

CEVA INC  
Form 10-Q  
November 09, 2016  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, DC 20549**

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended: September 30, 2016**

**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: 000-49842**

**CEVA, Inc.**

**(Exact Name of Registrant as Specified in Its Charter)**

**Delaware**  
**(State or Other Jurisdiction of**

**77-0556376**  
**(I.R.S. Employer**

**Incorporation or Organization)**

**Identification No.)**

**1174 Castro Street, Suite 210, Mountain View,**  
**California**

**94040**

**(Address of Principal Executive Offices)**

**(Zip Code)**

**(650) 417-7900**

**(Registrant's Telephone Number, Including Area Code)**

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: 21,230,589 shares of common stock, \$0.001 par value, as of November 3, 2016.

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**FORWARD-LOOKING STATEMENTS**

**FORWARD-LOOKING STATEMENTS AND INDUSTRY DATA**

This Quarterly Report contains forward-looking statements that involve risks and uncertainties, as well as assumptions that if they materialize or prove incorrect, could cause the results of CEVA to differ materially from those expressed or implied by such forward-looking statements and assumptions. All statements other than statements of historical fact are statements that could be deemed forward-looking statements. Forward-looking statements are generally written in the future tense and/or are preceded by words such as will, may, should, could, expect, suggest, believe, intend, plan, or other similar words. Forward-looking statements include the following:

Our belief that the adoption of our signal processing IP cores and software for smart, connected devices continues to progress;

Our belief that our market share in smartphones will continue to grow;

Our anticipation that the total number of LTE devices powered by our DSPs that we will report for 2016 will exceed the 200 million target;

Our belief that we will benefit from the handset market transitioning from feature phones to smartphones, in particular in emerging economies;

Our belief that RivieraWaves Bluetooth and Wi-Fi IPs allows us to expand further into IoT applications and increase our overall addressable market which is expected to be 35 billion devices by 2020, as per ABI Research;

Our belief that the business model of CEVA being a one stop shop for technologies, as evidenced by our first portfolio licensing agreement during the third quarter of 2016, may be extended to other tier one customers;

Our belief that we will continue to experience in 2016, similar to 2015, solid licensing environment for our entire products;

Our belief that our intelligent audio processing IP is required for IoT applications, as voice is becoming a primary user interface for such applications;

Our belief that our specialization and competitive edge in digital signal processor technologies and the inherent low cost and power performance balance of our

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technologies put us in a strong position to capitalize on market adoption of next generation LTE, 5G and Wi-Fi technologies for multiple market and product sectors;

Our belief that our vision processing IP offers an additional growth segment for the company, and that specifically ABI Research predicts that cameras equipped with vision processing are expected to exceed 2.7 billion units by 2018;

Our belief that the revolution in using machine learning and deep networks for camera-related use cases is an opportunity for us to expand our vision technology footprint to any camera-enabled device such as smartphones, tablets, automotive safety (ADAS), drones, robotics, security and surveillance, augmented reality (AR) and virtual reality (VR), drones, and signage;

Our belief that unit shipments for non-handset baseband applications will reach 200 million in 2016 and 700 to 900 million units annually by 2018;

Our anticipation that our cash and cash equivalents, short-term bank deposits and marketable securities, along with cash from operations, will provide sufficient capital to fund our operations for at least the next 12 months; and

Our belief that changes in interest rates within our investment portfolio will not have a material effect on our financial position on an annual or quarterly basis.

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Forward-looking statements are not guarantees of future performance and involve risks and uncertainties. The forward-looking statements contained in this report are based on information that is currently available to us and expectations and assumptions that we deem reasonable at the time the statements were made. We do not undertake any obligation to update any forward-looking statements in this report or in any of our other communications, except as required by law. All such forward-looking statements should be read as of the time the statements were made and with the recognition that these forward-looking statements may not be complete or accurate at a later date.

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, those risks set forth in Part II Item 1A Risk Factors of this Form 10-Q.

This report contains market data prepared by third party research firm. Actual market results may differ from their projections.

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS  
INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS**

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

|  | September 30,<br>2016<br>Unaudited | December 31,<br>2015<br>Audited |
|--|------------------------------------|---------------------------------|
| <b>ASSETS</b>                              |                                    |                                 |
| Current assets:                            |                                    |                                 |
| Cash and cash equivalents                  | \$ 19,998                          | \$ 18,909                       |
| Short term bank deposits                   | 40,953                             | 30,767                          |
| Marketable securities                      | 58,930                             | 48,266                          |
| Trade receivables, net                     | 17,250                             | 4,068                           |
| Prepaid expenses and other current assets  | 2,945                              | 4,017                           |
| Total current assets                       | 140,076                            | 106,027                         |
| Long term bank deposits                    | 25,135                             | 41,334                          |
| Severance pay fund                         | 8,072                              | 7,297                           |
| Deferred tax assets                        | 2,116                              | 1,628                           |
| Property and equipment, net                | 4,831                              | 3,731                           |
| Goodwill                                   | 46,612                             | 46,612                          |
| Intangible assets, net                     | 3,287                              | 4,214                           |
| Other long-term assets                     | 4,358                              | 1,806                           |
| Total long-term assets                     | 94,411                             | 106,622                         |
| Total assets                               | \$ 234,487                         | \$ 212,649                      |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b> |                                    |                                 |
| Current liabilities:                       |                                    |                                 |
| Trade payables                             | \$ 1,116                           | \$ 693                          |
| Deferred revenues                          | 4,032                              | 2,763                           |
| Accrued expenses and other payables        | 4,490                              | 3,633                           |
| Accrued payroll and related benefits       | 11,641                             | 11,894                          |
| Total current liabilities                  | 21,279                             | 18,983                          |

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|   |                   |                   |
|---|-------------------|-------------------|
| Long term liabilities:  |                   |                   |
| Accrued severance pay   | 8,533             | 7,571             |
| <b>Total long-term liabilities</b>  | <b>8,533</b>      | <b>7,571</b>      |
| Stockholders' equity:   |                   |                   |
| Preferred Stock:  |                   |                   |
| \$0.001 par value: 5,000,000 shares authorized; none issued and outstanding   |                   |                   |
| Common Stock:   |                   |                   |
| \$0.001 par value: 60,000,000 shares authorized; 23,595,160 shares issued at September 30, 2016 and December 31, 2015. 21,221,631 and 20,529,933 shares outstanding at September 30, 2016 and December 31, 2015, respectively |                   |                   |
| Additional paid in-capital  | 210,519           | 208,744           |
| Treasury stock at cost (2,373,529 and 3,065,227 shares of common stock at September 30, 2016 and December 31, 2015, respectively)   | (40,390)          | (51,798)          |
| Accumulated other comprehensive income (loss)   | 33                | (419)             |
| Retained earnings   | 34,492            | 29,547            |
| <b>Total stockholders' equity</b>   | <b>204,675</b>    | <b>186,095</b>    |
| <b>Total liabilities and stockholders' equity</b>   | <b>\$ 234,487</b> | <b>\$ 212,649</b> |

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



**Table of Contents****INTERIM CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

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

|  | <b>Nine months ended<br/>September 30,</b> |                 | <b>Three months ended<br/>September 30,</b> |                 |
|--|--|-----------------|---|-----------------|
|  | <b>2016</b>                                | <b>2015</b>     | <b>2016</b>                                 | <b>2015</b>     |
| <b>Revenues:</b>   |  |                 |   |                 |
| Licensing and related revenue  | \$ 23,576                                  | \$ 24,108       | \$ 7,456                                    | \$ 8,600        |
| Royalties  | 27,881                                     | 19,320          | 10,390                                      | 7,635           |
| <b>Total revenues</b>  | <b>51,457</b>                              | <b>43,428</b>   | <b>17,846</b>                               | <b>16,235</b>   |
| Cost of revenues   | 4,453                                      | 4,016           | 1,422                                       | 1,281           |
| <b>Gross profit</b>  | <b>47,004</b>                              | <b>39,412</b>   | <b>16,424</b>                               | <b>14,954</b>   |
| <b>Operating expenses:</b>   |  |                 |   |                 |
| Research and development, net  | 23,071                                     | 21,175          | 7,346                                       | 6,571           |
| Sales and marketing  | 8,463                                      | 7,358           | 2,763                                       | 2,384           |
| General and administrative   | 6,286                                      | 5,821           | 2,218                                       | 2,183           |
| Amortization of intangible assets  | 927  | 974             | 309   | 325             |
| <b>Total operating expenses</b>  | <b>38,747</b>                              | <b>35,328</b>   | <b>12,636</b>                               | <b>11,463</b>   |
| <b>Operating income</b>  | <b>8,257</b>                               | <b>4,084</b>    | <b>3,788</b>                                | <b>3,491</b>    |
| Financial income, net  | 1,617                                      | 643             | 615   | 401             |
| <b>Income before taxes on income</b>   | <b>9,874</b>                               | <b>4,727</b>    | <b>4,403</b>                                | <b>3,892</b>    |
| Income taxes   | 1,975                                      | 764             | 1,015                                       | 583             |
| <b>Net income</b>  | <b>\$ 7,899</b>                            | <b>\$ 3,963</b> | <b>\$ 3,388</b>                             | <b>\$ 3,309</b> |
| <b>Basic net income per share</b>  | <b>\$ 0.38</b>                             | <b>\$ 0.19</b>  | <b>\$ 0.16</b>                              | <b>\$ 0.16</b>  |
| <b>Diluted net income per share</b>  | <b>\$ 0.37</b>                             | <b>\$ 0.19</b>  | <b>\$ 0.15</b>                              | <b>\$ 0.16</b>  |
| Weighted-average shares used to compute net income per share (in thousands): |  |                 |   |                 |
| Basic  | 20,718                                     | 20,477          | 21,025                                      | 20,448          |
| Diluted  | 21,395                                     | 20,918          | 21,883                                      | 20,811          |

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



**Table of Contents****INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(UNAUDITED)****U.S. dollars in thousands**

|   | <b>Nine months ended</b> |             | <b>Three months ended</b> |             |
|---|--------------------------|-------------|---------------------------|-------------|
|   | <b>September 30,</b>     |             | <b>September 30,</b>      |             |
|   | <b>2016</b>              | <b>2015</b> | <b>2016</b>               | <b>2015</b> |
| Net income:   | \$ 7,899                 | \$ 3,963    | \$ 3,388                  | \$ 3,309    |
| Other comprehensive income (loss) before tax:   |                          |             |                           |             |
| Available-for-sale securities:  |                          |             |                           |             |
| Changes in unrealized gains (losses)  | 492                      | (47)        | 46                        | (47)        |
| Reclassification adjustments for losses included in net income                          | 16                       | 74          |                           | 28          |
| Net change  | 508                      | 27          | 46                        | (19)        |
| Cash flow hedges:   |                          |             |                           |             |
| Changes in unrealized gains (losses)  | 218                      | 137         | 75                        | (138)       |
| Reclassification adjustments for gains included in net income                           | (191)                    | (58)        | (69)                      | (59)        |
| Net change  | 27                       | 79          | 6                         | (197)       |
| Other comprehensive income (loss) before tax  | 535                      | 106         | 52                        | (216)       |
| Income tax expense (benefit) related to components of other comprehensive income (loss) | 83                       | (5)         | 13                        | (30)        |
| Other comprehensive income (loss), net of taxes   | 452                      | 111         | 39                        | (186)       |
| Comprehensive income  | \$ 8,351                 | \$ 4,074    | \$ 3,427                  | \$ 3,123    |

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

**Table of Contents****INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

U.S. dollars in thousands

|  | <b>Nine months ended<br/>September 30,</b> |             |
|--|--|-------------|
|  | <b>2016</b>                                | <b>2015</b> |
| <b>Cash flows from operating activities:</b>   |  |             |
| Net income   | \$ 7,899                                   | \$ 3,963    |
| Adjustments required to reconcile net income to net cash provided by operating activities: |  |             |
| Depreciation   | 998  | 784         |
| Amortization of intangible assets  | 927  | 974         |
| Equity-based compensation  | 4,648                                      | 2,795       |
| Realized loss, net on sale of available-for-sale marketable securities                     | 16   | 74          |
| Amortization of premiums on available-for-sale marketable securities                       | 757  | 841         |
| Unrealized foreign exchange (gain) loss  | (29)                                       | 213         |
| Changes in operating assets and liabilities:   |  |             |
| Trade receivables  | (13,172)                                   | (790)       |
| Prepaid expenses and other assets  | (1,403)                                    | 29          |
| Accrued interest on bank deposits  | (395)                                      | (42)        |
| Deferred tax, net  | (571)                                      | (712)       |
| Trade payables   | 370  | 21          |
| Deferred revenues  | 1,269                                      | 364         |
| Accrued expenses and other payables  | (62)                                       | (169)       |
| Accretion of contingent consideration  |  | 97          |
| Accrued payroll and related benefits   | (356)                                      | (413)       |
| Income taxes payable   | 894  | (277)       |
| Excess tax benefit from equity-based compensation  |  | (112)       |
| Accrued severance pay, net   | 176  | 172         |
| Net cash provided by operating activities  | 1,966                                      | 7,812       |
| <b>Cash flows from investing activities:</b>   |  |             |
| Purchase of property and equipment   | (2,031)                                    | (1,173)     |
| Investment in bank deposits  | (19,100)                                   | (46,328)    |
| Proceeds from bank deposits  | 25,613                                     | 47,451      |
| Investment in available-for-sale marketable securities                                     | (32,498)                                   | (26,195)    |
| Proceeds from maturity of available-for-sale marketable securities                         | 7,316                                      | 3,989       |
| Proceeds from sale of available-for-sale marketable securities                             | 14,253                                     | 20,883      |
| Proceeds from realization of investment in other company                                   |  | 111         |
| Net cash used in investing activities  | (6,447)                                    | (1,262)     |

| <b>Cash flows from financing activities:</b>                       |           |           |
|--|-----------|-----------|
| Payment of contingent consideration (see note 3)                   |           | (3,700)   |
| Purchase of treasury stock   | (3,417)   | (8,156)   |
| Proceeds from exercise of stock-based awards                       | 8,998     | 5,382     |
| Excess tax benefit from equity-based compensation                  |           | 112       |
| Net cash provided by (used in) financing activities                | 5,581     | (6,362)   |
| Effect of exchange rate changes on cash and cash equivalents       | (11)      | (38)      |
| Decrease in cash and cash equivalents                              | 1,089     | 150       |
| Cash and cash equivalents at the beginning of the period           | 18,909    | 16,166    |
| Cash and cash equivalents at the end of the period                 | \$ 19,998 | \$ 16,316 |
| <b>Supplemental information of cash-flow activities:</b>           |           |           |
| Cash paid during the period for:                                   |           |           |
| Income and withholding taxes, net of refunds                       | \$ 1,604  | \$ 1,693  |
| Property and equipment purchases incurred but unpaid at period end | \$ 67     | \$        |

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

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**NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(in thousands, except share data)**

**NOTE 1: BUSINESS**

The financial information in this quarterly report includes the results of CEVA, Inc. and its subsidiaries (the Company or CEVA ).

CEVA licenses a family of signal processing IPs, including programmable DSP cores and application-specific platforms for vision, imaging, audio and voice, as well as communications and connectivity technologies, including wireless baseband and wired modems, Wi-Fi, Bluetooth, and Serial ATA (SATA) and Serial Attached SCSI (SAS).

CEVA's technologies are licensed to leading semiconductor and original equipment manufacturer (OEM) companies in the form of intellectual property (IP). These companies design, manufacture, market and sell application-specific integrated circuits ( ASICs ) and application-specific standard products ( ASSPs ) based on CEVA's technology to wireless, consumer electronics and automotive companies for incorporation into a wide variety of end products.

**NOTE 2: BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Basis of Presentation*

The interim condensed consolidated financial statements have been prepared according to U.S Generally Accepted Accounting Principles ( U.S. GAAP ).

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. For further information, reference is made to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

The significant accounting policies applied in the annual consolidated financial statements of the Company as of December 31, 2015, contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 11, 2016, have been applied consistently in these unaudited interim condensed consolidated financial statements.

*Use of Estimates*

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

**NOTE 3: ACQUISITION OF RIVIERAWAVES**

On July 4, 2014 (the Closing Date), the Company acquired 100% of RivieraWaves SAS (RivieraWaves), a privately-held, French-based company and a provider of wireless connectivity intellectual property for Wi-Fi and Bluetooth technologies. The Company agreed to pay an aggregate of \$18,378 to acquire RivieraWaves with \$14,678 paid on the Closing Date and the remaining amount of \$3,700 payable upon the satisfaction of certain milestones (the Contingent Consideration). During the first nine months of 2015, the Company fully paid the Contingent Consideration.

The acquisition was accounted in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) No. 805, Business Combinations.

In addition, as part of the acquisition, the Company established an employee retention plan for the RivieraWaves employees at a cost of approximately \$3,400, payable on a semi-annual basis for a period of two years after the Closing Date. As of September 30, 2016, the Company fully paid the employee retention plan.

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(in thousands, except share data)

**NOTE 4: MARKETABLE SECURITIES**

The following is a summary of available-for-sale marketable securities:

|  | <b>September 30, 2016 (Unaudited)</b> |                                       |  |                       |
|--|---------------------------------------|---------------------------------------|--|-----------------------|
|  | <b>Amortized<br/>cost</b>             | <b>Gross<br/>unrealized<br/>gains</b> | <b>Gross<br/>unrealized<br/>losses</b> | <b>Fair<br/>value</b> |
| <b>Available-for-sale - matures within one year:</b>                       |                                       |                                       |  |                       |
| Certificate of deposits  | \$ 1                                  | \$                                    | \$                                     | \$ 1                  |
| Corporate bonds  | 7,536                                 | 8                                     | (9)                                    | 7,535                 |
|  | 7,537                                 | 8                                     | (9)                                    | 7,536                 |
| <b>Available-for-sale - matures after one year<br/>through five years:</b> |                                       |                                       |  |                       |
| Government bonds   | 501                                   |                                       | (1)                                    | 500                   |
| Corporate bonds  | 50,877                                | 116                                   | (99)                                   | 50,894                |
|  | 51,378                                | 116                                   | (100)                                  | 51,394                |
| <b>Total</b>   | <b>\$ 58,915</b>                      | <b>\$ 124</b>                         | <b>\$ (109)</b>                        | <b>\$ 58,930</b>      |

|   | <b>December 31, 2015 (Audited)</b> |                                       |  |                       |
|---|------------------------------------|---------------------------------------|--|-----------------------|
|   | <b>Amortized<br/>cost</b>          | <b>Gross<br/>unrealized<br/>gains</b> | <b>Gross<br/>unrealized<br/>losses</b> | <b>Fair<br/>value</b> |
| <b>Available-for-sale - matures within one year:</b>                        |                                    |                                       |  |                       |
| Certificate of deposits   | \$ 1                               | \$                                    | \$                                     | \$ 1                  |
| Corporate bonds   | 9,257                              | 1                                     | (50)                                   | 9,208                 |
|   | 9,258                              | 1                                     | (50)                                   | 9,209                 |
| <b>Available-for-sale - matures after one year<br/>through three years:</b> |                                    |                                       |  |                       |
| Corporate bonds   | 39,501                             |                                       | (444)                                  | 39,057                |
|   | 39,501                             |                                       | (444)                                  | 39,057                |
| <b>Total</b>  | <b>\$ 48,759</b>                   | <b>\$ 1</b>                           | <b>\$ (494)</b>                        | <b>\$ 48,266</b>      |



The following table presents gross unrealized losses and fair values for those investments that were in an unrealized loss position as of September 30, 2016 and December 31, 2015, and the length of time that those investments have been in a continuous loss position:

|                          | <b>Less than 12 months</b> |                        | <b>12 months or greater</b> |                        |
|--------------------------|----------------------------|------------------------|-----------------------------|------------------------|
|                          | <b>Fair</b>                | <b>Gross</b>           | <b>Fair</b>                 | <b>Gross</b>           |
|                          | <b>value</b>               | <b>unrealized loss</b> | <b>value</b>                | <b>unrealized loss</b> |
| As of September 30, 2016 | \$ 14,773                  | \$ (68)                | \$ 13,678                   | \$ (41)                |
| As of December 31, 2015  | \$ 32,695                  | \$ (389)               | \$ 14,488                   | \$ (105)               |

As of September 30, 2016 and December 31, 2015, management believes the impairments are not other than temporary and therefore the impairment losses were recorded in accumulated other comprehensive income (loss).

Table of ContentsNOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(in thousands, except share data)

The following table presents gross realized gains and losses from sale of available-for-sale marketable securities:

|   | Nine months<br>ended<br>September 30,<br>2016 |             | Three months<br>ended<br>September 30,<br>2015 |             |
|---|---|-------------|--|-------------|
|   | (unaudited)                                   | (unaudited) | (unaudited)                                    | (unaudited) |
| Gross realized gains from sale of available-for-sale marketable securities  | \$ 16   | \$ 2        | \$ 1   | \$          |
| Gross realized losses from sale of available-for-sale marketable securities | \$ (32)                                       | \$ (76)     | \$ (1)   | \$ (28)     |

**NOTE 5: FAIR VALUE MEASUREMENT**

FASB ASC No. 820, Fair Value Measurements and Disclosures defines fair value, establishes a framework for measuring fair value. Fair value is an exit price, representing the amount that would be received for selling an asset or paid for the transfer of a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. A three-tier fair value hierarchy is established as a basis for considering such assumptions and for inputs used in the valuation methodologies in measuring fair value:

- Level I Unadjusted quoted prices in active markets that are accessible on the measurement date for identical, unrestricted assets or liabilities;
- Level II Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability; and
- Level III Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

The Company measures its marketable securities and foreign currency derivative contracts at fair value. Marketable securities and foreign currency derivative contracts are classified within Level II as the valuation inputs are based on quoted prices and market observable data of similar instruments.

The table below sets forth the Company's assets and liabilities measured at fair value by level within the fair value hierarchy. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

| <b>Description</b>         | <b>September 30, 2016</b> |                 |                  |  |
|----------------------------|---------------------------|-----------------|------------------|--|
|                            | <b>Level I</b>            | <b>Level II</b> | <b>Level III</b> |  |
| <b>Assets:</b>             |                           |                 |                  |  |
| Marketable securities:     |                           |                 |                  |  |
| Certificate of deposits    | \$ 1                      | \$ 1            | \$               |  |
| Government bonds           | 500                       | 500             |                  |  |
| Corporate bonds            | 58,429                    | 58,429          |                  |  |
| Foreign exchange contracts | 48                        | 48              |                  |  |
| <b>Liabilities:</b>        |                           |                 |                  |  |
| Foreign exchange contracts | 12                        | 12              |                  |  |

| <b>Description</b>         | <b>December 31, 2015</b> | <b>Level I</b> | <b>Level II</b> | <b>Level III</b> |
|----------------------------|--------------------------|----------------|-----------------|------------------|
| <b>Assets:</b>             |                          |                |                 |                  |
| Marketable securities:     |                          |                |                 |                  |
| Certificate of deposits    | \$ 1                     | \$ 1           | \$              |                  |
| Corporate bonds            | 48,265                   | 48,265         |                 |                  |
| Foreign exchange contracts | 9                        | 9              |                 |                  |

**Table of Contents****NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

(in thousands, except share data)

**NOTE 6: GEOGRAPHIC INFORMATION AND MAJOR CUSTOMER DATA**

## a. Summary information about geographic areas:

The Company manages its business on the basis of one reportable segment: the licensing of intellectual property to semiconductor companies and electronic equipment manufacturers (see Note 1 for a brief description of the Company's business). The following is a summary of revenues within geographic areas:

|                                      | Nine months ended<br>September 30,<br>2016 |             | Three months ended<br>September 30,<br>2016 |             |
|--------------------------------------|--|-------------|---|-------------|
|                                      | (unaudited)                                | (unaudited) | (unaudited)                                 | (unaudited) |
| Revenues based on customer location: |  |             |   |             |
| United States                        | \$ 7,310                                   | \$ 8,335    | \$ 2,144                                    | \$ 3,482    |
| Europe and Middle East               | 7,492                                      | 5,202       | 2,986                                       | 1,590       |
| Asia Pacific (1) (2)                 | 36,655                                     | 29,891      | 12,716                                      | 11,163      |
|                                      | \$ 51,457                                  | \$ 43,428   | \$ 17,846                                   | \$ 16,235   |
| (1) China                            | \$ 23,064                                  | \$ 20,972   | \$ 7,073                                    | \$ 8,423    |
| (2) S. Korea                         | \$ 11,338                                  | \$ *)       | \$ 4,901                                    | \$ 2,131    |

\*) Less than 10%

## b. Major customer data as a percentage of total revenues:

The following table sets forth the customers that represented 10% or more of the Company's total revenues in each of the periods set forth below.

|            | Nine months<br>ended<br>September 30,<br>2016 |             | Three months<br>ended<br>September 30,<br>2016 |             |
|------------|---|-------------|--|-------------|
|            | (unaudited)                                   | (unaudited) | (unaudited)                                    | (unaudited) |
| Customer A | 27%   | 33%         | 27%  | 45%         |

|            |     |    |     |     |
|------------|-----|----|-----|-----|
| Customer B | 19% | *) | 21% | 11% |
| Customer C | *)  | *) | *)  | 13% |

\*) Less than 10%

**NOTE 7: NET INCOME PER SHARE OF COMMON STOCK**

Basic net income per share is computed based on the weighted average number of shares of common stock outstanding during each period. Diluted net income per share is computed based on the weighted average number of shares of common stock outstanding during each period, plus dilutive potential shares of common stock considered outstanding during the period, in accordance with FASB ASC No. 260, Earnings Per Share.

|   | Nine months ended<br>September 30,<br>2016   |          | Three months ended<br>September 30,<br>2016 |          |
|---|--|----------|---|----------|
|   | 2015   | 2015     | 2015  | 2015     |
|   | (unaudited)(unaudited)(unaudited)(unaudited) |          |   |          |
| <b>Numerator:</b>                                 |  |          |   |          |
| Net income  | \$ 7,899                                     | \$ 3,963 | \$ 3,388                                    | \$ 3,309 |
| <b>Denominator (in thousands):</b>                |  |          |   |          |
| Basic weighted-average common stock outstanding   | 20,718                                       | 20,477   | 21,025                                      | 20,448   |
| Effect of stock-based awards                      | 677  | 441      | 858   | 363      |
| Diluted weighted average common stock outstanding | 21,395                                       | 20,918   | 21,883                                      | 20,811   |
| Basic net income per share                        | \$ 0.38                                      | \$ 0.19  | \$ 0.16                                     | \$ 0.16  |
| Diluted net income per share                      | \$ 0.37                                      | \$ 0.19  | \$ 0.15                                     | \$ 0.16  |

**Table of Contents****NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED****(in thousands, except share data)**

The weighted average number of shares related to outstanding equity-based awards excluded from the calculation of diluted net income per share, since their effect was anti-dilutive, was 92,103 and 349,428 shares for the three and nine months ended September 30, 2016, respectively, and 915,898 and 861,491 for the corresponding periods of 2015.

**NOTE 8: COMMON STOCK AND STOCK-BASED COMPENSATION PLANS**

The Company grants stock options and stock appreciation rights ( SARs ) capped with a ceiling to employees and stock options to non-employee directors of the Company and its subsidiaries and provides the right to purchase common stock pursuant to the Company's 2002 employee stock purchase plan to employees of the Company and its subsidiaries. The SAR unit confers the holder the right to stock appreciation over a preset price of the Company's common stock during a specified period of time. When the unit is exercised, the appreciation amount is paid through the issuance of shares of the Company's common stock. The ceiling limits the maximum income for each SAR unit. SARs are considered an equity instrument as it is a net share settled award capped with a ceiling (400% for SAR grants). The options and SARs granted under the Company's stock incentive plans have been granted at the fair market value of the Company's common stock on the grant date. Options and SARs granted to employees under stock incentive plans vest at a rate of 25% of the shares underlying the option after one year and the remaining shares vest in equal portions over the following 36 months, such that all shares are vested after four years. Options granted to non-employee directors vest 25% of the shares underlying the option on each anniversary of the option grant. A summary of the Company's stock option and SARs activities and related information for the nine months ended September 30, 2016, are as follows:

|  | Number of<br>options and<br>SAR units (1) | Weighted<br>average<br>exercise<br>price | Weighted<br>average<br>remaining<br>contractual<br>term | Aggregate<br>intrinsic-value |
|--|---|--|---|------------------------------|
| Outstanding as of December 31, 2015      | 2,406,455                                 | \$ 18.15                                 |   |                              |
| Granted                                  | 66,000                                    | 27.17                                    |   |                              |
| Exercised                                | (940,526)                                 | 16.76                                    |   |                              |
| Forfeited or expired                     | (37,633)                                  | 17.89                                    |   |                              |
| Outstanding as of September 30, 2016 (2) | 1,494,296                                 | \$ 19.42                                 | 4.8   | \$ 23,378,563                |
| Exercisable as of September 30, 2016 (3) | 981,117                                   | \$ 19.97                                 | 4.0   | \$ 14,809,518                |

(1) The SAR units are convertible for a maximum number of shares of the Company's common stock equal to 75% of the SAR units subject to the grant.

- (2) Due to the ceiling imposed on the SAR grants, the outstanding amount equals a maximum of 1,331,360 shares of the Company's common stock issuable upon exercise.
- (3) Due to the ceiling imposed on the SAR grants, the exercisable amount equals a maximum of 895,288 shares of the Company's common stock issuable upon exercise.

As of September 30, 2016, there was \$1,559 of unrecognized compensation expense related to unvested stock options and SARs. This amount is expected to be recognized over a weighted-average period of 1.4 years. To the extent the actual forfeiture rate is different from what the Company has estimated, equity-based compensation related to these awards will be different from the Company's expectations.

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Starting in the second quarter of 2015, the Company granted to employees, including executive officers and non-employee directors, restricted stock units ( RSUs ) under the Company s 2011 Stock Incentive Plan. A RSU award is an agreement to issue shares of the Company s common stock at the time the award or a portion thereof vests. RSUs granted to employees generally vest in three equal annual installments starting on the first anniversary of the grant date. RSUs granted to non-employee directors generally vest in full on the first anniversary of the grant date. The fair value of each RSU is the market value as determined by the closing price of the common stock on the day of grant. The Company recognizes compensation expenses for the value of its RSU awards, based on the straight-line method over the requisite service period of each of the awards, net of estimated forfeitures. A summary of the Company s RSU activities and related information for the nine months ended September 30, 2016, are as follows:

|   | Number of<br>RSUs | Weighted Average<br>Grant-Date<br>Fair Value |
|---|-------------------|--|
| Unvested as of December 31, 2015          | 234,000           | \$ 19.89                                     |
| Granted                                   | 372,617           | 21.51  |
| Vested                                    | (97,640)          | 19.61  |
| Forfeited or expired                      | (15,969)          | 20.12  |
| Unvested as of September 30, 2016         | 493,008           | \$ 21.16                                     |
| Expected to vest after September 30, 2016 | 452,937           | \$ 21.16                                     |

As of September 30, 2016, there was \$8,019 of unrecognized compensation expense related to unvested RSUs. This amount is expected to be recognized over a weighted-average period of 1.6 years. To the extent the actual forfeiture rate is different from what the Company has estimated, equity-based compensation related to these awards will be different from the Company s expectations.

The following table shows the total equity-based compensation expense included in the interim condensed consolidated statements of income:

|                               | Nine months ended<br>September 30, |                     | Three months ended<br>September 30, |                     |
|-------------------------------|------------------------------------|---------------------|-------------------------------------|---------------------|
|                               | 2016<br>(unaudited)                | 2015<br>(unaudited) | 2016<br>(unaudited)                 | 2015<br>(unaudited) |
| Cost of revenue               | \$ 179                             | \$ 111              | \$ 65                               | \$ 34               |
| Research and development, net | 2,162                              | 1,323               | 741                                 | 438                 |
| Sales and marketing           | 681                                | 395                 | 179                                 | 151                 |
| General and administrative    | 1,626                              | 966                 | 580                                 | 496                 |



|   |          |          |          |          |
|---|----------|----------|----------|----------|
| Total equity-based compensation expense | \$ 4,648 | \$ 2,795 | \$ 1,565 | \$ 1,119 |
|---|----------|----------|----------|----------|

The fair value for the Company's stock options and SARs (other than share issuances in connection with the employee stock purchase plan, as detailed below) granted to employees and non-employees directors was estimated using the following assumptions:

|   | Nine months ended<br>September 30, |                     | Three months ended<br>September 30, |                     |
|---|------------------------------------|---------------------|-------------------------------------|---------------------|
|   | 2016<br>(unaudited)                | 2015<br>(unaudited) | 2016<br>(unaudited)                 | 2015<br>(unaudited) |
| Expected dividend yield                   | 0%                                 | 0%                  | 0%                                  | 0%                  |
| Expected volatility                       | 40%-49%                            | 33%-49%             | 40%-49%                             | 35%-49%             |
| Risk-free interest rate                   | 0.5%-1.5%                          | 0.2%-2.4%           | 0.5%-1.5%                           | 0.3%-2.4%           |
| Expected forfeiture (employees)           |                                    | 10%                 |                                     | 10%                 |
| Expected forfeiture (executives)          | 5%                                 | 5%                  | 5%                                  | 5%                  |
| Contractual term of up to                 | 10 Years                           | 10 Years            | 10 Years                            | 10 Years            |
| Suboptimal exercise multiple (employees)  |                                    | 2.1                 |                                     | 2.1                 |
| Suboptimal exercise multiple (executives) | 2.4                                | 2.4                 | 2.4                                 | 2.4                 |

**Table of Contents****NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED****(in thousands, except share data)**

The fair value for rights to purchase shares of common stock under the Company's employee stock purchase plan was estimated on the date of grant using the following assumptions:

|                           | Nine months ended<br>September 30, |                     | Three months ended<br>September 30, |                     |
|---------------------------|------------------------------------|---------------------|-------------------------------------|---------------------|
|                           | 2016<br>(unaudited)                | 2015<br>(unaudited) | 2016<br>(unaudited)                 | 2015<br>(unaudited) |
| Expected dividend yield   | 0%                                 | 0%                  | 0%                                  | 0%                  |
| Expected volatility       | 29%-57%                            | 35%-36%             | 29%-48%                             | 35%-36%             |
| Risk-free interest rate   | 0.3%-0.5%                          | 0.1%-0.3%           | 0.4%-0.5%                           | 0.2%-0.3%           |
| Expected forfeiture       | 0%                                 | 0%                  | 0%                                  | 0%                  |
| Contractual term of up to | 24 months                          | 24 months           | 24 months                           | 24 months           |

**NOTE 9: DERIVATIVES AND HEDGING ACTIVITIES**

The Company follows the requirements of FASB ASC No. 815, Derivatives and Hedging which requires companies to recognize all of their derivative instruments as either assets or liabilities in the statement of financial position at fair value. The accounting for changes in fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging transaction and further, on the type of hedging transaction. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation. Due to the Company's global operations, it is exposed to foreign currency exchange rate fluctuations in the normal course of its business. The Company's treasury policy allows it to offset the risks associated with the effects of certain foreign currency exposures through the purchase of foreign exchange forward or option contracts ( Hedging Contracts ). The policy, however, prohibits the Company from speculating on such Hedging Contracts for profit. To protect against the increase in value of forecasted foreign currency cash flow resulting from salaries paid in currencies other than the U.S. dollar during the year, the Company instituted a foreign currency cash flow hedging program. The Company hedges portions of the anticipated payroll of its non-U.S. employees denominated in the currencies other than the U.S. dollar for a period of one to twelve months with Hedging Contracts. Accordingly, when the dollar strengthens against the foreign currencies, the decline in present value of future foreign currency expenses is offset by losses in the fair value of the Hedging Contracts. Conversely, when the dollar weakens, the increase in the present value of future foreign currency expenses is offset by gains in the fair value of the Hedging Contracts. These Hedging Contracts are designated as cash flow hedges.

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 (loss) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Any gain or loss on a derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item

is recognized in current earnings during the period of change. As of September 30, 2016 and December 31, 2015, the notional principal amount of the Hedging Contracts to sell U.S. dollars held by the Company was \$2,550 and \$3,200, respectively.

The fair value of the Company's outstanding derivative instruments is as follows:

|  | September 30,<br>2016<br>(Unaudited) | December 31,<br>2015<br>(Audited) |
|--|--------------------------------------|-----------------------------------|
| <b>Derivative assets:</b>                                |                                      |                                   |
| Derivatives designated as cash flow hedging instruments: |                                      |                                   |
| Foreign exchange option contracts                        | \$ 48                                | \$                                |
| Foreign exchange forward contracts                       |                                      | 9                                 |
| <b>Total</b>   | <b>\$ 48</b>                         | <b>\$ 9</b>                       |
| <b>Derivative liabilities:</b>                           |                                      |                                   |
| Derivatives designated as cash flow hedging instruments: |                                      |                                   |
| Foreign exchange forward contracts                       | \$ 12                                | \$                                |

Table of ContentsNOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(in thousands, except share data)

The Company recorded the fair value of derivative assets in prepaid expenses and other current assets and the fair value of derivative liabilities in accrued expenses and other payables on the Company's interim condensed consolidated balance sheets.

The increase (decrease) in unrealized gains (losses) recognized in accumulated other comprehensive income (loss) on derivatives, before tax effect, is as follows:

|  | Nine months<br>ended<br>September 30,<br>2016 |             | Three months<br>ended<br>September 30,<br>2016 |             |
|--|---|-------------|--|-------------|
|  | 2015  | 2015        | 2015   | 2015        |
|  | (unaudited)                                   | (unaudited) | (unaudited)                                    | (unaudited) |
| Derivatives designated as cash flow hedging instruments: |   |             |  |             |
| Foreign exchange option contracts                        | \$ 118  | \$ 61       | \$ 44  | \$ (151)    |
| Foreign exchange forward contracts                       | 100   | 76          | 31   | 13          |
|  | \$ 218  | \$ 137      | \$ 75  | \$ (138)    |

The net (gains) losses reclassified from accumulated other comprehensive income (loss) into income are as follows:

|  | Nine months<br>ended<br>September 30,<br>2016 |             | Three months<br>ended<br>September 30,<br>2016 |             |
|--|---|-------------|--|-------------|
|  | 2015  | 2015        | 2015   | 2015        |
|  | (unaudited)                                   | (unaudited) | (unaudited)                                    | (unaudited) |
| Derivatives designated as cash flow hedging instruments: |   |             |  |             |
| Foreign exchange option contracts                        | \$ (70)                                       | \$ (5)      | \$ (21)  | \$ (64)     |
| Foreign exchange forward contracts                       | (121)   | (53)        | (48)   | 5           |
|  | \$ (191)                                      | \$ (58)     | \$ (69)  | \$ (59)     |

The Company recorded in cost of revenues and operating expenses a net gain of \$69 and \$191 during the three and nine months ended September 30, 2016, respectively, and a net gain of \$59 and \$58 for the comparable periods of 2015, related to its Hedging Contracts.

Table of ContentsNOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(in thousands, except share data)

**NOTE 10: ACCUMULATED OTHER COMPREHENSIVE INCOME**

The following tables summarize the changes in accumulated balances of other comprehensive income (loss), net of taxes:

|   | Nine months ended September 30, 2016<br>(unaudited)                   |   |          | Nine months ended September 30, 2015<br>(unaudited)                   |   |        |
|---|---|---|----------|---|---|--------|
|   | Unrealized gains (losses) on available-for-sale marketable securities | Unrealized gains (losses) on cash flow hedges | Total    | Unrealized gains (losses) on available-for-sale marketable securities | Unrealized gains (losses) on cash flow hedges | Total  |
| Beginning balance   | \$ (427)  | \$ 8  | \$ (419) | \$ (32)   | \$ 26   | \$ (6) |
| Other comprehensive income before reclassifications                     | 416   | 194   | 610      | 34  | 66  | 100    |
| Amounts reclassified from accumulated other comprehensive income (loss) | 13  | (171)   | (158)    |   | (61)  | (61)   |
| Net current period other comprehensive income                           | 429   | 23  | 452      | 34  | 5   | 39     |
| Ending balance  | \$ 2  | \$ 31   | \$ 33    | \$ 2  | \$ 31   | \$ 33  |

|  | Nine months ended September 30, 2015<br>(unaudited)                   |   |          | Three months ended September 30, 2015<br>(unaudited)                  |   |          |
|--|---|---|----------|---|---|----------|
|  | Unrealized gains (losses) on available-for-sale marketable securities | Unrealized gains (losses) on cash flow hedges | Total    | Unrealized gains (losses) on available-for-sale marketable securities | Unrealized gains (losses) on cash flow hedges | Total    |
| Beginning balance  | \$ (379)  | \$ (57)                                       | \$ (436) | \$ (327)  | \$ 188  | \$ (139) |
| Other comprehensive income (loss) before reclassifications | (26)  | 121   | 95       | (39)  | (123)   | (162)    |

|   |          |       |          |          |       |          |
|---|----------|-------|----------|----------|-------|----------|
| Amounts reclassified from accumulated other comprehensive income (loss) | 67       | (51)  | 16       | 28       | (52)  | (24)     |
| Net current period other comprehensive income (loss)                    | 41       | 70    | 111      | (11)     | (175) | (186)    |
| Ending balance  | \$ (338) | \$ 13 | \$ (325) | \$ (338) | \$ 13 | \$ (325) |

The following table provides details about reclassifications out of accumulated other comprehensive income:

| Details about Accumulated Other Comprehensive Income Components | Amount Reclassified from Accumulated Other Comprehensive Income |             |                                       |             | Affected Line Item in the Statements of Income |
|---|---|-------------|---------------------------------------|-------------|--|
|   | Nine months ended September 30, 2016                            |             | Three months ended September 30, 2015 |             |  |
|   | (unaudited)   | (unaudited) | (unaudited)                           | (unaudited) |  |
| Unrealized gains on cash flow hedges                            | \$ 4  | \$ (1)      | \$ 2                                  | \$ (1)      | Cost of revenues                               |
|   | 160   | 52          | 57                                    | 53          | Research and development                       |
|   | 13  | 2           | 5                                     | 2           | Sales and marketing                            |
|   | 14  | 5           | 5                                     | 5           | General and administrative                     |
|   | 191   | 58          | 69                                    | 59          | Total, before income taxes                     |
|   | 20  | 7           | 8                                     | 7           | Income tax expense                             |
|   | 171   | 51          | 61                                    | 52          | Total, net of income taxes                     |
| Unrealized losses on available-for-sale marketable securities   | (16)  | (74)        |                                       | (28)        | Financial income (loss), net                   |
|   | (3)   | (7)         |                                       |             | Income tax benefit                             |
|   | (13)  | (67)        |                                       | (28)        | Total, net of income taxes                     |
|   | \$ 158  | \$ (16)     | \$ 61                                 | \$ 24       | Total, net of income taxes                     |

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**Table of Contents****NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED****(in thousands, except share data)****NOTE 11: SHARE REPURCHASE PROGRAM**

The Company did not repurchase shares of common stock during the third quarter of 2016. During the third quarter of 2015, the Company repurchased 158,570 shares of common stock at an average purchase price of \$17.74 per share for an aggregate purchase price of \$2,813. During the first nine months ended September 30, 2016, the Company repurchased 180,013 shares of common stock at an average purchase price of \$18.98 per share for an aggregate purchase price of \$3,417. During the first nine months ended September 30, 2015, the Company repurchased 428,590 shares of common stock at an average purchase price of \$19.03 per share for an aggregate purchase price of \$8,156. As of September 30, 2016, 311,056 shares of common stock remained available for repurchase pursuant to the Company's share repurchase program.

The repurchases of common stock are accounted for as treasury stock, and result in a reduction of stockholders' equity. When treasury shares are reissued, the Company accounts for the reissuance in accordance with FASB ASC No. 505-30, Treasury Stock, and charges the excess of the repurchase cost over issuance price using the weighted average method to retained earnings. The purchase cost is calculated based on the specific identified method. In the case where the repurchase cost over issuance price using the weighted average method is lower than the issuance price, the Company credits the difference to additional paid-in capital.

**NOTE 12: UNDISTRIBUTED EARNINGS OF THE COMPANY'S FOREIGN SUBSIDIARIES**

The Company does not have a provision for U.S. Federal income taxes on the undistributed earnings of its international subsidiaries because such earnings are considered to be indefinitely reinvested. It would recognize a deferred income tax liability if it was determined that such earnings are no longer indefinitely reinvested. At September 30, 2016, undistributed earnings of the Company's foreign subsidiaries amounted to approximately \$138,340. The determination of the amount of additional taxes related to the distribution of these earnings is not practicable.

**NOTE 13: IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS NOT YET ADOPTED**

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers. Under this guidance, revenue is recognized when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. The updated standard will replace most existing revenue recognition guidance under GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. As currently issued and amended, ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, although early adoption is permitted for annual reporting periods beginning after December 15, 2016. The Company is currently evaluating the effect that the updated standard will have on its consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which will replace the existing guidance in ASC 840, Leases. The updated standard aims to increase transparency and comparability among organizations by

requiring lessees to recognize lease assets and lease liabilities on the balance sheet and requiring disclosure of key information about leasing arrangements. This ASU is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods; early adoption is permitted and modified retrospective application is required. The Company is in the process of evaluating this guidance to determine the impact it will have on its financial statements and related disclosures.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which clarifies the implementation guidance on principal versus agent considerations under the new revenue recognition standard, ASU 2014-09. In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, which clarifies the implementation guidance on identifying promised goods or services from a principal and agent perspective. The Company will adopt the standard effective January 1, 2018. The Company is continuing to evaluate the full effect that ASU 2014-09 and related subsequent updates will have on its consolidated financial statements and related disclosures.



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**Table of Contents****NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED****(in thousands, except share data)**

In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation, which simplifies several aspects of the accounting for share-based payments, including immediate recognition of all excess tax benefits and deficiencies in the income statement, changing the threshold to qualify for equity classification up to the employees maximum statutory tax rates, allowing an entity-wide accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures as they occur, and clarifying the classification on the statement of cash flows for the excess tax benefit and employee taxes paid when an employer withholds shares for tax-withholding purposes. The Company is evaluating the full effect that ASU 2016-09 will have on its consolidated financial statements and related disclosures and will adopt the standard effective January 1, 2017.

In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606). ASU 2016-10 amends ASC 606, Revenue from Contracts with Customers, to clarify two aspects of ASC 606, identifying performance obligations and the licensing implementation guidance, while retaining the related principles of those areas. The amendments in ASU 2016-10 do not change the core principle of the guidance in ASC 606. The amendments in ASU No. 2016-10 affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in ASU No. 2016-10 are the same as the effective date and transition requirements in ASC 606 and any other topic amended by ASU 2014-09. ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, defers the effective date of ASU 2014-09 by one year to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The Company is currently evaluating the effect that the adoption of ASU 2016-10 will have on its financial statements and related disclosures.

In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606). ASU 2016-12 amends ASC 606 to address certain issues in the guidance on assessing collectability, presentation of sales taxes, noncash consideration, and completed contracts and contract modifications at transition. The amendments in ASU 2016-12 do not change the core principle of the guidance in ASC 606. The amendments in ASU No. 2016-12 affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in ASU No. 2016-12 are the same as the effective date and transition requirements in ASC 606 and any other topic amended by ASU 2014-09. ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, defers the effective date of ASU 2014-09 by one year to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The Company is currently evaluating the effect that the adoption of ASU 2016-12 will have on its financial statements and related disclosures.

The FASB issued ASU 2016-13 Measurement of Credit Losses on Financial Instruments requiring an allowance to be recorded for all expected credit losses for financial assets. The allowance for credit losses is based on historical information, current conditions and reasonable and supportable forecasts. The new standard also makes revisions to the other than temporary impairment model for available-for-sale debt securities. Disclosures of credit quality indicators in relation to the amortized cost of financing receivables are further disaggregated by year of origination. The new accounting guidance is effective for interim and annual periods beginning after December 15, 2019 with early adoption permitted for interim and annual periods beginning after December 15, 2018. The amendments will be applied through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. The Company is analyzing the impact of this new standard and, at this time, cannot

estimate the impact of adoption on its net income. The Company plans to adopt ASU 2016-13 effective January 1, 2020.

In August 2016, FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This update will make eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. The update is effective for fiscal years beginning after December 15, 2017. The new standard will require adoption on a retrospective basis unless it is impracticable to apply, in which case it would be required to apply the amendments prospectively as of the earliest date practicable. The Company is currently evaluating the effect of this update on its financial statements and related disclosures.

**Table of Contents****Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read the following discussion together with the unaudited financial statements and related notes appearing elsewhere in this quarterly report. This discussion contains forward-looking statements that involve risks and uncertainties. Any or all of our forward-looking statements in this quarterly report may turn out to be wrong. These forward-looking statements can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. Factors which could cause actual results to differ materially include those set forth under in Part II Item 1A Risk Factors, as well as those discussed elsewhere in this quarterly report. See Forward-Looking Statements.*

**BUSINESS OVERVIEW**

The financial information presented in this quarterly report includes the results of CEVA, Inc. and its subsidiaries.

CEVA is a leading licensor of signal processing IP for a smarter, connected world. We partner with semiconductor companies and OEMs worldwide to create power-efficient, intelligent and connected devices for a range of end markets, including mobile, consumer, automotive, industrial and IoT. Our ultra-low-power IPs for vision, audio, communications and connectivity include comprehensive DSP-based platforms for LTE/LTE-A/5G baseband processing in handsets, base station and cellular IoT, computer vision/machine learning and computational photography for any camera-enabled devices, as well as audio/voice and ultra-low power always-on/sensing applications for multiple IoT markets. For connectivity, we offer the industry's most widely adopted IPs for Bluetooth (low energy and dual mode), Wi-Fi (802.11 a/b/g/n/ac up to 4x4) and serial storage (SATA and SAS). Our technologies are widely licensed and power many of the world's leading semiconductor and original equipment manufacturer (OEM) companies. One in three handsets sold worldwide is powered by CEVA. To date, more than 7 billion CEVA-powered devices have shipped, illustrating the strong market deployment of our technology.

Our DSPs power many leading handset OEMs in the world today, including Coolpad, HTC, Huawei, Intex, Karbonn, Lava, Lenovo, LG, Meizu, Micromax, OPPO, Samsung, Vivo, Xiaomi, ZTE and a tier-one U.S. brand, as well as hundreds of local handset manufacturers in China and India. Based on internal data and Strategy Analytics' provisional worldwide shipment data, CEVA's worldwide market share of handset baseband chips that incorporate our technologies was approximately 36% of the worldwide shipment volume in the second quarter of 2016.

In July 2014, we acquired RivieraWaves SAS (RivieraWaves), a privately-held, French company and a leading provider of wireless connectivity intellectual property for Wi-Fi and Bluetooth technologies. We agreed to pay an aggregate of \$18,378,000 to acquire RivieraWaves with \$14,678,000 paid at the closing of the acquisition and the remaining amount of \$3,700,000 payable upon the satisfaction of certain milestones (the Contingent Consideration). During 2015, we fully paid the Contingent Consideration. In addition, in connection with the acquisition, we established an employee retention plan for RivieraWaves' employees at an expense of approximately \$3,400,000, payable on a semi-annual basis for a period of two years after the closing of the acquisition. As of September 30, 2016, we fully paid the employee retention plan expenses.

We believe the adoption of our signal processing IP cores and software for smart, connected devices continues to progress. Devices for such markets include smartphones, tablets, smart home appliances, wearables, surveillance, connected car, drones, robots, industrial and medical equipment. During the third quarter of 2016, we concluded thirteen licensing deals, four of which were for our CEVA DSP cores, platforms and software and eight for our connectivity IPs. These customers will incorporate our technology into virtual and augmented reality devices, voice

processors, 5G mobile broadband baseband into handsets and a variety of Bluetooth-connected IoT devices. In addition to the deals outlined, we also signed our first portfolio licensing agreement with a major semiconductor company that covers our off-the-shelf range of baseband, vision, audio and connectivity IPs. We believe that this business model may be extended to other tier one customers who are looking for a one stop shop for technologies that are at the center of every smart and connected device.

We believe the following key elements represent significant growth drivers for the company:

CEVA is firmly established in the largest space in the semiconductor industry baseband for mobile handsets. In particular, our presence in the 3G & LTE smartphone markets continue to grow as our customers targeting those markets are gaining market share at the expense of the incumbents. As a testament to this, in the third quarter of 2016, we reported 52 million LTE chipsets shipped, which equates to 14% market share of the LTE devices sold worldwide in the second quarter of 2016. Moreover, we anticipate that the total number of LTE devices powered by our DSPs that we will report in 2016 will exceed the 200 million target that we set earlier in the year. The royalty we derive from smartphones is higher on average than that of feature phones, so we are set to benefit as handset markets around the world continue to transition and shift away from feature phones to smartphones, in particular in emerging economies.

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Our specialization and competitive edge in digital signal processor technologies for next generation LTE, 5G and Wi-Fi technologies in base stations, and the inherent low cost and power performance balance of our technologies, put us in a strong position to simultaneously capitalize on mass market adoption of such technologies and address multiple market and product sectors, including small cells, macrocells, routers and machine-to-machine.

Together with our presence in the baseband market, RivieraWaves Bluetooth and Wi-Fi IPs allow us to expand further into Internet-of-Things applications and substantially increase our overall addressable market. Our addressable market size is expected to be 35 billion devices by 2020, per recent data from ABI Research. Already, shipments of products incorporating our Bluetooth IP are sizeable, with more than 38 million CEVA-powered Bluetooth chips reported by our customers in the third quarter of 2016.

The market potential for intelligent audio processing required, as voice is becoming the primary user interface for IoT applications, including mobile, automotive and consumer devices, offers an additional growth segment for the company. Our proven track record in audio/voice, with more than 5 billion audio chips shipped to date, puts us in a strong position to power audio roadmaps across this new range of addressable end markets.

The market potential for machine learning and deep networks for camera-related use cases in automotive, mobile, consumer and IoT applications offers another growth segment for the company. Our CEVA-XM4 intelligent vision processor and our new CEVA-XM6 vision processor and platform for deep learning provide highly compelling offerings for any camera-enabled device such as smartphones, tablets, automotive safety (ADAS), drones, robotics, security and surveillance, augmented reality (AR) and virtual reality (VR), drones, and signage. Per ABI Research, camera shipments are expected to exceed 2.7 billion units by 2018. We have already signed more than 25 licensing agreements for our imaging and vision DSPs across those markets, where our customers can add camera-related enhancements such as smarter autofocus, better picture using super resolution algorithms, and better image capture in low-light environments. Other customers can add video analytics support to enable new services like augmented reality, gesture recognition and advanced safety capabilities in cars. This revolution in vision processing is an opportunity for us to expand our footprint in smartphones and further into tablets, drones, surveillance and automotive applications.

As a result of our diversification strategy beyond baseband for handsets and our progress in addressing these new markets under the umbrella of the Internet-of-Things, we expect significant growth in our unit shipments for non-handset baseband applications over the next few years, up from approximately 167 million royalty-bearing units annually in 2015 to 200 million in 2016 and 700 to 900 million units annually by 2018. This will be in addition to our existing handset baseband business, which we believe will continue to be a significant growth driver for us.

Notwithstanding the various growth opportunities we have outlined above, our business operates in a highly competitive and cyclical environment. The maintenance of our competitive position and our future growth are dependent on our ability to adapt to ever-changing technologies, short product life cycles, evolving industry standards, changing customer needs and the trend towards Internet-of-Things, handset baseband, connectivity, and voice, audio and video convergence in the markets that we operate. Also, our business relies significantly on revenues derived from a limited number of customers. The discontinuation of product lines or market sectors that incorporate our technology

by our significant customers or a change in direction of their business and our inability to adapt our technology to their new business needs could have material negative implications for our future royalty revenues. Moreover, competition has historically increased pricing pressures for our products and decreased our average selling prices. Royalty payments under our existing license agreements also could be lower than currently anticipated for a variety of reasons, including decreased royalty rates triggered by larger volume shipments, lower royalty rates negotiated with customers due to competitive pressure or consolidation among our customers. Some of our competitors have reduced their licensing and royalty fees to attract customers and expand their market share. In order to penetrate new markets and maintain our market share with our existing products, we may need to offer our products in the future at lower prices which may result in lower profits. In addition, our future growth is dependent not only on the continued success of our existing products but also the successful introduction of new products, which requires the dedication of resources into research and development which in turn may increase our operating expenses. Furthermore, since our products are incorporated into end products of our OEM and semiconductor customers, our business is very dependent on their ability to achieve market acceptance of their end products in the handset and consumer electronic markets, which are similarly very competitive. In addition, macroeconomic trends may significantly affect our operating results. For example, consolidation among our customers may negatively affect our revenue source, increase our existing customers' negotiation leverage and make us more dependent on a limited number of customers. Also, since we derive a significant portion of our revenues from the baseband handset market, any negative trends in that market would adversely affect our financial results.

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Moreover, the semiconductor and consumer electronics industries remain volatile, which makes it extremely difficult for our customers and us to accurately forecast financial results and plan for future business activities. Our license arrangements have not historically provided for substantial ongoing license payments so revenue recognized from licensing arrangements vary significantly from period to period, depending on the number and size of deals closed during a quarter, and is difficult to predict. Moreover, our royalty revenues are based on the sales of products incorporating the semiconductors or other products of our customers, and as a result we do not have direct access to information that will help us anticipate the timing and amount of future royalties. We have very little visibility into the timetable of product shipments incorporating our technology by our customers. As a result, our past operating results should not be relied upon as an indication of future results.

**RESULTS OF OPERATIONS***Total Revenues*

Total revenues were \$17.8 million and \$51.5 million for the third quarter and first nine months of 2016, respectively, representing an increase of 10% and 18%, respectively, as compared to the corresponding periods in 2015.

Five largest customers accounted for 65% and 64% of our total revenues for the third quarter and first nine months of 2016, respectively, as compared to 76% and 57% for the comparable periods in 2015. Two customers accounted for 27% and 21% of our total revenues for the third quarter of 2016, as compared to three customers that accounted for 45%, 11% and 13% of our total revenues for the third quarter of 2015. Two customers accounted for 27% and 19% of our total revenues for the first nine months of 2016, as compared to one customer that accounted for 33% of our total revenues for the first nine months of 2015. Sales to Spreadtrum represented 27% of our total revenues for both the third quarter and first nine months of 2016, as compared to 45% and 33% for the comparable periods in 2015. Generally, the identity of our other customers representing 10% or more of our total revenues varies from period to period, especially with respect to our licensing customers as we generate licensing revenues generally from new customers on a quarterly basis. With respect to our royalty revenues, three royalty paying customers each represented 10% or more of our total royalty revenues for the third quarter of 2016, and collectively represented 86% of our total royalty revenues for the third quarter of 2016. Two royalty paying customers each represented 10% or more of our total royalty revenues for the first nine months of 2016, and collectively represented 81% of our total royalty revenues for the first nine months of 2016. Two royalty paying customers each represented 10% or more of our total royalty revenues for both the third quarter and first nine months of 2015, and collectively represented 72% and 71% of our total royalty revenues for the third quarter and first nine months of 2015, respectively. We expect that a significant portion of our future revenues will continue to be generated by a limited number of customers. The concentration of our customers is explainable in part by consolidation in the semiconductor industry.

The following table sets forth the products and services as percentages of our total revenues for each of the periods set forth below:

|  | <b>Nine months<br/>2016</b> | <b>Nine months<br/>2015</b> | <b>Third Quarter<br/>2016</b> | <b>Third Quarter<br/>2015</b> |
|--|-----------------------------|-----------------------------|-------------------------------|-------------------------------|
| DSP products (DSP cores and platforms):              |                             |                             |                               |                               |
| Baseband for handset and other devices               | 66%                         | 68%                         | 65%                           | 80%                           |
| Other non-baseband (audio, imaging and vision)       | 15%                         | 12%                         | 14%                           | 6%                            |
| Connectivity products (Bluetooth, WiFi and SATA/SAS) | 19%                         | 20%                         | 21%                           | 14%                           |

We expect to continue to generate a significant portion of our revenues for 2016 from the above products and services.

*Licensing and Related Revenues*

Licensing and related revenues were \$7.5 million and \$23.6 million for the third quarter and first nine months of 2016, respectively, representing a decrease of 13% and 2%, respectively, as compared to the corresponding periods in 2015. The decrease in licensing and related revenues for both the third quarter and first nine months of 2016 is explained by lower revenues from the handset baseband markets, partially offset by good licensing demand and greater number of deals for our connectivity IPs, in particular Bluetooth IPs and our vision-related products. Overall, we continue to experience in 2016, similar to 2015, a strong licensing environment for our products.

Licensing and related revenues accounted for 42% and 46% of our total revenues for the third quarter and first nine months of 2016, respectively, compared to 53% and 56% for the comparable periods of 2015. During the third quarter of 2016, we concluded 13 new licensing deals. Of the 13 new licensing deals completed during the quarter, six were with first time customers, and 10 were for non-handset baseband applications. Four of the agreements were for CEVA DSP cores, platforms and software, eight were for CEVA connectivity IPs and one was a portfolio license agreement. Target applications for customer deployment are 5G handset basebands, vision processing surveillance cameras and 3D consumer products, and Bluetooth, including the upcoming new standard BT5 and Wi-Fi connectivity for various IoT devices. Geographically, four of the deals concluded were in the U.S, seven were in the Asia Pacific region and two were in Europe. Our licensing business is progressing in line with our expectations with a good pipeline and diverse customer base and target markets.



**Table of Contents***Royalty Revenues*

Royalty revenues were \$10.4 million and \$27.9 million for the third quarter and first nine months of 2016, respectively, representing an increase of 36% and 44%, respectively, as compared to the corresponding periods in 2015. Royalty revenues accounted for 58% and 54% of our total revenues for the third quarter and first nine months of 2016, respectively, as compared to 47% and 44% for the comparable periods of 2015. The increase in royalty revenues for the third quarter and first nine months of 2016 reflects an exceptional royalty revenue growth from smartphones in general and LTE shipments in particular. The growth of LTE baseband shipments powered by our DSPs has accelerated noticeably both in high tier premium phones as well as lower cost LTE smartphones, reaching 52 million devices reported in the third quarter of 2016 and overall 143 million in the first three quarters of 2016.

Our customers reported sales of 270 million and 726 million chipsets incorporating our technologies for the third quarter and first nine months of 2016, respectively, as compared to 225 million and 664 million for the comparable periods of 2015. Of these volumes, 52 million and 131 million were attributed to non-handset baseband for the third quarter and first nine months of 2016, respectively, as compared to 46 million and 117 million for the comparable periods of 2015. The volume increase in chipset sales in both the third quarter and first nine months of 2016 is attributable to a significant increase in smartphone baseband chip shipments, including LTE baseband chips (which also bear higher average selling prices than the 2G feature phone baseband products), partially offset by lower feature phone baseband chip shipments.

The five largest royalty-paying customers accounted for 94% and 92% of our total royalty revenues for the third quarter and first nine months of 2016, respectively, as compared to 88% and 87% for the comparable periods of 2015.

*Geographic Revenue Analysis*

|                        | Nine months<br>2016               |     | Nine months<br>2015 |     | Third Quarter<br>2016             |     | Third Quarter<br>2015 |     |
|------------------------|-----------------------------------|-----|---------------------|-----|-----------------------------------|-----|-----------------------|-----|
|                        | (in millions, except percentages) |     |                     |     | (in millions, except percentages) |     |                       |     |
| United States          | \$ 7.3                            | 14% | \$ 8.3              | 19% | \$ 2.1                            | 12% | \$ 3.4                | 21% |
| Europe and Middle East | \$ 7.5                            | 15% | \$ 5.2              | 12% | \$ 3.0                            | 17% | \$ 1.6                | 10% |
| Asia Pacific (1) (2)   | \$ 36.7                           | 71% | \$ 29.9             | 69% | \$ 12.7                           | 71% | \$ 11.2               | 69% |
| (1) China              | \$ 23.1                           | 45% | \$ 21.0             | 48% | \$ 7.1                            | 40% | \$ 8.4                | 52% |
| (2) S. Korea           | \$ 11.3                           | 22% | \$ *)               | *)  | \$ 4.9                            | 27% | \$ 2.1                | 13% |

\*) Less than 10%

Due to the nature of our license agreements and the associated potential large individual contract amounts, the geographic split of revenues both in absolute dollars and percentage terms generally varies from quarter to quarter.

*Cost of Revenues*

Cost of revenues were \$1.4 million and \$4.5 million for the third quarter and first nine months of 2016, respectively, as compared to \$1.3 million and \$4.0 million for the comparable periods of 2015. Cost of revenues accounted for 8% and 9% of our total revenues for the third quarter and first nine months of 2016, respectively, as compared to 8% and 9% for the comparable periods of 2015. The increase for the third quarter of 2016 principally reflected higher

customization work for our licensees. The increase for the first nine months of 2016 principally reflected higher customization work for our licensees and higher payments to the Office of the Chief Scientist of Israel (the OCS ). Included in cost of revenues for the third quarter and first nine months of 2016 was a non-cash equity-based compensation expense of \$65,000 and \$179,000, respectively, as compared to \$34,000 and \$111,000 for the comparable periods of 2015.

*Gross Margin*

Gross margin for the third quarter and first nine months of both 2016 and 2015 was 92% and 91%, respectively.

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**Table of Contents***Operating Expenses*

Total operating expenses were \$12.6 million and \$38.7 million for the third quarter and first nine months of 2016, respectively, as compared to \$11.5 million and \$35.3 million for the comparable periods of 2015. The net increase in total operating expenses for the third quarter of 2016 principally reflected higher salary and related costs mainly due to higher headcount, higher project-related expenses, higher commission costs and higher non-cash equity-based compensation expenses, partially offset by higher research grants received from the OCS. The net increase in total operating expenses for the first nine months of 2016 principally reflected higher salary and related costs mainly due to higher headcount, higher project-related expenses and higher non-cash equity-based compensation expenses, partially offset by higher research grants received from the OCS.

*Research and Development Expenses, Net*

Our research and development expenses, net, were \$7.3 million and \$23.1 million for the third quarter and first nine months of 2016, respectively, as compared to \$6.6 million and \$21.2 million for the comparable periods of 2015. The net increase for both the third quarter and first nine months of 2016 principally reflected higher salary and related costs mainly due to higher headcount, higher project-related expenses and higher non-cash equity-based compensation expenses, partially offset by higher research grants received from the OCS. Included in research and development expenses for the third quarter and first nine months of 2016 were non-cash equity-based compensation expenses of \$741,000 and \$2,162,000, respectively, as compared to \$438,000 and \$1,323,000 for the comparable periods of 2015. Research and development expenses as a percentage of our total revenues were 41% and 45% for the third quarter and first nine months of 2016, respectively, as compared to 40% and 49% for the comparable periods of 2015.

The number of research and development personnel was 202 at September 30, 2016, compared to 181 at September 30, 2015.

*Sales and Marketing Expenses*

Our sales and marketing expenses were \$2.8 million and \$8.5 million for the third quarter and first nine months of 2016, respectively, as compared to \$2.4 million and \$7.4 million for the comparable periods of 2015. The net increase for the third quarter of 2016 primarily reflected higher commission costs. The net increase for the first nine months of 2016 primarily reflected higher salary and related costs, higher commission costs, higher travel costs, higher marketing costs and higher non-cash equity-based compensation expenses. Included in sales and marketing expenses for the third quarter and first nine months of 2016 were non-cash equity-based compensation expenses of \$179,000 and \$681,000, respectively, as compared to \$151,000 and \$395,000 for the comparable periods of 2015. Sales and marketing expenses as a percentage of our total revenues were 15% and 16% for the third quarter and first nine months of 2016, respectively, as compared to 15% and 17% for the comparable periods of 2015.

The total number of sales and marketing personnel was 34 at September 30, 2016, compared to 32 at September 30, 2015.

*General and Administrative Expenses*

Our general and administrative expenses were \$2.2 million and \$6.3 million for the third quarter and first nine months of 2016, respectively, as compared to \$2.2 million and \$5.8 million for the comparable periods of 2015. The net increase for the first nine months of 2016 primarily reflected higher non-cash equity-based compensation expenses, partially offset by lower professional services costs. Included in general and administrative expenses for the third quarter and first nine months of 2016 were non-cash equity-based compensation expenses of \$580,000 and

\$1,626,000, respectively, as compared to \$496,000 and \$966,000 for the comparable periods of 2015. General and administrative expenses as a percentage of our total revenues were 12% for both the third quarter and first nine months of 2016, as compared to 13% for both the comparable periods of 2015.

The number of general and administrative personnel was 24 at September 30, 2016, compared to 22 at September 30, 2015.

*Amortization of intangible assets*

Our amortization charges were \$0.3 million and \$0.9 million for the third quarter and first nine months of 2016, respectively, as compared to \$0.3 million and \$1.0 million for the comparable periods of 2015. The charges were incurred in connection with the amortization of intangible assets associated with the acquisition of RivieraWaves in July 2014. As of September 30, 2016, the net amount of intangible assets was \$3.3 million.

**Table of Contents****Financial Income, Net (in millions)**

|   | Nine months<br>2016 | Nine months<br>2015 | Third Quarter<br>2016 | Third Quarter<br>2015 |
|---|---------------------|---------------------|-----------------------|-----------------------|
| <b>Financial income, net</b>  | \$ 1.62             | \$ 0.64             | \$ 0.62               | \$ 0.40               |
| <i>of which:</i>  |                     |                     |                       |                       |
| Interest income and gains and losses<br>from marketable securities, net | \$ 1.65             | \$ 1.19             | \$ 0.63               | \$ 0.40               |
| Foreign exchange loss   | \$ (0.03)           | \$ (0.45)           | \$ (0.01)             | \$                    |
| Accretion of Contingent Consideration                                   | \$                  | \$ (0.10)           | \$                    | \$                    |

Financial income, net, consists of interest earned on investments, gains and losses from sale of marketable securities, accretion (amortization) of discounts (premiums) on marketable securities, foreign exchange movements and changes in fair value related to contingent consideration as part of the acquisition of RivieraWaves.

The increase in interest income and gains and losses from marketable securities, net, during both the third quarter and first nine months of 2016 principally reflected higher combined cash, bank deposits and marketable securities balances held and higher yields.

We review our monthly expected major non-U.S. dollar denominated expenditures and look to hold equivalent non-U.S. dollar cash balances to mitigate currency fluctuations. However, our Euro cash balances increased significantly beyond our ordinary course Euro business liabilities as a result of the acquisition of RivieraWaves in July 2014 because we acquired cash balances of RivieraWaves on hand at the time of the closing of the transaction. This has resulted in an increase in foreign exchange loss during the first nine months of 2015 due to the devaluation of our Euro cash balances as the U.S. dollar strengthened significantly during this period as compared to the Euro.

**Provision for Income Taxes**

Our income tax expenses were \$1.0 million and \$2.0 million for the third quarter and first nine months of 2016, respectively, as compared to \$0.6 million and \$0.8 million for the comparable periods of 2015. The increase for both the third quarter and first nine months of 2016 primarily reflected: (1) higher income before taxes on income; (2) tax expenses relating to an uncertain tax position for prior years; and (3) lower tax benefit as a result of a higher valuation allowance on deferred tax assets of certain foreign subsidiaries. Currently, our Israeli and Irish subsidiaries are taxed at rates substantially lower than U.S. tax rates.

Our Irish subsidiary qualified for a 12.5% tax rate on its trade. Interest income generated by our Irish subsidiary is taxed at a rate of 25%. Our French subsidiary qualified for a 33.3% tax rate on its profits.

Our Israeli subsidiary is entitled to various tax benefits by virtue of the Approved Enterprise and/or Benefited Enterprise status granted to its eight investment programs, as defined by the Israeli Investment Law. In accordance with the Investment Law, our Israeli subsidiary's first six investment programs were subject to corporate tax rate of 25% for the first nine months of 2016, and our Israeli subsidiary's seventh and eighth investment programs were subject to corporate tax rate of 10% for the first nine months of 2016. However, our Israeli subsidiary received an approval for the erosion of tax basis with respect to its second, third, fourth, fifth and sixth investment programs, and this resulted in an increase in the taxable income attributable to the seventh and eighth investment programs, which were subject to a reduced tax rate of 10% for the first nine months of 2016. The tax benefits under our Israeli subsidiary's active investment programs are scheduled to gradually expire starting in 2017.

To maintain our Israeli subsidiary's eligibility for the above tax benefits, it must continue to meet certain conditions under the Investment Law. Should our Israeli subsidiary fail to meet such conditions in the future, these benefits would be cancelled and it would be subject to corporate tax in Israel at the standard corporate rate and could be required to refund tax benefits already received, with interest and adjustments for inflation based on the Israeli consumer price index.

***Critical Accounting Policies and Estimates***

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. We evaluate our estimates and assumptions on an ongoing basis. Our estimates are based on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Our actual results could differ from these estimates.

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We believe that the assumptions and estimates associated with revenue recognition, fair value of financial instruments, equity-based compensation and income taxes have the greatest potential impact on our consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates.

See our Annual Report on Form 10-K for the year ended December 31, 2015, filed with the SEC on March 11, 2016, for a discussion of additional critical accounting policies and estimates. There have been no changes in our critical accounting policies as compared to what was previously disclosed in the Form 10-K for the year ended December 31, 2015.

**LIQUIDITY AND CAPITAL RESOURCES**

As of September 30, 2016, we had approximately \$20.0 million in cash and cash equivalents, \$41.0 million in short term bank deposits, \$58.9 million in marketable securities, and \$25.1 million in long term bank deposits, totaling \$145.0 million, as compared to \$139.3 million at December 31, 2015. The increase for the first nine months of 2016 principally reflected cash proceeds from exercise of stock-based awards, partially offset by the repurchase of 180,013 shares of common stock.

Out of total cash, cash equivalents, bank deposits and marketable securities of \$145.0 million, \$111.9 million was held by our foreign subsidiaries. Our intent is to permanently reinvest earnings of our foreign subsidiaries and our current operating plans do not demonstrate a need to repatriate foreign earnings to fund our U.S. operations. However, if these funds were needed for our operations in the United States, we would be required to accrue and pay U.S. taxes as well as taxes in other countries to repatriate these funds. The determination of the amount of additional taxes related to the repatriation of these earnings is not practicable, as it may vary based on various factors such as the location of the cash and the effect of regulation in the various jurisdictions from which the cash would be repatriated.

During the first nine months of 2016, we invested \$51.6 million of cash in bank deposits and marketable securities with maturities up to 59 months from the balance sheet date. In addition, during the same period, bank deposits and marketable securities were sold or redeemed for cash amounting to \$47.2 million. All of our marketable securities are classified as available-for-sale. The purchase and sale or redemption of available-for-sale marketable securities are considered part of investing cash flow. Available-for-sale marketable securities are stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss), a separate component of stockholders equity, net of taxes. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the interim condensed consolidated statements of income. We did not recognize any other-than-temporarily-impaired charges on marketable securities during the first nine months of 2016. For more information about our marketable securities, see Notes 4 to the attached Notes to the Interim Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2016.

Bank deposits are classified as short-term bank deposits and long-term bank deposits. Short-term bank deposits are deposits with maturities of more than three months but no longer than one year from the balance sheet date, whereas long-term bank deposits are deposits with maturities of more than one year as of the balance sheet date. Bank deposits are presented at their cost, including accrued interest, and purchases and sales are considered part of cash flows from investing activities.

*Operating Activities*

Cash provided by operating activities for the first nine months of 2016 was \$2.0 million and consisted of net income of \$7.9 million, adjustments for non-cash items of \$7.3 million, and changes in operating assets and liabilities of \$13.2 million. Adjustments for non-cash items primarily consisted of \$1.9 million of depreciation and amortization of

intangible assets, \$4.6 million of equity-based compensation expenses and \$0.8 million of amortization of premiums on available-for-sale marketable securities. The decrease in cash from changes in operating assets and liabilities primarily consisted of an increase in trade receivables of \$13.2 million (mainly due to one of our large customer's internal reorganization of its financial and legal entities which affected the timing of payments to us), an increase in prepaid expenses and other assets of \$1.4 million, an increase in accrued interest on bank deposits of \$0.4 million, an increase in deferred tax assets, net, of \$0.6 million, and a decrease in accrued payroll and related benefits of \$0.4 million, partially offset by an increase in trade payables of \$0.4 million, an increase in deferred revenues of \$1.3 million and an increase in income tax payables of \$0.9 million.

Cash provided by operating activities for the first nine months of 2015 was \$7.8 million and consisted of net income of \$4.0 million, adjustments for non-cash items of \$5.6 million, and changes in operating assets and liabilities of \$1.8 million. Adjustments for non-cash items primarily consisted of \$1.8 million of depreciation and amortization of intangible assets, \$2.8 million of equity-based compensation expenses, \$0.8 million of amortization of premiums on available-for-sale marketable securities and \$0.2 million of unrealized foreign exchange loss. The decrease in cash from changes in operating assets and liabilities primarily consisted of an increase in trade receivables of \$0.8 million, an increase in deferred tax assets, net, of \$0.7 million, a decrease in accrued expenses and other payables of \$0.4 million, and a decrease in accrued payroll and related benefits of \$0.4 million, partially offset by an increase in deferred revenues of \$0.4 million.



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Cash flows from operating activities may vary significantly from quarter to quarter depending on the timing of our receipts and payments. Our ongoing cash outflows from operating activities principally relate to payroll-related costs and obligations under our property leases and design tool licenses. Our primary sources of cash inflows are receipts from our accounts receivable, to some extent, funding from R&D government grants and French research tax credits, and interest earned from our cash, deposits and marketable securities. The timing of receipts of accounts receivable from customers is based upon the completion of agreed milestones or agreed dates as set out in the contracts.

*Investing Activities*

Net cash used in investing activities for the first nine months of 2016 was \$6.4 million, compared to \$1.3 million of net cash used in investing activities for the comparable period of 2015. We had a cash outflow of \$32.5 million and a cash inflow of \$21.6 million with respect to investments in marketable securities during the first nine months of 2016, as compared to a cash outflow of \$26.2 million and a cash inflow of \$24.9 million with respect to investments in marketable securities during the first nine months of 2015. For the first nine months of 2016, we had net proceeds of \$6.5 million from bank deposits, as compared to net proceeds of \$1.1 million from bank deposits for the comparable period of 2015. We had a cash outflow of \$2.0 million (mainly for platform tools) and \$1.2 million during the first nine months of 2016 and 2015, respectively, from purchase of property and equipment. We had a cash inflow of \$0.1 million during the first nine months of 2015 from the sale of investment in Antcor Advanced Network Technologies S.A.

*Financing Activities*

Net cash provided by financing activities for the first nine months of 2016 was \$5.6 million, compared to \$6.4 million of net cash used in financing activities for the comparable period of 2015.

In August 2008, we announced that our board of directors approved a share repurchase program for up to one million shares of common stock which was further extended collectively by an additional five million shares in 2010, 2013 and 2014. During the first nine months of 2016, we repurchased 180,013 shares of common stock pursuant to our share repurchase program, at an average purchase price of \$18.98 per share, for an aggregate purchase price of \$3.4 million. During the first nine months of 2015, we repurchased 428,590 shares of common stock pursuant to our share repurchase program, at an average purchase price of \$19.03 per share, for an aggregate purchase price of \$8.2 million.

During the first nine months of 2016, we received \$9.0 million from the exercise of stock-based awards, as compared to \$5.4 million received for the comparable period of 2015. We had a cash outflow of \$3.7 million during the first nine months of 2015 to pay the Contingent Consideration in connection with the acquisition of RivieraWaves.

We believe that our cash and cash equivalents, short-term bank deposits and marketable securities, along with cash from operations, will provide sufficient capital to fund our operations for at least the next 12 months. We cannot provide assurances, however, that the underlying assumed levels of revenues and expenses will prove to be accurate.

In addition, as part of our business strategy, we occasionally evaluate potential acquisitions of businesses, products and technologies and minority equity investments. Accordingly, a portion of our available cash may be used at any time for the acquisition of complementary products or businesses or minority equity investments. 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 or investment candidates, complete acquisitions or investments, integrate acquired businesses into our current operations, or expand into new markets. Furthermore, we cannot provide assurances that additional financing will be available to us in any required time frame and on commercially reasonable terms, if at all. See **Risk Factors** We may seek to expand our

business in ways that could result in diversion of resources and extra expenses. for more detailed information.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

A majority of our revenues and a portion of our expenses are transacted in U.S. dollars and our assets and liabilities together with our cash holdings are predominately denominated in U.S. dollars. However, the majority of our expenses are denominated in currencies other than the U.S. dollar, principally the NIS and the Euro. Increases in volatility of the exchange rates of currencies other than the U.S. dollar versus the U.S. dollar could have an adverse effect on the expenses and liabilities that we incur when remeasured into U.S. dollars. We review our monthly expected non-U.S. dollar denominated expenditures and look to hold equivalent non-U.S. dollar cash balances to mitigate currency fluctuations. However, during the second half of 2014, our Euro cash balances increased significantly beyond our ordinary course Euro business liabilities as a result of the acquisition of RivieraWaves. This has resulted in a foreign exchange loss of \$5,000 and \$30,000 for the third quarter and first nine months of 2016, respectively, and a foreign exchange loss of \$3,000 and \$451,000 for the comparable periods of 2015. The foreign exchange losses during the first nine months of 2015 principally reflected a significant devaluation of our Euro cash balances as the U.S. dollar strengthened significantly as compared to the Euro.

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As a result of currency fluctuations and the remeasurement of non-U.S. dollar denominated expenditures to U.S. dollars for financial reporting purposes, we may experience fluctuations in our operating results on an annual and quarterly basis. To protect against the increase in value of forecasted foreign currency cash flow resulting from salaries paid in currencies other than the U.S. dollar during the year, we follow a foreign currency cash flow hedging program. We hedge portions of the anticipated payroll for our non-U.S. employees denominated in currencies other than the U.S. dollar for a period of one to twelve months with forward and option contracts. During the third quarter and first nine months of 2016, we recorded accumulated other comprehensive gain of \$5,000 and \$23,000, respectively, from our forward and option contracts, net of taxes, with respect to anticipated payroll expenses for our non-U.S. employees. During the third quarter and first nine months of 2015, we recorded accumulated other comprehensive loss of \$175,000 and accumulated other comprehensive gain of \$70,000, respectively, from our forward and option contracts, net of taxes, with respect to anticipated payroll expenses for our non-U.S. employees. As of September 30, 2016, the amount of other comprehensive gain from our forward and option contracts, net of taxes, was \$31,000, which will be recorded in the consolidated statements of income during the following three months. We recognized a net gain of \$69,000 and \$191,000 for the third quarter and first nine months of 2016, respectively, and a net gain of \$59,000 and \$58,000 for the comparable periods of 2015, related to forward and options contracts. We note that hedging transactions may not successfully mitigate losses caused by currency fluctuations. We expect to continue to experience the effect of exchange rate and currency fluctuations on an annual and quarterly basis.

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

We hold an investment portfolio consisting principally of corporate bonds. We have the ability to hold such investments until recovery of temporary declines in market value or maturity. Accordingly, as of September 30, 2016, we believe the losses associated with our investments are temporary and no impairment loss was recognized during the first nine months of 2016. However, we can provide no assurance that we will recover present declines in the market value of our investments.

Interest income and gains and losses from marketable securities, net, were \$0.63 million and \$1.65 million for the third quarter and first nine months of 2016, respectively, as compared to \$0.40 million and \$1.19 million for the comparable periods of 2015. The increase in interest income and gains and losses from marketable securities, net, during both the third quarter and first nine months of 2016, principally reflected higher combined cash, bank deposits and marketable securities balances held and higher yields (mainly as a result of investments with longer maturity dates).

We are exposed primarily to fluctuations in the level of U.S. interest rates. To the extent that interest rates rise, fixed interest investments may be adversely impacted, whereas a decline in interest rates may decrease the anticipated interest income for variable rate investments. We typically do not attempt to reduce or eliminate our market exposures on our investment securities because the majority of our investments are short-term. We currently do not have any derivative instruments but may put them in place in the future. Fluctuations in interest rates within our investment

portfolio have not had, and we do not currently anticipate such fluctuations will have, a material effect on our financial position on an annual or quarterly basis.

**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 were effective as of September 30, 2016.

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.

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**PART II. OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS**

We are not a party to any litigation or other legal proceedings that we believe could reasonably be expected to have a material effect on our business, results of operations and financial condition.

**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, 2015 other than (1) changes to the Risk Factor below entitled: **We rely significantly on revenue derived from a limited number of customers who contribute to our royalty and license revenues;** (2) changes to the Risk Factor below entitled **Royalty rates could decrease for existing and future license agreements which could materially adversely affect our operating results;** (3) changes to the Risk Factor below entitled **We generate a significant amount of our total revenues from the baseband market (for handset and for other devices) and our business and operating results may be materially adversely affected if we do not continue to succeed in these highly competitive markets;** (4) 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 revenues and business;** (5) changes to the Risk Factor below entitled **Our research and development expenses may increase if the grants we currently receive from the Israeli government and European Union are reduced or withheld;** (6) changes to the Risk Factor below entitled: **The Israeli tax benefits that we currently receive and the government programs in which we participate require us to meet certain conditions and may be terminated or reduced in the future, which could increase our tax expenses;** (7) changes to the Risk Factor below entitled **Our product development efforts are time-consuming and expensive and may not generate an acceptable return, if any;** and (8) the addition of the Risk Factor below entitled: **The terrorist attacks, acts of war or military actions and/or other civil unrest may adversely affect the territories in which we operate, and our business, financial condition and operating results.**

**The markets in which we operate are highly competitive, and as a result we could experience a loss of sales, lower prices and lower revenues.**

The markets for the products in which our technology is incorporated are highly competitive. Aggressive competition could result in substantial declines in the prices that we are able to charge for our intellectual property or loss of design wins to competitors. Many of our competitors are striving to increase their share of the growing signal processing IP markets and are reducing their licensing and royalty fees to attract customers. The following industry players and factors may have a significant impact on our competitiveness:

we compete directly in the DSP cores space with Verisilicon and Cadence;

we compete with CPU IP or configurable CPU IP (offering DSP configured CPU and/or DSP acceleration to their IP) providers, such as ARM Holdings (announced to be acquired by SoftBank), Imagination Technologies, Synopsys and Cadence;

we compete with internal engineering teams at companies such as Mediatek, Qualcomm, Samsung, Huawei and NXP that may design programmable DSP core products in-house and therefore not license our technologies;

we compete in the SATA and SAS IP markets with several vendors, such as Semtech's Snowbush IP Group and Synopsys, that offer similar products, thereby leading to pricing pressures for both licensing and royalty revenues;

we compete in the connectivity markets with Imagination Technologies, ARM Holdings, Mindtree and STMicroelectronics;

we compete in the digital photography and embedded vision market with Cadence, Synopsys, Videantis, ARM Holdings (NEON technology) and GPU IP providers such as ARM Holdings, Imagination Technologies and Vivante; and

we compete in the audio and voice applications market with ARM Holdings, Synopsys, Cadence and Verisilicon.

In addition, we may face increased competition from smaller, niche semiconductor design companies in the future. Some of our customers also may decide to satisfy their needs through in-house design. We compete on the basis of signal processing IP performance, overall chip cost, power consumption, flexibility, reliability, communication and multimedia software availability, design cycle time, tool chain, customer support, name recognition, reputation and financial strength. Our inability to compete effectively on these bases could have a material adverse effect on our business, results of operations and financial condition.

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**Our quarterly operating results fluctuate from quarter to quarter due to a variety of factors, including our lengthy sales cycle, and may not be a meaningful indicator of future performance.**

In some quarters our operating results could be below the expectations of securities analysts and investors, which could cause our stock price to fall. Factors that may affect our quarterly results of operations in the future include, among other things:

the gain or loss of significant licensees, partly due to our dependence on a limited number of customers generating a significant amount of quarterly revenues;

any delay in execution of any anticipated licensing arrangement during a particular quarter;

delays in revenue recognition for some license agreements based on percentage of completion of customized work or other accounting reasons;

the timing and volume of orders and production by our customers, as well as fluctuations in royalty revenues resulting from fluctuations in unit shipments by our licensees;

royalty pricing pressures and reduction in royalty rates due to an increase in volume shipments by customers, end-product price erosion and competitive pressures;

earnings or other financial announcements by our major customers that include shipment data or other information that implicates expectations for our future royalty revenues;

the mix of revenues among licensing and related revenues, and royalty revenues;

the timing of the introduction of new or enhanced technologies by us and our competitors, as well as the market acceptance of such technologies;

the discontinuation, or public announcement thereof, of product lines or market sectors that incorporate our technology by our significant customers;

our lengthy sales cycle and specifically in the third quarter of any fiscal year during which summer vacations slow down decision-making processes of our customers in executing contracts;

delays in the commercialization of end products that incorporate our technology;

currency fluctuations, mainly the Euro and the NIS versus the U.S. dollar;

fluctuations in operating expenses and gross margins associated with the introduction of new or enhanced technologies and adjustments to operating expenses resulting from restructurings;

the timing of Israeli R&D government grants from the Office of the Chief Scientist of Israel, EU grants and French research tax credits;

the timing of our payment of royalties to the Office of the Chief Scientist of Israel, which is impacted by the timing and magnitude of license agreements and royalty revenues derived from technologies that were funded by grant programs of the Office of the Chief Scientist;

statutory changes associated with research tax benefits applicable to French technology companies;

our ability to scale our operations in response to changes in demand for our technologies;

entry into new end markets that utilize our signal processing IPs, software and platforms;

changes in our pricing policies and those of our competitors;

restructuring, asset and goodwill impairment and related charges, as well as other accounting changes or adjustments; and

general economic conditions, including the current economic conditions, and its effect on the semiconductor industry and sales of consumer products into which our technologies are incorporated.

Each of the above factors is difficult to forecast and could harm our business, financial condition and results of operations. Also, we license our technology to OEMs and semiconductor companies for incorporation into their end products for consumer markets, including handsets and consumer electronics products. The royalties we generate are reported by our customers and invoiced by us one quarter in arrears. As a result, our royalty revenues are affected by seasonal buying patterns of consumer products sold by our OEM customers that incorporate our technology and the market acceptance of such end products supplied by our OEM customers. The second quarter in any given year is usually a sequentially down quarter for us in relation to royalty revenues as this period represents lower post-Christmas first quarter consumer product shipments and little to no new introduction of handsets during the first quarter of the year. However, the magnitude of this second quarter decrease varies annually and has been impacted by global economic conditions, market share changes, exiting or refocusing of market sectors by our customers and the timing of introduction of new and existing handset devices powered by CEVA technology sold in any given quarter



compared to the prior quarter.

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Moreover, the semiconductor and consumer electronics industries remain volatile, which makes it extremely difficult for our customers and us to accurately forecast financial results and plan for future business activities. As a result, our past operating results should not be relied upon as an indication of future performance.

**We rely significantly on revenues derived from a limited number of customers who contribute to our royalty and license revenues.**

We derive a significant amount of revenues from a limited number of customers. One customer, Spreadtrum, accounted for 27% of our total revenues for both the third quarter and first nine months of 2016, as compared to 45% and 33% for the comparable periods in 2015. With respect to our royalty revenues, three royalty paying customers each represented 10% or more of our total royalty revenues for the third quarter of 2016, and collectively represented 86% of our total royalty revenues for the third quarter of 2016. Two royalty paying customers each represented 10% or more of our total royalty revenues for the first nine months of 2016, and collectively represented 81% of our total royalty revenues for the first nine months of 2016. We expect that a significant portion of our future revenues will continue to be generated by a limited number of customers. The loss of any significant royalty paying customer could adversely affect our near-term future operating results. Furthermore, consolidation among our customers may negatively affect our revenue source, increase our existing customers' negotiation leverage and make us further dependent on a limited number of customers. Moreover, the discontinuation of product lines or market sectors that incorporate our technology by our significant customers or a change in direction of their business and our inability to adapt our technology to their new business needs could have material negative implications for our future royalty revenues.

**Our business is dependent on licensing revenues which may vary period to period.**

License agreements for our signal processing IP cores and platforms have not historically provided for substantial ongoing license payments so past licensing revenues may not be indicative of the amount of such revenues in any future period. We believe that there is a similar risk with the acquired RivieraWaves operations associated with Bluetooth and Wi-Fi connectivity technologies. Significant portions of our anticipated future revenues, therefore, will likely depend upon our success in attracting new customers or expanding our relationships with existing customers. However, revenues recognized from licensing arrangements vary significantly from period to period, depending on the number and size of deals closed during a quarter, and is difficult to predict. In addition, as we expand our business into the non-handset baseband markets, our licensing deals may be smaller but greater in volume which may further fluctuate our licensing revenues quarter to quarter. Our ability to succeed in our licensing efforts will depend on a variety of factors, including the performance, quality, breadth and depth of our current and future products, as well as our sales and marketing skills. In addition, some of our licensees may in the future decide to satisfy their needs through in-house design and production. Our failure to obtain future licensing customers would impede our future revenue growth and could materially harm our business.

**Royalty rates could decrease for existing and future license agreements which could materially adversely affect our operating results.**

Royalty payments to us under existing and future license agreements could be lower than currently anticipated for a variety of reasons. Average selling prices for semiconductor products generally decrease over time during the lifespan of a product. In addition, there is increasing downward pricing pressures in the semiconductor industry on end products incorporating our technology, especially end products for the handsets and consumer electronics markets. As a result, notwithstanding the existence of a license agreement, our customers may demand that royalty rates for our products be lower than our historic royalty rates. We have in the past and may be pressured in the future to renegotiate existing license agreements with our customers. In addition, certain of our license agreements provide that royalty

rates may decrease in connection with the sale of larger quantities of products incorporating our technology. Furthermore, our competitors may lower the royalty rates for their comparable products to win market share which may force us to lower our royalty rates as well. As a consequence of the above referenced factors, as well as unforeseen factors in the future, the royalty rates we receive for use of our technology could decrease, thereby decreasing future anticipated revenues and cash flow. Royalty revenues were 58% and 54% of our total revenues for the third quarter and first nine months of 2016, respectively. Therefore, a significant decrease in our royalty revenues could materially adversely affect our operating results.

Moreover, royalty rates may be negatively affected by macroeconomic trends or changes in products mix. For example, the shift away from feature phones by Intel and the handset baseband market by Broadcom and STMicroelectronics in 2014 negatively impacted our royalty revenues in 2014. Furthermore, consolidation among our customers may increase the leverage of our existing customers to extract concessions from us in royalty rates. Moreover, changes in products mix such as an increase in lower royalty bearing products shipped in high volume like low-cost feature phones and Bluetooth-based products in lieu of higher royalty bearing products like LTE phones could lower our royalty revenues.

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**We generate a significant amount of our total revenues from the baseband market (for handset and for other devices) and our business and operating results may be materially adversely affected if we do not continue to succeed in these highly competitive markets.**

Our total revenues derived solely from the baseband market (for handset and for other devices) represented 65% and 66% of our total revenues for the third quarter and first nine months of 2016, respectively. A significant portion of our royalty revenues in 2013 and 2014 were derived from lower cost feature phones. In 2015, a larger portion of LTE-based handsets utilized our technologies and generated higher royalty revenues and higher average selling prices. Although next generation products generally have higher average selling prices, the shift towards CEVA-powered LTE products was slower in 2013 and 2014, and we can provide no assurances that the positive trend in 2015 towards adoption of next generation products will continue on pace in future years. Furthermore, we can provide no assurances that we will be successful in offsetting any decline in revenues from feature phones with increased revenues from next generation products such as low-cost smartphones, including LTE-based phones. Any adverse change in our ability to compete and maintain our competitive position in the handset baseband market, including through the introduction by competitors of enhanced technologies that attract OEM customers that target those markets, would harm our business, financial condition and results of operations. Moreover, the handset baseband market is extremely competitive and are facing intense pricing pressures, and we expect that competition and pricing pressures will only increase. Furthermore, it can be very volatile with regards to volume shipments of different phones, standards and connected devices due to inventory build out or consumer demand changes or geographical macroeconomics, pricing changes, product discontinuations due to technical issues and timing of introduction of new phones and products. Our existing OEM customers also may fail to introduce new handset devices that attract consumers, or encounter significant delays in developing, manufacturing or shipping new or enhanced products in those markets. The inability of our OEM customers to compete would result in lower shipments of products powered by our technologies which in turn would have a material adverse effect on our business, financial condition and results of operations. Since a significant portion of our revenues are derived from the handset baseband market, adverse conditions in this market would have a material adverse effect on our business, financial condition and results of operations.

**Because our IP solutions are components of end products, if semiconductor companies and electronic equipment manufacturers do not incorporate our solutions into their end products or if the end products of our customers do not achieve market acceptance, we may not be able to generate adequate sales of our products.**

We do not sell our IP solutions directly to end-users; we license our technology primarily to semiconductor companies and electronic equipment manufacturers, who then incorporate our technology into the products they sell. As a result, we rely on our customers to incorporate our technology into their end products at the design stage. Once a company incorporates a competitor's technology into its end product, it becomes significantly more difficult for us to sell our technology to that company because changing suppliers involves significant cost, time, effort and risk for the company. As a result, we may incur significant expenditures on the development of a new technology without any assurance that our existing or potential customers will select our technology for incorporation into their own product and without this design win, it becomes significantly difficult to sell our IP solutions. Moreover, even after a customer agrees to incorporate our technology 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 technology not reaching the market until long after the initial design win with such customer. 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 customers' ability to ship products according to our customers' schedule. Moreover, current economic conditions may further prolong a customer's decision-making process and design cycle.

Further, because we do not control the business practices of our customers, we do not influence the degree to which they promote our technology or set the prices at which they sell products incorporating our technology. We cannot assure you that our customers will devote satisfactory efforts to promote their end products which incorporate our IP solutions.

In addition, our royalties from licenses and therefore the growth of our business, are dependent upon the success of our customers in introducing products incorporating our technology and the success of those products in the marketplace. The primary customers for our products are semiconductor design and manufacturing companies, system OEMs and electronic equipment manufacturers, particularly in the telecommunications field. These industries are highly competitive, cyclical and have been subject to significant economic downturns at various times. These downturns are characterized by production overcapacity and reduced revenues, which at times may encourage semiconductor companies or electronic product manufacturers to reduce their expenditure on our technology. If we do not retain our current customers and continue to attract new customers, our business may be harmed.

**We depend on market acceptance of third-party semiconductor intellectual property.**

The semiconductor intellectual property (SIP) industry is a relatively small and emerging industry. Our future growth will depend on the level of market acceptance of our third-party licensable intellectual property model, the variety of intellectual property offerings available on the market, and a shift in customer preference away from in-house development of proprietary signal processing IP towards licensing open signal processing IP cores and platforms. Furthermore, the third-party licensable intellectual property model is highly dependent on the market adoption of new services and products, such as low cost smartphones in emerging markets, LTE based smartphones, mobile broadband, small cell base stations and the increased use of advanced audio, voice, computational photography and embedded vision in mobile, automotive and consumer products, as well as in IoT and connectivity applications. Such market adoption is important because the increased cost associated with ownership and maintenance of the more complex architectures needed for the advanced services and products may motivate companies to license third-party intellectual property rather than design them in-house.

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The trends that would enable our growth are largely beyond our control. Semiconductor customers also may choose to adopt a multi-chip, off-the-shelf chip solution versus licensing or using highly-integrated chipsets that embed our technologies. If the above referenced market shifts do not materialize or third-party SIP does not achieve market acceptance, our business, results of operations and financial condition could be materially harmed.

**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 revenues and business.**

Approximately 86% of our total revenues for the first nine months of 2016 were derived from customers located outside of the United States. We expect that international customers will continue to account for a significant portion of our revenues for the foreseeable future. As a result, the occurrence of any negative international political, economic or geographic events could result in significant revenue shortfalls. These shortfalls 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 regulatory requirements;

fluctuations in the exchange rate for the U.S. dollar;

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;

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

political and economic instability, including terrorist attacks; and

changes in diplomatic and trade relationships.

**We depend on a limited number of key personnel who would be difficult to replace.**

Our success depends to a significant extent upon certain of our key employees and senior management, the loss of which could materially harm our business. Competition for skilled employees in our field is intense. We cannot assure you that in the future we will be successful in attracting and retaining the required personnel.

**The sales cycle for our IP solutions is lengthy, which makes forecasting of our customer orders and revenues difficult.**

The sales cycle for our IP solutions is lengthy, often lasting three to nine months. Our customers generally conduct significant technical evaluations, including customer trials, of our technology as well as competing technologies prior to making a purchasing decision. In addition, purchasing decisions also may be delayed because of a customer's internal budget approval process. Furthermore, given the current market conditions, we have less ability to predict the timing of our customers' purchasing cycle and potential unexpected delays in such a cycle. Because of the lengthy sales cycle and potential delays, our dependence on a limited number of customers to generate a significant amount of revenues for a particular period and the size of customer orders, if orders forecasted for a specific customer for a particular period do not occur in that period, our revenues and operating results for that particular quarter could suffer. Moreover, a portion of our expenses related to an anticipated order is fixed and difficult to reduce or change, which may further impact our operating results for a particular period.

**Because our IP solutions 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 IP solutions 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 failure in our products could lead to product liability claims or lawsuits against us or against our customers. 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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**Our success will depend on our ability to successfully manage our geographically dispersed operations.**

Most of our employees are located in Israel. We also added French employees after the RivieraWaves acquisition in 2014. Accordingly, our ability to compete successfully will depend in part on the ability of a limited number of key executives located in geographically dispersed offices to integrate management, address the needs of our customers and respond to changes in our markets. If we are unable to effectively manage and integrate our remote operations, our business may be materially harmed.

**Our operations in Israel may be adversely affected by instability in the Middle East region.**

One of our principal research and development facilities is located in Israel, and our executive officers and some of our directors are residents of Israel. Although substantially all of our sales currently are being made to customers outside Israel, we are nonetheless directly influenced by the political, economic and military conditions affecting Israel. Any major hostilities involving Israel could significantly harm our business, operating results and financial condition.

In addition, certain of our employees are currently obligated to perform annual reserve duty in the Israel Defense Forces and are subject to being called to 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 key employees due to military service.

**Terrorist attacks, acts of war or military actions and/or other civil unrest may adversely affect the territories in which we operate, and our business, financial condition and operating results.**

Terrorist attacks such as those that have recently occurred in France, where we have our wireless connectivity operations as a result of our acquisition of RivieraWaves, and attempted terrorist attacks, military responses to terrorist attacks, other military actions, or governmental action in response to or in anticipation of a terrorist attack, or civil unrest, may adversely affect prevailing economic conditions, resulting in work stoppages, reduced consumer spending or reduced demand for end products that incorporate our technologies. These developments subject our worldwide operations to increased risks and, depending on their magnitude, could reduce net sales and therefore could have a material adverse effect on our business, financial condition and operating results.

**Our research and development expenses may increase if the grants we currently receive from the Israeli government and European Union are reduced or withheld.**

We currently receive research grants from programs of the Office of the Chief Scientist of Israel of the Israeli Ministry of Industry and Trade and the Seventh Framework Program of the European Union. We recorded an aggregate of \$5,460,000 for the first nine months of 2016. To be eligible for these grants, we must meet certain development conditions and comply with periodic reporting obligations. Although we have met such conditions in the past, should we fail to meet such conditions in the future our research grants may be repayable, reduced or withheld. The repayment or reduction of such research grants may increase our research and development expenses which in turn may reduce our operating income. Also, the timing of such payments from the Office of the Chief Scientist and European Union may vary from year to year and quarter to quarter, and we have no control on the timing of such payment.

**The Israeli tax benefits that we currently receive and the government programs in which we participate require us to meet certain conditions and may be terminated or reduced in the future, which could increase our**



**tax expenses.**

We enjoy certain tax benefits in Israel, particularly as a result of the *Approved Enterprise* and the *Benefited Enterprise* status of our facilities and programs. To maintain our eligibility for these tax benefits, we must continue to 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. Should we fail to meet such conditions in the future, these benefits would be cancelled and we would be subject to corporate tax in Israel at the standard corporate rate (25% in 2016) and could be required to refund tax benefits already received. In addition, we cannot assure you that these tax benefits will be continued in the future at their current levels or otherwise. The tax benefits under our active investment programs are scheduled to gradually expire starting in 2017. The termination or reduction of certain programs and tax benefits (particularly benefits available to us as a result of the *Approved Enterprise* and the *Benefited Enterprise* status of our facilities and programs) or a requirement to refund tax benefits already received may seriously harm our business, operating results and financial condition.

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**Our failure to maintain certain research tax benefits applicable to French technology companies may adversely affect the results of operations of our RivieraWaves operations.**

Pursuant to our acquisition of the RivieraWaves operations, we will benefit from certain research tax credits applicable to French technology companies, including, for example, the Crédit Impôt Recherche ( CIR ). The CIR is a French tax credit aimed at stimulating research activities. The CIR can be offset against French corporate income tax due and the portion in excess (if any) may be refunded every three years. The French Parliament can decide to eliminate, or reduce the scope or the rate of, the CIR benefit, at any time or challenge our eligibility or calculations for such tax credits, all of which may have an adverse impact on our results of operations and future cash flows.

**We are exposed to fluctuations in currency exchange rates.**

A significant portion of our business is conducted outside the United States. Although most of our revenues 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, the majority of our expenses are denominated in foreign currencies, mainly New Israeli Shekel (NIS) and the Euro, which subjects us to the risks of foreign currency fluctuations. Our primary expenses paid in currencies other than the U.S. dollar are employee salaries. Increases in the volatility of the exchange rates of currencies other than the U.S. dollar versus the U.S. dollar could have an adverse effect on the expenses and liabilities that we incur in currencies other than the U.S. dollar when remeasured into U.S. dollars for financial reporting purposes. We have instituted a foreign cash flow hedging program to minimize the effects of currency fluctuations. However, hedging transactions may not successfully mitigate losses caused by currency fluctuations, and our hedging positions may be partial or may not exist at all in the future. We also review our monthly expected non-U.S. dollar denominated expenditure and look to hold equivalent non-U.S. dollar cash balances to mitigate currency fluctuations. However, in some cases, we expect to continue to experience the effect of exchange rate currency fluctuations on an annual and quarterly basis (for example, our Euro cash balances increase significantly on a quarterly basis beyond our Euro liabilities from the CIR, which is expected to be refunded every three years).

**We are exposed to the credit risk of our customers, which could result in material losses.**

As we diversify and expand our addressable market, we will enter into licensing arrangements with first time customers with whom we don't have full visible of their creditworthiness. Furthermore, we have increased business activities in the Asia Pacific region. As a result, our future credit risk exposure may increase. Although we monitor and attempt to mitigate credit risks, there can be no assurance that our efforts will be effective. 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.

**Our product development efforts are time-consuming and expensive and may not generate an acceptable return, if any.**

Our product development efforts require us to incur substantial research and development expense. Our research and development expenses were approximately \$23.1 million for the first nine months of 2016. We may not be able to achieve an acceptable return, if any, on our research and development efforts.

The development of our products is highly complex. We occasionally have experienced delays in completing the development and introduction of new products and product enhancements, and we could experience delays in the future. Unanticipated problems in developing products could also divert substantial engineering resources, which may impair our ability to develop new products and enhancements and could substantially increase our costs. Furthermore,

we may expend significant amounts on research and development programs that may not ultimately result in commercially successful products. Our research and development expense levels increased since the third quarter of 2014 after the acquisition of RivieraWaves. As a result of these and other factors, we may be unable to develop and introduce new products successfully and in a cost-effective and timely manner, and any new products we develop and offer may never achieve market acceptance. Any failure to successfully develop future products would have a material adverse effect on our business, financial condition and results of operations.

**If we are unable to meet the changing needs of our end-users or address evolving market demands, our business may be harmed.**

The markets for signal processing IPs are characterized by rapidly changing technology, emerging markets and new and developing end-user needs, and requiring significant expenditure for research and development. We cannot assure you that we will be able to introduce systems and solutions that reflect prevailing industry standards, on a timely basis, meet the specific technical requirements of our end-users or avoid significant losses due to rapid decreases in market prices of our products, and our failure to do so may seriously harm our business.

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**We may seek to expand our business in ways that could result in diversion of resources and extra expenses.**

We may in the future pursue acquisitions of businesses, products and technologies, establish joint venture arrangements, make minority equity investments or enhance our existing CEVAnet partner eco-system to expand our business. We are unable to predict whether or when any prospective acquisition, equity investment or joint venture will be completed. The process of negotiating potential acquisitions, joint ventures or equity investments, as well as the integration of acquired or jointly developed businesses, technologies or products 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 or investment candidates, complete acquisitions or investments, or integrate acquired businesses or joint ventures with our operations. If we were to make any acquisition or investment or enter into a joint venture, we may not receive the intended benefits of the acquisition, investment or joint venture or such an acquisition, investment or joint venture may not achieve comparable levels of revenues, profitability or productivity as our existing business or otherwise perform as expected. The expansion of our CEVAnet partner eco-system also may not achieve the anticipated benefits. The occurrence of any of these events could harm our business, financial condition or results of operations. Future acquisitions, investments or joint ventures may require substantial capital resources, which may require us to seek additional debt or equity financing.

Future acquisitions, joint ventures or minority equity investments 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 or equity investment impairment write-offs;

incurrence of debt and contingent liabilities;

difficulties in the assimilation and integration of operations, personnel, technologies, products and information systems of the acquired companies;

inability to realize cost efficiencies or synergies, thereby incurring higher operating expenditures as a result of the acquisition;

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.

**We may not be able to adequately protect our intellectual property.**

Our success and ability to compete depend in large part upon the protection of our proprietary technologies. We rely on a combination of patent, copyright, trademark, trade secret, mask work and other intellectual property rights, confidentiality procedures and licensing arrangements to establish and protect our proprietary rights. These agreements and measures may not be sufficient to protect our technology from third-party infringement or protect us from the claims of others. As a result, we face risks associated with our patent position, including the potential need to engage in significant legal proceedings to enforce our patents, the possibility that the validity or enforceability of our patents may be denied, the possibility that third parties will be able to compete against us without infringing our patents and the possibility that our products may infringe patent rights of third parties.

Our trade names or trademarks may be registered or utilized by third parties in countries other than those in which we have registered them, impairing our ability to enter and compete in those markets. If we were forced to change any of our brand names, we could lose a significant amount of our brand identity.

**Our business will suffer if we are sued for infringement of the intellectual property rights of third parties or if we cannot obtain licenses to these rights on commercially acceptable terms.**

We are subject to the risk of adverse claims and litigation alleging infringement of the intellectual property rights of others. There are a large number of patents held by others, including our competitors, pertaining to the broad areas in which we are active. We have not, and cannot reasonably, investigate all such patents. From time to time, we have become aware of patents in our technology areas and have sought legal counsel regarding the validity of such patents and their impact on how we operate our business, and we will continue to seek such counsel when appropriate in the future. In addition, patent infringement claims are increasingly being asserted by patent holding companies (so-called patent trolls), which do not use technology and whose sole business is to enforce patents against companies, such as us, for monetary gain. Because such patent holding companies do not provide services or use technology, the assertion of our own patents by way of counter-claim may be ineffective. Infringement claims may require us to enter into license arrangements or result in protracted and costly litigation, regardless of the merits of these claims. Any necessary licenses may not be available or, if available, may not be obtainable on commercially reasonable terms. If we cannot obtain necessary licenses on commercially reasonable terms, we may be forced to stop licensing our technology, and our business would be seriously harmed.

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**The future growth of our business depends in part on our ability to license to system OEMs and small-to-medium-sized semiconductor companies directly and to expand our sales geographically.**

Historically, a substantial portion of our licensing revenues has been derived in any given period from a relatively small number of licensees. Because of the substantial license fees we charge, our customers tend to be large semiconductor companies or vertically integrated system OEMs. Part of our current growth strategy is to broaden the adoption of our products by small and mid-size companies by offering different versions of our products targeted at these companies. If we are unable to develop and market effectively our intellectual property through these models, our revenues will continue to be dependent on a smaller number of licensees and a less geographically dispersed pattern of licensees, which could materially harm our business and results of operations.

**Our operating results are affected by the highly cyclical nature of the semiconductor industry.**

We operate within the semiconductor industry which experiences significant fluctuations in sales and profitability. 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.

**We may dispose of or discontinue existing product lines and technology developments, which may adversely impact our future results.**

On an ongoing basis, we evaluate our various product offerings and technology developments in order to determine whether any should be discontinued or, to the extent possible, divested. We cannot guarantee that we have correctly forecasted, or will correctly forecast in the future, the right product lines and technology developments to dispose or discontinue or that our decision to dispose of or discontinue various investments, products lines and technology developments is prudent if market conditions change. In addition, there are no assurances that the discontinuance of various product lines will reduce our operating expenses or will not cause us to incur material charges associated with such decision. Furthermore, the discontinuance of existing product lines entails various risks, including the risk that we will not be able to find a purchaser for a product line or the purchase price obtained will not be equal to at least the book value of the net assets for the product line. Other risks include managing the expectations of, and maintaining good relations with, our customers who previously purchased products from our disposed or discontinued product lines, which could prevent us from selling other products to them in the future. We may also incur other significant liabilities and costs associated with our disposal or discontinuance of product lines, including employee severance costs and excess facilities costs.

**Cybersecurity threats or other security breaches could compromise sensitive information belonging to us or our customers and could harm our business and our reputation.**

We store sensitive data, including intellectual property, proprietary business information and our customer and employee information. Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions that could result in unauthorized disclosure or loss of sensitive data. Because the techniques used to obtain unauthorized access to networks, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. Furthermore, in the operation of our business we also use third-party vendors that store certain sensitive data. Any security breach of our own or a third-party vendor's systems could cause us to be non-compliant with applicable laws or regulations, subject us to legal claims or proceedings, disrupt our operations, damage our reputation, and cause a loss of confidence in our products and services, any of which could adversely affect our business.

**Our corporate tax rate may increase, which could adversely impact our cash flow, financial condition and results of operations.**

We have significant operations in Israel, as well operations in the Republic of Ireland and France. A substantial portion of our taxable income historically has been generated in Israel. Currently, our Israeli and Irish subsidiaries are taxed at rates substantially lower than the U.S. tax rates. If our Israeli and Irish subsidiaries were no longer to qualify for these lower tax rates or if the applicable tax laws were rescinded or changed, our operating results could be materially adversely affected. In addition, because our Israeli, Irish and French operations are owned by subsidiaries of our U.S. parent corporation, distributions to the U.S. parent corporation, and in certain circumstances undistributed income of the subsidiaries, may be subject to U.S. taxes. Moreover, if U.S. or other authorities were to change applicable tax laws or successfully challenge the manner in which our subsidiaries' profits are currently recognized, our overall tax expenses could increase, and our business, cash flow, financial condition and results of operations could be materially adversely affected. Also our taxes on the Irish interest income may be double taxed both in Ireland and in the U.S. due to U.S. tax regulations and Irish tax restrictions on NOLs to off-set interest income. In addition, starting in 2012, our Israeli interest income also may be taxed both in Israel and the U.S. due to different Controlled Foreigner Corporation rules.

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**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**

There were no repurchases of our common stock during the three months ended September 30, 2016.

**Item 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**Item 4. MINE SAFETY DISCLOSURES**

Not applicable.

**Item 5. OTHER INFORMATION**

Not applicable.

**Item 6. EXHIBITS**

**Exhibit**

| <b>No.</b> | <b>Description</b>  |
|------------|---|
| 31.1       | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer                 |
| 31.2       | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer                 |
| 32         | Section 1350 Certification of Chief Executive Officer and Chief Financial Officer |
| 101.INS    | XBRL Instance Document  |
| 101.SCH    | XBRL Taxonomy Extension Schema Document   |
| 101.CAL    | XBRL Taxonomy Extension Calculation Linkbase Document                             |
| 101.DEF    | XBRL Taxonomy Extension Definition Linkbase Document                              |
| 101.LAB    | XBRL Taxonomy Extension Labels Linkbase Document                                  |
| 101.PRE    | XBRL Taxonomy Extension Presentation Linkbase Document                            |

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**SIGNATURES**

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

CEVA, INC.

Date: November 9, 2016

By: /s/ GIDEON WERTHEIZER  
Gideon Wertheizer  
Chief Executive Officer  
(principal executive officer)

Date: November 9, 2016

By: /s/ YANIV ARIELI  
Yaniv Arieli  
Chief Financial Officer  
(principal financial officer and principal accounting officer)