DSP GROUP INC /DE/
Form 10-Q
May 11, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended March 31, 2009

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _________ to _________

Commission File Number 0-23006

DSP GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-2683643**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. employer identification number)**

2580 North First Street, Suite 460

San Jose, California	**95131**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code: (408) 986-4300

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer 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 May 1, 2009, there were 22,733,748 shares of Common Stock ($.001 par value per share) outstanding.

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DSP GROUP, INC.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DSP GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

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

	March 31, 2009 Unaudited	December 31, 2008 Audited
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 45,284	$ 68,886
Restricted deposit	115	115
Marketable securities and short-term deposits	24,979	12,449
Trade receivables, net	23,826	39,603
Deferred income taxes	259	306
Other accounts receivable and prepaid expenses	17,187	14,607
Inventories	12,301	14,098
Related party receivable		2,760
TOTAL CURRENT ASSETS	123,951	152,824
PROPERTY AND EQUIPMENT, NET	13,208	14,822
LONG-TERM ASSETS:		
Long-term marketable securities	33,736	40,051
Long-term prepaid expenses and lease deposits	1,183	1,331
Deferred income taxes	200	212
Severance pay fund	6,822	7,286
Intangible assets, net	29,547	32,728
	71,488	81,608
TOTAL ASSETS	$ 208,647	$ 249,254

Note: The balance sheet at December 31, 2008 has been derived from the audited financial statements on that date.

See notes to condensed consolidated financial statements.

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DSP GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

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

	March 31, 2009 Unaudited	December 31, 2008 Audited
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Trade payables	$ 13,923	$ 12,721
Accrued compensation and benefits	6,949	11,490
Income tax accruals and payables	16,003	15,878
Accrued expenses and other accounts payable	11,858	12,070
Related party payable		8,306
Total current liabilities	48,733	60,465
LONG-TERM LIABILITIES:		
Accrued severance pay	8,028	8,008
Other long-term liability		455
Accrued pensions	1,526	1,675
Deferred tax liabilities	19	24
Total long-term liabilities	9,573	10,162
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY:		
Preferred stock, $ 0.001 par value - Authorized shares: 5,000,000 at March 31, 2009 and December 31, 2008; Issued and outstanding shares: none at March 31, 2009 and December 31, 2008		
Common stock, $ 0.001 par value - Authorized shares: 50,000,000 at March 31, 2009 and December 31, 2008; Issued and outstanding: 22,733,748 and 26,730,914 shares at March 31, 2009 and December 31, 2008, respectively	23	27
Additional paid-in capital	317,509	314,484
Treasury stock	(125,142)	(107,749)
Accumulated other comprehensive income (loss)	(1,680)	51
Accumulated deficit	(40,369)	(28,186)
Total stockholders equity	150,341	178,627
Total liabilities and stockholders equity	$ 208,647	$ 249,254

Note: The balance sheet at December 31, 2008 has been derived from the audited financial statements on that date.

See notes to condensed consolidated financial statements.

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DSP GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(U.S. dollars in thousands, except per share amounts)

	Three months ended March 31,	
	2009	**2008**
Revenues	$ 39,914	$ 72,729
Costs of revenues (includes $8,013 and $18,429 with related party for the three months ended March 31, 2009 and 2008, respectively) (1)	26,504	45,776
Gross profit	13,410	26,953
Operating expenses:		
Research and development (2)	13,738	20,028
Sales and marketing (3)	4,516	6,021
General and administrative (4)	3,814	4,250
Intangible assets amortization	3,047	5,782
Total operating expenses	25,115	36,081
Operating loss	(11,705)	(9,128)
Interest and other income, net	603	1,234
Loss before taxes on income	(11,102)	(7,894)
Tax benefit (5)	(411)	(286)
Net loss	$ (10,691)	$ (7,608)
Net loss per share:		
Basic	$ (0.41)	$ (0.25)
Diluted	$ (0.41)	$ (0.25)
Weighted average number of shares used in per share computations of net loss:		
Basic	26,083	30,574
Diluted	26,083	30,574

(1) Includes equity-based compensation expense in the amount of $208 and $257 for the three months ended March 31, 2009 and 2008, respectively.

(2) Includes equity-based compensation expense in the amount of $1,575 and $2,091 for the three months ended March 31, 2009 and 2008, respectively.

(3)

Includes equity-based compensation expense in the amount of $458 and $507 for the three months ended March 31, 2009 and 2008, respectively.

(4) Includes equity-based compensation expense in the amount of $780 and $1,106 for the three months ended March 31, 2009 and 2008, respectively.

(5) Includes tax benefit resulting from equity-based compensation expense in the amount of $0 and $131 for the three months ended March 31, 2009 and 2008, respectively.

See notes to condensed consolidated financial statements.

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DSP GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(U.S. dollars in thousands)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Net cash provided by (used in) operating activities	$ 4,546	$ (151)
Investing activities		
Purchase of marketable securities and short-term investments	(21,880)	(10,034)
Proceeds from maturity and sale of marketable securities and short-term investments	15,344	41,856
Investment in a restricted deposit		(3,293)
Purchases of property and equipment	(1,177)	(4,097)
Payment of transaction costs related to the acquisition of the cordless and VoIP terminals business of NXP B.V. (1)		(589)
Net cash provided by (used in) investing activities	(7,713)	23,843
Financial activities		
Purchase of treasury stock	(20,028)	(23,941)
Issuance of common stock and treasury stock for cash upon exercise of options		68
Net cash used in financing activities	(20,028)	(23,873)
Decrease in cash and cash equivalents	$ (23,195)	$ (181)
Cash erosion due to exchange rate differences	(407)	149
Cash and cash equivalents at the beginning of the period	$ 68,886	$ 69,586
Cash and cash equivalents at the end of the period	$ 45,284	$ 69,554

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

DSP GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(UNAUDITED)

(U.S. dollars in thousands)

	Number of Common Stock	Common Stock	Additional Paid-In Capital	Treasury Stock	Retained Earnings	Other Comprehensive Income (Loss)	Total Comprehensive Income	Total Stockholders Equity
Three Months Ended March 31, 2008								
Balance at December 31, 2007	31,230	$ 31	$ 300,542	$ (63,804)	$ 187,063	$ 1,025		$ 424,857
Net loss					(7,608)		$ (7,608)	(7,608)
Unrealized gain from hedging activities, net						89	89	89
Unrealized loss from marketable securities, net						(32)	(32)	(32)
Foreign currency translation adjustments, net						1,364	1,364	1,364
Total comprehensive loss							$ (6,187)	
Issuance of treasury stock upon purchase of common stock under employee stock purchase plan	82			1,605	(758)			847
Issuance of treasury stock upon exercise of stock options by employees	6			99	(31)			68
Purchase of treasury stock	(2,171)	(2)	2	(25,921)				(25,921)
Equity based compensation			3,961					3,961
Balance at March 31, 2008	29,147	$ 29	$ 304,505	$ (88,020)	$ 178,666	$ 2,446		$ 397,626
Three Months Ended March 31, 2009								
Balance at December 31, 2008	26,731	$ 27	$ 314,484	$ (107,749)	$ (28,186)	$ 51		$ 178,627
Net loss					(10,691)		$ (10,691)	(10,691)
Unrealized loss from hedging activities, net						(1,076)	(1,076)	(1,076)
Unrealized loss from marketable securities, net						(399)	(399)	(399)
Foreign currency translation adjustments, net						(256)	(256)	(256)
Total comprehensive loss							$ (12,422)	

Issuance of treasury stock upon purchase of common stock under employee stock purchase plan	190			2,635	(1,492)		1,143
Purchase of treasury stock	(4,187)	(4)	4	(20,028)			(20,028)
Equity based compensation			3,021				3,021
Balance at March 31, 2009	22,734	$ 23	$ 317,509	$ (125,142)	$ (40,369)	$ (1,680)	$ 150,341

(*) Represents an amount lower than $1.

See notes to condensed consolidated financial statements.

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DSP GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(UNAUDITED)

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

NOTE A BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. For further information, reference is made to the consolidated financial statements and footnotes thereto included in the Annual Report on Form 10-K of DSP Group, Inc. (the Company) for the year ended December 31, 2008.

NOTE B RESTRUCTURING COSTS AND OTHER

Following the acquisition (the Acquisition) of the cordless and VoIP terminals business (the CIPT Business) of NXP B.V. (NXP), the Company approved a plan to restructure certain operations of the CIPT Business to eliminate redundant costs resulting from the Acquisition and improve operational efficiencies.

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

During the third quarter of 2008, the Company initiated an additional restructuring plan to improve operating efficiency at its various operating sites and to reduce its operating expenses for 2009. The restructuring plan is expected to be completed by September 30, 2009.

As of March 31, 2009, payments aggregating $2,027 were made in connection with the additional restructuring plan. The total liability balance for the additional restructuring plan is $298.

Summary of the additional restructuring plan:

	Initial costs	Adjustments to cost	Cash payments	Accrued as of March 31, 2009	Total costs
Severance and related benefits	$ 1,920	$ (42)	$ (1814)	$ 64	$ 1,878
Other	487	(40)	(213)	234	447
Total restructuring and other	$ 2,407	$ (82)	$ (2,027)	$ 298	$ 2,325

NOTE C INVENTORIES

Inventories are stated at the lower of cost or market value. Cost is determined using the average cost method. The Company periodically evaluates the quantities on hand relative to current and historical selling prices, and historical and projected sales volume. Based on these evaluations, provisions are made in each period to write inventory down to its net realizable value. Inventories are composed of the following:

	March 31, 2009 (Unaudited)	December 31, 2008 (Audited)
Work-in-process	$ 1,374	$ 1,617
Finished goods (*)	10,927	12,481
	$ 12,301	$ 14,098

(*) The finished products inventory includes $363 and $755 of inventory held in consignment by other parties as of March 31, 2009 and December 31, 2008, respectively. Write off of inventory amounted to $44 and $678 for the three months ended March 31, 2009 and 2008, respectively.

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NOTE D NET EARNINGS PER SHARE

Basic net earnings per share are computed based on the weighted average number of shares of common stock outstanding during the period. For the same periods, diluted net earnings per share further include the effect of dilutive stock options and stock appreciation rights outstanding during the period, all in accordance with Statement of Financial Accounting Standard (SFAS) No. 128 Earnings per Share. The following table sets forth the computation of basic and diluted net earnings per share:

	Three months ended March 31, 2009	2008
Net loss	$ (10,691)	$ (7,608)
Loss per share:		
Basic	$ (0.41)	$ (0.25)
Diluted	$ (0.41)	$ (0.25)
Weighted average number of shares of common stock outstanding during the period used to compute basic net earnings per share (in thousands)	26,083	30,574
Incremental shares attributable to exercise of outstanding options (assuming proceeds would be used to purchase treasury stock) (in thousands)		
Weighted average number of shares of common stock used to compute diluted net earnings per share (in thousands)	26,083	30,574

NOTE E INVESTMENTS IN MARKETABLE SECURITIES

The Company accounts for investments in marketable securities in accordance with SFAS No. 115 Accounting for Certain Investments in Debt and Equity Securities. Management determines the appropriate classification of its investments in government and corporate marketable debt securities at the time of purchase and reevaluates such determinations at each balance sheet date.

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The Company classifies 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. The amortized cost of marketable securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and interest are included in financial income, net. Interest and dividends on securities are included in financial income, net. The following is a summary of available-for-sale securities at March 31, 2009 and December 31, 2008:

	Amortized cost		Unrealized gains (losses), net		Estimated fair value	
	March 31, 2009 (Unaudited)	December 31, 2008 (Audited)	March 31, 2009 (Unaudited)	December 31, 2008 (Audited)	March 31, 2009 (Unaudited)	December 31, 2008 (Audited)
Short-term deposit	$ 18,110	$ 2,518	$	$	$ 18,110	$ 2,518
U.S. government obligations and political subdivisions	11,647	19,163	48	274	11,695	19,437
Corporate obligations	29,511	30,973	(601)	(428)	28,910	30,545
	$ 59,268	$ 52,654	$ (553)	$ (154)	$ 58,715	$ 52,500

The amortized cost of available-for-sale debt securities at March 31, 2009, by contractual maturities, is shown below:

	Amortized cost	Unrealized gains (losses) Gains	(Losses)	Estimated fair value
Due in one year or less	$ 25,007	$ 19	$ (47)	$ 24,979
Due after one year to five years	34,261	142	(667)	33,736
	$ 59,268	$ 161	$ (714)	$ 58,715

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

The unrealized losses in the Company s investments in all types of marketable securities were caused mainly by overall market conditions and interest rate changes. Since the Company has the ability and intent to hold these investments until a recovery of fair value, other than certain investments referenced below, the Company does not consider its investments to be other than temporarily impaired at March 31, 2009.

The Company determined that the decline in the fair value of certain of its securities were other than temporary, notwithstanding its intent to hold such securities until maturity. As a result, the amortized cost of available-for-sale debt securities at March 31, 2009 set forth in the table above includes a write down of $2,961 associated with such securities, which write down was recorded in 2008.

Declines in the fair value of available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in cost.

NOTE F TAXES ON INCOME

The effective tax rate used in computing the provision for income taxes is based on projected fiscal year income before taxes, including estimated income by tax jurisdiction. Tax provision for the three months ended March 31, 2009 and March 31, 2008 included tax benefit associated with equity-based compensation expenses in the amount of $0 and $131, respectively. As of March 31, 2009 and December 31, 2008, the Company did not record any deferred tax assets due to a change in its estimation of future taxable income primarily as a result of general adverse market conditions.

The total amount of net unrecognized tax benefits that, if recognized, would affect the effective tax rate was $15,059 and $14,859 at March 31, 2009 and December 31, 2008, respectively. The Company accrues interest and penalties, relating to unrecognized tax benefits, in its provision for income taxes. At March 31, 2009 and December 31, 2008, the Company had accrued interest and penalties relating to unrecognized tax benefits of $3,700 and $3,500, respectively. A change in

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the amount of unrecognized tax benefit is reasonably possible in the next 12 months due to the examination by the U.S. Internal Revenue Service of the Company s U.S. federal income tax returns for 2003 and 2004. The Company currently cannot make an estimate of the range of change in the amount of the unrecognized tax benefits due to the ongoing status of the examination.

With respect to DSP Group Ltd., the Company s Israeli subsidiary, the Company is no longer subject to income tax audits for years before 2004.

NOTE G SIGNIFICANT CUSTOMERS

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

Revenues derived from sales through one distributor, Tomen Electronics Corporation (Tomen Electronics), accounted for 29% and 26% of the Company s total revenues for the three months ended March 31, 2009 and 2008, respectively. The Japanese market and the OEMs that operate in that market are among the largest suppliers in the world with significant market share in the U.S. market for residential wireless products. Tomen Electronics sells the Company s products to a limited number of customers. One customer, Panasonic Communications Co., Ltd. (Panasonic), has continually accounted for a majority of the sales of Tomen Electronics. Sales to Panasonic through Tomen Electronics generated approximately 15% and 16% of the Company s revenues for the three months ended March 31, 2009 and 2008, respectively. Additionally, sales to Uniden through Tomen Electronics or directly to Uniden represented 13% and 11% of the Company s total revenues for the three months ended March 31, 2009 and 2008, respectively.

Sales to Hong Kong-based VTech represented 28% and 18% of the Company s total revenues for the three months ended March 31, 2009 and 2008, respectively. Sales to Hong Kong-based CCT Telecom represented 6% and 10% of the Company s total revenues for the three months ended March 31, 2009 and 2008, respectively.

NOTE H DERIVATIVE INSTRUMENTS

Effective January 1, 2009, the Company adopted the disclosure requirements of SFAS No. 161 Disclosures about Derivative Instruments and Hedging Activities, An Amendment of SFAS Statement No. 133 (SFAS No. 161). Due to the Company s global operations, it is exposed to foreign currency exchange rate fluctuations in the normal course of its business. The Company s treasury policy allows it to offset the risks associated with the effects of certain foreign currency exposures through the purchase of foreign exchange forward contracts and put options (collectively, hedging contracts). The policy, however, prohibits the Company from speculating on hedging contracts for profit.

To protect against the increase in value of forecasted foreign currency cash flows resulting from salary and lease payments of its Israeli facilities denominated in the Israeli currency, the New Israeli Shekels (NIS), during the year, the Company instituted a foreign currency cash flow hedging program. The Company hedges portions of the anticipated payroll and lease payments denominated in NIS for a period of one to twelve months with hedging contracts. Accordingly, when the dollar strengthens against the foreign currencies, the decline in present value of future foreign currency expenses is offset by losses in the fair value of the hedging contracts. Conversely, when the dollar weakens, the increase in the present value of future foreign currency cash flows is offset by gains in the fair value of the hedging contracts. These hedging contracts are designated as cash flow hedges, as defined by SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133) and are all effective hedges of these expenses. In accordance with SFAS No. 133, for derivative instruments that are designated and qualify as a cash flow hedge (i.e.

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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. As of March 31, 2009, the aggregate amount of hedging contracts held by the Company to offset foreign currency fluctuations was $16,800. These hedging contracts do not contain any credit-risk-related contingency features. See Note L for information on the fair value of these hedging contracts.

The fair value of derivative assets and derivative liabilities were $34 and $1,137, respectively, at March 31, 2009. The Company recorded a net amount of $1,103 in accrued expenses and other accounts payable in the condensed consolidated balance sheets at March 31, 2009.

The amount recorded in research and development expenses, sales and marketing expenses and general and administrative expenses in the condensed consolidated statements of operations for the quarter ended March 31, 2009 that resulted from the above referenced hedging transactions was $560, $95 and $68, respectively.

NOTE I CONTINGENCIES

From time to time, the Company may become involved in litigation relating to claims arising from its ordinary course of business. Also, as is typical in the semiconductor industry, the Company has been and may from time to time be notified of claims that the Company may be infringing patents or intellectual property rights owned by third parties. For example, in a lawsuit against Microsoft Corporation, AT&T asserted that the Company s TrueSpeech 8.5 algorithm includes certain elements covered by a patent held by AT&T. AT&T sued Microsoft, one of the Company s TrueSpeech 8.5 licensees, for infringement. The Company was not named in AT&T s suit against Microsoft. During 2002, the Company created a provision, which was included in the cost of product revenues, in respect of this legal exposure. The Company currently believes that there are no claims or actions pending or threatened against it, the ultimate disposition of which would have a material adverse effect on Company.

NOTE J ACCOUNTING FOR EQUITY-BASED COMPENSATION

Grants for Three Months Ended March 31, 2009 and March 31, 2008:

The weighted average estimated fair value of employee stock options and share appreciation rights (SAR) granted during the three months ended March 31, 2009 and March 31, 2008 was $2.44 and $3.79 per share, respectively, using the binomial model, with the following weighted average assumptions (annualized percentages):

	Three months ended March 31, 2009	Three months ended March 31, 2008
Volatility	61.75%	52.92%
Risk-free interest rate	1.99%	3.34%
Dividend yield	0%	0%
Pre-vest cancellation rate	3.51%	3.68%
Post-vest cancellation rate	2.13%	1.59%
Suboptimal exercise factor	1.64	1.65

The expected life of employee stock options and SARs is impacted by all of the underlying assumptions used in the Company s model. The binomial model assumes that employees exercise behavior is a function of the remaining contractual life of the stock option or SAR and the extent to which the stock option or SAR is in-the-money (*i.e.*, the average stock price during the period is above the exercise price of the stock option or SAR). The binomial model estimates the probability of exercise as a function of these two variables based on the history of exercises and cancellations of past option and SAR grants made by the Company. The expected life for options and SARs granted during the three months ended March 31, 2009 and 2008 derived from the binomial model was 4.07 and 4.40 years, respectively.

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Employee Stock Benefit Plans

As of March 31, 2009, the Company had five stock option plans and one employee stock purchase plan. As of March 31, 2009, approximately 214,000 shares of common stock remain available for grant under the Company s employee stock purchase plan and approximately 1,402,000 shares of common stock remain available for grant under the Company s stock option plans.

The table below presents a summary of information relating to the Company s stock option and SAR grants pursuant to its stock option plans:

	Number of Options/SAR Units	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)
Outstanding at January 1, 2009	8,358,717	$ 18.54	
Options granted	585,900	$ 6.44	
SAR units granted (1)	2,303,200	$ 5.97	
Options / SAR units cancelled/forfeited/expired	(201,258)	$ 17.44	
Options exercised			
Outstanding at March 31, 2009 (2)	11,046,559	$ 15.30	5.09
Exercisable at March 31, 2009 (3)	4,996,994	$ 21.12	3.67

(1) The SAR units in the above table, which were granted subsequent to January 1, 2009, are convertible for a maximum number of shares of the Company s common stock equal to 75% of the SAR units subject to the grant.

(2) Due to the ceiling imposed on the SAR grants, the outstanding amount can be exercised for a maximum of 8,128,073 shares of the Company s common stock. SAR grants made prior to January 1, 2009 and after January 1, 2009 are convertible for a maximum number of shares of the Company s common stock equal to 50% and 75%, respectively, of the SAR units subject to the grant.

(3) Due to the ceiling imposed on the SAR grants, the currently exercisable amount is a maximum of 4,003,410 shares of the Company s common stock.

All stock options and SARs outstanding at March 31, 2009 are with exercise prices above $4.32 per unit (the closing price of the Company s common stock at March 31, 2009) and therefore are out of the money.

The Company s aggregate equity-based compensation expense for the three months ended March 31, 2009 and 2008 totaled $3,021 and $3,961, respectively. The total income tax benefit recognized in the statement of operations relating to the Company s equity-based compensation expense for the three months ended March 31, 2009 and 2008, was $0 and $131, respectively.

As of March 31, 2009, there was $13,008 of total unrecognized equity-based compensation expense related to unvested equity-based compensation awards granted under the Company s stock option plans. This amount is expected to be recognized during the period from 2009 through 2013.

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NOTE K PENSION LIABILITY

The information in this note represents the net periodic pension and post-retirement benefit costs and related components in accordance with SFAS 132(R) Employers Disclosures about Pensions and Other Postretirement Benefits (as amended) (SFAS 132(R)). The components of net pension and post-retirement periodic benefit cost (income) for the quarter ended March 31, 2009 and 2008 are as follows.

The following table provides the components of net periodic benefit cost for the period ended March 31, 2009 and 2008 (in thousands):

	March 31, 2009	March 31, 2008
Components of net periodic benefit cost		
Service cost	$ 53	$ 34
Interest cost	46	
Expected return on plan assets	(38)	
Exchange rate expenses (income)	(127)	211
Net periodic benefit cost (income)	$ (66)	$ 245

The liabilities for the Company s pension and other post-retirement benefit plans were calculated in accordance with SFAS No. 87 Employers Accounting for Pensions. The net pension liability as of March 31, 2009 amounted to $1,526.

NOTE L FAIR VALUE MEASUREMENTS

Assets and Liabilities Measured at Fair Value on a Recurring Basis:

The Company s financial assets and liabilities subject to fair value measurement provisions as of March 31, 2009 comprised the following (in thousands):

	Balance as of March 31, 2009	Fair Value Measurements Level 1	Level 2	Level 3
Description				
Assets:				
Cash equivalents:				
Time deposits	$ 18,179		$ 18,179	
Money market mutual funds	$ 1,604	$ 1,604		
Short-term marketable securities and cash deposits:				
Corporate debt securities	$ 6,869		$ 6,869	
Time deposits	$ 18,110		$ 18,110	
Long-term marketable securities:				
U.S. government securities	$ 11,695		$ 11,695	
Corporate debt securities	$ 22,041		$ 22,041	
Derivative liability	$ 1,103		$ 1,103	

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The Company s financial assets and liabilities subject to fair value measurement provisions as of December 31, 2008 comprised the following (in thousands):

	Balance as of December 31, 2008	Fair Value Measurements Level 1	Level 2	Level 3
Description				
Assets:				
Cash equivalents:				
Time deposits	$ 28,656		$ 28,656	
Money market mutual funds	$ 7,127	$ 7,127		
Short-term marketable securities and cash deposits:				
Corporate debt securities	$ 9,931		$ 9,931	
Time deposits	$ 2,518		$ 2,518	
Long-term marketable securities:				
U.S. government securities	$ 19,437		$ 19,437	
Corporate debt securities	$ 20,614		$ 20,614	
Derivative liability	$ 27		$ 27	

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis:

Effective January 1, 2009, all other nonfinancial assets and liabilities measured at fair value in the financial statements on a nonrecurring basis are subject to SFAS No. 157 Fair Value Measurements (SFAS No. 157). Nonfinancial nonrecurring assets and liabilities included in the Company s condensed consolidated balance sheets include long lived assets that are measured at fair value to test for and measure an impairment charge, when necessary. No such nonfinancial assets or liabilities were subject to SFAS No. 157 for the three months ended March 31, 2009.

NOTE M STOCKHOLDERS EQUITY

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

No shares were repurchased under the Company s board authorized share repurchase program during the first quarter of 2009. As of March 31, 2009, 255,488 shares of the Company s common stock remain authorized for repurchase under the share repurchase program.

NOTE N NEW ACCOUNTING PRONOUNCEMENTS

In April 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 142-3 Determination of the Useful Life of Intangible Assets (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No.142 Goodwill and Other Intangible Assets. The Company adopted FSP 142-3 effective January 1, 2009. The adoption of this standard did not have material impact on the Company s consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161 which requires additional disclosures about the objectives of the derivative instruments and hedging activities, the method of accounting for such instruments under SFAS No. 133 and its related interpretations, and a tabular disclosure of the effects of such instruments and related hedged items on a company s financial position, financial performance, and cash flows. The Company adopted SFAS No. 161 effective January 1, 2009. The adoption of SFAS No. 161 had no financial impact on the Company s consolidated financial statements and only required additional disclosures. The Company has applied the requirements of SFAS No. 161 prospectively. Therefore, disclosures related to comparative periods prior to the date of adoption have not been presented. See Note H for details.

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In February 2008, the FASB issued FSP 157-2 Effective Date of FASB Statement No. 157, which delays the effective date of SFAS 157 for all nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). In addition, the FASB issued FSP 157-3 Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP 157-3), which clarified the application of how the fair value of a financial asset is determined when the market for that financial asset is inactive. FSP 157-3 was effective upon issuance. FSP 157-2 was effective for the Company beginning January 1, 2009. The adoption of this standard did not have material impact on the Company s consolidated financial statements. See Note L for details.

In December 2008, the FASB issued FSP No. FAS 132 (R) -1 Employers Disclosures about Postretirement Benefit Plan Assets, an amendment of FASB Statement No. 132 (revised 2003) (FSP No. 132 (R) -1). It provides guidance on an employer s disclosures about plan assets, including: how investment allocation decisions are made and factors that are pertinent to an understanding of investment policies and strategies; the major categories of plan assets; the inputs and valuation techniques used to measure the fair value of plan assets; the effect of fair value measurements using significant unobservable inputs (level 3) on changes in plan assets for the period, and significant concentrations of risks within plan assets. FSP 132 (R) -1 is effective for fiscal years ending after December 15, 2009. The Company is currently assessing the potential impact that adoption of this standard may have on its financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1 Interim Disclosures about Fair Value of Financial Instruments. It requires the fair value for all financial instruments within the scope of SFAS No. 107 Disclosures about Fair Value of Financial Instruments (SFAS No. 107), to be disclosed in the interim periods as well as in annual financial statements. This standard is effective for the quarter ending after June 15, 2009. The Company is currently assessing the potential impact that adoption of this standard may have on its financial statements.

In April 2009, the FASB issued FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. It clarifies the objective and method of fair value measurement even when there has been a significant decrease in market activity for the asset being measured. This standard is effective for the quarter ending after June 15, 2009. The Company is currently assessing the potential impact that adoption of this standard may have on its financial statements.

In April 2009, the FASB issued FSP No. 115-2 and FAS 124-2 Recognition and Presentation of Other-Than-Temporary Impairments (collectively, the FSP). The FSP is intended to provide greater clarity to investors about the credit and noncredit component of a other-than-temporary impairment event and to more effectively communicate when a other-than-temporary impairment event has occurred. The FSP applies to fixed maturity securities only and requires separate display of losses related to credit deterioration and losses related to other market factors. When an entity does not intend to sell the security and it is more likely than not that an entity will not have to sell the security before recovery of its cost basis, it must recognize the credit component of a other-than-temporary impairment in earnings and the remaining portion in other comprehensive income. Upon adoption of the FSP, an entity will be required to record a cumulative-effect adjustment as of the beginning of the period of adoption to reclassify the noncredit component of a previously recognized other-than-temporary impairment from retained earnings to accumulate other comprehensive income. The FSP will be effective for the Company for the quarter ending June 30, 2009. The Company is currently evaluating the impact of adopting the FSP.

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

The discussions in this Quarterly Report on Form 10-Q should be read in conjunction with our accompanying financial statements and the related notes thereto. This Quarterly Report on Form 10-Q contains forward-looking statements within the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act of 1934, as amended. All statements included or incorporated by reference in this Quarterly Report, other than statements that are purely historical, are forward-looking statements. Words such as anticipates, expects, intends, plans, believes, seeks, estimates and similar expressions also identify forward looking statements. The forward looking statements in this Quarterly Report on Form 10-Q are not guarantees of future performance and include, without limitation, statements regarding:

- *Our expectation that sales from Digital Enhanced Cordless Telephony (DECT) and 2.4GHz products and, to a lesser extent, 5.8GHz products, will continue to represent a significant percentage of our revenue for the remainder of 2009;*

- *Our belief that international sales will continue to account for a significant portion of our net product sales for the foreseeable future;*

- *Our belief that sales to our Hong Kong-based customers will continue to increase in future periods in absolute dollars and as a percentage of total revenues as a result of the expansion of our new DECT product;.*

- *Our belief that our revenues and gross profit will decrease in 2009 as compared to 2008 mainly due to the severe global economic downturn generally and the significant declines in the semiconductor and consumer electronics industries specifically;*

- *Our belief that U.S. sales of our 2.4GHz and 5.8GHz products will continue to decrease for the remainder of 2009 with a sharper decrease in sales of our 5.8GHz products;*

- *Our belief that U.S. sales of our DECT 6.0 products will continue to increase on account of the decrease in sales of our 2.4GHz and 5.8GHz products as the shift to DECT 6.0 products in the U.S. market is occurring at a fast pace;*

- *Our belief that the rapid deployment of new communication access methods, as well as the projected lack of growth in fixed-line telephony, will reduce our total revenues derived from, and unit sales of, cordless telephony products, including our DECT, 2.4GHz and 5.8GHz product, for 2009 and the long term;*

- *Our belief that the market will remain price sensitive for the remainder of 2009 and that price erosion will continue;*

- *Our belief that research and development expenses in absolute dollars will decrease in 2009 as compared to 2008;*

- *Our belief that interest rate fluctuations will not have a material effect on our financial position on an annual or quarterly basis; and*

- *Our belief that our available cash, cash equivalents, cash deposits and marketable securities at March 31, 2009 should be sufficient to finance our operations for both the short and long term.*

All forward-looking statements included in this Quarterly Report on Form 10-Q are made as of the date hereof, based on information available to us as of the date hereof, and we assume no obligation to update any forward-looking statement. Many factors may cause actual results to *differ materially from those expressed or implied by the forward-looking statements contained in this report. These factors include, but are not limited to, our dependence on one primary distributor, our OEM relationships and competition, as well as those risks described in Part II Item 1A Risk Factors of this Form 10-Q.*

Overview

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 fabless semiconductor company that is a leader in providing chipsets to telephone equipment and design manufacturers (OEMs and ODMs) for incorporation into consumer products for the short-range residential wireless communications market.

In recent years, we have become a worldwide leader in developing and marketing Total Telephony Solutions for the wireless residential market by taking advantage of the market transformation from analog-based technologies to digital-based technologies for telephony products and the shift from 900MHz to 2.4GHz to 5.8GHz technologies. One additional primary factor that contributed to our success in recent years is our penetration of the DECT market in Europe and our current presence in the U.S. DECT market (known as DECT 6.0).

In September 2007, we acquired the cordless and VoIP terminals business (the CIPT Business) of NXP B.V. (NXP) (the Acquisition). In connection with the Acquisition, we paid NXP approximately $200 million in cash and issued 4,186,603 shares of our common stock to NXP. We also agreed to a contingent cash payment of up to $75 million payable based on future revenue performance of the products of the CIPT Business for the first four financial quarters following the closing of the Acquisition. Such revenue milestones were not achieved and no additional cash payments were made to NXP. On March 12, 2009, we repurchased the shares of common stock issued to NXP in connection with the Acquisition for an aggregate consideration of approximately $20,028,000.

Our current primary focus is digital cordless telephony with sales of our in-house developed Communications over Internet Protocol (CoIP), 1.9GHz (Digital Enhanced Cordless Telephony (DECT)), 2.4GHz and 5.8GHz chipsets representing approximately 91% of our total revenues for the first quarter of 2009. Our revenues were $39.9 million for the first quarter of 2009, a decrease of 45% in comparison to the same period of 2008. This decline resulted from decreased sales of all of our product lines. We believe that U.S. sales of our 2.4GHz and 5.8GHz products will continue to decrease for the remainder of 2009 with a sharper decrease in sales of our 5.8GHz products. On the other hand, we believe sales of our DECT 6.0 products in the U.S. market will continue to increase on account of the decrease in sales of our 2.4GHz and 5.8GHz products as the shift to DECT 6.0 products in the U.S. market is occurring at a fast pace.

Our business operates in a highly competitive environment. Competition has historically increased pricing pressures for our products and decreased our average selling prices. Our gross margin decreased to a level of 33.6% of total revenues for the first quarter of 2009 from 37% for the first quarter of 2008, primarily due to the decline in overall revenues, the continued decline in average selling prices of our products, and the increased sales of DECT products with lower gross margin on account of 5.8GHz and 2.4GHz products with higher gross margin. The cordless telephony market is additionally undergoing a challenging period of transition characterized by stagnation due to the lack of new model launches and market anticipation of next generation products. As a result, we expect the market to remain price sensitive for the remainder of 2009 and expect price erosion to continue. Moreover, various other factors, including increases in raw materials and commodity costs and our suppliers passing such increases onto us, increases in silicon wafer costs and increases in production, assembly and testing costs, all may decrease our gross profit in future periods. Furthermore, the current worldwide economic downturn has resulted in a decrease in product demand, excess customer inventories, accelerated erosion of prices, longer product cycles and decision-making processes at our customers organizations, reduced corporate profits and capital, liquidity concerns and general adverse business conditions. The downturn also has resulted in a significant downturn of the semiconductor industry, the industry in which we operate. Moreover, our semiconductor OEM customers incorporate our chipsets into consumer electronics products, the demand for which has significantly slowed due to the economic downturn and more specifically decreased consumer confidence. We currently anticipate that our revenues and gross profit will decrease in 2009 as compared to 2008 mainly due to the severe global economic downturn generally and the significant declines in the semiconductor and consumer electronics industries specifically.

Our operating expenses decreased by 30% for the first quarter of 2009 compared to the same period for 2008, reaching a level of $25.1 million. The decrease in operating expenses for the first quarter of 2009 as compared to the same period of 2008 was primarily attributable to (i) a decrease in the amortization cost for intangibles assets related to the Acquisition in the amount of $2.7 million, resulting from the recordation of impairment costs related to such intangible assets in 2008 which decreased the original cost of such intangible assets for future amortization measurement, (ii) a decrease in payroll and facilities expenses related to research and development, resulting from our restructuring plans, which included a reduction in the numbers of employees and the shut down of some of our sites, (iii) a decrease in IP and tapeout expenses related to research and development, (iv) a decrease in commission expenses due to decreased sales for the first quarter of 2009, and (v) a decrease in equity-based compensation expenses. Our operating loss was $11.7 million for the first quarter of 2009, approximately 29% of revenues, compared to $9.1 million of operating loss for the same period of 2008, representing 13% of revenues. The increase in operating loss was mainly due to the decrease in overall revenues and gross margins, offset to some extent by the decrease in operating expenses as noted above.

We believe there are also several emerging market trends that challenge our continued business growth potential. For example, the rapid deployment of new communication access methods, including mobile, wireless broadband, cable and other connectivity, as well as the projected lack of growth in products using fixed-line telephony, may reduce our revenues derived from, and unit sales of, cordless telephony products, which are currently our primary focus. Our business also may be affected by the outcome of the current competition between cellular phone operators and fixed-line operators for the provision of residential communication. Our revenues are currently generated from sales of chipsets used in cordless phones that are based on fixed-line telephony. Another market trend that could affect the results of our operations is the shift in the U.S. digital telephony market, our primary market, from sales of 2.4GHz and 5.8GHz products towards DECT products, a trend that is occurring faster than anticipated. The shift resulted in an overall decrease in our revenues and gross margin as our DECT 6.0 products are sold at lower average selling prices and gross margin than our 2.4GHz and 5.8GHz products. We also are witnessing a move of manufacturing activities from large systems suppliers in the U.S., Japan and Europe to Southeast Asia, a trend that also could adversely affect our business.

We recognize the competitive landscape and are actively engaged in addressing these market challenges and trends. We continue to expand our presence in the U.S. and European DECT markets to maintain our business. Revenues derived from the sale of DECT products represented 72% of our total revenues for the first quarter of 2009. In addition to DECT technologies, we are investing in developing CoIP technologies in-house. Our strategic focus is to launch next generation products to capitalize on the transition underway in the residential communications market with the move from wireless voice communication to voice communication over IP networks and ultimately the convergence of voice, video and data communication. As an initial step, we introduced products to facilitate the deployment of residential broadband services. Our long term goal is to leverage the Wi-Fi technology acquired in 2004 from Bermai Inc. to develop and offer products for home communication that integrate voice, data and video with broadband offerings. To that end, we recently introduced to the market the XpandR platform that integrates DECT and Wi-Fi capabilities to enable multimedia and web-related applications in our future products. However, our success in introducing new products and penetrating new markets may not occur and may require us to substantially increase our operating expenses. As a result, our past operating results should not be relied upon as an indication of future performance.

As of March 31, 2009, our principal source of liquidity consisted of cash and cash equivalents of approximately $45.3 million and marketable securities of approximately $58.7 million, totaling $104.0 million. Our cash, investments and securities were materially decreased during the first quarter of 2009, mainly due to the repurchase of 4,186,603 shares of our common stock from NXP for approximately $20,028,000.

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RESULTS OF OPERATIONS

Total Revenues. Our total revenues were $39.9 million for the first quarter of 2009, as compared to $72.7 million for the same period in 2008. This decrease was primarily as a result of decreased sales of all of our lines of products, especially our DECT products. Sales of DECT products were $28.9 million and $45.9 million for the first quarter of 2009 and 2008, respectively, representing approximately 72% and 63% of our total revenues for the first quarter of 2009 and 2008, respectively, a decrease of 37% in absolute dollars. Sales of 5.8GHz products were $0.7 million and $5.2 million for the first quarter of 2009 and 2008, respectively, representing approximately 2% and 7% of our total revenues for the first quarter of 2009 and 2008, respectively, representing a decrease of 86% in absolute dollars. Sales of 2.4GHz products were $6.8 million and $8.9 million for the first quarter of 2009 and 2008, respectively, represented 17% and 12% of our total revenues for the first quarter of 2009 and 2008, respectively, representing a decrease of 24% in absolute dollars. The decrease in revenues on a percentage basis and in absolute dollars generated by our 5.8 GHz and 2.4 GHz products for the comparable periods was mainly attributable to increased sales of our DECT 6.0 products in the U.S. market on account of sales of those products.

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

	Period ended March 31, 2009	2008
United States	$ 388	$ 6,732
Japan	$ 15,896	$ 26,308
Europe	$ 3,413	$ 10,398
Hong Kong	$ 17,218	$ 24,637
Other	$ 2,999	$ 4,654
Total revenues	$ 39,914	$ 72,729

Sales to our customers in Hong Kong decreased for the first quarter of 2009 as compared to the same period of 2008, representing a 30% decrease in absolute dollars. The decrease in our sales to Hong Kong for the comparable periods resulted from (i) a decrease in sales to Vetch, representing a 12% decrease in absolute dollars, and (ii) a decrease in sales to CCT, representing a 66% decrease in absolute dollars. The decrease in our sales to Japan for the comparable periods resulted from (i) a decrease in sales to Panasonic, representing a 48% decrease in absolute dollars, and (ii) a decrease in sales to the Japanese domestic market and to Uniden, both a 32% decline in absolute dollars. We anticipate that sales to our Hong Kong-based customers will continue to increase in future periods in absolute dollars and as a percentage of total revenues as a result of the expansion of our new DECT products.

As our products are generally incorporated into consumer products sold by our OEM customers, our revenues are affected by seasonal buying patterns of consumer products sold by our OEM customers that incorporate our products. The fourth quarter in any given year is usually the strongest quarter of sales for our OEM customers and, as a result, the third quarter in any given year is usually the strongest quarter for our revenues as our OEM customers request increased shipments of our products in anticipation of the fourth quarter holiday season. This trend can be generally observed from reviewing our quarterly information and results of operations. However, the magnitude of this trend varies annually.

Significant Customers. The Japanese market and the OEMs that operate in that market are among the largest suppliers of residential wireless products with significant market share in the U.S. market. Revenues derived from sales through our largest distributor, Tomen Electronics Corporation (Tomen Electronics), accounted for 29% of our total revenues for the first quarter of 2009 as compared to 26% for the same period of 2008. The increase was primarily due to the decrease in overall revenues for the first quarter of 2009, which increased the percentage of revenues attributable to Tomen out of our total revenues.

Tomen Electronics sells our products to a limited number of customers. One customer, Panasonic Communications Co., Ltd., (Panasonic), has continually accounted for a majority of the sales through Tomen Electronics. Sales to Panasonic through Tomen Electronics generated approximately 15% and 16% of our revenues for the three months ended March 31, 2009 and 2008, respectively. Sales through Tomen Electronics or directly to Uniden represented 13% and 11% of our revenues for the three months ended March 31, 2009 and 2008, respectively. The loss of

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Tomen Electronics as a distributor and our inability to obtain a satisfactory replacement in a timely manner would harm our sales and results of operations. Additionally, the loss of Panasonic and Tomen Electronics inability to thereafter effectively market our products would also harm our sales and results of operations.

Other significant customers of the company include various Hong Kong-based OEMs. Sales to VTech represented 28% and 18% of the total revenues for the three months ended March 31, 2009 and 2008, respectively. Sales to CCT Telecom represented 6% and 10% of our total revenues for the three months ended March 31, 2009 and 2008, respectively.

Significant Products. Revenues from our DECT products represented 72% of our total revenues for the first quarter of 2009. Revenues from our 5.8GHz and 2.4GHz digital products represented 2% and 17%, respectively, of our total revenues for the first quarter of 2009. We believe that sales of DECT and 2.4GHz digital products and, to a lesser extent, 5.8GHz digital products will continue to represent a substantial percentage of our revenues for the remainder of 2009. However, we believe that U.S. sales of our 2.4GHz and 5.8GHz products will decrease for the remainder of 2009 with a sharper decrease in sales of our 5.8GHz products. We believe that the rapid deployment of new communication access methods, as well as the projected lack of growth in fixed-line telephony, will reduce our total revenues derived from, and unit sales of, cordless telephony products, including future sales of our DECT, 2.4GHz and 5.8GHz products for the remainder of 2009 and the long term.

Gross Profit. Gross profit as a percentage of revenues was 33.6% for the first quarter of 2009 and 37% for the first quarter of 2008. The decrease in our gross profit was primarily due to the continuing decline in the average selling prices of our products and the increased sales of DECT products with lower average gross margin on account of 5.8GHz and 2.4GHz products with higher average gross margin. 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 the corresponding cost reductions, roll-out of new products in any given period and our failure to introduce new engineering processes, increases in raw materials such as gold and oil and silicon wafer costs and increases in production, assembly and testing costs. Moreover, our suppliers may pass the increase in raw materials and commodity costs onto us which would further reduce the gross margin of our products. We cannot guarantee that our ongoing efforts in cost reduction and yield improvements will be successful or that they will keep pace with the anticipated continuing decline in average selling prices of our products. One approach we are using to offset the expected decrease in gross profit is offering our customers bare-die chips that eliminate assembly and testing services in return for lower selling prices to our customers. Other steps we are taking include the implementation of cost improvement plans to reduce testing costs and offer our customers more cost effective products. However, we can provide no assurance that any alternative solutions we provide to our customers will be acceptable to them or that these steps will help us offset the continued decrease in gross margins of our products.

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

Research and Development Expenses. Our research and development expenses decreased to $13.7 million for the first quarter of 2009 from $20.0 million for the first quarter of 2008. The decrease in research and development expenses in 2009 as compared to the same period of 2008 was mainly attributed to (i) savings of $1.3 million as a result of the shut down of, or reduction in capacity at, some of our sites as part of our restructuring plans, (ii) savings of $1.4 million in IP and tapeouts expenses, (iii) savings of $1.8 million in payroll expenses, resulting mainly from the reduction in the number of employees at sites that remain operation after implementation of our restructuring plans in 2008, (iv) a devaluation of the NIS against the U.S. dollar with respect to our Israeli facilities and employees which reduced the research and development expenses attributable to such facilities and employees, and (v) a decrease in equity-based compensation expenses of $0.5 million.

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Our research and development expenses as a percentage of total revenues were 34% for the three months ended March 31, 2009 and 28% for the three months ended March 31, 2008. This increase in research and development expenses as a percentage of total revenues was due to the decrease in absolute dollars of our total revenues.

As we implemented two restructuring plans following the Acquisition to improve operational efficiency at our various sites and to reduce our operating expenses for 2009, our research and development expenses in absolute dollars are expected to decrease in 2009 in comparison to 2008.

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

Sales and Marketing Expenses. Our sales and marketing expenses decreased to $4.5 million for the first quarter of 2009 from $6.0 million for the first quarter of 2008. The decrease in sales and marketing expenses was mainly attributed to (i) a decrease in sales commissions paid due to a lower level of revenues subject to sales commissions for the first quarter of 2009, as compared to the same period of 2008, and (ii) a decrease in payroll expenses due to lower number of sales and marketing employees and contractors, partially as a result of our restructuring plans.

Our sales and marketing expenses as a percentage of total revenues were 11% and 8% for the three months ended March 31, 2009 and 2008, respectively. This increase in sales and marketing expenses as a percentage of total revenues was due to the decrease in our total revenues.

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 $3.8 million for the three months ended March 31, 2009, as compared to $4.3 million for the three months ended March 31, 2008. The decrease in general and administrative expenses for the first quarter of 2009 was mainly due to the decrease in equity-based compensation expenses. Equity-based compensation expenses amounted to $0.8 million for the first quarter of 2009 as compared to $1.1 million for the first quarter of 2008. General and administrative expenses as a percentage of total revenues were 10% and 6% for the first quarters of 2009 and 2008, respectively. This increase in general and administrative expenses as a percentage of total revenues was due to the decrease in our total revenues.

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

Amortization of Intangible Assets. During the first quarter of 2009, we recorded an expense of approximately $3.0 million, as compared to $5.8 million for the three month ended March 31, 2008, relating to the amortization of intangible assets associated with the Acquisition. The decrease was due to the recordation of impairment costs of such intangible assets in 2008, which reduced the basic cost of such intangible assets and therefore the future amortization cost of such intangible assets.

Interest and Other Income, net. Interest and other income, net, for the three months ended March 31, 2009 decreased to $0.6 million from $1.2 million for the three months ended March 31, 2008. The decrease was due to (i) a decrease in our level of cash, cash equivalents and marketable securities attributable to our various share repurchases since the first quarter of 2008, (ii) lower interest rates, and (iii) the devaluation of the Euro against the U.S. dollar, which resulted in expenses associated with the exchange rate differences.

Our total cash, cash equivalents and marketable securities were $104.0 million as of March 31, 2008, compared to $135.5 million as of March 31, 2008.

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Provision for Income Taxes. Our income tax benefit was $0.4 million for the first quarter of 2009, as compared to $0.3 million for the first quarter of 2008. As of March 31, 2009 and December 31, 2008, we did not record any deferred tax assets due to a change in our estimation of future taxable income primarily as a result of general adverse market conditions.

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

On April 1, 2005, an amendment to the Israeli Investment Law came into effect. The amendment revised the criteria for investments qualified to receive tax benefits. An eligible investment program under the amendment qualifies for benefits as a Privileged Enterprise (rather than the previous terminology of Approved Enterprise). Among other things, the amendment provides tax benefits to both local and foreign investors and simplified the approval process. The amendment does not apply to investment programs approved prior to December 31, 2004. The new tax regime applies to new investment programs only. We believe that we are currently in compliance with these requirements. However, if we fail to meet these requirements, we would be subject to corporate tax in Israel at the regular statutory rate (26% for 2009). We also could be required to refund tax benefits, with interest and adjustments for inflation based on the Israeli consumer price index.

As of December 31, 2006, DSP Group Ltd. has elected the status of a Privileged Enterprise under the amendment to the Israeli Investment Law for its seventh plan. The seventh plan entitles DSP Group Ltd. to a corporate tax exemption for a period of two years and to a reduced corporate tax rate of 10%-25% (based on the percentage of foreign ownership) for an additional period of eight years from the first year it has taxable income.

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

Currently, our U.S. federal income tax returns for 2003 and 2004 are under examination. A change in the amount of unrecognized tax benefit is reasonably possible in the next 12 months due to the examination by the U.S. Internal Revenue Service of the Company s U.S. federal income tax returns for 2003 and 2004. We currently cannot make an estimate of the range of change in the amount of the unrecognized tax benefits due to the ongoing status of the examination.

LIQUIDITY AND CAPITAL RESOURCES

Operating Activities. For the first quarter of 2009, we generated $4.5 million of cash and cash equivalents from our operating activities. Cash used for operating activities amounted to $0.2 million for the first quarter of 2008. The increase in net cash provided by operating activities for the first quarter of 2009 as compared to cash used for operating activities for the same period in 2008 resulted mainly from a decrease in accounts receivable by $16.1 million during the first quarter of 2009, as compared with a decrease in accounts receivable of $7.0 million during the first quarter of 2008. The increase in cash from operating activities was also the result of a decrease in inventories by $1.7 million for the first quarter of 2009, as compared to an increase by $1.3 million during the same period in 2008. The above increase in cash from operating activities was offset to some extent by an increase in net loss for the comparable periods.

Investing Activities. We invest excess cash in marketable securities of varying maturity, depending on our projected cash needs for operations, capital expenditures and other business purposes. During the first three months of 2009, we purchased $21.9 million of marketable securities and short-term deposits, as compared to $10.0 million during the first three months of 2008. During the first three months of 2009 and 2008, $15.3 million and $41.9 million, respectively, of marketable securities matured, were called by the issuer or were sold.

As of March 31, 2009, the amortized cost of our marketable securities and short-term deposits was $59.3 million and their stated market value was $58.7 million, representing an unrealized loss of $0.6 million, which was caused mainly by overall market conditions and interest rate changes. The amortized cost of our marketable securities and short-term deposits as of March 31, 2009 includes a write-down of $2,961,000 associated with certain securities that was recorded in 2008. This write-down was based on our determination that the decline in fair value of the securities was other than temporary, notwithstanding our intent to hold such securities until maturity.

Our capital equipment purchases for the first three months of 2009, consisting primarily of research and development software tools, computers and other peripheral equipment, engineering test and lab equipment, leasehold improvements, furniture and fixtures, totaled $1.2 million, as compared to $4.1 million for the first three months of 2008.

Financing Activities. During the first quarter of 2009, we repurchased 4,186,603 shares of our common stock that were issued to NXP in connection with the Acquisition at a purchase price of $4.78 per share for approximately $20,028,000.

We received $0 million and $0.1 million upon the exercise of employee stock options during the first quarter of 2009 and 2008, respectively. We cannot predict cash flows from option exercises for future periods.

In March 1999, our board of directors authorized the repurchase of up to 4.0 million shares of our common stock. In July 2003, October 2004 and January 2007, our board authorized the repurchase of an additional 2.5 million, 2.5 million and 3.0 million shares of our common stock, respectively, for repurchase. In January 2008, our board authorized an additional 2.9 million shares for repurchase. The number of shares authorized for repurchase after giving effect to the January 2008 board approval was 5.1 million. Also in January 2008, our board of directors approved the company s entry into a share repurchase plan for up to 5,000,000 shares of the 5.1 million shares of our common stock authorized for repurchase, which plan became effective on February 7, 2008. The share repurchase plan is in accordance with Rule 10b5-1 of the United States Securities Exchange Act of 1934, as amended, that is designed to facilitate these purchases. During the first quarter of 2008, we repurchased 2,170,584 shares of our common stock at an average purchase price of $11.91 per share for approximately $25.9 million (approximately $23.9 million was paid in cash as of March 31, 2008) pursuant to our board-approved share repurchase program. No repurchases were made during the first quarter of 2009 pursuant to our board-approved share repurchase program. As of March 31, 2009, 255,488 shares of our common stock remain authorized for repurchase.

As of March 31, 2009, we had cash and cash equivalents totaling approximately $45.3 million and marketable securities of approximately $58.7 million.

Our working capital at March 31, 2009 was approximately $75.2 million, compared to $108.9 million as of March 31, 2008. The decrease in working capital was mainly due to the share repurchases made since the first quarter of 2008 through March 31, 2009. We believe that our current cash, cash equivalents, cash deposits and marketable securities will be sufficient to meet our cash requirements for both the short and long term.

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

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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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 exposure since we do not have any financial obligation, and our financial assets are measured on an available for sale basis.

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

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

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

Foreign Currency Exchange Rate Risk. A significant part of our sales and expenses are denominated in U.S. dollars. Part of our expenses in Israel is paid in New Israeli Shekel (NIS), the Israeli currency, 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 Euro and Swiss Franc, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the Euro and Swiss Franc. Our primary expenses paid in Euro and Swiss Franc are employee salaries, lease and operational payments on our European facilities. To partially protect the company against an increase in value of forecasted foreign currency cash flows resulting from salary and lease payments denominated in NIS during 2009, we instituted a foreign currency cash flow hedging program. These option and forward contracts are designated as cash flow hedges, as defined by SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities, and are all effective as hedges of these expenses. For more information about our hedging activity, see Note H to the attached Notes to the Condensed Consolidated Financial Statement for the period ended March 31, 2009. An increase in the value of the NIS, Euro and Swiss Franc in comparison to the U.S. dollar could increase the cost of our research and development expenses and general and administrative expenses, all of which could harm our operating profit. Although we currently are using a hedging program to minimize the effects of currency fluctuations relating to the NIS, our hedging position is partial, may not exist at all in the future and may not succeed in minimizing our foreign currency fluctuation risks.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See Management s Discussion and Analysis of Financial Condition and Results of Operations Quantitative and Qualitative Disclosures about Market Risk.

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ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in this report.

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

From time to time, we may become involved in litigation relating to claims arising from our ordinary course of business activities. Also, as is typical in the semiconductor industry, we have been and may from time to time be notified of claims that we may be infringing patents or intellectual property rights owned by third parties. For example, in a lawsuit against Microsoft Corporation, AT&T asserted that our TrueSpeech 8.5 algorithm includes certain elements covered by a patent held by AT&T. AT&T sued Microsoft, one of our TrueSpeech 8.5 licensees, for infringement. We were not named in AT&T s suit against Microsoft. We currently believe that there are no claims or actions pending or threatened against us, the ultimate disposition of which would have a material adverse effect on us.

ITEM 1A. RISK FACTORS.

This Form 10-Q contains forward-looking statements concerning our future products, expenses, revenue, liquidity and cash needs as well as our plans and strategies. These forward-looking statements are based on current expectations and we assume no obligation to update this information. Numerous factors could cause our actual results to differ significantly from the results described in these forward-looking statements, including the following risk factors.

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

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

We sell our products to customers primarily through a network of distributors. Particularly, revenues derived from sales through our Japanese distributor, Tomen Electronics, accounted for approximately 29% of our total revenues for the three months ended March 31, 2009. Our future performance will depend, in part, on this distributor to continue to successfully market and sell our products. Furthermore, Tomen Electronics sells our products to a limited number of customers. One customer, Panasonic Communications Co., Ltd., has continually accounted for a majority of the sales through Tomen Electronics. Sales to Panasonic through Tomen Electronics generated approximately 15% of our revenues for the three months ended March 31, 2009. The loss of Tomen Electronics as our distributor and our inability to obtain a satisfactory replacement in a timely manner would materially harm our sales and results of operations. Additionally, the loss of Panasonic and Tomen Electronics inability to thereafter effectively market our products would also materially harm our sales and results of operations.

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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 five largest customers CCT, Gigaset, Panasonic, Uniden and VTech accounted for approximately 69% of total revenues for the three months ended March 31, 2009. In addition to Panasonic mentioned above, sales to Uniden, CCT Telecom and VTech represented approximately 13%, 6%, 28% and 7%, respectively, of total revenues for the three months ended March 31, 2009. Typically, our sales are made on a purchase order basis, and none of our customers has entered into a long-term agreement requiring it to purchase our products. Moreover, we do not typically require our customers to purchase a minimum quantity of our products, and our customers can generally cancel or significantly reduce their orders on short notice without significant penalties. A significant amount of our revenues will continue to be derived from a limited number of large customers. Furthermore, the primary customers for our products are OEMs and original design manufacturers (ODMs) in the cordless digital market. This industry is highly cyclical and has been subject to significant economic downturns at various times, particularly in recent periods. These downturns are characterized by production overcapacity and reduced revenues, which at times may affect the financial stability of our customers. Therefore, the loss of one of our major customers, or reduced demand for products from, or the reduction in purchasing capability of, one of our major customers, could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

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

Sales of our digital cordless telephony products comprised a majority of our total revenues for the first quarter of 2009. Specifically, sales of our 2.4GHz, 5.8GHz, DECT and CoIP products comprised 91% and 84% of our total revenues for the first quarters of 2009 and 2008, respectively. Revenues from our DECT products represented 72% and 63% of our total revenues for the first quarters of 2009 and 2008, respectively. Revenues from our 5.8GHz and 2.4GHz digital products represented 2% and 17%, respectively, of total revenue for the first quarter of 2009, and 7% and 12%, respectively, of our total revenues for the first quarter of 2008. We believe U.S. sales of our 2.4GHz and 5.8GHz products will decrease for the remainder of 2009 with a sharper decrease in sales of our 5.8GHz products.

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

We believe new developments in the home residential market may adversely affect the revenues we derive from our digital cordless telephony products. For example, the rapid deployment of new communication access methods, including mobile, wireless broadband, cable and other connectivity, may reduce the market for products using fixed-line telephony. This decrease in demand would reduce our revenues derived from, and unit sales of, our digital Because our quarterly operating results may fluctuate significantly, the price of our common stock may decline.

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

- fluctuations in volume and timing of product orders;
- timing, rescheduling or cancellation of significant customer orders and our ability, as well as the ability of our customers, to manage inventory;
- changes in demand for our products due to seasonal consumer buying patterns and other factors;
- timing of new product introductions by us, including our DECT and CoIP products, and by our customers or competitors;
- changes in the mix of products sold by us or our competitors;
- fluctuations in the level of sales by our OEM customers and other vendors of end products incorporating our products;
- timing and size of expenses, including expenses to develop new products and product improvements;
- 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 the current severe economic downturn in the United States and worldwide, and the adverse effects on the semiconductor and consumer electronics industries.

Each of the above factors is difficult to forecast and could harm our business, financial condition and results of operations. Also, we sell our products to OEM customers that operate in consumer markets. As a result, our revenues are affected by seasonal buying patterns of consumer products sold by our OEM customers that incorporate our products and the market acceptance of such products supplied by our OEM customers. The fourth quarter in any given year is usually the strongest quarter for sales by our OEM customers in the consumer markets, and thus, our third quarter in any given year is usually the strongest quarter for revenues as our OEM customers request increased shipments of our products in anticipation of the increased activity in the fourth quarter. By contrast, the first quarter in any given year is usually the weakest quarter for us. However, this general quarterly fluctuation may be impacted by the current global economic downturn. Specifically, the economic downturn may decrease demand for consumer electronics products, of which our chipsets are incorporated, for Christmas 2009, and therefore we can provide no assurance that the third quarter of 2009 will be the strongest quarter for revenues.

We currently believe that our revenues and gross profit will decrease in 2009 as compared to 2008 mainly due to the severe global economic downturn generally and the significant declines in the semiconductor and consumer electronics industries specifically.

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

We have experienced and will continue to experience a decrease in the average selling prices of our products. Decreasing average selling prices could result in decreased revenues even if the volume of products sold increases. Decreasing average selling prices may also require us to sell our products at much lower gross margin than in the past and reduce profitability. Although we have to date been able to partially offset on an annual basis the declining average selling prices through manufacturing cost reductions by achieving a higher level of product integration and improving our yield percentages, there is no guarantee that our ongoing efforts will be successful or that they will keep pace with the anticipated, continued decline in average selling prices of our products. As an example, our gross margin for the first quarter of 2009 was 33.6%, as compared to 37% for the first quarter of 2008. We currently believe that our gross profit will decrease in 2009 as compared to 2008 mainly due to the severe global economic downturn generally and the significant declines in the semiconductor and consumer electronics industries specifically. In addition to the continued decline in the average selling prices of our products, our gross profit may further 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, our gross margin decreased in 2008 due to the increased sales of DECT products with lower average gross margin on account of 5.8GHz and 2.4GHz products with higher average gross margin. We believe that U.S. sales of our 5.8GHz products will continue to decrease in 2009. We also anticipate that the shift to DECT 6.0 products in the U.S. market will continue at a fast pace in 2009.

Furthermore, increases in the price of silicon wafers, increases in testing costs and increases in gold, oil and other commodities which may result in increased production costs, mainly assembly and packaging costs may result in a decrease to our gross margins. Moreover, our suppliers may pass the increase in raw materials and commodity costs onto us which would further reduce the gross margin of our products. In addition, as we are a fables 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.

Our various restructuring and cost-cutting measures, including those related to the CIPT Business acquired from NXP, could disrupt the operation of our business.

Pursuant to the acquisition of the CIPT Business from NXP, we increased our headcount and established new foreign subsidiaries. In connection with the establishment of a new organizational structure for the combined company and the implementation of a unified synergy plan, we implemented a restructuring plan that mainly involved a reduction in workforce in several locations. During the third quarter of 2008, we initiated an additional restructuring plan, subsequent to our initial restructuring plan following the Acquisition, to improve operating efficiency at our various operating sites and to reduce our operating expenses for 2009. The additional restructuring plan resulted in our recognition of an expense of $1.87 million during the third quarter of 2008. Workforce reductions in connection with any restructuring activity could result in an erosion of morale, affect the focus and productivity of our remaining employees, including those directly responsible for revenue generation, and result in work stoppages, all of which in turn may adversely affect our future revenues or cause other administrative deficiencies. Additionally, reduction in workforce in EU countries may be protracted, require us to comply with complex foreign labor regulations and may entail substantial severance costs. We also may face actions from employees that may be costly to defend. Furthermore, such matters could divert the attention of our employees, including management, away from our operations, harm productivity, harm our reputation and increase our expenses. We cannot assure you that our restructuring and cost-cutting measures implemented to date will be successful. Furthermore, we may implement additional restructuring and cost-cutting measures in the future that could have the same effects as described above.

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 the first quarter of 2009. Furthermore, pursuant to the acquisition of the CIPT Business from NXP, we established new foreign subsidiaries, and currently have material operations, in Germany, Switzerland, Hong Kong and India and employ a number of individuals within those foreign operations. As a result, the occurrence of any negative international political, economic or geographic events, as well as our failure to mitigate the challenges in managing an organization operating in various countries, could result in significant revenue shortfalls and disrupt our workforce within our foreign operations. These shortfalls and disruptions could cause our business, financial condition and results of operations to be harmed. Some of the risks of doing business internationally include:

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

- political and economic instability; and
- changes in diplomatic and trade relationships.

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

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

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

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

In addition, as TSMC produces a significant portion of our integrated circuit products and ASE tests and assembles 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 we depend on NXP to manufacture all of our products for the CIPT Business, we are subject to additional risks that may materially disrupt our business.

As part of the acquisition of the CIPT Business, we entered into a Manufacturing Services Collaboration Agreement, as amended, with NXP pursuant to which NXP agreed to provide us with specified manufacturing, pre-testing, assembling and final-testing services relating to the CIPT Business products for up to seven years following the closing of the Acquisition at predetermined costs. Products from the CIPT Business (e.g. DECT and Voice over Internet Protocol, or VoIP products) currently represent a substantial portion of our total revenues and are anticipated to continue to generate significant revenues for the company in future periods. While NXP has been able to generally meet our manufacturing demands to date, in some cases NXP has failed to meet its required delivery schedule and may be subject to late delivery penalties as a result. These late deliveries have not adversely impacted our ability to satisfy our customers requirements in a timely manner. In addition, NXP has announced the closing of its Fishkill, New York, manufacturing facilities which will result in the transfer of some of our products being manufactured at the Fishkill facility to NXP s Nijmegen facility. We are in the process of working with NXP to re-qualify some of our products at the Nijmegen facility and establish other procedures for the transfer of manufacturing capabilities, including the building of sufficient inventory during the transition period, in order not to disrupt our product shipments and customer relationships. However, if the re-qualification of some of our products in the Nijmegen facility or the other procedures we are establishing for the transfer of manufacturing capabilities are not completed in a timely and satisfactory manner, we fail to build sufficient inventory during the transition period or NXP otherwise is not able to meet its obligations to us under the Manufacturing Services Collaboration Agreement, as amended, our product shipments may be disrupted, customer relationships may be harmed and our business could be materially adversely affected. There are inherent and unforeseen risks and delays associated with the transfer of manufacturing capacities from one facility to another. Our business also could be materially harmed if NXP fails to achieve acceptable manufacturing yields, quality levels or allocate to us a sufficient portion of its foundry capacity to meet our needs for the CIPT Business products due to its capacity constraints, including as a result of the provision of manufacturing services to NXP s internal business units. We also may encounter capacity shortage issues in the future if sales for the CIPT Business products continue to increase as we anticipate and NXP cannot sufficiently meet our increasing demands. A capacity shortage could lengthen our CIPT Business products manufacturing cycle, cause a delay in the shipment of our products to our customers, lead to a loss of sales of our products, harm our reputation and competitive position with customers, some of whom we recently established relationships as a result of the acquisition, and our revenues could be materially reduced. Our business would be materially harmed if NXP cannot for any reason fulfill its manufacturing obligations to us under the manufacturing agreement, including due to financial or operational hardships within NXP as a result of the current significant downturn within the semiconductors industry or otherwise, and we are unable to obtain satisfactory replacement to fulfill customer orders on a timely basis and in a cost-effective manner.

Moreover, in order to enable NXP to provide the specified manufacturing, pre-testing, assembling and final-testing services relating to the CIPT Business products to us, we provide binding capacity commitments to NXP based on a periodic rolling forecast. The manufacturing agreement with NXP provides that we may be subject to monetary penalties if we fail to meet our capacity commitments to NXP that we previously provided to them. If we fail to meet our capacity commitments due to errors in planning logistics, a decrease in forecast from our customers or other reasons, we may be subject to such monetary penalties.

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

Our operating results may be adversely impacted by the worldwide economic downturn and its significant adverse impact on the semiconductor industry.

The current general worldwide economic downturn has resulted in slower economic activity, concerns about inflation and deflation, decreased consumer confidence and spending, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns. These conditions make it extremely difficult for our customers, the end-product customers, our vendors and us to accurately forecast and plan future business activities and make reliable projections. The current downturn has significantly impacted, and will continue to significantly impact, our revenues and harm our business, financial condition and results of operations, all of which could cause our stock price to further decline. Furthermore, during challenging economic times our customers may face various economic issues, including reduced demand for their products, longer product cycles and inability to gain timely access to sufficient credit, all of which could result in an impairment of their ability to make timely payments to us and could cause reduced spending on our products. As a result of the adverse financial conditions of our customers, we may be required to increase our allowance for doubtful accounts, our days sales outstanding may be negatively impacted, and our revenues and gross profit may decrease.

Furthermore, we operate within the semiconductor industry, which has been materially adversely affected by the current general worldwide economic 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. The current downturn and future downturns in the semiconductor industry may be severe and prolonged.

We currently believe that our revenues and gross profit will decrease in 2009 as compared to 2008 mainly due to the severe global economic downturn generally and the significant decline in the semiconductor industry specifically.

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

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

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

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

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

Independent subcontractors, located in Asia, assemble and test our semiconductor products. Because we rely on independent subcontractors to perform these services, we cannot directly control our product delivery schedules or quality levels. 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, quality assurance problems, increased manufacturing costs, and/or supply chain disruption.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Our principal research and development facilities are located in the State of Israel and, as a result, at March 31, 2009, 255 of our 400 employees were located in Israel, including 163 out of 271 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, such as the current conflict in the Gaza Strip between Israel and Hamas, 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, such as the current conflict in the Gaza Strip between Israel and Hamas. We cannot predict whether or in what manner these conflicts will be resolved. Our results of operations may be negatively affected by the obligation of key personnel to perform military service. In addition, certain of our officers and employees are currently obligated to perform annual reserve duty in the Israel Defense Forces and are subject to being called for active military duty at any time. Although we have operated effectively under these requirements since our inception, we cannot predict the effect of these obligations on the company in the future. Our operations could be disrupted by the absence, for a significant period, of one or more of our officers or key employees due to military service.

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

Our facilities in Israel have been granted Approved Enterprise and Beneficiary Enterprise status under the Law for the Encouragement of Capital Investments, 1959, commonly referred to as the Investment Law, and as amended. The Investment Law provides that capital investments in a production facility (or other eligible assets) may be designated as an Approved Enterprise. Under that law, we receive certain tax benefits in Israel. To be eligible for tax benefits, we must meet certain conditions, relating principally to adherence to the investment program filed with the Investment Center of

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the Israeli Ministry of Industry and Trade and to periodic reporting obligations. Although we believe we have met such conditions in the past, should we fail to meet such conditions in the future, we would be subject to corporate tax in Israel at the standard corporate tax rate (27% for 2008 and 26% for 2009) and could be required to refund tax benefits already received. We cannot assure you that such grants and tax benefits will be continued in the future at their current levels, if at all. The tax benefits under these investment plans are scheduled to gradually expire by 2016. The termination or reduction of certain programs and tax benefits (particularly benefits available to us as a result of the Approved Enterprise status of our facilities and programs) or a requirement to refund tax benefits already received may have a material adverse effect on our business, operating results and financial condition.

On April 1, 2005, an amendment to the Investment Law came into effect. The amendment revised the criteria for investments qualified to receive tax benefits. An eligible investment program under the amendment will qualify for benefits as a Beneficiary Enterprise (rather than the previous terminology of Approved Enterprise). Among other things, the amendment provides tax benefits to both local and foreign investors and simplifies the approval process. The amendment does not apply to investment programs approved prior to December 31, 2004. The new tax regime applies to new investment programs only. We believe that we are currently in compliance with these requirements and have calculated our current tax provision for 2008 accordingly. However, if we fail to meet these requirements, we would be subject to corporate tax in Israel at the regular statutory rate (27% for 2008 and 26% for 2009). We also could be required to refund tax benefits, with interest and adjustments for inflation based on the Israeli consumer price index.

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

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

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

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

potential loss of key employees of acquired organizations.

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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 have been and may from time to time be notified of claims that we may be infringing patents or intellectual property rights owned by third parties. For example, in a lawsuit against Microsoft Corporation, AT&T asserted that our TrueSpeech 8.5 algorithm includes certain elements covered by a patent held by AT&T. AT&T sued Microsoft, one of our TrueSpeech 8.5 licensees, for infringement. We were not named in AT&T s suit against Microsoft. 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 litigation is determined in our favor.

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

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

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

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

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

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

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

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

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

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

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

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 the first quarter of 2009. Although most of our revenue and expenses are transacted in U.S. dollars, we may be exposed to currency exchange fluctuations in the future as business practices evolve and we are forced to transact business in local currencies. Moreover, part of our expenses in Israel are paid in Israeli currency, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the New Israeli Shekel (NIS) and to economic pressures resulting from Israel s general rate of inflation. Our primary expenses paid in NIS are employee salaries and lease payments on our Israeli facilities. Furthermore, due to the acquisition of the CIPT Business, a portion of our expenses for our European operations are paid in Euro and Swiss Franc, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the Euro and Swiss Franc. Our primary expenses paid in Euro and Swiss Franc are employee salaries, lease and operational payments on our European facilities. As a result, an increase in the value of the NIS, Euro and Swiss Franc in comparison to the U.S. dollar, which has been the trend in most of the year due to the devaluation of the U.S. dollar, could increase the cost of our technology development, research and development expenses and general and administrative expenses, all of which could harm our operating profit. From time to time, we use derivative instruments in order to minimize the effects of currency fluctuations, but our hedging positions may be partial, may not exist at all in the future or may not succeed in minimizing our foreign currency fluctuation risks. Our financial results may be harmed if the trend relating to the devaluation of the U.S. dollars continues for an extended period.

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

The markets for our products and services are characterized by rapidly changing technology, short product life cycles, evolving industry standards, changes in customer needs, demand for higher levels of integration, growing competition and new product introductions. Our future growth is dependent not only on the continued success of our existing products but also successful introduction of new products as some of our existing products, such as 900MHz, 2.4GHz and 5.8GHz, experienced decreased sales. Our ability to adapt to changing technology and anticipate future standards, and the rate of adoption and acceptance of those standards, will be a significant factor in maintaining or improving our competitive position and prospects for growth. If new industry standards emerge, our products or our customers products could become unmarketable or obsolete, and we could lose market share. We may also have to incur substantial unanticipated costs to comply with these new standards. If our product development and improvements take longer than planned, the availability of our products would be delayed. Any such delay may render our products obsolete or unmarketable, which would have a negative impact on our ability to sell our products and our results of operations.

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

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

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

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 Infineon and SiTel (formerly the DECT division of National Semiconductor). Our principal competitors in the VoIP market include Broadcom, Infineon, Texas Instruments and new Taiwanese IC vendors. Our principal competitors in the multimedia market include Wi-Fi and multimedia application processor IC vendors like Atheros, Broadcom, CSR, Freescale, Intel, Marvel, Ralink, Samsung and Texas Instruments.

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

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

Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws, regulations, accounting principles or interpretations thereof.

In addition, we are subject to the periodic examination of our income tax returns by the IRS and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. The outcomes from these examinations may have an adverse effect on our operating results and financial condition. Our U.S. Federal income tax returns for 2003 and 2004 have been selected for audit by the Internal Revenue Service and we are appealing the Internal Revenue Service s initial determination. While we believe that we have made adequate provisions related to the audits of these tax returns, the final determination of our obligations may exceed the amounts provided for by us in the accompanying consolidated financial statements. Specifically, we may receive assessments related to the audits and/or reviews of our U.S. income tax returns that exceed amounts provided for by us. In the event we are unsuccessful in reducing the amount of such assessments, our business, financial condition or results of operations could be adversely affected. Further, if additional taxes and/or penalties are assessed as a result of these audits, there could be a material effect on our income tax provision, operating expenses and net income in the period or periods for which that determination is made.

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

A growing trend in our industry is the integration of greater semiconductor content into a single chip to achieve higher levels of functionality. In order to remain competitive, we must achieve higher levels of design integration and deliver new integrated products on a timely basis. This will require us to expend greater research and development resources, and may require us to modify the manufacturing processes for some of our products, to achieve greater integration. We periodically evaluate the benefits, on a product-by-product basis, of migrating to smaller geometry process technologies to reduce our costs. Although this migration to smaller geometry process technologies has helped us

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to offset the declining average selling prices of our products, this effort may not continue to be successful. Also, because we are a fabless semiconductor company, we depend on our foundries to transition to smaller geometry processes successfully. We cannot assure you that our foundries will be able to effectively manage the transition. In case our foundries or we experience significant delays in this transition or fail to efficiently implement this transition, our business, financial condition and results of operations could be materially and adversely affected.

Our cash and cash equivalents and investment portfolio could be adversely affected by the current downturn in the financial and credit markets.

We invest our cash and cash equivalents in highly liquid investments with original maturities of generally three months or less at the time of purchase and maintain them with reputable major financial institutions. Deposits with these banks exceed the Federal Deposit Insurance Corporation (FDIC) insurance limits 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 and cash equivalent balances in the operating accounts and adjust the balances as appropriate, these balances could be impacted if one or more of the financial institutions with which we deposit 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 invested cash or cash equivalents; however, we can provide no assurance that access to our invested cash and cash equivalents will not be affected if the financial institutions in which we hold our cash and cash equivalents fail or the financial and credit markets continue to worsen.

Furthermore, we hold an investment portfolio consisting principally of corporate and U.S. government bonds. We intend, and have the ability, to hold such investments until recovery of temporary declines in market value or maturity; however, we can provide no assurance that we will recover declines in the market value of our investments. We recorded a loss of $2,961,000 in our statements of operations for fiscal year 2008 relating to one of our marketable securities in our investment portfolio because our management determined that the decline in the fair value of the referenced security was other-than-temporary, notwithstanding our intent to hold such investment until recovery.

Our certificate of incorporation and bylaws contain anti-takeover provisions that could prevent or discourage a third party from acquiring us.

Our certificate of incorporation and bylaws contain provisions that may prevent or discourage a third party from acquiring us, even if the acquisition would be beneficial to our stockholders. We have a staggered board, which means it will generally take two years to change the composition of our board. Our board of directors also has the authority to fix the rights and preferences of shares of our preferred stock and to issue such shares without a stockholder vote. It is possible that these provisions may prevent or discourage third parties from acquiring us, even if the acquisition would be beneficial to our stockholders. In addition, these factors may also adversely affect the market price of our common stock, and the voting and other rights of the holders of our common stock.

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

Announcements of developments related to our business, announcements by competitors, quarterly fluctuations in our financial results, changes in the general conditions of the highly dynamic industry in which we compete or the national economies in which we do business, and other factors could cause the price of our common stock to fluctuate, perhaps substantially. In addition, in recent years, the stock market has experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. These factors and fluctuations could have a material adverse effect on the market price of our common stock.

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

The table below sets forth the information with respect to repurchases of our common stock during the three months ended March 31, 2009.

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
Month #1 (January 1, 2009 to January 31, 2009)				255,488(1)
Month #2 (February 1, 2009 to February 29, 2009)				255,488(1)
Month #3 (March 1, 2009 to March 31, 2009)	4,186,603(2)	$ 4.78(2)		255,488(1)
TOTAL	4,186,603(2)	$ 4.78(2)		255,488(1)

(1) In March 1999, our board of directors authorized the repurchase of up to 4.0 million shares of our common stock. In July 2003, October 2004 and January 2007, our board authorized the repurchase of an additional 2.5 million shares, 2.5 million shares and 3.0 million shares of our common stock, respectively, for repurchase. In January 2008, our board authorized an additional 2.9 million shares for repurchase. The number of shares authorized for repurchase after giving affect to the January 2008 board approval was 5.1 million shares. Also in January 2008, our board of directors approved the company s entry into a share repurchase plan for up to 5,000,000 shares of the 5.1 million shares of our common stock authorized for repurchase, which plan became effective on February 7, 2008. The share repurchase plan is in accordance with Rule 10b5-1 of the United States Securities Exchange Act of 1934, as amended, that is designed to facilitate these purchases. The repurchase program is being affected from time to time, depending on market conditions and other factors, through open market purchases and privately negotiated transactions. The repurchase program has no set expiration or termination date. No repurchases were made during the first quarter of 2009 pursuant to our share repurchase program. Pursuant to our share repurchase program, 255,488 shares of our common stock remain authorized for repurchase as of March 31, 2009.

(2) On January 27, 2009, we entered into a Stock Repurchase Agreement with NXP pursuant to which we agreed to repurchase the 4,186,603 shares of our common stock issued to NXP in connection with the Acquisition (the Shares). The repurchase of the Shares occurred on March 12, 2009, at which time we repurchased the Shares at an average purchase price of $4.78 per share for an aggregate consideration of approximately $20,028,000.

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ITEM 6. EXHIBITS.

Exhibit 10.1	Stock Repurchase Agreement, dated January 27, 2009, between DSP Group, Inc. and NXP B.V. (filed on February 2, 2009 as Exhibit 10.1 to the Registrant s Current Report on Form 8-K, and incorporated herein by reference).
Exhibit 10.2	Amendment Agreement to the Manufacturing Services Collaboration Agreement, dated January 27, 2009, among DSP Group, Inc., NXP B.V. and DSP Group, Ltd. (filed as Exhibit 10.38 to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2008, and incorporated herein by reference) (confidential treatment has been granted for portions of this exhibit).
Exhibit 31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.1	Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.2	Certification of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

DSP GROUP, INC.

(Registrant)

Date: May 11, 2009

By: /s/ Dror Levy
Dror Levy, Chief Financial Officer and Secretary

(Principal Financial Officer and Principal Accounting Officer)

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