
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Fiscal Year Ended December 31, 2011

Commission File Number 001-35256

DSP GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation and organization)

94-2683643
(I.R.S. Employer
Identification No.)

2580 North First Street, Suite 460, San Jose, CA 95131
(Address of principal executive offices, including zip code)

(408) 986-4300
(Registrant's telephone number)

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, \$.001 per share
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 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 (Do not check if a smaller reporting company) Smaller reporting company

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

As of June 30, 2011, the aggregate market value of voting stock held by non-affiliates of the Registrant, based on the closing price of the Common Stock on June 30, 2011 as reported on the NASDAQ Global Select Market, was approximately \$98,778,269 million. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded from this computation in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 7, 2012, the Registrant had outstanding 22,731,823 shares of Common Stock.

Documents incorporated by reference: Portions of the Registrant's proxy statement to be filed pursuant to Regulation 14A within 120 days after Registrant's fiscal year end of December 31, 2011 are incorporated herein by reference into Item 5 of Part II and Items 10, 11, 12, 13 and 14 of Part III of this annual report.

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This report and certain information incorporated herein by reference contain forward-looking statements, which are provided under the “safe harbor” protection of the Private Securities Litigation Reform Act of 1995. All statements included or incorporated by reference in this report, other than statements that are purely historical in nature, are forward-looking statements. Forward-looking statements are generally written in the future tense and/or are preceded by words such as “will,” “may,” “should,” “could,” “expect,” “suggest,” “believe,” “anticipate,” “intend,” “plan,” or other similar words. Forward-looking statements include statements regarding:

- Our belief that we are prepared to meet the exciting challenges of the dynamic and evolving market for short-range multimedia communication and home wireless networking by our ability to integrate voice, data and video technologies;*
- Our belief that the company’s future growth depends on market acceptance and penetration of our next generation products, such as the XpandR-based and DECT/CAT-iq-based product;*
- Our belief that the BoneTone technology will enable us to bring additional value to our existing market verticals and address new market verticals, thus expanding our market opportunities;*
- Our belief that international sales will continue to account for a significant portion of our net product sales for the foreseeable future;*
- Our belief that sales of our DECT and 2.4GHz products will continue to represent a substantial percentage of our revenues for 2012;*
- Our belief that the rapid deployment of new communication access methods, as well as the projected lack of growth in fixed-line telephony, will reduce our total revenues derived from, and unit sales of, cordless telephony products, including our DECT, 2.4GHz and 5.8GHz product, for the long term;*
- Our belief that the market will remain price sensitive in 2012 and that price erosion and decrease in our average selling prices of our products will continue;*
- Our belief that we compete favorably in our industry with respect to price, system integration level, range, voice quality, customer support and the timing of product introductions;*
- Our belief that relations with our employees are good;*
- Our belief that the slowdown in demand for cordless telephony products experienced by the industry in 2011 has stabilized and customers are returning to their normalized inventory cycles in 2012;*
- Our belief that the new cost reduction program we implemented, focused mainly on our research and development activities, will result in an additional decrease in research and development expenses;*
- Our belief that annualized revenues generated from our next generation products to increase significantly in 2012 as compared to 2011; and*
- Our belief that our available cash and cash equivalents at December 31, 2011 should be sufficient to finance our operations for both the short and long term.*

This Annual Report on Form 10-K includes trademarks and registered trademarks of DSP Group. Products or service names of other companies mentioned in this Annual Report on Form 10-K may be trademarks or registered trademarks of their respective owners.

PART I

Item 1. BUSINESS.

Introduction

DSP Group, Inc. (NASDAQ: DSPG) is a leading global provider of wireless chipset solutions for converged communications at home and office. Delivering semiconductor system solutions with software and reference designs, DSP Group enables original equipment manufacturers (OEMs), original design manufacturers (ODMs), consumer electronics (CE) manufacturers and service providers to cost-effectively develop new revenue-generating products with fast time to market.

At the forefront of semiconductor innovation and operational excellence for over two decades, DSP Group provides a broad portfolio of wireless chipsets integrating DECT (Digital Enhanced Cordless Telecommunications)/CAT-iq (Cordless Advanced Technology—Internet and Quality), DECT ULE (Ultra Low Energy), Wi-Fi, PSTN (Public Switched Telephone Network), BoneTone™ intelligent voice enhancement and noise elimination, video and VoIP (Voice over Internet Protocol) technologies.

DSP Group enables converged voice, audio, video and data connectivity across diverse consumer and business products, including connected multimedia screens, mobile devices, home automation & security, cordless phones, VoIP systems and home gateways. Leveraging industry-leading experience and expertise, DSP Group partners with CE manufacturers and service providers to shape the future of converged communications at home and office.

We were incorporated in California in 1987 and reincorporated in Delaware in 1994. We completed our initial public offering in February 1994.

In November 2002, we transferred the assets and liabilities of our DSP cores licensing business to one of our then wholly-owned subsidiaries and immediately after the separation, the subsidiary affected a combination with Parthus Technologies plc to form CEVA, Inc. (NASDAQ: CEVA).

In September 2007, we acquired the cordless and VoIP terminals business (the “CIPT Business”) of NXP B.V. (“NXP”), then a part of NXP’s Mobile and Personal Business Unit. The CIPT Business products have been fully integrated within DSP Group’s product offerings.

In December 2011, we exercised our option from 2009 to acquire all of the equity interests of BoneTone Communications Ltd. (“BoneTone”), a provider of innovative bone conduction technology for intelligent voice enhancement and noise elimination that redefine audio quality and voice intelligibility in mobile devices and headsets, enabling us to enter new markets.

Industry Environment and Our Business

Over the past two decades, the desire to leverage existing telecommunications infrastructure, compounded by the increased use of new data-intensive computing, communication and video applications, is driving the convergence of voice, audio, data and video.

Our focus on the design of highly-integrated, mixed-signal devices that combine complex RF (radio frequency), analog and digital functions enables us to address the complex challenges of integrating various technologies, platforms and processes posed by these emerging trends in the communications industry. Our integrated circuit (IC) products are customizable, achieve high functionality and performance at reduced power consumption, especially for cordless telephony, IP telephony, multimedia products and home automation devices that require very low power consumption, and can be manufactured in high volumes using cost-effective process technologies. Our systems architecture provides an open design environment for ODMs to design and market their own end products with maximum differentiation.

Our expertise and investment in software development, including Board Support Package (BSP) and drivers layer, telephony, communication and power management stacks, application layer in Real-time Operating System (RTOS) and Full Featured Operating System (FFOS) frameworks, enable our customers fast time to market with cost- and performance-optimized solutions.

In response to the growing trend towards wireless residential and business connectivity in the past few years, we developed and are offering leading wireless voice and data transmission solutions for various applications. Since 1999, we have developed various technologies, including Direct Sequence Spread Spectrum (DSSS), Frequency Hopping Spread Spectrum (FHSS), Orthogonal Frequency Digital Modulation (OFDM), Digital Narrow Band, Complementary Metal Oxide Semiconductor (CMOS), Gallium Arsenide (GaAs) technology, and Silicon Germanium (SiGe) RF chips for 900MHz, 2.4GHz and 5.8GHz Industry Scientific and Medical (ISM) bands, European DECT (1.9GHz), DECT 6.0 (1.8GHz), Korean DECT (1.7GHz), Bluetooth (2.4GHz) and Wi-Fi (802.11, 2.4GHz/5GHz). With the acquisition of the CIPT Business in 2007, we added both BiCMOS (Bipolar CMOS) and deep sub-micron CMOS technologies to our portfolio of technologies.

Committed to advancing technology across the CE and telecommunications markets, DSP Group is actively involved in prominent industry associations, including the DECT Forum, the European Telecommunications Standards Institute and the Wi-Fi Alliance. DSP Group is also deeply involved in all stages of defining DECT CAT-iq as well as DECT ULE standards and is building full eco-systems to support these solutions. We are an active member of the Home Gateway Initiative (HGI), and support the specification activities of CableLabs, which is contributing to the evolution and implementation of CAT-iq in various markets and applications. Such involvement enables us to define standards and keep abreast of the latest innovations and requirements. We also maintain close relationships with many world-leading telecommunication service providers, thereby providing us with insight into future plans across the industry.

With the recent acquisition of BoneTone and the addition of their innovative intelligent voice enhancement and noise elimination technology to our product portfolio, we are able to bring additional value to our existing market verticals and address new market verticals, including mobile devices and headsets markets, thus expanding our market opportunities.

Target Markets and DSP Group Products

Our work in the field of wireless residential and business technologies has yielded various synergistic product families. We believe that we are prepared to meet the exciting challenges of the dynamic and evolving markets for short-range multimedia communication and home wireless networking with our ability to integrate voice, data, audio and video technologies.

As further discussed below, the acquisition of the CIPT Business significantly enhanced our product portfolio, especially in the cordless telephony and VoIP areas, whereas the acquisition of BoneTone enhanced our offerings in the cellular telephony, headsets and portable devices areas.

In response to market trends, we are concentrating our development efforts on new products, also referred to as next generation products, and opportunities to leverage our strong technology base and customer relationships to address evolving market opportunities and take advantage of the current market trends in our domain. Our next generation products include three main groups of products: (i) DECT/CAT-iq ICs targeted for residential gateway devices supplied by telecommunication service providers and which integrate the DECT/CAT-iq functionality and address the newly evolving market of smart home phones and home automation applications; (ii) VoIP products for enterprise, home and SoHo; and (iii) products for the mobile market in the form of fixed-mobile convergence solutions and products targeted for mobile headsets.

Products Targeted for Cordless Telephony, Home Gateways and Home Automation Market

Our DECT, 2.4 GHz and 5.8 GHz technologies are targeted at three broad categories of products: (a) digital cordless telephony, (b) home automation & security applications and (c) gateways, both home gateways and fixed mobile convergence.

We are a world-leading provider of chipsets for cordless telephony applications. Our XceedR cordless chipsets provide a total integrated digital cordless solution, home automation & security solution and home gateway solution, all of which include all required digital baseband, analog interface and RF functionality.

XceedR enables worldwide coverage, supporting all RF bands and cordless protocols, such as:

1.7GHz -1.9GHz DECT – used in Europe, U.S. (DECT6.0), Korea, Japan and Latin America;

2.4GHz – used in Japan, China and the U.S.; the dominant protocols for this RF band is our proprietary EDCT (Enhanced Digital Cordless Technology) and WDCT (Wireless Digital Cordless Technology) protocols; and

5.8GHz – used in the U.S., Australia and several other countries with our proprietary EDCT cordless protocol.

The XceedR chipset portfolio combines wireless communications technology with a range of telephony features, and audio and voice-processing algorithms to provide the industry a low cost and small footprint solution. Enhanced with our hardware and software packages, XceedR chipsets are highly versatile and enable the development of an array of cordless telephony solutions at a lower effort and faster time to market than alternative silicon offerings. The XceedR chipset portfolio supports cordless phones, cordless headsets, remote controls, home gateways, fixed-mobile convergence solutions and home control, monitoring and automation devices.

The XceedR chipset portfolio is comprised of two families—XceedR DCE and XceedR DCX.

The XceedR DCE chipset family is a mature and field-proven family of integrated digital baseband processor RF chipsets. The chipset is used to develop fully integrated cordless telephone systems, digital answering machines, digital voice recorders (DVRs), digital baby monitors, and other low-to-mid-range audio applications. Including the industry's most advanced digital cordless solutions, the XceedR DCE family maintains multi-line, multi-handset and digital answering machine capabilities, while supporting various RF protocols such as DECT (1.7GHz-1.9GHz), FHSS DECT 2.4GHz, EDCT 2.4GHz and 5.8GHz. Integration of the TeakLite™ RISC DSP core into the DE56 baseband chip enables software implementation of a variety of voice coders, and provides a flexible platform for developing a wide range of solutions. With its DSP-based architecture, the chipset enables cost-effective incorporation of the most advanced audio and telephony features.

The XceedR DCX chipset family is the next step in flexibility and performance for digital cordless applications. Combining state-of-the-art RF and ARM9 baseband functions in a single package with a rich set of telephony features and advanced audio-processing capabilities, the DCX provides the best cost-performance solution for mid-to-high-range DECT/DECT6.0/CAT-iq and WDCT cordless applications, home automation & security applications, home gateway applications and fixed mobile convergence applications.

Supporting all RF bands and comprised of Flash-based chips and a full set of ROM-based products with various memory configurations, the XceedR DCX chipset family offers a total integrated solution that includes a digital baseband controller, analog interface, RF transceiver and power amplifier.

Products Targeted for the VoIP Market

In 2004, we developed an IP cordless phone that enables connectivity to a broadband line feeding VoIP with cordless phone capabilities.

We continue to sell our current line of VoIP speech co-processors, which are DSP core-based, highly-integrated speech processors, targeted at the low to medium density Integrated Access Device (IAD), residential gateway and VoIP telephony markets.

In 2005, we developed an integrated CoIP (Communications over Internet Protocol) telephony system that supports both PSTN line and broadband for the VoIP residential market, supporting Session Initiation Protocol together with advanced TR-069 protocol, thereby enabling telecommunication operators' remote control and remote upgrade of VoIP products.

The acquisition of the CIPT Business enhanced our customer base for the VoIP market by adding major telecom brands to our customer base in Europe and Asia.

Since 2008, we have been selling products for the CoIP market while developing a new platform based on ARM9, the VegaFireBird and VegaOne system-on-a-chip (SoC) products, to the advanced IAD (Integrated Access Device) market.

During 2010, we launched a new VoIP chipset based on the VegaFireBird SoC and our RF products combining ARM9 and VoIP processing baseband functions in a single package with a rich set of telephony features targeting Corded IP phones for home and office, Analog Terminal Adaptors and Cordless IP Phones. These products support multi line and multi HD voice channels, superior audio processing capabilities including acoustic echo cancellation and superior full duplex speakerphone technologies.

The XciteR family of chipsets is based on VegaFireBird SoC and provides embedded solutions for low-cost corded IP-phones to advanced cordless IP-phones with DECT handsets and headsets. Our VoIP chipset family is most suitable for office and enterprise IP telephony products as well as Analog Telephone Adapters and some of the leading vendors have developed and are already developing their IP telephones and ATAs with our chipsets.

Products Targeted for Multimedia Connected Screens

To capitalize on the increasing convergence of voice, data, audio and video, we offer the XpandR family of multimedia chipset solutions. XpandR is the world's only system-on-a-chip (SoC) solution based on dual-core and integrating application processors, Wi-Fi and DECT baseband and comprehensive multimedia peripherals, along with companion analog front-end and power management units as well as Wi-Fi and cordless RF chips, to enable the development of always-on, portable, connected multimedia products.

The XpandR solution supports an array of telephony and non-telephony connected applications, including smart home phone, video/media phone, Wi-Fi VoIP phone, home automation and control center, security and video monitoring center, media/streaming set-top box, smart universal remote control, mobile Internet device, portable media player and Internet radio, based on open platform frameworks such as Android.

XpandR-I—In 2008, we demonstrated the first member of the XpandR product family –with ARM9 and DSP in a single chip along with its companion RF ICs to support Wi-Fi 802.11a/b/g/e.

XpandR-II—In 2009, we demonstrated the second member of the XpandR product family –this chipset enhances the CPU speed to 240MHz and the integration level by adding more functionality and more peripherals on-chip. The XpandR-II chipset has been designed by several vendors into enhanced products such as Wi-Fi handsets, Internet radios and Android cordless multimedia phones, which represent the evolution of the cordless home phones and improve the home user experience.

XpandR-III – In January 2011, we taped-out XpandR-III, our third generation XpandR processor. XpandR-III is a state-of-the-art system-on-a-chip that features two application processing cores, ARM Cortex A8

and ARM9, an advanced low-power media system that integrates smart acceleration engines for HD video decode and encode, 2D/3D Graphics Processing Unit (GPU), as well as a dedicated security controller and Wi-Fi 802.11n that will complement a full offering for converged voice, data, audio and video processor. XpandR-III has a wide range of interfaces, including display up HD resolution and dual camera sensors. Target applications include smart home telephony, video telephony, home security, media/streaming set-top box and portable multimedia. XpandR-III can be used in a system with our RF chipsets to provide wireless video transmission.

Products Targeted for Mobile Phones, Fixed-Line Phones and Headsets (Bluetooth, DECT, Wired and Gaming)

As a result of the acquisition of BoneTone, we enhanced our product portfolio with unparalleled technology of intelligent voice enhancement and noise elimination. This technology supports two solutions: HDClear™ and HDMobileSurround™ which are offered as part of the XsoundR product line.

HDClear™-based solution offers mobile voice quality and intelligibility, while completely removing background noise. Delivering clearer voice calls made from noisy environments, the solution powers a range of products, including Bluetooth/DECT headsets, wired headsets, online gaming headsets, mobile phones and fixed-line phones.

HDMobileSurround™ solution provides true 5.1 surround true sound on the go. As a result, users of tablets, smartphones and other mobile devices can enjoy either HD movies with a true sense of sound, or gaming with natural surround sound.

XsoundR enables a new experience for mobile users. Our HDClear technology fully removes background noise for far-end users, while maintaining privacy for near-end speakers. As such, our XsoundR mobile chipset offerings enable high voice quality and intelligibility for calls made in the noisiest environments. The solutions are anchored by the BTHD100 mixed-signal DSP-based processor for voice communication applications. They also feature a superior background noise cancellation processor, on-chip ADC, and diverse digital interfaces for seamless integration into current dense mobile device systems. Offered in a low-power, small footprint package, XsoundR is the ultimate noise-cancellation chip solution for Bluetooth and DECT wireless headsets, wired headsets, mobile phones and fixed-line phones.

Customers

We sell our products primarily through distributors and directly to OEMs and ODMs who incorporate our products into consumer products for the worldwide residential wireless communications market. In 2011, we continued expanding our customer base, and in some cases, increased our share of business with existing customers. Our customer list now includes additional major brand names and direct OEMs and ODMs worldwide. The major consumer electronics manufacturers and brands that have incorporated our ICs into their products include: Accton, AEG, Alcatel, Alcotel, AT&T, Audioline, Aztech, Belgacom, Binatone, British Telecom, Brother, CCT Tech, China Mobile, China Telecom, Cisco, Cybertan, Grandstream, Deutsche Telekom, Doro, France Telecom, Freebox, Gaoxinqi, GE, Gemtek, Global China Technologies, Grandstream, Hagenuk, Huawei, Intelbras, JXE, Korea Telecom, KPN, LG Electronics, Matsushita, Motorola, NEC, NTT, OnReal, OpenPeak, Panasonic, Philips, Pioneer, Plantronics, Sagem, Samsung, Sanyo, SGW, Sharp, Siemens (Gigaset), SK Telesys, Sony, Sumitomo, Swissvoice, Swisscom, TCL, Tecom, Telecom Italia, Telefonica, Telstra, Thomson, Topcom, Uniden, Unihan, Urmet, Verizon, VTech, WNC, Xingtel and Yamaha.

International Sales and Operations

Export sales accounted for 99% of our total revenues for 2011 and 2010, and 98% for 2009. Although most of our sales to foreign entities are denominated in United States dollars, we are subject to risks of conducting business internationally. These risks include unexpected changes in regulatory requirements, fluctuations in exchange rates that could increase the price of our products in foreign markets, delays resulting from difficulty in

obtaining export licenses for certain technology, tariffs, other barriers and restrictions and the burden of complying with a variety of foreign laws. See Note 13 of the attached Notes to Consolidated Financial Statements for the year ended December 31, 2011, for a summary of the geographic breakdown of our revenues and location of our long-lived assets.

Moreover, a portion of our expenses in Israel is paid in the Israeli currency (New Israeli Shekel (NIS)), which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the NIS. Our primary expenses paid in NIS are employee salaries and lease payments on our Israeli facilities. As a result, an increase in the value of Israeli currency in comparison to the U.S. dollar could increase the cost of our technology development, research and development expenses and general and administrative expenses. From time to time, we use derivative instruments to minimize the effects of currency fluctuations, but our hedging positions may be partial, may not exist at all in the future or may not succeed in minimizing our foreign currency fluctuation risks.

In addition, due to the acquisition of the CIPT Business, a portion of our expenses in Europe is paid in Euro, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the Euro. Our primary expenses paid in Euro are employee salaries and lease and operational payments on our European facilities. As a result, an increase in the value of the Euro in comparison to the U.S. dollar also could increase the cost of our technology development, research and development expenses and general and administrative expenses.

Sales, Marketing and Distribution

We market and distribute our products through our direct sales and marketing offices, as well as through a network of distributors. Our sales and marketing team, working out of our sales offices in Hong Kong, China; Nierenberg, Germany; San Jose, California; Tokyo, Japan; Herzelia Pituach, Israel and Edinburgh, Scotland, pursues business with our customers in North and South America, Europe and Asia. In territories where we do not have sales offices, we operate solely through a network of distributors and representatives. Revenues derived from sales through our Japanese distributor, Tomen Electronics, represented 19% of our total revenues for 2011, 25% for 2010 and 22% for 2009. We also derive a significant amount of revenues from a limited number of customers. Sales to VTech represented 33% of our total revenues for 2011, 31% for 2010 and 29% for 2009. Sales to Panasonic through Tomen Electronics represented approximately 13%, 16% and 13% of our revenues for 2011, 2010 and 2009, respectively. Sales to Uniden represented 10%, 9% and 12% of our total revenues for 2011, 2010 and 2009, respectively. Sales to CCT Telecom represented 11%, 10% and 8% of our total revenues for 2011, 2010 and 2009, respectively. The loss of any of our significant customers or distributors could harm our business, financial condition and results of operations. In addition, our customers and distributors are not subject to minimum purchase requirements and can cease making purchases of our products at any time.

As our products are generally incorporated into consumer products sold by our OEM customers, our revenues are affected by seasonal buying patterns of consumer products sold by our OEM customers. The fourth quarter in any given year is usually the strongest quarter of sales for our OEM customers and, as a result, the third quarter in any given year is usually the strongest quarter for our revenues as our OEM customers request increased shipments of our products in anticipation of the fourth quarter holiday season. However, the magnitude of this trend varies annually and is affected by macro-economic trends.

Manufacturing and Design Methodology

As part of the acquisition of the CIPT Business, we entered into a Manufacturing Services Collaboration Agreement, as amended, with NXP pursuant to which NXP agreed to provide us with specified manufacturing, pre-testing, assembling and final-testing services relating to CIPT Business products. The services under the agreement are provided by NXP on a purchase order basis. The agreement sets forth specified capacity guarantees by NXP, logistics for our provision of production schedules, penalties for late/non delivery by NXP for specified products, our purchase obligations and various technical specifications for the manufacturing services. In order to meet the agreement obligations, NXP uses its internal fabrication and back-end production

facilities, as well as third parties. We currently buy finished goods from NXP under the manufacturing agreement. In order to enable NXP to provide such services, we provide binding capacity commitments to NXP based on a periodic rolling forecast. The manufacturing agreement with NXP provides that we may be subject to monetary penalties if we fail to meet our capacity commitments to NXP that we previously provided to them.

The services under the agreement were to be provided by NXP at agreed upon prices initially for up to seven years following the closing of the Acquisition with the provision of certain specified services initially terminating at the end of 2010. In December 2010, NXP agreed to extend a number of specified services that were to terminate at the end of 2010 to December 31, 2011 with an option for an additional one-year extension. In December 2011, we exercised the option to extend NXP's provision of services for an additional year to December 31, 2012. Pursuant to our December 2010 agreement with NXP, NXP will provide us with specified services at agreed upon prices with specified capacity commitments from NXP and third parties NXP has contracted for manufacturing of the CIPT Business products.

Products from the CIPT Business currently represent a substantial portion of our total revenues and are anticipated to continue to generate significant revenues for us in future periods. Our business could be materially harmed if NXP, or third parties NXP has contracted, fails to achieve acceptable manufacturing yields, quality levels or allocate to us a sufficient portion of its foundry, and assembly and testing capacities to meet our needs for the CIPT Business products due to its capacity constraints, including as a result of the worldwide shortage in manufacturing capacity or the provision of manufacturing services to NXP's internal business units or other third parties. A capacity shortage could lengthen our CIPT Business products' manufacturing cycle, cause a delay in the shipment of our products to our customers, lead to a loss of sales of our products, harm our reputation and competitive position with customers, and our revenues could be materially reduced. Our business would be materially harmed if NXP cannot for any reason fulfill its manufacturing obligations to us under the manufacturing agreement, as extended, including due to financial or operational hardships within NXP as a result of the cyclical nature of semiconductors industry or otherwise, and we are unable to obtain a satisfactory replacement to fulfill customer orders on a timely basis and in a cost-effective manner. Unforeseen difficulties with NXP's manufacturing of the CIPT Business products could materially harm our business, financial condition and results of operations. Moreover, in accordance with the amendment we executed with NXP in December 2010 and our option exercise, NXP agreed to extend a number of manufacturing, pre-testing, assembling and final-testing services relating to CIPT Business products only to December 31, 2012. We are currently working with NXP and third party fabrication companies to move the manufacturing, pre-testing, assembling and final-testing services relating to CIPT Business products away from NXP by December 31, 2012. Notwithstanding our implementation of a detailed transition plan, we may experience difficulty in finding a suitable replacement manufacturer for the CIPT Business products, which may result in a disruption in product shipments, harm our customer relationships and generally disrupt our business. Even in the event we are able to find a suitable replacement manufacturer, transitioning of manufacturing processes, including re-qualification of CIPT Business Products, may be a difficult process. There are inherent and unforeseen risks and delays associated with the transfer of manufacturing capacities from one facility to another, including production and shipment delays, capacity constraints with the replacement manufacturer, IP incompatibility, logistical and administrative concerns or general difficulties associated with starting a new manufacturing process. Therefore, even with a suitable replacement manufacturer, we may experience a significant disruption in product shipments, harm to our customer relationships and generally a disruption of our business. In addition, we may incur higher manufacturing costs with the replacement manufacturer which may decrease our gross margins and generally adversely affect our results of operations.

Other than products for the CIPT Business for which we have an arrangement with NXP, we contract product fabrication services from TSMC, TriQuint and IBM. A majority of our integrated circuit products at this time are manufactured by TSMC. We intend to continue to use independent foundries to manufacture our products for the Digital Cordless telephony, VoIP and Multimedia Connected screens markets. Our reliance on independent foundries involves a number of risks, including the foundries' ability to achieve acceptable manufacturing yields at competitive costs and their allocation of sufficient capacity to us to meet our needs.

While we currently believe we have adequate capacity to support our current sales levels, we may encounter capacity issues in the future. In the event of a worldwide shortage in foundry capacity, we may not be able to obtain a sufficient allocation of foundry capacity to meet our product needs. Shortage or lack of capacity at the foundries we use to manufacture our products may lead to increased operating costs and lower gross margins. In addition, such a shortage could lengthen our products' manufacturing cycle and cause a delay in the shipment of our products to our customers. Moreover, as TSMC produces a significant portion of our wafer supply, earthquakes, aftershocks or other natural disasters in Asia could preclude us from obtaining an adequate supply of wafers to fill customer orders. Unforeseen difficulties with our independent foundries could harm our business, financial condition and results of operations.

Other than products for the CIPT Business for which we have an arrangement with NXP, we use independent subcontractors located in Asia, to assemble and test certain of our products. We develop detailed testing procedures and specifications for each product and require each subcontractor to use these procedures and specifications before shipping us the finished products. We test and/or assemble our products at ASE, ASEN, KYEC, SPIL and Giga Solutions.

Furthermore, our Digital Cordless products require an external component in the finished product to provide flash memory, which is supplied by third party manufacturers. Temporary fluctuations in the pricing and availability of this component could negatively impact sales of our Digital Cordless products, which could in turn harm our business, financial condition and results of operations.

Competition

The principal competitive factors in the cordless telephony market include price, system integration level, range, voice quality, customer support and the timing of product introductions by us and our competitors. We believe that we are competitive with respect to most of these factors. Our principal competitors in the cordless market include Lantiq and Dialog Semiconductors, and we have also noted efforts by Beken, a Chinese supplier of basebands for analog cordless phones, to penetrate the DECT market. Similar principal competitive factors affect the VoIP market. We also believe that we are competitive with respect to most of these factors. Our principal competitors in the VoIP market include Broadcom, Dialog Semiconductors, Infineon, Texas Instruments and new Taiwanese IC vendors. Our principal competitors in the multimedia market include Wi-Fi and multimedia application processor IC vendors like Atheros, Broadcom, CSR, Freescale, Intel, Marvel, Ralink, Samsung and Texas Instruments.

Price competition in the markets in which we currently compete and propose to compete is intense and may increase, which could harm our business, financial condition and results of operations. We have experienced and will continue to experience increased competitive pricing pressures for our ICs. Moreover, price competition has intensified due to the lack of new model launches and the anticipation of new products in the market. We were able to partially offset price reductions which occurred during 2010 through manufacturing cost reductions, improvements in our yield percentages and by achieving a higher level of product integration. However, we cannot assure you that we will be able to further reduce production costs, or be able to compete successfully with respect to price or any other key competitive factors in the future.

In future periods, due to various new developments in the residential telephony market, we also may be required to enter into new markets with competitors that have more established presence, and significantly greater financial, technical, manufacturing, marketing, sales and distribution resources and management expertise than we do.

Furthermore, there is a growing threat from alternative technologies accelerating the decline of the fixed-line telephony market. This competition comes from mobile telephony, including emerging dual-mode mobile

Wi-Fi phones, and other innovative applications, such as Skype and iChat. Given that we derive a significant amount of revenues from chipsets incorporated into fixed-line telephony products, if we are unable to develop new technologies in the face of the decline of this market, our business could be materially adversely affected.

Research and Development

We believe that timely development and introduction of new products are essential to maintain our competitive position. We currently conduct most of our product development at our facilities. At December 31, 2011, we had a staff of 236 research and development personnel, of which 180 were located in Israel. We also employ independent contractors to assist with certain product development and testing activities. We spent approximately \$53.2 million in 2011, \$55.6 million in 2010 and \$56.1 million in 2009 on research and development activities.

As noted above, due to various new developments in the home residential market, including the rapid deployment of new communication access methods and the rise of alternative technologies in lieu of fixed-line telephony, we will be required to expand our current product lines and develop products and services targeted at a wider multimedia market. We will need to continue to invest in research and development, and our research and development expenses may increase in the future, including the addition of new research and development personnel, to keep pace with new and rapidly changing trends in our industry.

Licenses, Patents and Trademarks

As of December 31, 2011, we have been granted a total of 184 patents. We have a total of over 133 pending patents.

We actively pursue foreign patent protection in countries of interest to us. Our policy is to apply for patents or for other appropriate statutory protection when we develop valuable new or improved technology. The status of any patent involves complex legal and factual questions, and the breadth of claims allowed is uncertain. Accordingly, we cannot assure you that any patent application filed by us will result in a patent being issued, or that our patents, and any patents that may be issued in the future, will afford adequate protection against competitors with similar technology; nor can we provide assurance that patents issued to us will not be infringed or designed around by others. In addition, the laws of certain countries in which our products are or may be developed, manufactured or sold, including China, Hong Kong, Japan, Korea and Taiwan, may not protect our products and intellectual property rights to the same extent as the laws of the United States.

We attempt to protect our trade secrets and other proprietary information through agreements with our customers, suppliers, employees and consultants, and through other security measures. Although we intend to protect our rights vigorously, we cannot assure you that these measures will be successful.

The semiconductor industry is subject to frequent litigation regarding patent and other intellectual property rights. While claims involving any material patent or other intellectual property rights have not been brought against us to date, we cannot provide assurance that third parties will not assert claims against us or our customers with respect to existing or future products, or that we will not need to assert claims against third parties to protect our proprietary technology. In addition, patent infringement claims are increasingly being asserted by patent holding companies (so-called patent “trolls”), which do not use technology and whose sole business is to enforce patents against companies, such as us, for monetary gain. Because such patent holding companies do not provide services or use technology, the assertion of our own patents by way of counter-claim may be ineffective. We have received claims that our products infringe upon the proprietary rights of such patent holding companies. In addition, third parties have asserted and may in the future assert intellectual property infringement claims against our customers, which we have agreed in certain circumstances to indemnify and defend against such claims. If litigation becomes necessary to determine the validity of any third party claims or to protect our proprietary technology, it could result in significant expense to us and could divert the efforts of

our technical and management personnel, whether or not the claim has any merit and notwithstanding that the litigation is determined in our favor. In the event of an adverse result in any litigation, we could be required to expend significant resources to develop non-infringing technology or to obtain licenses to the technology that is the subject of the litigation. We cannot provide assurance that we would be successful in developing non-infringing technology or that any licenses would be available on commercially reasonable terms.

We have trademark registration for the following marks in the United States: TRUESPEECH and TRIPLE RATE CODER.

While our ability to compete may be affected by our ability to protect our intellectual property, we believe that because of the rapid pace of technological change in our industry, our technical expertise and ability to innovate on a timely basis and in a cost-effective manner will be more important in maintaining our competitive position than the protection of our intellectual property. In addition, we believe that due to rapid technological changes in residential telephony, computer telephony and personal computer markets, patents and trade secret protection are important but must be supported by other factors, including expanding the knowledge, ability and experience of our personnel, new product introductions and frequent product enhancements. Although we continue to implement protective measures and intend to defend our intellectual property rights vigorously, we cannot assure you that these measures will be successful.

Backlog

At December 31, 2011, our backlog was approximately \$36.7 million, compared to approximately \$43.8 million and \$48.7 million at December 31, 2010 and 2009, respectively. We include in our backlog all accepted product purchase orders with respect to which a delivery schedule has been specified for product shipment within one year. Our business is characterized by short-term order and shipment schedules. Product orders in our current backlog are subject to change, sometimes on short notice, due to changes in delivery schedules or cancellation by a purchaser. Accordingly, although useful for scheduling production, backlog as of any particular date may not be a reliable measure of our sales for any future period.

Employees

At December 31, 2011, we had 395 employees, including 236 in research and development, 85 in marketing and sales and 74 in corporate, administration and manufacturing coordination. Competition for personnel in the semiconductor industry in general is intense. We believe that our future prospects will depend, in part, on our ability to continue to attract and retain highly-skilled technical, marketing and management personnel, who are in great demand. In particular, there is a limited supply of RF chip designers and highly-qualified engineers with digital signal processing experience. We believe that our relations with our employees are good.

Web Site Access to Company's Reports

Our Internet Web site address is www.dspg.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act are available free of charge through our Web site as soon as reasonably practicable after they are electronically filed with, or furnished to, the Securities and Exchange Commission. We will also provide the reports in electronic or paper form free of charge upon request.

Our website and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K.

Item 1A. RISK FACTORS.

The following risk factors, among others, could in the future affect our actual results of operations and could cause our actual results to differ materially from those expressed in forward-looking statements made by us. These forward-looking statements are based on current expectations and we assume no obligation to update this information. Before you decide to buy, hold, or sell our common stock, you should carefully consider the risks described below, in addition to the other information contained elsewhere in this report. The following risk factors are not the only risk factors facing our company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business. Our business, financial condition, and results of operation could be seriously harmed if any of the events underlying any of these risks or uncertainties actually occurs. In that event, the market price for our common stock could decline, and you may lose all or part of your investment.

We generate a significant amount of our total revenues from the sale of digital cordless telephony products and our business and operating results may be materially adversely affected if we do not continue to succeed in this highly competitive market or if sales within the overall cordless digital market decreases.

Sales of our digital cordless telephony products comprised a significant majority of our total revenues for 2011. Specifically, sales of our DECT, 2.4GHz, 5.8GHz and CoIP products comprised 94% of our total revenues for 2011, 94% for 2010 and 92% for 2009. Revenues from our DECT products represented 82% of our total revenues 2011, 78% of our total revenues 2010 and 77% for 2009. Revenues from our 2.4 GHz products represented 9% of our total revenues for 2011, 13% for 2010 and 12% for 2009.

Any adverse change in the digital cordless market or in our ability to compete and maintain our competitive position in that market would harm our business, financial condition and results of operations. The digital cordless telephony market is extremely competitive and is facing intense pricing pressures, and we expect that competition and pricing pressures will only increase. Our existing and potential competitors in this market include large and emerging domestic and foreign companies, many of whom have significantly greater financial, technical, manufacturing, marketing, sales and distribution resources and management expertise than we do. It is possible that we may one day be unable to respond to increased pricing competition for digital cordless telephony processors or other products through the introduction of new products or reduction of manufacturing costs. This inability to compete would have a material adverse effect on our business, financial condition and results of operations. Likewise, any significant delays by us in developing, manufacturing or shipping new or enhanced products in this market also would have a material adverse effect on our business, financial condition and results of operations.

In addition to general market competitiveness, the digital cordless telephony market is undergoing a challenging period of transition. With the rapid deployment of new communication access methods, including mobile, wireless broadband, cable and other connectivity, the traditional cordless telephony market using fixed-line telephony is stagnant, which reduces our revenues derived from, and unit sales of, cordless telephony products. Moreover, there was a temporary slowdown in demand for consumer electronics products, including cordless telephony products, during the second half of 2011 that negatively impacted our 2011 revenues and resulted in operating losses for 2011. Macro-economic trends in the consumer electronics industry may adversely impact our revenues in the future.

Furthermore, we believe new developments in the residential connectivity market may adversely affect the revenues we derive from our digital cordless telephony products. For example, the decline in fixed-line telephony together with the rapid deployment of new communication access methods, including mobile, wireless broadband, cable and other connectivity, may compound the decrease in sales of products using fixed-line telephony. Our business also may be affected by the outcome of the competition between cellular phone operators and fixed-line operators for the provision of residential communication. A significant majority of our revenues are currently generated from sales of chipsets used in cordless phones that are based on fixed-line telephony. Both of these trends would reduce our revenues derived from, and unit sales of, our digital cordless telephony products.

We rely significantly on revenue derived from a limited number of customers.

We expect that a limited number of customers, varying in identity from period-to-period, will account for a substantial portion of our revenues in any period. Our four largest customers – VTech, Panasonic, Uniden and CCT Telecom accounted for approximately 67% of our total revenues for 2011, 66% for 2010 and 62% for 2009. Sales to VTech represented 33% of our total revenues for 2011, 31% for 2010 and 29% for 2009. Sales to Panasonic through our distributor represented 13% of our total revenues for 2011, 16% for 2010, and 13% for 2009. Sales to Uniden through our distributor and directly to Uniden represented 10% of our total revenues for 2011, 9% for 2010 and 12% for 2009. Sales to CCT Telecom represented 11% of our total revenues for 2011, 10% for 2010 and 8% for 2009. Typically, our sales are made on a purchase order basis, and none of our customers has entered into a long-term agreement requiring it to purchase our products. Moreover, we do not typically require our customers to purchase a minimum quantity of our products, and our customers can generally cancel or significantly reduce their orders on short notice without significant penalties. A significant amount of our revenues will continue to be derived from a limited number of large customers. Furthermore, the primary customers for our products are original equipment manufacturers (OEMs) and original design manufacturers (ODMs) in the cordless digital market. This industry is highly cyclical and has been subject to significant economic downturns at various times, particularly in recent periods. These downturns are characterized by production overcapacity and reduced revenues, which at times may affect the financial stability of our customers. Therefore, the loss of one of our major customers, or reduced demand for products from, or the reduction in purchasing capability of, one of our major customers, could have a material adverse effect on our business, financial condition and results of operations.

Because our products are components of end products, if OEMs do not incorporate our products into their end products or if the end products of our OEM customers do not achieve market acceptance, we may not be able to generate adequate sales of our products.

Our products are not sold directly to the end-user; rather, they are components of end products. As a result, we rely upon OEMs to incorporate our products into their end products at the design stage. Once an OEM designs a competitor's product into its end product, it becomes significantly more difficult for us to sell our products to that customer because changing suppliers involves significant cost, time, effort and risk for the customer. As a result, we may incur significant expenditures on the development of a new product without any assurance that an OEM will select our product for design into its own product and without this "design win" it becomes significantly difficult to sell our products. Moreover, even after an OEM agrees to design our products into its end products, the design cycle is long and may be delayed due to factors beyond our control which may result in the end product incorporating our products not to reach the market until long after the initial "design win" with the OEM. From initial product design-in to volume production, many factors could impact the timing and/or amount of sales actually realized from the design-in. These factors include, but are not limited to, changes in the competitive position of our technology, our customers' financial stability, and our ability to ship products according to our customers' schedule. Moreover, the continued uncertainty about the sustainability of the global economic recovery and outlook may further prolong an OEM customer's decision-making process and design cycle.

Furthermore, we rely on the end products of our OEM customers that incorporate our products to achieve market acceptance. Many of our OEM customers face intense competition in their markets. If end products that incorporate our products are not accepted in the marketplace, we may not achieve adequate sales volume of our products, which would have a negative effect on our results of operations.

We rely on a primary distributor for a significant portion of our total revenues and the failure of this distributor to perform as expected would materially reduce our future sales and revenues.

In addition to direct sales, we use a network of distributors to sell our products. Particularly, revenues derived from sales through our Japanese distributor, Tomen Electronics, accounted for 19% of our total revenues for 2011, 25% for 2010 and 22% for 2009. Our future performance will depend, in part, on this distributor to

continue to successfully market and sell our products. Furthermore, Tomen Electronics sells our products to a limited number of customers. One customer, Panasonic, has continually accounted for a majority of the sales through Tomen Electronics. Sales to Panasonic through Tomen Electronics generated approximately 13% of our total revenues for 2011, 16% for 2010 and 13% for 2009. The loss of Tomen Electronics as our distributor and our inability to obtain a satisfactory replacement in a timely manner would materially harm our sales and results of operations. Additionally, the loss of Panasonic and Tomen Electronics' inability to thereafter effectively market our products would also materially harm our sales.

Because our quarterly operating results may fluctuate significantly, the price of our common stock may decline.

Our quarterly results of operations may vary significantly in the future for a variety of reasons, many of which are outside our control, including the following:

- fluctuations in volume and timing of product orders;
- timing, rescheduling or cancellation of significant customer orders and our ability, as well as the ability of our customers, to manage inventory;
- changes in demand for our products due to seasonal consumer buying patterns and other factors;
- timing of new product introductions by us, including our XpandR, VoIP and CAT-iq products, and by our customers or competitors;
- changes in the mix of products sold by us or our competitors;
- fluctuations in the level of sales by our OEM customers and other vendors of end products incorporating our products;
- timing and size of expenses, including expenses to develop new products and product improvements and expenses resulting from restructuring activities;
- entry into new markets, including China, Korea and South America;
- our ability to scale our operations in response to changes in demand for our existing products and services or demand for new products requested by our customers;
- mergers and acquisitions by us, our competitors and our existing and potential customers; and
- general economic conditions, including current economic conditions in the United States and worldwide, and the adverse effects on the semiconductor and consumer electronics industries.

Each of the above factors is difficult to forecast and could harm our business, financial condition and results of operations. Also, we sell our products to OEM customers that operate in consumer markets. As a result, our revenues are affected by seasonal buying patterns of consumer products sold by our OEM customers that incorporate our products and the market acceptance of such products supplied by our OEM customers. The fourth quarter in any given year is usually the strongest quarter for sales by our OEM customers in the consumer markets, and thus, our third quarter in any given year is usually the strongest quarter for revenues as our OEM customers request increased shipments of our products in anticipation of the increased activity in the fourth quarter. By contrast, the first quarter in any given year is usually the weakest quarter for us. However, the magnitude of this trend varies annually and is affected by macro-economic trends.

Our revenues, gross margins and profitability may be materially adversely affected by the continued decline in average selling prices of our products and other factors, including increases in assembly and testing expenses, and raw material and commodity costs.

We have experienced and will continue to experience a decrease in the average selling prices of our products. Decreasing average selling prices could result in decreased revenues even if the volume of products sold increases. Decreasing average selling prices may also require us to sell our products at much lower gross

margin than in the past and reduce profitability. Although we have to date been able to partially offset on an annual basis the declining average selling prices of our products through general operational efficiencies and manufacturing cost reductions by achieving a higher level of product integration and improving our yield percentages, there is no guarantee that our ongoing efforts will be successful or that they will keep pace with the anticipated, continued decline in average selling prices of our products.

Moreover, we believe there are significant pressures in the supply chain as a result principally of the uncertainty about the global economic recovery. The pressures in the supply chain make it very difficult for us to increase or even maintain our product pricing which further adversely affects our gross margins.

In addition to the continued decline in the average selling prices of our products, our gross profit may decrease in the future due to other factors, including the roll-out of new products in any given period and the penetration of new markets which may require us to sell products at a lower margin, our failure to introduce new engineering processes and mix of products sold.

Furthermore, increases in the price of silicon wafers, increases in testing costs and increases in gold, oil and other commodities which may result in increased production costs, mainly assembly and packaging costs may result in a decrease to our gross margins. Moreover, our suppliers may pass the increase in raw materials and commodity costs onto us which would further reduce the gross margin of our products. For example, an increase in the cost of gold contributed to a decrease in our gross margins. In addition, as we are a fabless company, global market trends such as “over-capacity” problems so that there is a shortage of capacity to fulfill our fabrication needs also may increase our raw material costs and thus decrease our gross margin.

Because we have significant international operations, we may be subject to political, economic and other conditions relating to our international operations that could increase our operating expenses and disrupt our business.

Although the majority of end users of the consumer products that incorporate our products are located in the U.S., we are dependent on sales to OEM customers, located outside of the U.S., that manufacture these consumer products. Also, we depend on a network of distributors to sell our products that also are primarily located outside of the U.S. Export sales, primarily consisting of digital cordless telephony products shipped to manufacturers in Europe and Asia, including Japan and Asia Pacific, represented 99% of our total revenues for 2011, 99% for 2010 and 98% for 2009. Furthermore, pursuant to the acquisition of the CIPT Business from NXP, we established new foreign subsidiaries, and currently have material operations in Germany, Hong Kong and India and employ a number of individuals within those foreign operations. As a result, the occurrence of any negative international political, economic or geographic events, as well as our failure to mitigate the challenges in managing an organization operating in various countries, could result in significant revenue shortfalls and disrupt our workforce within our foreign operations. These shortfalls and disruptions could cause our business, financial condition and results of operations to be harmed. Some of the risks of doing business internationally include:

- unexpected changes in foreign government regulatory requirements;
- fluctuations in the exchange rate for the United States dollar;
- import and export license requirements;
- imposition of tariffs and other barriers and restrictions;
- burdens of complying with a variety of foreign laws, treaties and technical standards;
- uncertainty of laws and enforcement in certain countries relating to the protection of intellectual property;
- difficulty in collecting accounts receivable and longer payment cycles for international customers than existing customers;

- difficulty in staffing and managing foreign operations and maintaining the morale and productivity of employees within foreign operations;
- multiple and possibly overlapping tax structures and potentially adverse tax consequences;
- political and economic instability; and
- changes in diplomatic and trade relationships.

One or more of these factors may have a material adverse effect on our future operations and consequently, on our business, financial conditions and operating results.

In order to sustain the future growth of our business, we must penetrate new markets and our new products must achieve widespread market acceptance.

In order to increase our sales volume and expand our business, we must penetrate new markets and introduce new products. We are exploring opportunities to expand sales of our products to China, Japan, Korea and South America. However, there are no assurances that we will gain significant market share in those competitive markets. In addition, many North American, European and Japanese OEMs are moving their manufacturing sites to Southeast Asia as a result of the cyclical nature of manufacturing capacity issues and cost of silicon integrated circuits, the continued decline of average selling prices of chipsets and other industry-wide factors. This trend may cause the mix of our OEM customers to change in the future, thereby further necessitating our need to penetrate new markets. Furthermore, to sustain the future growth of our business, we need to introduce new products as sales of our older products taper off. Moreover, the penetration of new competitive markets and introduction of new products could require us to reduce the sale prices of our products or increase the cost per product and thus reducing our total gross profit in future periods. As an example, we introduced to the market the XpandR and CAT-iq platforms to enable multimedia and web-related applications in our future products. Our future growth is dependent on market acceptance and penetration of our new products, such as the XpandR-based and CAT-iq-based products, for which we can provide no assurances. Our revenue growth is also dependent on the successful deployment of our new VoIP and BoneTone products. Our inability to penetrate the market or lack of customer acceptance of these products may harm our business and potential growth.

There are several emerging market trends that may challenge our ability to continue to grow our business.

New technological developments in the home connectivity market may adversely affect our operating results. For example, the rapid deployment of new communication access methods, including mobile, wireless broadband, cable and other connectivity, as well as the lack of growth in products using fixed-line telephony would reduce our total revenues derived from, and unit sales of, cordless fixed-line telephony products. Our ability to maintain our growth will depend on the expansion of our product lines to capitalize on the emerging access methods and on our success in developing and selling a portfolio of “system-on-a-chip” solutions that integrate video, voice, data and communication technologies in a wider multimedia market, as well as on our success in developing and selling DECT, XpandR, CAT-iq and video products. We cannot assure you that we will succeed in expanding our product lines or portfolio of “system-on-a-chip” solutions, or that they would receive market acceptance.

Furthermore, there is a growing threat from alternative technologies accelerating the decline of the fixed-line telephony market. This competition comes from mobile telephony, including emerging dual-mode mobile Wi-Fi phones and other innovative applications, such as Skype and iChat. Given that we derive a significant amount of revenues from chipsets incorporated into fixed-line telephony products, if we are unable to develop new technologies in the face of the decline of this market, our business could be materially adversely affected.

Because we depend on independent foundries and other third party suppliers to manufacture and test all of our integrated circuit products, we are subject to additional risks that may materially disrupt our business.

All of our integrated circuit products are manufactured and tested by independent foundries and other third party suppliers. While these foundries and other third party suppliers have been able to adequately meet the demands of our increasing business, we are and will continue to be dependent upon these foundries and third party suppliers to achieve acceptable manufacturing yields, quality levels and costs, and to allocate to us a sufficient portion of their foundry, assembly and test capacity to meet our needs in a timely manner.

While we currently believe we have adequate capacity to support our current sales levels pursuant to our arrangement with our foundries and other third party suppliers, we may encounter capacity shortage issues in the future. In the event of a worldwide shortage in foundry, assembly and/or test capacity, we may not be able to obtain a sufficient allocation of such capacity to meet our product needs or we may incur additional costs to ensure specified quantities of products and services. Over-capacity at the current foundries and other third party suppliers we use, or future foundries or other third party suppliers we may use, to manufacture and test our integrated circuit products may lead to increased operating costs and lower gross margins. In addition, such a shortage could lengthen our products' manufacturing and testing cycle and cause a delay in the shipment of our products to our customers. This could ultimately lead to a loss of sales of our products, harm our reputation and competitive position, and our revenues could be materially reduced. Our business could also be harmed if our current foundries or other third party suppliers terminate their relationship with us and we are unable to obtain satisfactory replacements to fulfill customer orders on a timely basis and in a cost-effective manner. Moreover, we do not have long term capacity guarantee agreements with our foundries and with other third party suppliers.

In addition, as TSMC produces a significant portion of our integrated circuit products and ASE tests and assembles a significant portion of them, earthquakes, aftershocks or other natural disasters in Asia, or adverse changes in the political situation in Taiwan, could preclude us from obtaining an adequate supply of wafers to fill customer orders. Such events could harm our reputation, business, financial condition, and results of operations.

Because NXP still manufactures certain of the CIPT Business products, we are subject to additional risks that may materially disrupt our business.

As part of the Acquisition, we entered into a Manufacturing Services Collaboration Agreement ("MSCA"), as amended, with NXP pursuant to which NXP agreed to provide us with specified manufacturing, pre-testing, assembling and final-testing services relating to the CIPT Business products.

The services under the MSCA were to be provided by NXP at agreed upon prices initially for up to seven years following the closing of the Acquisition with the provision of certain specified services initially terminating at the end of 2010. In December 2010, NXP agreed to extend a number of specified services that were to terminate at the end of 2010 to December 31, 2011 with an option for an additional one-year extension. In December 2011, we exercised the option to extend NXP's provision of services for an additional year to December 31, 2012. We are currently working with NXP and third party fabrication companies to move the manufacturing, pre-testing, assembling and final-testing services relating to CIPT Business products away from NXP by December 31, 2012. Notwithstanding our implementation of a detailed transition plan, we may experience difficulty in finding a suitable replacement manufacturer for the CIPT Business products, which may result in a disruption in product shipments, harm our customer relationships and generally disrupt our business. Even in the event we are able to find a suitable replacement manufacturer, transitioning of manufacturing processes, including re-qualification of CIPT Business Products, may be a difficult process. There are inherent and unforeseen risks and delays associated with the transfer of manufacturing capacities from one facility to another, including production and shipment delays, capacity constraints with the replacement manufacturer, IP incompatibility, logistical and administrative concerns or general difficulties associated with starting a new manufacturing process. Therefore, even with a suitable replacement manufacturer, we may experience a significant disruption in product shipments, harm to our

customer relationships and generally a disruption of our business. In addition, we may incur higher manufacturing costs with the replacement manufacturer which may decrease our gross margins and generally adversely affect our results of operations.

Our operating results are affected by general economic conditions and the highly cyclical nature of the semiconductor industry.

During the global downturn that started in the second half of 2008 and continued throughout 2009, general worldwide economic conditions significantly deteriorated, and resulted in decreased consumer confidence and spending, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns. Notwithstanding improvements in business conditions since the second half of 2009, there continues to be uncertainty about the global economy and outlook, which continue to make it difficult for our customers, the end-product customers, our vendors and us to accurately forecast and plan future business activities and make reliable projections.

Moreover, we operate within the semiconductor industry which experiences significant fluctuations in sales and profitability. The industry was materially adversely affected by the 2008-2009 global downturn. Downturns in the semiconductor industry are characterized by diminished product demand, excess customer inventories, accelerated erosion of prices and excess production capacity. These factors could cause substantial fluctuations in our revenues and in our results of operations.

If global economic and market conditions remain uncertain or deteriorate, we could experience a material adverse impact on our business and results of operations.

Because the manufacture of our products is complex, the foundries on which we depend may not achieve the necessary yields or product reliability that our business requires.

The manufacture of our products is a highly complex and precise process, requiring production in a highly controlled environment. Changes in manufacturing processes or the inadvertent use of defective or contaminated materials by a foundry could adversely affect the foundry's ability to achieve acceptable manufacturing yields and product reliability. If the foundries we currently use do not achieve the necessary yields or product reliability, our ability to fulfill our customers' needs could suffer. This could ultimately lead to a loss of sales of our products and have a negative effect on our gross margins and results of operations.

Furthermore, there are other significant risks associated with relying on these third-party foundries, including:

- risks due to the fact that we have reduced control over production cost, delivery schedules and product quality;
- less recourse if problems occur as the warranties on wafers or products supplied to us are limited; and
- increased exposure to potential misappropriation of our intellectual property.

As we depend on independent subcontractors, located in Asia, to assemble and test our semiconductor products, we are subject to additional risks that may materially disrupt our business.

Independent subcontractors, located in Asia, assemble and test our semiconductor products. Because we rely on independent subcontractors to perform these services, we cannot directly control our product delivery schedules or quality levels. We are dependent on these subcontractors to allocate to us a sufficient portion of their capacity to meet our needs in a timely manner. Our future success also depends on the financial viability of our independent subcontractors. If the capital structures of our independent subcontractors weaken, we may experience product shortages, production delays, quality assurance problems, increased manufacturing costs, and/or supply chain disruption. All of this could ultimately lead to a loss of sales of our products, harm our reputation and competitive position, and our revenues could be materially harmed.

Moreover, the economic, market, social, and political situations in countries where some of our independent subcontractors are located are unpredictable, can be volatile, and can have a significant impact on our business because we may not be able to obtain product in a timely manner. Market and political conditions, including currency fluctuation, terrorism, political strife, war, labor disruption, and other factors, including natural or man-made disasters, adverse changes in tax laws, tariff, import or export quotas, power and water shortages, or interruption in air transportation, in areas where our independent subcontractors are located also could have a severe negative impact on our operating capabilities.

We are subject to order and shipment uncertainties and if we are unable to accurately predict customer demand, our business may be harmed.

We typically sell products pursuant to purchase orders rather than long-term purchase commitments. Customers can generally cancel, change or defer purchase orders on short notice without incurring a significant penalty. Given current market conditions, we have less ability to accurately predict what or how many products our customers will need in the future. In addition, we have little visibility into and no control of the demand by our customer's customers – generally consumer electronics retailers. A decrease in the consumer electronics retailers' demand or a build up of their inventory, both of which are out of our control, may cause a cancellation, change or deferral of purchase orders on at short notice by our customers. Anticipating demand is difficult because our customers and their customers face volatile pricing and unpredictable demand for their own products, and are increasingly focused on cash preservation and tighter inventory management. We place orders with our suppliers based on forecasts of our customers' demand and, in some instances, may establish buffer inventories to accommodate anticipated demand. Our forecasts are based on multiple assumptions, each of which may introduce error into our estimates. If we overestimate our customers' demand or our customers overestimate their demand, we may allocate resources to manufacturing products that we may not be able to sell when we expect to, if at all. As a result, we could hold excess or obsolete inventory, which would reduce our profit margins and adversely affect our financial results. Conversely, if we underestimate our customers' demand or our customers underestimate their demand and insufficient manufacturing capacity is available, we could forego revenue opportunities and potentially lose market share and damage our customer relationships.

As a result of the Acquisition, we now maintain inventory, or hubbing, arrangements with certain of our customers. Pursuant to these arrangements, we deliver products to a customer or a designated third party warehouse based upon the customer's projected needs, but do not recognize product revenue unless and until the customer reports that it has removed our product from the warehouse to incorporate into its end products. Since we own inventory that is physically located in a third party's warehouse, our ability to effectively manage inventory levels may be impaired, causing our total inventory turns to decrease, which could increase expenses associated with excess and obsolete product and negatively impact our cash flow.

We are dependent on a small number of OEM customers, and our business could be harmed by the loss of any of these customers or reductions in their purchasing volumes.

We sell our products to a limited number of OEM customers directly or through a network of distributors. Moreover, many North American, European and Japanese OEMs are moving their manufacturing sites to Southeast Asia, as a result of the cyclical nature of manufacturing capacity issues and cost of silicon integrated circuits, the continued decline of average selling prices of chipsets and other industry-wide factors. In addition, OEMs located in Southeast Asia are growing and gaining competitive strength. As a result, the mix of our OEM customers may change in the future. However, we may not succeed in attracting new customers as these potential customers may have pre-existing relationships with our current or potential competitors. This trend also may promote the consolidation of OEMs located in North America, Europe and Japan with OEMs located in Southeast Asia, which may reduce the number of our potential customers and reduce the volume of chipsets the combined OEM customer may purchase from us. However, as is common in our industry, we typically do not enter into long term contracts with our customers in which they commit to purchase products from us. The loss of any of our OEM customers may have a material adverse effect on our results of operations. To attract new customers, we may be faced with intense price competition, which may affect our revenues and gross margins.

The possible emerging trend of our OEM customers outsourcing their production may cause our revenue to decline.

We believe there may be an emerging trend of our OEM customers outsourcing their production to third parties. We have invested substantial resources to build relationships with our OEM customers. However the outsourcing companies whom our OEM customers may choose to outsource production may not have prior business relationship with us or may instead have prior or ongoing relationships with our competitors. The emergence of this trend may require us to expend substantial additional resources to build relationships with these outsourcing companies, which would increase our operating expenses. Even if we do expend such resources, there are no assurances that these outsourcing companies will choose to incorporate our chipsets rather than chipsets of our competitors. Our inability to retain an OEM customer once such customer chooses to outsource production would have a material adverse effect on our future revenue.

Because we have significant operations in Israel, we may be subject to political, economic and other conditions affecting Israel that could increase our operating expenses and disrupt our business.

Our principal research and development facilities are located in the State of Israel and, as a result, at December 31, 2011, 259 of our 395 employees were located in Israel, including 180 out of 236 of our research and development personnel. In addition, although we are incorporated in Delaware, a majority of our directors and executive officers are residents of Israel. Although substantially all of our sales currently are being made to customers outside of Israel, we are nonetheless directly influenced by the political, economic and military conditions affecting Israel. Any major hostilities involving Israel, or the interruption or curtailment of trade between Israel and its present trading partners, could significantly harm our business, operating results and financial condition.

Israel's economy has been subject to numerous destabilizing factors, including a period of rampant inflation in the early to mid-1980s, low foreign exchange reserves, fluctuations in world commodity prices, military conflicts and civil unrest. In addition, Israel and companies doing business with Israel have been the subject of an economic boycott by the Arab countries since Israel's establishment. Although they have not done so to date, these restrictive laws and policies may have an adverse impact on our operating results, financial condition or expansion of our business.

Since the establishment of the State of Israel in 1948, a state of hostility has existed, varying in degree and intensity, between Israel and the Arab countries. Although Israel has entered into various agreements with certain Arab countries and the Palestinian Authority, and various declarations have been signed in connection with efforts to resolve some of the economic and political problems in the Middle East, hostilities between Israel and some of its Arab neighbors have recently escalated and intensified. We cannot predict whether or in what manner these conflicts will be resolved. Our results of operations may be negatively affected by the obligation of key personnel to perform military service. In addition, certain of our officers and employees are currently obligated to perform annual reserve duty in the Israel Defense Forces and are subject to being called for active military duty at any time. Although we have operated effectively under these requirements since our inception, we cannot predict the effect of these obligations on the company in the future. Our operations could be disrupted by the absence, for a significant period, of one or more of our officers or key employees due to military service.

The tax benefits available to us under Israeli law require us to meet several conditions, and may be terminated or reduced in the future, which would increase our taxes.

Our facilities in Israel have been granted Approved Enterprise and Beneficiary Enterprise status under the Law for the Encouragement of Capital Investments, 1959, commonly referred to as the "Investment Law," as amended. The Investment Law provides that capital investments in a production facility (or other eligible assets) designated as an Approved Enterprise or Beneficiary Enterprise receive certain tax benefits in Israel. Our

investment programs that generate taxable income are currently subject to an average tax rate of up to approximately 10% based on a variety of factors, including percentage of foreign ownership and approvals for the erosion of the tax basis of our investment programs. To be eligible for tax benefits, we must meet certain conditions, relating principally to adherence to the investment program filed with the Investment Center of the Israeli Ministry of Industry and Trade and periodic reporting obligations. Although we believe we have met such conditions in the past, should we fail to meet such conditions in the future, we would be subject to corporate tax in Israel at the standard corporate tax rate (25% for 2012) and could be required to refund tax benefits (including with interest and adjustments for inflation based on the Israeli consumer price index) already received. Our average tax rate for our investment programs also may change in the future due to circumstances outside of our control, including changes to legislation. Therefore, we cannot provide any assurances that our average tax rate for our investment programs will continue in the future at their current levels, if at all. The tax benefits under a majority of our current investment plans are scheduled to gradually expire in 2015. The termination or reduction of certain programs and tax benefits or a requirement to refund tax benefits (including with interest and adjustments for inflation based on the Israeli consumer price index) already received may have a material adverse effect on our business, operating results and financial condition.

We may engage in future acquisitions that could dilute our stockholders' equity and harm our business, results of operations and financial condition.

We have pursued, and will continue to pursue, growth opportunities through internal development and acquisition of complementary businesses, products and technologies. We are unable to predict whether or when any other prospective acquisition will be completed. The process of integrating an acquired business may be prolonged due to unforeseen difficulties and may require a disproportionate amount of our resources and management's attention. We cannot assure you that we will be able to successfully identify suitable acquisition candidates, complete acquisitions, integrate acquired businesses into our operations, or expand into new markets. Further, once integrated, acquisitions may not achieve comparable levels of revenues, profitability or productivity as our existing business or otherwise perform as expected. The occurrence of any of these events could harm our business, financial condition or results of operations. Future acquisitions may require substantial capital resources, which may require us to seek additional debt or equity financing.

Future acquisitions by us could result in the following, any of which could seriously harm our results of operations or the price of our stock:

- issuance of equity securities that would dilute our current stockholders' percentages of ownership;
- large one-time write-offs;
- the incurrence of debt and contingent liabilities;
- difficulties in the assimilation and integration of operations, personnel, technologies, products and information systems of the acquired companies;
- diversion of management's attention from other business concerns;
- contractual disputes;
- risks of entering geographic and business markets in which we have no or only limited prior experience; and
- potential loss of key employees of acquired organizations.

Because the markets in which we compete are subject to rapid changes, our products may become obsolete or unmarketable.

The markets for our products and services are characterized by rapidly changing technology, short product life cycles, evolving industry standards, changes in customer needs, demand for higher levels of integration, growing competition and new product introductions. Our future growth is dependent not only on the continued

success of our existing products but also successful introduction of new products. Our ability to adapt to changing technology and anticipate future standards, and the rate of adoption and acceptance of those standards, will be a significant factor in maintaining or improving our competitive position and prospects for growth. If new industry standards emerge, our products or our customers' products could become unmarketable or obsolete, and we could lose market share. We may also have to incur substantial unanticipated costs to comply with these new standards. If our product development and improvements take longer than planned, the availability of our products would be delayed. Any such delay may render our products obsolete or unmarketable, which would have a negative impact on our ability to sell our products and our results of operations.

Because of changing customer requirements and emerging industry standards, we may not be able to achieve broad market acceptance of our products. Our success is dependent, in part, on our ability to:

- successfully develop, introduce and market new and enhanced products at competitive prices and in a timely manner in order to meet changing customer needs;
- convince leading OEMs to select our new and enhanced products for design into their own new products;
- respond effectively to new technological changes or new product announcements by others;
- effectively use and offer leading technologies; and
- maintain close working relationships with our key customers.

There are no assurances that we will be successful in these pursuits, that the demand for our products will continue or that our products will achieve market acceptance. Our failure to develop and introduce new products that are compatible with industry standards and that satisfy customer requirements, and the failure of our products to achieve broad market acceptance, could have a negative impact on our ability to sell our products and our results of operations.

Third party claims of infringement or other claims against us could adversely affect our ability to market our products, require us to redesign our products or seek licenses from third parties, and seriously harm our operating results and disrupt our business.

As is typical in the semiconductor industry, we and our customers have been and may from time to time be notified of claims that we may be infringing patents or intellectual property rights owned by third parties. In addition, patent infringement claims are increasingly being asserted by patent holding companies (so-called patent "trolls"), which do not use technology and whose sole business is to enforce patents against companies, such as us, for monetary gain. Because such patent holding companies do not provide services or use technology, the assertion of our own patents by way of counter-claim may be ineffective. We have received claims that our products infringe upon the proprietary rights of such patent holding companies. In addition, third parties have asserted and may in the future assert intellectual property infringement claims against our customers, which we have agreed in certain circumstances to indemnify and defend against such claims. If litigation becomes necessary to determine the validity of any third party claims, it could result in significant expense to us and could divert the efforts of our technical and management personnel, whether or not the claim has merit and notwithstanding that the litigation is determined in our favor.

If it appears necessary or desirable, we may try to obtain licenses for those patents or intellectual property rights that we are allegedly infringing. Although holders of these types of intellectual property rights commonly offer these licenses, we cannot assure you that licenses will be offered or that the terms of any offered licenses will be acceptable to us. Our failure to obtain a license for key intellectual property rights from a third party for technology used by us could cause us to incur substantial liabilities, suspend the manufacturing of products utilizing the technology or damage the relationship with our customers. Alternatively, we could be required to expend significant resources to develop non-infringing technology. We cannot assure you that we would be successful in developing non-infringing technology. The occurrence of any of these events could harm our business, financial condition or results of operations.

We may not be able to adequately protect or enforce our intellectual property rights, which could harm our competitive position.

Our success and ability to compete is in part dependent upon our internally-developed technology and other proprietary rights, which we protect through a combination of copyright, trademark and trade secret laws, as well as through confidentiality agreements and licensing arrangements with our customers, suppliers, employees and consultants. In addition, we have filed a number of patents in the United States and in other foreign countries with respect to new or improved technology that we have developed. However, the status of any patent involves complex legal and factual questions, and the breadth of claims allowed is uncertain. Accordingly, we cannot assure you that any patent application filed by us will result in a patent being issued, or that the patents issued to us will not be infringed by others. Also, our competitors and potential competitors may develop products with similar technology or functionality as our products, or they may attempt to copy or reverse engineer aspects of our product line or to obtain and use information that we regard as proprietary. Moreover, the laws of certain countries in which our products are or may be developed, manufactured or sold, including Hong Kong, Japan, Korea and Taiwan, may not protect our products and intellectual property rights to the same extent as the laws of the United States. Policing the unauthorized use of our products is difficult and may result in significant expense to us and could divert the efforts of our technical and management personnel. Even if we spend significant resources and efforts to protect our intellectual property, we cannot assure you that we will be able to prevent misappropriation of our technology. Use by others of our proprietary rights could materially harm our business and expensive litigation may be necessary in the future to enforce our intellectual property rights.

Because our products are complex, the detection of errors in our products may be delayed, and if we deliver products with defects, our credibility will be harmed, the sales and market acceptance of our products may decrease and product liability claims may be made against us.

Our products are complex and may contain errors, defects and bugs when introduced. If we deliver products with errors, defects or bugs, our credibility and the market acceptance and sales of our products could be significantly harmed. Furthermore, the nature of our products may also delay the detection of any such error or defect. If our products contain errors, defects and bugs, then we may be required to expend significant capital and resources to alleviate these problems. This could result in the diversion of technical and other resources from our other development efforts. Any actual or perceived problems or delays may also adversely affect our ability to attract or retain customers. Furthermore, the existence of any defects, errors or failures in our products could lead to product liability claims or lawsuits against us or against our customers. We generally provide our customers with a standard warranty for our products, generally lasting one year from the date of purchase. Although we attempt to limit our liability for product defects to product replacements, we may not be successful, and customers may sue us or claim liability for the defective products. A successful product liability claim could result in substantial cost and divert management's attention and resources, which would have a negative impact on our financial condition and results of operations.

We are exposed to the credit risk of our customers and to credit exposures in weakened markets, which could result in material losses.

Most of our sales are on an open credit basis. Because of current conditions in the global economy, our exposure to credit risks relating to sales on an open credit basis has increased. We expect demand for enhanced open credit terms, for example, longer payment terms, to continue and believe that such arrangements are a competitive factor in obtaining business. Although we monitor and attempt to mitigate credit risks, including through insurance coverage from time to time, there can be no assurance that our efforts will be effective. Moreover, even if we attempt to mitigate credit risks through insurance coverage, such coverage may not be sufficient to cover all of our losses and we would be subject to a deductible under any insurance coverage. As a result, our future credit risk exposure may increase. Although any losses to date relating to credit exposure of our customers have not been material, future losses, if incurred, could harm our business and have a material adverse effect on our operating results and financial condition. Moreover, the loss of a customer due to its financial default also could harm our future business and potential growth.

Our executive officers and key personnel are critical to our business, and because there is significant competition for personnel in our industry, we may not be able to attract and retain such qualified personnel.

Our success depends to a significant degree upon the continued contributions of our executive management team, and our technical, marketing, sales customer support and product development personnel. The loss of significant numbers of such personnel could significantly harm our business, financial condition and results of operations. We do not have any life insurance or other insurance covering the loss of any of our key employees. Because our products are specialized and complex, our success depends upon our ability to attract, train and retain qualified personnel, including qualified technical, marketing and sales personnel. However, the competition for personnel is intense and we may have difficulty attracting and retaining such personnel.

We may have exposure to additional tax liabilities as a result of our foreign operations.

We are subject to income taxes in both the United States and various foreign jurisdictions. In addition to our significant operations in Israel, pursuant to the Acquisition, we currently have operations in Germany, Hong Kong and India. Significant judgment is required in determining our worldwide provision for income taxes and other tax liabilities. In the ordinary course of a global business, there are many intercompany transactions and calculations where the ultimate tax determination is uncertain. We are regularly under audit by tax authorities. Our intercompany transfer pricing may be reviewed by the U.S. Internal Revenue Service and by foreign tax jurisdictions. Although we believe that our tax estimates are reasonable, due to the complexity of our corporate structure, the multiple intercompany transactions and the various tax regimes, we cannot assure you that a tax audit or tax dispute to which we may be subject will result in a favorable outcome for us. If taxing authorities do not accept our tax positions and impose higher tax rates on our foreign operations, our overall tax expenses could increase.

Legislative action in the United States could materially and adversely affect us from a tax perspective.

Legislative action may be taken by the U.S. Congress which, if ultimately enacted, would adversely affect our effective tax rate and/or require us to take further action, at potentially significant expense, to seek to preserve our effective tax rate. President Obama's administration has announced budgets which included proposed future tax legislation that could substantially modify the rules governing the U.S. taxation of certain non-U.S. affiliates. These potential changes include, but are not limited to, curbing the deferral of U.S. taxation of certain foreign earnings and limiting the ability to use foreign tax credits. Many details of the proposal remain unknown, and any legislation enacting such modifications would require Congressional support and approval. We cannot predict the outcome of any specific legislative proposals. However, if any of these proposals are enacted into law, they could significantly impact our effective tax rate.

We are exposed to fluctuations in currency exchange rates.

A significant portion of our business is conducted outside the United States. Export sales to manufacturers in Europe and Asia, including Japan and Asia Pacific, represented 99% of our total revenues for 2011, 99% for 2010 and 98% for 2009. Although most of our revenue and expenses are transacted in U.S. dollars, we may be exposed to currency exchange fluctuations in the future as business practices evolve and we are forced to transact business in local currencies. Moreover, part of our expenses in Israel are paid in Israeli currency, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the New Israeli Shekel (NIS) and to economic pressures resulting from Israel's general rate of inflation. Our primary expenses paid in NIS are employee salaries and lease payments on our Israeli facilities. Furthermore, a portion of our expenses for our European operations are paid in the Euro, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the Euro. Our primary expenses paid in the Euro are employee salaries, lease and operational payments on our European facilities. As a result, an increase in the value of the NIS and Euro in comparison to the U.S. dollar, which has been the trend in most of the year due to the devaluation of the U.S. dollar, could increase the cost of our technology development, research and development expenses and general and administrative expenses, all of which could harm our operating profit. From time to time, we use derivative

instruments in order to minimize the effects of currency fluctuations, but our hedging positions may be partial, may not exist at all in the future or may not succeed in minimizing our foreign currency fluctuation risks. Our financial results may be harmed if the trend relating to the devaluation of the U.S. dollars continues for an extended period.

Because the markets in which we compete are highly competitive, and many of our competitors have greater resources than we do, we cannot be certain that our products will be accepted in the marketplace or capture market share.

The markets in which we operate are extremely competitive and characterized by rapid technological change, evolving standards, short product life cycles and price erosion. We expect competition to intensify as current competitors expand their product offerings and new competitors enter the market. Given the highly competitive environment in which we operate, we cannot be sure that any competitive advantages enjoyed by our current products would be sufficient to establish and sustain our new products in the market. Any increase in price or competition could result in the erosion of our market share, to the extent we have obtained market share, and would have a negative impact on our financial condition and results of operations.

In each of our business activities, we face current and potential competition from competitors that have significantly greater financial, technical, manufacturing, marketing, sales and distribution resources and management expertise than we do. These competitors may also have pre-existing relationships with our customers or potential customers. Further, in the event of a manufacturing capacity shortage, these competitors may be able to manufacture products when we are unable to do so. Our principal competitors in the cordless market include Lantiq and Dialog Semiconductors, and we have also noted efforts by Beken, a Chinese supplier of basebands for analog cordless phones, to penetrate the DECT market. Our principal competitors in the VoIP market include Broadcom, Dialog Semiconductors, Infineon, Texas Instruments and new Taiwanese IC vendors. Our principal competitors in the multimedia market include Wi-Fi and multimedia application processor IC vendors like Atheros, Broadcom, CSR, Freescale, Intel, Marvel, Ralink, Samsung and Texas Instruments.

As discussed above, various new developments in the home residential market may require us to enter into new markets with competitors that have more established presence, and significantly greater financial, technical, manufacturing, marketing, sales and distribution resources and management expertise than we do. The expenditure of greater resources to expand our current product lines and develop a portfolio of “system-on-a-chip” solutions that integrate video, voice, data and communication technologies in a wider multimedia market may increase our operating expenses and reduce our gross profit. We cannot assure you that we will succeed in developing and introducing new products that are responsive to market demands.

An unfavorable government review of our federal income tax returns or changes in our effective tax rates could adversely affect our operating results.

Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws, regulations, accounting principles or interpretations thereof. In addition, we are subject to the periodic examination of our income tax returns by the IRS and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. The outcomes from these examinations may have an adverse effect on our operating results and financial condition.

Our business operations would be disrupted if the information technology systems we rely on fail to function properly.

We rely on complex information technology systems to manage our business which operates in many geographical locations. For example, to achieve short delivery lead times and superior levels of customer service

while maintaining low levels of inventory, we constantly adjust our production schedules with manufacturers and subcontractors. We develop and adjust these schedules based on end customer demand as communicated by our customers and distributors and based on our inventory levels, manufacturing cycle times, component lead times, and projected production yields. We combine and distribute all of this information electronically over a complex global communications network. Our ability to estimate demand and to adjust our production schedules is highly dependent on this network. Any delay in the implementation of, or disruption in the transition to, new or enhanced processes, systems or controls, could adversely affect our ability to manage customer orders and manufacturing schedules, as well as generate accurate financial and management information in a timely manner. These systems are also susceptible to power and telecommunication disruptions and other system failures. Failure of our IT systems or difficulties in managing them could result in business disruption. Our business could be significantly disrupted and we could be subject to third party claims associated with such disruptions.

We may experience difficulties in transitioning to smaller geometry process technologies or in achieving higher levels of design integration, which may result in reduced manufacturing yields, delays in product deliveries and increased expenses.

A growing trend in our industry is the integration of greater semiconductor content into a single chip to achieve higher levels of functionality. In order to remain competitive, we must achieve higher levels of design integration and deliver new integrated products on a timely basis. This will require us to expend greater research and development resources, and may require us to modify the manufacturing processes for some of our products, to achieve greater integration. We periodically evaluate the benefits, on a product-by-product basis, of migrating to smaller geometry process technologies to reduce our costs. Although this migration to smaller geometry process technologies has helped us to offset the declining average selling prices of our products, this effort may not continue to be successful. Also, because we are a fabless semiconductor company, we depend on our foundries to transition to smaller geometry processes successfully. We cannot assure you that our foundries will be able to effectively manage the transition. In case our foundries or we experience significant delays in this transition or fail to efficiently implement this transition, our business, financial condition and results of operations could be materially and adversely affected.

The anti-takeover provisions in our certificate of incorporation and bylaws, as well as our rights plan, could prevent or discourage a third party from acquiring us.

Our certificate of incorporation and bylaws contain provisions that may prevent or discourage a third party from acquiring us, even if the acquisition would be beneficial to our stockholders. We have a staggered board, which means it will generally take two years to change the composition of our board. Our board of directors also has the authority to fix the rights and preferences of shares of our preferred stock and to issue such shares without a stockholder vote. Only the Chairman of the board, our Chief Executive Officer or the collective of at least three directors on our board is authorized to call a special meeting of stockholders. Our stockholders may take action only at a meeting of stockholders and not by written consent. We have advance notice procedures for stockholders desiring to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders. We also have a rights plan in place. It is possible that these provisions as well as the rights plan may prevent or discourage third parties from acquiring us. In addition, these factors may also adversely affect the market price of our common stock, and the voting and other rights of the holders of our common stock.

Our stock price may be volatile so you may not be able to resell your shares of our common stock at or above the price you paid for them.

Announcements of developments related to our business, announcements by competitors, quarterly fluctuations in our financial results, changes in the general conditions of the highly dynamic industry in which we compete or the national economies in which we do business, and other factors could cause the price of our

common stock to fluctuate, perhaps substantially. In addition, in recent years, the stock market has experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. These factors and fluctuations could have a material adverse effect on the market price of our common stock.

Item 1B. UNRESOLVED STAFF COMMENTS.

None.

Item 2. PROPERTIES.

Our principal executive offices in the United States are located in San Jose, California, where we lease approximately 3,800 square feet under a lease that expires in February 2014. Portions of our U.S. operations are located in leased facilities in Rancho Cordova, California under a lease that expires in July 2013 and El Dorado Hills, California under a lease that expires in March 2015. Our operations in Israel are located in leased facilities, with the primary leased facility of approximately 58,136 square feet located in Herzlia Pituach, Israel. These facilities are leased through November 2013. Our subsidiary in Tokyo, Japan has a lease that terminates in October 2014. Our subsidiary in Scotland has lease agreements for its facilities that terminate in 2012 with automatic renewals on a month-to-month basis. Our subsidiaries in Germany and India, primarily housing the CIPT Business acquired from NXP, have sublease agreements with NXP for their facilities that terminate in 2012. Our subsidiary in Hong Kong entered into a lease agreement that is effective until November 2013. We believe that our existing facilities are adequate to meet our needs for the immediate future.

Item 3. LEGAL PROCEEDINGS.

From time to time, we may become involved in litigation relating to claims arising from our ordinary course of business activities. Also, as is typical in the semiconductor industry, we have been and may from time to time be notified of claims that we may be infringing patents or intellectual property rights owned by third parties. We currently believe that there are no claims or actions pending or threatened against us, the ultimate disposition of which would have a material adverse effect on us.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

Item 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock, par value \$0.001, trades on the NASDAQ Global Select Market (NASDAQ symbol “DSPG”). The following table presents for the periods indicated the high and low sales prices for our common stock as reported by the NASDAQ Global Select Market:

| <u>Year Ended</u> <u>December 31, 2011</u> | <u>High</u> | <u>Low</u> |
|-----------------------------------------------|-------------|------------|
| First Quarter | 8.57 | 7.06 |
| Second Quarter | 9.24 | 7.52 |
| Third Quarter | 8.81 | 5.86 |
| Fourth Quarter | 6.75 | 5.12 |
| | | |
| <u>Year Ended</u> <u>December 31, 2010</u> | <u>High</u> | <u>Low</u> |
| First Quarter | 8.90 | 5.34 |
| Second Quarter | 9.10 | 5.76 |
| Third Quarter | 7.23 | 6.03 |
| Fourth Quarter | 8.53 | 6.73 |

As of March 7, 2012, there were 22,731,823 shares of common stock outstanding, representing approximately 41 holders of record. There were we believe approximately 2,960 beneficial holders as of February 15, 2012. We have never paid cash dividends on our common stock and presently intend to continue a policy of retaining any earnings for reinvestment in our business.

Equity Compensation Plan Information

Information relating to our equity compensation plans will be presented under the caption “Equity Compensation Plan Information” of our definitive proxy statement pursuant to Regulation 14A in connection with the annual meeting of stockholders to be held on May 15, 2012. The definitive proxy statement will be filed with the Securities and Exchange Commission no later than 120 days after the end of the fiscal year covered by this report. Such information is incorporated herein by reference.

Issuer Purchases of Equity Securities

During the fourth quarter of 2011, we repurchased 522,539 shares of our common stock at an average price of \$6.06 per share for approximately \$3,169,000. The table below sets forth the information with respect to repurchases of our common stock during the three months ended December 31, 2011.

| <u>Period</u> | <u>(a) Total</u> <u>Number of</u> <u>Shares</u> <u>Purchased</u> | <u>(b) Average</u> <u>Price Paid per</u> <u>Share</u> | <u>(c) Total Number</u> <u>of Shares</u> <u>Purchased as Part</u> <u>of Publicly</u> <u>Announced Plans</u> <u>or Programs</u> | <u>(d) Maximum</u> <u>Number of Shares</u> <u>that May Yet Be</u> <u>Purchased Under</u> <u>the Plans or</u> <u>Programs</u> (1) |
|--------------------------------------------------------|---------------------------------------------------------------------------|-------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------|
| Month #1 (October 1, 2011 to October 31, 2011) . . . | — | — | — | 2,113,718 |
| Month #2 (November 1, 2011 to November 30, 2011) | 379,009 | 6.08 | 379,009 | 1,734,709 |
| Month #3 (December 1, 2011 to December 31, 2011) | 143,530 | 6.03 | 143,530 | 1,591,179(1) |

(1) The number represents the number of shares of our common stock that remain available for repurchase pursuant to our board’s authorizations as of December 31, 2011.

Pursuant to authorizations in March 1999, July 2003, October 2004, January 2007 and January 2008, our board of directors authorized a share repurchase program for the repurchase of an aggregate of 14.9 million shares of our common stock. Also in January 2008, our board approved the company's entry into a share repurchase plan, in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934, for the repurchase of 5.0 million of the aggregate shares of our common stock authorized for repurchase, which plan has since expired. In October 2010, our board of directors authorized an increase in the number of shares available for repurchase, thereby increasing the aggregate number of shares authorized for repurchase under our share repurchase program to 2 million shares. In July 2011, the Company's Board of Directors authorized an increase in the Company's share repurchase program by 1 million shares of common stock.

At December 31, 2011, 1,591,179 shares of our common stock remained available for repurchase under our board authorized share repurchase program. The repurchase program is being affected from time to time, depending on market conditions and other factors, through open market purchases and privately negotiated transactions. The repurchase program has no set expiration or termination date.

Information relating to our equity compensation plans will be presented under the caption "Equity Compensation Plan Information" of our definitive proxy statement pursuant to Regulation 14A in connection with the annual meeting of stockholders to be held on May 15, 2012. The definitive proxy statement will be filed with the Securities and Exchange Commission no later than 120 days after the end of the fiscal year covered by this report. Such information is incorporated herein by reference.

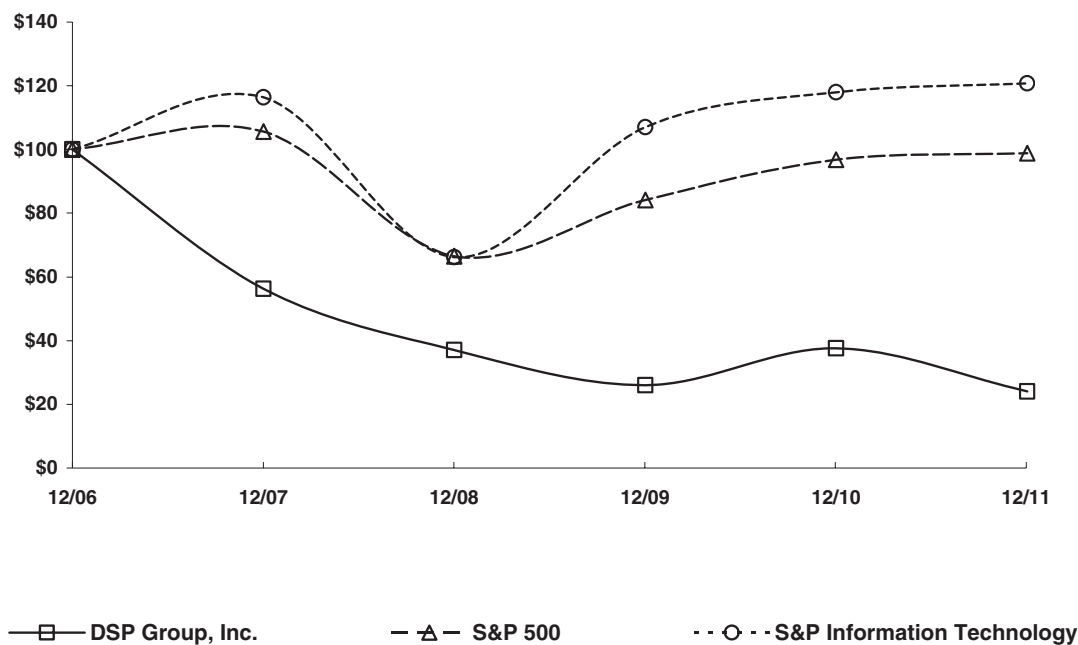
Stock Performance Graph

Notwithstanding anything to the contrary set forth in any of the Company's previous or future filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, that might incorporate this proxy statement or future filings made by the Company under those statutes, the Stock Performance Graph shall not be deemed filed with the United States Securities and Exchange Commission and shall not be deemed incorporated by reference into any of those prior filings or into any future filings made by the Company under those statutes.

The graph below compares the cumulative total stockholder return on our common stock with the cumulative total return on the Standard & Poor's 500 Index and Standard & Poor's Information Technology Index. The period shown commences on December 31, 2006 and ends on December 31, 2011, the end of our last fiscal year. The graph assumes an investment of \$100 on December 31, 2006, and the reinvestment of any dividends.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among DSP Group, Inc., the S&P 500 Index,
and the S&P Information Technology Index



*\$100 invested on 12/31/06 in stock or index, including reinvestment of dividends.
Fiscal year ending December 31.

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Comparisons in the graph above are based upon historical data and are not indicative of, nor intended to forecast, future performance of our common stock.

Item 6. SELECTED FINANCIAL DATA

The selected historical consolidated financial data presented below is derived from our consolidated financial statements. The selected consolidated financial data set forth below is qualified in its entirety by, and should be read in conjunction with, our consolidated financial statements for the year ended December 31, 2011, and the discussion of our business, operations and financial results in the section captioned, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

| | Year Ended December 31, | | | | |
|----------------------------------------------------------------------------------------------------------------------|-------------------------|-------------------|-------------------|---------------------|-------------------|
| | 2011 | 2010 | 2009 | 2008 | 2007 |
| (U.S. dollars in thousands) | | | | | |
| Statements of Operations Data: | | | | | |
| Revenues | \$193,861 | \$225,482 | \$212,186 | \$ 305,800 | \$248,788 |
| Cost of revenues | 123,734 | 137,571 | 133,590 | 191,811 | 148,075 |
| Gross profit | 70,127 | 87,911 | 78,596 | 113,989 | 100,713 |
| Operating expenses | | | | | |
| Research and development | 53,244 | 55,588 | 56,148 | 73,856 | 58,488 |
| General, administrative, sales and marketing | 29,417 | 31,561 | 33,117 | 40,583 | 33,674 |
| In process research and development write-off | — | — | — | — | 10,350 |
| Amortization of intangible assets | 7,972 | 9,975 | 12,258 | 22,853 | 11,102 |
| Impairment of goodwill and other intangible assets | — | — | — | 181,534 | — |
| Restructuring cost (income) | (170) | 463 | — | 1,870 | — |
| Total operating expenses | 90,463 | 97,587 | 101,523 | 320,696 | 113,614 |
| Operating loss | (20,336) | (9,676) | (22,927) | (206,707) | (12,901) |
| Financial and other income | | | | | |
| Financial income, net | 1,885 | 1,468 | 2,857 | 160 | 10,541 |
| Other income from remeasurement of investment in a business combination | 1,343 | — | — | — | — |
| Loss before taxes | (17,108) | (8,208) | (20,070) | (206,547) | (2,360) |
| Taxes on income (benefit) | (866) | (783) | (11,634) | 5,847 | 2,393 |
| Net loss | <u>\$ (16,242)</u> | <u>\$ (7,425)</u> | <u>\$ (8,436)</u> | <u>\$ (212,394)</u> | <u>\$ (4,753)</u> |
| Weighted average number of Common Stock outstanding during the period used to compute basic net earnings per share | 23,247 | 23,229 | 23,655 | 28,387 | 29,495 |
| Weighted average number of Common Stock outstanding during the period used to compute diluted net earnings per share | 23,247 | 23,229 | 23,655 | 28,387 | 29,495 |
| Basic net loss per share | \$ (0.70) | \$ (0.32) | \$ (0.36) | \$ (7.48) | \$ (0.16) |
| Diluted net loss per share | \$ (0.70) | \$ (0.32) | \$ (0.36) | \$ (7.48) | \$ (0.16) |
| Balance Sheet Data: | | | | | |
| Cash, cash equivalents, marketable securities and bank deposits, including restricted cash | \$117,909 | \$139,761 | \$123,065 | \$ 121,501 | \$167,737 |
| Working capital | \$ 60,010 | \$ 72,073 | \$ 68,013 | \$ 92,359 | \$134,896 |
| Total assets | \$196,056 | \$222,555 | \$219,769 | \$ 249,254 | \$512,843 |
| Total stockholders' equity | \$148,624 | \$167,103 | \$165,489 | \$ 178,627 | \$424,857 |

| Fiscal Years by Quarter Quarterly Data: | Year Ended December 31, | | | | | | | |
|--------------------------------------------|-----------------------------------------------------------------|------------|------------|------------|------------|----------|-----------|-----------|
| | 2011 | | | | 2010 | | | |
| | 4th | 3rd | 2nd | 1st | 4th | 3rd | 2nd | 1st |
| | (Unaudited, U.S. dollars in thousands, except per share amount) | | | | | | | |
| Revenues | \$38,195 | \$48,373 | \$58,517 | \$48,776 | \$43,372 | \$65,155 | \$60,846 | \$56,109 |
| Gross profit | \$13,628 | \$17,520 | \$21,751 | \$17,228 | \$15,720 | \$25,348 | \$23,254 | \$23,589 |
| Net income (loss) | \$ (4,823) | \$ (4,814) | \$ (2,041) | \$ (4,564) | \$ (8,792) | \$ 1,917 | \$ (366) | \$ (184) |
| Net income (loss) per share— | | | | | | | | |
| Basic | \$ (0.21) | \$ (0.21) | \$ (0.09) | \$ (0.19) | \$ (0.38) | \$ 0.08 | \$ (0.02) | \$ (0.01) |
| Net income (loss) per share— | | | | | | | | |
| Diluted | \$ (0.21) | \$ (0.21) | \$ (0.09) | \$ (0.19) | \$ (0.38) | \$ 0.08 | \$ (0.02) | \$ (0.01) |

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion and analysis is intended to provide an investor with a narrative of our financial results and an evaluation of our financial condition and results of operations. The discussion should be read in conjunction with our consolidated financial statements and notes thereto.

The following discussion and analysis is intended to provide an investor with a narrative of our financial results and an evaluation of our financial condition and results of operations. The discussion should be read in conjunction with our consolidated financial statements and notes thereto.

Business Overview

DSP Group is a leading global provider of wireless chipset solutions for converged communications at home, delivering system solutions that combine semiconductors and software with reference designs. We provide a broad portfolio of wireless chipsets integrating DECT, Wi-Fi, PSTN and VoIP technologies with state-of-the-art application processors. We also enable converged voice, audio, video and data connectivity across diverse consumer products – from cordless and VoIP phones to home gateways and connected multimedia screens. Our current primary focus is digital cordless telephony with sales of our in-house developed DECT, CoIP, 2.4GHz and 5.8GHz chipsets representing approximately 94% of our total revenues for 2011.

In December 2011, we exercised our option to acquire the remaining 70% equity interest, on a fully diluted basis, in BoneTone Communications, Ltd. (“BoneTone”) for a purchase price of \$8.6 million. In November 2009, we invested \$2.2 million in BoneTone in return for approximately 30% of BoneTone’s then outstanding equity, on a fully diluted basis.

In September 2007, we acquired the cordless and VoIP terminals business (the “CIPT Business”) of NXP B.V. (“NXP”) (the “Acquisition”). In connection with the Acquisition, we paid NXP approximately \$200 million in cash and issued 4,186,603 shares of our common stock to NXP. On March 12, 2009, we repurchased the shares of common stock issued to NXP in connection with the Acquisition for an aggregate consideration of approximately \$20 million.

Our revenues were \$193.9 million for 2011, a decrease of 14.0% in comparison to 2010, mainly due to the decrease in quantities and reduction in average selling prices of our cordless telephony products, offset by the increase in revenues from sales of next generation products, such as products for home gateways, monitoring and VoIP applications. Sales of our DECT 6.0 products in the U.S. market decreased from \$84.2 million for 2010 to \$75.4 million for 2011. Revenues derived from the sale of DECT products during 2011 represented 82% of our total revenues, as compared to 78% of our total revenues for 2010. Our gross margin decreased to 36.2% of our total revenues for 2011 from 39.0% for 2010, primarily due to (i) a decrease in overall revenues, (ii) a decrease in average selling prices of our products, (iii) an increase in certain production costs, such as gold, and (iv) income of \$2.5 million recorded in 2010 from a reversal of a reserve associated with a potential patent infringement claim that was determined to be no longer needed due to the expiration of the applicable statute of limitations.

Our operating loss increased to \$20.3 million for 2011, as compared to \$9.7 million for 2010. The increase in operating losses for 2011 was mainly as a result of a decrease in total revenues and gross margins during 2011 as compared to 2010, offset to some extent by a decrease in operating expenses in 2011 as compared to 2010.

Our 2011 operating results were negatively affected by a near-term and temporary industry-wide slowdown in demand for cordless telephony products that began in the second quarter of 2011 and continued throughout 2011. We believed there were two main reasons for the weakness: (i) softer consumer demand for cordless telephony products in the U.S. and Europe, and (ii) in anticipation of the market slowdown in 2011, customers reduced their normalized inventory levels and generally tightened their inventory policies across their supply chain to minimize working capital exposure. However, market conditions indicate that the slowdown in demand

for cordless telephony products experienced by the industry in 2011 has stabilized and customers are returning to their normalized inventory cycles in 2012. Also, we are actively engaged in addressing the market challenges and trends. Our operating expenses decreased by 7.3% to \$90.5 million for 2011, as compared to \$97.6 million for 2010. In addition, we implemented a new cost reduction program, focused mainly on our research and development activities, and expect the program to result in an additional decrease in research and development expenses.

Nonetheless, our business operates in a highly competitive environment. Competition has historically increased pricing pressures for our products and decreased our average selling prices, and we believe this trend will continue. As a result, we expect the market to remain price sensitive and expect price erosion to continue. Various other factors, including increases in the cost of raw materials and commodities and our suppliers passing such increases onto us, increases in silicon wafer costs and increases in production, assembly and testing costs, and shortage of capacity to fulfill our fabrication, assembly and testing needs, all may decrease our gross profit and could harm our ability to grow our revenues in future periods. Moreover, the continued uncertainty about the sustainability of the global economic recovery and outlook has resulted in accelerated erosion of prices, longer product cycles and decision-making processes at our customers' organizations, and general adverse business conditions.

In addition to general market competitiveness and weakness in consumer demands, the cordless telephony market, from which we derive most of our revenues, is undergoing a challenging period of transition characterized by stagnation due to the lack of new model launches and market anticipation of next generation products. With the rapid deployment of new communication access methods, including mobile, wireless broadband, cable and other connectivity, the traditional cordless telephony market using fixed-line telephony is stagnant, which may reduce our revenues derived from, and unit sales of, cordless telephony products. Furthermore, our business also may be significantly affected by the outcome of the competition between cellular phone operators and fixed-line operators for the provision of residential communication. A significant majority of our revenues are currently generated from sales of chipsets used in cordless phones that are based on fixed-line telephony. If we are unable to develop new technologies to address alternative connectivity methods, our business could be materially adversely affected.

In response to market trends, we are concentrating our development efforts on new products, also referred to as next generation products, and opportunities to leverage our strong technology base and customer relationships to address evolving market opportunities and take advantage of the current market trends in our domain. Our next generation products include three main groups of products: (i) DECT/CAT-iq ICs targeted for residential gateway devices supplied by telecommunication service providers and which integrate the DECT/CAT-iq functionality and address the newly evolving market of smart home phones and home automation applications; (ii) VoIP products for enterprise, home and SoHo; and (iii) products for the mobile market in the form of fixed-mobile convergence solutions and products targeted for mobile headsets. The first phase of products that integrate residential gateway products involves the integration of our DECT chip into the residential gateway, thereby allowing telecommunication operators to transform gateways into a base of the cordless system. The second phase of products that integrate residential gateway products involves the integration of our multimedia XpandR chipset into the residential gateway and into its cordless handsets, thereby enabling a distributed multimedia environment for home-connected devices embedded with DECT and Wi-Fi. These smart home phone devices, on top of delivering advanced voice services, would support many home related applications such as audio/video controls, home automation, monitoring and safety. In addition, these devices would support wireless multimedia streaming and processing, including music, HD video and video communications. The second family of VoIP SoCs for SoHo and the enterprise involve a technology that enables users to make voice calls via a broadband Internet connection. Our VoIP solution enables the design and production of low-cost terminals to provide best in class voice and call quality, expandability, multi line and multi-handset phones with an integrated full functionality PBX. The third group includes the fixed-mobile convergence solutions that involves products that enable dual-mode, fixed-mobile handsets with connectivity within the residence or outdoors. Other products

in this category include dual-mode, fixed-mobile base terminal and cordless products with Bluetooth connectivity. This group also includes products targeted for mobile headsets that are based on the BoneTone technology.

We are seeing strong evidence that our research and development investments in new technologies are beginning to materialize. We have achieved a number of design wins for these new products and commercial shipments for some products have begun with more shipments to occur during 2012. Aggregate revenues from our next generation products were 10.3% of our total revenues for 2011 and 7.1% for 2010. Based on a strong pipeline of design wins, our current mix of next generation products and anticipated commercialization schedules of customers incorporating our next generation products, we anticipate annualized revenues generated from our next generation products to increase significantly in 2012 as compared to 2011. As a result of the growth in revenues from next generation products, as well as stabilization of inventory cycles for our traditional cordless business discussed earlier and new design wins in cordless telephony products, we project annualized revenue growth in 2012 in comparison to 2011. However, we can provide no assurances about our success in introducing new products and penetrating new markets, as well as predictions about market trends. Furthermore, although next-generation products targeted at the convergence of voice, audio, video and data connectivity and at enterprise VoIP solutions are gradually being introduced into the market, market adoption of such products is at early stages. Although we have achieved a number of design wins with top-tier OEMs for next-generation products, revenue generated from the commercialization of new products is a measured process as there is generally a long lead time from a design win to commercialization. From initial product design win to volume production, many factors could impact the timing and/or amount of sales actually realized from the design win. The introduction of next-generation productions also may lead to price erosion of older products. As a result, we expect the market to remain price sensitive for 2012 for our traditional cordless telephony products and expect that price erosion and decrease in the average selling prices of such products to continue, both of which may negatively affect our revenues and gross margins for 2012.

As of December 31, 2011, our principal source of liquidity consisted of cash and cash equivalents of \$18.1 million and marketable securities and short term deposits of \$99.7 million, totaling \$117.8 million.

Critical Accounting policies

Our consolidated financial statements are prepared in accordance with U.S. GAAP. In connection with the preparation of the financial statements, we are required to make assumptions and estimates about future events, and apply judgment that affect the reported amounts of assets, liabilities, revenue, expenses and the related disclosure. We base our assumptions, estimates and judgments on historical experience, current trends and other factors that management believes to be relevant at the time the consolidated financial statements are prepared. On a regular basis, management reviews our accounting policies, assumptions, estimates and judgments to ensure that our financial statements are presented fairly and in accordance with U.S. GAAP. However, because future events and their effects cannot be determined with certainty, actual results could differ from our assumption and estimates, and such differences could be material.

Our significant accounting policies are discussed in Note 2, Significant Accounting Policies, of the Notes to our consolidated financial statements for the year ended December 31, 2011.

Management believes that the following accounting policies require management’s most difficult, subjective and complex judgments, resulting from the need to make estimates about the effect of matters that are inherently uncertain. Management has reviewed these critical accounting policies and related disclosures with our independent auditors and audit committee.

| <u>Description</u> | <u>Judgments & Uncertainties</u> | <u>Effect if Actual Results Differ from Assumptions</u> |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Tax Contingencies: Like most companies, domestic and foreign tax authorities periodically audit our income tax returns. These audits include questions regarding our tax filing positions, including the timing and amount of deductions and the allocation of income among various tax jurisdictions. In evaluating the exposure associated with our various tax filing positions, including state, foreign and local taxes, we record reserves for probable exposures. A number of years may elapse before a particular matter, for which we have established a reserve, is audited and fully resolved.</p> <p>We report a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. We recognize interest and penalties, if any, related to unrecognized tax benefits in income tax expense.</p> | <p>The estimate of our tax contingency reserve contains uncertainty because management must use judgment to estimate the exposure associated with our various tax filing positions.</p> <p>According to FASB ASC No. 740, “Income Taxes,” the first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement.</p> | <p>Although management believes that its estimates and judgments about tax contingencies are reasonable, actual results could differ, and we may be exposed to gains or losses that could be material. To the extent we prevail in matters for which reserve has been established, or are required to pay amounts in excess of the reserve, our effective tax rate for a given financial statement period could be materially affected. An unfavorable tax settlement would require use of our cash and result in an increase in our effective tax rate for the year of resolution. A favorable tax settlement would be recognized as a reduction in our effective tax rate for the year of resolution.</p> |
| <p>Tax Valuation Allowance: We have a valuation allowance for deferred tax assets based on the determination that it is more likely than not that some of these assets will not be realized.</p> | <p>Our management inherently must make estimates to determine the ultimate realization of these assets. The estimate of our tax valuation allowance contains uncertainty because management must use judgment to estimate the expected results for tax purposes.</p> | <p>Although management believes that its estimates and judgments about expected results for tax purposes are reasonable, actual results could differ, and we may be required to record an additional valuation allowance for our deferred tax assets.</p> |
| <p>Valuation of Long-Lived Assets, Intangible Assets and Goodwill : Goodwill represents the excess of purchase price over the fair value of identifiable net assets acquired in business combination. The goodwill on our consolidated balance sheet is a result of our acquisition of</p> | <p>We determine fair value using widely accepted valuation techniques, including discounted cash flow and market multiple analyses. These types of analyses require us to make assumptions and estimates regarding industry economic factors and the</p> | <p>If our estimates or related assumptions change in the future, we may be required to record impairment charges for our intangible assets.</p> |

| Description | Judgments & Uncertainties | Effect if Actual Results Differ from Assumptions |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------|
| <p>BoneTone. Goodwill and the identifiable intangible assets included on our consolidated balance sheet are current technology and customer relations, acquired from NXP in the Acquisition and in-process R&D and non-competition agreement acquired in the BoneTone acquisition.</p> | <p>profitability of future business strategies. It is our policy to conduct impairment testing based on our current business strategy in light of present industry and economic conditions, as well as future expectations.</p> | |
| <p>We perform our annual impairment analysis of goodwill and indefinite-lived intangible assets (such as in-process research and development) in the fourth quarter of each fiscal year, or more often if there are indicators of impairment. We review intangible assets with finite useful life for potential impairment when events or changes in circumstances indicate the carrying value of those intangible assets may be impaired. We may obtain an appraisal from an independent valuation firm to determine the amount of impairment, if any. In addition to the use of an independent valuation firm, we perform internal valuation analyses and consider other publicly available market information.</p> | | |
| <p>Contingencies and Other Accrued Expenses: We are from time to time involved in legal proceedings and other claims. We are required to assess the likelihood of any adverse judgments or outcomes to these matters, as well as potential ranges of probable losses.</p> | <p>A determination of the amount of reserve required, if any, for any contingencies and accruals is made after careful analysis of each individual issue. The required reserve may change due to future developments, such as a change in the settlement strategy in dealing with any contingencies, which may result in higher net losses.</p> | <p>If actual results are not consistent with our assumptions and judgments, we may be exposed to gains or losses that could be material.</p> |

| <u>Description</u> | <u>Judgments & Uncertainties</u> | <u>Effect if Actual Results Differ from Assumptions</u> |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Inventory Write-Off: We value our inventory at the lower of the cost of the inventory or fair market value through the establishment of write-off and inventory loss reserve. We have not made any changes in the accounting methodology used to establish our markdown or inventory loss reserves during the past four fiscal years.</p> | <p>Our write-off represents the excess of the carrying value, typically cost, over the amount we expect to realize from the ultimate sale or other disposal of inventory based upon our assumptions regarding forecasted consumer demand, the promotional environment, inventory aging and technological obsolescence.</p> | <p>If our estimates regarding consumer demand are inaccurate or changes in technology affect demand for certain products in an unforeseen manner, we may be exposed to losses or gains in excess of our established write-off that could be material.</p> |
| <p>Equity-Based Compensation Expense: Equity-based compensation expense is measured on the grant date based on the fair value of the award and is recognized as an expense over the requisite service periods.</p> | <p>Determining the fair value of equity-based awards on the grant date requires the exercise of judgment, including the amount of equity-based awards that are expected to be forfeited. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results, and future changes in estimates, may differ substantially from our current estimates.</p> | <p>Although management believes that their estimates and judgments about equity-based compensation expense are reasonable, actual results could differ.</p> |
| | <p>We estimate the fair value of equity-based awards using a binomial option pricing model. The fair value of an award is affected by our stock price on the date of grant as well as other assumptions, including expected stock price volatility and the expected term of the equity-based award. The risk-free interest rate is based on the yield from U.S. treasury bonds with an equivalent term. Expected volatility is calculated based upon actual historical stock price movements. The expected term of the equity-based award granted is based upon historical experience and represents the period of time that the award granted is expected to be outstanding. Our expected dividend rate is zero since we do not currently pay cash dividends and do not anticipate doing so in the foreseeable future.</p> | |

| <u>Description</u> | <u>Judgments & Uncertainties</u> | <u>Effect if Actual Results Differ from Assumptions</u> |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Pension Liability: We account for pension liability in accordance with FASB ASC No. 715, “Defined Benefit Plans.”</p> | <p>The costs and obligations of our defined benefit pension plans are dependent on actuarial assumptions. The two critical assumptions used, which impact the net periodic pension cost (income) and the benefit obligations, are the discount rate and expected return on plan assets. The discount rate represents the market rate for a high quality government bond, and the expected return on plan assets is based on current and expected asset allocations, historical trends and expected returns on plan assets. These key assumptions are evaluated annually. Changes in these assumptions can result in different expense and liability amounts.</p> | <p>Although management believes that their estimates and judgments about pension liability are reasonable, actual results could differ, and we may be exposed to gains or losses that could be material.</p> |
| <p>Marketable Securities: Management determines the appropriate classification for our investments in debt and equity securities at the time of purchase and re-evaluates such determination at each balance sheet date.</p> | <p>The marketable securities are periodically reviewed for impairment. If it is concluded that any of these investments are impaired, management determines whether such impairment is “other-than-temporary.” Factors that are considered in making such a determination include the duration and severity of the impairment, the reason for the decline in value and the potential recovery period, and our intent to sell, or whether it is more likely than not that we will be required to sell, the investment before recovery of its cost basis. If any impairment is considered “other-than-temporary,” the investment is written down to its fair value and a corresponding charge is recorded in financial income, net.</p> | <p>Although management believes that their considerations and judgments about fair value and whether a loss associated with a marketable security is other-than-temporary, actual results could differ. Given current market conditions and uncertainty, management’s judgments could prove to be wrong, and companies with relatively high credit ratings and solid financial conditions may not be able to fulfill their obligations and thereby cause other-than-temporary losses.</p> |

| <u>Description</u> | <u>Judgments & Uncertainties</u> | <u>Effect if Actual Results Differ from Assumptions</u> |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Business Combination: In December 2011, the Company exercised its option to acquire the remaining 70% equity interest in BoneTone, on a fully diluted basis, for a purchase price of \$8.6 . The acquisition was treated in accordance with ASC 805, “Business Combination Accounting.” The Company has allocated the purchase price of BoneTone to tangible and acquisition-related intangible assets acquired and liabilities assumed based on their estimated fair values.</p> | <p>The Company makes estimates of fair value using reasonable assumptions based on historical experience and information obtained from the BoneTone management in order to allocate the purchase price to the tangible and intangible assets.</p> | <p>The valuations require significant estimates and assumptions, especially with respect to acquisition-related intangible assets. Although management believes that their estimates and judgments about the business combination are reasonable, actual results could differ.</p> |

Results of Operations:

Total Revenues. Our total revenues were \$193.9 million for 2011, \$225.2 million for 2010 and \$212.2 million for 2009. The decrease of 14% in revenues for 2011 as compared to 2010 was primarily a result of decreased sales of our 2.4GHz and DECT products. The increase of 6% in revenues for 2010 as compared to 2009 was primarily a result of increased sales of our DECT products. Sales of DECT products were \$159.4 million, \$176.8 million and \$163.2 million for the years ended 2011, 2010 and 2009, respectively, representing approximately 82%, 78% and 77% of our total revenues for 2011, 2010 and 2009, respectively. The decrease of 10% in absolute dollars of DECT sales in 2011 as compared 2010 was mainly attributable to the general decrease in sales of all of our products. In addition, sales of our DECT 6.0 products for the U.S. end market were \$75.4 million, \$84.2 million and \$78.8 million for 2011, 2010 and 2009, respectively, representing 39%, 37% and 39% of our total revenues for 2011, 2010 and 2009, respectively.

Sales of 2.4GHz products were \$18.3 million, \$29.3 million and \$25.8 million for 2011, 2010 and 2009, respectively, representing 9%, 13% and 12% of our total revenues for 2011, 2010 and 2009, respectively. This represents a decrease of 38% in absolute dollars when comparing sales for 2011 to 2010, which resulted mainly from the decrease of the sales of our 2.4 GHz products in the Japanese domestic market. When comparing sales for 2010 to 2009, there was an increase of 14% in absolute dollars which resulted mainly from the increase of sales of our 2.4GHz products in the Japanese domestic market and the Chinese market.

The following table shows the breakdown of revenues for all product lines for the periods indicated by geographic location based on the geographic location of our customers (in thousands):

| | <u>Year Ended December 31,</u> | | |
|----------------------|--------------------------------|-------------|-------------|
| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
| United States | \$ 1,836 | \$ 1,423 | \$ 3,382 |
| Japan | 57,260 | 76,986 | 71,388 |
| Europe | 9,180 | 13,043 | 15,448 |
| Hong Kong | 100,894 | 112,319 | 95,204 |
| Korea | 5,909 | 8,081 | 20,233 |
| China | 8,577 | 6,807 | 4,472 |
| Taiwan | 7,225 | 3,208 | 2,031 |
| Other | 2,980 | 3,615 | 28 |
| Total revenues | \$193,861 | \$225,482 | \$212,186 |

Sales to our customers in Hong Kong decreased for 2011 as compared to the same period of 2010, representing a decrease of 10% in absolute dollars. The decrease in our sales to Hong Kong for the comparable periods resulted from the decrease in sales to all of our Hong Kong-based customers, including a decrease of 9% in sales to Vtech Holding Ltd. (“Vtech”) when comparing 2011 to 2010. Sales to our customers in Japan decreased for 2011 as compared to the same period of 2010, representing a decrease of 26% in absolute dollars. The decrease in our sales to Japan for the comparable periods resulted mainly from (i) a decrease in sales to Panasonic Communications Co. Ltd. (“Panasonic”), representing a 28% decrease in absolute dollars for 2011, as compared to 2010, and (ii) a decrease in sales to the Japanese domestic market, representing a 41% decrease in absolute dollars for 2011, as compared to 2010.

As our products are generally incorporated into consumer products sold by our OEM customers, our revenues are affected by seasonal buying patterns of consumer products sold by our OEM customers that incorporate our products. The fourth quarter in any given year is usually the strongest quarter of sales for our OEM customers and, as a result, the third quarter in any given year is usually the strongest quarter for our revenues as our OEM customers request increased shipments of our products in anticipation of the fourth quarter holiday season. By contrast, the first quarter in any given year is usually the weakest quarter for us. This trend can be generally observed from reviewing our quarterly information and results of operations. However, the magnitude of this trend varies annually and is affected by macro-economic trends. For example, as a result of the accumulation of inventory by our customers during the first half of 2010, there was excess inventory by 2010 year end, thereby causing a decrease in demand from our customers during the first quarter of 2011 and further negatively impacting the seasonality trend for the first quarter of 2011. Also, we believe there was a near-term and temporary slowdown in demand for cordless telephony products during the second half of 2011. In anticipation of this market slowdown, we witnessed certain reduction of normalized inventory levels by our customers and their customers. Both of these trends adversely impacted our revenues for the third and fourth quarters of 2011.

Significant Customers. VTech is a significant OEM customer based in Hong Kong. Sales to VTech represented 33%, 31% and 29% of our total revenues for 2011, 2010 and 2009, respectively. Another significant customer of the company in Hong Kong is CCT Telecom, whose sales represented 11%, 10% and 8% of our total revenues for 2011, 2010 and 2009, respectively.

The Japanese market and the OEMs that operate in that market are among the largest suppliers of residential wireless products with significant market share in the U.S. market. Revenues derived from sales through our largest distributor, Tomen Electronics Corporation (“Tomen Electronics”), accounted for 19% of our total revenues in 2011, as compared to 25% in 2010 and 22% for 2009. Sales to Uniden America Corp. (“Uniden”) represented 10%, 9% and 12% of our total revenues for 2011, 2010 and 2009, respectively.

Tomen Electronics sells our products to a limited number of customers. One customer, Panasonic, has continually accounted for a majority of sales through Tomen Electronics. Sales to Panasonic through Tomen Electronics generated approximately 13%, 16% and 13% of our total revenues for 2011, 2010 and 2009, respectively. The loss of Tomen Electronics as a distributor and our inability to obtain a satisfactory replacement in a timely manner would harm our sales and results of operations. Additionally, the loss of Panasonic and Tomen Electronics’ inability to thereafter effectively market our products would also harm our sales and results of operations.

In addition to Tomen Electronics and Panasonic, the loss of any of our other significant customers or distributors, including VTech, or reduced demand for products from, or the reduction in purchasing capability of, one of our other significant customers, could have a material adverse effect on our business, financial condition and results of operations.

Significant Products. Revenues from our DECT products represented 82%, 78% and 77% of our total revenues for 2011, 2010 and 2009, respectively. Revenues from our 2.4GHz products represented 9%, 13% and

12% of our total revenues for 2011, 2010 and 2009, respectively. We believe that sales of DECT and 2.4GHz products will continue to represent a substantial percentage of our revenues for 2012. We believe that the rapid deployment of new communication access methods, as well as the lack of growth in fixed-line telephony, will reduce our total revenues derived from, and unit sales of, cordless telephony products, including our DECT and 2.4GHz products, for the long term.

Gross Profit. Gross profit as a percentage of revenues was 36.2% for 2011, 39% for 2010 and 37% for 2009. The decrease in our gross profit for 2011 as compared to 2010 was primarily due to (i) a decrease in overall revenues, (ii) a decrease in average selling prices of our products, (iii) an increase in certain production costs and related materials, such as gold, and (iv) income from a reversal of a reserve, during 2010, amounting to \$2.5 million associated with a potential patent infringement claim that was determined to be no longer needed due to the expiration of the applicable statute of limitations. The increase in our gross profit for 2010 as compared to 2009 was primarily due to (i) the reversal of a reserve, during 2010, amounting to \$2.5 million associated with a potential patent infringement claim that was determined to be no longer needed due to the expiration of the applicable statute of limitations, (ii) an increase in overall revenues, and (iii) increased sales of products with higher gross margins. As gross profit reflects the sale of chips and chipsets that have different margins, changes in the mix of products sold have impacted and will continue to impact our gross profit in future periods. Our gross profit may decrease in the future due to a variety of factors, including the continued decline in the average selling prices of our products, changes in the mix of products sold, our failure to achieve cost reductions, roll-out of new products in any given period, our success in introducing new engineering processes to reduce manufacturing costs, increases in the cost of raw materials such as gold, oil and silicon wafers, and increases in production, assembly and testing costs. Moreover, our suppliers may pass the increase in the cost of raw materials and commodities onto us which would further reduce the gross margins of our products. We cannot guarantee that our ongoing efforts in cost reduction and yield improvements will be successful or that they will keep pace with the anticipated continuing decline in average selling prices of our products. Steps we are taking include the implementation of cost improvement plans to reduce testing costs and offering our customers more cost effective products by, for example, replacing gold wiring with copper wiring. However, we can provide no assurance that any alternative solutions we provide to our customers will be acceptable to them or that these steps will help us offset the continued decrease in gross margins of our products.

Cost of goods sold consists primarily of costs of wafer manufacturing and fabrication, assembly and testing of integrated circuit devices and related overhead costs, and compensation and associated expenses related to manufacturing and testing support and logistics personnel.

Operating Expenses. Our operating expenses were \$90.5 million for 2011, \$97.6 million for 2010 and \$101.5 million for 2009. The decrease in operating expenses for 2011 as compared to 2010 was primarily attributable to (i) a decrease in payroll and facilities expenses derived from the reorganization of our European operations and the closure of our Swiss operations in the amount of \$3.6 million, (ii) a decrease in equity-based compensation expenses in the amount of \$3.3 million and (iii) a decrease in the amortization cost for intangible assets related to the Acquisition in the amount of \$2.0 million. These decreases were offset to some extent by an increase in other general and administrative expenses, such as legal and stockholders and investors relations expenses. Our operating losses were \$20.3 million in 2011, as compared to \$9.7 million in 2010 and \$22.9 million in 2009. The increase in operating losses in 2011 as compared to 2010 was mainly as a result of a decrease in total revenues and gross margins during 2011 as compared to 2010, offset to some extent by the decrease in operating expenses in 2011 as compared to 2010. The decrease in operating expenses for 2010 as compared to 2009 was primarily attributable to (i) a decrease in the amortization cost for intangible assets related to the Acquisition in the amount of \$2.3 million, and (ii) a decrease in equity-based compensation expenses in the amount of \$1.5 million. The decrease in operating losses in 2010 as compared to 2009 was mainly due to an increase in revenues, an increase in gross margins and a decrease in operating expenses as noted above.

Research and Development Expenses. Our research and development expenses decreased to \$53.2 million for 2011 from \$55.6 million for 2010. Research and development expenses decreased to \$55.6 million in 2010 from \$56.1 million in 2009. The decrease for 2011 in research and development expenses, as

compared to 2010, was mainly due to (i) a decrease in equity-based compensation expenses in the amount of \$1.9 million, (ii) a decrease in the number of research and development employees and payroll related expenses in the amount of \$1.9 million and (iii) a decrease in subcontractors expenses in the amount of \$0.8 million. The decrease in research and development expenses for 2011, as compared to 2010, was offset mainly by an increase in projects-related expenses, mainly tape-out expenses.

The decrease for 2010 in research and development expenses, as compared to 2009, was mainly due to (i) a decrease in IP purchases and tapeout expenses in the amount of \$5.0 million, and (ii) a decrease in equity-based compensation expenses in the amount of \$0.5 million. The above referenced expense decrease was offset by an increase in the number of research and development employees, an increase in payroll and labor contractor expenses in the amount of \$3.7 million for 2010, as compared to 2009, and an increase in subcontractors, consultants and travel expenses for 2010 as compared to 2009.

Our research and development expenses as a percentage of our total revenues were 27%, 25% and 26% for 2011, 2010 and 2009, respectively. The increase in research and development expenses as a percentage of total revenues in 2011 as compared to 2010 and 2009 was mainly due to the decrease in absolute dollars of our total revenues in 2011 as compared to 2010 and 2009.

Research and development expenses consist mainly of payroll expenses to employees involved in research and development activities, expenses related to tapeout and mask work, subcontracting, labor contractors and engineering expenses, depreciation and maintenance fees related to equipment and software tools used in research and development, and facilities expenses associated with and allocated to research and development activities.

Sales and Marketing Expenses. Our sales and marketing expenses were \$16.5 million for 2011, \$17.2 million for 2010 and \$17.9 million for 2009. The decrease in sales and marketing expenses between 2011 and 2010 was mainly attributed to (i) a decrease in equity-based compensation expenses in the amount of \$0.5 million, and (ii) a decrease in commission paid to distributors due to a lower level of revenues subject to sales commissions in the amount of \$0.7 million. The decrease in sales and marketing expenses for 2011 as compared to 2010 was offset to some extent by an increase in the number of sales and marketing employees and payroll related expenses in the amount of \$0.6 million.

The decrease in sales and marketing expenses between 2010 and 2009 was mainly attributed to (i) a decrease in payroll expenses due to a lower number of sales and marketing employees and (ii) the decrease of \$0.3 million in equity-based compensation expenses.

Our sales and marketing expenses as a percentage of our total revenues were 9% for 2011, and 8% for both 2010 and 2009. The increase in sales and marketing expenses as a percentage of total revenues for 2011 as compared to 2010 and 2009 was mainly due to the decrease in absolute dollars of our total revenues in 2011 as compared to 2010 and 2009.

Sales and marketing expenses consist mainly of sales commissions, payroll expenses to direct sales and marketing employees, travel, trade show expenses, and facilities expenses associated with and allocated to sales and marketing activities.

General and Administrative Expenses. Our general and administrative expenses were \$12.9 million, \$14.4 million and \$15.2 million for 2011, 2010 and 2009, respectively. The decrease in general and administrative expenses for 2011 as compared to 2010 was mainly attributed to (i) a decrease in payroll and facilities expenses derived from the reorganization of our European operations and the closure of our Swiss operations and (ii) a decrease in equity-based compensation expenses in the amounts of \$0.6 million. These decreases were offset to some extent by an increase in other general and administrative expenses, such as legal and stockholders and investors relations expenses.

The decrease in general and administrative expenses for 2010 as compared to 2009 was mainly attributed to (i) a decrease in accounting expenses and (ii) a decrease in equity-based compensation expenses of \$0.7 million. The above referenced decreases were offset to some extent by an increase in other expenses, such as legal expenses in 2010, in comparison to 2009.

General and administrative expenses as a percentage of our total revenues were 7%, 6% and 7% for 2011, 2010 and 2009, respectively. The increase in general and administrative expenses in 2011 as a percentage of total revenues as compared to 2010 was due to the decrease in absolute dollars of our total revenues in 2011 as compared to 2010.

Our general and administrative expenses consist mainly of payroll expenses for management and administrative employees, accounting and legal fees, expenses related to investor relations as well as facilities expenses associated with general and administrative activities.

Amortization of Intangible Assets. During 2011, 2010 and 2009, we recorded an expense of approximately \$8.0 million, \$10.0 million and \$12.3 million, respectively, relating to the amortization of intangible assets associated with the Acquisition. The sequential decrease in 2011 as compared to 2010 and 2009 is consistent with, and is based on, the original amortization schedule determined following the impairment of goodwill and other intangible assets that took place in 2008.

Restructuring Costs and Other. During 2011, as part of our plan to improve operational efficiencies and reduce our operating expenses for fiscal year 2012, we restructured our U.S. operations. As part of this restructuring plan, we executed termination agreements with certain of our U.S. employees and renegotiated the lease for our U.S. facilities. We recorded an income in the amount of \$0.2 million during 2011 which was composed of an income of \$0.6 million associated with the restructuring plan that we initiated during the third quarter of 2010, offset by restructuring expenses in the amount of \$0.4 million associated with the restructuring of our U.S. operations as noted above. The above referenced income resulted mainly from the closure of our Swiss facilities and the termination of employment of the employees of our Swiss subsidiary, which resulted in a curtailment and settlement of our Swiss pension plan during the first quarter of 2011.

In 2010, as part of our plan to improve efficiencies in our European operations, we restructured our Swiss operations. As a part of this restructuring plan, we executed termination agreements with all of the employees of our Swiss subsidiary. We recorded, during 2010, an expense in the amount of \$0.5 million, consisting primarily of employee severance costs.

Financial income, net. Financial income, net, was \$1.9 million in 2011, \$1.5 million in 2010 and \$2.9 million in 2009. The increase in financial income, net, for 2011 as compared to 2010 was mainly due to (i) the devaluation of the Euro against the U.S. dollar and the devaluation of the U.S. dollar against the Swiss Franc, which resulted in higher expenses associated with the exchange rate differences during 2010 as compared to 2011, and (ii) a profit in the amount of \$0.2 million resulting from the sale of certain marketable securities during 2011, as compared to \$0.1 million profit recorded during 2010. The decrease in 2010 as compared to 2009 was mainly due to (i) gains from the realization of available-for-sale securities in the amount of \$0.9 million in 2009, in comparison to \$0.1 million of gain in 2010, and (ii) the devaluation of the Euro against the U.S. dollar and the devaluation of the U.S. dollar against the Swiss Franc which resulted in higher expenses associated with exchange rate differences during 2010 as compared to 2009.

Our total cash, cash equivalents, marketable securities and short term deposits, including restricted cash, were \$117.9 million as of December 31, 2011, as compared to \$139.8 million as of December 31, 2010.

Other income. We recorded other income in the amount of \$1.3 million during the fourth quarter of 2011. Other income was derived from the remeasurement to fair value of our investment in BoneTone made initially in November 2009 for approximately 30% of BoneTone's then outstanding equity, on a fully diluted basis when we exercised our option to acquire the remaining 70% equity interest in BoneTone, on a fully diluted basis, for a purchase price of \$8.6 million.

Provision for Income Taxes. Our income tax benefit was \$0.9 million for 2011, as compared to a tax benefit of \$0.8 million in 2010 and a tax benefit of \$11.6 million in 2009. The income tax benefit in 2011 resulted mainly from a tax benefit of \$0.6 million resulting from the reversal of an income tax contingency reserve that was determined to be no longer needed due to the expiration of the applicable statute of limitations. Two main items that occurred in 2009 that decreased our income tax benefit for 2010, as compared to 2009, were: (i) pursuant to a settlement with the U.S. Internal Revenue Service relating to an audit of our U.S. federal income tax returns for 2003 and 2004, we recorded in 2009 a tax benefit of \$3.5 million as a result of the partial reversal of the tax reserves associated with the tax audit, and (ii) we recorded in 2009 a tax benefit of \$7.6 million as a result of the reversal of an income tax contingency reserve that was determined to be no longer required due to the expiration of applicable statute of limitations. The income tax benefit in 2010 resulted mainly from a tax benefit of \$0.6 million resulting from the reversal of an income tax contingency reserve that was determined to be no longer needed due to the expiration of applicable statutes of limitation.

During 2011, we did not record any significant changes to the net deferred tax assets due to our current estimate of future taxable income.

DSP Group Ltd., our Israeli subsidiary, was granted “Approved Enterprise” status by the Israeli government with respect to six separate investment plans. Approved Enterprise status allows our Israeli subsidiary to enjoy a tax holiday for a period of two or four years, and a reduced corporate tax rate of 10%-25% (based on the percentage of foreign ownership) for an additional six or eight years, on each investment plan’s proportionate share of taxable income. The tax benefits under our Israeli subsidiary’s first four investment plans have expired and those under the fifth and sixth investment plans are scheduled to gradually expire by 2015.

On April 1, 2005, an amendment to the Israeli Investment Law came into effect (the “Amendment”). The Amendment revised the criteria for investments qualified to receive tax benefits. An eligible investment program under the Amendment qualifies for benefits as a Beneficiary Enterprise (rather than the previous terminology of Approved Enterprise). Among other things, the Amendment provides tax benefits to both local and foreign investors and simplified the approval process. The Amendment does not apply to investment programs approved prior to December 31, 2004. The new tax regime applies to new investment programs only.

For 2006 and 2009, DSP Group Ltd. elected the status of a Beneficiary Enterprise under the Amendment for its seventh and eighth plans, respectively. The seventh and eighth plans entitle DSP Group Ltd. to a corporate tax exemption for a period of two years and a reduced corporate tax rate of 10%-25% (based on the percentage of foreign ownership) for an additional period of eight years from the first year it has taxable income. The tax benefits under the seventh and eighth investment plans are scheduled to gradually expire between 2015 and 2013.

In December 2010, the Knesset (Israeli parliament) passed the New Amendment which prescribes, among other things, for a further amendment of the Israeli Investment Law. The New Amendment became effective as of January 1, 2011. Among other things, the New Amendment sets forth the following amended tax rates for income generated from qualified investment programs:

- for 2011 and 2012—15%;
- for 2013 and 2014—12.5%; and
- for 2015 and thereafter—12%.

We do not currently intend to implement the New Amendment; rather we intend to continue to comply with the Investment Law as in effect prior to enactment of the New Amendment until the earlier of such time that compliance with the Investment Law prior to enactment of the New Amendment is no longer in our best interests or until the expiration of our current investment programs. We are required to comply with the New Amendment subsequent to the expiration of our current investment programs and for any new qualified investment program after a transitional period. As a result, the New Amendment may increase our average tax rate in future years.

To be eligible for tax benefits under the investment programs, we must meet certain conditions, relating principally to adherence to the investment program filed with the investment Center of the Israeli Ministry of Industry and Trade and to periodic reporting obligations. We believe that our investment programs are currently in compliance with these requirements. However, if we fail to meet these requirements, we would be subject to corporate tax in Israel at the regular statutory rate (25%, 24% and 25% for 2010, 2011 and 2012, respectively). We also could be required to refund tax benefits, with interest and adjustments for inflation based on the Israeli consumer price index.

In connection with the Acquisition, we received a tax ruling from the Swiss tax authorities with respect to the taxable income generated by our Swiss subsidiary, including the amortization period for tax purposes of goodwill and all other intangible assets acquired in the Acquisition by our Swiss subsidiary. Pursuant to the tax ruling, our Swiss subsidiary is entitled to reduced tax rates of approximately 10% to 15%, depending on the source of income, and tax amortization period of up to 10 years for the goodwill and other intangible assets acquired in the Acquisition by our Swiss subsidiary.

LIQUIDITY AND CAPITAL RESOURCES

Operating Activities. We used \$0.6 million in operating activities during 2011. In 2010 and 2009, we generated \$22.3 million and \$26.6 million, respectively, of cash and cash equivalents from operating activities. The decrease in net cash provided by operating activities for 2011, as compared to 2010, was mainly as a result of (i) an increase in net loss, excluding non-cash items, such as depreciation, equity-based compensation expenses, amortization of intangible assets and other income, in the amount of \$16.3 million for 2011, as compared to 2010, (ii) an increase in accounts receivable by \$0.6 million during 2011, as compared to a decrease in accounts receivable of \$3.0 million during 2010, (iii) a decrease in other accounts receivable and prepaid expenses of \$0.5 million during 2011, as compared to a decrease in other accounts receivable and prepaid expenses of \$8.0 million during 2010, mainly due to a higher amount of advances that were returned from tax authorities in 2010 as compared to 2011, and (iv) a decrease in accrued compensation and benefits of \$1.6 million during 2011, as compared to an increase in accrued compensation and benefits of \$3.0 million during 2010. The decrease in the amount of cash generated from operating activities for 2011, as compared to 2010, was offset to some extent by a decrease in inventories of \$2.4 million during 2011, as compared to an increase in inventories of \$6.5 million during 2010.

Investing Activities. We invest excess cash in marketable securities of varying maturities, depending on our projected cash needs for operations, capital expenditures and other business purposes. During 2011, we purchased \$86.0 million of investments in marketable securities, and deposits, as compared to \$95.5 million during 2010 and \$86.1 million during 2009. During the same periods, \$68.1 million, \$35.2 million and \$22.7 million, respectively, of investments in marketable securities matured and were called by the issuer. During the same periods, \$11.9 million, \$25.4 million and \$17.2 million, respectively, of investments in marketable securities were sold. Additionally, during 2011, 2010 and 2009, \$10 million, \$12.5 million and \$15.6 million, respectively, of short term deposits matured.

As of December 31, 2011, the amortized cost of our marketable securities and deposits was \$100.7 million and their stated market value was \$99.7 million, representing an unrealized loss of \$1.0 million, which was mainly caused by overall market conditions and interest rate changes.

During 2009, we made an investment of \$2.2 million in BoneTone in return for approximately 30% of the then outstanding equity of the company, on a fully diluted basis. We also had the option to acquire the remaining equity of BoneTone within a 24-month period. In December 2011, we exercised our option to acquire the remaining 70% equity interest of BoneTone, on a fully diluted basis, for a net purchase price of \$8.3 million (\$8.6 million was paid, net of cash and cash equivalents of \$0.3 million that was in the company on the date of the acquisition).

Our capital equipment purchases for 2011, consisting primarily of research and development software tools, computers and other peripheral equipment, engineering test and lab equipment, leasehold improvements, furniture and fixtures, totaled \$2.3 million, as compared to \$3.5 million for 2010 and \$4.5 million for 2009.

Financing Activities. During 2011, we repurchased approximately 1.3 million shares of our common stock at an average purchase price of \$6.74 per share for an aggregate amount of approximately \$8,749 million. In addition, we received \$0.4 million upon the exercise of employee stock options. We cannot predict cash flows from stock option exercises for future periods.

During 2010, we repurchased approximately 111,000 shares of our common stock at an average purchase price of \$7.74 per share for an aggregate amount of approximately \$0.9 million. In addition, we received \$0.3 million upon the exercise of employee stock options. We cannot predict cash flows from stock option exercises for future periods.

During the first quarter of 2009, we repurchased approximately 4,187,000 shares of our common stock that were issued to NXP in connection with the Acquisition at a purchase price of \$4.78 per share for approximately \$20.0 million. During 2009, no employee stock options were exercised.

Pursuant to authorizations in March 1999, July 2003, October 2004, January 2007 and January 2008, our board of directors authorized a share repurchase program for the repurchase of an aggregate of 14.9 million shares of our common stock. Also in January 2008, our board approved the company's entry into a share repurchase plan, in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934, for the repurchase of 5.0 million of the aggregate shares of our common stock authorized for repurchase, which plan has since expired. In October 2010, our board of directors authorized an increase in the number of shares available for repurchase, thereby increasing the aggregate number of shares authorized for repurchase under our share repurchase program to two million shares. In July 2011, the Company's Board of Directors authorized an increase in the Company's share repurchase program by one million shares of common stock.

At December 31, 2011, approximately 1.6 million shares of our common stock remained available for repurchase under our board authorized share repurchase program.

As of December 31, 2011, we had cash and cash equivalents totaling approximately \$18.1 million and marketable securities and time deposits of approximately \$99.7 million.

Our working capital at December 31, 2011 was approximately \$60.0 million, as compared to \$72.1 million as of December 31, 2010. The decrease in working capital was mainly due to (i) a decrease in cash and cash equivalents of \$15.8 million (mainly from the acquisition of the remaining 70% equity interest in BoneTone and the repurchase of our common stock in 2011, and (ii) a decrease in inventories of \$2.4 million. The decrease in our working capital for 2011, as compared to 2010, was offset to some extent by (i) a decrease in accrued compensation and benefits in the amount of \$3.5 million and (ii) a decrease in trade payables in the amount of \$1.2 million.

In addition, as part of our business strategy, we may evaluate potential acquisitions of businesses, products and technologies. Accordingly, a portion of our available cash may be used at any time for the acquisition of complementary products or businesses. Such potential transactions may require substantial capital resources, which may require us to seek additional debt or equity financing. We cannot assure you that we will be able to successfully identify suitable acquisition candidates, complete acquisitions, integrate acquired businesses into our current operations, or expand into new markets. Furthermore, we cannot assure you that additional financing will be available to us in any required time frame and on commercially reasonable terms, if at all. See the section of the risk factors entitled "We may engage in future acquisitions that could dilute our stockholders' equity and harm our business, results of operations and financial condition." for more detailed information.

Contractual Obligations –

The following table aggregates our material expected obligations and commitments as of December 31, 2011 (in thousands):

| <u>Contractual Obligations</u> | <u>Payment Due By Period</u> | | | | |
|---------------------------------------|-------------------------------------|------------------------------------|-----------------------------|-----------------------------|-------------------------------------|
| | <u>Total</u> | <u>Less Than 1 Year</u> | <u>2-3 Years</u> | <u>4-5 Years</u> | <u>More Than 5 Years</u> |
| Operating Lease Commitments(1) | \$6,218 | \$3,647 | \$2,568 | \$ 3 | — |
| Net Pension Liability(2) | 1,658 | 42 | 1 | 41 | \$1,574 |
| Total Contractual Obligations | \$7,876 | \$3,689 | \$2,569 | \$44 | \$1,574 |

- (1) Represents mainly operating lease payments for facilities and vehicles under non-cancelable lease agreements. See Note 15 to Notes to Consolidated Financial Statements for the year ended December 31, 2011.
- (2) Includes estimates of gross contributions and future payments required to meet the requirements of several defined benefit plans. The amounts presented in the table are not discounted and do not take into consideration staff turnover assumptions.

At December 31, 2011, we had a liability for unrecognized tax benefits and an accrual for the payment of related interests totaling \$1.1 million. Due to uncertainties related to those tax matters, we currently are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, as such term is defined in recently enacted rules by the Securities and Exchange Commission, that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk. It is our policy not to enter into interest rate derivative financial instruments, except for hedging of foreign currency exposures discussed below. We do not currently have any significant interest rate risk since we do not have any financial obligations.

The majority of our cash and cash equivalents are invested in high grade certificates of deposits with major U.S., European and Israeli banks. Generally, cash and cash equivalents and short term deposits may be redeemed and therefore minimal credit risk exists with respect to them. Nonetheless, cash deposits with these banks exceed the Federal Deposit Insurance Corporation (“FDIC”) insurance limits in the U.S. or similar limits in foreign jurisdictions, to the extent such deposits are even insured in such foreign jurisdictions. While we monitor on a systematic basis the cash balances and adjust the balances as appropriate, these balances could be impacted if one or more of the financial institutions with which we deposit our funds fails or is subject to other adverse conditions in the financial or credit markets. To date we have experienced no loss of principal or lack of access to our cash; however, we can provide no assurances that access to our cash will not be affected if the financial institutions that we hold our cash fail or the financial and credit markets continue to worsen.

We hold an investment portfolio of marketable securities consisting principally of debentures of U.S. corporations, and state and political subdivisions of the U.S. government. We intend, and have the ability, to hold investments in marketable securities with a decline in fair value until an anticipated recovery of any temporary

declines in their market value. We typically do not attempt to reduce or eliminate our market exposures on our investment securities because the majority of our investments are short-term. However, we can provide no assurances that we will recover present declines in the market value of our investments.

Interest rate fluctuations relating to our cash and cash equivalents and within our investment portfolio have not had, and we do not currently anticipate such fluctuations will have, a material effect on our financial position on an annual or quarterly basis.

Foreign Currency Exchange Rate Risk. A significant part of our sales and expenses are denominated in U.S. dollars. Part of our expenses in Israel is paid in NIS, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the NIS. Our primary expenses paid in NIS are employee salaries and lease payments on our Israeli facilities. Furthermore, due to the Acquisition, a portion of our expenses for our European operations are paid in the Euro, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the Euro. Our primary expenses paid in Euro are employee salaries, lease and operational payments on our European facilities. To partially protect the company against an increase in value of forecasted foreign currency cash flows resulting from salary and lease payments denominated in NIS during 2011, we instituted a foreign currency cash flow hedging program. The option and forward contracts used are designated as cash flow hedges, as defined by ASB ASC No. 815, "Derivatives and Hedging," and are all effective as hedges of these expenses. For more information about our hedging activity, see Note 2 to the attached Notes to the Condensed Consolidated Financial Statement for the year ended December 31, 2011. An increase in the value of the NIS and the Euro in comparison to the U.S. dollar could increase the cost of our research and development expenses and general and administrative expenses, all of which could harm our operating profit. Although we currently are using a hedging program to minimize the effects of currency fluctuations relating to the NIS, our hedging position is partial, may not exist at all in the future and may not succeed in minimizing our foreign currency fluctuation risks.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2011

IN U.S. DOLLARS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

**The Board of Directors and Stockholders of
DSP GROUP, INC.**

We have audited the accompanying consolidated balance sheets of DSP Group, Inc. (the “Company”) as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2011. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2011 and 2010, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), DSP Group, Inc.’s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 15, 2012 expressed an unqualified opinion thereon.

/s/ KOST FORER GABBAY & KASIERER
KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

Tel-Aviv, Israel
March 15, 2012



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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
The Board of Directors and Stockholders of
DSP GROUP INC.

We have audited DSP Group, Inc.'s (the "Company") internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2011 and our report dated March 15, 2012 expressed an unqualified opinion thereon.

/s/ KOST FORER GABBAY & KASIERER
KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

Tel-Aviv, Israel
March 15, 2012

DSP GROUP, INC.
CONSOLIDATED BALANCE SHEETS
U.S. dollars in thousands

| | December 31, | |
|---------------------------------------------------------------|---------------------|------------------|
| | 2011 | 2010 |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 18,109 | \$ 33,912 |
| Restricted deposits | 128 | 121 |
| Marketable securities and short-term deposits (Note 3) | 30,626 | 29,903 |
| Trade receivables | 25,643 | 25,170 |
| Deferred income taxes | 89 | 121 |
| Other accounts receivable and prepaid expenses (Note 4) | 5,343 | 6,302 |
| Inventories (Note 5) | 16,434 | 18,803 |
| Total current assets | 96,372 | 114,332 |
| PROPERTY AND EQUIPMENT, NET (Note 6) | 5,803 | 7,786 |
| LONG-TERM ASSETS: | | |
| Long-term marketable securities (Note 3) | 69,046 | 75,825 |
| Long-term prepaid expenses and lease deposits | 466 | 642 |
| Severance pay fund | 9,974 | 11,336 |
| Intangible assets, net (Note 7) | 10,688 | 10,434 |
| Goodwill (Note 8) | 3,707 | — |
| Investment in other companies | — | 2,200 |
| | 93,881 | 100,437 |
| Total assets | \$196,056 | \$222,555 |

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

DSP GROUP, INC.
CONSOLIDATED BALANCE SHEETS
U.S. dollars in thousands, except share and per share data

| | December 31, | |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|-------------------|
| | 2011 | 2010 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Trade payables | \$ 17,989 | \$ 19,206 |
| Accrued compensation and benefits | 8,236 | 11,728 |
| Income tax accruals and payables | 2,582 | 3,778 |
| Accrued expenses and other accounts payable | 7,555 | 7,547 |
| Total current liabilities | 36,362 | 42,259 |
| LONG-TERM LIABILITIES: | | |
| Accrued severance pay | 10,278 | 12,419 |
| Accrued pensions (Note 10) | 792 | 774 |
| Total long-term liabilities | 11,070 | 13,193 |
| COMMITMENTS AND CONTINGENCIES (Note 15) | | |
| STOCKHOLDERS' EQUITY (Note 12): | | |
| Capital stock: | | |
| Preferred stock, \$ 0.001 par value—Authorized shares: 5,000,000 shares at December 31, 2011 and 2010; Issued and outstanding shares: none at December 31, 2011 and 2010 | — | — |
| Common stock, \$ 0.001 par value—Authorized shares: 50,000,000 shares at December 31, 2011 and 2010; Issued and outstanding shares: 22,501,644 and 23,252,547 shares at December 31, 2011 and 2010, respectively | 23 | 23 |
| Additional paid-in capital | 341,352 | 335,132 |
| Treasury stock | (122,236) | (119,280) |
| Accumulated other comprehensive income (loss) | (1,756) | 355 |
| Accumulated deficit | (68,759) | (49,127) |
| Total stockholders' equity | 148,624 | 167,103 |
| Total liabilities and stockholders' equity | \$ 196,056 | \$ 222,555 |

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

DSP GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
U.S. dollars in thousands, except share and per share data

| | Year ended December 31, | | |
|-------------------------------------------------------------------------------------------------------------|-------------------------|-------------------|-------------------|
| | 2011 | 2010 | 2009 |
| Revenues | \$193,861 | \$225,482 | \$212,186 |
| Costs of revenues (includes \$ 8,013 with related parties for the year ended December 31, 2009)(1) | 123,734 | 137,571 | 133,590 |
| Gross profit | 70,127 | 87,911 | 78,596 |
| Operating expenses: | | | |
| Research and development(2) | 53,244 | 55,588 | 56,148 |
| Sales and marketing(3) | 16,497 | 17,199 | 17,889 |
| General and administrative(4) | 12,920 | 14,362 | 15,228 |
| Amortization of intangible assets | 7,972 | 9,975 | 12,258 |
| Restructuring expenses (income) | (170) | 463 | — |
| Total operating expenses | 90,463 | 97,587 | 101,523 |
| Operating loss | (20,336) | (9,676) | (22,927) |
| Financial income, net | 1,885 | 1,468 | 2,857 |
| Other income from remeasurement of investment in a business combination | 1,343 | — | — |
| Loss before income tax benefit | (17,108) | (8,208) | (20,070) |
| Income tax benefit | (866) | (783) | (11,634) |
| Net loss | <u>\$ (16,242)</u> | <u>\$ (7,425)</u> | <u>\$ (8,436)</u> |
| Net loss per share: | | | |
| Basic and Diluted | <u>\$ (0.70)</u> | <u>\$ (0.32)</u> | <u>\$ (0.36)</u> |
| Weighted average number of shares used in per share computations of net loss per share: | | | |
| Basic and Diluted | <u>23,247</u> | <u>23,229</u> | <u>23,655</u> |

- (1) Includes equity-based compensation expense in the amount of \$ 403, \$ 704 and \$ 778 for the years ended December 31, 2011, 2010 and 2009, respectively.
- (2) Includes equity-based compensation expense in the amount of \$ 2,766, \$ 4,712 and \$ 5,253 for the years ended December 31, 2011, 2010 and 2009, respectively.
- (3) Includes equity-based compensation expense in the amount of \$ 987, \$ 1,493 and \$ 1,773 for the years ended December 31, 2011, 2010 and 2009, respectively.
- (4) Includes equity-based compensation expense in the amount of \$ 2,063, \$ 2,644 and \$ 3,296 for the years ended December 31, 2011, 2010 and 2009, respectively.

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

DSP GROUP INC.

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

U.S. dollars and shares in thousands

| | Number of shares of common stock | Common stock amount | Additional paid-in capital | Treasury stock | Accumulated other comprehensive income (loss) | Accumulated deficit | Total comprehensive loss | Total stockholders' equity |
|------------------------------------------------------------------------------------------------------|-------------------------------------------|---------------------------|----------------------------------|--------------------|--------------------------------------------------------|------------------------|--------------------------------|----------------------------------|
| Balance at January 1, 2009 | 26,731 | 27 | 314,479 | (107,744) | 51 | (28,186) | | 178,627 |
| Issuance of treasury stock upon purchase of common stock under employee stock purchase plan | 357 | *)— | — | 4,418 | — | (2,315) | | 2,103 |
| Purchase of treasury stock | (4,187) | (4) | — | (20,024) | — | — | | (20,028) |
| Equity-based compensation expenses | — | — | 11,100 | — | — | — | | 11,100 |
| Total comprehensive loss: | | | | | | | | |
| Net loss | — | — | — | — | — | (8,436) | \$(8,436) | (8,436) |
| Change in unrealized gain from hedging activities, net ... | — | — | — | — | 253 | — | 253 | 253 |
| Change in unrealized gain from marketable securities ... | — | — | — | — | 1,344 | — | 1,344 | 1,344 |
| Change in unrealized gain from pension | — | — | — | — | 464 | — | 464 | 464 |
| Change in foreign currency translation adjustments, net | — | — | — | — | 62 | — | 62 | 62 |
| Total comprehensive loss | | | | | | | <u>\$(6,313)</u> | |
| Balance at December 31, 2009 | <u>22,901</u> | <u>\$ 23</u> | <u>\$325,579</u> | <u>\$(123,350)</u> | <u>\$2,174</u> | <u>\$(38,937)</u> | | <u>\$165,489</u> |

56

*) Represents an amount lower than \$ 1.

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

DSP GROUP, INC.

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

U.S. dollars and shares in thousands

| | Number of shares of common stock | Common stock amount | Additional paid-in capital | Treasury stock | Accumulated other comprehensive income (loss) | Accumulated deficit | Total comprehensive loss | Total stockholders' equity |
|--------------------------------------------------------------------------------------------------------------------|-------------------------------------------|---------------------------|----------------------------------|--------------------|--------------------------------------------------------|------------------------|--------------------------------|----------------------------------|
| Balance at December 31, 2009 | 22,901 | \$ 23 | \$325,579 | \$(123,350) | \$ 2,174 | \$(38,937) | | \$165,489 |
| Issuance of treasury stock upon purchase of common stock under employee stock purchase plan | 388 | *)— | — | 4,138 | — | (2,293) | | 1,845 |
| Issuance of treasury stock upon exercise of stock options and stock appreciation rights by employees and directors | 75 | *)— | — | 794 | — | (472) | | 322 |
| Purchase of treasury stock | (111) | *)— | — | (862) | — | — | | (862) |
| Equity-based compensation expenses | — | — | 9,553 | — | — | — | | 9,553 |
| Total comprehensive loss: | | | | | | | | |
| Net loss | — | — | — | — | — | (7,425) | \$ (7,425) | (7,425) |
| Change in unrealized gain from hedging activities, net | — | — | — | — | 247 | — | 247 | 247 |
| Change in unrealized gain from marketable securities | — | — | — | — | (1,255) | — | (1,255) | (1,255) |
| Change in unrealized gain from pension | — | — | — | — | (538) | — | (538) | (538) |
| Change in foreign currency translation adjustments, net | — | — | — | — | (273) | — | (273) | (273) |
| Total comprehensive loss | | | | | | | <u>\$ (9,244)</u> | |
| Balance at December 31, 2010 | 23,253 | \$ 23 | \$335,132 | \$(119,280) | \$ 355 | \$(49,127) | | \$167,103 |
| Issuance of treasury stock upon purchase of common stock under employee stock purchase plan | 423 | 1 | — | 4,483 | — | (2,448) | | 2,036 |
| Issuance of treasury stock upon exercise of stock options and stock appreciation rights by employees and directors | 124(*) | — | — | 1,309 | — | (942) | | 367 |
| Purchase of treasury stock | (1,298) | (1) | — | (8,748) | — | — | | (8,749) |
| Equity-based compensation expenses | — | — | 6,220 | — | — | — | | 6,220 |
| Total comprehensive loss: | | | | | | | | |
| Net loss | — | — | — | — | — | (16,242) | (16,242) | (16,242) |
| Change in unrealized gain from hedging activities, net | — | — | — | — | (950) | — | (950) | (950) |
| Change in unrealized loss from marketable securities | — | — | — | — | (964) | — | (964) | (964) |
| Change in unrealized loss from pension | — | — | — | — | 37 | — | 37 | 37 |
| Change in foreign currency translation adjustments, net | — | — | — | — | (234) | — | (234) | (234) |
| Total comprehensive loss | | | | | | | <u>\$(18,354)</u> | |
| Balance at December 31, 2011 | <u>22,502</u> | <u>\$ 23</u> | <u>\$341,352</u> | <u>\$(122,236)</u> | <u>\$(1,756)</u> | <u>\$(68,759)</u> | | <u>\$148,624</u> |

*) Represents an amount lower than \$ 1.

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

DSP GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
U.S. dollars in thousands

| | Year ended December 31, | | |
|-----------------------------------------------------------------------------------------------|-------------------------|-----------------|-----------------|
| | 2011 | 2010 | 2009 |
| <u>Cash flows from operating activities:</u> | | | |
| Net loss | \$(16,242) | \$ (7,425) | \$ (8,436) |
| Adjustments required to reconcile net loss to net cash provided by operating activities: | | | |
| Depreciation | 4,244 | 5,732 | 7,216 |
| Equity-based compensation expenses related to employees' stock options and SARs | 6,220 | 9,553 | 11,100 |
| Decrease in deferred income tax assets, net | 32 | 65 | 308 |
| Capital loss (gain) from sale and disposal of property and equipment | 22 | (40) | 38 |
| Gain from sale of marketable securities | (155) | (67) | (933) |
| Amortization of other intangible assets | 7,972 | 9,975 | 12,258 |
| Accrued interest and amortization of premium on marketable securities and short-term deposits | 1,267 | 531 | 496 |
| Gain from remeasurement to fair value of investment as a result of business combination | (1,343) | — | — |
| Decrease (increase) in trade receivables, net | (562) | 3,010 | 11,388 |
| Decrease in other accounts receivable and prepaid expenses | 502 | 8,019 | 5,432 |
| Decrease (increase) in inventories | 2,395 | (6,505) | 1,642 |
| Decrease (increase) in long-term prepaid expenses and lease deposits | 175 | (39) | 46 |
| Increase (decrease) in trade payables | (1,216) | 903 | 7,130 |
| Increase (decrease) in accrued compensation and benefits | (1,562) | 3,044 | 533 |
| Decrease in income tax accruals and payables | (1,179) | (390) | (12,941) |
| Decrease in accrued expenses and other accounts payable | (463) | (4,085) | (1,068) |
| Increase (decrease) in accrued severance pay, net | (783) | 32 | 328 |
| Increase (decrease) in accrued pensions | 78 | 20 | (282) |
| Decrease in related party receivable/payable | — | — | (7,658) |
| Net cash (used) provided by operating activities | <u>(598)</u> | <u>22,333</u> | <u>26,597</u> |
| <u>Cash flows from investing activities:</u> | | | |
| Purchase of marketable securities | (73,002) | (95,510) | (48,042) |
| Purchase of deposits | (13,000) | — | (38,102) |
| Proceeds from maturity of marketable securities | 68,072 | 35,180 | 22,705 |
| Proceeds from sales of marketable securities | 11,910 | 25,352 | 17,206 |
| Proceeds from maturity of deposits | 10,000 | 12,500 | 15,550 |
| Proceeds from sales of property and equipment | 59 | 48 | — |
| Purchases of property and equipment | (2,317) | (3,463) | (4,527) |
| Investment in a company | — | — | (2,200) |
| Acquisition of initially consolidated subsidiary (1) | (8,320) | — | — |
| Net cash used in investing activities | <u>(6,598)</u> | <u>(25,893)</u> | <u>(37,410)</u> |

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

DSP GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
U.S. dollars in thousands

| | Year ended December 31, | | |
|-----------------------------------------------------------------------------------------------|-------------------------|----------|-----------|
| | 2011 | 2010 | 2009 |
| <u>Cash flows from financing activities:</u> | | | |
| Issuance of common stock and treasury stock upon exercise of stock options and SARs | 367 | 322 | — |
| Purchase of treasury stock | (8,749) | (862) | (20,028) |
| Net cash used in financing activities | (8,382) | (540) | (20,028) |
| Decrease in cash and cash equivalents | (15,578) | (4,100) | (30,841) |
| Cash and cash equivalents at the beginning of the year | 33,912 | 37,986 | 68,886 |
| Cash (erosion) due to exchange rate differences | (225) | 26 | (59) |
| Cash and cash equivalents at the end of the year | \$ 18,109 | \$33,912 | \$ 37,986 |
| <u>Supplemental disclosures of cash flows activities:</u> | | | |
| <u>Cash paid during the year for:</u> | | | |
| Taxes on income | \$ 332 | \$ 424 | \$ 2,457 |

(1) The net fair value of the assets acquired and the liabilities assumed, on the date of acquisition, was as follows:

| | |
|--------------------------------------------------------------------------------------------------------|----------|
| Working capital, excluding cash and cash equivalents | \$ (91) |
| Property and equipment | 26 |
| In process R&D | 7,702 |
| Non-Competition agreement | 519 |
| Goodwill | 3,707 |
| | 11,863 |
| The acquisition date fair value of the Company's previously held equity interest in BoneTone | (3,543) |
| | \$ 8,320 |

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

DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS U.S. dollars in thousands, except share and per share data

NOTE 1:- GENERAL

DSP Group, Inc. (the “Company”), a Delaware corporation, and its subsidiaries, collectively, are a fabless semiconductor company offering advanced chipset solutions for a variety of applications. The Company is a worldwide leader in the short-range wireless communication market, enabling home networking convergence for voice, audio, video and data.

All of the Company’s integrated circuit products are manufactured and tested by independent foundries and test houses. While these foundries and test houses have been able to adequately meet the demands of the Company’s business, the Company is and will continue to be dependent upon these foundries and test houses to achieve acceptable manufacturing yields, quality levels and costs, and to allocate to the Company a sufficient portion of foundry and test capacity to meet the Company’s needs in a timely manner. For the manufacturing services with NXP B.V. (“NXP”), see also Note 14. Revenues could be materially and adversely affected should any of these foundries and test houses fail to meet the Company’s request for product manufacturing due to a shortage of production capacity, process difficulties, low yield rates or financial instability. Additionally, certain of the raw materials, components, and subassemblies included in the products manufactured by the Company’s original equipment manufacturer (OEM) customers, which incorporate the Company’s products, are obtained from a limited group of suppliers. Disruptions, shortages, or termination of certain of these sources of supply could occur and could negatively affect the Company’s financial condition and results of operations.

The Company sells its products primarily through distributors and directly to OEMs and original design manufacturers (ODMs) who incorporate the Company’s products into consumer products. The Company’s future performance will depend, in part, on the continued success of its distributors in marketing and selling its products. The loss of the Company’s distributors and the Company’s inability to obtain satisfactory replacements in a timely manner may harm the Company’s sales and results of operations. In addition, the Company expects that a limited number of customers, varying in identity from period-to-period, will account for a substantial portion of its revenues in any period. The loss of, or reduced demand for products from, any of the Company’s major customers could have a material adverse effect on the Company’s business, financial condition and results of operations.

Sales to Hong Kong-based VTech Holdings Ltd. (“VTech”) represented 33%, 31% and 29% of the Company’s total revenues for 2011, 2010 and 2009, respectively. Revenues derived from sales through one distributor, Tomen Electronics Corporation (“Tomen Electronics”), accounted for 19%, 25% and 22% of the Company’s total revenues for 2011, 2010 and 2009, respectively. The Japanese market and the OEMs that operate in that market are among the largest suppliers in the world with significant market share in the U.S. market for residential wireless products. Tomen Electronics sells the Company’s products to a limited number of customers. One customer, Panasonic Communications Co., Ltd. (“Panasonic”), has continually accounted for a majority of the sales of Tomen Electronics. Sales to Panasonic through Tomen Electronics generated approximately 13%, 16% and 13% of the Company’s total revenues for 2011, 2010 and 2009, respectively. Additionally, sales to Uniden America Corporation (“Uniden”) represented 10%, 9% and 12% of the Company’s total revenues for the 2011, 2010 and 2009, respectively. Sales to CCT Telecom Holdings Ltd. represented 11%, 10% and 8% of the Company’s total revenues for 2011, 2010 and 2009, respectively.

Acquisition of BoneTone Communications.

In November 2009, the Company made an investment of \$2,200 in BoneTone Communications Ltd. (“BoneTone”), an Israeli private company and provider of innovative chip solutions that redefine audio quality and voice intelligibility in mobile devices and headsets, in return for approximately 30% of the equity of

DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
U.S. dollars in thousands, except share and per share data

BoneTone, on a fully diluted basis. The Company also signed a call option agreement pursuant to which the Company had the option to purchase from all holders of BoneTone all of the remaining outstanding securities for a period of 24 months commencing on the closing date of the initial investment.

On December 1, 2011, the Company exercised the option and acquired the remaining equity of BoneTone for a net purchase price of \$8,600 (the “BoneTone Acquisition”).

The BoneTone Acquisition has been accounted for using the purchase method of accounting as determined by Financial Accounting Standards Board (“FASB”) Accounting Standards Code (“ASC”) 805, “Business Combinations.” Accordingly, the purchase price has been allocated to the assets acquired and the liabilities assumed based on the estimated fair value on the date of the acquisition.

Subsequent to the BoneTone Acquisition and as a result of the remeasurement of the initial 30% equity interest in BoneTone in accordance with ASC 805-25, the Company recorded other income in the amount of \$1,343 that was calculated as follows:

| | |
|-----------------------------------------------------------------------------------------------------------|-----------|
| The acquisition-date fair value of the equity interest immediately before the acquisition date: | \$ 3,543 |
| Equity interest immediately before the acquisition date on a cost basis: | \$(2,200) |
| Gain as a result of remeasuring the fair value of the equity interest: | \$ 1,343 |

The Company used an income approach to measure the acquisition-date fair value of the equity interest in BoneTone held by the Company immediately before the acquisition date.

The BoneTone Acquisition provides the Company with diversification and cutting-edge technology in the promising and fast-growing mobile devices market.

The results of operations of BoneTone have been included in the Company’s consolidated financial statements since December 1, 2011.

Based upon a valuation of the tangible and intangible assets acquired and liabilities assumed, the Company has allocated the total purchase price of the BoneTone Acquisition as follows:

| | <u>As of</u> <u>December 1, 2011</u> |
|-----------------------------------------------|-----------------------------------------|
| Cash | \$ 267 |
| Other current assets | 32 |
| Property and equipment | 26 |
| Other non-current assets | 68 |
| Current liabilities | (107) |
| Accrued severance pay | (73) |
| Net tangible assets acquired | <u>213</u> |
| Intangible assets: | |
| In-process research and development | 7,702 |
| Non-competition agreement | 519 |
| Total intangible assets | <u>8,221</u> |
| Goodwill | <u>3,707</u> |
| Net assets acquired | <u><u>\$12,141</u></u> |

DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) U.S. dollars in thousands, except share and per share data

In performing the purchase price allocation, the Company considered, among other factors, the intention for future use of the acquired assets, analyses of historical financial performance and estimates of future performance of BoneTone products. The fair value of the intangible assets was based on a valuation completed by a third party valuation firm using an income approach and estimates and assumptions provided by management.

The Company is currently within the one-year measurement period with respect to the acquisition date, and thus, future material adjustments to these purchase accounting fair value adjustments are possible.

The amount allocated to in-process research and development (“IPR&D”) was determined using the income approach, on the basis of the present value of cash flows attributable to the IPR&D. The guidance in ASC 350 “Intangibles – Goodwill and Other” specifies that intangible assets acquired in a business combination for use in a particular R&D project are considered indefinite-lived intangible assets until the completion or abandonment of the associated R&D efforts. Accordingly, during the development period after the BoneTone Acquisition, these assets should not be amortized but, instead, should be subject to the impairment review and testing provisions of ASC 350-30-35-18 for indefinite-lived intangibles.

Upon completion of the development process for the acquired R&D, the associated assets will be considered to be finite-lived intangible assets and amortized on a straight line basis over its expected future life. The expected future life period is estimated based on the duration of the cash flow associated with the technologies created by the IPR&D once they are completed and start generating revenues.

The amount assigned to the non-competition agreement relates to the non-competition agreement that the Company entered into with the founder of BoneTone in connection with the BoneTone Acquisition, which was determined using the income approach and is amortized on a straight line basis over three years, which represents the non-competition period between the Company and BoneTone founder.

The excess of the purchase price of \$3,707 over the net tangible assets and identifiable intangible assets acquired in the BoneTone Acquisition is recognized as goodwill. An acquired workforce and control premium that did not meet the separability criteria have been included in the amount assigned to goodwill. The goodwill recognized represents mainly the synergies the Company expects from the BoneTone Acquisition, both in revenues and expenses, and the expected benefits to the Company from the acquisition. The goodwill associated with the BoneTone Acquisition is expected not to be deductible for tax purposes.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

a. Use of estimates:

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates, judgments and assumptions. The Company’s management believes that the estimates, judgments and assumptions used are reasonable based upon information available at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

Most of the revenues of the Company and its subsidiaries are generated in U.S. dollars (“dollar”). In addition, a substantial portion of the costs of the Company and its subsidiaries are incurred in dollars. The Company’s management believes that the dollar is the currency of the primary economic environment in which the Company and its subsidiaries operate. Thus, the functional and reporting currency of the Company and its subsidiaries is the dollar.

DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) U.S. dollars in thousands, except share and per share data

Monetary accounts maintained in currencies other than the dollar are remeasured into dollars in accordance with ASC No. 830-30, "Translation of Financial Statements." All transaction gains and losses resulting from the remeasurement of monetary balance sheet items are reflected in the consolidated statements of operations as financial income or expenses as appropriate.

As a result of an acquisition of the Cordless and VoIP Terminals Business (the "CIPT Business") of NXP B.V. ("NXP") (the "CIPT Acquisition"), the financial statements of the Company's subsidiary – DSP Group Technologies GmbH whose functional currency is not the dollar, has been translated into dollars. All amounts on the balance sheets have been translated into the dollar using the exchange rates in effect on the relevant balance sheet dates. All amounts in the consolidated statements of operations have been translated into the dollar using the average exchange rate for the relevant periods. The resulting translation adjustments are reported as a component of accumulated other comprehensive income (loss) in stockholders' equity.

Accumulated other comprehensive loss related to foreign currency translation adjustments, net, amounted to \$ 175 as of December 31, 2011. Accumulated other comprehensive income related to foreign currency translation adjustment, net, amounted to \$ 61 as of December 31, 2010.

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany transactions and balances have been eliminated in consolidation.

d. Cash and cash equivalents:

The Company and its subsidiaries consider all highly liquid investments, which are readily convertible to cash with a maturity of three months or less on the date of acquisition, to be cash equivalents.

e. Restricted cash:

Restricted cash is invested in a deposit, which is used as a security for one of the Company lease agreements.

f. Short-term deposits:

Bank deposits with original maturities of more than three months and less than one year are presented at cost, including accrued interest.

g. Marketable securities:

The Company and its subsidiaries account for investments in debt securities in accordance with FASB ASC No. 320-10, "Investments in Debt and Equity Securities." Management determines the appropriate classification of the Company's investments in debt securities at the time of purchase and reevaluates such determinations at each balance sheet date.

The Company classified all of its investments in marketable securities as available for sale.

Available-for-sale securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported in other comprehensive income (loss) using the specific identification method. Unrealized losses determined to be other-than-temporary are recorded as a financial expense. The amortized cost of marketable securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in financial income. Interest and dividends on securities are included in financial income.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) U.S. dollars in thousands, except share and per share data

The marketable securities are periodically reviewed for impairment. If management concludes that any of these investments are impaired, management determines whether such impairment is other-than-temporary. Factors considered in making such a determination include the duration and severity of the impairment, the reason for the decline in value and the potential recovery period, and the Company's intent to sell, or whether it is more likely than not that the Company will be required to sell the investment before recovery of cost basis. For debt securities, only the decline attributable to deteriorating credit of an-other-than-temporary impairment is recorded in the consolidated statement of operations, unless the Company intends, or more likely than not it will be forced, to sell the security. For the year ended December 31, 2009, the Company recorded \$ 531 of gains from the realization of the previously impaired available-for-sale securities recorded in 2008. During the years ended December 31, 2011, 2010 and 2009, the Company did not record an-other-than-temporary impairment loss (see Note 3).

h. Fair value of financial instruments:

Cash and cash equivalents, short-term deposits, trade receivables, trade payables and accrued liabilities approximate fair value due to short term maturities of these instruments. Marketable securities and derivative instruments are carried at fair value. See Note 3 for more information.

Fair value is an exit price, representing the amount that would be received for selling an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. A three-tier fair value hierarchy is established as a basis for considering such assumptions and for inputs used in valuation methodologies to measure fair value:

Level 1—Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2—Include other inputs that are directly or indirectly observable in the marketplace.

Level 3—Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

i. Inventories:

Inventories are stated at the lower of cost or market value. Inventory reserves are provided to cover risks arising from slow-moving items or technological obsolescence.

The Company and its subsidiaries periodically evaluate the quantities on hand relative to historical, current and projected sales volume. Based on this evaluation, an impairment charge is recorded when required to write-down inventory to its market value.

Cost is determined as follows:

Work in progress—on the basis of raw materials and manufacturing costs on an average basis.

Finished products—on the basis of raw materials and manufacturing costs on an average basis.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
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j. Property and equipment:

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, at the following annual rates:

| | % |
|------------------------------------------|--------------------------------------------------------------------------|
| Computers and equipment | 20 - 33 |
| Office furniture and equipment | 7 - 10 |
| Motor vehicles | 15 |
| Leasehold improvements | Over the shorter of the related lease period or the life of the asset |

Property and equipment of the Company and its subsidiaries are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The recoverability of assets to be held and used is measured by a comparison of the carrying amount of such assets to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

During the years ended December 31, 2011, 2010 and 2009, no impairment losses were identified for property and equipment.

The Company accounts for costs of computer software developed or obtained for internal use in accordance with FASB ASC No. 350-40, "The Internal Use Software." FASB ASC 350-40 requires the capitalization of certain costs incurred in connection with developing or obtaining internal use software. During 2011, 2010 and 2009, the Company capitalized \$ 253, \$ 1,087 and 1,433, respectively, of internal use software cost. Such costs are amortized using the straight-line method over their estimated useful life of three years.

k. Investments in other companies:

The Company's investment in BoneTone as of December 31, 2010, in which the Company held approximately 30% of BoneTone's equity, on a fully diluted basis, was presented at cost based on FASB ASC No. 323, "Investments- Equity Method and Joint Ventures." The investment was reviewed periodically to determine if its value had been impaired and adjustments were recorded as necessary. During 2011, 2010 and 2009, no impairment losses were identified. Please also refer to Note 1 for additional information.

l. Goodwill and other intangible assets:

The goodwill and certain other purchased intangible assets have been recorded as a result of the BoneTone Acquisition and the CIPT Acquisition. Goodwill represents the excess of the purchase price in a business combination over the fair value of net tangible and intangible assets acquired. Goodwill is not amortized, but rather is subject to an annual impairment test. The Company performs an annual impairment test during the forth quarter of each fiscal year, or more frequently if impairment indicators are present. The Company operates in one operating segment, and this segment comprises its only reporting unit and only group of assets. Fair value is determined using discounted cash flows, market multiples and market capitalization. Significant estimates used in the methodologies include estimates of future cash-flows, future short-term and long-term growth rates, weighted average cost of capital and market multiples for the reporting unit. Intangible assets that are not considered to have an indefinite useful life are amortized using the straight-line basis over their estimated useful

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lives, which range from 3 to 7.3 years. In-process R&D is not amortized until completion of development. The carrying amount of these assets is reviewed whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of these assets is measured by comparison of the carrying amount of the asset to the future undiscounted cash flows the asset is expected to generate.

If the asset is considered to be impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset.

During 2011, 2010 and 2009, no impairment losses were identified.

m. Severance pay:

DSP Group Ltd., the Company's Israeli subsidiary ("DSP Israel"), has a liability for severance pay pursuant to Israeli law, based on the most recent monthly salary of its employees multiplied by the number of years of employment as of the balance sheet date for such employees. DSP Israel's liability is fully provided for by monthly accrual and deposits with severance pay funds and insurance policies.

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israel's Severance Pay Law or labor agreements.

Severance expenses for the years ended December 31, 2011, 2010 and 2009, were approximately \$ 2,089, \$ 1,851 and \$ 1,969, respectively.

n. Employee benefit plan:

The Company has a 401(K) deferred compensation plan covering all employees in the U.S. All eligible employees may elect to contribute up to 75% of their compensation to the plan through salary deferrals, subject to IRS limits. The maximum deferral for calendar year 2011 was \$ 16.5 (\$ 22.0 if the employee reached the age of 50 by December 31, 2011). The Company currently offers an employer matching program. The matching contribution currently is 50% on the first 6% of compensation contributed per year. This matching contribution vests 25% per year over the first four years of the employee's service in the Company. Employer contribution to the plan for the years 2011, 2010 and 2009 was \$ 56, \$ 60 and \$ 80, respectively.

o. Revenue recognition

The Company and its subsidiaries generate their revenues from sales of products. The Company and its subsidiaries sell their products through a direct sales force and through a network of distributors.

Product sales are recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable, collectibility is reasonably assured, and no significant obligations remain.

Persuasive evidence of an arrangement exists. The Company's sales arrangements with customers are pursuant to written documentation, either a written contract or purchaser order. The actual documentation used is dependent on the business practice with each customer. Therefore, the Company determines that persuasive evidence of an arrangement exists with respect to a customer when it has a written contract, or a written purchase order from the customer.

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Delivery has occurred. Each written documentation relating to a sales arrangement that is agreed upon with the customer specifically sets forth when risk and title are being transferred (based on the agreed International Commercial terms, or “INCOTERMS”). Therefore, the Company determines that risk and title are transferred to the customer when the terms of the written documentation based on the applicable INCOTERMS are satisfied and thus delivery of its products has occurred.

Separately, the Company has consignment inventory which is held for specific customers at the customers’ premises. It recognizes revenue on the consigned inventory when the customer consumes the products from the warehouse, as that is when per the consignment inventory agreements, risk and title passes to the customer and the products are deemed delivered to the customer.

The fee is fixed or determinable. Pursuant to the customer agreements, the Company does not provide any price protection, stock rotation, right of return and/or other discount programs and thus the fee is considered fixed and determinable upon execution of the written documentation with the customers. Additionally, payments that are due within the normal course of the Company’s credit terms, which are currently no more than four months from the contract date, are deemed to be fixed and determinable based on the Company’s successful collection history for such arrangements.

Collectibility is reasonably assured. The Company determines whether collectibility is reasonably assured on a customer-by-customer basis pursuant to its credit review policy. The Company typically sells to customers with whom it has a long-term business relationship and a history of successful collection. A significant number of the Company’s customers are also large original equipment manufacturers with substantial financial resources. For a new customer, or when an existing customer substantially expands its commitments, the Company evaluates the customer’s financial position, the number of years the customer has been in business, the history of collection with the customer and the customer’s ability to pay and typically assigns a credit limit based on that review. The Company increases the credit limit only after it has established a successful collection history with the customer. If the Company determines at any time that collectibility is not reasonably assured under a particular arrangement based upon its credit review process, the customer’s payment history or information that comes to light about a customer’s financial position, it recognizes revenue under that arrangement as customer payments are actually received.

With respect to product sales through the Company’s distributors, such product revenues are deferred until the distributors resell the Company’s products to the end-customers (“sell through”) and recognized based upon receipt of reports from the distributors, provided all other revenue recognition criteria as discussed above are met.

The Company views its distributor arrangements as that of consignment because, although the actual sales are conducted through the distributors and legally title for the products passes to the distributors upon delivery to the distributors, in substance inventory is simply being transferred to another location for sale to the end-user customers as the Company’s primary business relationships and responsibilities are directly with the end-user customers. Because the Company views its arrangements with its distributors as that of consignment relationships, delivery of goods is not deemed to have occurred solely upon delivery to the distributors. Therefore, the Company recognizes revenues from distributors under the “sell-through” method. As a result, revenue is deferred at the time of shipment to the distributors and is recognized only when the distributors sell the products to the end-user customers.

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p. Warranty:

The Company warrants its products against errors, defects and bugs for generally one year. The Company estimates the costs that may be incurred under its warranty and records a liability in the amount of such costs. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. Warranty costs and liability were immaterial for the years ended December 31, 2011, 2010 and 2009.

q. Research and development costs:

Research and development costs are charged to the consolidated statement of operations as incurred.

r. Equity-based compensation:

At December 31, 2011, the Company had three equity incentive plans and one employee stock purchase plan, which are described more fully in Note 12.

The Company accounts for equity-based compensation in accordance with FASB ASC No. 718, "Stock Compensation" ("FASB ASC No. 718"). FASB ASC No. 718 requires companies to estimate the fair value of equity-based awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated statements of operations.

The Company recognizes compensation expenses for the value of its awards granted based on the accelerated attribution method, rather than a straight-line method over the requisite service period of each of the awards, net of estimated forfeitures. FASB ASC No. 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

FASB ASC No. 718 requires cash flows resulting from tax deductions in excess of the compensation costs recognized for those equity-based awards to be classified as financing cash flows.

The Company selected the lattice option pricing model as the most appropriate fair value method for its equity-based awards and values options and stock appreciation rights (SARs) based on the market value of the underlying shares on the date of grant. The option-pricing model requires a number of assumptions, of which the most significant are the expected stock price volatility and the expected term of the equity-based award. Expected volatility is calculated based upon actual historical stock price movements. The expected term of the equity-based award granted is based upon historical experience and represents the period of time that the award granted is expected to be outstanding. The risk-free interest rate is based on the yield from U.S. treasury bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

s. Net loss per share:

Basic net loss per share is computed based on the weighted average number of shares of common stock outstanding during the year. Diluted net earnings per share further include the dilutive effect of stock options and stock appreciation rights (SARs) outstanding during the year, all in accordance with FASB ASC No. 260, "Earnings Per Share."

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The total weighted average number of shares related to the outstanding stock options and SARs excluded from the calculation of diluted net loss per share due to their anti-dilutive effect was 7,980,475, 8,751,751 and 7,790,926 for the years ended December 31, 2011, 2010 and 2009, respectively.

t. Income taxes:

The Company and its subsidiaries account for income taxes in accordance with FASB ASC No. 740, "Income Taxes." This topic prescribes the use of the liability method, whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates that will be in effect when the differences are expected to reverse. The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

Deferred tax liabilities and assets are classified as current or non-current based on the classification of the related asset or liability for financial reporting, or according to the expected reversal dates of the specific temporary differences if not related to an asset or liability for financial reporting.

The Company reports a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax expense.

u. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, short-term deposits, trade receivables, long-term lease deposits and marketable securities.

The majority of cash and cash equivalents and short-term deposits of the Company and its subsidiaries is invested in dollar deposits with major U.S., European and Israeli banks. Such cash and cash equivalents in U.S. banks may be in excess of insured limits and are not insured in other jurisdictions. Generally, cash and cash equivalents and short-term deposits may be redeemed on demand and therefore a minimal credit risk exists with respect to these deposits and investments.

The Company's marketable securities consist of investment-grade corporate bonds and U.S. government-sponsored enterprise ("GSE") securities. As of December 31, 2011, the amortized cost of the Company's marketable securities was \$ 84,899, and their stated market value was \$ 83,870, representing an unrealized loss of \$ 1,029.

A significant portion of the products of the Company and its subsidiaries is sold to original equipment manufacturers of consumer electronics products. The customers of the Company and its subsidiaries are located primarily in Japan, Hong Kong, Taiwan, China, Korea, Europe and the United States. The Company and its subsidiaries perform ongoing credit evaluations of their customers. A specific allowance for doubtful accounts is determined, based on management's estimates and historical experience. Under certain circumstances, the Company may require a letter of credit. The Company covers most of its trade receivables through credit insurance. As of December 31, 2011 and 2010, no allowance for doubtful accounts was provided.

The Company and its subsidiaries have no off-balance-sheet concentration of credit risk, except for certain derivative instruments as mentioned below.

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v. Derivative instruments:

FASB ASC No. 815, "Derivatives and Hedging," requires companies to recognize all of their derivative instruments as either assets or liabilities on the balance sheet at fair value.

For derivative instruments that are designated and qualify as a cash flows hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Any gain or loss on a derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item is recognized in current earnings during the period of change.

To protect against the increase in value of forecasted foreign currency cash flows resulting from salary and rent payments in New Israeli Shekel ("NIS") during the year, the Company instituted a foreign currency cash flow hedging program. The Company hedges portions of the anticipated payroll and rent of its Israeli facilities denominated in NIS for a period of one to 12 months with put options and forward contracts. These forward contracts and put and call options are designated as cash flow hedges and are all effective as hedges of these expenses.

The fair value of the outstanding derivative instruments at December 31, 2011 and 2010 is summarized below:

| <u>Derivative assets (Liabilities)</u> | <u>Balance sheet location</u> | <u>Fair value of derivative instruments</u> | |
|-----------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|---------------------------------------------|--------------|
| | | <u>As of December 31</u> | |
| | | <u>2011</u> | <u>2010</u> |
| Foreign exchange forward contracts and put and call options | Other accounts receivable and prepaid expenses Accrued expenses and other accounts payable(*) | \$ — | \$473 |
| Total | | <u>\$(476)</u> | <u>\$—</u> |
| | | <u>\$(476)</u> | <u>\$473</u> |

*) Estimated to be reclassified into earnings in the following year.

The effect of derivative instruments in cash flow hedging transactions on income and other comprehensive income ("OCI") for the years ended December 31, 2011 and 2010 is summarized below:

| | | <u>Gains (Losses) on Derivatives Recognized in OCI</u> | |
|-----------------------------------------------------------------------|--|--------------------------------------------------------|--------------|
| | | <u>Year ended December 31,</u> | |
| | | <u>2011</u> | <u>2010</u> |
| Foreign exchange forward contracts and put and call options | | <u>\$(325)</u> | <u>\$771</u> |

| | <u>Location</u> | <u>Gains on Derivatives reclassified from OCI to income</u> | |
|-----------------------------------------------------------------------|--------------------|-------------------------------------------------------------|--------------|
| | | <u>Year ended December 31,</u> | |
| | | <u>2011</u> | <u>2010</u> |
| Foreign exchange forward contracts and put and call options | Operating expenses | <u>\$625</u> | <u>\$525</u> |

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As of December 31, 2011 and 2010, the Company had outstanding forward contracts in the amount of \$ 3,550 and \$ 7,550, respectively, and outstanding option contracts in the amount of \$ 16,500 and \$ 0, respectively.

w. Comprehensive income:

The Company accounts for comprehensive income in accordance with FASB ASC No. 220, "Comprehensive Income." This topic establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income generally represents all changes in stockholders' equity during the period except those resulting from investments by, or distributions to, stockholders. The Company determined that its items of comprehensive income relate to gains and losses on hedging derivative instruments, unrealized gains and losses on available-for-sale securities, unrealized gains and losses from pension and unrealized gain and losses from foreign currency translation adjustments.

x. Treasury stock:

The Company repurchases its common stock from time to time on the open market or in other transactions and holds such shares as treasury stock. The Company presents the cost to repurchase treasury stock as a reduction of stockholders' equity.

From time to time, the Company reissues treasury shares under its employee stock purchase plan and equity incentive plans, upon purchases or exercises of equity awards under the plans. When treasury stock is reissued, the Company accounts for the re-issuance in accordance with FASB ASC No. 505-30, "Treasury Stock" and charges the excess of the purchase cost over the re-issuance price (loss) to retained earnings. The purchase cost is calculated based on the specific identification method. In case the purchase cost is lower than the re-issuance price, the Company credits the difference to additional paid-in capital.

y. New accounting pronouncements:

In November 2010, the FASB issued ASU No. 2010-29, "Business Combination," which requires pro forma information for business combinations. Under the ASU, a public company must disclose pro forma revenue and earnings of the combined company for both the year in which the business combination occurred and the prior year as though the business combination had occurred as of the beginning of the prior year. The ASU affects any public entity that enters into business combinations that are material on an individual or aggregate basis. The adoption of the ASU had no impact on the Company's financial statement and its disclosures.

In November 2010, the FASB issued ASU No. 2010-28, "Intangible- Goodwill and Other" which determines when a company must perform step 2 of the goodwill impairment test for reporting units with zero or negative carrying amounts. The ASU concludes that when a reporting unit has a zero or a negative carrying amount and there are qualitative factors such as those set forth in ASC 350 "Intangibles – Goodwill and Other," that indicate it is more likely than not that goodwill is impaired, a company would be required to perform Step 2 of the impairment test. The adoption of the ASU has no material impact on the Company's financial statement and its disclosures.

In May 2011, the FASB issued ASU 2011-04 to amend ASC 820, "Fair Value Measurement." The amendment requires companies to disclose the following for assets and liabilities that are measured at fair value on a recurring or nonrecurring basis in the statement of financial position after initial recognition: the valuation

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techniques and inputs used to develop those measurements. For recurring fair value measurements using significant unobservable inputs (Level 3), companies are required to disclose the effect of the measurements on earnings (or changes in net assets) or other comprehensive income for the period. This guidance is effective for interim and annual periods beginning after December 15, 2011. The Company does not believe the adoption of this guidance will have a material impact on its consolidated financial statements.

In June 2011, FASB issued ASU 2011-05, “Presentation of Comprehensive Income,” which requires companies to present reclassification adjustments and the effect of those reclassification adjustments. This guidance is effective for interim and annual periods beginning after December 15, 2011. The Company does not believe the adoption of this guidance will have a material impact on its consolidated financial statements.

In September 2011 FASB issued ASU 2011-08, “Intangibles—Goodwill and Other,” which permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. This guidance is effective for interim and annual periods beginning after December 15, 2011. The Company does not believe the adoption of this guidance will have a material impact on its consolidated financial statements.

NOTE 3:- MARKETABLE SECURITIES AND TIME DEPOSITS

The following is a summary of marketable securities and time deposits at December 31, 2011 and 2010:

| | <u>Amortized cost</u> | | <u>Unrealized losses, net</u> | | <u>Fair value</u> | |
|-----------------------------------|-----------------------|------------------|-------------------------------|----------------|-------------------|------------------|
| | <u>2011</u> | <u>2010</u> | <u>2011</u> | <u>2010</u> | <u>2011</u> | <u>2010</u> |
| Short and long-term deposit . . . | \$ 15,803 | \$ 12,860 | \$ — | \$ — | \$15,803 | \$ 12,860 |
| U.S. GSE securities | 10,725 | 41,438 | (29) | (552) | 10,696 | 40,886 |
| Corporate obligations | 74,173 | 51,495 | (1,000) | 487 | 73,173 | 51,982 |
| | <u>\$100,701</u> | <u>\$105,793</u> | <u>\$(1,029)</u> | <u>\$ (65)</u> | <u>\$99,672</u> | <u>\$105,728</u> |

The amortized cost of marketable debt securities and time deposits at December 31, 2011, by contractual maturities or anticipated dates of sale, are shown below:

| | <u>Amortized cost</u> | <u>Unrealized gains (losses)</u> | | <u>Fair value</u> |
|-------------------------------------------|-----------------------|----------------------------------|------------------|-------------------|
| | | <u>Gains</u> | <u>Losses</u> | |
| Due in one year or less | \$ 30,616 | \$ 23 | \$ (13) | \$30,626 |
| Due after one year to six years | 70,085 | 175 | (1,214) | 69,046 |
| | <u>\$100,701</u> | <u>\$198</u> | <u>\$(1,227)</u> | <u>\$99,672</u> |

DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
U.S. dollars in thousands, except share and per share data

The amortized cost of marketable debt securities and time deposits at December 31, 2010, by contractual maturities or anticipated dates of sale, are shown below:

| | <u>Amortized cost</u> | <u>Unrealized gains (losses)</u> | | <u>Fair value</u> |
|-------------------------------------------|---------------------------|----------------------------------|----------------|-------------------|
| | | <u>Gains</u> | <u>Losses</u> | |
| Due in one year or less | \$ 29,792 | \$113 | \$ (2) | \$ 29,903 |
| Due after one year to ten years | <u>76,001</u> | <u>408</u> | <u>(584)</u> | <u>75,825</u> |
| | <u>\$105,793</u> | <u>\$521</u> | <u>\$(586)</u> | <u>\$105,728</u> |

The actual maturity dates may differ from the contractual maturities because debtors may have the right to call or prepay obligations without penalties.

Of the unrealized losses outstanding as of December 31, 2011 and 2010, no losses were outstanding for more than 12 months.

Management believes that as of December 31, 2011, the unrealized losses in the Company's investments in all types of marketable securities were temporary and no impairment loss was realized in the Company's consolidated statements of operations.

The unrealized losses related to U.S. treasury and GSE securities were primarily due to changes in interest rates. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2011.

Proceeds from maturity of available-for-sale marketable securities during 2011, 2010 and 2009 were \$68,072, \$35,180 and \$22,705, respectively. Proceeds from sales of available-for-sale marketable securities during 2011, 2010 and 2009 were \$11,910, \$25,352 and \$17,206, respectively. Net realized gains from the sale of available-for sale marketable securities for 2011, 2010 and 2009 were \$155, \$67 and \$933, respectively. The Company determines realized gains or losses on the sale of available-for-sale marketable securities based on a specific identification method.

NOTE 4:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

| | <u>December 31,</u> | |
|----------------------------|---------------------|----------------|
| | <u>2011</u> | <u>2010</u> |
| Tax receivables | \$ 662 | \$ 548 |
| Prepaid expenses | 3,490 | 1,994 |
| Deposits | 1,031 | 3,085 |
| Others | <u>160</u> | <u>675</u> |
| | <u>\$5,343</u> | <u>\$6,302</u> |

DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
U.S. dollars in thousands, except share and per share data

NOTE 5:- INVENTORIES

Inventories are composed of the following:

| | December 31, | |
|----------------------------|--------------|----------|
| | 2011 | 2010 |
| Work-in-progress | \$ 8,096 | \$ 5,148 |
| Finished products *) | 8,338 | 13,655 |
| | \$16,434 | \$18,803 |

*) The finished products inventory includes \$ 368 and \$ 1,033 of inventory held in consignment by other parties, at December 31, 2011 and 2010, respectively.

Inventory write-downs amounted to \$ 759, \$ 615 and \$ 626 for the years ended December 31, 2011, 2010 and 2009, respectively.

NOTE 6:- PROPERTY AND EQUIPMENT

Composition of assets, grouped by major classifications, is as follows:

| | December 31, | |
|--------------------------------------|--------------|----------|
| | 2011 | 2010 |
| Cost: | | |
| Computers and equipment | \$43,570 | \$47,303 |
| Office furniture and equipment | 1,636 | 1,583 |
| Motor vehicles | — | 77 |
| Leasehold improvements | 4,407 | 4,326 |
| | 49,613 | 53,289 |
| Less—accumulated depreciation | 43,810 | 45,503 |
| Depreciated cost | \$ 5,803 | \$ 7,786 |

During 2011, the Company recorded a disposal of equipment, which ceased to be used, in the amount of \$ 5,920, (depreciated cost of approximately \$ 5,898). The capital loss that was recorded due to this disposal in the consolidated statement of operations was \$ 22. The disposed assets included computer and equipment in the amount of \$ 2,665, which were accounted for as capital leases.

As of December 31, 2010, assets within the computers and equipments category amounted to \$ 2,665, which were accounted for as capital leases. Such assets included an amount of \$ 2,221 at December 31, 2010, for accumulated depreciation and amortization.

Depreciation expenses, which also include amortization expenses of assets recorded under capital leases, amounted to \$ 4,244, \$ 5,732 and \$ 7,216 for the years ended December 31, 2011, 2010 and 2009, respectively.

DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
U.S. dollars in thousands, except share and per share data

NOTE 7:- INTANGIBLE ASSETS, NET

The following table shows the Company's intangible assets for the periods presented:

| | <u>Useful life (years)</u> | <u>December 31,</u> | |
|---------------------------------|--------------------------------|---------------------|------------------|
| | | <u>2011</u> | <u>2010</u> |
| Cost: | | | |
| Current technology | 4.2 - 5.3 | \$ 77,080 | \$ 77,080 |
| Customer relations | 7.3 | 23,477 | 23,477 |
| In process R&D | | 7,702 | — |
| Non-competition agreement | 3 | 519 | — |
| | | <u>108,778</u> | <u>100,557</u> |
| Accumulated amortization: | | | |
| Current technology | | 46,473 | 39,229 |
| Customer relations | | 12,715 | 12,007 |
| In process R&D | | — | — |
| Non-competition agreement | | 15 | — |
| | | <u>59,203</u> | <u>51,236</u> |
| Impairment: (Note 7b) | | | |
| Current technology | | 28,817 | 28,817 |
| Customer relations | | 10,070 | 10,070 |
| | | <u>38,887</u> | <u>38,887</u> |
| Amortized cost | | <u>\$ 10,688</u> | <u>\$ 10,434</u> |

- a. Amortization expenses amounted to \$ 7,972, \$ 9,975 and \$ 12,258 for the years ended December 31, 2011, 2010 and 2009, respectively.
- b. In 2008, as a result of circumstances which indicated that the carrying amount of certain intangible assets would not be recoverable, the Company reassessed the fair value of its intangible assets, which resulted in impairment charges of approximately \$ 39,084.
- c. Estimated amortization expenses for the years ending:

| <u>Year ending December 31,</u> | |
|---------------------------------|-----------------|
| 2012 | \$ 2,913 |
| 2013 | 1,799 |
| 2014 | 1,700 |
| 2015 | 1,407 |
| Thereafter | <u>2,869</u> |
| | <u>\$10,688</u> |

DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
U.S. dollars in thousands, except share and per share data

NOTE 8:- GOODWILL

| | |
|----------------------------------------------|-----------------------|
| Balance as of January 1, 2011 | \$ — |
| Acquisition of BoneTone Communications | <u>3,707</u> |
| Balance as of December 31, 2011 | <u><u>\$3,707</u></u> |

See Note 1 for a discussion of the goodwill acquired during the year 2011.

NOTE 9:- FAIR VALUE MEASUREMENTS

The Company measures its cash equivalents, short-term deposits, marketable securities and foreign currency derivative contracts at fair value. Cash equivalents, short-term deposits, marketable securities and foreign currency derivative contracts are classified within Level 1 or Level 2 value hierarchies. This is because cash equivalents, short-term deposits and marketable securities are valued using quoted market prices or alternative pricing sources and models utilizing market observable inputs. Foreign currency derivative contracts are classified within Level 2 value hierarchy as the valuation inputs are based on quoted prices and market observable data of similar instruments.

The following table provides information by value level for financial assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2011.

| <u>Description</u> | <u>Balance as of December 31, 2011</u> | <u>Fair Value Measurements</u> | | |
|-----------------------------------------------------|--------------------------------------------|--------------------------------|----------------|----------------|
| | | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Time deposits | \$ 1,137 | | \$ 1,137 | |
| Money market mutual funds | \$ 2,934 | \$2,934 | | |
| Short-term marketable securities and time deposits: | | | | |
| U.S. GSE securities | \$ 563 | | \$ 563 | |
| Corporate debt securities | \$14,260 | | \$14,260 | |
| Time deposits | \$15,803 | | \$15,803 | |
| Long-term marketable securities: | | | | |
| U.S. GSE securities | \$10,133 | | \$10,133 | |
| Corporate debt securities | \$58,913 | | \$58,913 | |
| Derivative liabilities | \$ 476 | | \$ 476 | |

DSP GROUP INC.

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The following table provides information by value level for financial assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2010.

| <u>Description</u> | <u>Balance as of December 31, 2010</u> | <u>Fair Value Measurements</u> | | |
|-----------------------------------------------------|--------------------------------------------|--------------------------------|----------------|----------------|
| | | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Time deposits | \$ 5,601 | | \$ 5,601 | |
| Money market mutual funds | \$ 5,231 | \$5,231 | | |
| Short-term marketable securities and time deposits: | | | | |
| Corporate debt securities | \$17,043 | | \$17,043 | |
| Time deposits | \$12,860 | | \$12,860 | |
| Long-term marketable securities: | | | | |
| U.S. GSE securities | \$40,886 | | \$40,886 | |
| Corporate debt securities | \$34,939 | | \$34,939 | |
| Derivative assets | \$ 473 | | \$ 473 | |

In addition to the assets and liabilities described above, the Company's financial instruments also include cash, trade receivables, other accounts receivable, trade payables, accrued expenses and other payables. The fair value of these financial instruments was not materially different from their carrying value at December 31, 2011 and 2010 due to the short-term maturity of these instruments.

NOTE 10:- PENSION LIABILITIES

The Company acquired the CIPT Business on September 4, 2007. This business sponsors various defined benefits schemes for their employees, including pension funds, early retirement benefits, lump sum retirement indemnities and jubilee awards in several countries.

The largest of these plans that the Company assumed in connection with the CIPT Acquisition was the Swiss pension fund that insured the retirement, disability and death benefits of the employees who were formerly covered by the NXP Semiconductors Switzerland AG scheme. The difference between the Swiss liability (the Projected Benefit Obligation or PBO) and the market value of the plan assets was accounted for in the consolidated financial statements of the Company. The other defined benefits plans that the Company assumed in connection with the CIPT Acquisition that are accounted for in the Company's consolidated financial statements are the pension plans in Germany and India. Consistent with the requirements of local law, the Company deposits funds for certain plans with insurance companies, third-party trustees, or into government-managed accounts, and/or accrues for the unfunded portion of the obligation.

During the first quarter of 2011, the Company recorded a curtailment gain in the amount of \$660 derived from the closure of the Company's Swiss facilities and the termination of employment of the employees of the Company's Swiss subsidiary. As of December 31, 2011 there was no pension liability in connection with the Swiss pension plan.

For 2011 year end accounting purposes, liabilities associated with the German plans have been recalculated based on updated employee numbers and asset values at December 31, 2011. The value for the pension liability in India has been projected from results of the valuation of such liability on the date of CIPT Acquisition and has been since updated for changes in discount rate and was immaterial as of December 31, 2011.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
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The Company's pension obligation in Germany relating to the unvested pension claims (i.e. future obligation that will result from future service period) of the employees were outsourced in November 2010 to an external insurance company ("Nuremberger Versicherung"). From and after the outsourcing date, the Company is required to pay premiums to the external insurance company and in return the pension benefits earned by the German employees are covered by the Company's arrangement with the external insurance company. The Company legally is released from its obligations to the German employees once the premiums are paid, and it is no longer subject to any of the risks and rewards associated with the benefit obligations covered and the plan assets transferred to the external insurance company. Since the outsourcing arrangement meets the requirements of a nonparticipating annuity contract, the Company treats the costs of the outsourcing arrangement as the costs of the benefits being earned in accordance with ASC Paragraph 715-30-25-7 of ASC 715 "Compensation—Retirement Benefits."

The following tables provide a reconciliation of the changes in the pension plans' benefit obligation and fair value of assets for the years ended December 31, 2011 and 2010, and the statement of funded status as of December 31, 2011 and 2010:

| | December 31, | |
|----------------------------------------------------------|---------------------|----------------|
| | 2011 | 2010 |
| Accumulated benefit obligation | <u>\$ 1,197</u> | <u>\$5,452</u> |
| Change in benefit obligation | | |
| Benefit obligation at beginning of year | \$ 5,870 | \$4,242 |
| Service cost | 153 | 326 |
| Interest cost | 62 | 150 |
| Employee contributions | 14 | 90 |
| Plan curtailments | (660) | — |
| Plan settlements | (4,173) | — |
| Benefits paid from the plan | (31) | 226 |
| Expenses paid | — | (6) |
| Premiums paid | (3) | (35) |
| Actuarial loss (gain) | 1 | 614 |
| Exchange rates and others | (25) | 263 |
| Benefit obligation at end of year | <u>\$ 1,208</u> | <u>\$5,870</u> |
| Change in plan assets | | |
| Fair value of plan assets at beginning of year | \$ 4,448 | \$3,313 |
| Actual return on plan assets | 28 | 294 |
| Employer contributions to plan | 147 | 240 |
| Employee contributions | 14 | 90 |
| Plan settlements | (4,173) | — |
| Expenses paid | — | (6) |
| Benefits paid from the plan | (31) | 226 |
| Premiums paid | (3) | (35) |
| Exchange rates | (14) | 326 |
| Fair value of plan assets at end of year | <u>\$ 416</u> | <u>\$4,448</u> |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
U.S. dollars in thousands, except share and per share data

The assumptions used in the measurement of the Company's pension expense and benefit obligations as of December 31, 2011, 2010 and 2009 are as follows:

| | December 31, | | |
|--------------------------------------|--------------|-------|-------|
| | 2011 | 2010 | 2009 |
| Weighted-average assumptions | | | |
| Discount rate | 5.4% | 2.75% | 3.99% |
| Expected return on plan assets | 1.54% | 3.5% | 4.20% |
| Rate of compensation increase | 2.5% | 2.89% | 3.04% |

The amounts reported for net periodic pension costs and the respective benefit obligation amounts are dependent upon the actuarial assumptions used. The Company reviews historical trends, future expectations, current market conditions, and external data to determine the assumptions. The discount rate is determined considering the yield of government bonds. The rate of compensation increase is determined by the Company, based on its long-term plans for such increases.

The following table provides the components of net periodic benefit cost for the years ended December 31, 2011, 2010 and 2009:

| | December 31, | | |
|------------------------------------------------|--------------|--------|--------|
| | 2011 | 2010 | 2009 |
| Components of net periodic benefit cost | | | |
| Service cost | \$ 153 | \$ 326 | \$ 413 |
| Interest cost | 62 | 150 | 186 |
| Expected return on plan assets | (28) | (116) | (155) |
| Amortization of net loss (gain) | 39 | (102) | 9 |
| Settlement gain recognized | — | — | (278) |
| Curtailed gain(1) | (660) | — | — |
| Net periodic benefit cost | \$(434) | \$ 258 | \$ 175 |

- (1) The curtailment gain is derived from the closure of the Company's Swiss facilities and the termination of employment of the employees of the Company's Swiss subsidiary, which resulted in a curtailment and settlement of the Swiss pension plan.

| | December 31, | |
|-------------------------------------------------------------------------------|--------------|-----------|
| | 2011 | 2010 |
| Net amounts recognized in the consolidated balance sheets as of December 31, | | |
| 2011 and 2010 consist of: | | |
| Current liabilities | \$— | \$ 648 |
| Noncurrent liabilities | 792 | 774 |
| Net amounts recognized in the consolidated balance sheets | \$792 | \$ 1,422 |
| Net amounts recognized in accumulated other comprehensive income as of | | |
| December 31, 2011 and 2010 consist of: | | |
| Net actuarial loss | \$(78) | \$(1,253) |
| Other | — | 1,138 |
| Net amounts recognized in accumulated other comprehensive income (loss) | \$(78) | \$ (115) |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
U.S. dollars in thousands, except share and per share data

The estimated amount that will be amortized from accumulated other comprehensive income (loss) into net periodic benefit cost in 2011 is as follows:

| | |
|----------------------------------------|-------------|
| | <u>2011</u> |
| Net actuarial loss and other | <u>\$2</u> |

Benefit payments are expected to be paid as follows:

| | |
|---------------------------------|-------|
| <u>Year ending December 31,</u> | |
| 2012 | \$154 |
| 2013 | \$180 |
| 2014 | \$152 |
| 2015 | \$111 |
| 2016 | \$ 63 |
| 2017-2021 | \$150 |

The plan asset allocations at December 31 of the relevant years are as follows:

| | | |
|-----------------------|---------------------|-------------|
| | <u>December 31,</u> | |
| | <u>2011</u> | <u>2010</u> |
| Bonds | — | 44.0% |
| Real estate | — | 12.5% |
| Cash | — | 2.5% |
| Shares | — | 32.4% |
| Other | 100% | 8.6% |
| | <u>100%</u> | <u>100%</u> |

The fair value of the Company's pension plan assets at December 31, 2011 by asset category, classified by the three levels of inputs described in Note 2, are as follows:

| <u>Fair Value Measurements at December 31, 2011 Using:</u> | | | | |
|------------------------------------------------------------|----------------------------------------------------------|------------------------------------------------------------------|----------------------------------------------------------------------|--------------------------------------------------------------|
| | <u>Total Fair Value at December 31, 2011</u> | <u>Quoted Prices In Active Markets (Level 1)</u> | <u>Significant Other Observable Inputs (Level 2)</u> | <u>Significant Unobservable Inputs (Level 3)</u> |
| Cash | \$— | \$— | \$— | \$— |
| Equity securities | — | — | — | — |
| Real estate | — | — | — | — |
| Corporate bonds | — | — | — | — |
| Others | 416 | — | 416 | — |
| Total assets measured at fair value | <u>\$416</u> | <u>\$—</u> | <u>\$416</u> | <u>\$—</u> |

Valuation Techniques: For Level 1 inputs, the Company utilizes quoted market prices as these instruments have active markets. For Level 2 inputs, the Company utilizes quoted market prices in markets that are not active, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
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Regarding the policy for amortizing actuarial gains or losses for pension and post-employment plans, the Company has chosen the “corridor” option. This option consists of recognizing in the consolidated statements of operations, the part of unrecognized actuarial gains or losses exceeding 10% of the greater of the PBO or the market value of the plan assets. If amortization is required, the minimum amortization amount is that excess divided by the average remaining service period of the active employees expected to receive benefits under the plan.

For the year ended December 31, 2011, actuarial losses of \$ 1 were recognized in other comprehensive income (loss).

For the year ended December 31, 2010, actuarial losses of \$ 694 were recognized in other comprehensive income (loss).

NOTE 11:- FINANCIAL INCOME, NET

The components of financial income, net were as follows:

| | <u>Year ended December 31,</u> | | |
|------------------------------------------------------------------------------------------------------------------------|--------------------------------|----------------|----------------|
| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
| Foreign exchange gains | \$ 60 | \$ — | \$ 415 |
| Interest income from marketable securities and deposits, net of amortization of premium on marketable securities | 2,014 | 2,183 | 2,190 |
| Realized gains on marketable securities | 181 | 924 | 933 |
| Other | 7 | 8 | — |
| Financial income | <u>2,262</u> | <u>3,115</u> | <u>3,538</u> |
| Realized losses on marketable securities | 26 | 856 | — |
| Foreign exchange losses | 95 | 517 | 346 |
| Interest expenses | 42 | 103 | 118 |
| Other | 214 | 171 | 217 |
| Financial expense | <u>377</u> | <u>1,647</u> | <u>681</u> |
| Financial income, net | <u>\$1,885</u> | <u>\$1,468</u> | <u>\$2,857</u> |

NOTE 12:- STOCKHOLDERS' EQUITY

a. Preferred Stock:

The Company’s Board of Directors has the authority, without any further vote or action by the stockholders, to provide for the issuance of up to 5,000,000 shares of preferred stock in one or more series with such designations, rights, preferences, and limitations as the Board of Directors may determine, including the consideration received, the number of shares comprising each series, dividend rates, redemption provisions, liquidation preferences, sinking fund provisions, conversion rights and voting rights. No shares of preferred stock are currently outstanding.

On July 25, 2011, the Company’s Board of Directors approved the declaration of a dividend of one preferred share purchase right (a “Right”) for each outstanding share of its common stock on July 26, 2011. The dividend was paid on August 5, 2011 to the Company’s stockholders of record on August 5, 2011. In connection

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with the establishment of the Rights, the Company entered into a Rights Agreement, dated as of July 26, 2011, with American Stock Transfer & Trust Company, LLC, as rights agent, which specified the terms of the Rights (the “Rights Agreement”). Each Right allows its holder to purchase from the Company one one-thousandth of a share of Series B Junior Participating Preferred Stock for \$45, once the Rights become exercisable. Prior to exercise, the Right does not give its holder any dividend, voting, or liquidation rights. The Rights are not exercisable until 10 days after the public announcement that a person or group has become an acquiring person, as defined by the Rights Agreement (an “Acquiring Person”), by obtaining beneficial ownership of 10% or more of the Company’s outstanding common stock. The date when the Rights become exercisable is the “Distribution Date.” Until that date, the Company’s common stock certificates will also evidence the Rights, and any transfer of shares of common stock will constitute a transfer of Rights. After that date, the Rights will separate from the Company’s common stock and be evidenced by book-entry credits or by Rights certificates that the Company will mail to all eligible holders of its common stock. Any Rights held by an Acquiring Person are void and may not be exercised. New Rights will accompany any new shares of common stock the Company issues after August 5, 2011 until the Distribution Date. The Rights will expire on July 25, 2012.

b. Common Stock:

Currently, 50,000,000 shares of common stock are authorized. Holders of common stock are entitled to one vote per share on all matters to be voted upon by the Company’s stockholders. Subject to the rights of holders of preferred stock, if any, in the event of liquidation, dissolution or winding up, holders of common stock are entitled to share ratably in all of the Company’s assets. The Company’s Board of Directors may declare a dividend out of funds legally available therefore and, subject to the rights of holders of preferred stock, if any, the holders of common stock are entitled to receive ratably any such dividends.

Holders of common stock have no preemptive rights or other subscription rights to convert their shares into any other securities. There are no redemption or sinking fund provisions applicable to common stock.

c. Dividend Policy:

At December 31, 2011, the Company had an accumulated deficit of \$ 68,759. The Company has never paid cash dividends on the common stock and presently intends to follow a policy of retaining earnings for reinvestment in its business.

d. Share Repurchase Program:

In March 1999, the Company’s Board of Directors authorized the repurchase of up to 4.0 million shares of its common stock. In July 2003, October 2004, January 2007, January 2008 and July 2011, the Company’s board authorized an additional 2.5 million shares, 2.5 million shares, 3.0 million shares, 2.9 million shares and 1.0 million shares of common stock, respectively, for repurchase. The number of shares authorized for repurchase after giving affect to the January 2008 board approval was 5.1 million shares. Also in January 2008, the Company’s Board of Directors approved the Company’s entry into a share repurchase plan in accordance with Rule 10b5-1 of the United States Securities Exchange Act of 1934, as amended, for up to 5 million shares of the 5.1 million shares of the Company’s common stock authorized for repurchase. The plan, which became effective on February 7, 2008, expired on October 31, 2008. In October 2010, the Company’s Board of Directors authorized an increase in the number of shares available for repurchase, thereby increasing the aggregate number of authorized shares available for repurchase under its share repurchase program to two million shares. In July 2011, the Company’s Board of Directors authorized an increase in the Company’s share repurchase program by one million shares of common stock.

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In 2011 and 2010, the Company repurchased approximately 1,298,000 and 111,000 shares, respectively, of common stock at an average purchase price of \$ 6.74 and \$ 7.74 per share, respectively, for an aggregate purchase price of \$ 8,749 and \$ 862, respectively. No shares were repurchased under the Company's board-authorized share repurchase program during 2009. As of December 31, 2011, 1,591,179 shares of common stock remained authorized for repurchase under the Company's board-authorized share repurchase program.

In 2011, 2010 and 2009, the Company issued 547,000, 463,000 and 357,000 shares, respectively, of common stock, out of treasury stock, to employees who exercised their equity awards under the Company's equity incentive plans or purchased shares from the Company's 1993 Employee Stock Purchase Plan ("ESPP").

Outside of the share repurchase program, during the first quarter of 2009, in accordance with a Stock Repurchase Agreement executed by the Company and NXP on January 27, 2009, the Company repurchased 4,186,603 shares of its common stock that were issued to NXP in connection with the CIPT Acquisition at the purchase price of \$ 4.78 per share for approximately \$ 20,028.

e. Stock Purchase Plan and Equity Incentive Plans:

The Company has various equity incentive plans under which employees, officers, non-employee directors of the Company and its subsidiaries and others, including consultants, may be granted rights to purchase the Company's common stock. The plans authorize the administrator to grant incentive stock options at an exercise price of not less than 100% of the fair market value of the common stock on the date the option is granted and non-qualified stock options. It is the Company's policy to grant options at the fair market value.

Equity awards granted under all stock incentive plans that are cancelled or forfeited before expiration become available for future grant.

During 2011, 2010 and 2009, the Company granted to employees and executive officers of the Company and its subsidiaries primarily share appreciation rights ("SARs"), capped with a ceiling, under the various equity incentive plans. The SAR unit confers the holder the right to stock appreciation over a preset price of the Company's common stock during a specified period of time. When the unit is exercised, the appreciation amount is paid through the issuance of shares of the Company's common stock. The ceiling limits the maximum income for each SAR unit. SARs are considered an equity instrument as it is a net share settled award capped with a ceiling.

A summary of the various plans is as follows:

1993 Director Stock Option Plan

Upon the closing of the Company's initial public offering, the Company adopted the 1993 Director Stock Option Plan (the "Directors Plan"). Under the Directors Plan, which expires in 2014, the Company is authorized to issue nonqualified stock options to the Company's outside non-employee directors to purchase up to 1,980,875 shares of common stock at an exercise price equal to the fair market value of the common stock on the date of grant. The Directors Plan, as amended, provides that each person who becomes an outside, non-employee director of the Board of Directors shall automatically be granted an option to purchase 30,000 shares of common stock (the "First Option"). Thereafter, each outside director shall automatically be granted an option to purchase 15,000 shares of common stock (a "Subsequent Option") on January 1 of each year if, on such date, he shall have served on the Board of Directors for at least six months. In addition, an option to purchase an additional 15,000 shares of common stock (a "Committee Option") is granted on January 1 of each year to each outside director for each committee of the Board on which he shall have served as a chairperson for at least six months.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) U.S. dollars in thousands, except share and per share data

Options granted under the Directors Plan generally have a term of 10 years. One-third of the shares are exercisable after the first year and thereafter one-third at the end of each twelve-month period.

As of December 31, 2011, 468,784 shares of common stock remained available for grant under the Directors Plan.

1998 Non-Officer Employee Stock Option Plan

In 1998, the Company adopted the 1998 Non-Officer Employee Stock Option Plan (the “1998 Plan”). Under the 1998 Plan, employees may be granted non-qualified stock options for the purchase of common stock. The 1998 Plan currently provides for the purchase of up to 5,062,881 shares of common stock. As of December 31, 2011, 266,049 shares of common stock remained available for grant under the 1998 Plan.

The exercise price of options under the 1998 Plan shall not be less than the fair market value of common stock for nonqualified stock options, as determined by the Company’s Board of Directors.

Options under the 1998 Plan are generally exercisable over a 48-month period beginning 12 months after issuance, or as determined by the Company’s Board of Directors. Options under the 1998 Plan expire up to seven years after the date of grant.

2001 Stock Incentive Plan

In 2001, the Company adopted the 2001 Stock Incentive Plan (the “2001 Plan”). Under the 2001 Plan, employees, directors and consultants may be granted incentive or non-qualified stock options and other awards for the purchase of common stock. The 2001 Plan expired in 2011. As of December 31, 2011, 2,194,847 shares of common stock were granted under the plan and 10,000 shares of common stock remained in the plan prior to its expiration.

The 2001 Plan authorizes the administrator to grant incentive stock options at an exercise price of not less than 100% of the fair market value of the common stock on the date the option is granted.

Equity awards under the 2001 Plan are generally exercisable over a 48-month period beginning 12 months after issuance or as determined by the Company’s Board of Directors. Equity awards under the 2001 plan expire up to seven years after the date of grant.

2003 Israeli Share Option Plan

In 2003, the Company adopted the 2003 Israeli Share Option Plan (the “2003 Plan”), which complies with the Israeli tax reforms. Qualified options and shares are held in trust until the later of 24 months from the date of grant of the equity awards, or the vesting of the equity awards based on a vesting schedule determined by a committee appointed by the Company’s Board of Directors. 8,474,671 shares of common stock were reserved for issuance as of December 31, 2011 under the plan. Pursuant to the terms of the 2003 Plan, on the first business day of each calendar year beginning in 2004, the number of shares authorized under the plan increases by an amount equal to 3% of the number of shares of common stock outstanding as of such date, or a lower number of shares determined by the Company’s Board of Directors. As of December 31, 2011, 2,195,418 shares of common stock remained available for grant under the 2003 Plan.

Equity awards under the 2003 Plan are generally exercisable over a 48-month period beginning 12 months after issuance, or as determined by the Company’s Board of Directors. Equity awards under the 2003 Plan expire up to seven years after the date of grant.

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1993 Employee Stock Purchase Plan

Upon the closing of the Company's initial public offering, the Company adopted the ESPP. The Company has reserved an aggregate of 2,800,000 shares of common stock for issuance under the ESPP. The ESPP provides that substantially all employees of the Company may purchase Company common stock at 85% of its fair market value on specified dates via payroll deductions. There were approximately 423,000, 388,000 and 357,000 shares of common stock issued at a weighted average purchase price of \$ 4.81, \$ 4.75 and \$ 5.90 per share under the ESPP in 2011, 2010 and 2009, respectively.

Stock Reserved for Future Issuance

The following table summarizes the number of outstanding shares of common stock available for future issuance at December 31, 2011 (after giving effect to the above increases in the equity incentive plans):

| | |
|------------------------------------|------------------|
| ESPP | 535,000 |
| Equity awards | 2,930,000 |
| Undesignated preferred stock | 5,000,000 |
| | <u>8,465,000</u> |

The following is a summary of activities relating to the Company's stock options and SARs granted among the Company's various plans:

| | Year ended December 31, | | | | | |
|------------------------------------------------|---------------------------------------------------------|------------------------------------------|---------------------------------------------------------|------------------------------------------|---------------------------------------------------------|------------------------------------------|
| | 2011 | | 2010 | | 2009 | |
| | Amount of options/ SARs in thousands | Weighted average exercise price | Amount of options/ SARs in thousands | Weighted average exercise price | Amount of options/ SARs in thousands | Weighted average exercise price |
| Options outstanding at beginning of year | 11,305 | \$12.94 | 10,433 | \$15.20 | 8,359 | \$18.54 |
| Changes during the year: | | | | | | |
| Granted(1) | 1,263 | \$ 7.58 | 2,675 | \$ 7.21 | 2,981 | \$ 6.11 |
| Exercised | (339) | \$ 6.22 | (163) | \$ 6.07 | — | \$ — |
| Forfeited and cancelled | (1,665) | \$14.86 | (1,640) | \$18.62 | (907) | \$16.16 |
| Options/SARs outstanding at end of year(2) ... | <u>10,564</u> | <u>\$12.22</u> | <u>11,305</u> | <u>\$12.94</u> | <u>10,433</u> | <u>\$15.20</u> |
| Options/SARs exercisable at end of year(3) ... | <u>7,669</u> | <u>\$14.10</u> | <u>6,492</u> | <u>\$16.90</u> | <u>5,433</u> | <u>\$20.68</u> |

- (1) SAR grants made prior to January 1, 2009 are convertible for a maximum number of shares of the Company's common stock equal to 50% of the SAR units subject to the grant. SAR grants made on or after January 1, 2009 and before January 1, 2010 are convertible for a maximum number of shares of the Company's common stock equal to 75% of the SAR units subject to the grant. SAR grants made on or after January 1, 2010 are convertible for a maximum number of shares of the Company's common stock equal to 66.67% of the SAR units subject to the grant.
- (2) Due to the ceiling imposed on the SAR grants, the outstanding amount above can be exercised for a maximum of 7,427,676 shares of the Company's common stock as of December 31, 2011.
- (3) Due to the ceiling imposed on the SAR grants, the exercisable amount above can be exercised for a maximum of 5,280,357 shares of the Company's common stock as of December 31, 2011.

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The stock options and SARs outstanding as of December 31, 2011, have been separated into ranges of exercise price as follows:

| Range of exercise price \$ | Outstanding thousands | Remaining contractual life (years) | Aggregate intrinsic value (*) | Weighted average exercise price \$ | Exercisable thousands | Remaining contractual life (years) | Aggregate intrinsic value (*) | Weighted average exercise price \$ |
|-------------------------------|--------------------------|------------------------------------------|-------------------------------------|------------------------------------------------|--------------------------|------------------------------------------|-------------------------------------|------------------------------------------------|
| 5.63—7.23 | 2,180 | 3.73 | \$— | 6.03 | 1,529 | 3.33 | \$— | 6.03 |
| 7.25—10.23 | 5,317 | 4.23 | — | 8.42 | 3,075 | 3.16 | — | 9.03 |
| 10.28—14.82 | 170 | 5.05 | — | 12.28 | 168 | 5.07 | — | 12.29 |
| 15.79—21.04 | 213 | 1.94 | — | 17.84 | 214 | 1.94 | — | 17.84 |
| 21.05—28.72 | 2,684 | 1.64 | — | 24.32 | 2,683 | 1.64 | — | 24.32 |
| | <u>10,564</u> | <u>3.44</u> | <u>\$—</u> | <u>12.22</u> | <u>7,669</u> | <u>2.67</u> | <u>\$—</u> | <u>14.10</u> |

(*) Calculation of aggregate intrinsic value is based on the share price of the Company's common stock as of December 31, 2011 (\$ 5.21 per share).

As of December 31, 2011, the outstanding number of SARs was 8,046,974 and based on the share price of the Company's common stock as of December 31, 2011 (\$ 5.21 per share), no SARs were in-the-money.

The weighted-average estimated fair value of employee stock options and SARs granted during the years ended December 31, 2011, 2010 and 2009 was \$ 3.26, \$ 3.19 and \$ 2.47 per stock option and SAR, respectively, using the binomial model with the following weighted-average assumptions (annualized percentages):

| | Year ended December 31, | | |
|------------------------------------------|-------------------------|------------|------------|
| | 2011 | 2010 | 2009 |
| Volatility | 54.60% | 64.47% | 61.92% |
| Risk-free interest rate | 2.23% | 2.25% | 2.00% |
| Dividend yield | 0% | 0% | 0% |
| Pre-vest cancellation rate*) | 3.37% | 2.92% | 3.50% |
| Post-vest cancellation rate**) | 2.21% | 2.23% | 2.15% |
| Suboptimal exercise factor***) | 1.59 | 1.63 | 1.64 |
| Expected life | 4.14 years | 4.07 years | 4.07 years |

- *) The pre-vest cancellation rate was calculated on an annual basis and is presented here on an annual basis.
- **) The post-vest cancellation rate was calculated on a monthly basis and is presented here on an annual basis.
- ***) The ratio of the stock price to strike price at the time of exercise of the option.

The computation of volatility uses a combination of historical volatility and implied volatility derived from the Company's exchange traded options with similar characteristics.

The risk-free interest rate assumption is based on U.S. treasury bill interest rates appropriate for the term of the Company's employee equity-based awards.

The dividend yield assumption is based on the Company's historical and expectation of future dividend payouts and may be subject to substantial change in the future.

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The expected term of employee equity-based awards represents the weighted-average period the awards are expected to remain outstanding and is a derived output of the binomial model. The expected life of employee equity-based awards is impacted by all of the underlying assumptions used in the Company's model. The binomial model assumes that employees' exercise behavior is a function of the award's remaining contractual life and the extent to which the award is in-the-money (i.e., the average stock price during the period is above the strike price of the award). The binomial model estimates the probability of exercise as a function of these two variables based on the history of exercises and cancellations on past award grants made by the Company.

As equity-based compensation expense recognized in the consolidated statement of operations is based on awards ultimately expected to vest, it should be reduced for estimated forfeitures. The forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Pre and post-vesting forfeitures were estimated based on historical experience.

The fair value for rights to purchase shares of common stock under the Company's ESPP was estimated on each enrollment date using the same assumptions set forth above for the years ended 2011, 2010 and 2009 except the expected life and the volatility. The expected life was assumed to be between six to 24 months based on the contractual life of the plan, and the expected volatility was assumed to be in a range of 28.37%-61.02% in 2011, 50.25%-78.61% in 2010 and 58.16%-86.68% in 2009.

The Company's aggregate compensation expenses for the years ended December 31, 2011, 2010 and 2009 totaled \$ 6,220, \$ 9,553 and \$ 11,100, respectively. The Company recognized no tax benefit in its consolidated statements of operations for the years ended December 31, 2011, 2010 and 2009 for the Company's equity-based compensation arrangements.

A summary of the status of the Company's non-vested stock options and SARs as of December 31, 2011, and changes during the year ended December 31, 2011, is presented below:

| <u>Non-vested</u> | <u>Shares</u> | <u>Weighted average grant date fair value</u> |
|-------------------------------------------|----------------|-------------------------------------------------------|
| | (In thousands) | |
| Non-vested at January 1, 2011 | 4,813 | 3.14 |
| Granted | 1,263 | 3.26 |
| Vested | (2,490) | 3.23 |
| Forfeited | <u>(691)</u> | 3.21 |
| Non-vested at December 31, 2011 | <u>2,895</u> | 3.09 |

As of December 31, 2011, equity-based compensation arrangements to purchase a maximum of 6,685 shares of common stock were vested and expected to vest (the calculation takes into consideration the forfeiture rate).

As of December 31, 2011, there was a total unrecognized compensation expense of \$ 3,265 related to non-vested equity-based compensation arrangements granted under the Company's various equity incentive plans. That expense is expected to be recognized during the period from 2011 through 2015.

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NOTE 13:- MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION

The Company operates in one reportable segment (see Note 1 for a brief description of the Company's business).

The following is a summary of operations within geographic areas based on customer locations:

| | Year ended December 31, | | |
|-------------------------|-------------------------|------------------|------------------|
| | 2011 | 2010 | 2009 |
| Revenue distribution: | | | |
| Hong-Kong | \$100,894 | \$112,319 | \$ 95,204 |
| Japan | 57,260 | 76,986 | 71,388 |
| Korea | 5,909 | 8,081 | 20,233 |
| Europe | 9,180 | 13,043 | 15,448 |
| United States | 1,836 | 1,423 | 3,382 |
| China | 8,577 | 6,807 | 4,472 |
| Taiwan | 7,225 | 3,208 | 2,031 |
| Other | 2,980 | 3,615 | 28 |
| | <u>\$193,861</u> | <u>\$225,482</u> | <u>\$212,186</u> |

For a summary of revenues from major customers, please see Note 1.

The following is a summary of long-lived assets within geographic areas based on the assets' locations:

| | Year ended December 31, | |
|-------------------------|----------------------------|-----------------|
| | 2011 | 2010 |
| Long-lived assets: | | |
| Europe | \$ 2,613 | \$10,672 |
| Israel | 16,894 | 6,756 |
| United States | 40 | 263 |
| Other | 651 | 529 |
| | <u>\$20,198</u> | <u>\$18,220</u> |

NOTE 14:- RELATED PARTIES BALANCES AND TRANSACTIONS

As partial consideration for the Acquisition, the Company issued to NXP 4,186,603 shares of its common stock, representing 16% of the Company's outstanding common stock as of December 31, 2008.

In connection with the CIPT Acquisition, the Company, DSP Israel and NXP entered into, among others, the following ancillary documents, each effective as of September 4, 2007:

- (1) Manufacturing Services Collaboration Agreement, as amended, pursuant to which NXP agreed to provide the Company and its affiliates with specified manufacturing, pre-testing, assembling and final-testing services relating to the CIPT Business products at agreed upon prices for up to seven years following the closing of the CIPT Acquisition. The services are provided on a purchase order basis.

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- (2) Umbrella Transitional Services Agreement pursuant to which NXP agreed to provide the Company and its affiliates with other specified transitional services at agreed upon prices for a limited period to assist the Company and its affiliates in achieving a smooth transition of the CIPT Business. The services are provided pursuant to specified service level agreements and include HR, finance and administration, IT, infrastructure, warehousing, CAD tool services, Intellectual Property Library Services and R&D services. The term of each service is agreed upon in the service level agreements.

On January 27, 2009, the Company and NXP entered into a Stock Repurchase Agreement (the “Repurchase Agreement”) pursuant to which the Company agreed to repurchase the 4,186,603 shares of the Company’s common stock issued to NXP in connection with the CIPT Acquisition (the “Shares”). The per share purchase price for the Shares was determined by the parties to be the average closing price per share of the common stock on the NASDAQ Global Market during the 20 business days commencing on February 5, 2009, less fifteen percent of such average. The closing of the repurchase occurred on March 12, 2009 (the “Closing Date”), at which time the Company repurchased the Shares for an aggregate consideration of approximately \$ 20,028. Effective as of the Closing Date, the Stockholders Agreement previously executed by the Company and NXP and all rights and obligations of the parties therein terminated and the NXP nominee to the Company’s Board of Directors resigned.

The termination of the Stockholders Agreement had no impact on the Manufacturing Services Collaboration Agreement, as amended, or the Umbrella Transitional Services Agreement.

Transactions with related party:

| | <u>Year ended December 31,</u> | | |
|---------------------------------------------------|--------------------------------|-------------|-------------|
| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
| Cost of revenues (1) | \$— | \$— | \$8,013 |
| Research and development expenses (2) | \$— | \$— | \$ 209 |
| Sales and marketing expenses (2) | \$— | \$— | \$ 19 |
| General and administrative expenses (2) | \$— | \$— | \$ 60 |

- (1) Includes the purchase of inventory from NXP pursuant to the Manufacturing Services Collaboration Agreement described above.
- (2) Includes certain research and development, sales and marketing, and general and administrative services provided by NXP pursuant to the agreements described above.
- (3) The amounts included for 2009 were for the period that NXP was deemed a related party.

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NOTE 15:- COMMITMENTS AND CONTINGENCIES

Commitments:

The Company and its subsidiaries lease certain equipment and facilities under non-cancelable operating leases. The Company has significant leased facilities in Herzliya Pituach, Israel and in California, USA. The lease agreement for the Israeli facilities is effective until November 2013. The Company has various agreements for its facilities in the U.S. that terminate in 2013 through 2015. The Company's subsidiaries in Scotland, Japan and Hong-Kong have lease agreements for their facilities that terminate in 2012, 2014 and 2013, respectively. The Company's subsidiaries in Germany and India have sublease agreements with NXP for their facilities that terminate in 2012. The Company has operating lease agreements for its motor vehicles, which terminate in 2012 through 2014. In addition, certain of the Company's subsidiaries have fixed service agreements with NXP (see Note 14).

At December 31, 2011, the Company is required to make the following minimum lease payments under non-cancelable operating leases for its motor vehicles and facilities:

| <u>Year ended December 31,</u> | |
|--------------------------------|----------------|
| 2012 | \$3,647 |
| 2013 | 2,398 |
| 2014 | 170 |
| 2015 | <u>3</u> |
| | <u>\$6,218</u> |

Facilities rental expenses amounted to \$ 3,375, \$ 3,391 and \$ 3,163 (out of which \$ 102 is to a related party) for the years ended December 31, 2011, 2010 and 2009, respectively.

Claims

- a. The Company is involved in certain claims arising in the normal course of business. However, the Company believes that the ultimate resolution of these matters will not have a material adverse effect on its financial position, results of operations, or cash flows.
- b. From time to time, the Company may become involved in litigation relating to claims arising in the ordinary course of business activities. Also, as is typical in the semiconductor industry, the Company has been and, from time to time may be, notified of claims that it may be infringing on patents or intellectual property rights owned by third parties. During 2010, the Company recorded an income of \$ 2,500 in cost of revenues (the account in which the provision was originally recorded) resulting from the reversal of a provision that was determined to be no longer needed due to the expiration of the applicable statute of limitations.

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NOTE 16:- TAXES ON INCOME

a. The provision for income taxes is as follows:

| | Year ended December 31, | | |
|---------------------------|-------------------------|---------|------------|
| | 2011 | 2010 | 2009 |
| Domestic taxes: | | | |
| Federal taxes: | | | |
| Current | \$ 36 | \$(931) | \$(13,095) |
| Deferred | — | — | — |
| Valuation allowance | — | — | — |
| | 36 | (931) | (13,095) |
| State taxes: | | | |
| Current | (623) | 34 | 173 |
| Deferred | — | — | — |
| Valuation allowance | — | — | — |
| | (623) | 34 | 173 |
| Foreign taxes: | | | |
| Current | (311) | 52 | 963 |
| Deferred | 32 | (81) | 42 |
| Valuation allowance | — | 143 | 283 |
| | (279) | 114 | 1,288 |
| Taxes on income | \$(866) | \$(783) | \$(11,634) |

There were no tax benefits associated with the exercise of non-qualified stock option in 2011, 2010 and 2009.

b. Loss before taxes is comprised as follows:

| | Year ended December 31, | | |
|----------------|-------------------------|-----------|------------|
| | 2011 | 2010 | 2009 |
| Domestic | \$ (3,162) | \$(2,794) | \$ (4,851) |
| Foreign | (13,946) | (5,414) | (15,219) |
| | \$(17,108) | \$(8,208) | \$(20,070) |

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- c. A reconciliation between the Company's effective tax rate assuming all income is taxed at statutory tax rate applicable to the income of the Company and the U.S. statutory rate is as follows:

| | Year ended December 31, | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------|-----------|------------|
| | 2011 | 2010 | 2009 |
| Losses before taxes on income | \$(17,108) | \$(8,208) | \$(20,070) |
| Theoretical tax at U.S. statutory tax rate (35%) | \$ (5,988) | \$(2,873) | \$ (7,025) |
| State taxes, net of federal benefit | 2 | 1 | 3 |
| Foreign income taxed at rates other than the U.S. rate (including deferred taxes that were not provided, valuation allowance and current adjustment and interest on uncertain tax position liability) | 2,563 | (1,082) | 3,008 |
| Nondeductible equity-based compensation expenses | 2,177 | 3,344 | 3,885 |
| Current adjustment and interest on uncertain tax position liability in U.S. | (598) | (517) | (10,970) |
| Valuation allowance in U.S. | 957 | 723 | — |
| Other | 21 | (379) | (535) |
| | \$ (866) | \$ (783) | \$(11,634) |

- d. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

| | December 31, | |
|--------------------------------------------------|--------------|----------|
| | 2011 | 2010 |
| Deferred tax assets (short-term): | | |
| Reserves and accruals | \$ 89 | \$ 121 |
| Total deferred tax assets (short-term) | 89 | 121 |
| Valuation allowance | — | — |
| Total | 89 | 121 |
| Deferred tax assets (long-term): | | |
| Reserves and accruals | 1,044 | 1,012 |
| Equity-based compensation | 2,252 | 2,108 |
| Intangible assets | 4,272 | 4,658 |
| Carryforward tax losses | 29,411 | 27,608 |
| Other | 137 | 145 |
| Total deferred tax assets (long-term) | 37,116 | 35,531 |
| Valuation allowance | (37,116) | (35,531) |
| Total | — | — |
| Total deferred tax assets | \$ 89 | \$ 121 |

Management believes that the deferred net tax assets will not be realized based on current levels of future taxable income and potentially refundable taxes. Accordingly, a valuation allowance in the amount of \$ 37,116 and \$ 35,531 was provided as of December 31, 2011 and 2010, respectively. The Company does not have a provision for U.S. income taxes on the undistributed earnings of its international subsidiaries since the Company intends to indefinitely reinvest these earnings outside the U.S.

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e. Uncertain tax positions:

A reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits is as follows:

| | December 31, 2011 |
|------------------------------------------------------------|------------------------------|
| Gross unrecognized tax benefits at January 1, 2011 | \$2,442 |
| Decrease in tax positions for previous years | (729) |
| Increases in tax positions for previous years, net | — |
| Increase in interest related to tax positions | 37 |
| Lapse in statute of limitations | (635) |
| Gross unrecognized tax benefits at December 31, 2011 | <u>\$1,115</u> |
| | |
| | December 31, 2010 |
| Gross unrecognized tax benefits at January 1, 2010 | \$3,107 |
| Decrease in tax positions for previous years | (193) |
| Increases in tax positions for previous years, net | 316 |
| Increase in interest related to tax positions | 18 |
| Lapse in statute of limitations | (806) |
| Gross unrecognized tax benefits at December 31, 2010 | <u>\$2,442</u> |

The total amount of net unrecognized tax benefits that, if recognized, would affect the effective tax rate was \$ 1,115 and \$ 2,442 at December 31, 2011 and 2010, respectively. The Company accrues interest and penalties relating to unrecognized tax benefits in its provision for income taxes. At December 31, 2011 and 2010, the Company had accrued interest and penalties related to unrecognized tax benefits of \$ 276 and \$ 506, respectively.

The Company reversed income tax contingency reserves that were determined to be no longer required due to the expiration of applicable statute of limitations. Pursuant to this reversal, the Company recorded a tax benefit of \$ 635 and \$ 1,018 during 2011 and 2010, respectively.

The Company and certain of its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. The last examination conducted by U.S. tax authorities was with respect to the Company’s U.S. federal income tax returns for 2004. The statute of limitations relating to the consolidated Federal income tax return is closed for all tax years up to and including 2003.

With respect to DSP Israel, the Israeli tax authorities audited its income tax returns for the years up to and including 2003. The statute of limitations related to such tax returns is closed for all tax years up to and including 2004.

With respect to the Company’s Swiss subsidiary, the statute of limitation related to its tax returns is opened for all tax years since its incorporation.

f. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 (“Investment Law”): Six separate investment programs of DSP Israel’s production facilities have been granted “Approved Enterprise” status and two investment programs of DSP Israel’s production facilities was filed under “Beneficiary Enterprise” status under the Investment Law. The Investment Law provides certain Israeli tax benefits for eligible capital investments in a production facility, as discussed in greater detail below.

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On April 1, 2005, an amendment to the Investment Law came into effect (the “Amendment”) and significantly changed the provisions of the Investment Law. Generally, DSP Israel’s investment programs that obtained approval for Approved Enterprise status prior to enactment of the Amendment will continue to be subject to the old provisions of the Investment Law.

The Amendment enacted major changes in the manner in which tax benefits are awarded under the Investment Law so that companies are no longer required to get the Investment Center’s prior approval to qualify for tax benefits. An enterprise that receives tax benefits without the initial approval from the Investment Center is called a “Beneficiary Enterprise,” rather than the previous terminology of Approved Enterprise. The period of tax benefits for a new Beneficiary Enterprise commences in the “Year of Commencement,” which is the later of: (1) the year in which taxable income is first generated by the company, or (2) the year of election.

In addition, under the Amendment, tax benefits are available to production facilities, which generally are required to derive more than 25% of their business income from export. Furthermore, in order to receive the tax benefits under the Amendment, a company must make an investment in the Benefited Enterprise exceeding a certain percentage or a minimum amount specified in the Investment Law.

DSP Israel has chosen the “alternative benefits” track for all of its investment programs. Accordingly, DSP Israel’s income from an “Approved Enterprise” and “Beneficiary Enterprise” is tax-exempt for a period of two or four years and is subject to a reduced corporate tax rate of 10%-25% (based on the percentage of foreign ownership) for an additional period of eight or six years, respectively.

DSP Israel’s first and second investment programs, which were completed and commenced operations in 1994 and 1996, respectively, were tax exempt for two and four years, respectively, from the first year they had taxable income and were entitled to a reduced corporate tax rate of 10%-25% (based on the percentage of foreign ownership) for an additional period of eight and six years, respectively. As of 2011, those investment programs were no longer entitled to a reduced corporate tax.

DSP Israel’s third investment program, which was completed and commenced operations in 1998, was tax exempt for two years from the first year it had taxable income and was entitled to a reduced corporate tax rate of 10%-25% (based on the percentage of foreign ownership) for an additional period of eight years from the first year it had taxable income. As of 2011, this investment program was no longer entitled to a reduced corporate tax.

DSP Israel’s fourth, fifth and sixth investment programs were approved in 1998, 2001 and 2003, respectively, which entitled DSP Israel to a corporate tax exemption for a period of two years and to a reduced corporate tax rate of 10%-25% (based on the percentage of foreign ownership) for an additional period of eight years from the first year the production facility subject to the investment program had taxable income. As of 2011, the fourth investment program was no longer entitled to a reduced corporate tax.

DSP Israel’s seventh and eighth investment programs have been in operation since 2006 and 2009, respectively, and entitles DSP Israel to a corporate tax exemption for a period of two years and a reduced corporate tax rate of 10%-25% (based on the percentage of foreign ownership) for an additional period of eight years from the first year it has taxable income.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) U.S. dollars in thousands, except share and per share data

Since DSP Israel is operating under more than one approval, its effective tax rate is the result of a weighted combination of the various applicable tax rates and tax exemptions and the computation is made for income derived from each investment program on the basis and formulas specified in the Investment Law and the approvals.

During 2006, DSP Israel received an approval for the erosion of tax basis in respect to its fifth and sixth investment programs. During 2008, DSP Israel received an approval for the erosion of tax basis with respect to its second, third and fourth investment programs. Those approvals resulted in increasing the taxable income attributable to the later investment programs, which are currently in operation and will be taxed at a lower tax rate than the previous investment programs, which in turn will decrease the overall effective tax rate.

The Company's investment programs that generate taxable income are currently subject to an average tax rate of up to approximately 10% based on a variety of factors, including percentage of foreign ownership and approvals for the erosion of the tax basis of our investment programs. The Company's average tax rate for its investment programs may change in the future due to circumstances outside of its control and therefore, the Company cannot provide any assurances that its average tax rate for its investment programs will continue at an approximate rate of 10% in the future.

As of December 31, 2011, DSP Israel believed that it met all the conditions required under the plans, which include inter-alia an obligation to invest certain amounts in property and equipment and an obligation to finance a percentage of investments by share capital.

Should DSP Israel fail to meet such conditions in the future, it could be subject to corporate tax in Israel at the standard tax rate (24% for 2011 and 25% for 2012) and could be required to refund tax benefits already received.

As of December 31, 2011, approximately \$ 35,481 was derived from tax exempt profits earned by DSP Israel's "Approved Enterprises" and "Beneficiary Enterprise." The Company has determined that such tax-exempt income will not be distributed as dividends and intends to reinvest the amount of its tax exempt income earned by DSP Israel. Accordingly, no provision for deferred income taxes has been provided on income attributable to DSP Israel's "Approved Enterprises" and "Beneficiary Enterprise" as such income is essentially permanently reinvested.

If DSP Israel's retained tax-exempt income is distributed in a manner other than on its complete liquidation, the income would be taxed at the applicable corporate tax rate (currently 10%) as if it had not elected the alternative tax benefits under the Investment Law and an income tax liability of approximately \$ 3,942 would have been incurred as of December 31, 2011.

DSP Israel's income from sources other than the "Approved Enterprises" and "Beneficiary Enterprise" during the benefit period will be subject to tax at the effective standard corporate tax rate in Israel (25% for 2011 and 2012).

By virtue of the Investment Law, DSP Israel is entitled to claim accelerated rates of depreciation on equipment used by an "Approved Enterprise" and "Beneficiary Enterprise" during the first five tax years from the beginning of such use.

DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) U.S. dollars in thousands, except share and per share data

In January 2011, the Knesset (Israeli parliament) passed the Law for Economic Policy for 2011 and 2012 (Amended Legislation), 2011, which prescribes, among other things, for a further amendment of the Israeli Investment Law. The amendment became effective as of January 1, 2011. Among other things, the amendment sets forth the following amended tax rates for income generated from qualified investment programs:

- for 2011 and 2012—15%;
- for 2013 and 2014—12.5%; and
- for 2015 and thereafter—12%.

The Company does not currently intend to implement the amendment, and intend to continue to comply with the Investment Law as in effect prior to enactment of the amendment until the earlier of such time that compliance with the Investment Law prior to amendment is no longer in the Company's interests or until the expiration of the Company's current investment programs. The Company is required to comply with the amendment subsequent to the expiration of its current investment programs and for any new qualified investment program, after a transitional period. As a result, the amendment may increase the Company's average tax rate in future years.

g. Tax benefits under Israel's Law for Encouragement of Industry (Taxation), 1969:

DSP Israel is an "industrial company" under the Law for the Encouragement of Industry (Taxation), 1969, and as such is entitled to certain tax benefits, mainly the amortization of costs relating to know-how and patents, over eight years and accelerated depreciation.

h. Israeli tax rates:

The rate of the Israeli corporate tax is as follows: 2009—26%, 2010 -25% and 2011—24%. Tax at a rate of 25% applies on capital gains arising after January 1, 2003.

On December 5, 2011, the Israeli Parliament (the Knesset) passed the Law for Tax Burden Reform (Legislative Amendments), 2011 which, among others, cancels effective starting in 2012, the scheduled progressive reduction in the corporate tax rate. This law also increases the corporate tax rate to 25% for 2012.

j. In connection with the CIPT Acquisition, the Company received a tax ruling from the Swiss tax authorities with respect to the taxable income generated by its Swiss subsidiary, including the amortization period for tax purposes of goodwill and all other intangible assets acquired in the CIPT Acquisition by its Swiss subsidiary. Pursuant to the tax ruling, the Company's Swiss subsidiary is entitled to reduced tax rates of approximately 10% to 15%, depending on the source of income, and tax amortization period of up to 10 years for the goodwill and other intangible assets acquired in the CIPT Acquisition by its Swiss subsidiary.

k. The Company has accumulated losses for federal tax purposes as of December 31, 2011 of approximately \$ 5,733 which may be carried forward and offset against future taxable income for a period of twenty years from its creation. In addition, the Company has accumulated capital losses of approximately \$ 1,997, which may be carried forward and offset against future capital gains for a period of five years from its creation. DSP Israel has accumulated losses for tax purposes as of December 31, 2011, of approximately \$ 42,639 (including research and development expenses carry forward), which may be carried forward and offset against future taxable income for an indefinite period. The Swiss subsidiary has accumulated losses for tax purposes as of December 31, 2011, of approximately \$ 241,695, which may be carried forward and offset against future taxable income for a period of seven years from its creation.

DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
U.S. dollars in thousands, except share and per share data

NOTE 17:- NET LOSS PER SHARE

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

| | <u>Year ended December 31,</u> | | |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|------------------|------------------|
| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
| Numerator: | | | |
| Net loss | <u>\$(16,242)</u> | <u>\$(7,425)</u> | <u>\$(8,436)</u> |
| Denominator: | | | |
| Weighted average number of shares of common stock outstanding during the year used to compute basic net loss per share (in thousands) | 23,247 | 23,229 | 23,655 |
| Incremental shares attributable to exercise of outstanding options and SARs (assuming proceeds would be used to purchase treasury stock) (in thousands) | — | — | — |
| Weighted average number of shares of common stock used to compute diluted net loss per share (in thousands) | <u>23,247</u> | <u>23,229</u> | <u>23,655</u> |
| Basic net loss per share | <u>\$ (0.70)</u> | <u>\$ (0.32)</u> | <u>\$ (0.36)</u> |
| Diluted net loss per share | <u>\$ (0.70)</u> | <u>\$ (0.32)</u> | <u>\$ (0.36)</u> |

NOTE 18:- RESTRUCTURING COSTS AND OTHER

During the third quarter of 2011, as part of the Company’s plan to improve operating efficiencies and reduce its operating expenses for fiscal year 2012, it restructured its U.S. operations. As part of this restructuring plan, the Company executed termination agreements with certain of its U.S. employees and renegotiated the lease for its U.S facilities. The Company recorded an expense in the amount of \$419 in the third quarter of 2011, consisting of employee severance costs and lease agreement termination.

As of December 31, 2011, \$224 of restructuring payments were paid in connection with the above restructuring plan. The Company anticipates that the remaining accrued restructuring balance of \$ 195 will be paid out in cash throughout fiscal year 2012.

During the third quarter of 2010, the Company initiated a restructuring plan to improve operational efficiencies at its Swiss subsidiary and reduce its operating expenses for fiscal year 2011. As a result of the closure of the Swiss facilities in 2011 and the termination of employment of all the Swiss subsidiary’s employees, the Company incurred total costs of \$463 in 2010, which were primarily related to costs associated with involuntary employee terminations.

During the first quarter of 2011, the Company recorded total income of \$590 in connection with the restructuring plan implemented in the third quarter of 2010. The income resulted mainly from the closure of the Swiss facilities and the termination of employment of the employees of its Swiss subsidiary, which resulted in a curtailment and settlement of the Swiss pension plan during the first quarter of 2011.

As of December 31, 2011, all of the restructuring payments were paid in connection with the above Swiss restructuring plan.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

Item 9A. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2011.

There has been no change in our internal control over financial reporting that occurred during our most recent fiscal quarter that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) and Rule 15d-15(f) promulgated under the Securities Exchange Act of 1934, as amended. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. 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.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, our management concluded that our internal control over financial reporting was effective as of December 31, 2011.

The effectiveness of our internal control over financial reporting as of December 31, 2011 has been audited by Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global, an independent registered public accounting firm, who audited and reported on the consolidated financial statements of the company for the year ended December 31, 2011, as stated in their report which is presented in this Annual Report on Form 10-K under Item 8.

Item 9B. OTHER INFORMATION.

None.

PART III

Certain information required by Part III of this Annual Report is omitted and will be incorporated by reference herein from our definitive proxy statement pursuant to Regulation 14A in connection with the 2012 Annual Meeting of Stockholders to be held on May 15, 2012.

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

Information relating to our directors and executive officers will be presented under the captions “Proposal No. 1—Election of Directors” and “Executive Offices and Directors” in our definitive proxy statement. Such information is incorporated herein by reference.

Item 11. EXECUTIVE COMPENSATION.

Information relating to executive compensation will be presented under the caption “Executive Compensation” in our definitive proxy statement. Such information is incorporated herein by reference.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Information relating to the security ownership of our common stock by our management and other beneficial owners will be presented under the caption “Security Ownership of Certain Beneficial Owners and Management” in our definitive proxy statement. Such information is incorporated herein by reference.

Information relating to our equity compensation plans will be presented under the caption “Equity Compensation Plan Information” in our definitive proxy statement. Such information is incorporated herein by reference.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

Information relating to certain relationships of our directors and executive officers and related transactions, as well as director independence information, will be presented under the caption “Certain Relationships and Related Transactions” in our definitive proxy statement. Such information is incorporated herein by reference.

Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

Information relating to principal accountant fees and services will be presented under the caption “Principal Accountant Fees and Services” in our definitive proxy statement. Such information is incorporated herein by reference.

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a) The following documents have been filed as a part of this Annual Report on Form 10-K.

1. Index to Financial Statements.

Description:

Report of Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global

Consolidated Balance Sheets as of December 31, 2011 and 2010

Consolidated Statements of Operations for the years ended December 31, 2011, 2010 and 2009

Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2011, 2010 and 2009

Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009

Notes to Consolidated Financial Statements

2. Index to Financial Statement Schedules.

The following financial statement schedule and related auditor's report are filed as part of this Annual Report on Form 10-K:

Description:

Valuation and Qualifying Accounts Schedule II

All other schedules are omitted because they are not applicable or the required information is included in the attached consolidated financial statements or the related notes for the year ended December 31, 2011.

List of Exhibits:

| <u>Exhibit Number</u> | <u>Description</u> |
|-----------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.1 | Share and Business Sale Agreement, dated September 3, 2007, by and among DSP Group, Inc., DSP Group Ltd. and NXP, B.V. (filed as Exhibit 2.1 to the Registrant's Current Report on 8-K filed September 7, 2007, and incorporated herein by reference). |
| 3.1 | Amended and Restated Certificate of Incorporation (filed as Exhibit 3.1B to the Registrant's Registration Statement on Form S-1, file no. 33-73482, as declared effective on February 11, 1994, and incorporated herein by reference). |
| 3.2 | Certificate of Amendment of the Amended and Restated Certificate of Incorporation, Effective as of July 19, 1999 (filed as Exhibit 3.2 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2006, and incorporated herein by reference). |
| 3.3 | Amended and Restated Bylaws, effective as of July 25, 2011 (filed as Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on July 26, 2011, and incorporated herein by reference). |
| 3.4 | Certificate of Designations for DSP Group, Inc. Series B Junior Participating Preferred Stock as filed with the Secretary of State of the State of Delaware on July 26, 2011 (filed as Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed on July 26, 2011, and incorporated herein by reference). |

| <u>Exhibit Number</u> | <u>Description</u> |
|-----------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 4.1 | Rights Agreement, dated as of July 26, 2011, between DSP Group, Inc. and American Stock Transfer and Trust Company, LLC, which includes the form of Right Certificate as Exhibit B and the Summary of Rights to Purchaser Preferred Shares as Exhibit C (filed as Exhibit 3.3 to the Registrant's Current Report on Form 8-K filed on July 26, 2011, and incorporated herein by reference). |
| 10.1 | Amended and Restated 1991 Employee and Consultant Stock Plan (filed as Exhibit 10.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003, and incorporated herein by reference). †† |
| 10.2 | Amended and Restated 1993 Director Stock Option Plan. †† * |
| 10.3 | Form of Option Agreement for Israeli Directors under the Amended and Restated 1993 Director Stock Option Plan (filed as Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004, and incorporated herein by reference). †† |
| 10.4 | Form of Option Agreement for Non-Israeli Directors under the Amended and Restated 1993 Director Stock Option Plan (filed as Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004, and incorporated herein by reference). †† |
| 10.5 | Amended and Restated 1993 Employee Stock Purchase Plan and form of subscription agreement thereunder. †† * |
| 10.6 | Form of Indemnification Agreement for directors and executive officers (filed as Exhibit 10.1 to the Registrant's Registration Statement on Form S-1, file no. 33-73482, as declared effective on February 11, 1994, and incorporated herein by reference). |
| 10.7 | Employment Agreement, dated April 22, 1996, by and between the Registrant and Eliyahu Ayalon (filed as Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1996, and incorporated herein by reference). †† |
| 10.8 | Amendment to Employment Agreement with Eliyahu Ayalon, dated as of November 3, 1997 (filed as Exhibit 10.26 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated herein by reference). †† |
| 10.9 | Amendment to Employment Agreement with Eliyahu Ayalon, effective as of November 11, 1999 (filed as Exhibit 10.26 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated herein by reference). †† |
| 10.10 | Amendment to Employment Agreement by and among DSP Group, Inc., DSP Group, Ltd. and Eli Ayalon, as amended, effective as of October 27, 2009 (filed as Exhibit 10.1 to Registrant's Current Report on 8-K filed on October 29, 2009, and incorporated herein by reference). †† |
| 10.11 | Amendment to Employment Agreement by and among DSP Group, Inc., DSP Group, Ltd. and Eli Ayalon, as amended, effective as of May 24, 2010 (filed as Exhibit 10.1 to Registrant's Current Report on 8-K filed on May 28, 2010, and incorporated herein by reference). †† |
| 10.12 | Amendment to Employment Agreement by and among DSP Group, Inc., DSP Group, Ltd. and Eli Ayalon, as amended, effective as of May 24, 2010 (filed as Exhibit 10.1 to Registrant's Current Report on 8-K filed on May 28, 2010, and incorporated herein by reference) †† |
| 10.13 | Amendment to Employment Agreement by and among DSP Group, Inc., DSP Group, Ltd. and Eli Ayalon, as amended, effective as of May 16, 2011 (filed as Exhibit 10.1 to Registrant's Current Report on 8-K filed on May 20, 2011, and incorporated herein by reference) †† |

| <u>Exhibit Number</u> | <u>Description</u> |
|-----------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.14 | Lease, dated November 28, 1996, by and between DSP Semiconductors Ltd. and Gav-Yam Lands Company Ltd., relating to the property located on Shenkar Street, Herzelia Pituach, Israel (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1997, and incorporated herein by reference). |
| 10.15 | Lease, dated September 13, 1998, between DSP Group, Ltd. and Bayside Land Corporation Ltd., relating to the property located on Shenkar Street, Herzelia Pituach, Israel (filed as Exhibit 10.22 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1998, and incorporated herein by reference). |
| 10.16 | Amended and Restated 1998 Non-Officer Employee Stock Option Plan (filed as Exhibit 10.19 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003, and incorporated herein by reference). †† |
| 10.17 | Appendix Agreement, dated May 5, 1999, by and between DSP Group, Ltd. and Bayside Land Corporation Ltd., relating to the property located on Shenkar Street, Herzelia Pituach, Israel (filed as Exhibit 10.25 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated herein by reference). |
| 10.18 | Non-Exclusive Distribution Agreement between the Registrant and Tomen Electronics Corporation as amended on October 12, 2000 (filed as Exhibit 10.28 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000, and incorporated herein by reference). |
| 10.19 | Amended and Restated 2001 Stock Incentive Plan and form of option agreement thereunder (filed as Exhibit 10.31 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003, and incorporated herein by reference). †† |
| 10.20 | Amended and Restated 2003 Israeli Share Incentive Plan (filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on May 4, 2011, and incorporated herein by reference) and form of option agreement thereunder (filed as Exhibit 10.32 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003, and incorporated herein by reference). †† |
| 10.21 | Agreement, dated March 5, 2003, between DSP Group, Ltd. and The Gav-Yam Real Estate Company Ltd., relating to the property located on Shenkar Street, Herzelia Pituach, Israel (filed as Exhibit 10.33 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2003, and incorporated herein by reference). |
| 10.22 | Form of Option Agreement under DSP Group, Inc.'s 2001 Stock Incentive Plan for Eliyahu Ayalon (filed as Exhibit 10.41 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2003, and incorporated herein by reference). †† |
| 10.23 | Manufacturing Capacity Agreement, effective as of July 1, 2004, by and among DSP Group, Inc., DSP Group, Ltd, and Taiwan Semiconductor Manufacturing Company Ltd (filed as Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004, and incorporated herein by reference) (confidential treatment has been granted for portions of this exhibit). |
| 10.24 | Form of Non-Qualified Stock Option Agreement Providing for the Grant of Options as a Material Inducement of Employment (filed as Exhibit 4.1 to Registrant's Registration Statement on Form S-8 filed on July 21, 2005, and incorporated herein by reference). †† |
| 10.25 | Form of Stock Appreciation Right Agreement for Executive Officers pursuant to the Amended and Restated 2003 Israeli Share Incentive Plan (filed as Exhibit 99.2 to Registrant's Current Report on 8-K filed on April 11, 2006, and incorporated herein by reference). †† |

| <u>Exhibit Number</u> | <u>Description</u> |
|-----------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.26 | Stock Appreciation Right Agreement with Eliyahu Ayalon, dated July 2, 2006 (filed as Exhibit 99.1 to Registrant's Current Report on 8-K filed on July 5, 2006, and incorporated herein by reference). †† |
| 10.27 | Manufacturing Services Collaboration Agreement, dated September 4, 2007, by and among DSP Group, Inc., DSP Group Ltd. and NXP, B.V. (filed as Exhibit 10.39 to Registrant's Quarterly Report on 10-Q for the quarter ended September 30, 2007, and incorporated herein by reference) (confidential treatment has been granted for portions of this exhibit). |
| 10.28 | Amendment Agreement to Manufacturing Services Collaboration Agreement, dated January 27, 2009, by and among DSP Group, Inc., DSP Group Ltd. and NXP, B.V. (filed as Exhibit 10.38 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2008, and incorporated herein by reference) (confidential treatment has been granted for portions of this exhibit). |
| 10.29 | Agreement to Amend the Manufacturing Services Collaboration Agreement, dated December 8, 2010, by and among DSP Group, Inc., DSP Group, Ltd. and NXP B.V. (filed as Exhibit 10.1 to Registrant's Current Report on 8-K filed on December 10, 2010, and incorporated herein by reference) (confidential treatment has been granted for portions of this exhibit). |
| 10.30 | Intellectual Property Transfer and License Agreement, dated September 4, 2007, by and among DSP Group, Inc., DSP Group Ltd. and NXP, B.V. (filed as Exhibit 10.40 to Registrant's Quarterly Report on 10-Q for the quarter ended September 30, 2007, and incorporated herein by reference) (confidential treatment has been granted for portions of this exhibit). |
| 10.31 | Intellectual Property Library Services and R&D Agreement, dated September 4, 2007, by and among DSP Group, Inc., DSP Group Ltd. and NXP, B.V. (filed as Exhibit 10.41 to Registrant's Quarterly Report on 10-Q for the quarter ended September 30, 2007, and incorporated herein by reference) (confidential treatment has been granted for portions of this exhibit). |
| 10.32 | Umbrella Transitional Services Agreement, dated September 4, 2007, by and among DSP Group, Inc., DSP Group Ltd. and NXP, B.V. (filed as Exhibit 10.42 to Registrant's Quarterly Report on 10-Q for the quarter ended September 30, 2007, and incorporated herein by reference) (confidential treatment has been granted for portions of this exhibit). |
| 10.33 | Employment Agreement by and between DSP Group, Ltd. and Ofer Elyakim, effective June 25, 2009. (filed as Exhibit 10.32 to Registrant's Annual Report on 10-K for the year ended December 31, 2010, and incorporated herein by reference) †† |
| 10.34 | Amendment to Employment Agreement by and between DSP Group, Ltd. and Ofer Elyakim, effective January 31, 2011. (filed as Exhibit 10.33 to Registrant's Annual Report on 10-K for the year ended December 31, 2010, and incorporated herein by reference) †† |
| 10.35 | Amendment to Employment Agreement by and between DSP Group, Ltd. and Ofer Elyakim, as amended, effective as of May 16, 2011.(filed as Exhibit 10.2 to Registrant's Current Report on 8-K filed on May 20, 2011, and incorporated herein by reference) †† |
| 10.36 | Employment Agreement by and between DSP Group, Ltd. and Dror Levy, effective June 9, 2002. (filed as Exhibit 10.34 to Registrant's Annual Report on 10-K for the year ended December 31, 2010, and incorporated herein by reference) †† |
| 10.37 | Amendment to Employment Agreement by and between DSP Group, Ltd. and Dror Levy, effective January 31, 2011. (filed as Exhibit 10.35 to Registrant's Annual Report on 10-K for the year ended December 31, 2010, and incorporated herein by reference) †† |

| <u>Exhibit Number</u> | <u>Description</u> |
|-----------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.38 | Amendment to Employment Agreement by and between DSP Group, Ltd. and Dror Levy, as amended, effective as of May 16, 2011. (filed as Exhibit 10.3 to Registrant's Current Report on 8-K filed on May 20, 2011, and incorporated herein by reference) †† |
| 10.39 | Employment Agreement by and between DSP Group, Ltd. and Lior Blanka, effective May 7, 2007. (filed as Exhibit 10.36 to Registrant's Annual Report on 10-K for the year ended December 31, 2010, and incorporated herein by reference) †† |
| 10.40 | 2011 Performance-Based Bonus Plan (description of the plan provided in the Registrant's Current Report on Form 8-K filed on February 4, 2011, and incorporated herein by reference). †† |
| 10.41 | Employment Agreement by and between DSP Group, Ltd. and David Dahan, effective February 1, 2012. †† * |
| 21.1 | Subsidiaries of DSP Group, Inc.* |
| 23.1 | Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, Independent Registered Public Accounting Firm.* |
| 24.1 | Power of Attorney (See signature page of this Annual Report on Form 10-K).* |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.* |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.* |
| 32.1 | Section 1350 Certification of Chief Executive Officer.* |
| 32.2 | Section 1350 Certification of Chief Financial Officer.* |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Labels Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

†† Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 15(c) of Form 10-K.

* Filed herewith.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

DSP GROUP, INC.

By: /s/ OFER ELYAKIM
Ofer Elyakim
Chief Executive Officer
(Principal Executive Officer)

Date: March 15, 2012

Power of Attorney

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Ofer Elyakim and Dror Levy or either of them, his true and lawful attorneys-in-fact and agents, with full power of substitution and re-substitution, for him and in his name, place and stead, in any and all capacities to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or either of them, or their or his substitutes or substitute, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|--------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------|----------------|
| <u> /s/ ELIJAHU AYALON </u> Eliyahu Ayalon | Chairman of the Board | March 15, 2012 |
| <u> /s/ OFER ELYAKIM </u> Ofer Elyakim | Chief Executive Officer (Principal Executive Officer) and Director | March 15, 2012 |
| <u> /s/ DROR LEVY </u> Dror Levy | Chief Financial Officer and Secretary (Principal Financial Officer and Principal Accounting Officer) | March 15, 2012 |
| <u> /s/ REUVEN REGEV </u> Reuven Regev | Director | March 15, 2012 |
| <u> /s/ ZVI LIMON </u> Zvi Limon | Director | March 15, 2012 |
| <u> /s/ YAIR SHAMIR </u> Yair Shamir | Director | March 15, 2012 |

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|----------------------------------------------------------|--------------|----------------|
| <hr/> <u>/S/ YAIR SEROUSSI</u> Yair Seroussi | Director | March 15, 2012 |
| <hr/> <u>/S/ LOUIS SILVER</u> Louis Silver | Director | March 15, 2012 |
| <hr/> <u>/S/ PATRICK TANGUY</u> Patrick Tanguy | Director | March 15, 2012 |

Schedule II

DSP GROUP, INC.
VALUATION AND QUALIFYING ACCOUNTS
(in thousands)

| <u>Description</u> | <u>Balance at Beginning of Period</u> | <u>Charged to (deducted from) Costs and Expenses</u> | <u>Balance at End of Period</u> |
|---------------------------------------|-----------------------------------------------|------------------------------------------------------------------|-------------------------------------|
| Year ended December 31, 2009: | | | |
| Allowance for doubtful accounts | 184 | (67) | 117 |
| Sales returns reserve | 0 | 0 | 0 |
| Year ended December 31, 2010: | | | |
| Allowance for doubtful accounts | 117 | (117) | 0 |
| Sales returns reserve | 0 | 0 | 0 |
| Year ended December 31, 2011: | | | |
| Allowance for doubtful accounts | — | — | — |
| Sales returns reserve | — | — | — |

DSP GROUP, INC.

1993 DIRECTOR STOCK OPTION PLAN
(Amended and Restated July 19, 1999)
(Amended and Restated July 18, 2001)
(Amended and Restated April 4, 2002)
(Amended and Restated November 25, 2002)
(Amended and Restated January 22, 2003)
(Amended and Restated March 12, 2003)
(Amended and Restated May 5, 2004)
(Amended and Restated March 28, 2006)
(Amended and Restated March 25, 2008)
(Amended and Restated March 2011)

1. Purposes of the Plan. The purposes of this Director Stock Option Plan are to attract and retain the best available personnel for service as Directors of the Company, to provide additional incentive to the Outside Directors of the Company to serve as Directors, and to encourage their continued service on the Board.

All options granted hereunder shall be “nonstatutory stock options.”

2. Definitions. As used herein, the following definitions shall apply:

- a. “Board” shall mean the Board of Directors of the Company.
- b. “Code” shall mean the Internal Revenue Code of 1986, as amended.
- c. “Common Stock” shall mean the Common Stock of the Company.
- d. “Company” shall mean DSP Group, Inc., a Delaware corporation.
- e. “Continuous Status as a Director” shall mean the absence of any interruption or termination of service as a Director.
- f. “Director” shall mean a member of the Board.
- g. “Effective Date” shall have the meaning as set forth in Section 6 below.
- h. “Employee” shall mean any person, including officers and Directors, employed by the Company or any Parent or Subsidiary of either company. The payment of a Director’s fee by the Company or any Parent or Subsidiary of either company shall not be sufficient in and of itself to constitute “employment” by the Company.
- i. “Exchange Act” shall mean the Securities Exchange Act of 1934, as amended.
- j. “First Option” shall have the meaning as set forth in Section 4.b.ii. below.
- k. “Option” shall mean a stock option granted pursuant to the Plan.
- l. “Optioned Stock” shall mean the Common Stock subject to an Option.
- m. “Optionee” shall mean an Outside Director who receives an Option.
- n. “Outside Director” shall mean a Director who is not an Employee.
- o. “Parent” shall mean a “parent corporation,” whether now or hereafter existing, as defined in Section 424(e) of the Code.
- p. “Plan” shall mean this 1993 Director Stock Option Plan.
- q. “Share” shall mean a share of the Common Stock, as adjusted in accordance with Section 11 of the Plan.

r. "Spin-off Transaction" means a distribution by the Company to its stockholders of all or any portion of the securities of any Subsidiary of the Company.

s. "Subsequent Option" shall have the meaning as set forth in Section 4.b.iii. below.

t. "Subsidiary" shall mean a "Subsidiary Corporation," whether now or hereafter existing, as defined in Section 424(f) of the Code.

u. "Affiliate" and "Associate" shall have the respective meanings ascribed to such terms in Rule 126-2 promulgated under the Exchange Act.

v. "Change in Control" means a change in ownership or control of the Company effected through either of the following transactions:

(i) the direct or indirect acquisition by any person or related group of persons (other than an acquisition from or by the Company or by a Company-sponsored employee benefit plan or by a person that directly or indirectly controls, is controlled by, or is under common control with, the Company) of beneficial ownership (within the meaning of Rule 13d-3 of the Exchange Act) of securities possessing more than fifty percent (50%) of the total combined voting power of the Company's outstanding securities pursuant to a tender or exchange offer made directly to the Company's stockholders which a majority of the Continuing Directors who are not Affiliates or Associates of the offeror do not recommend such stockholders accept, or

(ii) a change in the composition of the Board over a period of thirty-six (36) months or less such that a majority of the Board members (rounded up to the next whole number) ceases, by reason of one or more contested elections for Board membership, to be comprised of individuals who are Continuing Directors.

w. "Continuing Directors" means members of the Board who either (i) have been Board members continuously for a period of at least thirty-six (36) months or (ii) have been Board members for less than thirty-six (36) months and were elected or nominated for election as Board members by at least a majority of the Board members described in clause (i) who were still in office at the time such election or nomination was approved by the Board.

x. "Corporate Transaction" means any of the following stockholder-approved transactions to which the Company is a party:

(i) a merger or consolidation in which the Company is not the surviving entity, except for a transaction the principal purpose of which is to change the state in which the Company is incorporated;

(ii) the sale, transfer or other disposition of all or substantially all of the assets of the Company (including the capital stock of the Company's subsidiary corporations) in connection with the complete liquidation or dissolution of the Company; or

(iii) any reverse merger in which the Company is the surviving entity but in which securities possessing more than fifty percent (50%) of the total combined voting power of the Company's outstanding securities are transferred to a person or persons different from those who held such securities immediately prior to such merger.

3. Stock Subject to the Plan. Subject to the provisions of Section 11 of the Plan, the maximum aggregate number of Shares which may be optioned and sold under the Plan is 1,980,875 Shares (the "Pool") of Common Stock. The Shares may be authorized, but unissued, or reacquired Common Stock.

Initially, 175,000 Shares were reserved for issuance under the Plan. In June 1999, the Plan was amended and restated to increase the number of Shares reserved for issuance under the Plan by 100,000 shares for a total reserve of 275,000 Shares. In March 2000, the Company effected a two-for-one split of the Company's common stock thereby increasing the number of Shares reserved for issuance under the Plan to

550,000 Shares. In June 2002, the Plan was amended and restated to increase the number of Shares reserved for issuance under the Plan by 200,000 Shares for a total reserve of 750,000 Shares. As a result of the Company's distribution of all (or substantially all) of the shares of capital stock of Ceva, Inc. in November 2002, the number of shares reserved for issuance under the Plan was adjusted so that 890,875 Shares are available for issuance under the Plan. In January 2003, the Plan was again amended and restated to increase the number of Shares reserved for issuance under the Plan by 240,000 Shares for a total reserve of 1,130,875 Shares. In March 2006, the Plan was again amended and restated to increase the number of Shares reserved for issuance under the Plan by 250,000 Shares for a total reserve of 1,380,875 Shares. In March 2008, the Plan was again amended and restated to increase the number of Shares reserved for issuance under the Plan by 300,000 Shares for a total reserve of 1,680,875 Shares. In March 2011, the Plan was again amended and restated to increase the number of Shares reserved for issuance under the Plan by 300,000 Shares for a total reserve of 1,980,875 Shares.

If an Option should expire or become unexercisable for any reason without having been exercised in full, the unpurchased Shares which were subject thereto shall, unless the Plan shall have been terminated, become available for future grant under the Plan. If Shares which were acquired upon exercise of an Option are subsequently repurchased by the Company, such Shares shall not in any event be returned to the Plan and shall not become available for future grant under the Plan.

4. Administration of and Grants of Options under the Plan.

a. Administrator. Except as otherwise required herein, the Plan shall be administered by the Board.

b. Procedure for Grants. All grants of Options hereunder shall be automatic and nondiscretionary and shall be made strictly in accordance with the following provisions:

i) No person shall have any discretion to select which Outside Directors of the Company shall be granted Options or to determine the number of Shares to be covered by Options granted to Outside Directors of the Company.

ii) Each person who is an Outside Director of the Company on the Effective Date of this Plan shall be automatically granted an Option to purchase 30,000 Shares (the "First Option") on the Effective Date of this Plan, as determined in accordance with Section 6 hereof. Each Outside Director who becomes a member of the Board after the Effective Date but prior to January 21, 2003 shall be automatically granted an Option to purchase 30,000 Shares (also a "First Option") on the date on which such person first becomes an Outside Director of the Company, whether through election by the stockholders of the Company or appointment by the Board to fill a vacancy. Each Outside Director who becomes a member of the Board after January 21, 2003 shall be automatically granted an Option to purchase 60,000 Shares (also a "First Option") on the date on which such person first becomes an Outside Director of the Company, whether through election by the stockholders of the Company or appointment by the Board to fill a vacancy. Each Outside Director who becomes a member of the Board after May 5, 2004 shall be automatically granted an Option to purchase 30,000 Shares (also a "First Option") on the date on which such person first becomes an Outside Director of the Company, whether through election by the stockholders of the Company or appointment by the Board to fill a vacancy.

iii) From January 1, 1997 through December 31, 2003, each Outside Director of the Company shall be automatically granted (i) an Option to purchase 10,000 Shares (a "Subsequent Option"), on January 1 of each year, if on such date, he or she shall have served on the Board for at least six (6) months and (ii) an Option to purchase 10,000 Shares (a "Committee Option"), on January 1 of each year, for each committee of the Board on which he or she shall have served as the chairperson for at least six (6) months on such date. From January 1, 2004 to December 31, 2004, each Outside Director of the Company shall be automatically granted (i) an Option to purchase 20,000 Shares (also a "Subsequent Option"), on January 1 of each year, if on such date, he or she shall have served on the Board for at least six (6) months and (ii) an Option to purchase 20,000 Shares (also a "Committee Option"), on January 1 of each year, for each committee of the Board on which he or she shall have served as the chairperson for at least six (6) months on such date. Beginning on January 1, 2005, each Outside Director of the Company shall be automatically granted (i) an Option to purchase 15,000 Shares (also a "Subsequent Option"), on January 1 of each year, if on such date, he

or she shall have served on the Board for at least six (6) months and (ii) an Option to purchase 15,000 Shares (also a "Committee Option"), on January 1 of each year, for each committee of the Board on which he or she shall have served as the chairperson for at least six (6) months on such date.

iv) Notwithstanding the provisions of subsections ii) and iii) hereof, in the event that a grant would cause the number of Shares subject to outstanding Options, plus the number of shares previously purchased upon exercise of Options to exceed the Pool, then each such automatic grant shall be for that number of Shares determined by dividing the total number of Shares remaining available for grant by the number of grants to be made on the automatic grant date. Any further grants shall then be deferred until such time, if any, as additional Shares become available for grant under the Plan through action of the stockholders to increase the number of Shares which may be issued under the Plan or through cancellation or expiration of Options previously granted hereunder.

v) Notwithstanding the provisions of subsections ii) and iii) hereof, any grant of an Option made before the Company has obtained stockholder approval of the Plan in accordance with Section 17 hereof shall have their exercisability conditioned upon obtaining such stockholder approval of the Plan in accordance with Section 17 hereof.

vi) The terms of any Option granted hereunder shall be as follows:

a) The Option shall be exercisable only while the Outside Director remains a Director of the Company, except as set forth in Section 9 hereof.

b) The exercise price per Share shall be 100% of the fair market value (as defined in Section 8.b. hereunder) per Share on the date of grant of the Option.

c) The Option shall vest and become exercisable as to one-third of the Shares subject to the Option on the first anniversary of the date of grant of the Option, and shall vest and become exercisable as to one-third of the Shares subject to the Option at the end of each twelve-month period thereafter, subject to the provisions set forth in Section 9, below.

d) The Board may accelerate the unvested portion of any Option granted under the Plan held by any Director whose Continuous Status as Director terminates for any reason prior to the Option being fully exercisable.

c. Powers of the Board. Subject to the provisions and restrictions of the Plan, the Board shall have the authority, in its discretion: (i) to determine, upon review of relevant information and in accordance with Section 8.b. of the Plan, the fair market value of the Common Stock; (ii) to determine the exercise price per share of Options to be granted, which exercise price shall be determined in accordance with Section 8.a. of the Plan; (iii) to interpret the Plan; (iv) to prescribe, amend and rescind rules and regulations relating to the Plan; (v) to authorize any person to execute on behalf of the Company any instrument required to effectuate the grant of an Option previously granted hereunder; and (vi) to make all other determinations deemed necessary or advisable for the administration of the Plan.

d. Effect of Board's Decision. All decisions, determinations and interpretations of the Board shall be final and binding on all Optionees and any other holders of any Options granted under the Plan.

5. Eligibility. Options may be granted only to Outside Directors of the Company. All Options shall be automatically granted in accordance with the terms set forth in Section 4.b. hereof. An Outside Director who has been granted an Option may, if he or she is otherwise eligible, be granted an additional Option or Options in accordance with such provisions.

The Plan shall not confer upon an Optionee any right with respect to continuation of service as a Director or nomination to serve as a Director, nor shall it interfere in any way with any rights which the Director or the Company may have to terminate his or her directorship at any time.

6. Term of Plan; Effective Date. The Plan shall become effective on the date on which the Company's registration statement on Form S-1 (or any successor form thereof) is declared effective by the Securities and Exchange Commission (the "Effective Date"). It shall continue in effect for a term of twenty (20) years, unless sooner terminated under Section 13 of the Plan, subject to the limitations set forth in this Plan.

7. Term of Option. The term of each Option shall be ten (10) years from the date of grant thereof.

8. Exercise Price and Consideration.

a. Exercise Price. The per Share exercise price for the Shares to be issued pursuant to exercise of an Option shall be 100% of the fair market value per Share on the date of grant of the Option.

b. Fair Market Value. The fair market value per Share shall be the mean of the bid and asked prices of the Common Stock in the over-the-counter market on the date of grant, as reported in The Wall Street Journal (or, if not so reported, as otherwise reported by the National Association of Securities Dealers Automated Quotation (“NASDAQ”) System) or, in the event that the Common Stock is traded on the NASDAQ National Market System or listed on a stock exchange, the fair market value per Share shall be the closing price on such system or exchange on the date of grant of the Option, as reported in The Wall Street Journal; provided, however, that if such market or exchange is closed on the date of the grant of the Option then the fair market value per Share shall be based on the most recent date on which such trading occurred immediately prior to the date of the grant of the Option; provided, further, that for purposes of First Options granted on the Effective Date, the fair market value per share shall be the initial public offering price as set forth in the final prospectus filed with the Securities and Exchange Commission pursuant to Rule 424 under the Securities Act of 1933, as amended.

c. Form of Consideration. The consideration to be paid for the Share to be issued upon exercise of an Option shall consist entirely of cash, check, other Shares having a fair market value on the date of surrender equal to the aggregate exercise price of the Shares as to which said Option shall be exercised (which, if acquired from the Company, shall have been held for at least six months), delivery of a properly executed exercise notice, together with such other documentation as the Company and the broker, if applicable, shall require to effect an exercise of the Option and delivery to the Company of the funds required to pay the exercise price, or any combination of such methods of payment and/or any other consideration or method of payment as shall be permitted under applicable corporate law.

9. Exercise of Option.

a. Procedure for Exercise: Rights as a Stockholder. An Option granted hereunder shall be exercisable at such times as are set forth in Section 4.b. hereof; provided, however, that no Options shall be exercisable until stockholder approval of the Plan in accordance with Section 17 hereof has been obtained.

An option may not be exercised for a fraction of a Share.

An Option shall be deemed to be exercised when written notice of such exercise has been given to the Company in accordance with the terms of the Option by the person entitled to exercise the Option and full payment for the Shares with respect to which the Option is exercised has been received by the Company. Full payment may consist of any consideration and method of payment allowable under Section 8.c. of the Plan. Until the issuance (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company) of the stock certificate evidencing such Shares, no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to the Optioned Stock, notwithstanding the exercise of the Option. A share certificate for the number of Shares so acquired shall be issued to the Optionee as soon as practicable after exercise of the Option. No adjustment will be made for a dividend or other right for which the record date is prior to the date the stock certificate is issued, except as provided in Section 11 of the Plan.

Exercise of an Option in any manner shall result in a decrease in the number of Shares which thereafter may be available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised.

b. Termination of Status as a Director. If an Outside Director ceases to serve as a Director, he or she may, but only within three (3) months after the date he or she ceases to be a Director, exercise his or her Option to the extent that he or she was entitled to exercise it at the date of such termination Option’s expiration date. Notwithstanding the foregoing, in no event may the Option be exercised after its term set forth in Section 7 has expired. The Board may extend the exercise period of an Option held by a Director

whose term is expiring to any date prior to the Option's expiration date. To the extent that such Outside Director was not entitled to exercise an Option at the date of such termination, or does not exercise such Option (which he or she was entitled to exercise) within the time specified herein, the Option shall terminate.

c. Disability of Optionee. Notwithstanding the provisions of Section 9.b. above, in the event a Director is unable to continue his or her service as a Director as a result of his or her total and permanent disability (as defined in Section 22(e)(3) of the Internal Revenue Code), he or she may, but only within six (6) months from the date of such termination, exercise his or her Option to the extent he or she was entitled to exercise it at the date of such termination. The Board may extend the exercise period of an Option held by a Director whose Continuous Status as Director terminates as a result of his or her total and permanent disability. Notwithstanding the foregoing, in no event may the Option be exercised after its term set forth in Section 7 has expired. To the extent that he or she was not entitled to exercise the Option at the date of termination, or if he or she does not exercise such Option (which he or she was entitled to exercise) within the time specified herein, the Option shall terminate.

d. Death of Optionee. In the event of the death of an Optionee:

i) during the term of the Option who is, at the time of his or her death, a Director and who shall have been in Continuous Status as a Director since the date of grant of the Option, the Option may be exercised, at any time within twelve (12) months following the date of death, by the Optionee's estate or by a person who acquired the right to exercise the Option by bequest or inheritance, but only to the extent of the right to exercise that would have accrued had the Optionee continued living and remained in Continuous Status as Director for six (6) months after the date of death. The Board may extend the exercise period of an Option held by a Director whose Continuous Status as Director terminates as a result of his or her death. Notwithstanding the foregoing, in no event may the Option be exercised after its term set forth in Section 7 has expired.

ii) within three (3) months after the termination of Continuous Status as a Director, the Option may be exercised, at any time within twelve (12) months following the date of death, by the Optionee's estate or by a person who acquired the right to exercise the Option by bequest or inheritance, but only to the extent of the right to exercise that had accrued at the date of termination. The Board may extend the exercise period of an Option held by a Director who dies within three (3) months after the termination of Continuous Status as a Director. Notwithstanding the foregoing, in no event may the option be exercised after its term set forth in Section 7 has expired.

10. Nontransferability of Options. The Option may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution. The designation of a beneficiary by an Optionee does not constitute a transfer. An Option may be exercised during the lifetime of an Optionee only by the Optionee or a transferee permitted under this Section.

11. Adjustments Upon Changes in Capitalization, Dissolution, Merger or Asset Sale.

a. Changes in Capitalization. Subject to any required action by the stockholders of the Company, the number of Shares covered by each outstanding Option and the number of Shares which have been authorized for issuance under the Plan but as to which no Options have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Option, as well as the price per Share covered by each such outstanding Option, shall be proportionately adjusted for an increase or decrease in the number of issued Shares resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock, or any other increase or decrease in the number of issued shares effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or prices of Shares subject to an Option. Notwithstanding any terms of the Plan to the contrary, in the event of a Spin-off Transaction, the Board may in its discretion and without stockholder approval make such adjustments and take such other action as it deems appropriate with respect to outstanding Options under the Plan, including but not limited to adjustments to the number and kind of shares, the price per share and the vesting periods of outstanding Options or the substitution, exchange or grant of Options to purchase securities of the Subsidiary; provided that the Board shall not be obligated to make any such adjustments or take any such action hereunder.

b. Dissolution or Liquidation. In the event of the proposed dissolution or liquidation of the Company, to the extent that an Option has not been previously exercised, it will terminate immediately prior to the consummation of such proposed action. The Board may, in the exercise of its sole discretion in such instances, declare that any Option shall terminate as of a date fixed by the Board and give each Optionee the right to exercise his or her Option as to all or any part of the Optioned Stock, including Shares as to which the Option would not otherwise be exercisable.

c. Merger or Asset Sale. In the event of a Corporate Transaction, each Option which is at the time outstanding under the Plan automatically shall become fully vested and exercisable and be released from any restrictions on transfer and repurchase or forfeiture rights, immediately prior to the specified effective date of such Corporate Transaction, for all of the Shares at the time represented by such Option. Effective upon the consummation of the Corporate Transaction, all outstanding Options under the Plan shall terminate unless assumed by the successor company or its Parent. In the event of a Change in Control (other than a Change in Control which also is a Corporate Transaction), each Option which is at the time outstanding under the Plan automatically shall become fully vested and exercisable and be released from any restrictions on transfer and repurchase or forfeiture rights, immediately prior to the specified effective date of such Change in Control, for all of the Shares at the time represented by such Options. Each such Option shall remain exercisable until the expiration or sooner termination of the applicable Option term.

12. Time of Granting Options. The date of grant of an Option shall, for all purposes, be the date determined in accordance with Section 4.b. hereof. Notice of the determination shall be given to each Outside Director to whom an Option is so granted within a reasonable time after the date of such grant.

13. Amendment and Termination of the Plan.

a. Amendment and Termination. The Board may amend or terminate the Plan from time to time in such respects as the Board may deem advisable; provided that, to the extent necessary and desirable to comply with Rule 16b-3 under the Exchange Act (or any other applicable law or regulation), the Company shall obtain approval of the stockholders of the Company to Plan amendments to the extent and in the manner required by such law or regulation. In addition, the approval of the stockholders is required for any Plan amendment which would permit decreasing the exercise price of any Option outstanding under the Plan, subject to Section 11(a). Further, the approval of the Company's stockholders is required for any Plan amendment which would change any of the provisions of this Section 13(a). For purposes of this Section, approval of the stockholders means, except as provided by applicable law or regulation, approval by the holders of a majority of the Shares of Common Stock of the Company present or represented by proxy (and entitled to vote) at a meeting of the Company's stockholders.

b. Effect of Amendment or Termination. Any such amendment or termination of the Plan that would impair the rights of any Optionee shall not affect Options already granted to such Optionee and such Options shall remain in full force and effect as if this Plan had not been amended or terminated, unless mutually agreed otherwise between the Optionee and the Board, which agreement must be in writing and signed by the Optionee and the Company.

14. Conditions Upon Issuance of Shares. Shares shall not be issued pursuant to the exercise of an Option unless the exercise of such Option and the issuance and delivery of such Shares pursuant thereto shall comply with all relevant provisions of law, including, without limitation, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, state securities laws, and the requirements of any stock exchange upon which the Shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

As a condition to the exercise of an Option, the Company may require the person exercising such Option to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares, if, in the opinion of counsel for the Company, such a representation is required by any of the aforementioned relevant provisions of law.

Inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

15. Reservation of Shares. The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.

16. Option Agreement. Options shall be evidenced by written option agreements in such form as the Board shall approve.

17. Plan Approval. The Plan was adopted by the Board on November 29, 1993 and adopted by the stockholders of the Company in January 10, 1994. The Plan was subsequently amended and restated, as approved by the Company's stockholders in May 1996. In June 1999, the Board adopted and approved an amendment and restatement of the Plan to increase the number of shares of common stock reserved for issuance under the Plan, which amendment was approved by the Company's stockholders. In July 2001, the Board adopted and approved an amendment and restatement of the Plan to amend various terms of the Plan in anticipation of the distribution of all (or substantially all) of the shares of capital stock of Ceva, Inc., a Delaware corporation and a wholly-owned subsidiary, held by the Company to the stockholders of the Company. In April 2002, the Board adopted and approved an amendment and restatement of the Plan to increase the number of shares of common stock reserved for issuance under the Plan and the term of the Plan, which amendments were approved by the Company's stockholders. In November 2002, the Board adopted and approved an amendment and restatement of the Plan to include an appendix to the Plan designed to comply with changes in Israeli tax law effective January 1, 2003, which amendment did not require approval by the Company's stockholders. Subject to stockholder approval, the Board further adopted and approved in January 2003 an amendment and restatement of the Plan to (a) increase the number of shares of Common Stock reserved for issuance under the Plan, (b) increase the number of shares subject to each First Option, Subsequent Option and Committee Option (which increases shall be effective on a prospective basis) and (c) amend certain other administrative terms of the Plan. In March 2003, the Board adopted and approved an amendment and restatement of the Plan to amend the appendix to the Plan in order to comply with further changes in Israeli tax law which amendment did not require approval by the Company's stockholders. In May 2004, the Board adopted and approved an amendment and restatement of the Plan to decrease the number of shares subject to each First Option, Subsequent Option and Committee Option on a prospective basis, which amendment did not require approval by the Company's stockholders. The Board adopted and approved in March 2006 an amendment and restatement of the Plan to increase the number of Shares reserved for issuance under the Plan by 250,000 Shares, which amendment and restatement of the Plan was subsequently approved by the stockholders. In March 2008, the Board adopted and approved an amendment and restatement of the Plan to increase the number of Shares reserved for issuance under the Plan by 300,000 Shares, which amendment and restatement of the Plan was subsequently approved by the stockholders. In March 2011, the Board adopted and approved an amendment and restatement of the Plan to increase the number of Shares reserved for issuance under the Plan by 300,000 Shares, which amendment and restatement of the Plan was subsequently approved by the stockholders.

DSP GROUP, INC. 1993 DIRECTOR STOCK OPTION PLAN

APPENDIX A—ISRAEL

1. GENERAL

- 1.1 This appendix (the “**Appendix**”) shall apply only to Grantees who are residents of the state of Israel or those who are deemed to be residents of the state of Israel for the payment of tax. The provisions specified hereunder shall form an integral part of the 1993 Director Stock Option Plan (hereinafter: the “**Plan**”), which applies to the issuance of options to purchase Common Stock of DSP Group Inc. (hereinafter: the “**Company**”).
- 1.2 This Appendix is effective with respect to Options granted as of January 1, 2003 and shall comply with Amendment no. 132 of the Israeli Tax Ordinance.
- 1.3 This Appendix is to be read as a continuation of the Plan and only modifies Options granted to Israeli Grantees so that they comply with the requirements set by the Israeli law in general, and in particular with the provisions of Section 102 (as specified herein), as may be amended or replaced from time to time. For the avoidance of doubt, this Appendix does not add to or modify the Plan in respect of any other category of Grantees.
- 1.4 The Plan and this Appendix are complimentary to each other and shall be deemed as one. In any case of contradiction, whether explicit or implied, between the provisions of this Appendix and the Plan, the provisions set out in the Appendix shall prevail.
- 1.5 Any capitalized term not specifically defined in this Appendix shall be construed according to the defined meaning given to it in the Plan.

2. DEFINITIONS

- 2.1 “**Affiliate**” means any “employing company” within the meaning of Section 102(a) of the Ordinance.
- 2.2 “**Approved 102 Option**” means an Option granted pursuant to Section 102(b) of the Ordinance and held in trust by a Trustee for the benefit of the Grantee.
- 2.3 “**Capital Gain Option (CGO)**” means an Approved 102 Option elected and designated by the Company to qualify under the capital gain tax treatment in accordance with the provisions of Section 102(b)(2) of the Ordinance.
- 2.4 “**Controlling Stockholder**” shall have the meaning ascribed to it in Section 32(9) of the Ordinance.
- 2.5 “**Director**” means a member of the Board, but excluding any Controlling Stockholder.
- 2.6 “**ITA**” means the Israeli Tax Authorities.
- 2.7 “**Ordinary Income Option (OIO)**” means an Approved 102 Option elected and designated by the Company to qualify under the ordinary income tax treatment in accordance with the provisions of Section 102(b)(1) of the Ordinance.
- 2.8 “**Option**” means an option to purchase one or more shares of Common Stock of the Company pursuant to the Plan.

- 2.9 **“102 Option”** means any Option granted to Directors pursuant to Section 102 of the Ordinance.
- 2.10 **“3(i) Option”** means an Option granted pursuant to Section 3(i) of the Ordinance to any person who is a Non-Employee.
- 2.11 **“Ordinance”** means the 1961 Israeli Income Tax Ordinance [New Version] 1961 as now in effect or as hereafter amended.
- 2.12 **“Section 102”** means section 102 of the Ordinance and any regulations, rules, orders or procedures promulgated thereunder as now in effect or as hereafter amended.
- 2.13 **“Trustee”** means any individual appointed by the Company to serve as a trustee and approved by the ITA, all in accordance with the provisions of Section 102(a) of the Ordinance.
- 2.14 **“Unapproved 102 Option”** means an Option granted pursuant to Section 102(c) of the Ordinance and not held in trust by a Trustee.

3. ISSUANCE OF OPTIONS

- 3.1 The persons eligible for participation in the Plan as Grantees shall be Directors of the Company or of any Affiliate; provided, however, that (i) Directors who are not Controlling Stockholders may only be granted 102 Options; and (ii) Directors who are Controlling Stockholders may only be granted 3(i) Options.
- 3.2 The Company may designate Options granted to Directors pursuant to Section 102 as Unapproved 102 Options or Approved 102 Options.
- 3.3 The grant of Approved 102 Options shall be made under this Appendix adopted by the Board, and shall be conditioned upon the approval of this Appendix by the ITA.
- 3.4 Approved 102 Options may either be classified as Capital Gain Options (“**CGOs**”) or Ordinary Income Options (“**OIOs**”).
- 3.5 No Approved 102 Options may be granted under this Appendix to any eligible Director, unless and until, the Company’s election of the type of Approved 102 Options as CGI or OIO granted to Directors (the “**Election**”), is appropriately filed with the ITA. Such Election shall become effective beginning the first grant date of an Approved 102 Option under this Appendix and shall remain in effect until the end of the year following the year during which the Company first granted Approved 102 Options. The Election shall obligate the Company to grant *only* the type of Approved 102 Option it has elected, and shall apply to all Grantees who were granted Approved 102 Options during the period indicated herein, all in accordance with the provisions of Section 102(g) of the Ordinance. For the avoidance of doubt, such Election shall not prevent the Company from granting Unapproved 102 Options simultaneously.
- 3.6 All Approved 102 Options must be held in trust by a Trustee, as described in Section 4 below.
- 3.7 For the avoidance of doubt, the designation of Unapproved 102 Options and Approved 102 Options shall be subject to the terms and conditions set forth in Section 102.

3.8 With respect to Unapproved 102 Option, if the Optionee ceases to be employed by the Company or any Affiliate, the Optionee shall extend to the Company and/or its Affiliate a security or guarantee for the payment of tax due at the time of sale of Shares, all in accordance with the provisions of Section 102 and the rules, regulation or orders promulgated thereunder.

4. TRUSTEE

- 4.1 Approved 102 Options which shall be granted under this Appendix and/or any Common Stock allocated or issued upon exercise of such Approved 102 Options and/or other Common Stock received subsequently following any realization of rights, including bonus shares, shall be allocated or issued to the Trustee and held for the benefit of the Grantees for such period of time as required by Section 102 or any regulations, rules or orders or procedures promulgated thereunder (the “**Holding Period**”). In the case the requirements for Approved 102 Options are not met, then the Approved 102 Options shall be regarded as Unapproved 102 Options, all in accordance with the provisions of Section 102.
- 4.2 Notwithstanding anything to the contrary, the Trustee shall not release any Common Stock allocated or issued upon exercise of Approved 102 Options prior to the full payment of the Grantee’s tax liabilities arising from Approved 102 Options which were granted to him and/or any Common Stock allocated or issued upon exercise of such Options.
- 4.3 Upon receipt of Approved 102 Options, the Grantee will sign an undertaking to release the Trustee from any liability in respect of any action or decision duly taken and bona fide executed in relation with this Appendix, or any Approved 102 Option or Common Stock granted to him thereunder.
- 4.4 With respect to any Approved 102 Option, subject to the provisions of Section 102 and any rules or regulation or orders or procedures promulgated thereunder, an Optionee shall not sell or release from trust any Share received upon the exercise of an Approved 102 Option and/or any share received subsequently following any realization of rights, including without limitation, bonus shares, until the lapse of the Holding Period required under Section 102 of the Ordinance. Notwithstanding the above, if any such sale or release occurs during the Holding Period, the sanctions under Section 102 of the Ordinance and under any rules or regulation or orders or procedures promulgated thereunder shall apply to and shall be borne by such Optionee.

5. THE OPTIONS

The terms and conditions upon which the Options shall be issued and exercised, shall be as specified in the Award Agreement to be executed pursuant to the Plan and to this Appendix. Each Award Agreement shall state, inter alia, the number of Common Stock to which the Option relates, the type of Option granted thereunder (whether a CGI, OIO, Unapproved 102 Option or a 3(i) Option), the vesting provisions and the exercise price.

6. FAIR MARKET VALUE FOR TAX PURPOSES

Solely for the purpose of determining the tax liability pursuant to Section 102(b)(3) of the Ordinance, if at the date of grant the Company’s Common Stock is listed on any established stock exchange or a national market system or if the Company’s Common Stock will be registered for trading within ninety (90) days following the date of grant of the CGOs, the fair market value of the Common Stock at the date of grant shall be determined in accordance with the average value of the Company’s common stock on the thirty (30) trading days preceding the date of grant or on the thirty (30) trading days following the date of registration for trading, as the case may be.

7. EXERCISE OF OPTIONS

Options shall be exercised in accordance with the provisions of Section 9 of the Plan and when applicable, in accordance with the requirements of Section 102.

8. ASSIGNABILITY AND SALE OF OPTIONS

8.1 Notwithstanding any other provision of the Plan, no Option or any right with respect thereto, purchasable hereunder, whether fully paid or not, shall be assignable, transferable or given as collateral or any right with respect to them given to any third party whatsoever, and during the lifetime of the Grantee each and all of such Grantee's rights to purchase Common Stock hereunder shall be exercisable only by the Grantee.

Any such action made directly or indirectly, for an immediate validation or for a future one, shall be void.

8.2 As long as Options or Common Stock purchased pursuant to thereto are held by the Trustee on behalf of the Grantee, all rights of the Grantee over the Common Stock are personal, can not be transferred, assigned, pledged or mortgaged, other than by will or laws of descent and distribution.

9. INTEGRATION OF SECTION 102 AND TAX ASSESSING OFFICER'S PERMIT

9.1 With regards to Approved 102 Options, the provisions of the Plan and/or the Appendix and/or the Award Agreement shall be subject to the provisions of Section 102 and the Tax Assessing Officer's permit, and the said provisions and permit shall be deemed an integral part of the Plan and of the Appendix and of the Award Agreement.

9.2 Any provision of Section 102 and/or the said permit which is necessary in order to receive and/or to keep any tax benefit pursuant to Section 102, which is not expressly specified in the Plan or the Appendix or the Award Agreement, shall be considered binding upon the Company and the Grantees.

10. DIVIDEND

With respect to all Shares (but excluding, for avoidance of any doubt, any unexercised Options) allocated or issued upon the exercise of Options purchased by the Optionee and held by the Optionee or by the Trustee, as the case may be, the Optionee shall be entitled to receive dividends in accordance with the quantity of such Shares, subject to the provisions of the Company's incorporation documents (and all amendments thereto) and subject to any applicable taxation on distribution of dividends, and when applicable subject to the provisions of Section 102 and the rules, regulations or orders promulgated thereunder.

11. TAX CONSEQUENCES

11.1 Any tax consequences arising from the grant or exercise of any Option, from the payment for Common Stock covered thereby or from any other event or act (of the Company, and/or its Affiliates, and the Trustee or the Grantee), hereunder, shall be borne solely by the Grantee. The Company and/or its Affiliates, and/or the Trustee shall withhold taxes according to the requirements under the applicable laws, rules, and regulations, including withholding taxes at source. Furthermore, the Grantee shall agree to indemnify the Company and/or its Affiliates and/or the Trustee and hold them harmless against and from any and all liability for any such tax or interest or penalty thereon, including without limitation, liabilities relating to the necessity to withhold, or to have withheld, any such tax from any payment made to the Grantee.

11.2 The Company and/or, when applicable, the Trustee shall not be required to release any common stock certificate to an Grantee until all required payments have been fully made.

12. GOVERNING LAW & JURISDICTION

This Appendix shall be governed by and construed and enforced in accordance with the laws of the State of Israel applicable to contracts made and to be performed therein, without giving effect to the principles of conflict of laws. The competent courts of Tel-Aviv, Israel shall have sole jurisdiction in any matters pertaining to this Appendix.

DSP GROUP, INC.
1993 EMPLOYEE STOCK PURCHASE PLAN
(as amended and restated effective March 2011)

The following constitute the provisions of the 1993 Employee Stock Purchase Plan of DSP Group, Inc.

1. Purpose. The purpose of the Plan is to provide employees of the Company and its Designated Subsidiaries with an opportunity to purchase Common Stock of the Company through accumulated payroll deductions. It is the intention of the Company to have the Plan qualify as an "Employee Stock Purchase Plan" under Section 423 of the Internal Revenue Code of 1986, as amended. The provisions of the Plan, accordingly, shall be construed so as to extend and limit participation in a manner consistent with the requirements of that section of the Code.

2. Definitions.

(a) "Board" shall mean the Board of Directors of the Company.

(b) "Code" shall mean the Internal Revenue Code of 1986, as amended.

(c) "Common Stock" shall mean the Common Stock of the Company.

(d) "Company" shall mean DSP Group, Inc., a Delaware corporation.

(e) "Compensation" shall mean all base straight time gross earnings, exclusive of payments for overtime, shift premium, incentive compensation, incentive payments, bonuses, commissions and other compensation.

(f) "Designated Subsidiaries" shall mean the Subsidiaries which have been designated by the Board from time to time in its sole discretion as eligible to participate in the Plan.

(g) "Employee" shall mean any individual who is an Employee of the Company for purposes of tax withholding under the Code whose customary employment with the Company or any Designated Subsidiary is at least twenty (20) hours per week and more than five (5) months in any calendar year. For purposes of the Plan, the employment relationship shall be treated as continuing intact while the individual is on sick leave or other leave of absence approved by the Company. Where the period of leave exceeds three (3) months and the individual's right to reemployment is not guaranteed either by statute or by contract, the employment relationship will be deemed to have terminated on the day three (3) months and one (1) day following the expiration of such three (3) month period.

(h) "Enrollment Date" shall mean the first Trading Day of each Offering Period.

(i) "Exercise Date" shall mean the last Trading Day of each Purchase Period.

(j) "Fair Market Value" shall mean, as of any date, the value of Common Stock determined as follows:

(1) If the Common Stock is listed on any established stock exchange or a national market system, including without limitation the National Market System of the National Association of Securities Dealers, Inc. Automated Quotation ("NASDAQ") System, its Fair Market Value shall be the closing sale price for the Common Stock (or the mean of the closing bid and asked prices, if no sales were reported), as quoted on such exchange (or the exchange with the greatest volume of trading in Common stock) or system on the date of such determination, as reported in *The Wall Street Journal* or such other source as the Board deems reliable, or;

(2) If the Common Stock is quoted on the NASDAQ system (but not on the National Market System thereof) or is regularly quoted by a recognized securities dealer but selling prices are not reported, its Fair market value shall be the mean of the closing bid and asked prices for the Common Stock on the date of such determination, as reported in *The Wall Street Journal* or such other source as the Board deems reliable, or;

(3) In the absence of an established market for the Common Stock, the Fair Market Value thereof shall be determined in good faith by the Board.

(4) For purposes of the Enrollment Date under the first Offering Period under the Plan, the Fair Market Value of the Common Stock shall be the Price to Public as set forth in the final prospectus filed with the Securities and Exchange Commission pursuant to Rule 424 under the securities Act of 1933, as amended.

(k) "Offering Period" shall mean the period of approximately twenty-four (24) months during which an option granted pursuant to the Plan may be exercised, commencing on the first Trading Day on or after January 1 and July 1 of each year and terminating on the last Trading Day in the periods ending twenty-four months later, except that the first Offering Period shall be an extended Offering Period of approximately twenty-five months, commencing with the date on which the Company's registration statement on Form S-1 (or any successor form thereof) is declared effective by the Securities and Exchange Commission and ending on the last Trading Day in the period ending December 31, 1995. The second Offering Period under the Plan shall commence with the first Trading Day on or after July 1, 1994. The duration of Offering Periods may be changed pursuant to Section 4 of this Plan.

(l) "Plan" shall mean this Employee Stock Purchase Plan.

(m) "Purchase Price" shall mean an amount equal to 85% of the Fair Market Value of a share of Common Stock on the Enrollment Date or on the Exercise Date, whichever is lower.

(n) "Purchase Period" shall mean the approximately six month period commencing after one Exercise Date and ending with the next Exercise Date, except that the first Purchase Period of any Offering Period shall commence on the Enrollment Date and end with the next Exercise Date; provided, however, that the first Purchase Period of the first Offering Period under the Plan shall commence with the date on which the Company's registration

statement on Form S-1 (or any successor form thereof) is declared effective by the Securities and Exchange Commission and end on the last Trading Day occurring in the period ending June 30, 1994.

(o) “Reserves” shall mean the number of shares of Common Stock covered by each option under the Plan which have not yet been exercised and the number of shares of Common Stock which have been authorized for issuance under the Plan but not yet placed under option.

(p) “Subsidiary” shall mean a corporation, domestic or foreign, of which not less than 50% of the voting shares are held by the Company or a Subsidiary, whether or not such corporation now exists or is hereafter organized or acquired by the Company or a subsidiary.

(q) “Trading Day” shall mean a day on which national stock exchanges and the National Association of Securities Dealers Automated Quotation (NASDAQ) System are open for trading.

3. Eligibility.

(a) Any Employee (as defined in Section 2(g)), who shall be employed by the Company on a given Enrollment Date shall be eligible to participate in the Plan.

(b) Any Provisions of the Plan to the contrary notwithstanding, no Employee shall be granted an option under the Plan (i) if, immediately after the grant, such Employee (or any other person whose stock would be attributed to such Employee pursuant to Section 424(d) of the Code) would own capital stock of the Company and/or hold outstanding options to purchase such stock possessing five percent (5%) or more of the total combined voting power or value of all classes of the capital stock of the Company or of any Subsidiary, or (ii) which permits his or her rights to purchase stock under all employee stock purchase plans of the Company and its subsidiaries to accrue at a rate which exceeds twenty-five thousand dollars (\$25,000) worth of stock (determined at the fair market value of the shares at the time such option is granted) for each calendar year in which such option is outstanding at any time.

4. Offering Periods. The Plan shall be implemented by consecutive, overlapping Offering Periods with a new Offering Period commencing on the first Trading Day on or after January 1 and July 1 each year, or on such other date as the Board shall determine, and continuing thereafter until terminated in accordance with Section 19 hereof; provided, however, that the first Offering Period under the Plan shall be an extended Offering Period of approximately twenty-five months, commencing with the first Trading Day on or after the date on which the Company’s registration statement on Form S-1 (or any successor form thereof) is declared effective by the Securities and Exchange Commission and ending on the last Trading Day in the period ending December 31, 1995. The second Offering Period under the Plan shall commence with the first Trading Day on or after July 1, 1994. The Board shall have the power to change the duration of Offering Periods (including the commencement and termination dates thereof) with respect to future offerings without shareholder approval if such change is announced at least fifteen (15) days prior to the scheduled beginning of the first Offering Period to be affected thereafter.

5. Participation.

(a) An eligible Employee may become a participant in the Plan by completing a subscription agreement authorizing payroll deductions in the form of Exhibit A to this Plan and filing it with the Company's payroll office prior to the applicable Enrollment Date, unless a later time for filing the subscription agreement is set by the Board for all eligible Employees with respect to a given Offering Period.

(b) Payroll deductions for a participant shall commence on the first payroll following the Enrollment Date and shall end on the last payroll in the Offering Period to which such authorization is applicable, unless sooner terminated by the participant as provided in Section 10 hereof.

6. Payroll Deductions.

(a) At the time a participant files his or her subscription agreement, he or she shall elect to have payroll deductions made on each pay day during the Offering Period in an amount not exceeding ten percent (10%) of the Compensation which he or she receives on each pay day during the Offering Period, and the aggregate of such payroll deductions during the Offering Period shall not exceed ten percent (10%) of the participant's Compensation during said Offering Period.

(b) All payroll deductions made for a participant shall be credited to his or her account under the Plan and will be credited withheld in whole percentages only. A participant may not make any additional payments into such account.

(c) A participant may discontinue his or her participation in the Plan as provided in Section 10 hereof, or may increase or decrease the rate of his or her payroll deductions during the Offering Period by completing or filing with the Company a new subscription agreement authorizing a change in payroll deduction rate. The Board may, in its discretion, limit the number of participation rate changes during any Offering Period. The change in rate shall be effective with the first full payroll period following five (5) business days after the Company's receipt of the new subscription agreement unless the Company elects to process a given change in participation more quickly. A participant's subscription agreement shall remain in effect for successive Offering Periods unless terminated as provided in Section 10 hereof.

(d) Notwithstanding the foregoing, to the extent necessary to comply with Section 423 (b)(8) of the Code and Section 3(b) hereof, a participant's payroll deductions may be decreased to 0% at such time during any Purchase Period which is scheduled to end during the current calendar year (the "Current Purchase Period") that the aggregate of all payroll deductions which were previously used to purchase stock under the Plan in a prior Purchase Period which ended during that calendar year plus all payroll deductions accumulated with respect to the Current Purchase Period equal \$21,250. Payroll deductions shall recommence at the rate provided in such participant's subscription agreement at the beginning of the first Purchase Period which is scheduled to end in the following calendar year, unless terminated by the participant as provided in Section 10 hereof.

(e) At the time the option is exercised, in whole or in part, or at the time some or all of the Company's Common Stock issued under the Plan is disposed of, the participant must make adequate provision for the Company's federal, state, or other tax withholding obligations, if any, which arise upon the exercise of the option or the disposition of the Common Stock. At any time, the Company may, but will not be obligated to, withhold from the participant's cooperation the amount necessary for the Company to most applicable withholding obligations, including any withholding required to make available to the Company any tax deductions or benefits attributable to sale or early disposition of Common Stock by the Employee.

7. Grant of Option. On the Enrollment Date of each Offering Period, each eligible Employee participating in such Offering Period shall be granted an option to purchase on each Exercise Date during such Offering Period (at the applicable Purchase price) up to a number of shares of the Company's Common Stock determined by dividing such Employee's payroll deductions accumulated prior to such Exercise Date and retained in the Participant's account as of the Exercise Date by the applicable purchase Price; provided that in no event shall an Employee be permitted to purchase during each Purchase period more than a number of Shares determined by dividing \$25,000 by the Fair Market Value of a share of the Company's Common Stock on the Enrollment Date; and provided further that such purchase shall be subject to the limitations set forth in Sections 3(b) and 12 hereof. Exercise of the option shall occur as provided in Section 8 hereof, unless the participant has withdrawn pursuant to Section 10 hereof, and shall expire on the last day of the Offering Period.

8. Exercise of Option. Unless a participant withdraws from the Plan as provided in Section 10 hereof, his or her option for the purchase of shares will be exercised automatically on the Exercise Date, and the maximum number of full shares subject to option shall be purchased for such participant at the applicable Purchase Price with the accumulated payroll deductions in his or her account. No fractional shares will be purchased; any payroll deductions accumulated in a participant's account which are not sufficient to purchase a full share shall be retained in the participant's account for the subsequent Purchase Period or Offering Period, subject to earlier withdrawal by the participant as provided in Section 10 hereof. Any other monies left over in a participant's account after the Exercise Date shall be returned to the participant. During a participant's lifetime, a participant's option to purchase shares hereunder is exercisable only by him or her.

9. Delivery. As promptly as practicable after each Exercise Date on which a purchase of shares occurs, the Company shall arrange the delivery to each participant, as appropriate, of a certificate representing the shares purchased upon exercise of his or her option.

10. Withdrawal; Termination of Employment.

(a) A participant may withdraw all but not less than all the payroll deductions credited to his or her account and not yet used to exercise his or her option under the Plan at any time by giving written notice to the Company in the form of Exhibit B to this Plan. All of the participant's payroll deductions credited to his or her account will be paid to such participant promptly after receipt of notice of withdrawal and such participant's option for the Offering Period will be automatically terminated, and no further payroll deductions for the purchase of shares will be made during the Offering Period. If a participant withdraws from an Offering Period, payroll deductions will not resume at the beginning of the succeeding Offering Period unless the participant delivers to the Company a new subscription agreement.

(b) Upon a participant's ceasing to be an Employee (as defined in Section 2(g) hereof), for any reason, including by virtue of him or her having failed to remain an Employee of the Company for at least twenty (20) hours per week during an Offering Period in which the Employee is a participant, he or she will be deemed to have elected to withdraw from the Plan and the payroll deductions credited to such participant's account during the Offering Period but not yet used to exercise the option will be returned to such participant or, in the case of his or her death, to the person or persons entitled thereto under Section 14 hereof, and such participant's option will be automatically terminated.

11. Interest. No interest shall accrue on the payroll deductions of a participant in the Plan.

12. Stock.

(a) The maximum number of shares of the Company's Common Stock which shall be made available for sale under the Plan shall be 2,800,000 shares, subject to further adjustment upon changes in capitalization of the Company as provided in Section 18 hereof. If on a given Exercise Date the number of shares with respect to which options are to be exercised exceeds the number of shares then available under the Plan, the Company shall make a pro rata allocation of the shares remaining available for purchase in as uniform a manner as shall be practicable and as it shall determine to be equitable.

(b) The participant will have no interest or voting right in shares covered by his option until such option has been exercised.

(c) Shares to be delivered to a participant under the Plan will be registered in the name of the participant or in the name of the participant and his or her spouse.

13. Administration.

(a) Administrative Body. The plan shall be administered by the Board or a committee of members of the Board appointed by the Board. The Board or its committee shall have full and exclusive discretionary authority to construe, interpret and apply the terms of the Plan, to determine eligibility and to adjudicate all disputed claims filed under the Plan. Every finding, decision and determination made by the Board or its committee shall, to the full extent permitted by law, be final and binding upon all parties. Members of the Board who are eligible Employees are permitted to participate in the Plan, provided that:

(1) Members of the Board who are eligible to participate in the Plan may not vote on any matter affecting the administration of the Plan or the grant of any option pursuant to the Plan.

(2) If a Committee is established to administer the Plan, no member of the Board who is eligible to participate in the Plan may be a member of the Committee.

(b) Rule 16b-3 Limitations. Notwithstanding the provisions of Subsection (a) of this Section 13, in the event that Rule 16b-3 promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), or any successor provision (“Rule 16b-3”) provides specific requirements for the administrators of plans of this type, the Plan shall be only administered by such a body and in such a manner as shall comply with the applicable requirements of Rule 16b-3. Unless permitted by Rule 16b-3, no discretion concerning decisions regarding the Plan shall be afforded to any committee or person that is not “disinterested” as that term is used in Rule 16b-3.

14. Designation of Beneficiary.

(a) A participant may file a written designation of a beneficiary who is to receive any shares and cash, if any, from the participant’s account under the Plan in the event of such participant’s death subsequent to an Exercise Date on which the option is exercised but prior to delivery to such participant of such shares and cash. In addition, a participant may file a written designation of a beneficiary who is to receive any cash from the participant’s account under the Plan in the event of such participant’s death prior to exercise of the option. If a participant is married and the designated beneficiary is not the spouse, spousal consent shall be required for such designation to be effective.

(b) Such designation of beneficiary may be changed by the participant at any time by written notice. In the event of the death of a participant and in the absence of a beneficiary validly designated under the Plan who is living at the time of such participant’s death, the Company shall deliver such shares and/or cash to the executor or administrator of the estate of the participant, or if no such executor or administrator has been appointed (to the knowledge of the Company), the Company, in its discretion, may deliver such shares and/or cash to the spouse or to any one or more dependents or relatives of the participant, or if no spouse, dependent or relative is known to the Company, then to such other person as the Company may designate.

15. Transferability. Neither payroll deductions credited to a participant’s account nor any rights with regard to the exercise of an option or to receive shares under the Plan may be assigned, transferred, pledged or otherwise disposed of in any way (other than by will, the laws of descent and distribution or as provided in Section 14 hereof) by the participant. Any such attempt at assignment, transfer, pledge or other disposition shall be without effect, except that the Company may treat such act as an election to withdraw funds from an Offering Period in accordance with Section 10 hereof.

16. Use of Funds. All payroll deductions received or held by the Company under the Plan may be used by the Company for corporate purpose, and the Company shall not be obligated to segregate such payroll deductions.

17. Reports. Individual accounts will be maintained for each participant in the Plan. Statements of account will be given to participating Employees at least annually, which statement will set forth the amounts of payroll deductions, the Purchase Price, the number of shares purchased and the remaining cash balance, if any.

18. Adjustments Upon Changes in Capitalization, Dissolution, Liquidation, Merger or Asset Sale.

(a) Changes in Capitalization. Subject to any required action by the shareholders of the Company, the Reserves as well as the price per share of Common Stock covered by each option under the Plan which has not yet been exercised shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common stock, or any other increase or decrease in the number of shares of Common Stock effected without receipt of consideration by the Company, provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been “effected without receipt of consideration.” Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an option.

(b) Dissolution or Liquidation. In the event of the proposed dissolution or liquidation of the Company, the Offering Periods will terminate immediately prior to the consummation of such proposed action, unless otherwise provided by the Board.

(c) Merger or Asset Sale. In the event of a proposed sale of all or substantially all of the assets of the Company, or the merger of the Company with or into another corporation, each option under the Plan shall be assumed or an equivalent option shall be substituted by such successor corporation or a parent or subsidiary of such successor corporation, unless the Board determines, in the exercise of its sole discretion and in lieu of such assumption or substitution, to shorten the Offering Periods then in progress by setting a new Exercise Date (the “New Exercise Date”). If the Board shortens the Offering Periods then in progress in lieu of assumption or substitution in the event of a merger or sale of assets, the Board shall notify each participant in writing, at least ten (10) business days prior to the New Exercise Date, that the Exercise Date for his option has been changed to the New Exercise Date and that his option will be exercised automatically on the New Exercise Date, unless prior to such date he has withdrawn from the Offering Period as provided in Section 10 hereof. For purposes of this paragraph, an option granted under the Plan shall be deemed to be assumed if, following the sale of assets or merger, the option confers the right to purchase, for each share of option stock subject to the option immediately prior to the sale of assets or merger, the consideration (whether stock, cash or other securities or property) received in the sale of assets or merger by holders of common stock for each share of Common Stock held on the effective date of the transaction (and if such holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding shares of common Stock); provided, however, that if such consideration received in the sale of assets or merger was not solely common stock of the successor corporation or its parent (as defined in Section 424(e) of the Code), the Board may, with the consent of the successor corporation and the participant, provide for the consideration to be received upon exercise of the option to be solely common stock of the successor corporation or its parent equal in fair market value to the per share consideration received by holders of common stock and the sale of assets or merger.

19. Amendment or Termination.

(a) The Board of Directors of the Company may at any time and for any reason suspend, terminate or amend the Plan. Except as provided in Section 18 and this Section 19, no such termination may affect options previously granted, provided that the Plan or any one or more Offering Periods may be terminated by the Board (or its committee) on any Exercise Date or by the Board (or its committee) establishing a new Exercise Date with respect to any Offering Period and/or any Purchase Period then in progress if the Board (or its committee) determines that the termination of the Plan or such one or more Offering Periods is in the best interests of the Company and its shareholders. Except as provided in Section 18 and this Section 19, no amendment may make any change in any option theretofore granted which adversely affects the rights of any participant without the consent of the affected participants. To the extent necessary to comply with Section 423 of the Code (or any successor rule or provision or any other applicable law or regulation), the Company shall obtain shareholder approval in such a manner and to such a degree as so required.

(b) Without shareholder consent and without regard to whether any participant rights may be considered to have been “adversely affected,” the Board (or its committee) shall be entitled to limit the frequency and/or number of changes in the amount withheld during Offering Periods, change the length of Purchase Periods within any Offering Period, determine the length of any future Offering Period, determine whether future Offering Periods shall be consecutive or overlapping, establish the exchange ratio applicable to amounts withheld in a currency other than U.S. dollars, establish additional terms, conditions, rules or procedures to accommodate the rules or laws of applicable non-U.S. jurisdictions, permit payroll withholding in excess of the amount designated by a participant in order to adjust for delays or mistakes in the Company’s processing of properly completed withholding elections, establish reasonable waiting and adjustment periods and/or accounting and crediting procedures to ensure that amounts applied toward the purchase of Common Stock for each participant properly correspond with amounts withheld from the participant’s Compensation, and establish such other limitations or procedures as the Board (or its committee) determines in its sole discretion advisable and which are consistent with the Plan.

20. Notices. All notices or other communications by a participant to the Company under or in connection with the Plan shall be deemed to have been duly given when received in the form specified by the Company at the location, or by the person, designated by the Company for the receipt thereof.

21. Conditions Upon Issuance of Shares. Shares shall not be issued with respect to an option unless the exercise of such option and the issuance and delivery of such shares pursuant thereto shall comply with all applicable provisions of law, domestic or foreign, including, without limitation, the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the rules and regulations promulgated thereunder, and the requirements of any stock exchange upon which the shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

As a condition to the exercise of an option, the Company may require the person exercising such option to represent and warrant at the time of any such exercise that the shares

are being purchased only for investment and without any present intention to sell or distribute such shares if, in the opinion of counsel for the Company, such a representation is required by any of the aforementioned applicable provisions of law.

22. Term of Plan. The Plan shall become effective upon the earlier to occur of its adoption by the Board of Directors or its approval by the shareholders of the Company. It shall continue in effect until terminated under Section 19 hereof.

23. Additional Restrictions of Rule 16b-3. The terms and conditions of options granted hereunder to, and the purchase of shares by, persons subject to Section 16 of the Exchange Act shall comply with the applicable provisions of Rule 16b-3. This plan shall be deemed to contain, and such options shall contain, and the shares issued upon exercise thereof shall be subject to, such additional conditions and restrictions as may be required by Rule 16b-3 to qualify for the maximum exemption from Section 16 of the Exchange Act with respect to Plan transactions.

24. Automatic Transfer to Low Price Offering Period. To the extent permitted by Rule 16b-3 of the Exchange Act, if the Fair Market Value of the Common Stock on any Exercise Date in an Offering Period is lower than the Fair Market Value of the Common Stock on the Enrollment Date of such Offering Period, then all participants in such Offering Period shall be automatically withdrawn from such Offering Period immediately after the exercise of their option on such Exercise Date and automatically re-enrolled in the immediately following Offering Period as of the first day thereof.

25. Plan Approval. The Plan was initially approved by the Board and the shareholders of the Company in the year 1993. Effective January 1, 2004, the Board approved an amendment and restatement of the Plan to extend the term of the Plan, which amendment and restatement was not subject to shareholder approval. In March 28, 2006, the Board approved an amendment and restatement of the Plan to increase the number of shares reserved for issuance under the Plan from 700,000 to 1,000,000 Shares, which amendment and restatement was subsequently approved by stockholders. In March 2008, the Board approved an amendment and restatement of the Plan to increase the number of shares reserved for issuance under the Plan from 1,000,000 to 1,500,000 Shares, which amendment and restatement was subsequently approved by stockholders. In March 2009, the Board approved an amendment and restatement of the Plan to increase the number of shares reserved for issuance under the Plan from 1,500,000 to 2,000,000 Shares, which amendment and restatement was subsequently approved by stockholders. In March 2010, the Board approved an amendment and restatement of the Plan to increase the number of shares reserved for issuance under the Plan from 2,000,000 to 2,300,000 Shares, which amendment and restatement was subsequently approved by stockholders. In March 2011, the Board approved an amendment and restatement of the Plan to increase the number of shares reserved for issuance under the Plan from 2,300,000 to 2,800,000 Shares, which amendment and restatement was subsequently approved by stockholders.

EXHIBIT A
DSP GROUP, INC.
1993 EMPLOYEE STOCK PURCHASE PLAN
SUBSCRIPTION AGREEMENT

_____ Original Application
_____ Change in Payroll Deduction Rate
_____ Change of Beneficiary(ies)

Enrollment Date: _____

1. _____ hereby elects to Participate in the DSP Group, Inc. 1993 Employee Stock Purchase Plan (the "Employee Stock Purchase Plan") and subscribes to purchase shares of the Company's Common Stock in accordance with this Subscription Agreement and the Employee Stock Purchase Plan.
2. I hereby authorize payroll deductions from each paycheck in the amount of _____ % of my Compensation on each payday (not to exceed 20%) during the Offering Period in accordance with the Employee Stock Purchase Plan. (Please note that no fractional percentages are permitted.)
3. I understand that said payroll deductions shall be accumulated for the purchase of shares of Common Stock at the applicable Purchase Price determined in accordance with the Employee Stock Purchase Plan. I understand that if I do not withdraw from an Offering Period, any accumulated payroll deductions will be used to automatically exercise my option.
4. I have received a copy of the complete "DSP Group, Inc. 1993 Employee Stock Purchase Plan." I understand that my participation in the Employee Stock Purchase Plan is in all respects subject to the term of the Plan. I understand that the grant of the option by the Company under this Subscription Agreement is subject to obtaining shareholder approval of the Employee Stock Purchase Plan.
5. Shares purchased for me under the Employee Stock Purchase Plan should be issued in the name(s) of (Employee or Employee and spouse only): _____.
6. I understand that if I dispose of any shares received by me pursuant to the Plan within 2 years after the Enrollment Date (the first day of the Offering Period during which I purchased such shares) or one year after the Exercise Date, I will be treated for federal income tax purposes as having received ordinary income at the time of such disposition in an amount equal to the excess of the fair market value of the shares at the time such shares were purchased over the price which I paid for the shares. **I hereby agree to notify the Company in writing within 30 days after the date of any disposition of my shares and I will make adequate provision for Federal, state or other tax withholding obligations, if any, which arise upon the disposition of the Common**

Stock. The Company may, but will not be obligated to, withhold from my compensation the amount necessary to meet any applicable withholding obligation including any withholding necessary to make available to the Company any tax deductions or benefits attributable to sale or early disposition of Common Stock by me. If I dispose of such shares at any time after the expiration of the 2-year and 1-year holding periods, I understand that I will be treated for federal income tax purposes as having received income only at the time of such disposition, and that such income will be taxed as ordinary income only to the extent of an amount equal to the lesser of (1) the excess of the fair market value of the shares at the time of such disposition over the purchase price which I paid for the shares, or (2) 15% of the fair market value of the shares on the first day of the Offering Period. The remainder of the gain, if any, recognized on such disposition will be taxed as capital gain.

7. I hereby agree to be bound by the terms of the Employee Stock Purchase Plan. The effectiveness of this Subscription Agreement is dependent upon my eligibility to participate in the Employee Stock Purchase Plan.
8. In the event of my death, I hereby designate the following as my beneficiary(ies) to receive all payments and shares due me under the Employee Stock Purchase Plan:

NAME: (Please print) _____
(First) (Middle) (Last)

Relationship _____

(Address)

Employee's Social Security Number: _____

Employee's Address: _____

I UNDERSTAND THAT THIS SUBSCRIPTION AGREEMENT SHALL REMAIN IN EFFECT THROUGHOUT SUCCESSIVE OFFERING PERIODS UNLESS TERMINATED BY ME.

Dated: _____

Signature of Employee

Spouse's Signature (If beneficiary other than spouse)

EXHIBIT B
DSP GROUP, INC.
1993 EMPLOYEE STOCK PURCHASE PLAN
NOTICE OF WITHDRAWAL

The undersigned participant in the Offering Period of the DSP Group, Inc. 1993 Employee Stock Purchase Plan which began on _____, _____ (the "Enrollment Date") hereby notifies the company that he or she hereby withdraws from the Offering Period. He or she directs the Company to pay to the undersigned as promptly as practicable all the payroll deductions credited to his or her account with respect to such Offering Period. The undersigned understands and agrees that his or her option for such Offering Period will be automatically terminated. The undersigned understands further that no further payroll deductions will be made for the purchase of shares in the current Offering Period and the undersigned shall be eligible to participate in succeeding Offering Periods only by delivering to the Company a new Subscription Agreement.

Name and Address of Participant:

Signature:

Date: _____



To:

David Dahan

Re: Your Employment at DSP Group Ltd.

We are pleased to ask you to join DSP Group Ltd (hereinafter: the “Company”) in accordance with the following Employment Terms:

1. Job Description

- a. Your position at the Company will be: COO
- b. Directly subordinate to: Ofer Elyakim, CEO

2. Employment Terms

a. Salary

1. In consideration for your work at the Company, the Company will pay you the gross monthly sum of 62,600 New Israeli Shekels (hereinafter: “the Salary”),
The Salary sum is gross and includes all the Salary components and various increases, and you will not be entitled to receive any consideration or additional payment of any kind whatsoever, beyond the Salary, unless otherwise explicitly stated in this Agreement.
2. The Salary will be updated in accordance with the updating rates of the cost of living increases in the economy.
3. The company will pay you monthly travels reimbursement equivalent to NIS 500.

b. Directors Insurance

1. The Company will allocate amounts from your Salary, as specified in Sections 2a.1 and 2a.2 above, for the pension fund or provident fund or Directors Insurance, at your discretion, according to the following details:
 - a) 8.33% of the Salary on account of severance pay – at the Company’s expense.
 - b) 5% of the Salary on account of benefits—at the Company’s expense.
 - c) 5% of the Salary on account of benefits—at your expense
 - d) Disability Income Insurance at the Company’s expense and in accordance with the Company’s procedures
2. The company’s allocations for Directors Insurance as stated in Section 2b.1 above are on account of every other obligation to remit severance pay and/or pension fund allocations, insofar as these exist according to law.

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3. If, in the future, the Company is required by law and/or expansion order applicable to the entire economy to allocate sums for an arrangement or comprehensive pension fund, this allocation will be intended for the fund or the applicable new arrangement, in lieu of the arrangement in this Agreement, and the Company will not be able to withdraw sums on account of the deposits made into the previous arrangement, but rather subject to the regulations of the fund and/or other appropriate fund.

c. In-service Training Fund

During your period of employment at the Company, it will allocate sums to a professional development fund. These allocations will be calculated at the rate of 7.5% of your Salary on the Company's account and at 2.5% of the Salary on the employee's account.

d. Annual Vacation

1. During your employment period, you will be entitled to an annual vacation of 23 (twenty- three) working days. You must coordinate the time of your departure for said vacation with your superior.
2. Accumulation of vacation days for a duration exceeding the total vacation days due for two contractual years will not be allowed.
3. The Company will be entitled to order you to take an annual vacation and use up to half of your annual vacation days, including departure for an organized, concentrated vacation.

e. Sickness

1. You are entitled to 30 (thirty) days' sick leave per year, with the possibility of accumulating 3 (three) years' sick leave, i.e. 90 (ninety) days.
2. Full payment for sick leave will be remitted from the first day. You must submit a doctor's note.
3. Accumulated sick leave may not be redeemed for money.

f. Reserve Duty

1. Before taking time off for reserve duty, you must notify the Company upon receipt of your reserve duty order.
2. The Salary for the reserve duty period will be paid to you in full, as stated above in this Agreement, subject to submission of an appropriate document verifying your active reserve duty.

g. Your Eligibility for the Company's Employee Option Plan

The Company's management will recommend that the DSP Group, Inc.'s Board of Directors grant you options to acquire 50,000 shares of the DSP Group, Inc. common stock subject to the terms of the DSP Group Inc.'s employee stock option plan.

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In order to dispel any manner of doubt, it is hereby clarified that, in any case, approval to grant the aforementioned options is subject to approval by the DSP Group, Inc.'s Board of Directors and the Authorities, as specified in the

h. Annual Bonus

It is customary to allocate bonuses to some Company employees, and when management-level discussions of bonuses are held, the Company will decide, at its sole discretion and in accordance with common practice among members of management, whether to discuss your eligibility for a bonus as well.

3. The Contractual Period and its Termination

- a. This Agreement is valid as of the day it is signed by the parties to it. The contractual arrangement is for a period that is undetermined in advance. The beginning date of your employment at the Company has hereby been determined as February 1, 2012.

Each party will be entitled to terminate the contractual arrangement by informing the other party in writing 3 (three) month in advance. The Company reserves the right to refrain from exploiting the notification period and/or from terminating your employment immediately. In this case, you will be paid an early notification fee equal to the Salary for the aforementioned period, on the basis of your last Salary.

- c. The Company will be entitled to terminate your employment without prior notification in the following cases:
1. You have been convicted of a work-related criminal offense and/or an infamous offense.
 2. You have violated your duty of fidelity to the Company and/or committed an act constituting a conflict of interest.
 3. You have violated your obligation to maintain confidentiality as specified below in this Agreement and its appendices.
 4. You have maliciously harmed the Company or caused it damage in consequence of an act of gross negligence.

4. Transfer of Allocations and Severance Pay

Should your employment be terminated, the Company will transfer to you all the allocations that you have accumulated in your name in the Directors Insurance Policy and/or the fund (hereinafter: the "Allocations"). In any case, should your employment be terminated under circumstances that entitle you to severance pay, the Company shall act in accordance with the Severance Pay Law, 5723-1963.

The following is a list of the reasons that will negate the transfer of the Company's allocations in your name:

- a. The Company has dismissed you under circumstances entitling it to legally dismiss you without severance pay.

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- b. You have violated your fiduciary duty and/or duty of confidentiality toward the Company, under this Agreement, and without derogating from the generality of the aforementioned— violation of the Confidentiality Agreement attached as Appendix A to this Agreement and which constitutes an integral part thereof.
- c. You have been convicted of a criminal offense and/or infamous offense.
- d. You have stopped working at the Company without giving the required advance notification specified in Section 3b above.
- e. You have stopped working at the Company without transferring your job, as specified in Section 7 below.

It is hereby clarified that your transfer from the employment framework of the Company to that of a new company that is established—if established as part of the Company—and your employment at such a company, will not constitute termination of your employment or your resignation and/or dismissal from the Company, for the purpose of transferring the various allocations, including severance pay, yet without derogating from the generality of the aforementioned, unless a significant change in your job occurs.

5. Working Hours

- a. Scope of position: 100%
- b. As your position is among those requiring a special degree of personal trust, as defined in the Working Hours and Rest Law, 5711—1951, you will not be subject to the provisions of this law. From time to time, the requirements of your position will necessitate your working beyond the customary hours and on Fridays. In these cases, you will not be paid for overtime.

6. The Duty of Fidelity and Avoidance of Conflicts of Interest

- a. You hereby undertake to carry out your job with dedication and fidelity; to use all your skills, knowledge and experience for the Company's benefit and advancement, at the highest, most efficient level and as the Company sees fit. In addition, you hereby undertake to act according to the Company's instructions regarding everything related to the work performance, work arrangements, discipline and conduct put into effect from time to time.
- b. Once you begin working full time for the Company specified in Section 3a above, i.e. beginning on May 1st, 2007, you may not work at any other job and/or occupation as a salaried employee and/or consultant and/or self-employed individual, be it directly and/or indirectly, unless you have the Company's advance written approval to do so. In any case, you may not work in any capacity if said job conflicts with the Company's interests (a list of your current activities is attached as an appendix to this Agreement).
- c. Throughout the agreement period, you will not receive any payment or other benefit from any third party, be it directly or indirectly related to your job. It is hereby clarified that a violation of this provision constitutes a violation of a fundamental condition of this Agreement, and, in addition, the aforementioned sum or benefit received by you will belong to the Company, which will be entitled to deduct the said sum or the value of the benefit from all the sums due you from the Company.

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- d. You will not carry out any action that constitutes harm to your fidelity to the Company and/or is liable to place you in a position of conflict of interest vis—vis the Company. You hereby undertake to immediately inform the Company of any matter or issue in which you have a personal stake and/or any other action that is liable to place you in the aforementioned position.
- e. Commencement of your employment pursuant to this Agreement is conditional upon your signature on the Confidentiality Agreement attached to this Agreement as Appendix A, and constitutes an integral part thereof.
- f. You hereby undertake to inform the Company's CEO of any business opportunity related in any way to the information specified in Appendix A. You undertake to refrain from designating yourself or any other person for such an opportunity, be it directly or indirectly, unless the CEO has given his advance written approval for same.

7. Transferring the Position

In the case of termination of your job, and/or expiration of this Agreement for any reason whatsoever, you undertake to transfer your position—and without derogating from the generality of the aforesaid—and all the matters you handle and/or any information whatsoever in your possession and which relates in any way to your job at the Company. Said transfer will be performed in an orderly and full manner, and include disclosure of any important detail regarding the Company's dealings. You further undertake to transfer to the Company all the documents, information, material, equipment, and the like, which you have received and/or prepared in relation to your job at the Company, up to termination of your job at the Company; said transfer will be performed in an orderly and full manner.

8. Declaration of Confidentiality

You undertake to maintain confidentiality, both during and after your employment at the Company, as specified in the Pledge to Maintain Confidentiality attached to this Agreement as Appendix A, which constitutes an integral part thereof.

11. Patents, Inventions and Trade Secrets

- a. The copyrights on any invention and/or patent and/or trade secret and/or professional secret and/or innovation whatsoever conceived by you and/or by any of the Company's employees subordinate to you during your Period of Employment at the Company and as part of your employment thereat will be the sole property of the Company.

The Company will be entitled to protect an aforementioned invention and/or patent and/or trade secret by duly registering same or by performing any other action, be it in Israel or anywhere else.

It is hereby clarified that you will not be entitled to register the invention and/or patent and/or trade secret, or take any action related to them, except actions that are required for registration or exploitation of the aforementioned by or on behalf of the Company. The aforesaid will also apply to the period following your employment at the Company.



- b. You undertake to inform the Company, in writing, of any invention and/or patent and/or trade secret conceived by you and/or by any of the Company's employees subordinate to you, once you become aware of same. (A description of a patent-in-process is attached hereto.)
- c. The aforesaid in this section is supplementary to Appendix A of this Agreement.

On the occasion of signing this personal employment contract, we welcome you to the Company and wish you the utmost satisfaction from your job.

We hope this will mark the beginning of many years of cooperation between us for your own personal benefit as well as that of the Company.

Sincerely yours,

Tali Chen

VP Human Resources

DSP Group, Ltd.

I have read this letter carefully and hereby consent to its contents.

I know that the Salary conditions I have been offered, and those that will prevail during my employment, are personal, and that this letter constitutes a personal, unique employment contract that formalizes my relationship with the Company; therefore, I hereby confirm my knowledge of the fact that I will not be subject to the provisions of any other agreements, including collective-bargaining agreements, between the Company and its employees as long as this Agreement is valid, and I hereby undertake to maintain the confidentiality of said conditions.

/s/ David Dahan

David Dahan

Signature

Date: 2/1/2012

ID No.

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Appendix A to My Employment Agreement with DSP Group Ltd

Pledge of Confidentiality

Whereas I hereby request to be employed at DSP Group Ltd (Private Company No. 511354722);
and whereas the Company has clarified to me the importance it attaches to the obligations specified in this document below, including everything related to the maintenance of confidentiality (hereinafter: "the Obligations");
and whereas the Company has conditioned my employment at the Company on my pledge to fulfill them;
and whereas the "Company" for the matter of this obligation also includes the American parent company, D.S.P. Group, Inc. (hereinafter: "the American Company"), the subsidiaries of the Company and those of the American Company;
and whereas I know that the Company took said obligations into account when it determined my Salary and eligibility for employee options (hereinafter; "the Employment Terms")
and whereas I have given my full consent to the limitations stemming from the obligations, after having understood their meaning, examined their scope and weighed the consideration for them;
and whereas the Employment Terms agreed to between myself and the Company constitute, from my viewpoint, proper consideration for the obligations;
and whereas I hereby take the obligations upon myself;
and whereas I hereby undertake to fulfill the obligations that I have assumed;
and whereas I know that, on the basis of the aforementioned, the Company has consented to
employ me;

therefore, I hereby declare and undertake the following:

1. The preamble to this document constitutes an integral part thereof.
2. Confidentiality
 - 2.1 I hereby undertake to maintain full and total confidentiality regarding everything directly or indirectly related to the Company and its business, including professional and/or commercial information related to the Company inclusive of the aforesaid, I hereby undertake, both regarding Israel and any other place outside of Israel, not to reveal or make available to others any information whatsoever related to same in any form whatsoever, be it directly and/or indirectly, except information in the public domain (hereinafter: "the

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Confidential Information”), and not to use said Confidential Information for my own personal needs or for the purpose of deriving any benefit for myself—or for others, be it during my employment period at the Company or during any other subsequent period, when the

Confidential Information is passed or revealed to me in consequence of my employment or during my aforesaid employment, be it by the Company, directly or indirectly, through hearing, sight or reading, including from third parties with whom the company deals, as well as when the Confidential Information is the product of an idea or self-development during my employment period or as part of my aforesaid employment, except for the purpose of executing out my job during my employment period at the Company.

In this Agreement—the Confidential Information regarding and/or concerning the Company, including technical and commercial know-how and data (whether written or verbal), drafts, documents (reports, papers and records, assignment requests), descriptions, plans, software, hardware, trade secrets, including information related to the Company’s customers, suppliers and business partners and/or to the Company’s production or marketing system, or which concerning the relations of the Company and/or its associated companies, control, are controlled, or are potentially or actually affiliated with any third parties whatsoever, including customers, suppliers, banking institutions, governmental institutions, and private, quasi-public or public entities of any type, as well as any business, financial, commercial know-how, financial statements and balances before their publication, and any internal information whatsoever that can affect the value of the Company’s shares, formulae, data, plans, patents, inventions, discoveries, innovations, improvements, research, methods of any kind, progress in scientific, technical, economic, commercial or other developments, patent application letters, prototypes, samples, pictures, descriptions, blueprints, sketches, sun prints, booklets, models and specification documents, lists, documentation, source and object codes, tapes, discs and other storage means, letters, records, record booklets, reports and flow charts, as well as information related to the Company’s current business and/or business that the Company is going to conduct (as it will develop and as is described by the Company in its development plan booklet and business plans or in any other informational material on behalf of the Company) sales reports, short- and long-term policy covering Company-related, products, product features, marketing methods, customer lists, price lists, discounts, supplier lists, business/commercial/financial contacts, economic calculations, including operating and product costs, and every other thing and matter that contains Confidential Information or which is likely to serve as a source of Confidential Information, including any information of commercial, technical and non-technical value, be it written or unwritten, data, a set of lists, models, specification documents, source and destination codes, processes, algorithms, computer magnetic tape, discs and other storage means that are tantamount to intellectual property or confidential material of the Company or of any of its predecessors or of its associated companies, in whole or in part, and particularly including, without limitation, computer hardware, computer programmer’s plans and applications, price matters and marketing information, as well as inventions

that are not limited according to the definition of an invention as it is stipulated in the applicable Israeli or US patent laws, and each improvement or adaptation of the said information was planned, developed or obtained by me or for the Company, directly or indirectly, provided that it is not information and/or an available product that is in the public domain or can be purchased freely from an independent third party, and everything in relation to any matter related to the Company's business and/or customers or which stems therefrom or is related in any way whatsoever, provided that is not in the public domain.

- 2.2 Without derogating from the generality of the aforesaid in Section 2.1 above, I hereby undertake not to reveal and/or transfer and/or sell – be it for consideration or not for consideration—and/or to cause the exposure of the Confidential Information, directly or indirectly, and to take all the measures to maintain the confidentiality of the information and prevent said information from reaching any third party whatsoever, person, body or corporation, other than my superiors at the Company or in accordance with their instructions for the purpose of fulfilling my duty as an employee of the Company.
- 2.3 I hereby undertake not to make any use of the information, be it in whole or in part, for my own needs or for other needs, directly or indirectly, other than for the purpose of carrying out my tasks as an employee of the Company in accordance with the instructions given by my superiors, and not to make copies of the Confidential Information in any manner whatsoever or in any form whatsoever, except at the instructions of the Company or anyone it has authorized to do so on its behalf.
- 2.4 I hereby undertake not to take any materials whatsoever that relate to the Confidential Information or the products, or any equipment from the Company, without obtaining the advance express written consent of: (1) the Company's president or CEO, or (2) a person who has been authorized to do so, in writing, by the Company's president or CEO.
- 2.5 I know that my failure to safeguard any Confidential Information and/or my performance of an act construed as jeopardizing the security of the Confidential Information will, for the matter of this document, be tantamount to passing on the Confidential Information without the Company's consent, as stated above.
- 2.6 Without derogating from the statements above and below, I know that I do not, and will not, have any proprietary rights in the Confidential Information defined in this document.
 - 2.6.1 I hereby undertake to inform the Company and/or those who come in its stead and/or its assignees of any inventions revealed to me during my Employment Period at the Company and/or in consequence of my work at the Company, and are related to the Company's business and/or to the Confidential Information, and I hereby assign every interest I have, or will have, in said inventions for the benefit of the Company and/or those who come in its stead and/or its assignees, without receiving any



additional consideration for said assignment, provided that I will not be required to bear any expenses whatsoever for the aforementioned assignment. If I create an invention that is registered as a patent either during my Employment Period at the Company or in consequence of my work at the Company, the Company will register my name on the patent documents as the inventor, provided that the Company is convinced beyond all doubt that the invention was indeed created by me, and that said registration does not constitute an infringement upon the proprietary and/or other rights of the Company and/or those who come in its stead and/or its assignees, in said invention and/or patent specified above.

2.6.2 I hereby undertake that, as long as I am required to do so, including during the period following termination of my employment for any reason whatsoever, I will sign every document that the Company deems necessary for the submission of an application for a patent or copyrights in accordance with the laws of Israel, the US and/or any foreign country in order to protect the Company's interest in the aforementioned invention.

2.6.3 I hereby declare that, apart from the contents of Section below, I possess no interest in any patent or patent application whatsoever, and not even in material subject to the copyrights, patents and patent applications currently belonging to me.

2.6.4 Existing patents and/or pending patent applications, and/or research activities at the stage of patent registration submission:

1. _____
2. _____
3. _____
4. _____

2.7 I know that disclosure of the Confidential Information and/or any part thereof to any third party whatsoever is liable to cause the Company severe damage, and I hereby undertake that I will not, in any way, perform an action involving a transfer and/or sale of the information and/or the products developed by the Company and/or existing products and/or which have been developed either by myself, in cooperation with others—including customers of the Company—or in cooperation with any third party whatsoever, to customers of the Company or to others.

2.8 I hereby declare my understanding that the nature of the Company's business is such that, by entering into contractual arrangements with third parties, it undertakes and/or is likely to undertake confidentiality obligations that also apply to its employees, and non-fulfillment of the aforementioned obligations will constitute, among other things, a contract violation between the Company and the third party. I hereby undertake, therefore, to fulfill all said obligations as stipulated between the Company and the third party, as stated above.

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- 2.9 I hereby undertake not to directly or indirectly damage the Company's reputation of and/or its status among its actual and potential customers. I hereby undertake to safeguard the confidentiality of information related to all the financial aspects of the Company's activity, including relations with banking institutions and the customs and tax authorities, and the Company's liabilities and rights vis—vis third parties. Furthermore, I will safeguard the confidentiality of the information that comes into my hands and is related to entities such as the investment center, the Chief Scientist, the Company's accountants and legal advisors, and the like.
- 2.10 In order to dispel any manner of doubt, it is hereby stressed that my obligations as stated above will be in effect both during my Employment Period at the Company and following termination of my employment at the Company for any reason whatsoever, and will also obligate my legal representatives, without time limitations.
- 2.11 I hereby agree that each document I have prepared and/or information I have obtained for the purpose of performing my job at the Company during my Employment Period at the Company is the Company's property that will be transferred to the Company immediately following my employment as specified below. Furthermore, I hereby undertake to return to the Company all information—be it in written or any other form—that is or will be in my possession at any time, and I will do so immediately following conclusion of my employment for any reason whatsoever, or immediately on demand by the Company at any time.
3. I again hereby declare my knowledge of the fact that the obligations in this document are especially important to the Company and constituted a precondition to my employment and were taken into account when the Company determined the Employment Terms, and that I fully consented to the limitations stemming therefrom after having understood their meaning, examined their scope, and weighed the consideration for them; therefore, I know that any violation of the obligations I have taken upon myself will grant the Company all the legal rights and remedies.

/s/ David Dahan

David Dahan

Employee's Signature

Date: 2/1/2012

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LIST OF SUBSIDIARIES

| <u>Name of Subsidiary</u> | <u>Jurisdiction of Incorporation</u> |
|------------------------------------------|--------------------------------------|
| 1. DSP Group Ltd. | Israel |
| 2. Nihon DSP K.K. | Japan |
| 3. RF Integrated Systems, Inc. | Delaware, U.S. |
| 4. DSPG Edinburgh Ltd. | Scotland |
| 5. DSPG Technologies GmbH | Germany |
| 6. DSP Group HK Limited | Hong Kong |
| 7. DSP Technology Indian Private Limited | India |
| 8. DSP Switzerland AG | Switzerland |
| 9. BoneTone Communications LTD | Israel |

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements (Form S-8 Nos. 333-175172, 333-161206, 333-151527, 333-140233, 333-135220, 333-131324, 333-126773, 333-112417, 333-108937, 333-147561) pertaining to the 1991 Employee and Consultant Stock Plan, 1993 Director Stock Option Plan, 1998 Employee Stock Purchase Plan, 2001 Stock Incentive Plan and 2003 Israeli Share Option Plan of DSP Group, Inc., the 239,000 shares of common stock of DSP Group, Inc. issuable pursuant to options granted on December 1, 2004, and the 235,000 shares of common stock of DSP Group, Inc. issuable pursuant to options granted on October 31, 2007, of our reports dated March 15, 2012, with respect to the consolidated financial statements and schedule of DSP Group Inc., and the effectiveness of internal control over financial reporting of DSP Group Inc. included in this Annual Report on Form 10-K for the year ended December 31, 2011.

/s/ KOST FORER GABBAY & KASIERER

KOST FORER GABBAY & KASIERER

A Member of Ernst & Young Global

Tel-Aviv, Israel
March 15, 2012

DSP GROUP, INC.

CERTIFICATION

I, Ofer Elyakim, certify that:

1. I have reviewed this annual report on Form 10-K of DSP Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 15, 2012

/s/ Ofer Elyakim

Ofer Elyakim
Chief Executive Officer

DSP GROUP, INC.**CERTIFICATION**

I, Dror Levy, certify that:

1. I have reviewed this annual report on Form 10-K of DSP Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 15, 2012

/s/ Dror Levy

Dror Levy

Chief Financial Officer

DSP GROUP, INC.

CERTIFICATION

In connection with the annual report of DSP Group, Inc. (the "Company") on Form 10-K for the year ended December 31, 2011 as filed with the Securities and Exchange Commission (the "Report"), I, Ofer Elyakim, Chief Executive Officer of the Company, hereby certify as of the date hereof, solely for purposes of Title 18, Chapter 63, Section 1350 of the United States Code, that to the best of my knowledge:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company at the dates and for the periods indicated.

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

This Certification has not been, and shall not be deemed, "filed" with the Securities and Exchange Commission.

Date: March 15, 2012

/s/ Ofer Elyakim
Ofer Elyakim
Chief Executive Officer

DSP GROUP, INC.

CERTIFICATION

In connection with the annual report of DSP Group, Inc. (the "Company") on Form 10-K for the year ended December 31, 2011 as filed with the Securities and Exchange Commission (the "Report"), I, Dror Levy, Chief Financial Officer of the Company, hereby certify as of the date hereof, solely for purposes of Title 18, Chapter 63, Section 1350 of the United States Code, that to the best of my knowledge:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company at the dates and for the periods indicated.

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

This Certification has not been, and shall not be deemed, "filed" with the Securities and Exchange Commission.

Date: March 15, 2012

/s/ Dror Levy

Dror Levy
Chief Financial Officer