is volatile.

Our common stock is listed on the NYSE Amex and is thinly traded. In the past, our trading price has fluctuated widely, depending on many factors that may have little to do with our operations or business prospects. The exercise

of outstanding options and warrants may adversely affect our stock price and a shareholder's percentage of ownership. As of September 30, 2012, we had outstanding exercisable options to purchase an aggregate of 488,513 shares of common stock, with a weighted average exercise price of $1.20 per share.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. RESERVED

ITEM 5. OTHER INFORMATION

On November 20, 2012, the Company issued a press release announcing its financial results for the second quarter ended September 30, 2012. A copy of the press release is furnished as Exhibit 99.1 hereto.

On July 31, 2012, we received a letter from the SEC in relation to our Form 10-K for the year ended December 31, 2011 file on April 3, 2012 and our Form 10-Q Amendment No. 1 for the quarter ended March 31, 2012 filed on May 25, 2012. Our response was filed with the SEC and we have received no further comments from them.

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	Bylaws of Digital Power Corporation (1)
10.1	1996 Digital Power Stock Option Plan (1)
10.2	1998 Digital Power Stock Option Plan (2)
10.3	2002 Digital Power Stock Option Plan (3)
10.4	Lease, dated as of August 21, 2007, between the Company and SDC Fremont Business Center, Inc. (4)
10.5	Employment Agreement with Amos Kohn (5)
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer and Chief Financial Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.1	Press Release, dated August 10, 2011, 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

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(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 10.7 to the Company's Form 10-KSB for the year ended December 31, 1998.

(3) Previously filed with the Commission as Exhibit A to the Company's Proxy Statement filed on September 5, 2002.

(4) Previously filed with the Commission as Exhibit 10.1 to the Company's Form 8-K filed on October 22, 2007.

(5)

Previously filed with the Commission as Exhibit 10.1 to the Company's Form 8-K filed on July 10, 2008.

** 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 20, 2012

Digital Power Corporation

By: /s/ Amos Kohn
Amos Kohn
President, Chief Executive Officer and Chief Financial Officer
(Principal Executive Officer and Principal Financial Officer)

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540

840.4

802.0

671

674

Total

$

2,874

$

2,866

1,799.3

1,786.9

1,597

1,604

	First Six Months					
	Revenues		Units		Revenue per Unit	
	2012	2011	2012	2011	2012	2011
	($ in millions)		(in thousands)		($ per unit)	
Coal	$ 1,521	$ 1,709	713.8	808.7	$ 2,130	$ 2,113
General merchandise:						
Agriculture/consumer/gov't	740	720	302.4	305.7	2,446	2,357
Chemicals	741	693	194.5	191.1	3,808	3,629
Metals and construction	711	589	345.7	321.7	2,057	1,830
Automotive	465	375	194.7	163.2	2,388	2,297
Paper/clay/forest	395	375	153.6	158.8	2,573	2,361
General merchandise	3,052	2,752	1,190.9	1,140.5	2,563	2,413
Intermodal	1,090	1,025	1,625.4	1,548.9	671	662
Total	$ 5,663	$ 5,486	3,530.1	3,498.1	1,604	1,568

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Coal

Coal revenues decreased $138 million, or 15%, in the second quarter, reflecting a 12% decrease in traffic volume and a 4% decline in average revenue per unit as compared with the same period last year. For the first six months, coal revenues decreased $188 million, or 11%, reflecting a 12% decline in traffic volume, partially offset by a 1% improvement in average revenue per unit. Coal tonnage by market was as follows:

	Second Quarter		First Six Months	
	2012	2011	2012	2011
	(tons in thousands)			
Utility	23,527	29,455	49,788	60,965
Export	8,530	7,938	15,254	15,376
Domestic metallurgical	5,019	4,859	9,591	8,633
Industrial	1,880	1,906	3,801	3,731
Total	38,956	44,158	78,434	88,705

Utility coal tonnage decreased 20% in the second quarter and 18% in the first six months, reflecting competition from low natural gas prices and reduced electrical demand in NS-served regions. Export coal tonnage increased 7% in the second quarter due to strong thermal shipments, but decreased 1% in the first six months. Both periods were negatively impacted by the return of Australian supply and weaker global demand for steel production. Domestic metallurgical coal tonnage was up 3% in the second quarter and 11% in the first six months, as domestic steel production improved and a softening export coal market increased coking coal availability for the domestic market.

Coal revenues for the remainder of the year are expected to decrease compared to last year due to lower average revenue per unit and lower traffic volumes.

General Merchandise

General merchandise revenues increased $123 million, or 9%, in the second quarter and $300 million, or 11%, in the first six months as compared with the same periods last year. Both increases reflect improvements in average revenue per unit (up 5% for the quarter and 6% for the first six months) and traffic volume (up 4% in both periods).

Agriculture, consumer products, and government volume was flat during the second quarter, but decreased 1% for the first six months. The first six months reflected reduced corn shipments driven by plant closures and fewer shipments of fertilizer due to certain network classification changes. These volume declines were offset in part by more revenue movements of empty equipment, as well as more shipments of corn-based feed to Texas.

Chemicals volume increased 3% in the second quarter and 2% for the first six months, reflecting more shipments of crude oil, additional shipments of liquefied petroleum gas, and improved shipments of plastics driven by increased demand for plastic bottles. These volume increases were offset in part by fewer shipments of rock salt as the recent mild winter resulted in higher inventory levels, as well as reduced shipments of chlor-alkali traffic due to soft domestic demand for chlorine.

Metals and construction volume increased 4% in the second quarter and 7% for the first six months, reflecting higher shipments of fractionating sand for natural gas drilling, as well as more shipments of coil and scrap metal driven by increased steel and automotive production. The first six months also reflected more iron and steel shipments.

Automotive volume grew 16% in the second quarter and 19% for the first six months, primarily a result of increased North American light vehicle production at NS-served plants, in addition to new business.

Paper, clay, and forest products volume was down 3% in the second quarter and for the first six months, reflecting reduced shipments of miscellaneous wood driven by the loss of business. Both periods also reflect fewer shipments of pulp due to declining consumption.

General merchandise revenues for the remainder of the year are expected to increase compared to last year due to higher traffic volumes and slightly higher average revenue per unit.

Intermodal

Intermodal revenues increased $23 million, or 4%, in the second quarter, compared with the same period last year, reflecting a 5% increase in traffic volumes and a slight decline in average revenue per unit. For the first six months, intermodal revenues increased $65 million, or 6%, reflecting a 5% increase in traffic volume and 1% improvement in average revenue per unit.

Domestic (which includes truckload and intermodal marketing companies’ volumes) increased 10% for the second quarter and 11% for the first six months, reflecting continued highway conversions.

Premium business, which includes parcel and less-than-truckload (LTL) carriers, increased 3% for the second quarter and 1% for the first six months, reflecting stronger demand.

International traffic volume declined 1% for the second quarter and 2% in the first six months, reflecting the loss of business from a shipping line.

Triple Crown Services, a service with rail-to-highway trailers, experienced a volume decline of 1% in the second quarter due to reduced trailer inventory but an increase of 1% for the first six months, reflecting stronger demand.

Intermodal revenues for the remainder of the year are expected to increase, reflecting higher traffic volumes partially offset by lower average revenue per unit.

Railway Operating Expenses

Second quarter railway operating expenses were $1.9 billion in 2012, down $51 million, or 3%, compared to the same period last year. For the first six months, expenses were $4.0 billion, down $27 million, or 1%, compared to the same period last year. Both periods reflect improved network fluidity which reduced costs despite increased volumes. In addition, second quarter benefited from effective cost control. The first six months also reflects the absence of the prior year's first quarter $58 million unfavorable arbitration ruling. These decreases were offset in part by higher depreciation expense as a result of an increased capital base.

Compensation and benefits expenses decreased $15 million, or 2%, in the second quarter, but increased $6 million in the first six months. Both periods reflect changes in:

· employee activity levels (down $17 million for the quarter and $12 million for the first six months),

· health and welfare benefit costs for employees (down $7 million for the quarter and

$1 million for the first six months),

· payroll taxes (down $4 million for the quarter, but up $2 million for the first six months),

· incentive compensation (up $4 million for the quarter and $3 million for the first six months), and

· pay rates (up $5 million for the quarter and $16 million for the first six months).

The first six months also reflects lower stock-based compensation (down $8 million) and higher pension costs (up $5 million).

Purchased services and rents includes the costs of services provided by outside contractors, the net costs of operating joint (or leased) facilities with other railroads and the net cost of equipment rentals. This category of expenses decreased $13 million, or 3%, for the second quarter and $5 million, or 1%, for the first six months, reflecting lower equipment rents and haulage expenses, which were offset in part by increased costs associated with intermodal operations, and professional and consulting fees. The first six months also reflects increased advertising and utilities expenses.

Fuel expense, which includes the cost of locomotive fuel as well as other fuel used in railway operations, decreased $22 million, or 5%, for the second quarter, but increased $2 million for the first six months. The decrease for the quarter was principally the result of lower fuel prices (locomotive fuel prices declined 3%), which had an impact of $14 million, as well as decreased fuel consumption (locomotive fuel consumption decreased 2%), which had an impact of $8 million. The increase for the first six months was principally the result of higher fuel prices (locomotive fuel prices grew 3%), which had an impact of $23 million, offset in part by decreased fuel consumption (locomotive fuel consumption declined 2%), which had an effect of $21 million.

Materials and other expenses (including the estimates of costs related to personal injury, property damage, and environmental matters) decreased $17 million, or 8%, in the second quarter and $59 million, or 12%, for the first six months. Both periods reflect more favorable personal injury claims development. The quarter also reflects decreased costs for materials, whereas the first six months reflect the absence of the prior year’s unfavorable Graniteville-related arbitration ruling, partially offset by higher costs associated with materials used for equipment and roadway repairs.

The following table shows the components of materials and other expenses:

	Second Quarter		First Six Months	
	2012	2011	2012	2011
	($ in millions)			
Materials	$ 95	$ 103	$ 207	$ 197
Casualties and other claims	30	43	68	142
Other	80	76	160	155
Total	$ 205	$ 222	$ 435	$ 494

The Consolidated Balance Sheets reflect long-term receivables for estimated recoveries from NS’ insurance carriers for claims associated with the January 6, 2005, derailment in Graniteville, S.C. In the first quarter of 2011, NS received an unfavorable ruling for an arbitration claim with an insurance carrier, and was denied recovery of the contested portion ($43 million) of the claim. As a result, NS recorded a $43 million charge during the first quarter of 2011 for the receivables associated with the contested portion of the claim and a $15 million charge for other receivables affected by the ruling for which recovery was no longer probable.

Other Income – Net

Other income – net decreased $3 million in the second quarter and $1 million for the first six months, primarily reflecting higher interest expense on uncertain tax positions (up $5 million for the quarter and $8 million for the first six months) offset in part by higher other miscellaneous income items (up $2 million for the quarter and $7 million for the first six months).

Provision for Income Taxes

The second quarter and year-to-date effective income tax rates were 37.8% and 37.6% in 2012, respectively, compared with 30.0% and 32.7%, respectively, for the same periods last year. The higher effective rates for both periods primarily reflect the absence of the prior year's favorable resolution of an Internal Revenue Service (IRS) examination of NS' 2008 return and review of certain claims for refund ($40 million) and the absence of a favorable reduction in deferred tax expense for state law changes ($19 million).

In December 2010, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act increased bonus depreciation to 100 percent for the period September 2010 through the end of 2011 and allows 50 percent bonus depreciation in 2012. Bonus depreciation does not affect NS' total provision for income taxes or effective tax rate, but does significantly lower current tax expense and the related cash outflows for income taxes paid.

NS' consolidated income tax returns for 2009 and 2010 are being audited by the IRS and NS expects the examinations to be completed by the end of 2012. NS does not expect that the results of the examinations will have a material effect on income tax expense.

FINANCIAL CONDITION AND LIQUIDITY

Cash provided by operating activities, NS' principal source of liquidity, was $1.7 billion for the first six months of both 2012 and 2011. NS had working capital of $110 million at June 30, 2012, compared with $50 million at December 31, 2011, reflecting higher borrowings net of repayments. Cash, cash equivalents, and short-term investment balances totaled $371 million at June 30, 2012, and were invested in accordance with NS' corporate investment policy as approved by the Board of Directors. The portfolio contains securities that are subject to market risk. There are no limits or restrictions on NS' access to the assets. NS expects that cash on hand combined with cash flows from operations will be sufficient to meet its ongoing obligations. During the first quarter of 2012, NS issued $600 million

of 3.0% senior notes due 2022. Other than this item, there have been no material changes to the information on NS' future obligations contained in NS' Form 10-K for the year ended December 31, 2011.

Cash used in investing activities was $932 million in the first six months of 2011, compared with $801 million in the same period last year, reflecting an increase in property additions and a decrease in investment sales, net of purchases.

The Crescent Corridor consists of a program of projects for infrastructure and other facility improvements geared toward creating a seamless, high-capacity intermodal route spanning 11 states from New Jersey to Louisiana and offering truck-competitive service along several major interstate highway corridors, including I-81, I-85, I-20, I-40, I-59, I-78, and I-75. Based on the public benefits that stand to be derived in the form of highway congestion relief, NS plans to implement certain elements of the Crescent Corridor through a series of public-private partnerships. Currently, the Crescent Corridor has received or expects to receive a total of $306 million in public capital funding commitments from the Commonwealths of Pennsylvania and Virginia, the State of Tennessee, the federal TIGER Stimulus Program and other federal funding sources related to projects in Alabama, Pennsylvania, Tennessee, and North Carolina. With respect to the private funding component, NS currently anticipates spending up to $393 million for the substantial completion of work on these projects, which is expected in 2014, including planned investments for the remainder of 2012 of approximately $104 million.

Cash used in financing activities was $651 million in the first six months of 2012 compared with $1.0 billion in the same period last year. The change reflected increased proceeds from borrowings and lower debt repayments and maturities, offset in part by increased share repurchases. Share repurchases were 12.3 million, totaling $850 million in the first six months of 2012, compared to 11.6 million shares, totaling $792 million in the same period last year. The timing and volume of future share repurchases will be guided by management's assessment of market conditions and other pertinent factors. Any near-term purchases under the program are expected to be made with internally generated cash, cash on hand, or proceeds from borrowings. NS' total debt-to-total capitalization ratio was 45.0% at June 30, 2012 and 43.2% at December 31, 2011.

As of June 30, 2012, NS has authority from its Board of Directors to issue an additional $400 million of debt or equity securities through public or private sale. NS has on file with the Securities and Exchange Commission a Form S-3 automatic shelf registration statement for well-known seasoned issuers under which securities may be issued pursuant to this authority.

NS also has in place and available a $750 million, five-year credit agreement expiring in 2016, which provides for borrowings at prevailing rates and includes covenants. NS had no amounts outstanding under this facility at June 30, 2012, and NS is in compliance with all of its covenants. In October 2011, NS renewed its $350 million accounts receivable securitization program with a 364-day term to run until October 2012. There was $100 million and $200 million outstanding under this program at June 30, 2012 and December 31, 2011, respectively.

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. These estimates and assumptions may require significant judgment about matters that are inherently uncertain, and future events are likely to occur that may require management to make changes to these estimates and assumptions. Accordingly, management regularly reviews these estimates and assumptions based on historical experience, changes in the business environment, and other factors that management believes to be reasonable under the circumstances. Management regularly discusses the development, selection, and disclosures concerning critical accounting estimates with the Audit Committee of its Board of Directors. There have been no significant changes to the Application of Critical Accounting Estimates disclosure contained in NS' Form 10-K as of December 31, 2011.

OTHER MATTERS

Labor Agreements

More than 80% of NS' railroad employees are covered by collective bargaining agreements with various labor unions. These agreements remain in effect until changed pursuant to the Railway Labor Act. NS largely bargains nationally in concert with other major railroads, represented by the National Carriers Conference Committee (NCCC). Moratorium provisions in the labor agreements govern when the railroads and the unions may propose changes.

The NCCC has concluded the round of bargaining that began in November 2009 and reached national agreements with all applicable labor unions. Although NS previously concluded separate agreements with each of the Brotherhood of Locomotive Engineers and Trainmen (BLET) and the American Train Dispatchers Association (ATDA) that extend through December 31, 2014, the health and welfare provisions from the national agreements apply to the BLET and ATDA. NS bargains separately with its Ashtabula (Ohio) Docks longshoremen, who are represented by the International Longshoremen's Association (ILA) and do not participate in national bargaining. The present agreement remains in effect and no negotiations are in progress with ILA.

Market Risks

NS manages its overall exposure to fluctuations in interest rates by issuing both fixed- and floating-rate debt instruments. At June 30, 2012, NS' debt subject to interest rate fluctuations totaled $100 million. A 1% point increase in interest rates would increase NS' total annual interest expense related to all its variable debt by $1 million. Management considers it unlikely that interest rate fluctuations applicable to these instruments will have a material adverse effect on NS' financial position, results of operations, or liquidity.

Environmental Matters

NS is subject to various jurisdictions' environmental laws and regulations. It is NS' policy to record a liability where such liability or loss is probable and its amount can be estimated reasonably. Claims, if any, against third parties for recovery of cleanup costs incurred by NS, are reflected as receivables (when collection is probable) in the Consolidated Balance Sheets and are not netted against the associated NS liability. Environmental engineers regularly participate in ongoing evaluations of all known sites and in determining any necessary adjustments to liability estimates. NS also has established an Environmental Policy Council, composed of senior managers, to oversee and interpret its environmental policy.

NS' Consolidated Balance Sheets included liabilities for environmental exposures in the amount of $36 million and $35 million at June 30, 2012 and December 31, 2011, respectively, (of which $12 million is classified as a current liability at the end of each period). At June 30, 2012, the liability represents NS' estimate of the probable cleanup and remediation costs based on available information at 141 known locations and projects. As of that date, seven sites accounted for $17 million of the liability, and no individual site was considered to be material. NS anticipates that much of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At 25 locations, one or more NS subsidiaries in conjunction with a number of other parties have been identified as potentially responsible parties under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, or comparable state statutes that impose joint and several liability for cleanup costs. NS calculates its estimated liability for these sites based on facts and legal defenses applicable to each site and not solely on the basis of the potential joint liability.

With respect to known environmental sites (whether identified by NS or by the EPA or comparable state authorities), estimates of NS' ultimate potential financial exposure for a given site or in the aggregate for all such sites are necessarily imprecise because of the widely varying costs of currently available cleanup techniques, the likely development of new cleanup technologies, unpredictable contaminant recovery and reduction rates associated with available clean-up technologies, the difficulty of determining in advance the nature and full extent of contamination and each potential participant's share of any estimated loss (and that participant's ability to bear it), and evolving statutory and regulatory standards governing liability. NS estimates its environmental remediation liability on a site-by-site basis, using assumptions and judgments that management deems appropriate for each site. As a result, it is not practical to quantitatively describe the effects of changes in these many assumptions and judgments. NS has consistently applied its methodology of estimating its environmental liabilities.

Based on its assessment of the facts and circumstances now known, management believes that it has recorded the probable and reasonably estimable costs for dealing with those environmental matters of which NS is aware. Further, management believes that it is unlikely that any known matters, either individually or in the aggregate, will have a material adverse effect on NS' financial position, results of operations, or liquidity.

Inflation

In preparing financial statements, U.S. generally accepted accounting principles require the use of historical cost that disregards the effects of inflation on the replacement cost of property. NS, a capital-intensive company, has most of its capital invested in such property. The replacement cost of these assets, as well as the related depreciation expense, would be substantially greater than the amounts reported on the basis of historical cost.

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that may be identified by the use of words like "believe," "expect," "anticipate," "estimate," "unlikely," and "project." Forward-looking statements reflect management's good-faith evaluation of information currently available.

However, such statements are dependent on and, therefore, can be influenced by a number of external variables over which management has little or no control, including: transportation of hazardous materials as a common carrier by rail; acts of terrorism or war; general economic conditions; competition and consolidation within the transportation industry; the operations of carriers with which NS interchanges; disruptions to NS' technology infrastructure, including computer systems; labor difficulties, including strikes and work stoppages; commercial, operating, environmental, and climate change legislative and regulatory developments; results of litigation; natural events such as severe weather, hurricanes, and floods; unavailability of qualified personnel due to unpredictability of demand for rail services; fluctuation in supplies and prices of key materials, in particular diesel fuel; and changes in securities and capital markets. For a discussion of significant risk factors applicable to NS, see Part II, Item 1A "Risk Factors." Forward-looking statements are not, and should not be relied upon as, a guarantee of future performance or results, nor will they necessarily prove to be accurate indications of the times at or by which any such performance or results will be achieved. As a result, actual outcomes and results may differ materially from those expressed in forward-looking statements. NS undertakes no obligation to update or revise forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The information required by this item is included in Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the heading "Market Risks."

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Norfolk Southern's Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of NS' disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of June 30, 2012. Based on such evaluation, such officers have concluded that, as of June 30, 2012, NS' disclosure controls and procedures are effective in alerting them on a timely basis to material information relating to NS (including its consolidated subsidiaries) required to be included in NS' periodic filings under the Exchange Act.

(b) Changes in Internal Control Over Financial Reporting

During the second quarter of 2012, management did not identify any changes in NS' internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, NS' internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On November 6, 2007, various antitrust class actions filed against NS and other Class 1 railroads in various Federal district courts regarding fuel surcharges were consolidated in the District of Columbia by the Judicial Panel on Multidistrict Litigation. On June 21, 2012, the court certified the case as a class action. NS believes the allegations in the complaints are without merit and intends to vigorously defend the cases. NS does not believe the outcome of these proceedings will have a material effect on its financial position, results of operations, or liquidity. A lawsuit containing similar allegations against NS and four other major railroads that was filed on March 25, 2008, in the U.S. District Court for the District of Minnesota was voluntarily dismissed by the plaintiff subject to a tolling agreement entered into in August 2008.

NS received a Notice of Violation (NOV) issued by the Tennessee Department of Environmental Conservation concerning soil runoff in connection with construction of an intermodal facility near Memphis, TN. Although NS will contest liability and the imposition of any penalties, this matter is described here consistent with SEC rules and requirements concerning governmental proceedings with respect to environmental laws and regulations. NS does not believe that the outcome of this proceeding will have a material effect on its financial position, results of operations, or liquidity.

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Item 1A. Risk Factors

The risk factors included in NS' 2011 Form 10-K remain unchanged and are incorporated herein by reference.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Period	(a) Total Number of Shares (or Units) Purchased(1)	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs(2)	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that may yet be the Plans or Programs(2)
April 1-30, 2012	1,615,750	$68.13	1,615,750	8,119,421
May 1-31, 2012	2,959,092	$68.08	2,956,676	5,162,745
June 1-30, 2012	2,085,886	$66.41	2,079,075	3,083,670
Total	6,660,728		6,651,501	

(1) Of this amount, 9,227 represents shares tendered by employees in connection with the exercise of stock options under the Long-Term Incentive Plan.

(2) On November 22, 2005, the Board of Directors authorized a share repurchase program, pursuant to which up to 50 million shares of Common Stock could be purchased through December 31, 2015. On March 27, 2007, the Board of Directors amended the program and increased the number of shares that may be repurchased to 75 million, and shortened the repurchase term by five years to December 31, 2010. On July 27, 2010, NS' Board of Directors authorized the repurchase of up to an additional 50 million shares of Common Stock through December 31, 2014.

Item 6. Exhibits

See Exhibit Index beginning on page 32 for a description of the exhibits filed as part of this report.

SIGNATURES

Pursuant to 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.

NORFOLK SOUTHERN CORPORATION

Registrant

Date: July 27, 2012 /s/Howard D. McFadden

Howard D. McFadden

Corporate Secretary (Signature)

Date: July 27, 2012 /s/C. H. Allison, Jr.

C. H. Allison, Jr.

Vice President and Controller

(Principal Accounting Officer) (Signature)

EXHIBIT INDEX

15* Letter regarding unaudited interim financial information.

31* Rule 13a-14(a)/15d-014(a) Certifications.

32* Section 1350 Certifications.

101* The following financial information from Norfolk Southern Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, formatted in Extensible Business Reporting Language (XBRL) includes (i) the Consolidated Statements of Income for each of the three and six-month periods ended June 30, 2012 and 2011; (ii) the Consolidated Statements of Comprehensive Income for each of the three and six-month periods ended June 30, 2012 and 2011; (iii) the Consolidated Balance Sheets as of June 30, 2012, and December 31, 2011; (iv) the Consolidated Statements of Cash Flows for each of the six-month periods ended June 30, 2012 and 2011; and (v) the Notes to Consolidated Financial Statements.

* Filed herewith.