DSP GROUP INC /DE/
Form 10-K
March 18, 2013
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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, 2012

Commission File Number 001-35256

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

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

As of June 30, 2012, 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 29, 2012 as reported on the NASDAQ Global Select Market, was approximately $88,042,762. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock (other than Starboard Value LP and its affiliates) 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 4, 2013, the Registrant had outstanding 21,916,855 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, 2012 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 sales of our DECT products will continue to represent a substantial percentage of our revenues for 2013;*
- *Our belief that our past research and development investments in new technologies are beginning to materialize;*
- *Our belief that the rapid deployment of new communication access methods, including mobile, wireless broadband, cable and other connectivity, the traditional cordless telephony market using fixed-line telephony is declining and will continue to decline, which will reduce our revenues derived from, and unit sales of, cordless telephony products;*
- *Our belief that the market will remain price sensitive for 2013 for our traditional cordless telephony products and expect that price erosion and the decrease in the average selling prices of such products to continue;*
- *Our belief that our cost reduction programs implemented in 2012 will result in an additional decrease in operating expenses for 2013;*
- *Our anticipation that annualized revenues generated from our next generation products to increase significantly in 2013 as compared to 2012;*
- *Our belief that commercial shipments of products incorporating our next generation products will continue during 2013;*
- *Our focus remains on generating non-GAAP operating income for 2013;*
- *Our anticipation that there will be a significant decrease in our operating expenses for 2013, as compared to 2012;*
- *Our belief that our available cash and cash equivalents at December 31, 2012 should be sufficient to finance our operations for the foreseeable future; and*
- *Market data prepared by third parties, including IDC.*

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.

DSP Group, Inc. is referred to in this Annual Report as DSP Group, we, us, our or company.

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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. Delivering semiconductor system solutions with software and reference designs, DSP Group enables original equipment manufacturers (OEMs), original design manufacturers (ODMs), consumer electronics (CE) manufacturers and service providers to cost-effectively develop new revenue-generating products with fast time to market.

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

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

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

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

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

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

Industry Environment and Our Business

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

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

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

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

Recently, we expanded into chips and phones for office and business applications, and have quickly gained market share in this growing segment. Today, DSP Group offers a comprehensive solution for voice-over-IP (VoIP) home and office products. VoIP is a technology that enables users to make voice calls via a broadband Internet connection rather than an analog phone line.

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

Furthermore, with mobile devices playing an increasingly significant role in peoples lives, in February 2013, we unveiled our revolutionary HDClear solution, a comprehensive voice enhancement product for mobile devices. According to a recent Reuters report, market research firm IDC estimates that 63 percent of all mobile units will incorporate technology to eliminate background noise by 2015, or about 1.7 billion units, up from 500 million units in 2012. Incorporating proprietary noise cancellation algorithms, HDClear dramatically improves user experience and delivers unparalleled voice quality and call intelligibility. This technology will enable people to use their cell phones for conversation in virtually any condition, whether in a car, on a train or in any noisy surroundings. HDClear will also facilitate the use of speech recognition and voice commands by eliminating background noise. Our HDClear product family was developed through the acquisition of BoneTone and the addition of their innovative intelligent voice enhancement.

With our in-house innovations and acquired intellectual property, we are now able to bring additional value to our existing market verticals and address new market verticals, including markets for office phones, mobile devices and headsets, thus expanding our market opportunities.

Target Markets and DSP Group Products

Our work in the field of wireless residential and business technologies, as well as our prior acquisitions, have yielded various synergistic product families. As further discussed below, the acquisition of the CIPT Business significantly enhanced our product portfolio, especially in the cordless telephony and VoIP areas, whereas the acquisition of BoneTone enhanced our offerings in the cellular telephony, headsets and portable devices areas.

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

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

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

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

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

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

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

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

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

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

The XceedR DCE chipset family is a mature and field-proven family of integrated digital baseband processor RF chipsets. The chipset is used to develop fully integrated cordless telephone systems, digital answering machines, digital voice recorders (DVRs), digital baby monitors, and other low-to-mid-range audio applications. Including the industry s most advanced digital cordless solutions, the XceedR DCE family maintains multi-line, multi-handset and digital answering machine capabilities, while supporting various RF protocols such as DECT (1.7GHz-1.9GHz), FHSS DECT 2.4GHz, EDCT 2.4GHz and 5.8GHz. Integration of the TeakLite RISC DSP core into the DE56 and DCE58 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

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solution for mid-to-high-range DECT/DECT6.0/CAT-iq and WDCT cordless applications, home gateway applications and fixed mobile convergence applications.

In 2012, we launched DCX81 SoC featuring advanced QSPI Flash architecture and 208MHz ARM926 core targeted solution for digital cordless telephony and cordless products.

In 2012, we also taped-out DHX91, a DECT ULE SoC targeting home automation and security applications.

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

Products Targeted for 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 a system-on-a-chip (SoC) solution based on dual-core and integrating application processors, Wi-Fi and DECT baseband and comprehensive multimedia peripherals, along with companion analog front-end and power management units as well as Wi-Fi and cordless RF chips, to enable the development of always-on, portable, connected multimedia products.

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

In 2008 and 2009, we introduced XpandR-I and XpandR-II the first and second members of the XpandR product family. The XpandR-II chipset has been designed by several vendors into enhanced products such as Wi-Fi handsets, Internet radios and Android cordless multimedia phones.

XpandR-III In 2011, we taped-out XpandR-III, our third generation XpandR processor. XpandR-III is a state-of-the-art system-on-a-chip that features two application processing cores, ARM Cortex A8 and ARM9, an advanced low-power media system that integrates smart acceleration engines for HD video decode and encode, 2D/3D Graphics Processing Unit (GPU), as well as a dedicated security controller and Wi-Fi 802.11n that will complement a full offering for converged voice, data, audio and video processor. XpandR-III has a wide range of interfaces, including display up HD resolution and dual camera sensors. Target applications include smart home telephony, video telephony, home security, media/streaming set-top box and portable multimedia.

Products Targeted for the VoIP Market

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

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

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

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

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

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

In 2012, we taped-out a new VoIP SoC DVF99xx. Built with two ARM926EJ-S cores, this new VoIP SoC provides combined processing speed of 1.1 GHz, and is designed to support IP phone processing needs from basic single-line IP phones to high-end multi-line gigabit Ethernet IP phones with large color display and advanced GUI. The DVF99 also integrates multiple hardware accelerators, including a hardware security engine which enables a new class of secure IP phones, an LCD controller, a 2D graphics engine, a high-speed USB 2.0 port, DDR3 memory and minimal power consumption during low-usage periods. This product was designed to meet the needs of the enterprise IP telephony market.

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

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

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

HDClear-based solution offers mobile voice quality and intelligibility, while completely removing background noise. Delivering clearer voice calls made from noisy environments, HDClear also maximizes accuracy of Automatic Speech Recognition (ASR) applications in noisy environments by leveraging robust and powerful noise cancellation algorithms. HDClear more effectively isolates voice from ambient noise, thereby drastically lowering Word Error Rate (WER) and dramatically improves the user experience for speech-enabled applications like virtual assistants, voice search, and speech-to-text on mobile devices, tablets and other consumer devices.

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

XsoundR enables a new experience for mobile users. Our HDClear technology fully removes background noise for far-end users, while maintaining privacy for near-end speakers. As such, our XsoundR mobile chipset offerings enable high voice quality and intelligibility for calls made in the noisiest environments. The solutions are anchored by the DBM family DBMD11 (BTHD100) and DBMD12, mixed-signal DSP-based processor for voice communication applications. They also feature a superior background noise cancellation algorithm, on-chip ADC, and diverse digital interfaces for seamless integration into current dense mobile device systems. Offered in a low-power, small footprint package, XsoundR is the ultimate noise-cancellation chip solution for mobile phones, Bluetooth and DECT wireless headsets, wired headsets and fixed-line phones.

In 2012, we taped-out a new DBMD2, one of the most efficient voice enhancement processors in the market, in our belief. It is measured just 3.0 x 3.0 x 0.65mm. Offered with a 36-pin BGA and 0.4mm ball pitch, DBMD2 embeds a programmable 32-bit DSP, incorporates advanced connectivity options, including four TDM/I2S ports and SLIMbus, and equipped with a comprehensive software framework that enables rapid development and fast time-to-market, thereby overcoming the challenges of portable design, real estate and power consumption.

DBMD2 enables mobile OEMs to offload voice and audio tasks from mobile device CPUs, in addition to running HDClear to enhance ASR accuracy. OEMs can leverage DBMD2 s open and flexible architecture to differentiate their products by utilizing the free DSP MIPS headroom and memory to run their own or third party voice/audio enhancement software for pre- and post-processing.

Customers

We sell our products primarily through distributors and directly to OEMs and ODMs who incorporate our products into consumer products for the worldwide residential wireless communications market. In 2012, 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, AT&T, Audioline, Belgacom, Binatone, British Telecom, Brother, CCT Tech, Cetis, China Telecom, Cisco, Cybertan, Grandstream, Deutsche Telekom, Doro, France Telecom, Freebox, Giant, Gaoxinqi, Gemtek, Global China Technologies, Grandstream, Hagenuk, Huawei, Intelbras, JXE, Korea Telecom, KPN, LG Electronics, Matsushita, Motorola, Moimstone, NEC, NTT, OnReal, Ooma, Panasonic, Philips, Pioneer, Plantronics, Sagemcom, Samsung, Sanyo, SGW, Sharp, Siemens (Gigaset), SK Telecom, Sony, Spracht, Sumitomo, Swissvoice, Swisscom, TCL, Tecom, Telecom Italia, Telefonica, Telstra, Technicolor, Telefield (RCA), Topcom, Uniden, Unihan, Urmet, Turkcell, Verizon, VTech, WNC, Xingtel, Yamaha, Yealink and ZTE.

International Sales and Operations

Export sales accounted for 99% of our total revenues for 2012, 2011 and 2010. 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 16 of the attached Notes to Consolidated Financial Statements for the year ended December 31, 2012, for a summary of the geographic breakdown of our revenues and location of our long-lived assets.

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

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

Sales, Marketing and Distribution

We market and distribute our products through our direct sales and marketing offices, as well as through a network of distributors. Our sales and marketing team, working out of our sales offices in Hong Kong, China;

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Nierenberg, Germany; San Jose, California; Tokyo, Japan; Herzelia Pituach, Israel and Edinburgh, Scotland, pursues business with our customers in North and South America, Europe and Asia. In territories where we do not have sales offices, we operate solely through a network of distributors and representatives. Revenues derived from sales through our Japanese distributor, Tomen Electronics, represented 21% of our total revenues for 2012, 19% for 2011 and 25% for 2010. We also derive a significant amount of revenues from a limited number of customers. Sales to VTech represented 35% of our total revenues for 2012, 33% for 2011 and 31% for 2010. Sales to Panasonic through Tomen Electronics represented approximately 15%, 13% and 16% of our revenues for 2012, 2011 and 2010, respectively. Sales to Uniden represented 11%, 10% and 9% of our total revenues for 2012, 2011 and 2010, respectively. Sales to CCT Telecom represented 8%, 11% and 10% of our total revenues for 2012, 2011 and 2010, respectively. The loss of any of our significant customers or distributors could harm our business, financial condition and results of operations. In addition, our customers and distributors are not subject to minimum purchase requirements and can cease making purchases of our products at any time.

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

Manufacturing and Design Methodology

We contract product wafer fabrication services from TSMC, TriQuint and IBM. A majority of our integrated circuit products at this time are manufactured by TSMC. We intend to continue to use independent foundries to manufacture our products. 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.

As part of the acquisition of the CIPT Business, we entered into a Manufacturing Services Collaboration Agreement, as amended, with NXP pursuant to which NXP agreed to provide us with specified manufacturing, pre-testing, assembling and final-testing services relating to CIPT Business products. The services under the agreement are provided by NXP on a purchase order basis and will expire by December 31, 2014. The agreement sets forth specified capacity guarantees by NXP, logistics for our provision of production schedules, penalties for late/non delivery by NXP for specified products, our purchase obligations and various technical specifications for the manufacturing services. Products from the CIPT Business that are still manufactured by NXP currently do not represent a substantial portion of our total revenues. However, our business could be still harmed if NXP, or third parties NXP has contracted, fails to achieve acceptable manufacturing yields, quality levels or allocate to us a sufficient portion of its foundry, and assembly and testing capacities to meet our needs for the CIPT Business products.

We use independent subcontractors located in Asia, to assemble and test certain of our products. We develop detailed testing procedures and specifications for each product and require each subcontractor to use these procedures and specifications before shipping us the finished products. We test and/or assemble our products at ASE, ASEN, KYEC, SPIL and Giga Solutions.

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

Competition

The principal competitive factors in the cordless telephony market include price, performance, system integration level, range, voice quality, customer support and the timing of product introductions by us and our competitors. We believe that we are competitive with respect to most of these factors. Our principal competitors in the cordless market include Lantiq and Dialog Semiconductors, and we have also noted efforts by Beken, a Chinese supplier of basebands for analog cordless phones, to penetrate the DECT market.

Similar principal competitive factors affect the VoIP market. We also believe that we are competitive with respect to most of these factors. Our principal competitors in the VoIP market include Broadcom, Dialog Semiconductors, Infineon, Texas Instruments and new Taiwanese IC vendors. Our principal competitors in the multimedia market include Wi-Fi and multimedia application processor IC vendors like Atheros, Broadcom, CSR, Freescale, Intel, Marvel, Ralink, Samsung and Texas Instruments.

Similar principal competitive factors affect the Home Automation (DECT ULE) market. We also believe that we are competitive with respect to most of these factors. Our principal competitors are developers of different wireless home automation technologies, including Analog, Z-wave and Zigbee. Among those, the major competition in digital home automation is Zigbee and the principal competitors are Freescale, NXP, Texas Instruments and Silicon Lab.

Similar principal competitive factors affect the mobile audio noise reduction market. An additional competitive factor relating to this market is that we are a newcomer to this market and this market already has a number of dominant, well-established companies with significant existing market shares. Nonetheless, we believe that we are competitive in this market with HDClear s outstanding performance. Competitors in this market include Audience and Cirrus Logic and developers of noise cancellation software running on mobile phones.

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. We were able to partially offset price reductions which occurred during 2012 through manufacturing cost reductions, improvements in our yield percentages and by achieving a higher level of product integration. However, we cannot assure 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 and mobile markets, we intend to enter into new markets with competitors that have more established presence, and significantly greater financial, technical, manufacturing, marketing, sales and distribution resources 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, 2012, we had a staff of 190 research and development personnel, of which 142 were located in Israel. We also employ independent contractors to assist with certain product development and testing activities. We spent approximately $42.5 million in 2012, $53.2 million in 2011 and $55.6 million in 2010 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 are expanding our current product lines and develop products and services targeted at wider markets, including the intensively competitive mobile device 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, 2012, we have been granted a total of 168 patents and 98 patents are pending.

We actively pursue foreign patent protection in countries of interest to us. Our policy is to apply for patents or for other appropriate statutory protection when we develop valuable new or improved technology. The status of any patent involves complex legal and factual questions, and the breadth of claims allowed is uncertain. Accordingly, we cannot assure 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 that these measures will be successful.

The technology industry is subject to frequent litigation regarding patent and other intellectual property rights. While claims involving any material patent or other intellectual property rights have not been brought against us to date, we cannot provide assurance that third parties will not assert claims against us or our customers with respect to existing or future products, or that we will not need to assert claims against third parties to protect our proprietary technology. In addition, patent infringement claims are increasingly being asserted by patent holding companies (so-called patent trolls), which do not use technology and whose sole business is to enforce patents against companies, such as us, for monetary gain. Because such patent holding companies do not provide services or use technology, the assertion of our own patents by way of counter-claim may be ineffective. We have received claims that our products infringe upon the proprietary rights of such patent holding companies. In addition, third parties have asserted and may in the future assert intellectual property infringement claims against our customers, which we have agreed in certain circumstances to indemnify and defend against such claims. If litigation becomes necessary to determine the validity of any third party claims or to protect our proprietary technology, it could result in significant expense to us and could divert the efforts of our technical and management personnel, whether or not the claim has any merit and notwithstanding that the litigation is determined in our favor. In the event of an adverse result in any litigation, we could be required to expend significant resources to develop non-infringing technology or to obtain licenses to the technology that is the subject of the litigation. We cannot provide assurance that we would be successful in developing non-infringing technology or that any licenses would be available on commercially reasonable terms.

We have trademark registration for the following marks in the United States: DSP Group, TRUESPEECH and XpandR. We also are in the process of registering the HDClear and HDMobileSurround marks in the United States.

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 that these measures will be successful.

Backlog

At December 31, 2012, our backlog was approximately $32.7 million, compared to approximately $36.7 million and $43.8 million at December 31, 2011 and 2010, 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, 2012, we had 317 employees, including 186 in research and development, 60 in marketing and sales and 71 in corporate, administration and manufacturing coordination. Competition for personnel in the semiconductor industry in general is intense. We believe that our future prospects will depend, in part, on our ability to continue to attract and retain highly-skilled technical, marketing and management personnel, who are in 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.

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

Sales of our digital cordless telephony products comprised a significant majority of our total revenues for 2012. Specifically, sales of our DECT, 2.4GHz, and CoIP products comprised 94% of our total revenues for 2012, 2011 and 2010. Revenues from our DECT products represented 82% of our total revenues 2012, 82% of our total revenues 2011 and 78% for 2010. Revenues from our 2.4 GHz products represented 7% of our total revenues for 2012, 9% for 2011 and 13% for 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 intense pricing pressures, and we expect that competition and pricing pressures may increase. Our existing and potential competitors in this market include large and emerging domestic and foreign companies, many of whom have significantly greater financial, technical, manufacturing, marketing, sales and distribution resources and management expertise than we do. It is possible that we may one day be unable to respond to increased pricing competition for digital cordless telephony processors or other products through the introduction of new products or reduction of manufacturing costs. This inability to compete would have a material adverse effect on our business, financial condition and results of operations. Likewise, any significant delays by us in developing, manufacturing or shipping new or enhanced products in this market also would have a material adverse effect on our business, financial condition and results of operations.

In addition, to general market competitiveness, the digital cordless telephony market is undergoing a challenging period of transition. With the rapid deployment of new communication access methods, including mobile, wireless broadband, cable and other connectivity, the traditional cordless telephony market using fixed-line telephony is declining and will continue to decline, which reduces our revenues derived from, and unit sales of, cordless telephony products. Macro-economic trends in the consumer electronics industry may adversely impact our future revenues.

Furthermore, the decline in fixed line telephony together with the rapid deployment of new communication access methods, including mobile, wireless broadband, cable and other connectivity will decrease sales of products using fixed-line telephony. Our business also may be affected by the outcome of the competition between cellular phone operators and fixed-line operators for the provision of residential communication. A significant majority of our revenues are currently generated from sales of chipsets used in cordless phones that are based on fixed-line telephony, and the continued decline in fixed-line telephony 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 68% of our total revenues for 2012, 67% for 2011 and 66% for 2010. Sales to VTech represented 35% of our total revenues for 2012, 33% for 2011 and 31% for 2010. Sales to Panasonic through our distributor represented 15% of our total revenues for 2012, 13% for 2011, and 16% for 2010. Sales to Uniden represented 11% of our total revenues for 2012, 10% for 2011 and 9% for 2010. Sales to CCT Telecom represented 8% of our total revenues for 2012, 11% for 2011 and 10% for 2010. 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

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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.

Our future success is dependent on market acceptance of our HDClear product family targeted for the mobile device market, which is an intensively competitive market with dominant and established players.

Our ability to increase our revenues and offset declining revenues from our cordless product family are substantially dependent on our ability to gain market share for our HDClear product family, a comprehensive voice enhancement and noise cancellation product targeted for mobile devices. Although a number of potential customers have expressed interest, we do not currently have any design wins for this product family, which is the initial step to incorporating OEM design wins, and we cannot assure that we will be successful in doing so. Even if we achieve design wins, the design-in process is labor intensive, long and often delayed. Therefore, the period from design-in to revenue generation may be long, and during the interim period, we would be expending significant time and resources through our sales and development cycles, potentially without achieving any economic return. Moreover, we are targeting a new market with our HDClear product family, a market with dominant and established players selling to OEM customers with whom they have established relationships. We will need to win over such customers, with whom we do not have established relationships, to gain market share. If we are unable to generate revenues from our HDClear product family and gain significant market share in the mobile device market, our operating results would be adversely affected.

The market for mobile device components is highly competitive and we expect competition to intensify in the future.

The market for mobile device components is highly competitive and characterized by the presence of large companies with significantly greater resources than we have. Our HDClear product family relates only to the voice and audio subsystem of a mobile device and there are only a limited number of OEMs targeted for this market. Our competitors include Audience and Cirrus Logic. We also face competition from smaller, privately held companies and could face competition from new market entrants. We also compete against solutions internally developed by OEMs, as well as combined third-party software and hardware systems. If we are unable to compete effectively, we may not succeed in achieving design wins and may have to lower our pricing to gain design wins, both of which would adversely impact our operating results.

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. This is especially the case for our HDClear product family. Moreover, even after an OEM agrees to design our products into its end products, the design cycle is long and may be delayed due to factors beyond our control which may result in the end product incorporating our products not to reach the market until long after the initial design win with the OEM. From initial product design-in to volume production, many factors could impact the timing and/or amount of sales actually realized from the design-in. These factors include, but are not limited to, changes in the competitive position of our technology, our customers financial stability, and our ability to ship products according to our customers schedule. Moreover, the continued uncertainty about the sustainability of the global economic recovery and outlook may further prolong an OEM customer s decision-making process and design cycle.

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

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

In addition to direct sales, we use a network of distributors to sell our products. Particularly, revenues derived from sales through our Japanese distributor, Tomen Electronics, accounted for 21% of our total revenues for 2012, 19% for 2011 and 25% for 2010. 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 15% of our total revenues for 2012, 13% for 2011 and 16% for 2010. 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 and by our customers or competitors;
- changes in the mix of products sold by us or our competitors;
- fluctuations in the level of sales by our OEM customers and other vendors of end products incorporating our products;
- timing and size of expenses, including expenses to develop new products and product improvements, and expenses resulting from restructuring activities;
- entry into new markets, including China, Korea and South America;
- our ability to scale our operations in response to changes in demand for our existing products and services or demand for new products requested by our customers;

- mergers and acquisitions by us, our competitors and our existing and potential customers; and

- general economic conditions, including current economic conditions in the United States and worldwide, and the adverse effects on the semiconductor and consumer electronics industries.

Each of the above factors is difficult to forecast and could harm our business, financial condition and results of operations. Also, we sell our products to OEM customers that operate in consumer markets. As a result, our revenues are affected by seasonal buying patterns of consumer products sold by our OEM customers that incorporate our products and the market acceptance of such products supplied by our OEM customers. The fourth quarter in any given year is usually the strongest quarter for sales by our OEM customers in the consumer markets, and thus, our third quarter in any given year is usually the strongest quarter for revenues as our OEM

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customers request increased shipments of our products in anticipation of the increased activity in the fourth quarter. By contrast, the first quarter in any given year is usually the weakest quarter for us. However, the magnitude of this trend varies annually and is affected by macro-economic trends. For example, due to the slowdown in demand for consumer electronics products in 2012, particularly cordless telephony products, our revenues for 2012 were weaker than 2011.

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

We have experienced and will continue to experience a decrease in the average selling prices of our products. Decreasing average selling prices could result in decreased revenues even if the volume of products sold increases. Decreasing average selling prices may also require us to sell our products at much lower gross margin than in the past and reduce profitability. Although we have to date been able to partially offset on an annual basis the declining average selling prices of our products through general operational efficiencies and manufacturing cost reductions by achieving a higher level of product integration and improving our yield percentages, there is no guarantee that our ongoing efforts will be successful or that they will keep pace with the anticipated, continued decline in average selling prices of our products.

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

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

Our gross margins also are affected by the product mix. For example, DECT products have lower average gross margins than other products, such as our 2.4GHz products. The DECT product line represented 82% of our total revenues for 2012. Therefore, increased sales of our DECT products could lower our gross margins.

Furthermore, increases in the price of silicon wafers, testing costs and commodities such as gold and oil, which may result in increased production costs, mainly assembly and packaging costs, may result in a decrease in our gross margins. Moreover, our suppliers may pass the increase in raw materials and commodity costs which could 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.

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

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

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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.

Our future business growth depends on the growth in demand for mobile devices with improved sound quality.

Our HDClear product family is designed to enhance the sound quality and eliminate background voices for mobile device users. OEMs and ODMs may decide that the costs of improving sound quality outweigh the benefits which could limit demand for our HDClear product family. Moreover, users may also be satisfied with existing sound quality or blame poor quality on their phone carriers. The market that we are targeting is evolving rapidly and is technologically challenging. New mobile devices with different components or software may be introduced that provide the same functionality as HDClear product family. Alternatively, wireless network technology may be improved to serve the same functionality. Our future business growth will depend on the growth of this market and our ability to adapt to technological changes, user preferences and OEM demands. Our business could be materially adversely affected if we fail to do so.

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

Although the majority of end users of the consumer products that incorporate our products are located in the U.S., we are dependent on sales to OEM customers, located outside of the U.S., that manufacture these consumer products. Also, we depend on a network of distributors to sell our products that also are primarily located outside of the U.S. Export sales, primarily consisting of digital cordless telephony products shipped to manufacturers in Europe and Asia, including Japan and Asia Pacific, represented 99% of our total revenues for 2012, 2011 and 2010. Furthermore, pursuant to the acquisition of the CIPT Business from NXP, we established new foreign subsidiaries, and currently have material operations in Germany, Hong Kong and India and employ a number of individuals within those foreign operations. As a result, the occurrence of any negative international political, economic or geographic events, as well as our failure to mitigate the challenges in managing an organization operating in various countries, could result in significant revenue shortfalls and disrupt our workforce within our foreign operations. These shortfalls and disruptions could cause our business, financial condition and results of operations to be harmed. Some of the risks of doing business internationally include:

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

multiple and possibly overlapping tax structures and potentially adverse tax consequences;

political and economic instability; and

changes in diplomatic and trade relationships.

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

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

In order to increase our sales volume and expand our business, we must penetrate new markets and introduce new products, especially our HDClear product family. We are exploring opportunities to expand sales of our products in China, Japan, Korea and South America. However, there are no assurances that we will gain significant market share in those competitive markets. In addition, due to the cyclical nature of manufacturing capacity issues, the increasing cost of silicon integrated circuits, the continued decline of average selling prices of chipsets and other industry-wide factors, many North American, European and Japanese OEMs are moving their manufacturing sites to Asia. 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. Our future growth is dependent on market acceptance and penetration of our new products, especially our HDClear product family, for which we can provide no assurances. Our revenue growth is also dependent on the successful deployment of our new VoIP products. Our inability to penetrate the market or lack of customer acceptance of these products may harm our business and potential growth.

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. This is especially the case for the mobile device market. 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

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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.

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

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

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

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

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

As part of the Acquisition of the CIPT Business, we entered into a Manufacturing Services Collaboration Agreement (MSCA), as amended, with NXP pursuant to which NXP agreed to provide us with specified manufacturing, pre-testing, assembling and final-testing services relating to the CIPT Business products. The services under the MSCA were to be provided by NXP at agreed upon prices initially for up to seven years following the closing of the acquisition and will expire by the end of 2014. Our business could be harmed if NXP, or third parties NXP has contracted, fails to achieve acceptable manufacturing yields, quality levels or allocate to us a sufficient portion of its foundry, and assembly and testing capacities to meet our needs for the CIPT Business products.

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. This downturn resulted in decreased consumer confidence and spending, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns among business. Notwithstanding improvements in business conditions since the second half of 2009, sustainability of the global economic recovery is uncertain, which continues to make it difficult for our customers, the end-product customers, our vendors and us to accurately forecast and plan future business activities and make reliable projections.

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

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

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

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

- risks due to the fact that we have reduced control over production cost, delivery schedules and product quality;

- less recourse if problems occur as the warranties on wafers or products supplied to us are limited; and

- increased exposure to potential misappropriation of our intellectual property.

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

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

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

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

We typically sell products pursuant to purchase orders rather than long-term purchase commitments. Customers can generally cancel, change or defer purchase orders on short notice without incurring a significant penalty. Given current market conditions, we have less ability to accurately predict what or how many products our customers will need in the future. In addition, we have little visibility into and no control of the demand by

our customer s customers generally consumer electronics retailers. Furthermore, based on discussions with our

customers, we understand that our customers also have less visibility into their product demands. A decrease in the consumer electronics retailers demand or a build-up of their inventory, both of which are out of the control of our customers and us, may cause a cancellation, change or deferral of purchase orders on 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. Based on these trends, our customers are reluctant to place orders with normal lead times, and we are seeing a shift to shorter lead-times and rush orders. However, 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 the 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 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 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 Asia, which may reduce the number of our potential customers and reduce the volume of chipsets the combined OEM customer may purchase from us. However, as is common in our industry, we typically do not enter into long term contracts with our customers in which they commit to purchase products from us. The loss of any of our OEM customers may have a material adverse effect on our results of operations. To attract new customers, we may be faced with intense price competition, which may affect our revenues and gross margins.

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

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

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

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

If it appears necessary or desirable, we may try to obtain licenses for those patents or intellectual property rights that we are allegedly infringing. Although holders of these types of intellectual property rights commonly offer these licenses, we cannot assure 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 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.

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 facilities are located in the State of Israel and, as a result, at December 31, 2012, 215 of our 317 employees were located in Israel, including 142 out of 186 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

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predict the effect of these obligations on the company in the future. Our operations could be disrupted by the absence, for a significant period, of one or more of our officers or key employees due to military service.

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

Our facilities in Israel have been granted Approved Enterprise and Beneficiary Enterprise status under the Law for the Encouragement of Capital Investments, 1959, commonly referred to as the Investment Law, as amended. The Investment Law provides that capital investments in a production facility (or other eligible assets) designated as an Approved Enterprise or Beneficiary Enterprise receive certain tax benefits in Israel. Our investment programs that generate taxable income are currently subject to an average tax rate of up to approximately 10% based on a variety of factors, including percentage of foreign ownership and approvals for the erosion of the tax basis of our investment programs. To be eligible for tax benefits, we must meet certain conditions, relating principally to adherence to the investment program filed with the Investment Center of the Israeli Ministry of Industry and Trade and periodic reporting obligations. Although we believe we have met such conditions in the past, should we fail to meet such conditions in the future, we would be subject to corporate tax in Israel at the standard corporate tax rate (25% for 2013) and could be required to refund tax benefits (including with interest and adjustments for inflation based on the Israeli consumer price index) already received. Our average tax rate for our investment programs also may change in the future due to circumstances outside of our control, including changes to legislation. Therefore, we cannot provide any assurances that our average tax rate for our investment programs will continue in the future at their current levels, if at all. The termination or reduction of certain programs and tax benefits or a requirement to refund tax benefits (including with interest and adjustments for inflation based on the Israeli consumer price index) already received may have a material adverse effect on our business, operating results and financial condition.

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

We have pursued, and will continue to pursue, growth opportunities through internal development and acquisition of complementary businesses, products and technologies. We are unable to predict whether or when any other prospective acquisition will be completed. The process of integrating an acquired business may be prolonged due to unforeseen difficulties and may require a disproportionate amount of our resources and management s attention. We cannot assure 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

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potential loss of key employees of acquired organizations.

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

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

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

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

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

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

We are subject to income taxes in the United States and various foreign jurisdictions. In addition to our significant operations in Israel, pursuant to the Acquisition, we currently have operations in Germany, Hong Kong and India. Significant judgment is required in determining our worldwide provision for income taxes and other tax liabilities. In the ordinary course of a global business, there are many intracompany transactions and calculations where the ultimate tax determination is uncertain. We are regularly under audit by tax authorities. Our intracompany 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 intracompany transactions and the various tax regimes, we cannot assure 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.

We are exposed to fluctuations in currency exchange rates.

A significant portion of our business is conducted outside the United States. Export sales to manufacturers in Europe and Asia, including Japan and Asia Pacific, represented 99% of our total revenues for 2012, 2011 and 2010. Although most of our revenue and expenses are transacted in U.S. dollars, we may be exposed to currency exchange fluctuations in the future as business practices evolve and we are forced to transact business in local currencies. Moreover, part of our expenses in Israel are paid in Israeli currency, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the New Israeli Shekel (NIS) and to economic pressures resulting from Israel s general rate of inflation. Our primary expenses paid in NIS are employee salaries and lease payments on our Israeli facilities. Furthermore, a portion of our expenses for our European operations are paid in the Euro, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the Euro. Our primary expenses paid in the Euro are employee salaries, lease and operational payments on our European facilities. As a result, an increase in the value of the NIS and Euro in comparison to the U.S. dollar, which has been the trend in most of the year due to the devaluation of the U.S. dollar, could increase the cost of our technology development, research and development expenses and general and administrative expenses, all of which could harm our operating profit. From time to time, we use derivative instruments in order to minimize the effects of currency fluctuations, but our hedging positions may be partial, may not exist at all in the future or may not succeed in minimizing our foreign currency fluctuation risks. Our financial results may be harmed if the trend relating to the devaluation of the U.S. dollars continues for an extended period.

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

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

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

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

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

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

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

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

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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 requires 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 that our foundries will be able to effectively manage the transition. In case our foundries or we experience significant delays in this transition or fail to efficiently implement this transition, our business, financial condition and results of operations could be materially and adversely affected.

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

Our certificate of incorporation and bylaws contain provisions that may prevent or discourage a third party from acquiring us, even if the acquisition would be beneficial to our stockholders. We have a staggered board, which means it will generally take two years to change the composition of our board. Our board of directors also has the authority to fix the rights and preferences of shares of our preferred stock and to issue such shares without a stockholder vote. Our bylaws also place limitations on the authority to call a special meeting of stockholders. Our stockholders may take action only at a meeting of stockholders and not by written consent. We have advance notice procedures for stockholders desiring to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders. 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 business could be negatively affected as a result of a proxy fight and the actions of activist stockholders.

Starboard Value and Opportunity Master Fund Ltd (collectively Starboard) has nominated candidates for each director position to be elected at our 2013 annual meeting of stockholders. Starboard is an activist stockholder that has engaged in numerous proxy contests. In April 2012, to avoid a proxy contest with Starboard at the 2012 annual meeting, we entered into an agreement with Starboard pursuant to which two directors selected by Starboard, Thomas Lacey and Kenneth Traub (the Starboard Nominees), were named to our board of directors. Each of the Starboard Nominees has been named at Starboard s insistence to boards of other public companies in which Starboard has acquired a stake. In connection with its decision to nominate candidates for election at the upcoming 2013 annual meeting, that would result in a majority of the board being directors hand-picked by Starboard, Starboard has advised our CEO and the chairman of our board that it is dissatisfied because during the past year DSP Group has not been sold as requested by Starboard. If Starboard is successful in a proxy contest at our 2013 annual meeting, and a majority of our directors are persons selected by Starboard, we believe that would subject DSP Group to undue influence and control by Starboard, which we believe would seek to pursue policies contrary to the best interests of DSP Group and all of its stockholders, and that it would adversely affect our ability to effectively and timely implement strategic plans that we believe are in the best interests of DSP Group and its stockholders.

Our efforts to convince Starboard not to engage in a proxy contest have been unsuccessful to date. If a proxy contest occurs litigation could ensue, including over statements made by us concerning the Starboard Nominees. In connection or as a result of such a contest, litigation and related matters, our business, business prospects and results of operations and financial condition could be subject to a material adverse effect, including because: (i) responding to proxy contests and other actions by activist stockholders can be costly and time-consuming, disrupting our operations and diverting the attention of our management and employees; (ii) perceived uncertainties as to our future direction may result in the loss of existing customers and potential business opportunities, and (iii) it may make it more difficult for us to attract and retain qualified personnel and business partners. A proxy contest could also cause our stock price to experience periods of volatility.

In connection with these matters, you should know that, despite having been selected by Starboard to serve on our board, and the board of other companies, the Starboard Nominees have claimed that they are entirely independent and have said that our statements about Starboard and the wisdom of allowing Starboard nominees to constitute a majority of our board have included false and misleading statements about the two Starboard Nominees, particularly in relation to their independence. The majority of our board of directors respectfully disagrees. The Starboard Nominees have also refused to sign our Annual Report on Form 10-K for the year ended December 31, 2012 as they claim that disclosure in this risk factor is inaccurate, a claim which the other directors of the company disagree.

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 offices in the United States are located in San Jose, California, where we lease approximately 3,800 square feet under a lease that expires in February 2014. Portions of our U.S. operations are located in leased facilities in El Dorado Hills, California under a lease that expires in March 2015. Our operations in Israel are located in leased facilities, with the primary leased facility of approximately 45,359 square feet located in Herzelia Pituach, Israel. These facilities are leased through November 2018. Our subsidiary in Tokyo, Japan has a lease that terminates in October 2014. Our subsidiary in Nuremberg, Germany has a lease that terminates in December 2015. Our subsidiary in Scotland has lease agreements for its facilities with automatic renewals on a month-to-month basis. Our subsidiary in India has sublease agreements with NXP for its facilities that terminate in March 2017. Our subsidiary in Hong Kong entered into a lease agreement that is effective until November 2013. We believe that our existing facilities are adequate to meet our needs for the immediate future.

Item 3. LEGAL PROCEEDINGS.

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

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

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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, 2011	High	Low
First Quarter	8.57	7.06
Second Quarter	9.24	7.52
Third Quarter	8.81	5.86
Fourth Quarter	6.75	5.12
Year Ended December 31, 2012	**High**	**Low**
First Quarter	6.79	4.85
Second Quarter	6.95	5.77
Third Quarter	6.40	5.36
Fourth Quarter	6.02	5.05

As of March 4, 2013, there were 21,916,855 shares of common stock outstanding. As of March 11, 2013, the company had approximately 37 holders of record and approximately 2,717 beneficial holders. 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 June 10, 2013. The definitive proxy statement will be filed with the Securities and Exchange Commission no later than 120 days after the end of the fiscal year covered by this report. Such information is incorporated herein by reference.

Issuer Purchases of Equity Securities

During the fourth quarter of 2012, we repurchased 100,840 shares of our common stock at an average price of $5.44 per share for approximately $548,000. The table below sets forth the information with respect to repurchases of our common stock during the three months ended December 31, 2012.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs)(1)
Month #1 (October 1, 2012 to October 31, 2012)	50,256	$ 5.42	50,256	358,333
Month #2 (November 1, 2012 to November 30, 2012)	12,800	$ 5.46	12,800	345,536
Month #3 (December 1, 2012 to December 31, 2012)	37,784	$ 5.46	37,784	307,749(1)

(1) The number represents the number of shares of our common stock that remain available for repurchase pursuant to our board s authorizations as of December 31, 2012.

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

At December 31, 2012, 307,749 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 as well as through entry into a share repurchase plan, in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934. 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 June 10, 2013. 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, 2007 and ends on December 31, 2012, the end of our last fiscal year. The graph assumes an investment of $100 on December 31, 2007, 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, 2012, 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,				
	2012	2011	2010	2009	2008
	(U.S. dollars in thousands)				
Statements of Operations Data:					
Revenues	$ 162,790	$ 193,861	$ 225,482	$ 212,186	$ 305,800
Cost of revenues	101,660	123,734	137,571	133,590	191,811
Gross profit	61,130	70,127	87,911	78,596	113,989
Operating expenses					
Research and development, net	42,539	53,244	55,588	56,148	73,856
General, administrative, sales and marketing	24,875	29,417	31,561	33,117	40,583
Amortization of intangible assets	2,310	7,972	9,975	12,258	22,853
Impairment of goodwill and other intangible assets					181,534
Restructuring cost (income)	2,008	(170)	463		1,870
Total operating expenses	71,732	90,463	97,587	101,523	320,696
Operating loss	(10,602)	(20,336)	(9,676)	(22,927)	(206,707)
Financial and other income					
Financial income, net	2,388	1,885	1,468	2,857	160
Other income from remeasurement of investment in a business Combination		1,343			
Loss before taxes	(8,214)	(17,108)	(8,208)	(20,070)	(206,547)
Taxes on income (benefit)	(172)	(866)	(783)	(11,634)	5,847
Net loss	$ (8,042)	$ (16,242)	$ (7,425)	$ (8,436)	$ (212,394)
Weighted average number of Common Stock outstanding during the period used to compute basic net earnings per share	21,950	23,247	23,229	23,655	28,387
Weighted average number of Common Stock outstanding during the period used to compute diluted net earnings per share	21,950	23,247	23,229	23,655	28,387
Basic net loss per share	$ (0.37)	$ (0.70)	$ (0.32)	$ (0.36)	$ (7.48)
Diluted net loss per share	$ (0.37)	$ (0.70)	$ (0.32)	$ (0.36)	$ (7.48)
Balance Sheet Data:					
Cash, cash equivalents, marketable securities and bank deposits, including restricted deposits	$ 120,339	$ 117,909	$ 139,761	$ 123,065	$ 121,501
Working capital	$ 49,102	$ 60,010	$ 72,073	$ 68,013	$ 92,359
Total assets	$ 185,182	$ 197,625	$ 222,555	$ 219,769	$ 249,254
Total stockholders equity	$ 142,227	$ 148,624	$ 167,103	$ 165,489	$ 178,627

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Fiscal Years by Quarter	Year Ended December 31, 2012				2011			
Quarterly Data:	4th	3rd	2nd	1st	4th	3rd	2nd	1st
	(Unaudited, U.S. dollars in thousands, except per share amount)							
Revenues	$ 38,429	$ 36,666	$ 44,191	$ 43,504	$ 38,195	$ 48,373	$ 58,517	$ 48,776
Gross profit	$ 14,739	$ 13,902	$ 16,511	$ 15,978	$ 13,628	$ 17,520	$ 21,751	$ 17,228
Other income from remeasurement of investment in a business Combination					$ 1,343			
Net loss	$ (141)	$ (2,415)	$ (2,224)	$ (3,262)	$ (4,823)	$ (4,814)	$ (2,041)	$ (4,564)
Net loss per share Basic	$ (0.01)	$ (0.11)	$ (0.10)	$ (0.14)	$ (0.21)	$ (0.21)	$ (0.09)	$ (0.19)
Net loss per share Diluted	$ (0.01)	$ (0.11)	$ (0.10)	$ (0.14)	$ (0.21)	$ (0.21)	$ (0.09)	$ (0.19)

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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, delivering system solutions that combine semiconductors and software with reference designs. We provide a broad portfolio of wireless chipsets integrating DECT, Wi-Fi, PSTN and VoIP technologies with state-of-the-art application processors. We also enable converged voice, audio, video and data connectivity across diverse consumer products from cordless and VoIP phones to home gateways and connected multimedia screens. Our current primary focus is digital cordless telephony with sales of our in-house developed DECT, CoIP, 2.4GHz and 5.8GHz chipsets representing approximately 94% of our total revenues for 2012.

Our revenues were $162.8 million for 2012, a decrease of 16.0% in comparison to 2011, mainly due to a decrease in sales, and reduction in average selling prices, of our cordless telephony products. Sales of our DECT 6.0 products for the U.S. market decreased from $75.4 million for 2011 to $69.1 million for 2012. Sales of our DECT products for the European market decreased from $79.3 million for 2011 to $56.7 million for 2012. Revenues derived from the sale of DECT products represented 82% of our total revenues for both 2012 and 2011. Our gross margin increased to 37.6% of our total revenues for 2012 from 36.2% for 2011, primarily due to (i) a decrease in the provision for slow or obsolete inventories, (ii) an improvement in the production yield of certain of our products, (iii) a decrease in certain production costs such as gold due to the replacement of gold with copper in certain of our products, and (iv) a reduction in manufacturing and other related operational expenses such as boards, materials and subcontractors.

Our operating loss decreased to $10.6 million for 2012, as compared to $20.3 million for 2011. The decrease in operating losses for 2012 was mainly as a result of a decrease in operating expenses in all expense categories in 2012 as compared to 2011, offset to some extent by a decrease in total revenues during 2012 as compared to 2011. Our operating expenses decreased by 20.7% to $71.7 million for 2012, as compared to $90.5 million for 2011. In addition, we implemented two cost reduction programs during 2012, and expect the programs to result in an additional decrease in operating expenses for 2013.

Notwithstanding our success in reducing our operating expenses, revenues derived from our cordless products are continuing to decline. This is primarily due to the lack of growth of the cordless telephony market, as well as continuing decline in the average selling prices of all of our cordless products. The cordless telephony market is undergoing a challenging period of transition. With the rapid deployment of new communication access methods, including mobile, wireless broadband, cable and other connectivity, the traditional cordless telephony market using fixed-line telephony will likely continue to decline, which will continue to reduce our revenues derived from, and unit sales of, cordless telephony products. Furthermore, our business also may be significantly affected by the outcome of the competition between cellular phone operators and fixed-line operators for the provision of residential communication. A significant majority of our revenues are currently generated from sales of chipsets used in cordless phones that are based on fixed-line telephony. If we are unable to develop new technologies to address alternative connectivity methods, our business could be materially adversely affected.

Therefore, in order to increase our revenues and offset the declining revenues generated from our cordless products, we need to introduce new products and penetrate new markets. We recently unveiled our revolutionary HDClear solution, a comprehensive voice enhancement product for mobile devices. Incorporating proprietary noise cancellation algorithms, HDClear improves user experience and delivers high voice quality and call intelligibility. This technology will enable people to use their cell phones for conversation in virtually any condition, whether in a car, on a train or in other noisy surroundings. HDClear will also facilitate the use of speech recognition and voice commands by eliminating background noise.

In addition, we are concentrating our development efforts on other next generation products. Our next generation products also include: (i) DECT/CAT-iq integrated circuits targeted for residential gateway devices supplied by telecommunication service providers and which integrate the DECT/CAT-iq functionality and can also address home automation applications, as well as fixed-mobile convergence solutions, which products are included in our home segment; and (ii) VoIP products for enterprise which products are included in our office segment. We hope to leverage our strong technology base and customer relationships with our next generate products to maximize growth and revenue opportunities.

We are seeing evidence that our past research and development investments in new technologies are beginning to materialize. We have achieved a number of design wins for our next generation products. Commercial shipments for some products have begun with more shipments to occur during 2013. Aggregate revenues derived from our next generate products were 11.9%, 10.3% and 7.1% of our total revenues for 2012, 2011 and 2010, respectively. Based on a strong pipeline of design wins, our current mix of next generation products and anticipated commercialization schedules of customers incorporating our next generation products, we anticipate annualized revenues generated from our next generation products to increase significantly in 2013 as compared to 2012.

However, we can provide no assurances about our success in introducing new products and penetrating new markets, as well as our predictions regarding market trends. For example, although a number of potential customers have expressed interest, we have not achieved a design win for our HDClear product for mobile devices. Furthermore, although next generation products targeted at the convergence of voice and data connectivity, enterprise VoIP solutions and mobile device market are gradually being introduced into the market, market adoption of such products is at early stages. Although we have achieved a number of design wins with top-tier OEMs for next-generation products, revenue generated from the commercialization of new products is a measured process as there is generally a long lead time from a design win to commercialization. From initial product design win to volume production, many factors could impact the timing and/or amount of sales actually realized from the design win. In addition to general price sensitive and price erosion in the markets we operate, the introduction of next-generation productions may accelerate price erosion of older products. As a result, we expect the market to remain price sensitive for our traditional cordless telephony products and expect that price erosion and the decrease in the average selling prices of such products to continue. Furthermore, various other factors, including increases in the cost of raw materials and commodities and our suppliers passing such increases onto us, increases in silicon wafer costs and increases in production, assembly and testing costs, and shortage of capacity to fulfill our fabrication, assembly and testing needs, all may decrease our gross profit and harm our ability to grow our revenues in future periods.

Nonetheless, we remain focused on generating non-GAAP operating income for 2013, and continue to closely monitor market trends. As a result of our cost cutting measures implemented during 2012, we anticipate a significant decrease in our operating expenses for 2013, as compared to 2012.

As of December 31, 2012, our principal source of liquidity consisted of cash and cash equivalents of $21.7 million and marketable securities and short term deposits of $98.5 million, totaling $120.2 million.

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Critical Accounting policies

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

Our significant accounting policies are discussed in Note 2, Significant Accounting Policies, of the notes to our consolidated financial statements for the year ended December 31, 2012.

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 Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) No. 740, Income Taxes, the first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement.	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.

Description	Judgments & Uncertainties	Effect if Actual Results Differ from Assumptions
Tax Valuation Allowance: We have a valuation allowance for deferred tax assets based on the determination that it is more likely than not that some of these assets will not be realized.	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.
Valuation of Long-Lived Assets, Intangible Assets and Goodwill : Goodwill represents the excess of purchase price over the fair value of identifiable net assets acquired in business combination. The goodwill on our consolidated balance sheet is a result of our acquisition of BoneTone. Goodwill and the identifiable intangible assets included on our consolidated balance sheet are current customer relations, acquired from NXP in the Acquisition and in-process R&D and non-competition agreement acquired in the BoneTone acquisition. We perform our annual impairment analysis of goodwill and indefinite-lived intangible assets (such as in-process research and development) in the fourth quarter of each fiscal year, or more often if there are indicators of impairment. We review intangible assets with finite useful life for potential impairment when events or changes in circumstances indicate the carrying value of those intangible assets may be impaired. We may obtain an appraisal from an independent valuation firm to determine the amount of impairment, if any. In addition to the use of an independent valuation firm, we perform internal valuation analyses and consider other publicly available market information.	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 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.	If management s estimates or related assumptions change in the future, we may be required to record impairment charges for our intangible assets.

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Description	Judgments & Uncertainties	Effect if Actual Results Differ from Assumptions
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 management s 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 four 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 management s 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. We estimate the fair value of equity-based awards using a binomial option pricing model. The fair value of an award is affected by our stock price on the date of grant as well as other assumptions, including expected stock price volatility and the expected term of the equity-based award. The risk-free interest rate is based on the yield from U.S. treasury bonds with an equivalent term. Expected volatility is calculated based upon actual historical stock price movements. The expected term of the equity-based award granted is based upon historical experience and represents the period of time that the award granted is expected to be outstanding. Our expected dividend rate is zero since we do not currently pay cash dividends and do not anticipate doing so in the foreseeable future.	Although management believes that their estimates and judgments about equity-based compensation expense are reasonable, actual results could differ.

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

Description	Judgments & Uncertainties	Effect if Actual Results Differ from Assumptions
Business Combination: In December 2011, we exercised our option to acquire the remaining 70% equity interest our, on a fully diluted basis, in BoneTone for a purchase price of $8.6 million. The acquisition was recorded in accordance with ASC 805, Business Combination Accounting. We have allocated the purchase price of BoneTone to tangible and acquisition-related intangible assets acquired and liabilities assumed based on their estimated fair values.	Management makes estimates of fair value using reasonable assumptions based on historical experience and information obtained from the BoneTone management in order to allocate the purchase price to the tangible and intangible assets.	The valuation requires 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.

Results of Operations:

Total Revenues. Our total revenues were $162.8 million for 2012, $193.9 million for 2011 and $225.5 million for 2010. The decrease of 16% in revenues for 2012 as compared to 2011 and the decrease of 14% in revenues for 2011 as compared to 2010 were both primarily as a result of decreased sales of our 2.4GHz and DECT products. Sales of DECT products were $133.9 million, $159.4 million and $176.8 million for the years ended 2012, 2011 and 2010, respectively, representing approximately 82%, 82% and 78% of our total revenues for 2012, 2011 and 2010, respectively. The decrease of 16% in absolute dollars of DECT sales in 2012 as compared to 2011 and the decrease of 10% in absolute dollars of DECT sales in 2011 as compared to 2010 were mainly attributable to a decline in market demands and the decrease in average selling prices of our products. In addition, sales of our DECT 6.0 products for the U.S. end market were $69.1 million, $75.4 million and $84.2 million for 2012, 2011 and 2010, respectively, representing 42%, 39% and 37% of our total revenues for 2012, 2011 and 2010, respectively. Sales of our DECT products for the European market decreased from $84.2 million in 2010 to $79.3 million for 2011 and to $56.7 million for 2012.

Sales of 2.4GHz products were $12.1 million, $18.3 million and $29.3 million for 2012, 2011 and 2010, respectively, representing 7%, 9% and 13% of our total revenues for 2012, 2011 and 2010, respectively. This represents a decrease of 34% in absolute dollars when comparing sales for 2012 to 2011, which resulted mainly from the decrease of sales of our 2.4 GHz products in the Japanese domestic and the U.S. markets. When comparing 2.4 GHz sales for 2011 to 2010, there was a decrease of 38% in absolute dollars which resulted mainly from the decrease of sales of our 2.4 GHz products in the Japanese domestic market.

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

	Year Ended December 31,		
	2012	2011	2010
United States	$ 2,028	$ 1,836	$ 1,423
Hong Kong	84,736	100,894	112,319
Japan	51,033	57,260	76,986
Europe	7,429	9,180	13,043
Korea	1,968	5,909	8,081
China	6,270	8,577	6,807
Taiwan	6,496	7,225	3,208
Other	2,830	2,980	3,615
Total revenues	$ 162,790	$ 193,861	$ 225,482

Sales to our customers in Hong Kong decreased for 2012 as compared to the same period of 2011, representing a decrease of 16% in absolute dollars. The decrease in our sales to Hong Kong for the comparable periods resulted mainly from the decrease in sales to Vtech Holding Ltd. (Vtech) of 10% when comparing 2012 to 2011 and a decrease in sales to CCT Telecom Holdings Ltd. of 40% when comparing 2012 to 2011. Sales to our customers in Japan decreased for 2012 as compared to the same period of 2011, representing a decrease of 11% in absolute dollars. The decrease in our sales to Japan for the comparable periods resulted mainly from (i) a decrease in sales to Panasonic Communications Co. Ltd. (Panasonic), representing a 7% decrease in absolute dollars for 2012 as compared to 2011, (ii) a decrease in sales to the Japanese domestic market, representing a 15% decrease in absolute dollars for 2012 as compared to 2011, and (iii) a decrease in sales to the Uniden America Corporation (Uniden), representing a 14% decrease in absolute dollars for 2012, as compared to 2011. Sales to our customers in Hong Kong decreased for 2011 as compared to 2010, representing a decrease of 10% in absolute dollars. The decrease in our sales to Hong Kong for the comparable periods resulted from the decrease in sales to all of our Hong Kong-based customers, including a decrease of 9% in sales to Vtech when comparing 2011 to 2010. Sales to our customers in Japan decreased for 2011 as compared to 2010, representing a decrease of 26% in absolute dollars. The decrease in our sales to Japan for the comparable periods resulted mainly from (i) a decrease in sales to Panasonic, representing a 28% decrease in absolute dollars for 2011, as compared to 2010, and (ii) a decrease in sales to the Japanese domestic market, representing a 41% decrease in absolute dollars for 2011, as compared to 2010.

As our products are generally incorporated into consumer products sold by our OEM customers, our revenues are affected by seasonal buying patterns of consumer products sold by our OEM customers that incorporate our products.

Significant Customers. The Japanese and Hong Kong markets and the OEMs that operate in those markets are among the largest suppliers of residential wireless products with significant market share in the U.S. market. The loss of any of our significant customers or distributors could have a material adverse effect on our business, financial condition and results of operations.

VTech is a significant OEM customer based in Hong Kong. Sales to VTech represented 35%, 33% and 31% of our total revenues for 2012, 2011 and 2010, respectively. Another significant customer of the company in Hong Kong is CCT Telecom, whose sales represented 8%, 11% and 10% of our total revenues for 2012, 2011 and 2010, respectively.

Revenues derived from sales through our largest distributor, Japan-based Tomen Electronics Corporation (Tomen Electronics), accounted for 21% of our total revenues for 2012, as compared to 19% for 2011 and 25% for 2010. Sales to Uniden America Corp. (Uniden) represented 11%, 10% and 9% of our total revenues for 2012, 2011 and 2010, respectively.

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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 15%, 13% and 16% of our total revenues for 2012, 2011 and 2010, respectively.

Significant Products. Revenues from our DECT products represented 82%, 82% and 78% of our total revenues for 2012, 2011 and 2010, respectively. Revenues from our 2.4GHz products represented 7%, 9% and 13% of our total revenues for 2012, 2011 and 2010, respectively. We believe that sales of DECT and 2.4GHz products will continue to represent a substantial percentage of our revenues for 2013. We believe that the rapid deployment of new communication access methods, as well as the lack of growth in fixed-line telephony, will reduce our total revenues derived from, and unit sales of, cordless telephony products, including our DECT and 2.4GHz products, for the short and long term.

Gross Profit. Gross profit as a percentage of revenues was 37.6% for 2012, 36.2% for 2011 and 39% for 2010. The increase in our gross profit for 2012 as compared to 2011 was primarily due to (i) a decrease in the provision for slow or obsolete inventories, (ii) an improvement in the production yield of certain of our products, (iii) a decrease in certain production costs such as gold due to the replacement of gold with copper in certain of our products, and (iv) a reduction in other operational expenses such as boards, materials, internal headcount and subcontractors. The decrease in our gross profit for 2011 as compared to 2010 was primarily due to (i) a decrease in overall revenues, (ii) a decrease in average selling prices of our products, (iii) an increase in certain production costs and related materials, such as gold, and (iv) income from a reversal of a reserve, during 2010, amounting to $2.5 million associated with a potential patent infringement claim that was determined to be no longer needed due to the expiration of the applicable statute of limitations. As gross profit reflects the sale of chips and chipsets that have different margins, changes in the mix of products sold have impacted and will continue to impact our gross profit in future periods. Our gross profit may decrease in the future due to a variety of factors, including the continued decline in the average selling prices of our products, changes in the mix of products sold, our failure to achieve cost reductions, roll-out of new products in any given period, our success in introducing new engineering processes to reduce manufacturing costs, increases in the cost of raw materials such as gold, oil and silicon wafers, and increases in production, assembly and testing costs. Moreover, our suppliers may pass the increase in the cost of raw materials and commodities onto us which would further reduce the gross margins of our products. We cannot guarantee that our ongoing efforts in cost reduction and yield improvements will be successful or that they will keep pace with the anticipated continuing decline in average selling prices of our products. Steps we are taking include the implementation of cost improvement plans to reduce testing costs and offering our customers more cost effective products by, for example, replacing gold wiring with copper wiring. However, we can provide no assurance that any alternative solutions we provide to our customers will be acceptable to them or that these steps will help us offset the continued decrease in gross margins of our products.

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

Operating Expenses. Our operating expenses were $71.7 million for 2012, $90.5 million for 2011 and $97.6 million for 2010. The decrease in operating expenses for 2012 as compared to 2011 was primarily attributable to a decrease in research and development expenses in the amount of $10.7 million in 2012 as compared to 2011, which was attributed mainly to (x) the restructuring of our U.S. operations, implemented during the third quarter of 2011 which reduced our research and development expenses for 2012, (y) a decrease in projects-related expenses (mainly tape-out, materials, subcontractors and travel expenses), and (z) a decrease in labor and employee-related expenses, (in addition to the restructuring of our U.S. operations that was initiated during the third quarter of 2011). This decrease in labor and employee-related expenses for both comparable periods was mainly due to (a) a decrease in the number of employees, (b) the devaluation of the New Israeli Shekel (NIS) against the U.S. dollar, which decreased the Israeli employee labor expenses, and (c) the restructuring of our operations that was initiated during the second and the third quarters of 2012. Other factors that contributed to the decrease in our operating expenses are: (i) a decrease in general and administrative

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expenses such as legal and stockholders and investors relations expenses in the amount of $1.2 million in 2012 as compared to 2011, (ii) a decrease in sales commission paid in 2012 as compared to 2011 in the amount of $0.6 million due to a lower level of revenues subject to sales commissions, (iii) a decrease in equity-based compensation expenses in the amount of $1.2 million, and (iv) a decrease in the amortization cost for intangible assets related mostly to the CIPT Acquisition in the amount of $5.7 million. These decreases were offset to some extent by an increase in expenses in the amount of $2.2 million, which were related to the above mentioned restructuring plans executed in 2012. Our operating losses were $10.6 million for 2012, as compared to $20.3 million for 2011 and $9.7 million for 2010. The decrease in operating losses for 2012 as compared to 2011 was mainly due to an increase in gross margins and a decrease in operating expenses as noted above, offset to some extent by a decrease in revenues in 2012 as compared to 2011. The decrease in operating expenses for 2011 as compared to 2010 was primarily attributable to (i) a decrease in payroll and facilities expenses derived from the reorganization of our European operations and the closure of our Swiss operations in the amount of $3.6 million, (ii) a decrease in equity-based compensation expenses in the amount of $3.3 million, and (iii) a decrease in the amortization cost for intangible assets related to the CIPT Acquisition in the amount of $2.0 million. These decreases were offset to some extent by an increase in other general and administrative expenses, such as legal and stockholders and investors relations expenses. The increase in operating losses in 2011 as compared to 2010 was mainly as a result of a decrease in total revenues and gross margins during 2011 as compared to 2010, offset to some extent by a decrease in operating expenses in 2011 as compared to 2010.

Research and Development Expenses. Our research and development expenses were $42.5 million for 2012, $53.2 million for 2011 and $55.6 million for 2010. The decrease for 2012 in research and development expenses, as compared to 2011, was mainly due to (i) the restructuring of our U.S. operations, which was implemented during the third quarter of 2011 and reduced our research and development expenses for 2012 as compared to 2011 in the amount of $2 million (ii) a decrease in projects-related expenses (mainly tape-out, materials, subcontractors and travel expenses) in the amount of $3.7 million, (iii) a decrease in equity-based compensation expenses in the amount of $0.3 million, and (iv) a decrease in labor and employee-related expenses in the amount of $3.1 million (in addition to the planned restructuring of our U.S. operations initiated during the third quarter of 2011). This decrease in labor and employee-related expenses for 2012 was mainly due to (x) a decrease in the number of employees, (y) the devaluation of the NIS against the U.S. dollar, which decreased our Israeli employee labor expenses, and (z) the restructuring of our operations that was initiated during the second and the third quarters of 2012, which are described in greater detail in Note 15 of the notes to our consolidated financial statements for the year ended December 31, 2012. In addition, during 2012, we recorded grants receivable in the amount of $0.4 million from the Office of Chief Scientist in Israel in support of one of our research and development projects, which also decreased our research and development expenses, in comparison to 2011.

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

Our research and development expenses as a percentage of our total revenues were 26%, 27% and 25% for 2012, 2011 and 2010, respectively. The decrease in research and development expenses as a percentage of total revenues for 2012 as compared to 2011 was mainly due to a decrease in a research and development expenses in 2012 as compared to 2011, which was offset to some extent by a decrease in absolute dollars of our total revenues in 2012 as compared to 2011. The increase in research and development expenses as a percentage of total revenues for 2011 as compared to 2010 was mainly due to a decrease in absolute dollars of our total revenues for 2011 as compared to 2010.

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

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Sales and Marketing Expenses. Our sales and marketing expenses were $14.2 million for 2012, $16.5 million for 2011 and $17.2 million for 2010. The decrease in sales and marketing expenses between 2012 and 2011 was mainly attributed to (i) a decrease in the number of sales and marketing employees and labor expenses in the amount of $1 million, (ii) a decrease in the amount of $0.6 million in sales commission paid due to a lower level of revenues subject to sales commissions, (iii) a decrease in overseas travel expenses in the amount of $0.3 million, and (iv) a decrease in equity-based compensation expenses in the amount of $0.2 million.

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

Our sales and marketing expenses as a percentage of our total revenues were 9% for both 2012 and 2011 and 8% for 2010. The increase in sales and marketing expenses as a percentage of total revenues for 2011 as compared to 2010 was mainly due to a decrease in absolute dollars of our total revenues for 2011 as compared to 2010.

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 $10.6 million, $12.9 million and $14.4 million for 2012, 2011 and 2010, respectively. The decrease in general and administrative expenses for 2012 as compared to 2011 was mainly attributed to (i) a decrease in investors relations, legal and accounting expenses in the amount of $1.3 million, (ii) a decrease in equity-based compensation expenses in the amount of $0.6 million, and (iii) a decrease in payroll related expenses in the amount of $0.3 million mainly due to the devaluation of the NIS against the U.S. dollar, which decreased our Israeli employee payroll expenses in U.S. dollar.

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

General and administrative expenses as a percentage of our total revenues were 7% for both 2012 and 2011, and 6% for 2010. The increase in general and administrative expenses in 2011 as a percentage of total revenues as compared to 2010 was due to a decrease in absolute dollars of our total revenues in 2011 as compared to 2010.

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

Description of Segments.

Until the second quarter of 2012, we operated under one reporting segment.

During the third quarter of 2012, following a change in the manner our management evaluates financial information, management determined that the company operates under three reportable segments in accordance with ASC 280 Disclosure about Segments of an Enterprise and Related Information.

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Our operating segments are as follows: Home, Office and Mobile. The classification of our business segments is based on a number of factors that management uses to evaluate, view and run our business operations, which include, but are not limited to, customer base, homogeneity of products and technology.

A description of the types of products provided by each business segment is as follows:

Home Wireless chipset solutions for converged communication at home. Such solutions include integrated circuits targeted for cordless phones sold in retail or supplied by telecommunication service providers, residential gateway devices supplied by telecommunication service providers which integrate the DECT/CAT-iq functionality and also wireless chipsets for home automation applications, as well as fixed-mobile convergence solutions.

Office Comprehensive solution for Voice-over-IP (VoIP) office products, including office solutions that offer businesses of all size low-cost VoIP terminals with converged voice and data applications.

Mobile Products for the mobile market that provides voice enhancement and far-end noise elimination targeted for mobile phone and mobile headsets.

Segment data:

We derive the results of our business segments directly from our internal management reporting system and by using certain allocation methods. The accounting policies we use to derive business segment results are substantially the same as those we use for consolidation of our financial statements. Management measures the performance of each business segment based on several metrics, including earnings from operations. Management uses these results, in part, to evaluate the performance of, and to assign resources to, each of the business segments. We do not allocate to our business segments certain operating expenses, which are managed separately at the corporate level. These unallocated costs include primarily restructuring charges, amortization of purchased intangible assets, equity-based compensation expenses and certain corporate governance costs.

Selected operating results information for each business segment was as follows for the year ended December 31, 2012 and 2011:

	Twelve months ended December 31					
	Revenues			Income (loss) from operations		
	2012	2011	2010	2012	2011	2010
Home	$ 155,211	$ 188,192	$ 223,354	$ 15,040	*	*
Office	$ 7,579	$ 5,669	$ 2,128	$ (5,156)	*	*
Mobile	$	$	$	$ (8,585)	*	*
Total	$ 162,790	$ 193,861	$ 225,482	$ 1,299	$ (2,830)	$ 10,234

*) It is impracticable to present 2011 and 2010 income (loss) from operations by segments due to lack in internal management reporting and tracking system, which tracks and reports employees actual hours in the various projects.

Sales to our customers in the home segment decreased for 2012 as compared to the same period of 2011, representing a decrease of 17% in absolute dollars and decreased for 2011 as compared to the same period of 2010, representing a decrease of 14% in absolute dollars. The decrease in our sales in the home segment for the comparable periods was mainly attributable to the decline in market demands and the decrease in the average selling prices of cordless phones over the comparative periods.

Sales to our customers in the office segment increased for 2012 as compared to the same period of 2011, representing an increase of 34% in absolute dollars. Sales to our customers in the office segment increased for 2011 as compared to the same period of 2010, representing an increase of 166% in absolute dollars. The increase in our sales in the office segment for both comparable periods was mainly due to the increase in market share in sales to this new segment and in increase in market demand for VoIP products.

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The reconciliation of segment operating results information to our consolidated financial information was as follows:

	Year ended December 31,		
	2012	2011	2010
Income (loss) from operations	$ 1,299	$ (2,830)	$ 10,234
Unallocated corporate, general and administrative expenses	(2,600)	(3,485)	(2,419)
Restructuring (expenses) income	(2,008)	170	(463)
Equity-based compensation expenses	(4,983)	(6,220)	(9,553)
Intangible assets amortization expenses	(2,310)	(7,972)	(9,975)
Other income from remeasurement of initial investment in an affiliated company		1,343	
Reversal of a reserve that was determined to be no longer needed due to the expiration of applicable statute of limitations included in costs of goods sold			2,500
Financial income, net	2,388	1,885	1,468
Total consolidated loss before taxes	$ (8,214)	$ (17,108)	$ (8,208)

***Amortization of Intangible Assets*.** During 2012, 2011 and 2010, we recorded an expense of $2.3 million, $8.0 million and $10.0 million, respectively, relating to the amortization of intangible assets associated with the CIPT acquisition and the acquisition of BoneTone in 2011. The sequential decrease in 2012 as compared to 2011 and 2010 is consistent with, and is based on, the original amortization schedule determined following the impairment of goodwill and other intangible assets that took place in 2008 in relation to the CIPT Acquisition.

***Restructuring Costs and Other*.** During 2012, we recorded an expense of $2.0 million in connection with the restructuring of our operations, which was composed of two restructuring plans executed during the second and third quarters of 2012. As part of these restructuring plans, we executed termination agreements with certain of our employees and recorded an expense related to the future expected under-utilization of existing development tool agreements with expiry dates in 2013 and 2014. During 2011, as part of our plan to improve operational efficiencies and reduce our operating expenses for fiscal year 2012, we restructured our U.S. operations. As part of this restructuring plan, we executed termination agreements with certain of our U.S. employees and renegotiated the lease for our U.S. facilities. We recorded an income in the amount of $0.2 million during 2011 which was composed of an income of $0.6 million associated with the restructuring plan that we initiated during the third quarter of 2010, offset by restructuring expenses in the amount of $0.4 million associated with the restructuring of our U.S. operations as noted above. The above referenced income resulted mainly from the closure of our Swiss facilities and the termination of employment of the employees of our Swiss subsidiary, which resulted in a curtailment and settlement of our Swiss pension plan during the first quarter of 2011.

Financial income, net. Financial income, net, was $2.4 million for 2012, $1.9 million for 2011 and $1.5 million for 2010. The increase in financial income, net, for 2012 as compared to 2011 was mainly due to a profit in the amount of $0.7 million resulting from the sale of certain marketable securities during 2012, as compared to a $0.2 million profit recorded during 2011. The increase in financial income, net, for 2011 as compared to 2010 was mainly due to (i) the devaluation of the Euro against the U.S. dollar and the devaluation of the U.S. dollar against the Swiss Franc, which resulted in higher expenses associated with the exchange rate differences during 2010 as compared to 2011, and (ii) a profit in the amount of $0.2 million resulting from the sale of certain marketable securities during 2011, as compared to a $0.1 million profit recorded during 2010.

Our total cash, cash equivalents, marketable securities and short term deposits, including restricted deposits, were $120.3 million as of December 31, 2012, as compared to $117.9 million as of December 31, 2011.

Other income. We recorded other income in the amount of $1.3 million during the fourth quarter of 2011. Other income was derived from the remeasurement to fair value of our investment in BoneTone when we

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exercised our option to acquire the remaining 70% equity interest in BoneTone, on a fully diluted basis, for a purchase price of $8.6 million in December 2011. We initially acquired 30% of BoneTone s then outstanding equity, on a fully diluted basis, in November 2009.

Provision for Income Taxes. Our income tax benefit was $0.2 million for 2012, as compared to a tax benefit of $0.9 million for 2011 and a tax benefit of $0.8 million for 2010. The income tax benefit for 2012 was mainly attributed to a reversal of an income tax contingency reserve in the amount of $0.5 million that was determined to be no longer required due to the expiration of the applicable statutes of limitation during the third quarter of 2012. The income tax benefit for 2011 resulted mainly from a tax benefit of $0.6 million resulting from the reversal of an income tax contingency reserve that was determined to be no longer needed due to the expiration of the applicable statute of limitations and from an approval that was received from the Israeli governmental authorities with respect to the recognition for tax purposes of our research and development expenses for previous years. The income tax benefit for 2010 resulted mainly from a tax benefit of $0.6 million resulting from the reversal of an income tax contingency reserve that was determined to be no longer needed due to the expiration of applicable statutes of limitation.

During 2012, we did not record any significant changes to the net deferred tax assets due to our current estimate of future taxable income.

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

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

For 2006 and 2009, DSP Group Ltd. elected the status of a Beneficiary Enterprise under the Amendment for its seventh and eight plans, respectively. The seventh and eight plans entitle DSP Group Ltd. to a corporate tax exemption for a period of two years and a reduced corporate tax rate of 10%-25% (based on the percentage of foreign ownership) for an additional period of eight years from the first year it has taxable income. The tax benefits under the seventh and eighth investment plans are scheduled to gradually expire between 2016 and 2021.

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

for 2011 and 2012 15%;

for 2013 and 2014 12.5%; and

for 2015 and thereafter 12%.

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

In November 2012, the Knesset passed Amendment No. 69 to the Investment Law (the Trapped Earnings Law) which provides a temporary, partial, relief from taxation on a distribution from exempt income for companies which elect the relief through November 2013. The Trapped Earnings Law allows a company to qualify a portion of its exempt income (Elected Earnings) for a reduced tax rate ranging between 17.5% and 6%. While the reduced tax is payable within 30 days of election, an electing company is not required to actually distribute the Elected Earnings within a certain period of time. The applicable rate is based on a linear formula involving the portion of Elected Earnings to exempt income and the applicable tax rate prescribed in the Investment Law. A company electing to qualify its exempt income must undertake to make designated investments in productive fixed assets, research and development, or wages of new employees (Designated Investment). The Designated Investment amount is defined by a formula which considers the portion of Elected Earnings to the exempt income and the applicable tax rate prescribed by the Investment Law. In addition to the reduced tax rate, a distribution of Elected Earnings would be subject to a 15% withholding tax. The Trapped Earnings Law provides an exemption from the 15% withholding tax for a distribution to an Israeli resident company from companies which have elected the Beneficiary Enterprise status and waived their Approved Enterprise and Beneficiary Enterprise Status through June 2015. At this time, we do not believe the Trapped Earnings law has any effects on our financial statements.

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

In connection with the CIPT 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 CIPT 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 CIPT Acquisition by our Swiss subsidiary.

LIQUIDITY AND CAPITAL RESOURCES

Operating Activities. We generated $10.2 million of cash and cash equivalents from our operating activities during 2012. In 2011, we used $0.6 million of cash and cash equivalents from operating activities, and in 2010 we generated $22.3 million of cash and cash equivalents from operating activities. The increase in net cash generated by operating activities for 2012, as compared to 2011, was mainly as a result of (i) a decrease in net loss, excluding non-cash items, such as depreciation, equity-based compensation expenses, amortization of intangible assets and a gain from remeasurement to fair value of an investment as a result of a business combination, in the amount of $1.0 million, (ii) a decrease in trade receivable in the amount of $5.3 million during 2012, as compared to an increase in trade receivable in the amount of $0.6 million during 2011, (iii) a decrease in other accounts receivable and prepaid expenses in the amount of $2.2 million during 2012, as compared to a decrease in other accounts receivable and prepaid expenses in the amount of $0.5 million during 2011, (iv) a decrease in inventories in the amount of $3.5 million during 2012, as compared to a decrease in inventories in the amount of $2.4 million during 2011, and (v) an increase in accrued compensation and benefits in the amount of $1.3 million during 2012, as compared to a decrease in accrued compensation and benefits in the amount of $1.6 million during 2011. The increase in the amount of cash generated from operating activities for 2012, as compared to 2011, was offset to some extent by a decrease in trade payable in the amount of $4.0 million during 2012, as compared to an increase in trade payable in the amount of $1.2 million during 2011. The decrease in net cash provided by operating activities for 2011, as compared to 2010, was mainly as a result of (i) an increase in net loss, excluding non-cash items, such as depreciation, equity-based compensation expenses, amortization of intangible assets and other income, in the amount of $16.3 million for 2011, as compared to 2010, (ii) an increase in accounts receivable by $0.6 million during 2011, as compared to a decrease in accounts receivable of $3.0 million during 2010, (iii) a decrease in other accounts receivable and prepaid expenses of $0.5 million during 2011, as compared to a decrease in other accounts receivable and prepaid expenses of $8.0 million during 2010, mainly due to a higher amount of advances that were returned from tax authorities in 2010 as compared to 2011, and (iv) a decrease in accrued compensation and benefits of $1.6 million during 2011, as compared to an increase in accrued compensation and benefits of $3.0 million during 2010. The decrease in the amount of cash generated from operating activities for 2011, as compared to 2010, was offset to some extent by a decrease in inventories of $2.4 million during 2011, as compared to an increase in inventories of $6.5 million during 2010.

Investing Activities. We invest excess cash in marketable securities of varying maturities, depending on our projected cash needs for operations, capital expenditures and other business purposes. During 2012, we purchased $78.2 million of investments in marketable securities and deposits, as compared to $86.0 million during 2011 and $95.5 million during 2010. During the same periods, $25.9 million, $68.1 million and $35.2 million, respectively, of investments in marketable securities matured and were called by the issuer. During the same periods, $39.1 million, $11.9 million and $25.4 million, respectively, of investments in marketable securities were sold. Additionally, during 2012, 2011 and 2010, $15.7 million, $10.0 million and $12.5 million, respectively, of short term deposits matured.

As of December 31, 2012, the amortized cost of our marketable securities and deposits was $97.6 million and their stated market value was $98.5 million, representing an unrealized gain of $0.9 million.

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

Our capital equipment purchases for 2012, consisting primarily of research and development software tools, computers and other peripheral equipment, engineering test and lab equipment, leasehold improvements, furniture and fixtures, totaled $1.1 million, as compared to $2.3 million for 2011, and $3.5 million for 2010.

Financing Activities. During 2012, we repurchased 1.3 million shares of our common stock at an average purchase price of $6.28 per share for an aggregate amount of $8.06 million. No exercises of employee stock options were executed during 2012. We cannot predict cash flows from exercises of stock options for future periods.

During 2011, we repurchased 1.3 million shares of our common stock at an average purchase price of $6.74 per share for an aggregate amount of $8.75 million. In addition, we received $0.4 million upon the exercise of employee stock options. During 2010, we repurchased 111,000 shares of our common stock at an average purchase price of $7.74 per share for an aggregate amount of $0.9 million. In addition, we received $0.3 million upon the exercise of employee stock options.

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 of directors approved the company s entry into a share repurchase plan, in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934, for the repurchase of 5.0 million of the aggregate shares of our common stock authorized for repurchase, which plan has since expired. In October 2010, our board of directors authorized an increase in the number of shares available for repurchase, thereby increasing the aggregate number of shares authorized for repurchase under our share repurchase program to two million shares. In July 2011, our board of directors authorized an increase in our share repurchase program by one million shares of common stock.

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At December 31, 2012, approximately 0.3 million shares of our common stock remained available for repurchase under our board authorized share repurchase program.

As of December 31, 2012, we had cash and cash equivalents totaling approximately $21.7 million and marketable securities and time deposits of approximately $98.5 million. We believe that our available cash and cash equivalents at December 31, 2012 should be sufficient to finance our operations for the foreseeable future.

Our working capital at December 31, 2012 was approximately $49.1 million, as compared to $60.0 million as of December 31, 2011. The decrease in working capital was mainly due to the repurchase of our common stock in the amount of $8.06 million during 2012 and the replacement of short term marketable securities and deposits with long term marketable securities, offset to some extent by the cash and cash equivalents generated during 2012 from our operating activities.

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 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 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, 2012 (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)	$ 11,267	$ 2,923	$ 3,995	$ 3,032	1,317
Net Pension Liability(2)	1,610	67	77	60	$ 1,406
Development tools lease(3)	975	975			
Total Contractual Obligations	$ 13,852	$ 3,965	$ 4,072	$ 3,092	$ 2,723

(1) Represents mainly operating lease payments for facilities and vehicles under non-cancelable lease agreements. See Note 12 to notes to our consolidated financial statements for the year ended December 31, 2012.
(2) Includes estimates of gross contributions and future payments required to meet the requirements of several defined benefit plans. The amounts presented in the table are not discounted and do not take into consideration staff turnover assumptions.
(3) Represents lease payments for development tools under non-cancelable lease agreements.

At December 31, 2012, we had a liability for unrecognized tax benefits and an accrual for the payment of related interests totaling $1.8 million. Due to uncertainties related to those tax matters, we currently are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur.

Off-Balance Sheet Arrangements

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

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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. and European corporations, and state and political subdivisions of the U.S. government. We intend, and have the ability, to hold investments in marketable securities with a decline in fair value until an anticipated recovery of any temporary declines in their market value. We typically do not attempt to reduce or eliminate our market exposures on our investment securities because the majority of our investments are short-term. However, we can provide no assurances that we will recover present declines in the market value of our investments.

Interest rate fluctuations relating to our cash and cash equivalents and within our investment portfolio have not had, and we do not currently anticipate such fluctuations will have, a material 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, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the Euro. Our primary expenses paid in Euro are employee salaries, lease and operational payments on our European facilities. To partially protect the company against an increase in value of forecasted foreign currency cash flows resulting from salary and lease payments denominated in NIS during 2012, we instituted a foreign currency cash flow hedging program. The option and forward contracts used are designated as cash flow hedges, as defined by FASB ASC No. 815, Derivatives and Hedging, and are all effective as hedges of these expenses. For more information about our hedging activity, see Note 2 to our notes to our consolidated financial statement for the year ended December 31, 2012. An increase in the value of the NIS and the Euro in comparison to the U.S. dollar could increase the cost of our research and development expenses and general and administrative expenses, all of which could harm our operating profit. Although we currently are using a hedging program to minimize the effects of currency fluctuations relating to the NIS, our hedging position is partial, may not exist at all in the future and may not succeed in minimizing our foreign currency fluctuation risks.

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Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2012

IN U.S. DOLLARS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of

DSP GROUP, INC.

We have audited the accompanying consolidated balance sheets of DSP Group, Inc. (the Company) as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive loss, changes in stockholders equity, and cash flows for each of the three years in the period ended December 31, 2012. 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, 2012 and 2011, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, 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, 2012, 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 18, 2013 expressed an unqualified opinion thereon.

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

Tel-Aviv, Israel

March 18, 2013

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of

DSP GROUP INC.

We have audited DSP Group, Inc. s (the Company) internal control over financial reporting as of December 31, 2012, 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, 2012, based on the COSO criteria.

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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, 2012 and 2011, 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, 2012 and our report dated March 18, 2013 expressed an unqualified opinion thereon.

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

Tel-Aviv, Israel

March 18, 2013

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DSP GROUP, INC.

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31, 2012	December 31, 2011
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 21,684	$ 18,109
Restricted deposits	121	128
Marketable securities and short-term deposits (Note 3)	20,201	30,626
Trade receivables	20,403	25,643
Deferred income taxes	101	89
Other accounts receivable and prepaid expenses (Note 4)	3,656	5,343
Inventories (Note 5)	12,916	16,434
Total current assets	79,082	96,372
PROPERTY AND EQUIPMENT, NET (Note 6)	3,706	5,803
LONG-TERM ASSETS:		
Long-term marketable securities (Note 3)	78,333	69,046
Long-term prepaid expenses and lease deposits	208	466
Severance pay fund	10,197	9,974
Intangible assets, net (Note 7)	8,380	10,688
Goodwill	5,276	5,276
	102,394	95,450
Total assets	$ 185,182	$ 197,625

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, 2012	December 31, 2011
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Trade payables	$ 14,027	$ 17,989
Accrued compensation and benefits	7,545	8,236
Income tax accruals and payables	1,894	2,582
Accrued expenses and other accounts payable	6,514	7,555
Total current liabilities	29,980	36,362
LONG-TERM LIABILITIES:		
Deferred income taxes	1,569	1,569
Accrued severance pay	10,436	10,278
Accrued pensions (Note 9)	970	792
Total long-term liabilities	12,975	12,639
COMMITMENTS AND CONTINGENCIES (Note 12)		
STOCKHOLDERS EQUITY (Note 11):		
Capital stock:		
Preferred stock, $0.001 par value Authorized: 5,000,000 shares at December 31, 2012 and 2011; Issued and outstanding: none at December 31, 2012 and 2011		
Common stock, $0.001 par value Authorized: 50,000,000 shares at December 31, 2012 and 2011; Issued and outstanding: 21,673,779 and 22,501,644 shares at December 31, 2012 and 2011, respectively	22	23
Additional paid-in capital	346,335	341,352
Treasury stock	(125,724)	(122,236)
Accumulated other comprehensive income (loss)	988	(1,756)
Accumulated deficit	(79,394)	(68,759)
Total stockholders equity	142,227	148,624
Total liabilities and stockholders equity	$ 185,182	$ 197,625

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,		
	2012	**2011**	**2010**
Revenues	$ 162,790	$ 193,861	$ 225,482
Costs of revenues(1)	101,660	123,734	137,571
Gross profit	61,130	70,127	87,911
Operating expenses:			
Research and development, net(2)	42,539	53,244	55,588
Sales and marketing(3)	14,237	16,497	17,199
General and administrative(4)	10,638	12,920	14,362
Amortization of intangible assets	2,310	7,972	9,975
Restructuring expenses (income)	2,008	(170)	463
Total operating expenses	71,732	90,463	97,587
Operating loss	(10,602)	(20,336)	(9,676)
Financial income, net	2,388	1,885	1,468
Other income from remeasurement of investment in a business combination		1,343	
Loss before income tax benefit	(8,214)	(17,108)	(8,208)
Income tax benefit	(172)	(866)	(783)
Net loss	$ (8,042)	$ (16,242)	$ (7,425)
Net loss per share:			
Basic and diluted	$ (0.37)	$ (0.70)	$ (0.32)
Weighted average number of shares used in per share computations of net loss per share:			
Basic and diluted	21,950	23,247	23,229

(1) Includes equity-based compensation expense in the amount of $330, $403 and $704 for the years ended December 31, 2012, 2011 and 2010, respectively.
(2) Includes equity-based compensation expense in the amount of $2,425, $2,767 and $4,712 for the years ended December 31, 2012, 2011 and 2010, respectively.
(3) Includes equity-based compensation expense in the amount of $778, $987 and $1,493 for the years ended December 31, 2012, 2011 and 2010, respectively.
(4) Includes equity-based compensation expense in the amount of $1,450, $2,063 and $2,644 for the years ended December 31, 2012, 2011 and 2010, respectively.

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

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DSP GROUP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(U.S. dollars in thousands)

	Year Ended December 31,		
	2012	2011	2010
Net loss:	$ (8,042)	$ (16,242)	$ (7,425)
Other comprehensive income:			
Available-for-sale securities:			
Changes in unrealized gains (losses)	2,621	(809)	(1,188)
Reclassification adjustments for (gains) losses included in net loss	(670)	(155)	(67)
Net change	1,951	(964)	(1,255)
Cash flow hedges:			
Changes in unrealized gains (losses)	635	(325)	772
Reclassification adjustments for (gains) losses included in net loss	325	(625)	(525)
Net change	960	(950)	247
Change in unrealized components of defined benefit plans:			
Losses arising during the period	(161)	(1)	(516)
Amortization of actuarial loss and prior service benefit	2	2	(22)
Curtailments, settlements and other		36	
Net change	(159)	37	(538)
Foreign currency translation adjustments, net	(8)	(234)	(273)
Other comprehensive income (loss)	2,744	(2,111)	(1,819)
Comprehensive loss	$ (5,298)	$ (18,353)	$ (9,244)

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DSP GROUP INC.

STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

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

	Number of shares of common stock	Common stock amount	Additional paid-in capital	Treasury stock	Accumulated other comprehensive income (loss)	Accumulated deficit	Total stockholders equity
Balance at January 1, 2010	22,901	$ 23	$ 325,579	$ (123,350)	$ 2,174	$ (38,937)	$ 165,489
Issuance of treasury stock upon purchase of common stock under employee stock purchase plan	388	*)		4,138		(2,293)	1,845
Issuance of treasury stock upon exercise of stock options and stock appreciation rights by employees and directors	75	*)		794		(472)	322
Purchase of treasury stock	(111)	*)		(862)			(862)
Equity-based compensation expenses			9,553				9,553
Net loss						(7,425)	(7,425)
Change in Accumulated other comprehensive loss					(1,819)		(1,819)
Balance at December 31, 2010	23,253	$ 23	$ 335,132	$ (119,280)	$ 355	$ (49,127)	$ 167,103

*) 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, except share data

	Number of shares of common stock	Common stock amount	Additional paid-in capital	Treasury stock	Accumulated other comprehensive income (loss)	Accumulated deficit	Total stockholders equity
Cont.							
Balance at December 31, 2010	23,253	$ 23	$ 335,132	$ (119,280)	$ 355	$ (49,127)	$ 167,103
Issuance of treasury stock upon purchase of common stock under employee stock purchase plan	423	1		4,483		(2,448)	2,036
Issuance of treasury stock upon exercise of stock options and stock appreciation rights by employees and directors	124	*)		1,309		(942)	367
Purchase of treasury stock	(1,298)	(1)		(8,748)			(8,749)
Equity-based compensation expenses			6,220				6,220
Net loss						(16,242)	(16,242)
Change in Accumulated other comprehensive loss					(2,111)		(2,111)
Balance at December 31, 2011	22,502	23	341,352	(122,236)	(1,756)	(68,759)	148,624
Issuance of treasury stock upon purchase of common stock under employee stock purchase plan	446	*)		4,485		(2,507)	1,978
Issuance of treasury stock upon exercise of stock options and stock appreciation rights by employees and directors	9	*)		86		(86)	
Purchase of treasury stock	(1,283)	(1)		(8,059)			(8,060)
Equity-based compensation expenses			4,983				4,983
Net loss						(8,042)	(8,042)
Change in Accumulated other comprehensive income					2,744		2,744
Balance at December 31, 2012	21,674	$ 22	$ 346,335	$ (125,724)	$ 988	$ (79,394)	$ 142,227

*) 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.

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31, 2012	2011	2010
Cash flows from operating activities:			
Net loss	$ (8,042)	$ (16,242)	$ (7,425)
Adjustments required to reconcile net loss to net cash provided by operating activities:			
Depreciation	3,168	4,244	5,732
Equity-based compensation expenses related to employees stock options and SARs	4,983	6,220	9,553
Capital loss (gain) from sale and disposal of property and equipment	(57)	22	(40)
Gain from sale of marketable securities	(670)	(155)	(67)
Amortization of intangible assets	2,310	7,972	9,975
Accrued interest and amortization of premium on marketable securities and short-term deposits	1,295	1,267	531
Gain from remeasurement to fair value of investment as a result of business combination		(1,343)	
Change in operating assets and liabilities:			
Deferred income tax assets, net	(12)	32	65
Trade receivables, net	5,281	(562)	3,010
Other accounts receivable and prepaid expenses	2,175	502	8,019
Inventories	3,535	2,395	(6,505)
Long-term prepaid expenses and lease deposits	264	175	(39)
Trade payables	(3,965)	(1,216)	903
Accrued compensation and benefits	1,277	(1,562)	3,044
Income tax accruals and payables	(705)	(1,179)	(390)
Accrued expenses and other accounts payable	(567)	(463)	(4,085)
Accrued severance pay, net	(65)	(783)	32
Accrued pensions		78	20
Net cash (used in) provided by operating activities	10,205	(598)	22,333
Cash flows from investing activities:			
Purchase of marketable securities	(75,483)	(73,002)	(95,510)
Purchase of deposits	(2,670)	(13,000)	
Proceeds from maturity of marketable securities	25,911	68,072	35,180
Proceeds from sales of marketable securities	39,063	11,910	25,352
Proceeds from maturity of deposits	15,643	10,000	12,500
Proceeds from sales of property and equipment	81	59	48
Purchases of property and equipment	(1,094)	(2,317)	(3,463)
Acquisition of initially consolidated subsidiary(1)		(8,320)	
Net cash (used in) provided by investing activities	1,451	(6,598)	(25,893)

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,		
	2012	2011	2010
Cash flows from financing activities:			
Issuance of common stock and treasury stock upon exercise of stock options and SARs		367	322
Purchase of treasury stock	(8,060)	(8,749)	(862)
Net cash used in financing activities	(8,060)	(8,382)	(540)
Increase (decrease) in cash and cash equivalents	3,596	(15,578)	(4,100)
Cash and cash equivalents at the beginning of the year	18,109	33,912	37,986
Cash (erosion) due to exchange rate differences	(21)	(225)	26
Cash and cash equivalents at the end of the year	$ 21,684	$ 18,109	$ 33,912
Supplemental disclosures of cash flows activities:			
Cash paid during the year for:			
Taxes on income	$ 145	$ 332	$ 424

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

	Year ended December 31, 2011
Working capital, excluding cash and cash equivalents	$ (91)
Property and equipment	26
Long-Term deferred tax liabilities, net	(1,569)
In-process R&D	7,702
Non-competition agreement	519
Goodwill	5,276
	11,863
The acquisition date fair value of the Company s previously held equity interest in BoneTone	(3,543)
	$ 8,320

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

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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. Revenues could be materially and adversely affected should any of these foundries and test houses fail to meet the Company s request for product manufacturing due to a shortage of production capacity, process difficulties, low yield rates or financial instability. Additionally, certain of the raw materials, components, and subassemblies included in the products manufactured by the Company s original equipment manufacturer (OEM) customers, which incorporate the Company s products, are obtained from a limited group of suppliers. Disruptions, shortages, or termination of certain of these sources of supply could occur and could negatively affect the Company s financial condition and results of operations.

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

Sales to Hong Kong-based VTech Holdings Ltd. (VTech) represented 35%, 33% and 31% of the Company s total revenues for 2012, 2011 and 2010, respectively. Revenues derived from sales through one distributor, Tomen Electronics Corporation (Tomen Electronics), accounted for 21%, 19% and 25% of the Company s total revenues for 2012, 2011 and 2010, respectively. 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 15%, 13% and 16% of the Company s total revenues for 2012, 2011 and 2010, respectively. Additionally, sales to Uniden America Corporation (Uniden) represented 11%, 10% and 9% of the Company s total revenues for 2012, 2011 and 2010, respectively. Sales to CCT Telecom Holdings Ltd. represented 8%, 11% and 10% of the Company s total revenues for 2012, 2011 and 2010, respectively. The Japanese and Hong Kong markets and the OEMs that operate in those markets are among the largest suppliers in the world with significant market share in the U.S. market for residential wireless products.

Acquisition of BoneTone Communications

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

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DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

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

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

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

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

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

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

	December 1, 2011
Cash	$ 267
Other current assets	32
Property and equipment	26
Other non-current assets	68
Current liabilities	(107)
Long-term deferred tax liability, net	(1,569)
Accrued severance pay	(73)
Net liabilities assumed	(1,356)

Intangible assets:		
In-process research and development		7,702
Non-competition agreement		519
Total intangible assets		8,221
Goodwill -		5,276
Net assets acquired	$	12,141

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DSP GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

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

The excess of the purchase price of $5,276 over the net tangible assets and identifiable intangible assets acquired in the BoneTone Acquisition is recognized as goodwill. An acquired workforce and control premium that did not meet the separability criteria have been included in the amount assigned to goodwill. The goodwill recognized represents mainly the synergies the Company expects from the BoneTone Acquisition, both in revenues and expenses, and the expected benefits to the Company from the acquisition. The goodwill associated with the BoneTone Acquisition is expected not to be deductible for tax purposes.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

a. Use of estimates:

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

b. Financial statements in U.S. dollars:

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

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

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

Accumulated other comprehensive loss related to foreign currency translation adjustments, net amounted to $183 and $175 as of December 31, 2012 and 2011, respectively.

c. Principles of consolidation:

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

d. Cash and cash equivalents:

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

e. Restricted deposits:

Restricted deposits include cash which is used as security for one of the Company s lease agreements.

f. Short-term deposits:

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

g. Marketable securities:

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

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

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

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The marketable securities are periodically reviewed for impairment. If management concludes that any of these investments are impaired, management determines whether such impairment is other-than-temporary. Factors considered in making such a determination include the duration and severity of the impairment, the reason for the decline in value and the potential recovery period, and the Company s intent to sell, or whether it is more likely than not that the Company will be required to sell the investment before recovery of cost basis. For debt securities, only the decline attributable to deteriorating credit of an-other-than-temporary impairment is recorded in the consolidated statement of operations, unless the Company intends, or more likely than not it will be forced, to sell the security. During the years ended December 31, 2012, 2011 and 2010, the Company did not record an-other-than-temporary impairment loss (see Note 3).

h. Fair value of financial instruments:

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

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

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

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

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

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

i. Inventories:

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

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

Cost is determined as follows:

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

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

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j. Property and equipment:

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

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

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

During the years ended December 31, 2012, 2011 and 2010, no impairment losses were identified for property and equipment.

The Company accounts for costs of computer software developed or obtained for internal use in accordance with FASB ASC No. 350-40, The Internal Use Software. FASB ASC 350-40 requires the capitalization of certain costs incurred in connection with developing or obtaining internal use software. During 2012, 2011 and 2010, the Company capitalized $22, $253 and $1,087, respectively, of internal use software cost. Such costs are amortized using the straight-line method over their estimated useful life of three years.

k. Goodwill and other intangible assets

The goodwill and certain other purchased intangible assets have been recorded as a result of the BoneTone Acquisition and the CIPT Acquisition. Goodwill represents the excess of the purchase price in a business combination over the fair value of net tangible and intangible assets acquired. Goodwill and indefinite-lived intangible assets (such as In-process R&D) are not amortized, but rather is subject to an annual impairment test. The Company performs an annual impairment test during the fourth quarter of each fiscal year, or more frequently if impairment indicators are present.

For goodwill, the Company may first assess qualitative factors , in accordance with ASU 2011-08, to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of the reporting unit is less than its carrying amount and whether the two-step impairment test on goodwill is required. If based upon qualitative factors it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, it will not be required to proceed to a two-step impairment test on goodwill. However, the Company also has the option to proceed directly to a two-step impairment test on goodwill. In the first step of the two-step impairment test, the Company compares the fair value of each reporting unit to its carrying value. If the fair value exceeds the carrying value of the net assets, goodwill is considered not impaired and the Company is not required to perform further testing. If the carrying value of the net assets exceeds the fair value, then the Company must perform the second step of the two-step impairment test in order to determine the implied fair value of goodwill. If the carrying value of goodwill exceeds its implied fair value, then the Company would record an impairment loss equal to the difference.

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The Company s reporting units are consistent with the reportable segments identified in Note 16.

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.

For indefinite-lived intangible assets, the Company also has the option to first assess qualitative factors to determine whether events and circumstances indicate that it is more likely than not that the indefinite-lived intangible asset is impaired and determine whether further action is needed. For the fiscal year ended December 31, 2012, the Company performed a quantitative assessment on its indefinite-lived intangible assets and goodwill.

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 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 2012, 2011 and 2010, no impairment losses were identified.

l. Severance pay:

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

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

Severance expenses for the years ended December 31, 2012, 2011 and 2010, were $1,660, $2,089 and $1,851, respectively.

m. 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 2012 was $17 ($22.5 if the employee reached the age of 50 by December 31, 2012). The Company currently offers an employer matching program. The matching contribution currently is 50% on the first 6% of compensation contributed per year. This matching contribution vests 25% per year over the first four years of the employee s service in the Company. Employer contribution to the plan for the years 2012, 2011 and 2010 was $28, $56 and $60, respectively.

n. 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.

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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.

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

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

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

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

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

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

The Company views its distributor arrangements as that of consignment because, although the actual sales are conducted through the distributors and legally title for the products passes to the distributors upon delivery to the distributors, in substance inventory is simply being transferred to another location for sale to the end-user customers as the Company s primary business relationships and responsibilities are directly with the end-user customers. Because the Company views its arrangements with its distributors as that of consignment

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relationships, delivery of goods is not deemed to have occurred solely upon delivery to the distributors. Therefore, the Company recognizes revenues from distributors under the sell-through method. As a result, revenue is deferred at the time of shipment to the distributors and is recognized only when the distributors sell the products to the end-user customers.

o. 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, 2012, 2011 and 2010.

p. Research and development costs:

Research and development costs, net of grants received, are charged to the consolidated statement of operations as incurred.

q. Non-royalty bearing grants:

In 2012, the Company received non-royalty-bearing grants from the Israeli Office of the Chief Scientist (OCS). The grants are not required to be repaid unless the technology that was developed using those grants will be sold directly or indirectly, and are recognized at the time the Company is entitled to such grants, on the basis of the costs incurred. These grants are recorded as a deduction of research and development costs and amounted to $386.

r. Equity-based compensation:

At December 31, 2012, the Company had three equity incentive plans from which the Company may grant future equity awards and two expired equity incentive plans from which no future equity awards may be granted but had outstanding equity awards granted prior to expiration. The Company also had one employee stock purchase plan. See full description in Note 11.

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

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

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

The Company selected the lattice option pricing model as the most appropriate fair value method for its equity-based awards and values options and stock appreciation rights (SARs) based on the market value of the underlying shares on the date of grant. The option-pricing model requires a number of assumptions, of which the

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most significant are the expected stock price volatility and the expected term of the equity-based award. Expected volatility is calculated based upon actual historical stock price movements. The expected term of the equity-based award granted is based upon historical experience and represents the period of time that the award granted is expected to be outstanding. The risk-free interest rate is based on the yield from U.S. treasury bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

s. Basic and diluted 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 losses per share further include the dilutive effect of stock options and stock appreciation rights (SARs) outstanding during the year, all in accordance with FASB ASC No. 260, Earnings Per Share.

The total weighted average number of shares related to the outstanding stock options and SARs excluded from the calculation of diluted net loss per share due to their anti-dilutive effect was 7,584,336, 7,980,475 and 8,751,751 for the years ended December 31, 2012, 2011 and 2010, respectively.

t. Income taxes:

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

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

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

u. Concentrations of credit risk:

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

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

The Company s marketable securities consist of investment-grade corporate bonds and U.S. government-sponsored enterprise (GSE) securities. As of December 31, 2012, the amortized cost of the Company s marketable securities was $94,904, and their stated market value was $95,826, representing an unrealized gain of $922.

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A significant portion of the products of the Company and its subsidiaries is sold to original equipment manufacturers of consumer electronics products. The customers of the Company and its subsidiaries are located primarily in Japan, Hong Kong, Taiwan, China, Korea, Europe and the United States. The Company and its subsidiaries perform ongoing credit evaluations of their customers. A specific allowance for doubtful accounts is determined, based on management s estimates and historical experience. Under certain circumstances, the Company may require a letter of credit. The Company covers most of its trade receivables through credit insurance. As of December 31, 2012 and 2011, no allowance for doubtful accounts was provided.

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

v. Derivative instruments:

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

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

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

The fair value of the outstanding derivative instruments at December 31, 2012 and 2011 is summarized below:

Derivative assets (liabilities)	**Balance sheet location**	**Fair value of derivative in struments As of December 31, 2012**	**2011**
Foreign exchange forward contracts and put and call options	Other accounts receivable and prepaid expenses (*)	$ 484	$
	Accrued expenses and other accounts payable		(476)
Total		$ 484	$ (476)

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

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The effect of derivative instruments in cash flow hedging transactions on income and other comprehensive income (OCI) for the years ended December 31, 2012, 2011 and 2010 is summarized below:

	Gains (losses) on derivatives recognized in OCI Year ended December 31,		
	2012	2011	2010
Foreign exchange forward contracts and put and call options	$ 635	$ (325)	$ 771

		Gains (losses) on derivatives reclassified from OCI to income Year ended December 31,		
	Location	2012	2011	2010
Foreign exchange forward contracts and put and call options	Operating expenses	$ (325)	$ 625	$ 525

As of December 31, 2012 and 2011, the Company had outstanding forward contracts in the amount of $0 and $3,550, respectively, and outstanding option contracts in the amount of $15,800 and $16,500, respectively.

w. Comprehensive income:

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

	December 31, 2012	December 31, 2011
Accumulate other comprehensive income (loss) on:		
Available-for-sale securities	$ 922	$ (1,029)
Cash flow hedges	484	(476)
Benefit plans	(237)	(78)
Foreign currency translation adjustments, net	(181)	(173)
Total accumulate other comprehensive income (loss):	$ 988	$ (1,756)

x. Treasury stock:

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

From time to time, the Company reissues treasury shares under its employee stock purchase plan and equity incentive plans, upon purchases or exercises of equity awards under the plans. When treasury stock is reissued,

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the Company accounts for the re-issuance in accordance with FASB ASC No. 505-30, Treasury Stock and charges the excess of the purchase cost over the re-issuance price (loss) to retained earnings. The purchase cost is calculated based on the specific identification method. In case the purchase cost is lower than the re-issuance price, the Company credits the difference to additional paid-in capital.

y. Reclassification:
Certain amounts previously reported in the consolidated financial statements have been reclassified to conform to current year presentation. Such reclassifications did not affect net loss, shareholders equity or cash flows

z. Impact of recently issued accounting pronouncements:
Indefinite-lived intangible assets impairment

In July 2012, the FASB issued an update to the authoritative guidance related to testing indefinite-lived intangible assets impairment. This update gives an entity the option to first consider certain qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount as a basis for determining whether it is necessary to perform the quantitative impairment test. This update is effective for the indefinite-lived intangible asset impairment test performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company s consolidated financial statements.

Reclassification of accumulated other comprehensive loss

In February 2013, the FASB issued an accounting standards update requiring new disclosures about reclassifications from accumulated other comprehensive loss to net income. These disclosures may be presented on the face of the statements or in the notes to the consolidated financial statements. The standard update is effective for fiscal years beginning after December 15, 2012. The adoption of this guidance is not expected to have a material impact on the Company s financial statements.

NOTE 3:- MARKETABLE SECURITIES AND TIME DEPOSITS

The following is a summary of marketable securities and time deposits at December 31, 2012 and 2011:

	Amortized cost		Unrealized gains (losses), net		Fair value	
	2012	2011	2012	2011	2012	2011
Short and long-term deposit	$ 2,708	$ 15,803	$	$	$ 2,708	$ 15,803
U.S. GSE securities	1,506	10,725	4	(29)	1,510	10,696
Corporate obligations	93,398	74,173	918	(1,000)	94,316	73,173
	$ 97,612	$ 100,701	$ 922	$ (1,029)	$ 98,534	$ 99,672

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The amortized cost of marketable debt securities and time deposits at December 31, 2012, by contractual maturities or anticipated dates of sale, are shown below:

	Amortized Cost	Unrealized gains (losses) Gains	Losses	Fair value
Due in one year or less	$ 20,162	$ 40	$ (1)	$ 20,201
Due after one year to six years	77,450	1,018	(135)	78,333
	$ 97,612	$ 1,058	$ (136)	$ 98,534

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

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

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

The total fair value of marketable securities with outstanding unrealized losses as of December 31, 2012 amounted to $31,546. Of the $136 unrealized losses outstanding as of December 31, 2012, a portion of which in the amount of $13 was outstanding for more than 12 months and the remaining portion of $123 was outstanding for less than 12 months.

Management believes that as of December 31, 2012, the unrealized losses in the Company s investments in all types of marketable securities were temporary and no impairment loss was realized in the Company s consolidated statements of operations.

The unrealized losses related to U.S. treasury and GSE securities were primarily due to changes in interest rates. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2012.

Proceeds from maturity of available-for-sale marketable securities during 2012, 2011 and 2010 were $25,911, $68,072 and $35,180, respectively. Proceeds from sales of available-for-sale marketable securities during 2012, 2011 and 2010 were $39,063, $11,910 and $25,352, respectively. Net realized gains from the sale of available-for sale marketable securities for 2012, 2011 and 2010 were $670, $155 and $67, respectively. The Company determines realized gains or losses on the sale of available-for-sale marketable securities based on a specific identification method.

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NOTE 4:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31, 2012	December 31, 2011
Tax receivables	$ 508	$ 662
Prepaid expenses	2,651	3,490
Deposits	419	1,031
Others	78	160
	$ 3,656	$ 5,343

NOTE 5:- INVENTORIES

Inventories are composed of the following:

	December 31, 2012	December 31, 2011
Work-in-progress	$ 6,821	$ 8,096
Finished products	6,095	8,338
	$ 12,916	$ 16,434