DSP GROUP INC /DE/
Form 10-K
March 16, 2010
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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, 2009

Commission File Number 0-23006

DSP GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-2683643**
(State or other jurisdiction of incorporation and organization)	**(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 x

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 x

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 x 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 x Non-accelerated filer ¨ 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 x

As of June 30, 2009, 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, 2009 as reported on the NASDAQ Global Select Market, was approximately $86,969,157. 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 10, 2010, the Registrant had outstanding 23,125,431 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, 2009 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 new products and categories of products for home communication, including Wi-Fi application products, will start to contribute to our revenues in 2010 and beyond;*
- *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 CAT-iq, which has been widely embraced by all leading European operators, will also proliferate into other regions that have adopted DECT telephony, such as the U.S., and that this new standard will enable the introduction of new cordless products into the market;*
- *Our belief that the XpandR product family will present unique opportunities for us to expand the domain of applications and add new customers served by our products;*
- *Our belief that international sales will continue to account for a significant portion of our net product sales for the foreseeable future;*
- *Our optimism about an economic recovery in 2010, and our belief that our revenues and gross profit will increase in 2010 as compared to 2009 mainly due to the launching of new products and operational efficiencies;*
- *Our belief that U.S. sales of our 2.4GHz and 5.8GHz products will continue to decrease during 2010;*
- *Our belief that sales of our DECT 6.0 products in the U.S. market will continue to increase;*
- *Our belief that sales of our DECT and 2.4GHz products will continue to represent a substantial percentage of our revenues for 2010;*
- *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 2010 and that price erosion 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; and

Our belief that our available cash and cash equivalents at December 31, 2009 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.

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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. Delivering system solutions that combine semiconductors and software with reference designs, DSP Group enables consumer electronics (CE) manufacturers to cost-effectively develop new revenue-generating applications with fast time to market.

At the forefront of semiconductor innovation and operational excellence for over two decades, and with a leading position in wireless home telephony market, DSP Group provides a broad portfolio of wireless chipsets integrating Digital Enhanced Cordless Telecommunications (DECT), Wi-Fi, Public Switched Telephone Network (PSTN) and Voice over Internet Protocol (VoIP)/Communications over Internet Protocol (CoIP) technologies with state-of-the-art application processors. Enabling converged voice, audio, video and data connectivity across diverse consumer products from cordless and VoIP phones to home gateways and connected multimedia screens DSP Group proactively partners with CE manufacturers to shape the future of converged communications at home.

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 targets applications for the cordless and VoIP residential telephony market, mainly European DECT.

Industry Environment and Our Business

Over the past two decades, communications technology has evolved from simple analog voice signals transmitted over networks of copper telephone lines to complex analog and digital voice and data signals transmitted over hybrid networks, such as copper, wireless transmission over radio frequencies (RF), DSL cable and fiber optic lines. In addition, information is increasingly available via wired and wireless networks through a variety of access devices, including cordless phones, cellular phones, personal computers, tablets, personal digital assistants (PDAs), and portable media players (PMPs) and digital cable, satellite and IP set-top boxes. Moreover, the desire to leverage existing telecommunications infrastructure, compounded by the increased use of new data-intensive computing, communication and video applications, are driving the convergence of voice, audio, data and video.

Our focus on the design of highly-integrated, mixed-signal devices that combine complex RF, 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 applications, IP telephony and multi-media products, and can be manufactured in high volumes using cost-effective process technologies. Our systems architecture provides an open design environment for original design manufacturers (ODMs) to design and market their own end products with maximum differentiation.

In response to the growing trend towards wireless residential 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) Radio Frequency (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 and deep sub-micron CMOS technologies to our portfolio of technologies.

We also are an active member in all relevant cordless industry standardization bodies such as the DECT Forum and the European Telecommunications Standards Institute. 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 telecom service providers, thereby providing us with insight into future plans across the industry.

Product Development

Since 1989, when we introduced the first Integrated Digital Telephony (IDT) speech processor, DSP Group has continued to bring innovative products to the market. In 2001, we introduced the 900MHz narrow-band cordless chipset into mass market. During the same year, we also developed an integrated CMOS RF device which combines a communications modem and RF device into an integrated phone-on-a-chip solution. This device was an important step in our development efforts to integrate telephony features.

In 2002, we introduced a complete chipset for a 2.4GHz single handset solution and an advanced Enhanced Digital Cordless Telephone (EDCT) 2.4GHz multi-handset solution with walkie-talkie and in-room baby monitor capabilities, thereby supporting the transition of the U.S. market from 900MHz to 2.4GHz technology. For the 5.8GHz market, we also developed the first generation up-converter solution and are in the process of developing a complete IC device solution to replace the discrete 5.8GHz converter currently used in the market. During 2006, we introduced to the market our RF technology in the 5.8GHz radio chip, which enabled improved sensitivity.

In 2003, we moved into the multimedia communications market by acquiring the assets of Teleman Multimedia Inc., a U.S. corporation. Teleman developed an advanced silicon platform for video compression and decompression designed to interface with image sensors and panel displays. During October 2004, we acquired substantially all of the assets of Bermai Inc., a U.S. corporation. Bermai developed an advanced Wi-Fi technology which is optimized for quality of service (QoS) for video streaming applications. The incorporation of this acquired Wi-Fi technology into our existing technology enabled us to develop low power, cost optimized solutions for residential voice, video and data communication over broadband.

In 2004, we completed the development of our chipset for the DECT market. This product line included the DE56000 baseband processor family, CMOS RF transceiver and SiGe power amplifier. The DE56000 chipset family also entered into mass production during the fourth quarter of 2004 for incorporation into products developed for the U.S. 2.4GHz and 5.8GHz markets. We also have used our RF technology for the 5.8GHz radio chip to introduce a DECT solution covering 1.7-1.9GHz bands with superior channel capacity for voice and data. During 2006 and 2007, the first DECT 6.0 products were introduced to the U.S. market by our customers. Also during 2007, we started production of a RF transceiver, which in addition to providing outstanding performance characteristics, allows simultaneous support of up to 12 handset links and supports emerging next generation DECT standard CAT-IQ which is aimed at the global DECT market.

We also announced in 2004 the development of an Internet Protocol (IP) cordless phone that enables connectivity to a broadband line feeding VoIP with cordless phone capabilities. In addition, we have started the development of a new feature that is anticipated to enable connectivity of cellular phones to residential fixed-line phones.

During 2005, we developed a motion JPEG cordless application for slow motion monitoring applications, such as door phones, security and baby monitoring, as well as USB dongle connectivity to a variety of PC instant messaging applications, such as Skype, MSN and GoogleTalk. All these applications, together with cellular connectivity, were incorporated into end products of our customers that entered into the market in 2006.

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During 2006, we introduced to the market our short wave (SW) radio technology for the 5.8GHz radio chip. The new product achieves improved sensitivity. We have used this technology to introduce a DECT solution covering 1.7-1.9GHz banks with superior channel capacity for voice and data.

During 2007, we acquired the CIPT Business, strengthening our research and development capabilities with development sites in Europe and India. This business line had developed cordless and VoIP products using ARM7 and ARM9 processors and BiCMOS radio frequency technology. During 2007 and 2008, the CIPT Business focused its development efforts on the ARM9-based products, including VegaONE, a single chip cordless system solution containing the ARM9 processor, a programmable burst mode controller, power management, audio codecs, RF transceiver and power amplifier; and VegaFireBird, a powerful dual core processor suitable for VoIP-base stations and high-end terminals containing an ARM9 processor and a REAL DSP core alongside a programmable burst mode controller.

During 2008, we introduced a new generation of 1.9GHz cordless RF devices, integrating the power amplifier into the transceiver, thereby substantially reducing the cost of production for our customers by reducing the bill-of-materials cost for the devices.

Also during 2008, we implemented several actions, primarily targeting the overlap between the two cordless product lines within the company following the acquisition of the CIPT Business, to reduce research and development expenses within the company. The activities included discontinuing BiCMOS RF product development to concentrate on CMOS for cordless product lines and consolidating our system and baseband IC activities into fewer development sites within the company.

In 2008, we also launched the first generation of our XpandR family of multimedia chipset solutions, a system-on-a-chip (SoC) solution supporting both Wi-Fi, DECT and an application processor. The XpandR family of products integrates much of the company s technology from cordless applications and technologies that we acquired and developed further in-house such as the processing capability from Teleman and the Wi-Fi technology from Bermai. Concurrent with the introduction of this first generation of XpandR products to the market, we started developing a second generation of XpandR products family.

During 2009, we introduced the second generation of our XpandR family. The XpandR II chipset solution includes a powerful dual-core wireless multimedia and DECT baseband processor, an analog front end and power management unit, Wi-Fi and cordless RF chips, and comprehensive multimedia peripherals to enable the development of always-on portable, connected multimedia products. The XpandR II chipset significantly reduces cost of production for our customers by reducing the bill-of-materials cost for the targeted multimedia devices and enabling higher end applications at an optimized cost.

Also, during 2009, we launched the XceedR DCX family of chipsets combining RF and ARM9 baseband functions in a single package with a rich set of telephony features and advanced audio processing capabilities. DCX provides a cost-performance solution for mid-range DECT/DECT6.0/CAT-iq and offers a total integrated digital cordless telephone solution comprising a digital processing unit (DPU), radio frequency analog processing unit (RFAPU), hardware development kit (HDK) and software development kit (SDK).

We expect that all of the above referenced products will continue to contribute a significant share of our business in 2010. We further anticipate that new products and categories of products for home communication, including Wi-Fi application products, will start contributing to our revenues in 2010 and beyond.

Target Markets and DSP Group Products

Our work in the field of wireless residential technologies has yielded various synergistic product families targeted for specific segments of the residential communications market. We believe 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.

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The acquisition of the CIPT Business significantly enhanced our product portfolio, especially in the cordless telephony and VoIP areas, as described below.

Products Targeted for Digital Cordless Telephony

We are a world-leading provider of chipsets for cordless telephony applications. Our XceedR cordless chipsets provide a total integrated digital cordless solution that includes 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 and Latin America;
- 2.4GHz used in Japan, China and the U.S.; the dominant protocols for this RF band is our proprietary EDCT and WDCT (Wireless Digital Cordless Technology) protocols; and
- 5.8GHz used in the U.S. 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 s lowest system cost and smallest footprint. 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 is comprised of two families XceedR DE and XceedR DCX:

The XceedR DE chipset family is a mature and field-proven family of integrated digital baseband processors RF chips for digital cordless telephony. 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 DE 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, and 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 (Cordless Advanced Technology Internet and Quality) and WDCT cordless applications. Supporting all RF bands, the XceedR DCX chipset family offers a total integrated digital cordless telephone solution that includes a digital baseband controller, analog interface, RF transceiver, and power amplifier. Comprised of Flash-based chips and a full set of ROM-based products with various memory configurations, the XceedR DCX chipset family meets all digital cordless application needs.

Products Targeted for the VoIP Market

In 2004, we announced that we were developing an IP cordless phone that was anticipated to enable 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. These devices integrate all necessary DSP functionality with built-in analog front-end and support one to four channels of VoIP and FAX over IP for use in conjunction with other microprocessors to transmit VoIP-based public and private networks, including the Internet, local area networks

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(LANs), frame relay networks, DSL links, cable networks, other data networks and combined data/voice networks. Voice-over-IP refers to the transmission of voice signals over networks using the Internet protocol, which involves dividing the signals into numerous small data packets that are individually transmitted over a network and re-assembled in the correct order at their destination. This technology also can be used to implement the speech component of video conferencing applications.

In 2005, we developed an integrated CoIP telephony system that supports both PSTN line and broadband for the emerging VoIP residential market, supporting Session Initiation Protocol (SIP) 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.

In 2008, we continued to sell products for the CoIP market while developing a new platform based on ARM9, the VegaFireBird and VegaONE products, to the advanced IAD market.

The XciteR family of chipsets is based on the legacy VegaFireBird and provides embedded solutions for low-cost corded IP-phones to advanced cordless IP-phones with DECT handsets and headsets, which are based on the new XciteR DCX chipset family. Our VoIP chipset family is most suitable for enterprise IP telephony products and some of the leading vendors are already developing their IP telephones 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 ARM and DSP, Wi-Fi and DECT baseband processors and comprehensive multimedia peripherals along with companion analog front-end and power management unit, and Wi-Fi and cordless RF chips, to enable the development of always-on portable, connected multimedia products.

The XpandR solution supports a full spectrum of connected applications including web browsing, email, widgets, web radio, Picasa and YouTube uploading based on open platform frameworks such as Android. In addition, the solution supports an array of home-specific applications, including universal remote control and interactive TV controller, Digital Living Network Alliance (DLNA) client for local streaming, home automation, and monitoring and storage manager.

XpandR-I in 2008, we demonstrated the first member of the XpandR product family the DW52 chip with ARM9 and DSP in a single chip along with its companion RF ICs to support Wi-Fi a/b/g/e.

XpandR-II in 2009, we demonstrated the second member of the XpandR product family the DMW74; 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, multimedia tablets and Android cordless multimedia handsets, which represent the evolution of the cordless home phones and improve the experience of smartphones for home users.

XpandR-III: the DMW96 the third generation XpandR processor is expected to be sampled during 2010. DMW96 is a state-of-the-art system-on-a-chip (SoC) that features an advanced low-power media system that integrates smart acceleration engines to deliver high-definition video, image processing, 2D/3D graphics, as well as a dedicated security controller and 802.11n that will complement a full offering for converged voice, data, audio and video processor chip a chip that is targeted at low bit rate video applications, such as those based on H.263, JPEG and MPEG4 compression standards. DMW96 includes a complete stand-alone system, including direct image sensor and display interfaces, as well as an advanced video compression engine. Target applications include video telephony, home security and portable multimedia. DMW96 can be used in a system with our cordless chipsets to provide wireless video transmission.

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Products Targeted for the Digital Voice Recorder

We developed a DVR that integrates the TeakLiteDSPCore® to enable many different speech compression rates at the highest possible quality. During 2005, we developed and released an integrated DVR with MP3 playback and USB dongle connectivity for voice recording application for personal and business use. We continued to ship our DVR products to major brand name manufacturers in Japan and Korea in 2009.

Customers

We sell our products primarily through distributors and directly to original equipment manufacturers (OEMs) and ODMs who incorporate our products into consumer products for the worldwide residential wireless communications market. In 2009, 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, Deutsche Telekom, Doro, France Telecom, Freebox, Gaoxinqi, GE, Giant Electronics, Global China Technologies, Grandstream, Hagenuk, Huawei, Intelbras, JXE, Korea Telecom, KPN, LG Electronics, Matsushita, Motorola, NEC, NTT, OpenPeak, Panasonic, Philips, Pioneer, Plantronics, Sagem, Samsung, Sanyo, SGW, Sharp, Siemens (Gigaset), SK Telesys, Sony, Swisscom, TCL, Telecom Italia, Telefonica, Telstra, Thomson, Topcom, Uniden, Urmet, Verizon, VTech, WNC, Xingtel and Yamaha.

International Sales and Operations

Export sales accounted for 98% of our total revenues for 2009, 92% for 2008 and 98% for 2007. 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, 2009, 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 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 and Swiss Franc, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the Euro and the Swiss Franc. Our primary expenses paid in Euro and Swiss Franc are employee salaries and lease and operational payments on our European facilities. As a result, an increase in the value of the Euro and Swiss Franc 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; Zurich, Switzerland; 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. Sales to Hong Kong-based VTech represented 29% of our total revenues for 2009, 21% for 2008 and 10% in 2007. Revenues derived from sales through our Japanese distributor, Tomen Electronics, represented 22% of our total revenues for 2009, 25% for 2008 and 37% for 2007. Furthermore, 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%, 13% and 23% of our revenue in 2009, 2008 and 2007, respectively. Sales through Tomen Electronics or directly to Uniden represented 12%, 13% and 13% of our total revenues in 2009, 2008 and 2007 respectively. Sales to Hong Kong-based CCT Telecom represented 8%, 9% and 12% of our total revenues for 2009, 2008 and 2007, 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. This trend can be generally observed from reviewing our quarterly information and results of operations.

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 at agreed upon prices for up to seven years following the closing of the Acquisition. The services are provided on a purchase order basis. The agreement also sets forth specified capacity guarantees by NXP, logistics for our provision of production schedules, our purchase obligations, penalties for late/non delivery by NXP 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.

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 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. We also may encounter capacity shortage issues in the future if sales for the CIPT Business products continue to increase as we anticipate and NXP cannot sufficiently meet our increasing demands. 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, 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 MSCA, NXP s manufacturing of certain CIPT Business products would expire in 2010, subject to our ability to extend the period for two consecutive one-year terms under specified circumstances. Upon expiration as a result of our inability to extend the manufacturing period by NXP, we may experience difficulty in finding a suitable replacement manufacturer for these 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 certain of our product fabrication services for speech and telephony processors and RF devices mainly 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 digital speech processors, cordless devices and other products for the consumer telephony and computer telephony 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, KYEC, SPIL and Giga.

Furthermore, our IDT speech processor 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 IDT speech processors, which could in turn harm our business, financial condition and results of operations.

Competition

The markets in which we operate are extremely competitive, and we expect that competition will continue to increase. In each of our business activities, we face current and potential competition from competitors that have sometimes significantly greater financial, technical, manufacturing, marketing, sales and distribution resources and management expertise than we do. Our future prospects will depend greatly on our ability to successfully develop and introduce new products that are responsive to market demands. We cannot assure you that we will be able to successfully develop or market new products.

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 (formerly Infineon) and SiTel (formerly the DECT division of National Semiconductor). 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, Infineon, SiTel, 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 2009 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, 2009, we had a staff of 256 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 $56.1 million in 2009, $73.9 million in 2008 and $58.5 million in 2007 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, 2009, we have been granted a total of 138 patents, including 82 United States patents, 1 Canadian patent, 7 Israeli patents, 4 Japanese patents, 6 German, French and Great Britain patents, 2 Italian patents and 1 Taiwanese patent. We have a total of over 110 pending patents, out of which 5 patent applications have been approved and are pending publication, 45 patents are pending in the United States, 21 patents are pending in Europe (PCT), 18 patents are pending in Japan and 6 patents are pending in Korea.

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.

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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. For example, in a lawsuit against Microsoft Corporation, AT&T asserted that our TrueSpeech 8.5 algorithm includes certain elements covered by a patent held by AT&T. AT&T sued Microsoft, one of our TrueSpeech 8.5 licensees, for infringement. We were not named in AT&T s suit against Microsoft. 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, 2009, our backlog was approximately $48.7 million, compared to approximately $35.1 million and $75.8 million at December 31, 2008 and 2007, 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, 2009, we had 409 employees, including 256 in research and development, 64 in marketing and sales and 89 in corporate, administration and manufacturing coordination. Competition for personnel in the semiconductor and personal computer industries 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 majority of our total revenues for 2009. Specifically, sales of our DECT, 2.4GHz, 5.8GHz and CoIP products comprised 92% of our total revenues for 2009, 89% for 2008 and 86% for 2007. Revenues from our DECT products represented 77%, 70% and 38% of our total revenues for 2009, 2008 and 2007, respectively. Revenues from our 2.4GHz and 5.8GHz products represented 12% and 2%, respectively, of our total revenues for 2009, 13% and 6%, respectively, of our total revenues for 2008 and 19% and 24%, respectively, of our total revenues for 2007. We believe U.S. sales of our 2.4GHz and 5.8GHz products will continue to decrease in 2010.

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 intensive 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, sale 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, 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 projected 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. This decrease in demand 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 62% of our total revenues for 2009, 56% in 2008 and 58% in 2007. Sales to VTech represented 29%, 21% and 10% of our total revenues for 2009, 2008 and 2007, respectively. Sales to Panasonic represented 13%, 13% and 23% of our total revenues for 2009, 2008 and 2007, respectively. Sales to Uniden represented 12% of total revenues for 2009 and 13% of our total revenues for both 2008 and 2007. Sales to CCT Telecom represented 8%, 9% and 12% of total revenues for 2009, 2008 and 2007, respectively. 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 current global economic downturn 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.

We sell our products to customers primarily through a network of distributors. Particularly, revenues derived from sales through our Japanese distributor, Tomen Electronics, accounted for 22% of our total revenues for 2009, 25% for 2008 and 37% for 2007. 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%, 13% and 23% of our total revenues for 2009, 2008 and 2007, respectively. 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 DECT and XpandR 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.

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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.

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 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. As an example, our gross margin for 2009 was 37.0%, as compared to 37.3% and 40.5% in 2008 and 2007, respectively. 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.

Our gross margins also are affected by the product mix. For example, DECT products have lower average gross margins than 5.8GHz and 2.4GHz products and the increased sales of DECT products lower our gross margins. We anticipate that the shift to DECT 6.0 products in the U.S. market will continue in 2010. This trend will continue to put pressure on our gross margins.

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. 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 98% of our total revenues for 2009, 92% for 2008 and 98% for 2007. Furthermore, pursuant to the acquisition of the CIPT Business from NXP, we established new foreign subsidiaries, and currently have material operations, in Germany, Switzerland, 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

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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.

Because we depend on independent foundries to manufacture 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 by independent foundries. While these foundries have been able to adequately meet the demands of our increasing business, we are and will continue to be dependent upon these foundries to achieve acceptable manufacturing yields, quality levels and costs, and to allocate to us a sufficient portion of their foundry 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, we may encounter capacity shortage 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 or we may incur additional costs to ensure specified quantities of products and services. Over-capacity at the current foundries we use, or future foundries we may use, to manufacture our integrated circuit 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. 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 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.

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.

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Because we depend on NXP to manufacture all of our products for the CIPT Business, we are subject to additional risks that may materially disrupt our business.

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 the CIPT Business products for up to seven years following the closing of the Acquisition at predetermined costs. Products from the CIPT Business (e.g, DECT and Voice-over-Internet Protocol (VoIP) products) currently represent a substantial portion of our total revenues and are anticipated to continue to generate significant revenues for the company in future periods. While NXP has been able to generally meet our manufacturing demands to date, in some cases NXP has failed to meet its required delivery schedule and may be subject to late delivery penalties as a result. These late deliveries have not adversely impacted our ability to satisfy our customers requirements in a timely manner. Our business also could be materially harmed if NXP 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 provision of manufacturing services to NXP s internal business units or other third parties. We also may encounter capacity shortage issues in the future if sales for the CIPT Business products continue to increase as we anticipate and NXP cannot sufficiently meet our increasing demands. 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, some of whom we recently established relationships as a result of the acquisition, 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, including due to financial or operational hardships within NXP as a result of the cyclical nature of the 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.

Additionally, in order to enable NXP to provide the specified manufacturing, pre-testing, assembling and final-testing services relating to the CIPT Business products to us, 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. If we fail to meet our capacity commitments due to errors in planning logistics, a decrease in forecast from our customers or other reasons, we may be subject to such monetary penalties.

Moreover, in accordance with the MSCA, NXP s manufacturing of certain CIPT Business products would expire in 2010, subject to our ability to extend the period for two consecutive one-year terms under specified circumstances. Upon expiration as a result of our inability to extend the manufacturing period by NXP, we may experience difficulty in finding a suitable replacement manufacturer for these 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.

Furthermore, NXP s assembly and testing facility in the Philippines, where some of our products were assembled and tested by NXP pursuant to the manufacturing agreement, has been sold to STMicroelectronics. Our business also would be materially harmed if NXP cannot fulfill its assembly and testing services for the specified products as a result of the sale. There are inherent and unforeseen risks and delays associated with the transfer of assembly and testing capacities from one facility to another.

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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. These conditions made and continue to make it extremely difficult for our customers, the end-product customers, our vendors and us to accurately forecast and plan future business activities and make reliable projections. Furthermore, during challenging economic times our customers may face various economic issues, including reduced demand for their products, longer product cycles, inability to gain timely access to sufficient credit, focus on cash preservation and tighter inventory management, all of which could result in an impairment of their ability to make timely payments to us and could cause reduced spending on our products. In 2009, we experienced a decrease of 31% in total revenues from 2008. Although business conditions improved during the second half of 2009, that trend may not continue.

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 persist, spread or deteriorate further, 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.

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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.

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, 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 platform that integrates DECT and Wi-Fi capabilities to enable multimedia and web-related applications in our future products. Our future growth is dependent on market acceptance and penetration of the XpandR-based products, for which we can provide no assurances. Our inability to penetrate the market or lack of customer acceptance of these products may harm our business and potential growth.

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 of NXP s CIPT Business, 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.

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

We believe 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 projected 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 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.

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.

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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, 2009, 268 of our 409 employees were located in Israel, including 180 out of 256 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, and as amended. The Investment Law provides that capital investments in a production facility (or other eligible assets) may be designated as an Approved Enterprise. Under that law, we receive certain tax benefits in Israel. 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 to 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 2010) and could be required to refund tax benefits already received. We cannot assure you that such grants and tax benefits will be continued in the future at their current levels, if at all. The tax benefits under these investment plans are scheduled to gradually expire by 2015. The termination or reduction of certain programs and tax benefits (particularly benefits available to us as a result of the Approved Enterprise status of our facilities and programs) or a requirement to refund tax benefits already received may have a material adverse effect on our business, operating results and financial condition.

On April 1, 2005, an amendment to the Investment Law came into effect. The amendment revised the criteria for investments qualified to receive tax benefits. An eligible investment program under the amendment will qualify 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 simplifies 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. We believe that we 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% for 2010). We also could be required to refund tax benefits, with interest and adjustments for inflation based on the Israeli consumer price index.

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.

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. For example, in a lawsuit against Microsoft Corporation, AT&T asserted that our TrueSpeech 8.5 algorithm includes certain elements covered by a patent held by AT&T. AT&T sued Microsoft, one of our TrueSpeech 8.5 licensees, for infringement. We were not named in AT&T s suit against Microsoft. 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

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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.

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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. Furthermore, as part of the acquisition of the CIPT Business from NXP, we increased our customer base with new customers in Europe and Asia. 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 of the CIPT Business from NXP, we currently have operations in Germany, Switzerland, 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. In 2009 and 2010, President Obama s administration 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.

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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 98% of our total revenues 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, due to the acquisition of the CIPT Business from NXP, a portion of our expenses for our European operations are paid in the Euro and Swiss Franc, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the Euro and Swiss Franc. Our primary expenses paid in the Euro and Swiss Franc are employee salaries, lease and operational payments on our European facilities. As a result, an increase in the value of the NIS, Euro and Swiss Franc 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 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.

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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 (formerly Infineon) and SiTel (formerly the DECT division of National Semiconductor). Our principal competitors in the VoIP market include Broadcom, Infineon, SiTel, 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.

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.

Our certificate of incorporation and bylaws contain anti-takeover provisions that 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. It is possible that these provisions may prevent or discourage third parties from acquiring us, even if the acquisition would be beneficial to our stockholders. 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 2011. Portions of our operations are located in leased facilities in Rancho Cordova, California; Colorado Springs, Colorado; and Bloomington, Minnesota. These facilities are leased through 2011. Our operations in Israel are located in leased facilities, with the primary leased facility of approximately 58,136 square feet located in Herzelia Pituach, Israel. These facilities are leased through November 2013. The Company s subsidiary in Tokyo, Japan has a lease that terminates in October 2010. The Company s subsidiary in Scotland has lease agreements for its facilities that terminate in 2010. The Company s subsidiaries in Germany, India and Switzerland, primarily housing the CIPT Business acquired from NXP, have sublease agreements with NXP for their facilities that terminate from 2010 through 2012. In addition, the Company s subsidiary in Hong Kong entered into a lease agreement that is effective until 2010. 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. For example, in a lawsuit against Microsoft Corporation, AT&T asserted that our TrueSpeech 8.5 algorithm includes

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certain elements covered by a patent held by AT&T. AT&T sued Microsoft, one of our TrueSpeech 8.5 licensees, for infringement. We were not named in AT&T s suit against Microsoft. 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. RESERVED.

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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:

Year Ended December 31, 2009	High	Low
First Quarter	8.54	3.83
Second Quarter	7.86	4.09
Third Quarter	9.41	6.74
Fourth Quarter	8.43	5.27

Year Ended December 31, 2008	High	Low
First Quarter	13.18	9.305
Second Quarter	14.16	6.67
Third Quarter	8.41	6.70
Fourth Quarter	8.07	4.64

As of March 10, 2010, there were 23,125,431 shares of common stock outstanding, representing approximately 47 holders of record. There were we believe approximately 2,962 beneficial holders as of February 18, 2010. 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 24, 2010. 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

There were no repurchases of our common stock pursuant to our board authorized share repurchase program during the fourth quarter of 2009.

In March 1999, our board of directors authorized the repurchase of up to 4.0 million shares of our common stock. In July 2003, October 2004, January 2007 and January 2008, our board authorized an additional 2.5 million shares, 2.5 million shares, 3.0 million shares and 2.9 million shares of our 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, our 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 our common stock authorized for repurchase, which plan expired in October 2008.

At December 31, 2009, 255,488 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 24, 2010. 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.

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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, 2004 and ends on December 31, 2009, the end of our last fiscal year. The graph assumes an investment of $100 on December 31, 2004, and the reinvestment of any dividends.

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.

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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, 2009, 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,				
	2009	2008	2007	2006	2005
	(U.S. dollars in thousands)				
Statements of Operations Data:					
Revenues	$ 212,186	$ 305,800	$ 248,788	$ 216,948	$ 187,225
Cost of revenues	133,590	191,811	148,075	128,559	101,074
Gross profit	78,596	113,989	100,713	88,389	86,151
Operating expenses					
Research and development	56,148	73,856	58,488	47,525	40,290
General, administrative, sales and marketing	33,117	40,583	33,674	27,443	20,517
In process research and development write-off			10,350		
Amortization of intangible assets	12,258	22,853	11,102		
Impairment of goodwill and other intangible assets		181,534			
Restructuring cost		1,870			
Total operating expenses	101,523	320,696	113,614	74,968	60,807
Operating (loss) income	(22,927)	(206,707)	(12,901)	13,421	25,344
Financial and other income					
Financial income, net	2,857	160	10,541	13,198	10,166
Income (loss) before taxes on income (loss)	(20,070)	(206,547)	(2,360)	26,619	35,510
Taxes on income (loss)	(11,634)	5,847	2,393	4,240	6,037
Net income (loss)	$ (8,436)	$ (212,394)	$ (4,753)	$ 22,379	$ 29,473
Weighted average number of Common Stock outstanding during the period used to compute basic net earnings per share	23,655	28,387	29,495	29,343	28,435
Weighted average number of Common Stock outstanding during the period used to compute diluted net earnings per share	23,655	28,387	29,495	30,049	29,843
Basic net earnings (loss) per share	$ (0.36)	$ (7.48)	$ (0.16)	$ 0.76	$ 1.04
Diluted net earnings (loss) per share	$ (0.36)	$ (7.48)	$ (0.16)	$ 0.74	$ 0.99
Balance Sheet Data:					
Cash, cash equivalents, marketable securities and bank deposits	$ 123,065	$ 121,501	$ 167,737	$ 348,882	$ 345,216
Working capital	$ 68,013	$ 92,359	$ 134,896	$ 169,760	$ 145,745
Total assets	$ 219,769	$ 249,254	$ 512,843	$ 413,988	$ 400,005
Total stockholders equity	$ 165,489	$ 178,627	$ 424,857	$ 366,749	$ 349,134

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	Year Ended December 31,							
Fiscal Years by Quarter	2009				2008			
Quarterly Data:	4th	3rd	2nd	1st	4th	3rd	2nd	1st
	(Unaudited, U.S. dollars in thousands, except per share amount)							
Revenues	$ 54,720	$ 65,532	$ 52,020	$ 39,914	$ 71,551	$ 87,368	$ 74,152	$ 72,729
Gross profit	$ 21,381	$ 24,725	$ 19,080	$ 13,410	$ 28,201	$ 32,866	$ 25,969	$ 26,953
Net Income (loss)	$ (2,871)	$ 6,803	$ (1,677)	$ (10,691)	$ (194,401)	$ (3,030)	$ (7,355)	$ (7,608)
Net earnings (loss) per share Basic	$ (0.13)	$ 0.30	$ (0.07)	$ (0.41)	$ (7.23)	$ (0.11)	$ (0.26)	$ (0.25)
Net earnings (loss) per share Diluted	$ (0.13)	$ 0.29	$ (0.07)	$ (0.41)	$ (7.23)	$ (0.11)	$ (0.26)	$ (0.25)

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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.

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 92% of our total revenues for 2009.

In September 2007, we acquired the CIPT Business of 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 business operates in a highly competitive environment. Our revenues were $212.2 million for 2009, a decrease of 31% in comparison to 2008. During 2009, sales of our DECT 6.0 products in the U.S. market increased from $71.9 million in 2008 to $78.8 million in 2009. We believe that sales of our DECT 6.0 products in the U.S. market will continue to increase. Competition has historically increased pricing pressures for our products and decreased our average selling prices, and we believe this trend will continue. Our gross margin decreased to 37.0% of total revenues for 2009 from 37.3% for 2008, primarily due to the decline in overall revenues, the continued decline in average selling prices of our products, and increased sales of DECT products with lower gross margins in lieu of 5.8GHz and 2.4GHz products with higher gross margins. In addition to general market competitiveness, the cordless telephony market 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. As a result, we expect the market to remain price sensitive and expect price erosion to continue. Moreover, 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, all may decrease our gross profit in future periods. The market downturn that started during the second half of 2008 and continued throughout 2009 also resulted in a significant downturn of the semiconductor industry, the industry in which we operate. Moreover, our semiconductor OEM customers incorporate our chipsets into consumer electronics products, the demand for which significantly slowed in 2009 due to the economic downturn and decreased consumer confidence. Furthermore, the continued uncertainty with global economic conditions and outlook has resulted in a decrease in product demand, excess customer inventories, accelerated erosion of prices, longer product cycles and decision-making processes at our customers organizations, reduced corporate profits and capital, liquidity concerns and general adverse business conditions. Notwithstanding these challenges, we remain optimistic about a recovery in 2010 and currently anticipate that our revenues and gross profit will be higher in 2010 as compared to 2009, mainly due to our launch of new products and operational efficiencies.

We had operating losses of $22.9 million for 2009, compared to $206.7 million for 2008. The decrease in operating losses for 2009 was primarily attributable to (i) the impairment and amortization of intangible assets related to the Acquisition in the amount of $204.4 million for 2008, in comparison to $12.3 million for 2009, (ii) a decrease in expenses related to research and development in 2009 as compared to 2008, mainly due to the shut down of, or reduction in capacity and the number of employees at, some of our sites as part of our restructuring and (iii) restructuring expenses in the amount of $1.87 million for 2008 in comparison to no such expenses incurred for 2009. The above decreases were offset to some extent by the decrease in revenues in 2009 as compared to 2008. Operating expenses decreased by 68% in 2009 compared to 2008, reaching a level of $101.5 million. The decrease in operating expenses was mainly due to the same factors as noted above for the decrease in operating losses.

In addition to the highly competitive environment in which we operate, we believe there are also several emerging market trends that challenge our continued business growth potential. For example, the rapid deployment of new communication access methods, including mobile, wireless broadband, cable and other connectivity, as well as the projected lack of growth in products using fixed-line telephony, may reduce our revenues derived from, and unit sales of, cordless telephony products, which are currently our primary focus. Our business also may be affected by the outcome of the current 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.

Nonetheless, we recognize the competitive landscape and are actively engaged in addressing these market challenges and trends. We decreased our operating expenses by 68% to $101.5 million for 2009 as compared to 2008. Our operating losses also decreased to $22.9 million for 2009 as compared to $206.7 million for 2008. Revenues derived from the sale of DECT products represented 77% of our total revenues for 2009 as compared to 70% of our total revenues for 2008. We are also concentrating our development efforts on a new cordless telephony DECT standard, the CAT-iq protocol, which stands for Cordless Advanced Technology: Internet and Quality. CAT-iq has been widely embraced by all leading European operators, and we believe that this technology will also proliferate into other regions that have adopted DECT telephony, such as the U.S. This new standard is anticipated to enable the introduction of new cordless products into the market as telecom operators have begun deploying home gateways and mobile handsets with CAT-iq in the market. In addition to DECT technologies, we are investing in developing CoIP (Cordless over IP) technologies in-house. Our goal is to leverage the Wi-Fi technology acquired in 2004 from Bermai Inc. to further develop and offer products for residential communication that integrate voice, data and video with broadband offerings. We already introduced to the market the XpandR platform that integrates DECT and Wi-Fi capabilities to enable multimedia and web-related applications in our future products. In 2010, our third generation of the XpandR platform will be sampled by potential customers. However, our success in introducing new products and penetrating new markets may not occur and may require us to substantially increase our operating expenses. As a result, our past operating results should not be relied upon as an indication of future performance.

As of December 31, 2009, our principal source of liquidity consisted of cash and cash equivalents of $38.0 million and marketable securities and short and long term deposits of $85.0 million, totaling $122.9 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 3, Significant Accounting Policies, of the Notes to Consolidated Financial Statements, included in Item 8, Financial Statements and Supplementary Data, of this Annual Report on Form 10-K.

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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.

Description	Judgments & Uncertainties	Effect if Actual Results Differ from Assumptions
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. 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.	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. According to FASB ASC No. 740, 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.	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.
Tax Valuation Allowance: The Company has 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.	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.	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.
Other Intangible Assets: The identifiable intangible assets included on our balance sheet are current technology and customer relations, acquired from NXP as a result of the Acquisition. We review goodwill and other intangible assets for potential impairment annually during the	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 profitability of future business	If our estimates or their related assumptions change in the future, we may be required to record additional impairment charges for our intangible assets.

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Description	Judgments & Uncertainties	Effect if Actual Results Differ from Assumptions
second quarter of each fiscal year and when events or changes in circumstances indicate the carrying value of the goodwill or other 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. We review other intangible assets for potential impairment when events or changes in circumstances indicate the carrying value of the other intangible assets may be impaired. In such an event, 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.	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.	
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.	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.	If actual results are not consistent with our assumptions and judgments, we may be exposed to gains or losses that could be material.
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 three fiscal years.	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.	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.

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Description	Judgments & Uncertainties	Effect if Actual Results Differ from Assumptions
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.	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.	Although management believes that their estimates and judgments about equity-based compensation expense are reasonable, actual results could differ.
Pension Liability: We account for pension liability in accordance with FASB ASC No. 715 Defined Benefit Plans.	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.	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.
Business Combination: In September 2007, we acquired the assets and assumed the liabilities of the CIPT Business for approximately $270 million. The Acquisition was accounted in accordance with business combination accounting. We allocated the purchase price of the CIPT Business to tangible and acquisition-related intangible assets acquired and liabilities assumed, as well as to in-process research and development, based on their estimated fair values.	We make estimates of fair value using reasonable assumptions based on historical experience and information obtained from the management of NXP in order to allocate the purchase price to the tangible and intangible assets. Assumptions are also made regarding the estimated useful life of the intangible assets.	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.

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Description	Judgments & Uncertainties	Effect if Actual Results Differ from Assumptions
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.	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.	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.

Results of Operations:

Total Revenues. Our total revenues were $212.2 million in 2009, $305.8 million in 2008 and $248.8 million in 2007. The decrease of 31% in revenues for 2009 as compared to 2008 was primarily as a result of decreased sales of our products mainly due to the significant global economic downturn that started during the second half of 2008 and continued throughout 2009, and the continued decline in the average selling prices of our products. The increase in 2008 revenues in comparison to 2007 was primarily as a result of the inclusion of the revenues of the CIPT Business from the beginning of the year in 2008 in comparison to its inclusion as of September 4, 2007, the date of the completion of the Acquisition. Sales of DECT products were $163.2 million, $213.2 and $95.7 million for the years ended 2009, 2008 and 2007, respectively, representing approximately 77%, 70% and 38% of our total revenues for 2009, 2008, and 2007, respectively. This represents a decrease of 23% in absolute dollars in 2009 as compared 2008, which was mainly attributable to the general decrease in sales of all of our products in the European market. The increase in sales of DECT products from 2007 to 2008 was mainly attributable to the consolidation of the results of the CIPT Business within our combined results beginning on September 4, 2007 and the shift in sales from 2.4GHz and 5.8GHz products to DECT 6.0 products in the U.S. market. Sales of 2.4GHz products were $25.8 million, $38.5 million and $47.4 million for 2009, 2008 and 2007, respectively, representing 12%, 13% and 19% of our total revenues for 2009, 2008 and 2007, respectively. This represents a decrease of 33% in absolute dollars in 2009 as compared 2008. Sales of 5.8GHz products were $3.9 million, $18.3 million and $60.5 million for 2009, 2008 and 2007, respectively, representing approximately 2%, 6% and 24% of our total revenues for 2009, 2008 and 2007, respectively. This represents a decrease of 79% in absolute dollars in 2009 as compared 2008. The decrease in percentage of revenues and absolute dollars for the comparable periods relating to our 2.4GHz and 5.8GHz products was mainly attributable to the shift in sales of those products to DECT 6.0 products in the U.S. market. Revenues from CoIP products were $3.2 million, $1.7 million and $10.0 million for the years ended in 2009, 2008 and 2007, respectively. Sales of CoIP products represented approximately 1%, 1% and 4% of our total revenues for 2009, 2008 and 2007, respectively. This represents an increase of 88% in absolute dollars in 2009 as compared 2008.

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The following table shows the breakdown of revenues for the periods indicated by geographic location (in thousands):

	Year Ended December 31,		
	2009	2008	2007
United States	$ 3,382	$ 23,579	$ 6,132
Japan	71,388	108,471	122,832
Europe	15,448	31,724	18,657
Hong Kong	95,204	120,175	89,748
Korea	20,233	11,922	5,248
Other	6,531	9,929	6,171
Total revenues	$ 212,186	$ 305,800	$ 248,788

The decreased sales of our products to the above referenced geographic locations for 2009 as compared to 2008 primarily resulted from decreased sales to customers in those locations mainly due to the significant global economic downturn that started during the second half of 2008 and continued throughout 2009, and the continued decline in the average selling prices of our products.

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. This trend can be generally observed from reviewing our quarterly information and results of operations. However the magnitude of this trend varies annually.

Significant Customers. VTech is a significant OEM customer based in Hong Kong. Sales to VTech represented 29%, 21% and 10% of our total revenues for 2009, 2008 and 2007, respectively. The increase was primarily due to the decrease in overall revenues for 2009, which increased the percentage of revenues attributable to VTech of our total revenues for 2009. Another significant customer of the company in Hong Kong is CCT Telecom, whose sales represented 8%, 9% and 12% of our total revenues for 2009, 2008 and 2007, 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, accounted for 22% of our total revenues in 2009, as compared to 25% in 2008 and 37% in 2007. The sales decrease for the comparable periods was primarily due to a decrease in absolute dollars of sales to Panasonic and the Japanese domestic market.

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%, 13% and 23% of our total revenues in 2009, 2008 and 2007, respectively. Sales through Tomen Electronics or directly to Uniden represented 12%, 13% and 13% for 2009, 2008 and 2007, 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.

The loss of a significant customer, or reduced demand for products from, or the reduction in purchasing capability of, one of our 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 77%, 70% and 38% of our total revenues for 2009, 2008 and 2007, respectively. Revenues from our 2.4GHz and 5.8GHz products represented 12% and 2%, respectively, of our total revenues for 2009, 13% and 6%, respectively, of our total revenues for

2008, and 19% and 24% respectively of our total revenues for 2007. We believe that sales of DECT and 2.4GHz products will continue to represent a substantial percentage of our revenues for 2010. However, we believe that U.S. sales of our 2.4GHz and 5.8GHz products will decrease in 2010. We believe 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 products, for the long term.

Gross Profit. Gross profit as a percentage of revenues was 37.0% in 2009, 37.3% in 2008 and 40.5% in 2007. The decrease in our gross profit for 2009 as compared to 2008 was primarily due to the decline in overall revenues, the continuing decline in the average selling prices of our products and increased sales of DECT products with lower average gross margins on account of 5.8GHz and 2.4GHz products with higher average gross margins. The decrease was offset to some extent by savings realized from the shut down of, or reduction in capacity at, some of our sites as part of our restructuring plans, manufacturing cost reductions, improvements in our yield percentages and by achieving a higher level of product integration. 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. One approach we are using to offset the expected decrease in gross profit is offering our customers bare-die chips that eliminate assembly and testing services in return for lower selling prices to our customers. Other steps we are taking include the implementation of cost improvement plans to reduce testing costs and offering our customers more cost effective products. 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 $101.5 million in 2009, $320.7 million in 2008 and $113.6 million in 2007. The decrease in operating expenses for 2009 as compared to 2008 was primarily attributable to (i) impairment of goodwill and other intangible assets related mainly to the Acquisition in the amount of $181.5 million in 2008, (ii) a decrease in the amortization cost for intangible assets related to the Acquisition in the amount of $10.6 million, resulting from the recording of impairment costs related to such intangible assets in 2008 which decreased the original cost of such intangible assets for future amortization measurement, including in 2009, (iii) a decrease in payroll and facilities expenses related to research and development, resulting from our restructuring plans, which included a reduction in the numbers of employees and the shut-down of some of our sites, (iv) a decrease in sales commissions due to decreased sales for 2009, and (v) a decrease in equity-based compensation expenses. Our operating losses were $22.9 million in 2009, as compared to $206.5 million of operating losses in 2008 and $12.9 million of operating losses in 2007. The decrease in operating losses was mainly due to the decrease in operating expenses as noted above, offset to some extent by the decrease in overall revenues and gross margin.

Research and Development Expenses. Our research and development expenses decreased to $56.1 million for 2009 from $73.9 million for 2008. Research and development expenses increased to $73.9 million in 2008 from $58.5 million in 2007. The decrease for 2009 in research and development expenses, as compared to 2008, was mainly attributed to (i) savings of $13.9 million for 2009 as a result of the shut-down of, or reduction in capacity and the number of employees at, some of our sites as part of our restructuring plans,

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(ii) a devaluation of the New Israeli Shekel (NIS) against the U.S. dollar which reduced the research and development expenses attributable to our Israeli facilities and employees, (iii) a decrease in equity-based compensation expenses by $2.0 million for 2009 as compared to 2008, and (iv) a decrease in other expenses such as travel expenses for 2009 as compared to 2008. Equity-based compensation expenses amounted to $5.3 million for 2009. The above referenced expense decreases were offset to some extent by an increase in IP purchases and tapeout expenses in 2009 as compared to 2008.

The increase in research and development expenses in 2008 as compared to 2007 was mainly attributed to (i) the inclusion of the expenses of the CIPT Business in the combined results for all of 2008, as compared to the inclusion of such expenses since September 4, 2007 for 2007; (ii) an increase in IP and tape-out expenses; (iii) an increase in labor expenses related to research and development due to the increase in the number of employees, as well as increases in salary, and (iv) the devaluation of the U.S. dollar against the NIS for 2008, as compared to 2007, that increased our salaries and other expenses for our Israeli employees and facilities. Equity-based compensation expenses amounted to $7.2 and $7.1 million for 2008 and 2007, respectively. The above-referenced increases were partially offset by a decrease in other project-related expenses in 2008 as compared to 2007.

Our research and development expenses as a percentage of our total revenues were 26%, 24% and 24% for 2009, 2008 and 2007, respectively. The increase in research and development expenses as a percentage of our total revenues in 2009 as compared to 2008 was due to the decrease in absolute dollars of our total revenues for 2009 as compared to 2008.

Research and development expenses consist mainly of payroll expenses to employees involved in research and development activities, expenses related to IP purchases, 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 $17.9 million for 2009, $22.7 million for 2008 and $19.1 million for 2007. The decrease in sales and marketing was mainly attributed to (i) a decrease in sales commissions paid due to a lower level of revenues subject to sales commissions for 2009 as compared to 2008, (ii) a decrease in payroll expenses due to a lower number of sales and marketing employees and contractors, partially as a result of our restructuring plans, and (iii) the devaluation of the NIS against the U.S. dollar.

The increase in sales and marketing expenses between 2007 and 2008 was mainly a result of the inclusion of the expenses of the CIPT Business in the combined results for all of 2008, as compared to the inclusion of such expenses since September 4, 2007 for 2007. The increase in our sales and marketing expenses in 2008 in comparison to 2007 was partially offset by a decrease in sales commission due to a lower level of revenues subject to commissions, and a decrease in the average commission.

Our sales and marketing expenses as a percentage of our total revenues were 8%, 7% and 8% for 2009, 2008 and 2007, respectively. The increase in sales and marketing expenses as a percentage of our total revenues for 2009 was due to the decrease in absolute dollars of our total revenues in 2009 as compared to 2008.

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 $15.2 million, $17.9 million and $14.6 million for 2009, 2008 and 2007 respectively. The decrease in general and administrative expenses was mainly attributed to (i) a decrease in equity-based compensation expenses of $0.8 million for 2009 as compared to 2008, (ii) operational savings as a result of the shut-down of some of our sites as part of our restructuring plans, (iii) a decrease in other expenses such as accounting and legal expenses for 2009 as compared to 2008, and (iv) the devaluation of the NIS against the U.S. dollar.

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The increase in general and administrative expenses for 2008 as compared to 2007 was mainly a result of the inclusion of the expenses of the CIPT Business in the combined results for all of 2008, as compared to such expenses included since September 4, 2007 for 2007. One additional factor that increased general and administrative expenses was higher professional fees for 2008, as compared to the same periods in 2007. The increase in general and administrative expenses for 2008 was partially offset by a decrease related to equity-based compensation expense. Equity-based compensation expense amounted to $4.1 million and $4.6 million for 2008 and 2007, respectively.

General and administrative expenses as a percentage of our total revenues were 7% in 2009 and 6% in both 2008 and 2007. The increase in general and administrative expenses as a percentage of our total revenues was due to the decrease in absolute dollars of our total revenues in 2009 as compared to 2008.

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 2009, 2008 and 2007, we recorded an expense item of approximately $12.3 million, $22.8 million and $11.1 million, respectively, relating to the amortization of intangible assets associated with the Acquisition. The decrease in 2009 as compared to 2008 was due to the impairment costs of such intangible assets in 2008, which reduced the basic cost of such intangible assets and therefore the future amortization cost of such intangible assets, including in 2009. The increase from 2007 as compared to 2008 was due to the inclusion of the amortization expense for the full year 2008 as compared to the inclusion of such expense since September 4, 2007 for 2007.

Impairment of Goodwill and Other Intangible Assets. In the fourth quarter of 2008, we performed an additional impairment test due to indicators that occurred subsequent to our second quarter 2008 annual impairment test. Indicators we considered important which could trigger an impairment include, but are not limited to, significant underperformance relative to historical or projected future operating results, significant changes in the manner of use of the acquired assets or the strategy for our overall business, significant negative industry or economic trends, a significant decline in our stock price for a sustained period and our market capitalization relative to net book value. We determined, based on the valuation conducted during the fourth quarter of 2008, that goodwill, trade name and trademark acquired in the Acquisition, were impaired and that there was partial impairment of our other intangible assets, namely current technology and customer relations. The impairment was prompted primarily by the continued deterioration in market conditions in general and the decrease in our projected income for future periods. As a result, we recorded an expense item in the amount of approximately $181.5 million related to the impairment of goodwill and other intangible assets. $142.4 million of impairment was allocated to goodwill and $39.1 million was allocated to other intangible assets. No impairment loss was recorded in 2009.

Restructuring Costs and Other. During the third quarter of 2008, we initiated an additional restructuring plan, subsequent to our initial restructuring plan following the Acquisition, to improve operating efficiency at our various operating sites and to reduce our operating expenses for 2009. The restructuring plan was completed as of June 30, 2009. As a significant majority of the restructuring associated with the additional restructuring plan occurred during the third quarter of 2008, we recognized an expense in the amount of $1.87 million, mainly for employee contract termination costs. This expense amount is net of $0.54 million of gain resulting from adjustments made to our employee pension liabilities associated with employees whose employment was terminated in connection with the restructuring plan.

Interest and Other Income, net. Interest and other income, net, was $2.9 million in 2009, $0.2 million in 2008 and $10.5 million in 2007. The increase in 2009 was due to the gain from the realization of previously impaired available-for-sale securities in the amount of $531,000, as compared to a loss in the amount of approximately $3.0 million in 2008 due to the decline in the fair value of such securities, which was offset to some extent by lower interest income as a result of (i) a decrease in our level of cash, cash equivalents and marketable securities which was attributable to our various share repurchases, and (ii) lower interest rates.

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The decrease in 2008 compared to 2007 was due to the payment of approximately $200 million in cash on September 4, 2007 as partial consideration for the Acquisition, which resulted in less investment balance held during 2008. Additional factors for the decreased financial income for 2008, as compared to 2007, were (i) lower interest rates, (ii) the repurchase of 4.8 million shares of our common stock for approximately $49.0 million in cash during 2008, (iii) the devaluation of the Euro against the U.S. dollar, which resulted in expenses associated with exchange rates differences, and (iv) the decline in fair market value of one of our marketable securities which resulted as of December 31, 2008, in an impairment loss in the amount of approximately $3.0 million.

Our total cash, cash equivalents and marketable securities were $123.1 million as of December 31, 2009, compared to $121.5 million as of December 31, 2008.

Provision for Income Taxes. Our income tax benefit was $11.6 million for 2009, as compared to tax expenses of $5.8 million and $2.4 million in 2008 and 2007, respectively. Three main items caused an increase in our income tax benefit for 2009, as compared to tax expenses in 2008: (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 a tax benefit of $3.5 million as a result of the partial reversal of the tax reserves associated with the tax audit, (ii) we recorded 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 limitation statutes, and (iii) deferred tax valuation allowance recorded in 2008 due to the change in the estimation for taxable income in future years.

During 2009, we did not record any net deferred tax assets due to our current estimation of future taxable income, primarily as a result of general adverse market conditions.

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 these 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 revised the criteria for investments qualified to receive tax benefits. An eligible investment program under the amendment qualifies for benefits as a Privileged 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. We believe that we 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% for 2010). We also could be required to refund tax benefits, with interest and adjustments for inflation based on the Israeli consumer price index.

As of December 31, 2006, DSP Group Ltd. has elected the status of a Privileged Enterprise under the amendment to the Israeli Investment Law for its seventh plan. The seventh plan entitles DSP Group Ltd. 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 it has taxable income.

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 generated $26.6 million, $16.4 million and $55.5 million of cash and cash equivalents from operating activities during 2009, 2008 and 2007, respectively. The increase in net cash provided by operating activities for 2009, as compared to net cash provided by operating activities for 2008, resulted from changes in working capital as follows (i) a decrease in other accounts receivable and prepaid expenses by $5.4 million during 2009, mainly due to excess tax advances that were refunded from tax authorities, as compared to an increase by $7.4 million during 2008, mainly due to tax advances paid to tax authorities and the payment of other deposits, (ii) an increase in accrued compensation and benefits by $0.5 million during 2009, as compared to a decrease of $5.5 million during 2008, mainly due to severance payments associated with our restructuring plans that were paid during 2008 and higher employee bonus payments made in 2008 as compared to 2009, and (iii) a decrease in trade payables (including to related parties) by $0.3 million during 2009, as compared to a decrease of $10.9 million (including to related parties) during 2008. The above changes in working capital were offset to some extent by an increase in operating losses for 2009, as compared to 2008 (after eliminating non-cash charges such as intangible assets amortization and equity-based compensation expense from the operating losses for both periods).

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 2009, we purchased $86.1 million of investments in marketable securities, and short and long term deposits, as compared to $48.1 million during 2008 and $63.5 million during 2007. During the same periods, $55.5 million, $89.4 million and 272.0 million, respectively, of investments in marketable securities and deposits matured, were called by the issuer or were sold.

As of December 31, 2009, the amortized cost of our marketable securities and deposits was $83.8 million and their stated market value was $85.0 million, representing an unrealized gain of $1.2 million, which was mainly caused by overall market conditions and interest rate changes.

Our capital equipment purchases for 2009, consisting primarily of research and development software tools, computers and other peripheral equipment, engineering test and lab equipment, leasehold improvements, furniture and fixtures, totaled $4.5 million, as compared to $8.2 million for 2008 and $3.4 million for 2007.

During 2009, we made an investment of $2.2 million in an Israeli private company in return for approximately 30% of the equity of the company, on a fully diluted basis. We also have the option to acquire the remaining equity of the Israeli private company within a 24 months period for an additional $8.7 million.

Financing Activities. During the first quarter of 2009, we repurchased 4,186,603 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, as compared to the receipt of $0.1 million during 2008 and $3.1 million during 2007 upon the exercise of employee stock options. We cannot predict cash flows from option exercises and employee stock purchases for future periods.

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. As of December 31, 2009, 255,488 shares of our common stock remain authorized for repurchase pursuant to our share repurchase program.

During 2008, we repurchased 4,798,000 shares of our common stock at an average purchase price of $10.21 per share for approximately $49.0 million pursuant to our share repurchase program. During 2007, we repurchased approximately 1,618,000 shares of our common stock at an average purchase price of $15.88 per share for an aggregate amount of approximately $25.7 million. No repurchases were made during 2009 pursuant to our share repurchase program.

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As of December 31, 2009, we had cash and cash equivalents totaling approximately $38.0 million and marketable securities and time deposits of approximately $85.0 million.

Our working capital at December 31, 2009 was approximately $68.0 million, as compared to $92.4 million as of December 31, 2008. The decrease in working capital was mainly due to our investment in long-term marketable securities and time deposits. We believe that our current cash, cash equivalents, time deposits and marketable securities will be sufficient to meet our cash requirements for both the short and long term.

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, 2009 (in thousands):

		Payment Due By Period			
Contractual Obligations	**Total**	**Less Than 1 Year**	**2-3 Years**	**4-5 Years**	**More Than 5 Years**
Operating Lease Commitments(1)	$ 10,304	$ 4,331	$ 4,468	$ 1,505	
Capital Lease	455	455			
Purchase Obligations(2)	7,036	7,036			
Net Pension Liability(3)	775	11	33	350	$ 381
Total Contractual Obligations	$ 18,570	$ 11,833	$ 4,501	$ 1,855	$ 381

(1) Represents mainly operating lease payments for facilities and vehicles under non-cancelable lease agreements. See Note 15 to Notes to Consolidated Financial Statements.

(2) Represents purchase obligations with NXP pursuant to a Manufacturing Services Collaboration Agreement, as amended, we entered into with NXP in connection with the Acquisition. The amount of the purchase obligations set forth in the table includes payments due under agreements to purchase finished goods from NXP. See Note 14 to Notes to Consolidated Financial Statements.

(3) Includes estimates of gross contributions required to meet the requirements of several defined benefit plans. Amounts are subject to change based upon the performance of plan assets, as well as the discount rate used to determine the plan obligations. We do not have any long-term debt.

At December 31, 2009, we had a liability for unrecognized tax benefits and an accrual for the payment of related interests totaling $3.1 million. Due to the 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.

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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 such investments until recovery of any temporary declines in market value or maturity. 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 affect 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 and Swiss Franc, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the Euro and Swiss Franc. Our primary expenses paid in Euro and Swiss Franc 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 2009, 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 3 to the attached Notes to the Condensed Consolidated Financial Statement for the period ended December 31, 2009. An increase in the value of the NIS, Euro and Swiss Franc 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.

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Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To The Stockholders and Board of Directors of

DSP GROUP, INC.

We have audited the accompanying consolidated balance sheets of DSP Group, Inc. (the Company) as of December 31, 2009 and 2008, 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, 2009. 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, 2009 and 2008, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2009, 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, 2009, 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 16, 2010 expressed an unqualified opinion thereon.

/s/ Kost Forer Gabbay & Kasierer

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

Tel-Aviv, Israel

March 16, 2010

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of

DSP GROUP INC.

We have audited DSP Group, Inc. s (the Company) internal control over financial reporting as of December 31, 2009, 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, 2009, 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, 2009 and 2008, 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, 2009 and our report dated March 16, 2010 expressed an unqualified opinion thereon.

/s/ Kost Forer Gabbay & Kasierer

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

Tel-Aviv, Israel

March 16, 2010

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DSP GROUP, INC.

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31, 2009	December 31, 2008
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 37,986	$ 68,886
Restricted deposits	120	115
Marketable securities and short-term deposits	19,567	12,449
Trade receivables, net	28,352	39,603
Deferred income taxes	178	306
Other accounts receivable and prepaid expenses	12,162	14,607
Inventories	12,427	14,098
Related party receivable		2,760
Total current assets	110,792	152,824
PROPERTY AND EQUIPMENT, NET	10,090	14,822
LONG-TERM ASSETS:		
Long-term marketable securities and deposits	65,392	40,051
Long-term prepaid expenses and lease deposits	1,286	1,331
Deferred income taxes	15	212
Severance pay fund	9,521	7,286
Intangible assets, net	20,473	32,728
Investment in other companies	2,200	
	98,887	81,608
Total assets	$ 219,769	$ 249,254

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

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DSP GROUP, INC.

CONSOLIDATED BALANCE SHEETS

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

	December 31, 2009	December 31, 2008
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Trade payables	$ 18,309	$ 12,721
Accrued compensation and benefits	9,900	11,490
Income tax accruals and payables	2,939	15,878
Accrued expenses and other accounts payable	11,631	12,070
Related party payables		8,306
Total current liabilities	42,779	60,465
LONG-TERM LIABILITIES:		
Accrued severance pay	10,572	8,008
Accrued pensions	929	1,675
Deferred tax liabilities		24
Other long-term liability		455
Total long-term liabilities	11,501	10,162
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY:		
Capital stock:		
Preferred stock, $ 0.001 par value Authorized shares: 5,000,000 shares at December 31, 2009 and 2008; Issued and outstanding shares: none at December 31, 2009 and 2008		
Common stock, $ 0.001 par value Authorized shares: 50,000,000 shares at December 31, 2009 and 2008; Issued and outstanding shares: 22,901,051 and 26,730,914 shares at December 31, 2009 and 2008, respectively	23	27
Additional paid-in capital	325,579	314,479
Treasury stock	(123,350)	(107,744)
Accumulated other comprehensive income	2,174	51
Accumulated deficit	(38,937)	(28,186)
Total stockholders equity	165,489	178,627
Total liabilities and stockholders equity	$ 219,769	$ 249,254

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

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DSP GROUP, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Year ended December 31, 2009	2008	2007
Revenues	$ 212,186	$ 305,800	$ 248,788
Costs of revenues (including $8,013, $78,118 and $33,165 with related party for the years ended December 31, 2009, 2008 and 2007, respectively)(1)	133,590	191,811	148,075
Gross profit	78,596	113,989	100,713
Operating expenses:			
Research and development(2)	56,148	73,856	58,488
Sales and marketing(3)	17,889	22,712	19,060
General and administrative(4)	15,228	17,871	14,614
In-process research and development write-off			10,350
Amortization of intangible assets	12,258	22,853	11,102
Impairment of goodwill and other intangible assets		181,534	
Restructuring cost and other		1,870	
Total operating expenses	101,523	320,696	113,614
Operating loss	(22,927)	(206,707)	(12,901)
Financial income, net	2,857	160	10,541
Loss before taxes on income	(20,070)	(206,547)	(2,360)
Taxes on income (income tax benefit)(5)	(11,634)	5,847	2,393
Net loss	$ (8,436)	$ (212,394)	$ (4,753)
Net loss per share:			
Basic and Diluted	$ (0.36)	$ (7.48)	$ (0.16)
Weighted average number of shares used in per share computations of net loss:			
Basic and Diluted	23,655	28,387	29,495

(1) Includes equity-based compensation expense in the amount of $778, $919 and $663 for the years ended December 31, 2009, 2008 and 2007, respectively.

(2) Includes equity-based compensation expense in the amount of $5,253, $7,247 and $7,143 for the years ended December 31, 2009, 2008 and 2007, respectively.

(3) Includes equity-based compensation expense in the amount of $1,773, $1,696 and $1,616 for the years ended December 31, 2009, 2008 and 2007, respectively.

(4) Includes equity-based compensation expense in the amount of $3,296, $4,076 and $4,600 for the years ended December 31, 2009, 2008 and 2007, respectively.

(5) Includes tax benefit (expenses) resulting from equity-based compensation expense in the amount of $0, $(1,070) and $580 for the years ended December 31, 2009, 2008 and 2007, respectively. The tax expense above in 2008 is comprised of a tax benefit of $459 offset by an increase in the deferred tax valuation allowance of $1,529.

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

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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	Retained earnings (accumulated deficit)	Total comprehensive income (loss)	Total stockholders equity
Balance at January 1, 2007	28,378	$ 28	$ 216,041	$ (44,546)	$ 28	$ 195,198		$ 366,749
Issuance of treasury stock upon purchase of ESPP shares by employees	93	(*)		2,124		(456)		1,668
Issuance of treasury stock upon exercise of stock options by employees	190	(*)		4,317		(1,441)		2,876
Tax benefit related to exercise of stock options			147					147
Issuance of shares in relation to the acquisition of the cordless and VoIP terminals business of NXP B.V. (Acquisition)	4,187	4	70,331					70,335
Purchase of treasury stock	(1,618)	(1)		(25,698)				(25,699)
Equity-based compensation expenses for employees			14,022					14,022
Cumulative impact of change in accounting for uncertainties in income taxes						(1,485)		(1,485)
Total comprehensive loss:								
Net loss						(4,753)	$ (4,753)	(4,753)
Change in unrealized gain from hedging activities, net					453		453	453
Change in unrealized loss from marketable securities					(223)		(223)	(223)
Change in unrealized loss from pension					(277)		(277)	(277)
Change in foreign currency translation adjustments, net					1,044		1,044	1,044
Total comprehensive loss							$ (3,756)	
Balance at December 31, 2007	31,230	$ 31	$ 300,541	$ (63,803)	$ 1,025	$ 187,063		$ 424,857
Issuance of treasury stock upon purchase of ESPP shares by employees	290	(*)		4,901		(2,811)		2,090
Issuance of treasury stock upon exercise of stock options by employees	9	(*)		145		(44)		101
Purchase of treasury stock	(4,798)	(4)		(48,987)				(48,991)
Equity-based compensation expenses			13,938					13,938
Total comprehensive loss:								
Net loss						(212,394)	$ (212,394)	(212,394)
Change in unrealized loss from hedging activities, net					(508)		(508)	(508)
Change in unrealized loss from marketable securities					69		69	69
Change in unrealized loss from pension					236		236	236
Change in foreign currency translation adjustments, net					(771)		(771)	(771)
Total comprehensive loss							$ (213,368)	
Balance at December 31, 2008	26,731	$ 27	$ 314,479	$ (107,744)	$ 51	$ (28,186)		$ 178,627

(*) Represents an amount lower than $1.

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

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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	Retained earnings	Total comprehensive income (loss)	Total stockholders equity
Balance at December 31, 2008	26,731	$ 27	$ 314,479	$ (107,744)	$ 51	$ (28,186)		$ 178,627
Issuance of treasury stock upon purchase of ESPP shares by employees	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							$ (6,313)	
Balance at December 31, 2009	22,901	$ 23	$ 325,579	$ (123,350)	$ 2,174	$ (38,937)		$ 165,489

(*) 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,		
	2009	**2008**	**2007**
Cash flows from operating activities:			
Net loss	$ (8,436)	$ (212,394)	$ (4,753)
Adjustments required to reconcile net loss to net cash provided by operating activities:			
Depreciation	7,216	7,335	6,081
Equity-based compensation expenses related to employees stock options	11,100	13,938	14,022
Decrease (increase) in deferred income taxes assets, net	308	8,248	(4,892)
Capital loss (gain) from sale and disposal of property and equipment	38	552	(10)
Loss (profit) from sale of marketable securities and other-than-temporary impairment on marketable securities	(933)	3,065	1,510
Amortization and impairment of other intangible assets and impairment of goodwill	12,258	204,815	11,868
In-process research and development write-off			10,350
Accrued interest and amortization of premium on marketable securities and short-term deposits	496	1,298	3,162
Profit from realization of foreign currency translation adjustment		(341)	
Decrease (increase) in trade receivables, net	11,388	12,556	(30,147)
Decrease (increase) in other accounts receivable and prepaid expenses	5,432	(7,357)	23,542
Decrease in inventories	1,642	2,110	1,488
Decrease (increase) in long-term prepaid expenses and lease deposits	46	(637)	(22)
Increase (decrease) in trade payables	7,130	(7,107)	6,679
Increase (decrease) in accrued compensation and benefits	533	(5,574)	3,612
Increase (decrease) in income taxes payable	(12,941)	1,752	1,645
Decrease in accrued expenses and other accounts payable	(1,068)	(568)	(181)
Increase in accrued severance pay, net	328	302	44
Increase (decrease) in accrued pensions	(282)	177	146
Increase (decrease) in related party receivable/payable	(7,658)	(5,800)	11,346
Net cash provided by operating activities	26,597	16,370	55,490
Cash flows from investing activities:			
Purchase of marketable securities and deposits	(86,144)	(48,081)	(63,482)
Proceeds from maturity and sale of marketable securities and deposits	55,461	89,438	271,974
Proceeds from sale of property and equipment			68
Purchase of property and equipment	(4,527)	(8,185)	(3,395)
Investment in other company	(2,200)		
Payment for acquisition of the cordless and VoIP Terminals business of NXP B.V.(1)		(843)	(206,040)
Net cash provided by (used in) investing activities	(37,410)	32,329	(875)

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

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DSP GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2009	**2008**	**2007**
Cash flows from financing activities:			
Issuance of common stock and treasury stock upon exercise of stock options		101	3,116
Purchase of treasury stock	(20,028)	(48,991)	(25,699)
Tax benefit related to exercise of stock options			130
Net cash used in financing activities	(20,028)	(48,890)	(22,453)
Increase (decrease) in cash and cash equivalents	(30,841)	(191)	32,162
Cash and cash equivalents at the beginning of the year	68,886	69,586	37,344
Cash (erosion) due to exchange rate differences	(59)	(509)	80
Cash and cash equivalents at the end of the year	$ 37,986	$ 68,886	$ 69,586
Supplemental disclosures of cash flows activities:			
Cash paid during the year for:			
Taxes on income	$ 2,457	$ 3,193	$ 6,777

(1) On September 4, 2007, the Company acquired certain assets and assumed certain liabilities of the cordless and VoIP terminals business of NXP B.V.

The net fair value of the assets acquired and the liabilities assumed, on the date of the Acquisition, was as follows:

Working capital, excluding cash and cash equivalents	$ 18,600
Pension liability	(1,298)
Property and equipment	2,798
Technology	77,080
Backlog	4,449
In-process research and development	10,350
Customer relations	23,321
Trademarks	590
Goodwill	140,762
	276,652
Issuance of shares	(70,335)
Unpaid transaction costs	(277)
	$ 206,040

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

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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 NYP B.V., 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 products 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 original equipment manufacturers (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. A significant amount of its revenues will continue to be derived from a limited number of large customers. 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 29%, 21% and 10% of the Company s total revenues for 2009, 2008 and 2007, respectively. Revenues derived from sales through one distributor, Tomen Electronics Corporation (Tomen Electronics), accounted for 22%, 25% and 37% of the Company s total revenues for 2009, 2008 and 2007, 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%, 13% and 23% of the Company s total revenues for 2009, 2008 and 2007, respectively. Additionally, sales to Uniden America Corporation (Uniden) through Tomen Electronics or directly to Uniden represented 12%, 13% and 13% of the Company s total revenues for the 2009, 2008 and 2007 respectively. Sales to CCT Telecom Holdings Ltd. represented 8%, 9% and 12% of the Company s total revenues for 2009, 2008 and 2007, respectively.

During the second half of 2008, the Company faced an adverse change in the business climate in which it operates, due to a significant downturn in the semiconductors industry that led to a significant decrease in demand for the Company s products. The Company realized that its future corporate sales would be adversely impacted by the market downturn.

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DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

As a result, the Company concluded that impairment indicators existed as of December 31, 2008. The Company recorded in 2008 an impairment of intangible assets and goodwill as follows:

1. Goodwill approximately $142,450

2. Intangible assets approximately $39,084 (see Note 8)

Acquisition (the Acquisition) of the Cordless and VoIP Terminals Business (the CIPT Business) of NXP B.V. (NXP),

On September 4, 2007, the Company acquired certain assets and assumed certain liabilities of the CIPT Business, then a part of the Mobile and Personal Business Unit of NXP.

The CIPT Business targets applications for the cordless and VoIP residential telephony market, mainly European (1.9GHz) telephony (DECT). In connection with the Acquisition, the Company paid NXP approximately $200,000 in cash and issued 4,186,603 shares of the Company s Common stock to NXP. With the Acquisition, the Company sought to elevate the cordless and VoIP terminals business, leverage NXP s customer relations in Europe and introduce to the market products containing new features and applications. In connection with the Acquisition, the Company entered into a manufacturing agreement, which was subsequently amended, with NXP for the production of the products constituting the CIPT Business (See Note 14).

The Acquisition was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to the assets acquired and the liabilities assumed based on the estimated fair value on the date of the Acquisition. The allocation period ended on December 28, 2007, when the Company determined that it had the information necessary to properly identify and measure the fair value of the assets acquired and the liabilities assumed.

The results of operations of the CIPT Business have been included in the Company s consolidated financial statements since September 4, 2007.

The total consideration of $277,218 (including estimated transaction costs of $5,718, which included investment banking fees, legal and accounting fees, and other external costs directly related to the Acquisition) for the CIPT Business included payments to NXP of (i) cash in the amount of $201,123 and (ii) 4,186,603 newly issued shares of the Company s common stock, with an aggregate value of $70,377.

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DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

	As of September 4, 2007
Current assets	$ 29,551
Property and equipment	2,798
Other non-current assets	286
Intangible assets:	
Goodwill	140,762
In-process research and development	10,350
Current technology	77,080
Customer relations	23,321
Trade name and trademark	590
Backlog	4,449
Total assets acquired	289,187
Liabilities assumed:	
Current liabilities	(4,671)
Restructuring accrual	(6,000)
Pension liability	(1,298)
Net assets acquired	$ 277,218

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 the CIPT Business products. The fair value of the intangible assets was based on a valuation using an income approach and estimates and assumptions provided by management.

The amount allocated to in-process research and development (IPR&D) of the cordless and VoIP technologies was determined using the income approach. These technologies were considered to have no alternative future use, other than the technological indications for which they were in development, and no technological feasibility had been established. Accordingly, this amount was expensed in the consolidated statement of operations, upon consummation of the Acquisition.

The amount of the excess cost attributable to current technologies related to VoIP and cordless technologies, other than the technology that was identified as IPR&D, was determined using the income approach on the basis of the present value of cash flows attributable to the current VoIP and cordless technologies and is amortized on a straight-line basis over expected future life of between four to five years. The expected future life period was estimated based on the duration of the cash flow associated with the existing technologies and management s estimates of its useful life.

The value assigned to customer relations was determined using the income approach. This valuation was based on the backlog on the date of the Acquisition, historical revenues by customer and customer renewal rates, and is amortized using the accelerated method over 11 years, which is the expected cash flow utilization period.

The value of trade names and trademarks was based on cost to generate and maintain such intellectual property. This cost was estimated based on historical advertising and promotion spending and is amortized on a straight-line basis over two years.

The value assigned to the backlog was determined using the income approach and is amortized on a straight line basis over 0.3 years.

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DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

The excess of the cost of $140,762 over the net aggregate amounts assigned to assets acquired and liabilities assumed was recognized as goodwill. An acquired workforce that did not meet the separability criteria was included in the amount assigned to goodwill. The goodwill recognized represented mainly the synergies, both in revenues and expenses, the Company expected of the CIPT Business and the expected benefits to the Company from the acquisition of a major competitor in the cordless and VoIP market.

Following the Acquisition, the Company approved a plan to restructure certain operations of the CIPT Business to eliminate redundant costs resulting from the Acquisition and improve operational efficiencies. The restructuring charges recorded were based on the Company management s best estimates.

The estimated restructuring costs associated with exiting activities of the CIPT Business totaled $6,000, consisting primarily of employee severance costs. These costs were recognized as a liability assumed in the Acquisition and included in the allocation of the cost to acquire the CIPT Business and, accordingly, resulted in an increase in goodwill. The Company finalized the restructuring plan as of June 30, 2008. All restructuring costs related to that plan were paid in cash.

The unaudited pro forma information below assumes that the Acquisition was consummated on January 1, 2007, included the effect of amortization of intangibles and other assets and did not include the IPR&D write-off on this date. This data is presented for information purposes only and is not necessarily indicative of the results of future operations or the results that would have been achieved had the Acquisition taken place on January 1, 2007. The pro forma information is as follows:

	Year ended December 31, 2007 Unaudited
Net revenues	$ 366,195
Net income	$ 3,217
Net earning per share basic	$ 0.10
Net earning per share diluted	$ 0.10

NOTE 2:- RESTRUCTURING COSTS AND OTHER

Following the Acquisition, the Company approved a plan to restructure certain operations of the CIPT Business to eliminate redundant costs resulting from the Acquisition and improve operational efficiencies.

The restructuring costs associated with exiting activities of the CIPT Business totaled $6,000, consisting primarily of employee severance costs. These costs were recognized as a liability assumed in the Acquisition and included in the allocation of the cost to acquire the CIPT Business and, accordingly, resulted in an increase in goodwill. The Company finalized the restructuring plan as of June 30, 2008. All restructuring costs relating to the restructuring plan were paid in cash.

During the third quarter of 2008, the Company initiated an additional restructuring plan to improve operating efficiency at its various operating sites and to reduce its operating expenses for 2009. As a significant majority of the restructuring associated with the additional restructuring plan occurred during the third quarter of 2008, the Company recognized an expense of $1,870 mainly for employee contract termination costs on its statement of operations for the third quarter of 2008. This expense amount is net of $537 of gain resulting from

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DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

adjustments made to the Company s employee pension liabilities associated with employees whose employment was terminated in connection with the restructuring plan. As of December 31, 2008, payments aggregating $1,609 were made in connection with the additional restructuring plan.

Summary of the plan:

	Initial costs	Adjustments to cost	Cash payments	Accrued as of December 31, 2008	Total costs
Severance and related benefits	$ 1,920	$ (42)	$ (1,441)	$ 437	$ 1,878
Other	487	42	(168)	361	529
Total restructuring and other	$ 2,407	$	$ (1,609)	$ 798	$ 2,407

The Company has finalized the restructuring plan as of June 30, 2009 and all restructuring costs relating to the restructuring plan have been paid in cash.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES

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.

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.

Monetary accounts maintained in currencies other than the dollar are remeasured into dollars in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Code (ASC) No. 830-30, Translation of Financial Statement. 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, and have not been significant to date for all years presented.

As a result of the Acquisition, the financial statements of the Company s subsidiaries whose functional currency is not the dollar, specifically DSP Group Technologies GmbH and DSP Group France SAS (which was liquidated as of July 2008) have 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 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 in stockholders equity.

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DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Accumulated other comprehensive income related to foreign currency translation adjustments, net, amounted to $335 and $273 as of December 31, 2009 and 2008, respectively. In 2008, an amount of $341 was transferred from accumulated other comprehensive income to the consolidated statement of operations as a result of the liquidation of DSP Group France SAS as of July 2008.

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.

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 at the date of acquisition, to be cash equivalents.

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.

Marketable securities

The Company and its subsidiaries account for investments in debt and equity 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 and equity 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 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.

Prior to the second quarter of 2007, marketable securities were classified as held-to-maturity as the Company previously had the intent and ability to hold the securities to maturity and were stated at amortized cost.

Due to the anticipated Acquisition, beginning in the second quarter of 2007, the Company classified its debt securities as available-for-sale. Since the Company did not have the intent to hold the securities until maturity, the Company changed the classification of its investments from held-to-maturity to available-for-sale. As a result of the sale of securities in connection with the Acquisition, the Company recognized an impairment loss on its marketable securities in the amount of approximately $1,500.

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. If any impairment is considered other-than-temporary , the investment is written down to its fair value through a

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DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

corresponding charge to financial income, net. For the year ended December 31, 2008, the Company recorded an other-than-temporary impairment loss in the amount of $2,961 as financial expenses. During 2009, the Company recorded $531 of gains from the realization of that previously impaired available-for-sale security. (See note 4).

Fair value of financial instruments

Cash and cash equivalents, short-term deposits, marketable securities, trade receivables, trade payables and accrued liabilities are measured at fair values.

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.

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.

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

63

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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.

As of December 31 2009, 2008 and 2007, no impairment losses were identified for property and equipment.

Investments in other companies

The Company s investment in an Israeli private company, in which the Company holds approximately 30% of the equity of the company, on a fully diluted basis, is presented at cost. The investment is reviewed to determine if its value has been impaired and adjustments are recorded as necessary.

Goodwill and other intangible assets

Goodwill and certain other purchased intangible assets have been recorded as a result of acquisitions. 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 second 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 lives, which range from 0.3 to 7.3 years. 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 2009 and 2007, no impairment losses were identified. During 2008, impairment losses in the amount of $181,534 were recognized ($142,450 relating to goodwill impairment and $39,084 relating to impairment of other intangible assets) (See Notes 1 and 8).

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. The value of the deposited funds is based on the cash surrender value of these policies and includes immaterial profits.

Severance expense for the years ended December 31, 2009, 2008 and 2007, was approximately $1,969, $2,600 and $1,703, respectively.

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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 2009 was $16.5 ($22.0 if the employee reached the age of 50 by December 31, 2009). The Company currently offers an employer matching program. This matching contribution currently is 50% of the employee s contribution up to a maximum of 3% of the employee s compensation per year. This matching contribution vests 25% per year over the first four years of the employee s service to the Company. Employer contribution to the plan for the years 2009, 2008 and 2007 was $80, $45 and $43, respectively.

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. Revenue is recognized when title to the product passes to the customer.

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

Product revenues on shipment to distributors are deferred until the distributors resell the Company s products to the end-customers (sell through) based upon receipt of reports from the distributors provided all other revenue recognition criteria are met.

The Company does not grant any rights of return.

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, 2009, 2008 and 2007.

Research and development costs

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

Equity-based compensation

At December 31, 2009, the Company has five stock-based employee compensation plans, 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. 718-10 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

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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 binomial 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.

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 SARs outstanding during the year, all in accordance with FASB ASC No. 260, Earnings Per Share.

The total weighted average number of shares related to the outstanding options and SARs excluded from the calculations of diluted net loss per share due to their anti-dilutive effect was 7,790,926, 8,656,161 and 6,924,392 for the years ended December 31, 2009, 2008 and 2007, respectively.

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.

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.

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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 agency securities. As of December 31, 2009, the amortized cost of the Company s marketable securities was $58,511, and their stated market value was $59,701, representing an unrealized gain of $1,190.

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, 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 estimation 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. Allowance for doubtful accounts amounted to $117 and $184 as of December 31, 2009 and 2008, respectively.

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

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 options are designated as cash flow hedges and are all effective as hedges of these expenses.

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The fair value of the outstanding derivative instruments at December 31, 2008 and 2009 is summarized below:

		Fair Value of Derivative Instruments	
	Balance Sheet Location	As of December 31, 2009	As of December 31, 2008
Derivative Assets			
Foreign exchange forward contracts and put options	Other accounts receivable and prepaid expenses(*)	227	
Total		$ 227	$
Derivative Liabilities			
Foreign exchange forward contracts and put options	Other accounts payable and accrued expenses	$	$ 27
Total		$	$ 27

(*) Estimated to be reclassified into earnings during 2010.

The effect of derivative instruments in cash flow hedging transactions on income and other comprehensive income (OCI) for the years ended December 31, 2008 and 2009 is summarized below:

	Gains (Losses) on Derivatives Recognized in OCI Year ended December 31,	
	2009	2008
Foreign exchange forward contracts	$ (343)	$ 452