DSP GROUP INC /DE/
Form 10-Q
November 10, 2008
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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 September 30, 2008

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 **(State or other jurisdiction of** **incorporation or organization)**	**94-2683643** **(I.R.S. employer identification number)**
2580 North First Street, Suite 460, San Jose ,California **(Address of Principal Executive Offices)**	**95131** **(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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes x 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 ¨ 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 November 3, 2008, there were 26,850,831 shares of Common Stock ($.001 par value per share) outstanding.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DSP GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(US dollars in thousands, except share and per share data)

	September 30, 2008 Unaudited	December 31, 2007 Audited
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 64,089	$ 69,586
Restricted deposit	115	
Marketable securities	9,700	63,682
Trade receivables, net	44,233	51,636
Deferred income taxes	547	4,011
Other accounts receivable and prepaid expenses	12,921	7,705
Inventories	21,847	16,361
Related party receivable	2,761	468
TOTAL CURRENT ASSETS	156,213	213,449
PROPERTY AND EQUIPMENT, NET	16,451	14,270
LONG-TERM ASSETS:		
Long-term marketable securities	46,647	34,469
Long-term prepaid expenses and lease deposits	1,704	694
Deferred income taxes	8,842	5,109
Severance pay fund	8,123	6,883
Intangible assets, net	77,672	95,234
Goodwill	142,614	142,735
	285,602	285,124
TOTAL ASSETS	$ 458,266	$ 512,843

Note: The balance sheet at December 31, 2007 has been derived from the audited financial statements at that date.

See notes to condensed consolidated financial statements.

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DSP GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(US dollars in thousands, except share and per share data)

	September 30, 2008 Unaudited	December 31, 2007 Audited
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Trade payables	$ 20,736	$ 18,817
Accrued compensation and benefits	12,734	19,130
Income tax accruals and payables	15,105	14,136
Accrued expenses and other accounts payable	11,824	13,292
Related party payable	11,714	11,814
TOTAL CURRENT LIABILITIES	72,113	77,189
LONG-TERM LIABILITIES:		
Accrued severance pay	8,491	7,303
Other long-term liability	455	1,364
Accrued pensions	1,091	1,758
Deferred tax liabilities	1,613	372
TOTAL LONG-TERM LIABILITIES	11,650	10,797
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY:		
Preferred stock, $ 0.001 par value -		
Authorized shares: 5,000,000 at September 30, 2008 and December 31, 2007; Issued and outstanding shares: none at September 30, 2008 and December 31, 2007		
Common stock, $ 0.001 par value -		
Authorized shares: 50,000,000 at September 30, 2008 and December 31, 2007; Issued and outstanding: 27,550,760 and 31,229,810 shares at September 30, 2008 and December 31, 2007, respectively	28	31
Additional paid-in capital	311,296	300,542
Treasury stock	(102,662)	(63,804)
Accumulated other comprehensive income (loss)	(378)	1,025
Retained earnings	166,219	187,063
TOTAL STOCKHOLDERS EQUITY	374,503	424,857
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 458,266	$ 512,843

Note: The balance sheet at December 31, 2007 has been derived from the audited financial statements at that date.

See notes to condensed consolidated financial statements.

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DSP GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(US dollars in thousands, except per share amounts)

	Three months ended September 30,		Nine Months Ended September 30,	
	2008 (Unaudited)	2007 (Unaudited)	2008 (Unaudited)	2007 (Unaudited)
Revenues	$ 87,368	$ 61,866	$ 234,250	$ 163,590
Cost of revenues (1) (2)	54,503	37,201	148,462	98,434
Gross profit	32,865	24,665	85,788	65,156
Operating expenses:				
Research and development (3)	17,908	13,874	56,825	39,095
Sales and marketing (4)	5,483	4,680	17,124	12,987
General and administrative (5)	4,539	3,271	13,336	10,196
In process R&D write-off		10,120		10,120
Intangible assets amortization	5,702	3,057	17,200	3,057
Restructuring costs and other	1,870		1,870	
Total operating expenses	35,502	35,002	106,355	75,455
Operating loss	(2,637)	(10,337)	(20,567)	(10,299)
Interest and other income (loss), net	(185)	2,569	1,948	9,148
Loss before taxes on income	(2,822)	(7,768)	(18,619)	(1,151)
Taxes on income (tax benefit) (6)	208	(272)	(630)	2,016
Net loss	$ (3,030)	$ (7,496)	$ (17,989)	$ (3,167)
Net loss per share:				
Basic	$ (0.11)	$ (0.25)	$ (0.62)	$ (0.11)
Diluted	$ (0.11)	$ (0.25)	$ (0.62)	$ (0.11)

(1) Includes $59,726 and $7,711 with a related party for the nine months ended September 30, 2008 and 2007, respectively. The three months ended September 30, 2008 and 2007 includes $19,981 and $7,711, respectively, with a related party.

(2) Includes equity-based compensation expense in the amount of $208 and $143 for the three months ended September 30, 2008 and 2007, respectively, and equity-based compensation expense in the amount of $712 and $475 for the nine months ended September 30, 2008 and 2007, respectively.

(3) Includes equity-based compensation expense in the amount of $1,641 and $1,450 for the three months ended September 30, 2008 and 2007, respectively, and equity-based compensation expense in the amount of $5,624 and $5,467 for the nine months ended September 30, 2008 and 2007, respectively.

(4) Includes equity-based compensation expense in the amount of $356 and $329 for the three months ended September 30, 2008 and 2007, respectively, and equity-based compensation expense in the amount of $1,292 and $1,216 for the nine months ended September 30, 2008 and 2007, respectively.

(5) Includes equity-based compensation expense in the amount of $1,000 and $958 for the three months ended September 30, 2008 and 2007, respectively, and equity-based compensation expense in the amount of $3,122 and $3,583 for the nine months ended September 30, 2008 and 2007, respectively.

(6) Includes tax benefit resulting from equity-based compensation expense in the amount of $111 and $113 for the three months ended September 30, 2008 and 2007, respectively. For the nine months ended September 30, 2008 and 2007, the figures include tax benefit resulting from equity-based compensation expense in the amount of $360 and $456, respectively.

See notes to condensed consolidated financial statements.

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DSP GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(US dollars in thousands)

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Net cash provided by operating activities	$ 8,214	$ 23,159
Investing activities		
Purchase of marketable securities and short-term investments	(44,430)	(56,675)
Proceeds from maturity and sale of marketable securities and short-term investments	83,338	242,681
Proceeds from sale of property and equipment		46
Purchases of property and equipment	(7,955)	(2,613)
Payment of transaction costs related to the acquisition of the cordless and VoIP terminals business of NXP B.V. (1)	(843)	(201,081)
Net cash provided by investing activities	30,110	(17,642)
Financial activities		
Purchase of treasury stock	(43,710)	(7,730)
Issuance of common stock and treasury stock for cash upon exercise of options	101	3,055
Net cash used in financing activities	(43,609)	(4,675)
Increase (decrease) in cash and cash equivalents	$ (5,285)	$ 842
Cash erosion due to exchange rate differences	(212)	6
Cash and cash equivalents at the beginning of the period	$ 69,586	$ 37,344
Cash and cash equivalents at the end of the period	$ 64,089	$ 38,192

(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.

See notes to condensed consolidated financial statements.

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DSP GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(UNAUDITED)

(US dollars in thousands)

Three Months Ended September 30, 2007	Number of Common Stock	Common Stock	Additional Paid-In Capital	Treasury Stock	Retained Earnings	Other Comprehensive Income (Loss)	Total Comprehensive Income (Loss)	Total Stockholders Equity
Balance at June 30, 2007	28,163	$ 28	$ 223,902	$ (47,544)	$ 196,637	$ (1,533)		$ 371,490
Net loss					(7,496)		$ (7,496)	(7,496)
Unrealized gain from hedging activities, net						618	618	618
Unrealized gain from marketable securities						843	843	843
Unrealized gain from foreign currency translation adjustments, net						641	641	641
Total comprehensive loss							$ (5,394)	
Equity-based compensation			2,880					2,880
Issuance of shares related to the acquisition of the cordless and VoIP terminals business of NXP B.V.	4,187	4	71,391					71,395
Issuance of treasury stock upon purchase of ESPP shares	49	(*		1,095	(242)			853
Issuance of treasury stock upon exercise of stock options by employees	22	(*		495	(192)			303
Balance at September 30, 2007	**32,421**	**$ 32**	**$ 298,173**	**$ (45,954)**	**$ 188,707**	**$ 569**		**$ 441,527**
Three Months Ended September 30, 2008								
Balance at June 30, 2008	28,091	$ 28	$ 308,090	$ (100,747)	$ 171,298	$ 1,327		$ 379,996
Net loss					(3,030)		$ (3,030)	(3,030)
Realized gain from hedging activities, net						67	67	67
Realized gain from decrease in pension liability, net						301	301	301
Unrealized loss from marketable securities						(497)	(497)	(497)
Unrealized loss from foreign currency transaction adjustments, net						(1,576)	(1,576)	(1,576)
Total comprehensive loss							$ (4,735)	
Issuance of treasury stock upon purchase of common stock under employee stock purchase plan	209	(*		3,295	(2,049)			1,246
Issuance of treasury stock upon exercise of stock options by employees								
Purchase of treasury stock	(750)			(5,210)				(5,210)
Equity-based compensation			3,206					3,206
Balance at September 30, 2008	**27,551**	**$ 28**	**$ 311,296**	**$ (102,662)**	**$ 166,219**	**$ (378)**		**$ 374,503**

(* Represents an amount lower than $1.

See notes to condensed consolidated financial statements.

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DSP GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(UNAUDITED)

(US dollars in thousands)

Nine Months Ended September 30, 2007	Number of Common Stock	Common Stock	Additional Paid-In Capital	Treasury Stock	Retained Earnings	Other Comprehensive Income (Loss)	Total Comprehensive Income (Loss)	Total Stockholders Equity
Balance at December 31, 2006	28,378	$ 28	$ 216,041	$ (44,546)	$ 195,198	$ 28		$ 366,749
Net loss					(3,167)		$ (3,167)	(3,167)
Unrealized gain from hedging activities, net						457	457	457
Unrealized loss from marketable securities						(557)	(557)	(557)
Unrealized gain from foreign currency translation adjustments, net						641	641	641
Total comprehensive loss							$ (2,625)	
Purchase of treasury stock	(421)	(*		(7,730)				(7,730)
Equity-based compensation			10,741					10,741
Issuance of shares related to the acquisition of the cordless and VoIP terminals business from NXP B.V.	4,187	4	71,391					71,395
Issuance of treasury stock upon purchase of ESPP shares	93	(*		2,125	(457)			1,668
Issuance of treasury stock upon exercise of stock options by employees	184	(*		4,197	(1,382)			2,815
Cumulative impact of change in accounting for uncertainties in income taxes (FIN-48)					(1,485)			(1,485)
Balance at September 30, 2007	**32,421**	**$ 32**	**$ 298,173**	**$ (45,954)**	**$ 188,707**	**$ 569**		**$ 441,527**
Balance at December 31, 2007	31,230	$ 31	300,542	$ (63,804)	$ 187,063	$ 1,025		$ 424,857
Net loss					(17,989)		$ (17,989)	(17,989)
Realized gain from hedging activities, net						(168)	(168)	(168)
Realized gain from decrease in pension liability, net						301	301	301
Unrealized loss from marketable securities, net						(1,288)	(1,288)	(1,288)
Unrealized loss from foreign currency translation adjustments, net						(248)	(248)	(248)
Total comprehensive loss							$ (19,393)	
Issuance of treasury stock upon purchase of common stock under employee stock purchase plan	291	(*		4,900	(2,810)			2,090
Issuance of treasury stock upon exercise of stock options by employees	8	(*		146	(45)			101
Purchase of treasury stock	(3,978)	(3)	3	(43,904)				(43,904)
Equity-based compensation			10,751					10,751

Balance at September 30, 2008	**27,551**	**$ 28**	**$ 311,296**	**$ (102,662)**	**$ 166,219**	**$**	**(378)**	**$ 374,503**

(* Represents an amount lower than $1.

See notes to condensed consolidated financial statements.

DSP GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2008

(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 and nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. 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, 2007.

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, have resulted in an increase in goodwill. The Company finalized the initial restructuring plan as of June 30, 2008. All restructuring costs relating to the initial 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 a significant majority of the restructuring associated with the additional restructuring plan occurred during the third quarter of 2008, the Company recognized an expense of $1,870 mainly for employee contract termination costs on its statement of operations. This expense amount is net of $540 of gain resulting from adjustments made to the Company s employee pension liabilities associated with employees whose employment was terminated in connection with the restructuring plan (See Note K).

As of September 30, 2008, payments aggregating $170 were made in connection with the additional restructuring plan. The total liability balance for the additional restructuring plan is $2,240.

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:

	September 30, 2008 (Unaudited)	December 31, 2007 (Audited)
Work-in-process	$ 4,818	$ 4,437
Finished goods (*)	17,029	11,924

	$	21,847	$	16,361

(*) The finished products inventory includes $567 and $585 of inventory held in consignment by other parties as of September 30, 2008 and December 31, 2007, respectively. Write-off of inventory amounted to $1,344 and $803 for the nine months ended September 30, 2008 and 2007, 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 September 30,		Nine month ended September 30,	
	2008	2007	2008	2007
	Unaudited			
Net loss	$ (3,030)	$ (7,496)	$ (17,989)	$ (3,167)
Loss per share:				
Basic	$ (0.11)	$ (0.25)	$ (0.62)	$ (0.11)
Diluted	$ (0.11)	$ (0.25)	$ (0.62)	$ (0.11)
Weighted average number of shares of common stock outstanding during the period used to compute basic net earnings per share	27,728	29,436	28,885	28,716
Incremental shares attributable to exercise of outstanding options (assuming proceeds would be used to purchase treasury stock)		113		187
Weighted average number of shares of common stock used to compute diluted net earnings per share	27,728	29,549	28,885	28,903

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.

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 marketable securities at September 30, 2008 and December 31, 2007:

	Amortized cost		Unrealized gains (losses), net		Estimated fair value	
	September 30, 2008 (Unaudited)	December 31, 2007 (Audited)	September 30, 2008 (Unaudited)	December 31, 2007 (Audited)	September 30, 2008 (Unaudited)	December 31, 2007 (Audited)
U.S. government obligations and political subdivisions	$ 22,006	$ 58,249	$ (78)	$ (117)	$ 21,928	$ 58,132
Corporate obligations	35,852	40,125	(1,433)	(106)	34,419	40,019
	$ 57,858	$ 98,374	$ (1,511)	$ (223)	$ 56,347	$ 98,151

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The amortized cost of available-for-sale debt securities at September 30, 2008, by contractual maturities, is shown below:

	Amortized cost	Unrealized gains (losses) Gains	(Losses)	Estimated fair value
Due in one year or less	$ 9,867	$ 10	$ (177)	$ 9,700
Due after one year to five years	47,991	56	(1,400)	46,647
	$ 57,858	$ 66	$ (1,577)	$ 56,347

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. Since the Company has the ability and intent to hold these investments until a recovery of fair value, the investments were not considered to be other than temporarily impaired at September 30, 2008, except with respect to one of the Company s securities as further explained below.

The Company determined that the decline in the fair value of one of its securities was other than temporary, notwithstanding its intent to hold such investment until maturity. The amortized cost of available-for-sale debt securities at September 30, 2008 set forth in the table above includes write down of $671 associated with the referenced security. 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. The difference between the effective tax rate and the statutory rate primarily is due to foreign tax holiday and tax-exempt income in Israel and Switzerland as further described below. Tax provision for the three and nine months ended September 30, 2008 included a tax benefit associated with equity-based compensation expenses in the amount of $111 and $360, respectively. Tax provision for the three and nine months ended September 30, 2007 included a tax benefit associated with equity-based compensation expenses in the amount of $113 and $456, respectively.

In connection with the Acquisition, the Company applied for a tax ruling with the Swiss tax authorities to determine the tax rate applicable 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. The Swiss tax ruling process was finalized during the second quarter of 2008. Pursuant to the tax ruling, the Company s Swiss subsidiary will be entitled to reduced tax rates of approximately 10% to 15% depending on the source of income and a tax amortization period of 5 to 10 years for the goodwill and other intangible assets acquired in the Acquisition.

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48), which establishes a single model to address accounting for uncertain tax positions. FIN 48 clarified the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The total amount of net unrecognized tax benefits that, if recognized, would affect the effective tax rate was $ 13,673 and $13,244 at September 30, 2008 and December 31, 2007, respectively. The Company accrues interest and penalties, related to unrecognized tax benefits, in its provision for income taxes. At September 30, 2008 and December 31, 2007, the Company had accrued interest and penalties related to unrecognized tax benefits of $3,400 and $2,700, respectively. A change in the amount of unrecognized tax benefit is reasonably possible within 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 and the Company s appeal of the Internal Revenue Service s initial determination. 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 to customers primarily through a network of distributors and original equipment manufacturer (OEM) representatives. The Company s future performance will depend, in part, on the continued success of its distributors and representatives in marketing and selling its products. The loss of the Company s distributors and representatives 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 22% and 40% of the Company s total revenues for the three months ended September 30, 2008 and 2007, respectively. Additionally, Tomen Electronics accounted for 23% and 46% of the Company s total revenues for the nine months ended September 30, 2008 and 2007, respectively. The Japanese market and the original equipment manufacturers (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 12% and 14% of the Company s revenues for the three and nine months ended September 30, 2008, respectively. Sales to Panasonic through Tomen Electronics generated approximately 24% and 29% of our revenues for the three and nine months ended September 30, 2007, respectively. Additionally, sales to Uniden through Tomen Electronics or directly to Uniden represented 15% and 9% of our total revenues for the three months ended September 30, 2008 and 2007, respectively. Sales to Uniden represented 13% and 16% of our total revenues for the nine months ended September 30, 2008 and 2007 respectively.

Sales to Hong Kong-based VTech represented 20% and 13% of the Company s total revenues for the three months ended September 30, 2008 and 2007, respectively. Sales to VTech represented 21% and 5% of the Company s total revenues for the nine months ended September 30, 2008 and 2007, respectively. Sales to Hong Kong-based CCT Telecom represented 9% and 14% of our total revenues for both the three and nine months ended September 30, 2008 and 2007, respectively. Sales to Hong Kong-based SunCorp represented 6% and 7% of our total revenues for the three months ended September 30, 2008 and 2007, respectively. Sales to SunCorp represented 4% and 10% of our total revenues for the nine months ended September 30, 2008 and 2007, respectively.

NOTE H DERIVATIVE INSTRUMENTS

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133) requires companies to recognize all of its derivative instruments as either assets or liabilities in the statement of financial position at fair value.

For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings during 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.

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To protect against the increase in value of forecasted foreign currency cash flow resulting from salary and rent payments in New Israeli Shekels (NIS) during the year, the Company has instituted a foreign currency cash flow hedging program. The Company hedges portions of the anticipated payroll and lease payments of its Israeli facilities denominated in NIS for a period of one to twelve months with put options and forward contracts.

These forward contracts and put options are designated as cash flow hedges, as defined by SFAS No. 133, and are all effective as hedges of these expenses.

As of September 30, 2008 and December 31, 2007, the Company recorded comprehensive income of $313 and $481, respectively, from its put options and forward contracts in respect to anticipated payroll and rent payments expected in 2008. Such amounts will be recorded into earnings during the remainder of 2008 and 2009.

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

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123(R), Share-Based Payment (SFAS 123(R)). SFAS 123(R) establishes accounting for equity-based awards exchanged for employee services. Accordingly, equity-based compensation cost is measured at grant date, based on the fair value of the award, and is recognized as an expense over the employee s requisite service period. The Company previously applied APB 25, Accounting for Stock Issued to Employees and related interpretations and provided the required pro forma disclosures required under SFAS 123, Accounting for Stock-Based Compensation (SFAS 123). The Company elected to adopt the modified prospective application method as provided by SFAS 123(R), and, accordingly, the Company recorded compensation costs as the requisite service rendered for the unvested portion of previously issued awards that remain outstanding at the initial date of adoption and any awards issued, modified, repurchased or cancelled after the effective date of SFAS 123(R). Upon adoption of SFAS 123(R), the Company also changed its method of valuation for equity-based awards granted beginning in fiscal year 2006 to an exercise multiple-based lattice option-pricing model (EMLM /binomial model) from the Black-Scholes option-pricing model (Black-Scholes model), which was previously used to present the Company s pro forma information required under SFAS 123. For options granted prior to 2006, the Company did not change its valuation method. Binomial models have evolved such that the currently available models are more capable of incorporating the features of the Company s employee stock options than closed-form models such as the Black-Scholes model.

Grants for three months ended September 30, 2008 and September 30, 2007:

The weighted average estimated fair value of employee stock options and share appreciation rights (SAR) granted during the three months ended September 30, 2008 and 2007 was $2.80 and $5.49 per share, respectively, using the binomial model with the following weighted average assumptions (annualized percentages):

	Three months ended September 30, 2008	**Three months ended September 30, 2007**
Volatility	52.05%	33.83%
Risk-free interest rate	3.14%	4.61%
Dividend yield	0%	0%
Pre-vest cancellation rate	3.57%	5.05%
Post-vest cancellation rate	1.85%	1.50%

Suboptimal exercise factor	1.83	1.66

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The expected life of employee stock options 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 option s remaining contractual life and the extent to which the option is in-the-money (*i.e.*, the average stock price during the period is above the strike price of the stock option). 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 grants made by the Company. The expected life for options granted during the three months ended September 30, 2008 and 2007 derived from the binomial model was 4.91 and 4.45 years, respectively.

Employee Stock Benefit Plans

As of September 30, 2008, the Company had five stock option plans and one employee stock purchase plan. Pursuant to the 2008 Annual Meeting of Stockholders held on May 19, 2008, the Company s stockholders approved an increase of 300,000 shares authorized for issuance under the Company s 1993 Director Stock Option Plan and an increase of 500,000 shares authorized for issuance under the Company s 1993 Employee Stock Purchase Plan.

As of September 30, 2008, after giving effect to the above increases in the stock option plans, approximately 402,000 shares of common stock remain available for grant under the Company s employees stock purchase plan and approximately 2,627,000 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)	Aggregate Intrinsic Value (*) (in thousands)
Outstanding at July 1, 2008	8,883,391	$ 18.53		
Options granted	30,000	$ 7.12		
SAR units granted (**)	80,500	$ 7.22		
Options / SAR units cancelled/forfeited/expired	(408,678)	$ 15.15		
Options exercised				
Outstanding at September 30, 2008 (***)	8,585,213	$ 18.54	4.91	50,550
Exercisable at September 30, 2008 (****)	3,905,831	$ 22.98	3.52	

(*) Calculation of aggregate intrinsic value is based on the share price of the Company s common stock as of September 30, 2008 ($7.65 per share).

(**) Each SAR grant is convertible for a maximum number of shares of the Company s common stock equal to 50% of the SAR units subject to the grant.

(***) Due to the ceiling imposed on the SAR grants, the outstanding amount can be exercised for a maximum of 6,168,729 shares of the Company s common stock.

(****) Due to the ceiling imposed on the SAR grants, the currently exercisable amount can be exercised for a maximum of 3,370,039 shares of the Company s common stock.

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Additional information about stock options and SAR units outstanding and exercisable at September 30, 2008 with exercise prices above $7.65 per share (the closing price of the Company s Common Stock at September 30, 2008) is as follows:

	Exercisable		Unexercisable		Total	
Exercise Prices	**Number of Options/ SAR Units**	**Weighted Average Exercise Price**	**Number of Options/ SAR Units**	**Weighted Average Exercise Price**	**Number of Options/ SAR Units**	**Weighted Average Exercise Price**
Less than $7.65			110,500	$ 7.19	110,500	$ 7.19
Above $7.65	3,905,831	$ 22.98	4,568,882	$ 15.02	8,474,713	$ 18.69
Total	3,905,831	$ 22.98	4,679,382	$ 14.84	8,585,213	$ 18.54

The Company s aggregate compensation expense for the three months ended September 30, 2008 and 2007 totaled $3,205 and $2,880, respectively. The total income tax benefit recognized in the income statement related to the Company s equity-based compensation expense for the three months ended September 30, 2008 and 2007 was $111 and $113, respectively.

The Company s aggregate compensation expense for the nine months ended September 30, 2008 and 2007 totaled $10,750 and $10,742, respectively. The total income tax benefit recognized in the income statement related to the Company s equity-based compensation expense for the nine months ended September 30, 2008 and 2007 was $360 and $456, respectively.

As of September 30, 2008, there was $12,522 of total unrecognized 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 periods from 2008 through 2012.

NOTE K PENSION LIABILITY

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

The largest of these plans that the Company assumed in connection with the Acquisition is the Swiss pension fund that insures the retirement, disability and death benefits of the employees who were formerly covered by the NXP Semiconductors Switzerland AG scheme. The Swiss pension plan is currently the only pension plan externally funded through a foundation. The difference between the liability (the Projected Benefit Obligation or PBO as defined in SFAS No. 87 Employers Accounting for Pensions (SFAS No. 87)) and the market value of the plan assets is accounted for in the financial statements of the Company. The other defined benefits plans that the Company assumed in connection with the Acquisition that are accounted for in the Company s financial statements are the pension plans in Germany, Hong Kong and India. Consistent with the requirements of local law, the Company deposits funds for certain plans with insurance companies, third-party trustees, or into government-managed accounts, and/or accrue for the unfunded portion of the obligation.

The liabilities for these plans have been calculated in accordance with SFAS No. 87. The net pension liability as of September 30, 2008 amounted to $1,091.

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The following table provides the components of net periodic benefits cost for the nine months ended September 30, 2008:

	September 30, 2008
Components of net periodic benefits	
Service cost	$ 225
Interest expenses	397
Expected return on plan assets	(473)
Amortization of net gain	
Curtailment gain (1)	(537)
Exchange rate expenses	22
Net periodic benefit income	$ (366)

(1) The gain above is a result of the implementation of the additional restructuring plan in the third quarter of 2008 and adjustments made to certain employee pension liabilities associated with employees whose employment was terminated in connection with the restructuring plan (See Note B).

NOTE L FAIR VALUE MEASUREMENTS

As discussed in Note N, the Company adopted SFAS No. 157 Fair Value Measurements (as impacted by FSP Nos. 157-1 and 157-2) (SFAS No. 157) effective January 1, 2008, with respect to fair value measurements of (a) nonfinancial assets and liabilities that are recognized or disclosed at fair value in the Company s financial statements on a recurring basis (at least annually) and (b) all financial assets and liabilities.

SFAS No. 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, SFAS No. 157 establishes a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value as follows:

Level 1- observable inputs such as quoted prices in active markets;

Level 2- inputs, other than the quoted market prices in active markets, which are observable, either directly or indirectly; and

Level 3- unobservable inputs in which there are little or no market data, which requires the reporting entity to develop its own assumptions.

Assets and liabilities are to be measured at fair value using one or more of the three valuations techniques noted in SFAS No. 157. The valuation techniques are as follows:

(a) Market approach prices and other relevant information generated by market transactions involving identical or comparable assets;

(b) Cost approach amount that would be required to replace the service capacity of an asset (replacement cost); and

(c) Income approach techniques to convert future amounts to a single present amount based on expectations (including present value techniques, option pricing and excess earnings models).

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The following table provides information by level for assets and liabilities that are measured at fair value, as defined by SFAS No. 157, on a recurring basis as of September 30, 2008:

Description	Fair Value	Fair Value Measurements Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	$ 64,089	$ 64,089		
Short-term marketable securities	$ 9,700	$ 9,700		
Long-term marketable securities	$ 46,647	$ 46,647		
Derivative assets	$ 313		$ 313	

NOTE M STOCKHOLDERS EQUITY

On January 30, 2008, the Company s board of directors approved an increase of additional 2.9 million shares available for repurchase under the Company s share repurchase program. Also on January 30, 2008, the Company s board of directors approved the Company s entry into a share repurchase plan, in accordance with Rule 10b(5)-1 of the Securities Exchange Act of 1934, as amended, for up to 5,000,000 shares of the Company s common stock, which plan became effective on February 7, 2008.

During the first nine months of 2008, the Company repurchased 3,978,378 shares of its common stock at an average purchase price of $11.04 per share for an aggregate amount of approximately $43,900 (approximately $43,700 was paid in cash as of September 30, 2008). During the third quarter of 2008, the Company repurchased 749,567 shares of its common stock at an average purchase price of $6.951 per share for an aggregate amount of approximately $5,200 (approximately $5,000 was paid in cash as of September 30, 2008). Pursuant to the share repurchase program, 1,075,334 shares of the Company s common stock remain authorized for repurchase as of September 30, 2008.

NOTE N NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157 Fair Value Measurements (SFAS No. 157), which establishes a single definition of fair value and a framework for measuring fair value, sets out a fair value hierarchy to be used to classify the source of information used in fair value measurements, and requires new disclosures of assets and liabilities measured at fair value based on their level in the hierarchy. This statement applies to other accounting pronouncements that require or permit fair value measurements. In February 2008, the FASB issued Staff Positions (FSPs) No. 157-1 and No. 157-2, which, respectively, removed leasing transactions from the scope of SFAS No. 157 and deferred SFAS No. 157 s effective date for one year relative to certain nonfinancial assets and liabilities. As a result, the application of the definition of fair value and related disclosures of SFAS No. 157 (as impacted by these two FSPs) was effective for the Company beginning on January 1, 2008 on a prospective basis with respect to fair value measurements of (a) nonfinancial assets and liabilities that are recognized or disclosed at fair value in the Company s financial statements on a recurring basis (at least annually) and (b) all financial assets and liabilities. This adoption did not have a material impact on the Company s consolidated results of operations or financial condition. The remaining aspects of SFAS No. 157 for which the effective date was deferred under FSP No. 157-2 are currently being evaluated by the Company. Areas impacted by the deferral relate to nonfinancial assets and liabilities that are measured at fair value, but are recognized or disclosed at fair value on a nonrecurring basis. This deferral applies to such items as nonfinancial assets and liabilities initially measured at fair value in a business combination (but not measured at fair value in subsequent periods) or nonfinancial long-lived asset groups measured at fair value for an impairment assessment. The effects of these remaining aspects of SFAS No. 157 are to be applied by the Company to fair value measurements prospectively beginning on January 1, 2009. The Company does not expect them to have a material impact on the Company s consolidated results of operations or financial condition. Refer to Note L for disclosures required by SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159). SFAS No. 159 permits an entity to choose, at specified election dates, to measure eligible financial instruments and certain other items at fair value that are not currently required to be measured at fair value. An entity reports unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected are recognized in earnings as incurred and not deferred. SFAS No. 159 also established presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 was effective for financial statements issued for fiscal years beginning after November 15, 2007 (January 1, 2008 for the Company). On the effective date, an entity could elect the fair value option for eligible items that existed on that date. The entity was required to report the effect of the first remeasurement to fair value as a cumulative-effect adjustment to the opening balance of retained earnings. The Company did not elect the fair value option for eligible items that existed as of January 1, 2008.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) Business Combinations (SFAS No. 141(R)). Under SFAS No. 141(R), an entity is required to recognize the assets acquired, liabilities assumed, contractual contingencies and contingent consideration at their fair value on the acquisition date. It further requires that acquisition-related costs be recognized separately from the acquisition and expensed as incurred, restructuring costs generally be expensed in periods subsequent to the acquisition date, and changes in accounting for deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period that impact income tax expenses. In addition, acquired in-process research and development (IPR&D) is capitalized as an intangible asset and amortized over its estimated useful life. The adoption of SFAS No. 141(R) will change the Company s accounting treatment for business combinations on a prospective basis beginning in the first quarter of fiscal year 2009.

In March 2008, the FASB issued SFAS No. 161 Disclosures about Derivative Instruments and Hedging Activities (SFAS No. 161), which will require increased disclosures about an entity s strategies and objectives for using derivative instruments; the location and amounts of derivative instruments in an entity s financial statements; how derivative instruments and related hedged items are accounted for under SFAS No. 133, and how derivative instruments and related hedged items affect its financial position, financial performance, and cash flows. Certain disclosures will also be required with respect to derivative features that are credit risk-related. SFAS No. 161 is effective for the Company beginning on January 1, 2009 on a prospective basis. The Company does not expect this standard to have a material impact on the Company s consolidated results of operations or financial condition.

In April 2008, the FASB issued 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 (SFAS 142). This change is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141(r) and other GAAP. FSP 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The requirement for determining useful lives must be applied prospectively to intangible assets acquired after the effective date and the disclosure requirements must be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. FSP 142-3 is effective for the Company beginning in the first quarter of fiscal year 2009. The Company is currently evaluating the impact of FSP 142-3 on its consolidated financial statements.

In February 2008, the FASB issued FSP No. FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions (FSP 140-3). FSP 140-3 provides guidance for evaluating whether to account for a transfer of a financial asset and repurchase financing as a single transaction or as two separate transactions. FSP 140-3 is effective prospectively for financial statements issued for fiscal years beginning after November 15, 2008. FSP 140-3 is effective for the Company beginning in the first quarter of fiscal year 2009. The Company is currently evaluating the impact of FSP 140-3 on its consolidated financial statements.

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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 are subject to risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward looking statements and include, without limitation, statements regarding:

Our expectation that sales from 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 2008 and in future periods;

Our belief that U.S. sales of our 2.4GHz and 5.8GHz products will continue to decrease during the fourth quarter of 2008 with a sharper decrease in sales of our 5.8GHz products;

Our belief that for the long term, 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;

Our expectation that the shift from 2.4GHz and 5.8GHz products to DECT 6.0 products in the U.S. market will continue at a fast pace during the fourth quarter of 2008;

Our belief that revenues from our DECT products will continue to increase in absolute number and as a percentage of total revenues in 2008 as compared to 2007;

Our belief that price sensitivity in the market will continue for the remainder of 2008 and in 2009;

Our expectation that the cost-cutting measures implemented during the third quarter of 2008 will reduce our operating expenses in 2009;

Our belief that our future growth will depend on our success in maintaining our presence in the European DECT market, expanding our market share in other developing markets, maintaining our market share during the shift from the traditional 2.4GHz and 5.8 GHz products to DECT 6.0 products in the U.S. market and the general market deployment and acceptance of our DECT and CoIP products;

Our belief that our Hong Kong-based customers will continue to increase in future periods in absolute dollars and as a percentage of total revenues; and

Our belief that our available cash and cash equivalents at September 30 2008 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, fluctuations in sales of our 5.8GHz and DECT 6.0 products; successful implementation of the restructuring plan to reduce 2009 operating expenses; slower than expected change in the nature of residential communications domain; unexpected delays in the introduction of new products or failure of such products to achieve broad market acceptance; our ability to develop and produce new products at competitive costs; decline or fluctuations in gross margins and the effect on revenues and profitability; and general market demand for products that incorporate our technology in the market, 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.

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Acquisition of the Cordless and VoIP Terminals Business of NXP B.V.

On September 4, 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 cash payments were made to NXP.

Information contained in this Quarterly Report, including forward looking information and discussions about our business and market trends, should be read in light of the Acquisition.

Business

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).

Our current primary focus is digital cordless telephony with sales of our in-house developed Cordless over Internet Protocol (CoIP), 1.9GHz (Digital Enhanced Cordless Telephony (DECT)), 2.4GHz and 5.8GHz chipsets representing approximately 89% of our total revenues for the first nine months of 2008. Our revenues were $234.3 million for the first nine months of 2008, an increase of 43% in comparison to the same period during 2007. This increase was mainly the result of increased sales of our DECT products, mainly due to the Acquisition, which increase was partially offset by decreased sales of our 2.4GHz and 5.8GHz products. During the first nine months of 2008, we experienced a decrease in sales of 2.4 GHz and 5.8GHz products in the U.S. market, our primary market, where the shift to DECT 6.0 products is occurring faster than anticipated. We believe that U.S. sales of our 2.4GHz and 5.8GHz products will continue to decrease during the fourth quarter of 2008 with a sharper decrease in sales of our 5.8GHz products. We also anticipate that the shift to DECT 6.0 products in the U.S. market to continue at a fast pace during the fourth quarter of 2008.

Notwithstanding our successes to date, our business operates in a highly competitive environment. Competition has historically increased pricing pressures for our products and decreased our average selling prices. To address pricing pressures, we may need to offer our products in the future at lower prices which may result in lower gross profits. Our gross margin decreased to a level of 37% of total revenues for the first nine months of 2008 from 40% for the first nine months of 2007, primarily due to the continued decline in the average selling prices of our products and the increased sales of DECT products with lower gross margin on account of 5.8GHz 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 2008 and in 2009 and expect price erosion to continue. Moreover, various other factors, including increases in raw materials and commodity costs (including gold and oil) and our suppliers passing such increases onto us, increases in silicon wafer costs and increases in production, assembly or testing costs, all may decrease our gross profit in future periods. Furthermore, the current general worldwide economic downturn has resulted in slower economic activity, concerns about inflation and deflation, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns. We operate in the semiconductor industry, which is cyclical, and the recent worldwide economic downturn may result in a significant downturn of the semiconductor industry. These downturns are characterized by a decrease in product demand, excess customer inventories, and accelerated erosion of prices. These conditions make it extremely difficult for our customers, our vendors and us to accurately forecast and plan future business activities, and could cause reduced spending on our products and services. Our results and future revenues could be harmed by the worldwide economic downturn and specifically the volatility in the semiconductor industry.

Operating expenses increased by 41% during the first nine months of 2008, as compared to the same period for 2007, reaching a level of $106.4 million. The increase in operating expenses for the first nine months of 2008 was primarily attributable to (i) the inclusion of the operating expenses of the CIPT Business in the amount of $24.5 million for the first nine months of 2008, in comparison to the inclusion of the operating expenses of the CIPT Business in the amount of $2.4 million only from September 4, 2007 for the first nine months of 2007, (ii) the amortization of intangibles and other assets related to the Acquisition in the amount of $17.2 million for the first nine months of 2008, in comparison to $13.2 million in 2007, and (iii) an increase in IP, tapeout and payroll expenses related to research and development. Our operating loss was $20.6 million for the first nine months of 2008, approximately 9% of revenues, compared to $10.3 million of operating loss for the same period in 2007. The increase in operating loss was mainly due to the same factors as noted above for the increase in operating expenses. An additional factor for the increase in operating loss was the decrease in gross margin for the first nine months of 2008, as compared to the same period in 2007. Notwithstanding the increase in our operating expenses primarily due to the absorption of the operating expenses of the CIPT Business, there are no assurances that the proposed benefits of the Acquisition can be achieved or achieved at the levels currently anticipated, which could materially harm our business. During the third quarter of 2008, we implemented an additional restructuring plan, subsequent to the initial restructuring plan following the Acquisition, to improve operating efficiency at our various operating sites and to reduce our operating expenses for 2009. We recognized an expense of $1.87 million during the third quarter of 2008 associated with the additional restructuring plan.

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 primarily 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 results 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. 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 market to grow our business. Revenues derived from the sale of DECT products represented 70% of our total revenues for the first nine months of 2008. We believe that sales of our DECT products will increase in absolute number and as a percentage of total revenues in 2008 in comparison to 2007. In addition to DECT technologies, we are investing in developing CoIP technologies in house. We believe our future growth will depend on our success in maintaining our presence in the European DECT market, expanding our market share in other developing markets, maintaining our market share during the shift from the traditional 2.4GHz and 5.8GHz products to DECT 6.0 products in the U.S. market, and the general market deployment and acceptance of our DECT and CoIP products. Moreover, 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 have 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 September 30, 2008, our principal source of liquidity consisted of cash and cash equivalents of approximately $64.1 million and marketable securities of approximately $56.3 million, totaling $120.4 million. Our cash, investments and securities were materially decreased during the first nine months of 2008 mainly due to the repurchase of 4.0 million shares of our common stock for approximately $43.9 million during the first nine months of 2008 (of which approximately $43.7 million was paid in cash as of September 30, 2008).

RESULTS OF OPERATIONS

Total Revenues. Our total revenues were $87.4 million for the third quarter of 2008 as compared to $61.9 million for the same period in 2007. Our total revenues were $234.3 million for the first nine months of 2008, as compared to 163.6 million for the same period in 2007. This represents an increase in revenues of 41% and 43% for the three months and first nine months ended September 30, 2008, as compared to the same periods in 2007. This increase was primarily as a result of the inclusion of the revenues of the CIPT Business, which is based primarily on sales of DECT products, partially offset by decreased sales of our 2.4GHz and 5.8GHz products. Sales of DECT products were $66.0 million and $165.2 million for the third quarter and first nine months of 2008, respectively, representing 75% and 70% of total revenues, respectively. Sales of DECT products were $25.1 million and $43.1 million for the third quarter and first nine months of 2007, respectively, representing 41% and 26% of total revenues, respectively. The increase in sales of DECT products for the first nine months of 2008, as compared to the same period in 2007, was mainly attributable to the consolidation of the results of the CIPT Business within our combined results beginning on September 4, 2007 and the shift from 2.4GHz and 5.8GHz products to DECT 6.0 products in the U.S. market. Sales of 5.8GHz products for the third quarter of 2008 and 2007 were $4.8 million and $13.8 million, respectively, representing approximately 5% and 22% of our total revenues, respectively, a decrease of 65% in absolute dollars when comparing sales for the third quarter of 2008 to sales for the third quarter of 2007. Sales of 5.8GHz products for the first nine months of 2008 and 2007 were $14.2 million and $51.0 million, respectively, representing approximately 6% and 31% of our total revenues, respectively, a decrease of 72% when comparing sales for the nine months of 2008 in relation to the same period of 2007. Sales of 2.4GHz products for the third quarter of 2008 and 2007 were $8.8 and $11.6 million, respectively, representing approximately 10% and 19% of our total revenues, respectively, a decrease of 24% in absolute dollars when comparing sales for the third quarter of 2008 to sales for the third quarter of 2007. Revenues from 2.4GHz products for the nine months of 2008 and 2007 were $26.6 million and $34.4 million, respectively, representing approximately 11% and 21% of our total revenues, respectively, a decrease of 23% in absolute dollars when comparing sales for the nine months of 2008 to the first nine months of 2007. A factor that may decrease our revenues for future periods is the continued shift from 2.4GHz and 5.8GHz products to DECT 6.0 products in the U.S. market, our primary market, as DECT 6.0 products are being sold at lower average selling prices than our 5.8GHz and 2.4GHz products.

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

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
United States	$ 7,295	$ 331	$ 16,260	$ 566
Japan	32,205	29,838	83,036	99,549
Europe	7,996	3,835	24,627	4,046
Hong Kong	34,866	25,311	94,318	53,100
Other	5,006	2,551	16,009	6,329
Total revenues	$ 87,368	$ 61,866	$ 234,250	$ 163,590

Sales to our customers in Hong Kong increased for the first nine month of 2008 as compared to the same period in 2007, representing a 78% increase in absolute dollars ($57 million and $9.7 million of such revenues for the first nine months of 2008 and 2007, respectively, resulted from the inclusion of the CIPT Business in the combined results since

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September 4, 2007). The increase in sales to Europe and the United States resulted mainly from the inclusion of the CIPT Business in the combined results since September 4, 2007. 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, mainly to customers of the CIPT Business, which are sold to original design manufacturers (ODMs) that are mainly located in Hong Kong.

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 22% and 40% of our total revenues for the three months ended September 30, 2008 and 2007, respectively. Additionally, Tomen Electronics accounted for 23% and 46% of our total revenues for the nine months ended September 30, 2008 and 2007, respectively. The sales decrease for the comparable periods was primarily due to a decrease in sales to Panasonic and the Japanese domestic market. In addition, due to the increase in revenues for the first nine months of 2008 (mainly as a result of the inclusion of the revenues of the CIPT Business), the percentage of revenues attributable to Tomen out of our total revenues decreased.

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 12% and 14% of our revenues for the three and nine months ended September 30, 2008, respectively. Sales to Panasonic through Tomen Electronics generated approximately 24% and 29% of our revenues for the three and nine months ended September 30, 2007. Sales to Uniden through Tomen Electronics or directly to Uniden represented 15% and 9% of our total revenues for the three months ended September 30, 2008 and 2007, respectively. Sales to Uniden represented 13% and 16% of our total revenues for the nine months ended September 30, 2008 and 2007. The loss of Tomen Electronics as a distributor and our inability to obtain a satisfactory replacement in a timely manner would harm our sales and results of operations. Additionally, the loss of Panasonic and Tomen Electronics inability to thereafter effectively market our products would also harm our sales and results of operations.

Other significant customers of the company include various Hong Kong-based OEMs. Sales to VTech represented 20% and 13% of total revenues for the three months ended September 30, 2008 and 2007, respectively. Sales to VTech represented 21% and 5% of total revenues for the nine months ended September 30, 2008 and 2007, respectively. Sales to CCT Telecom represented 9% and 14% of our total revenues for both the three and nine months ended September 30, 2008 and 2007, respectively. Sales to SunCorp represented 6% and 7% of our total revenues for the three months ended September 30, 2008 and 2007, respectively. Sales to SunCorp represented 4% and 10% of our total revenues for the nine months ended September 30, 2008 and 2007, respectively.

Significant Products. Revenues from our DECT products represented 75% and 70% of our total revenues for the three months and nine months ended September 30, 2008, respectively. Revenues from our 5.8GHz and 2.4GHz digital products represented 5% and 10%, respectively, of total revenues for the third quarter of 2008. Revenues from our 5.8GHz and 2.4GHz digital products represented 6% and 11%, respectively, of total revenues for the first nine months of 2008. 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 reminder of 2008 and in future period. However, we believe that U.S. sales of our 2.4GHz and 5.8GHz products will decrease in the fourth quarter of 2008 with a sharper

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decrease in sales of our 5.8GHz products. For the long term, 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.

Gross Profit. Gross profit as a percentage of revenues was 38% for the third quarter of 2008 and 40% for the third quarter of 2007. Gross profit as a percentage of revenues was 37% for the first nine months of 2008 and 40% for the first nine months of 2007. 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 or 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 to 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 increased to $17.9 million for the third quarter of 2008 from $13.9 million for the third quarter of 2007. Research and development expenses increased to $56.8 million for the first nine months of 2008 from $39.1 million for the first nine months of 2007. The increase for the third quarter and first nine months of 2008 in research and development expenses, as compared to the same period in 2007, was mainly attributed to (i) an increase in research and development expenses in the amount of $12.0 million for the first nine months of 2008 and $2.1 million for the third quarter of 2008, in comparison to the comparable periods in 2007, as a result of the inclusion of the expenses of the CIPT Business in the combined results, for the all nine months and three months of 2008, as compared to the inclusion of such expenses since September 4, 2007 for the first nine months of 2007, (ii) an increase in IP and tapeout expenses; (iii) an increase in labor expenses related to research and development due to the increase in the number of employees, as well as increases in salary, and (iv) devaluation of the U.S. dollar against the Israeli currency (NIS) for the third quarter and the nine months ended September 30, 2008, as compared to the same periods in 2007, that included our salaries and other expenses, such as rent for our Israeli facilities, denominated in NIS.

Our research and development expenses as a percentage of total revenues were 20% and 22% for the three months ended September 30, 2008 and 2007, respectively, and 24% for both the nine months ended September 30, 2008 and 2007. This increase in research and development expenses as a percentage of total revenues was due to the increase in absolute dollars of the research and development expenses.

As our research and development staff is currently working on various projects simultaneously, we may need to incur additional expenses and hire additional research and development staff and contractors related to the development of new products and to support the development of existing products and technologies. In addition, the research and development expenses for 2008 will include all the research and development expenses attributable to the CIPT Business whereas such expenses were prorated from September 4, 2007, the date of completion of the Acquisition, in our 2007 results.

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

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Sales and Marketing Expenses. Our sales and marketing expenses increased to $5.5 million for the third quarter of 2008 from $4.7 million for the third quarter of 2007. Our sales and marketing expenses were $17.1 million for the nine months ended September 30, 2008, as compared to $13.0 million for the same period in 2007. The increase in sales and marketing expenses was mainly a result of the inclusion of the expenses of the CIPT Business in the amount of $6.2 million and $2.1 million for the first nine months and third quarter of 2008, respectively, as compared to $0.4 million of expenses included since September 4, 2007 for the first nine months of 2007. The increase in our sales and marketing expenses was partially offset by a decrease in commission paid to our sales representatives due to a lower level of revenues subject to commissions and a decrease in the average commission. Our sales and marketing expenses as a percentage of total revenues were 6% and 8% for the three months ended September 30, 2008 and 2007, respectively, and 7% and 8% for the nine months ended September 30, 2008 and 2007, respectively.

Sales and marketing expenses consist mainly of sales commissions to our representatives and distributors, 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 $4.5 million for the three months ended September 30, 2008, as compared to $3.3 million for the three months ended September 30, 2007. For the first nine months of 2008, general and administrative expenses were $13.3 million, as compared to $10.2 million for the same period in 2007. The increase in general and administrative expenses for the first nine months of 2008 was mainly a result of the inclusion of the expenses of the CIPT Business in the amount of $3.1 million and $1.3 million for the first nine months and third quarter of 2008, respectively, in the combined results, as compared to 0.3 million of expenses included since September 4, 2007 for the first nine months of 2007. One additional factor that increased general and administrative expenses was higher professional fees for the third quarter and the first nine months of 2008, as compared to the same periods in 2007. The increase in general and administrative expenses for the first nine month of 2008 was partially offset by a decrease related to equity-based compensation expense. Equity-based compensation expense amounted to $3.1 million and $3.6 million for the first nine of 2008 and 2007, respectively. General and administrative expenses as a percentage of total revenues were 6% for both the first nine months of 2008 and 2007. General and administrative expenses as a percentage of total revenues were 5% for both third quarters of 2008 and 2007.

Our general and administrative expenses consist mainly of payroll expenses for management and administrative employees, professional fees such as 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 nine months and third quarter of 2008, we recorded an expense item in the amount of $17.2 million and $5.7 million, respectively, related to the amortization of intangible assets associated with the Acquisition. During the first nine months and third quarter of 2007, we recorded an expense item in the amount of $3.06 million, related to the amortization of intangible assets associated with the Acquisition and an expense item in the amount of $10.1 million, related to in-process R&D write off associated with the Acquisition. The increase mainly resulted from the inclusion of the CIPT Business for the first nine months and third quarter of 2008, in comparison to such inclusion since September 4, 2007 for the first nine months of 2007.

Restructuring Costs and Other: During the third quarter of 2008, we initiated an additional restructuring plan, subsequent to our initial restructuring plan following the Acquisition, to improve operating efficiency at our various operating sites and to reduce our operating expenses for 2009. The restructuring plan is expected to be completed by September 30, 2009. As a significant majority of the restructuring associated with the additional restructuring plan occurred during the third quarter of 2008, we recognized an expense in the amount of $1.87 million mainly for employee contract termination costs. This expense amount is net of $540,000 of gain resulting from adjustments made to our employee pension liabilities associated with employees whose employment was terminated in connection with the restructuring plan (For additional details, see Note K to Notes for Condensed Consolidated Financial Statement for September 30, 2008). As of September 30, 2008, payments aggregating $170,000 were made in connection with the additional restructuring plan. The total liability balance for the additional restructuring plan is $2.24 million.

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Interest and Other Income, net. Interest and other income, net, for the three months ended September 30, 2008 decreased to expenses of $0.2 million from income of $2.6 million for the three months ended September 30, 2007 and decreased to income of $1.9 million for the nine months ended September 30, 2008 from income of $9.1 million for the nine months ended September 30, 2007. The decrease for the comparable periods in 2008 and 2007 was primarily due to the payment of approximately $200 million in cash on September 4, 2007 as partial consideration for the Acquisition, which resulted in less investment balance held during the first nine months of 2008. Additional factors for the decreased interest income for the first nine months of 2008, as compared to the first nine months of 2007, were (i) lower interest rates, (ii) the repurchase of 5.6 million shares of our common stock for approximately $69.6 million since the second quarter of 2007, (iii) the devaluation of the U.S. dollar against the Israeli currency (NIS) which resulted in expenses associated with the exchange rate differences, (iv) the devaluation of the Euro against the U.S dollar, which resulted in expenses associated with exchange rates differences, and (v) the decline in the fair market value of one of our marketable securities amounting to $ 0.7 million, which was recorded in the third quarter of 2008.

Our total cash, cash equivalents, short term investments and marketable securities were $120.4 million as of September 30, 2008, compared to $159.0 million as of September 30, 2007.

Provision for Income Taxes. Our income tax benefit was $0.6 million for the first nine months of 2008, as compared to tax expenses of $2.0 million for the first nine month of 2007. Our income tax expense for the third quarter of 2008 was $0.2 million, as compared to tax benefit of $0.3 million for the third quarter of 2007. The decrease in provision for income taxes for the first nine months of 2008 was mainly a result of a decrease in income before taxes. The increase in provision for income taxes for the third quarter of 2008 was mainly a result of the decrease in loss before taxes.

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 will qualify 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 will apply 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 (27% for 2008). 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, 2007, 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. As of September 30, 2008, DSP Group Ltd. did not generate taxable income related to this plan.

In connection with the Acquisition, we applied for a tax ruling with the Swiss tax authorities to determine the tax rate applicable to the taxable income generated by our Swiss subsidiary, including the amortization period for tax purposes of goodwill and all other intangible assets acquired in the Acquisition. The ruling process with the Swiss tax authorities was finalized during the second quarter of 2008. Pursuant to the tax ruling, the Company s Swiss subsidiary will be entitled to reduced tax rates of approximately 10% to 15% depending on the source of income and a tax amortization period of 5 to 10 years on the goodwill and other intangible assets acquired in the Acquisition.

Currently, our U.S. federal income tax returns for 2003 and 2004 are under examination and we are appealing the Internal Revenue Service s initial determination. 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 our 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.

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LIQUIDITY AND CAPITAL RESOURCES

Operating Activities. Our cash flows from operating activities were $8.2 million and $23.2 million for the first nine months of 2008 and 2007, respectively. The decrease in net cash provided by operating activities for the first nine months of 2008, as compared to the same period in 2007, resulted mainly from the decrease in net income for the comparable periods. The decrease in cash from operating activities also was a result of a decrease in accrued compensation and benefits by $6.6 million for the first nine months of 2008, as compared to an increase of $1.8 million for the first nine months of 2007, mainly due to the severance payments associated with our various restructuring and cost-cutting measures that were paid during the first nine months of 2008. In addition, the decrease was due to an increase in inventories by $5.6 million for the first nine months of 2008, as compared to a decrease in inventories of $1.2 million for the first nine months of 2007. In addition, the decrease was due to an increase in prepaid expenses and other current assets by $7.6 million for the first nine months of 2008, as compared to a decrease of $8.8 million for the first nine months of 2007. The above-referenced factors were partially offset by a decrease in accounts receivable by $7.8 million for the first nine months of 2008, as compared to an increase in accounts receivable of $21.3 million for the first nine months of 2007.

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 nine months of 2008, we purchased $44.4 million of investments in marketable securities, as compared to $56.7 million during the first nine months of 2007. During the same periods, $83.3 million and $95.6 million, respectively, of investments in marketable securities matured, were called by the issuer or were sold. In addition, during the third quarter of 2007, $147.0 million of marketable securities and short term investments were sold to finance the approximate $200 million cash payment to NXP in connection with the Acquisition.

As of September 30, 2008, the amortized cost of our marketable securities was $57.9 million and their stated market value was $56.3 million, representing an unrealized loss of $1.5 million.

Our capital equipment purchases for the first nine months of 2008, consisting primarily of research and development software tools, computers and other peripheral equipment, engineering test and lab equipment, leasehold improvements, furniture and fixtures totaled $8.0 million, as compared to $2.6 million for the first nine months of 2007. The increase for the first nine months of 2008, as compared to the same period for 2007, was also the result of capital equipment purchases for the CIPT Business during the first quarter of 2008.

Financing Activities. During the first nine months of 2008 and 2007, we paid $43.7 million and $7.7 million, respectively, for the purchase of treasury stock. During the first nine months of 2008, we received $0.1 million upon the exercise of employee stock options, as compared to $3.1 million during the first nine months of 2007. We cannot predict cash flows from option exercises and employee stock purchases 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 affect 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 nine months of 2008, we repurchased 3,978,378 shares of our common stock at an average purchase price of $11.04 per share for an aggregate amount of approximately $43.9 million (approximately $43.7 million was paid in cash as of September 30, 2008). Pursuant to our share repurchase program, 1,075,334 shares of our common stock remain authorized for repurchase as of September 30, 2008. Additional share repurchases occurred after the third quarter of 2008, and as of the date of this quarterly report, 255,488 shares of our common stock remain authorized for repurchase.

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As of September 30, 2008, we had cash and cash equivalents totaling approximately $64.1 million and marketable securities of approximately $56.3 million. The repurchase of our common stock that occurred since September 30, 2007 was the main reason for the decrease in our cash investments and securities as of September 30, 2008, in comparison to September 30, 2007.

Our working capital at September 30, 2008 was approximately $84.1 million, as compared to $125.6 as of September 30, 2007. The decrease in working capital was mainly due to share repurchases made since September 30, 2007. As we generate most of our cash flows from our operating activities, we believe that our current cash, cash equivalents, cash deposits and marketable securities and our forecasted positive cash flows for future periods, will be sufficient to meet our cash requirements for both the short and long term. In addition, as part of our business strategy, we occasionally 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.

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 a held-to-maturity basis.

Foreign Currency Exchange Rate Risk. As a significant part of our sales and expenses are denominated in U.S. dollars, we have experienced only insignificant foreign exchange gains and losses to date, and do not expect to incur significant gains and losses in 2008. However, 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 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. 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 2008, 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 September 30, 2008. An increase in the value of the NIS, Euro and Swiss Franc in comparison to the U.S. dollar could increase the cost of our research and development expenses and general and administrative expenses, all of which could harm our operating profit. Although we currently are using a hedging program to minimize the effects of currency fluctuations relating to the NIS, our hedging position is partial, may not exist at all in the future and may not succeed in minimizing our foreign currency fluctuation risks.

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ITEM 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.

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.

There are no material changes to the Risk Factors described under the title Factors That May Affect Future Performance in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 other than (1) changes to the Risk Factor below entitled 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; (2) changes to the Risk Factor below entitled We rely significantly on revenue derived from a limited number of customers; (3) changes to the Risk Factor below entitled 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; (4) changes to the Risk Factor below entitled Because our quarterly operating results may fluctuate significantly, the price of our common stock may decline; (5) changes to the Risk Factor below entitled 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; (6) changes to the Risk Factor below entitled Our various restructuring and cost-cutting measures, including those related to the CIPT Business acquired from NXP, could disrupt the operation of our business; (7) changes to the Risk Factor below entitled 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; (8) changes to the Risk Factor below entitled 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; (9) changes to the Risk Factor below entitled 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; (10) changes to the Risk Factor below entitled In order to sustain the future growth of our business, we must penetrate new markets and our new products must achieve widespread market acceptance; (11) changes to the Risk Factor below entitled: We are exposed to the credit risk of our customers and to credit exposures in weakened markets, which could result in material losses; (12) changes to the Risk Factor below entitled We are exposed to fluctuations in currency exchange rates; and (13) changes to the Risk Factor below entitled An unfavorable government review of our federal income tax returns or changes in our effective tax rates could adversely affect our operating results. We also added the following risk factors entitled: (i) Our operating results may be adversely impacted by worldwide economic uncertainties and the cyclical nature of and volatility in the semiconductor industry; and (ii) We are subject to order and shipment uncertainties and if we are unable to accurately predict customer demand, our business may be harmed. We further deleted the following risk factors entitled: (a) An unfavorable tax ruling from the Swiss tax authorities relating to the tax rate applicable to the taxable income generated by our Swiss subsidiary could affect our operating results; and (b) Our failure to compete effectively in the U.S. DECT market could have a material adverse effect on our business.

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 and original equipment manufacturer (OEM) representatives. Particularly, revenues derived from sales through our Japanese distributor, Tomen Electronics, accounted for 23% and 46% of our total revenues for the nine months ended September 30, 2008 and 2007, respectively. 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 14% and 29% of our revenues for the nine months ended September 30, 2008 and 2007, respectively. The loss of Tomen Electronics as our distributor and our inability to obtain a satisfactory replacement in a timely manner would materially harm our sales and results of operations. Additionally, the loss of Panasonic and Tomen Electronics inability to thereafter effectively market our products would also materially harm our sales and results of operations.

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

We expect that a limited number of customers, varying in identity from period-to-period, will account for a substantial portion of our revenues in any period. Our four largest customers Panasonic, Uniden, CCT and VTech accounted for approximately 56% of our total revenues for the nine months ended September 30, 2008. In addition to Panasonic mentioned above, sales to Uniden, CCT Telecom and VTech represented approximately 13%, 9% and 21%, respectively, of our total revenues for the nine months ended September 30, 2008. 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. For example, the financial instability of a Canadian customer resulted in decreased sales to this customer which in turn decreased our overall projected sales for 2008. 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.

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 nine months of 2008. Specifically, sales of our 2.4GHz, 5.8GHz, DECT and CoIP products comprised 89% and 85% of our total revenues for the first nine months of 2008 and 2007, respectively. Revenues from our 5.8GHz and 2.4GHz digital products represented 6% and 11%, respectively, of our total revenue for the first nine months of 2008, and 31% and 21%, respectively, of our total revenues for the first nine months of 2007. We believe U.S. sales of our 2.4GHz and 5.8GHz products will decrease for the remainder of 2008 with a sharper decrease in sales of our 5.8GHz products.

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

In addition, we believe new developments in the 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 cordless telephony products.

Our business and results of operations may be affected by the acquisition of the cordless and VoIP terminals business.

On September 4, 2007, we acquired the cordless and VoIP terminals business (the CIPT Business) of NXP B.V. The acquisition could have an adverse effect on our business in the near term if current and prospective customers and strategic partners are reluctant to enter into new agreements with us due to uncertainty about the direction of the company after the acquisition. In addition, the process of integrating the CIPT Business into our company may be prolonged due to unforeseen difficulties and may require a disproportionate amount of our resources and management s attention. The diversion of management s and employees attention from our day-to-day business, including implementation of strategic initiatives, may cause disruptions among our relationships with customers and strategic partners, all of which could detract from our ability to generate revenue and implement strategic initiatives. Furthermore, we cannot assure you that the proposed benefits of the acquisition can be achieved or achieved at the level currently anticipated. Our results of

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operations after the acquisition could be below the expectations of market analysts, which could cause a decline in our stock price. Moreover, the acquisition diluted our stockholders equity as we issued 4,186,603 shares of our common stock to NXP as partial consideration for the acquisition.

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 changing economic conditions in the United States and worldwide, and the effect on the semiconductor industry.

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

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

We have experienced and will continue to experience a decrease in the average selling prices of our products. Decreasing average selling prices could result in decreased revenues even if the volume of products sold increases. Decreasing average selling prices may also require us to sell our products at much lower gross margin than in the past and reduce profitability. Although we have to date been able to partially offset on an annual basis the declining average selling prices through 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 nine months of 2008 was 37%, as compared to 40% for the first nine months of 2007. 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 for the first nine months of 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 during the fourth quarter of 2008. We also anticipate that the shift to DECT 6.0 products in the U.S. market to continue at a fast pace during the fourth quarter of 2008.

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 and representatives 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 93% of our total revenues for the first nine months of 2008. 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;

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

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

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

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

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

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

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

As part of the acquisition of the CIPT Business, we entered into a Manufacturing Services Collaboration Agreement 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 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 its intent to close one of its manufacturing facilities and transfer the products being manufactured there to another NXP facility. If the qualification of the new facility relating to our customers products is not completed in a timely manner and NXP is not able to meet its obligations to us under the Manufacturing Services Collaboration Agreement, our business could be materially harmed. 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. Furthermore, as part of the acquisition, we negotiated a predetermined cost structure for NXP s provision of manufacturing, pre-testing, assembling and final-testing services relating to the CIPT Business products. Our business would be harmed if such cost structure increases, which reduces the anticipated gross margin for our CIPT Business products. Our business also would be materially harmed if NXP terminates its relationship with us 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.

Our operating results may be adversely impacted by worldwide economic uncertainties and the cyclical nature of and volatility in the semiconductor industry.

The current general worldwide economic downturn, due to the credit conditions impacted by the subprime-mortgage turmoil and other factors, 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. 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. Therefore, the worldwide economic downturn could seriously harm our business, financial condition and results of operations, which could cause our stock price to decline.

Furthermore, we operate within the semiconductor industry, which is cyclical and subject to rapid technological change and evolving industry standards. From time to time, the semiconductor industry has experienced significant downturns such as the one we experienced during the 2000 and 2001 periods. In addition, the current general worldwide economic downturn may adversely impact the semiconductor industry or cause a downturn of the industry. 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 downturn we experienced during the 2000 and 2001 periods was, and future downturns in the semiconductor industry may be, severe and prolonged. Also, the failure of the semiconductor industry to fully recover in any future downturns could seriously impact our revenue and harm our business, financial condition and results of operations, which could cause our stock price to decline.

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which could result in an impairment of their ability to make timely payments to us. If that were to occur, we may be required to increase our allowance for doubtful accounts and our days sales outstanding would be negatively impacted. Therefore, the worldwide economic downturn and specifically the volatility in the semiconductor industry could seriously impact our revenue and harm our business, financial condition and results of operations, which could cause our stock price to decline.

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. Our inability to penetrate the market or lack of customer acceptance of these products may harm the business and potential growth.

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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 customers 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 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 if 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 through a network of distributors and OEM representatives. 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.

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 September 30, 2008, 266 of our 461 employees were located in Israel, including 174 out of 309 of our research and development personnel. In addition, although we are incorporated in Delaware, a majority of our directors and executive officers are residents of Israel. Although substantially all of our sales currently are being made to customers outside of Israel, we are nonetheless directly influenced by the political, economic and military conditions affecting Israel. Any major hostilities involving Israel, or the interruption or curtailment of trade between Israel and its present trading partners, could significantly harm our business, operating results and financial condition.

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

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

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

Our facilities in Israel have been granted Approved Enterprise and Beneficiary Enterprise status under the Law for the Encouragement of Capital Investments, 1959, commonly referred to as the Investment Law, and as amended. The Investment Law provides that capital investments in a production facility (or other eligible assets) may be designated as an Approved Enterprise. Under that law, we receive certain tax benefits in Israel. To be eligible for tax benefits, we must meet certain conditions, relating principally to adherence to the investment program filed with the Investment Center of the Israeli Ministry of Industry and Trade and to periodic reporting obligations. Although we believe we have met such conditions in the past, should we fail to meet such conditions in the future, we would be subject to corporate tax in Israel at the standard corporate tax rate (27% for 2008) and could be required to refund tax benefits already received. We cannot

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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 2018. 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 will apply to new investment programs only. We believe that we are currently in compliance with these requirements and have calculated our current tax provision for the first half of 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). 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.

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

Most of our sales are on an open credit basis. Because of current conditions in the global economy, our exposure to credit risks relating to sales on an open credit basis has increased. We expect demand for enhanced open credit terms, for example, longer payment terms, to continue and believe that such arrangements are a competitive factor in obtaining business. Although we monitor and attempt to mitigate credit risks, including through insurance coverage from time to time, there can be no assurance that our efforts will be effective. Moreover, even if we attempt to mitigate credit risks through insurance coverage, such coverage may not be sufficient to cover all of our losses and we would be subject to a deductible under any insurance coverage. Furthermore, as part of the acquisition of the CIPT Business, 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 93% of our total revenues for the first nine months of 2008. 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

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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

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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 AudioCodes, Broadcom, Infineon, Texas Instruments and new Taiwanese IC vendors.

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

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

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

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

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

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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 pursuant to our Rule 10b5-1 compliant share repurchase program during the three months ended September 30, 2008.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)
Month #1 (July 1, 2008 to July 31, 2008)	630,524	$ 6.943	630,524	1,194,377
Month #2 (August 1, 2008 to August 31, 2008)	5,000	$ 7.03	5,000	1,189,377
Month #3 (September 1, 2008 to September 30, 2008)	114,043	$ 6.988	114,043	1,075,334
TOTAL	749,567	$ 6.951	749,567	1,075,334(2)

(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.

(2) The number represents the number of shares of our common stock that remain available for the repurchase pursuant to our board s authorizations as of September 30, 2008. Additional repurchases occurred after the second quarter of 2008 and as of the date of this quarterly report, 255,488 share of our common stock remains available for repurchase.

ITEM 6. EXHIBITS.

Exhibit 3.3 Amended and Restated Bylaws, effective as of October 30, 2008 (incorporated herein by reference to Exhibit 99.2 filed with DSP Group, Inc. s Current Report on Form 8-K, filed with the Securities and Exchange Commission on October 30, 2008).

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: November 10, 2008	By: /s/ Dror Levy Dror Levy,
	Vice President of Finance, Chief Financial Officer and Secretary
	(Principal Financial Officer and Principal Accounting Officer)