CEVA INC
Form 10-K
March 15, 2013
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2012

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	**77-0556376**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	Identification No.)
1943 Landings Drive, Mountain View, California	**94043**
(Address of principal executive offices)	**(Zip Code)**

(650) 417-7900

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.001 par value per share	NASDAQ GLOBAL MARKET

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

As of June 30, 2012, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was $270,613,000 based on the closing sale price as reported on the National Association of Securities Dealers Automated Quotation System National Market System on June 29, 2012. Shares of common stock held by each officer, director, and holder of 5% or more of the outstanding common stock of the Registrant have been excluded from this calculation in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at March 7, 2013
Common Stock, $0.001 par value per share	22,186,371 shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive Proxy Statement for its Annual Meeting of Stockholders to be held on June 11, 2013 (the 2013 Proxy Statement) are incorporated by reference into Item 5 of Part II and Items 10, 11, 12, 13, and 14 of Part III.

Table of Contents

TABLE OF CONTENTS

Table of Contents

FORWARD-LOOKING STATEMENTS AND INDUSTRY DATA

This Annual 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, anticipate, intend, plan, or other similar words. Forward-looking statements include the following:

- We believe the adoption of our DSP cores and technologies in the handset and mobile broadband markets continues to progress;
- Our belief that the emergence of merchant 3G cellular chips from companies such as Broadcom, Intel and Spreadtrum, all of whom are our customers, are strong positive drivers for our future market share expansion;
- Our belief that we are well positioned to leverage the growth in the 3G enabled phones in developing countries, especially China, and the broad adoption of 4G LTE-based advanced smartphones in developed counties progresses;
- Our belief that the following represent key growth drivers for us: (1) CEVA being firmly established in the largest space in the semiconductor industry baseband for mobile handset as well as the other evolving cellular markets, such as mobile computing and machine to machine, with our competitive edge in software-defined radio technology, (2) our proven track record in baseband technologies, (3) the spectral efficiency of LTE enabling additional and very interesting new opportunities for DSP-related products, and (4) the market potential for image enhancement and vision analytics, including in cameras and cars, thereby offering new growth segments for the company;
- Our belief that there is a growing demand for high performance and low power DSP and application-specific platforms incorporating DSP cores and all the necessary hardware and software for target applications, and that we are well positioned to take full advantage of this industry shift;
- Our anticipation that our 2013 annual research and development costs would be higher;
- Our anticipation that our current cash on hand, short-term deposits and marketable securities, along with cash from operations, will provide sufficient capital to fund our operations for at least the next 12 months;
- 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; and
- Market data prepared by third parties, including ABI Research, Gartner Research and Strategy Analytics.

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.

1

Table of Contents

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 Item 1A: Risk Factors.

This report contains market data prepared by third party research firms. Actual market results may differ from their projections. This report includes trademarks and registered trademarks of CEVA. Products or service names of other companies mentioned in this Annual Report on Form 10-K may be trademarks or registered trademarks of their respective owners.

Table of Contents

PART I

ITEM 1. BUSINESS

Company Overview

Headquartered in Mountain View, California, CEVA is the world s leading licensor of silicon intellectual property (SIP) DSP cores and DSP-based platforms for the mobile, portable, consumer and automotive markets. CEVA s IP portfolio includes comprehensive technology offerings for wireless communications (2G/3G/LTE/LTE-A/802.11ac), image enhancement and computer vision (super resolution, high dynamic range, video stabilizer, gesture recognition and computational photography), advanced audio and voice processing, Bluetooth, Serial Attached SCSI (SAS) and Serial ATA (SATA).

Our technology is licensed to leading semiconductor and OEM companies throughout the world. These companies incorporate our IP into application-specific integrated circuits (ASICs) and application-specific standard products (ASSPs) that they manufacture, market and sell to consumer electronics companies. Our IP is primarily deployed in high volume markets, including wireless handsets, mobile computing (tablets and notebooks), machine-to-machine modules, home entertainment (smart TVs, DVDs, set-top boxes and game consoles), telecommunication (small cells, broadband modems and VoIP), and storage (enterprise and servers). Our state-of-the-art technology has shipped in more than 4 billion chips to date for a wide range of diverse end markets. In 2012 alone, our licensees shipped more than 1 billion CEVA-powered products.

Our revenue mix comprises of primarily IP licensing fees, royalties and other revenues. Other revenues include revenues from support, training and sale of development systems. As post contract support, training and sale of development systems are directly associated with licensing revenue and none of them separately is significant in relation to our total revenue, starting in the first quarter of 2013, we intend to consolidate licensing revenue and other revenue into one revenue line titled licensing and related revenue for the sake of simplicity.

We have built a strong network of licensing customers who rely on our technologies to deploy their silicon solutions. Our comprehensive customer base includes many of the world s leading semiconductor and consumer electronics companies. Broadcom, Icom, Intel, Intersil, Marvell, Mediatek, Mindspeed, MStar, NEC, NXP, PMC-Sierra, Renesas, Samsung, Sharp, Solomon Systech, Sony, Spreadtrum, ST Ericsson, Sunplus, Toshiba, VIA Telecom and Xincomm all leverage CEVA s industry-leading platform solutions and DSP cores.

CEVA was created through the combination of the DSP IP licensing division of DSP Group, Inc. and Parthus Technologies plc (Parthus) in November 2002. We have over 190 employees worldwide, with research and development facilities in Israel, Ireland and the United Kingdom, and sales and support offices throughout Asia Pacific (APAC), Japan, Sweden, Israel and the United States.

CEVA is traded on the NASDAQ Global Market (CEVA).

Industry Background

DSP Cores

Digital signal processing is a key technology that is powering many of today s fastest growing electronics markets. Digital signal processors (DSPs) are specialized high-speed processors that are optimized for performing repetitive arithmetic calculations on an array of data. DSPs provide the foundation supporting a vast majority of today s electronic products that are connected devices and offer multimedia capabilities (e.g. video, audio, imaging and vision).

Table of Contents

Design Gap

The demand for advanced smartphones, mobile computing and home entertainment equipment continues to grow. As consumers demand electronic products with more connectivity, portability and capability, semiconductor manufacturers face ever growing pressures to make smaller, feature-rich integrated circuits that are more reliable, less expensive and have greater performance, all in the face of decreasing product lifecycles and constrained battery power. The advent of wireless technologies like LTE-Advanced and Wi-Fi 802.11ac, advanced image enhancement, computer vision, and voice and audio pre- and post-processing have further increased these pressures. While semiconductor manufacturing processes have advanced significantly to allow a substantial increase in the number of circuits placed on a single chip, resources for design capabilities have not kept pace with the advances in manufacturing processes, resulting in a growing design gap between the increasing manufacturing potential and the constrained design capabilities.

CEVA Business

CEVA addresses the requirements of the handsets, portable and home electronics markets by designing and licensing programmable DSP cores, application-specific platforms and a range of software components which enable the rapid design of DSP-based chipsets or application-specific solutions for developing a wide variety of applications.

Given the design gap, as well as the increasing complexity and the unique skill set required to develop a DSP platform, many semiconductor design and manufacturing companies increasingly choose to license proven intellectual property, such as processor cores (e.g. DSPs), memory and application-specific platforms, from silicon intellectual property (SIP) companies like CEVA rather than develop those technologies in-house. In addition, with more complex designs and shorter time to market, it is no longer cost efficient and becoming progressively more difficult for most semiconductor companies to develop the DSP and software for baseband, image enhancement, and vision, audio and voice applications. As a result, companies increasingly seek to license application-specific DSP platforms and associated software from CEVA or a third-party community of developers, such as CEVAnet, CEVA s third-party network.

Our IP Business Model

Our objective is for our CEVA DSP cores and platforms to become the de facto technology in the embedded DSP market. To enable this goal, we license our technologies on a worldwide basis to semiconductor and OEM companies that design and manufacture products that combine CEVA-based solutions with their own differentiating technology. We believe our business model offers us some key advantages. By not focusing on manufacturing or selling silicon products, we are free to widely license our technology and free to focus most of our resources on research and development of DSP technologies. By choosing to license our DSP cores and platforms, manufacturers can achieve the advantage of creating their own differentiated solutions and develop their own unique product roadmaps. Through our licensing efforts, we have established a worldwide community developing CEVA-based solutions, and therefore we can leverage their strengths, customer relationships, proprietary technology advantages, and existing sales and marketing infrastructure. As an example, our CEVA-XCnet partner program focuses on various technology and solution providers in the Software-Defined-Radio (SDR) space with complimentary offerings for our CEVA-XC communication processor addressing wireless, infrastructure, smart grid Wi-Fi and digital TV markets. In addition, as our intellectual property is widely licensed and deployed, system OEM companies can obtain CEVA-based chipsets from a wide range of suppliers, thus reducing dependence on any one supplier and fostering price competition, both of which help to contain the cost of CEVA-based products.

We operate a licensing and royalty business model. We typically charge a license fee for access to our technology and a royalty fee for each unit of silicon which incorporates our technology. License fees are invoiced in accordance with agreed-upon contractual terms. Royalties are reported and invoiced one quarter in arrears and generally are based on a fixed unit rate or a percentage of the sale price for the CEVA- based silicon product.

Table of Contents

Strategy

We believe there is a growing demand for high performance and low power DSP and application-specific platforms incorporating DSP cores and all the necessary hardware and software for target applications. We believe the growth in the demand for these platforms will drive demand for our technology. As CEVA offers expertise developing these complete solutions in a number of key growth markets, including handsets, mobile broadband, wireless infrastructure, image enhancement, and vision, audio and voice applications, Bluetooth and storage, we believe we are well positioned to take full advantage of this industry shift. To capitalize on this industry shift, we intend to:

- continue to develop and enhance our range of DSP cores with additional features, performance and capabilities;
- continue to develop and enhance our range of complete and highly integrated platform solutions to deliver to our licensing partners a complete and verified system solution;
- continue to develop an ecosystem of third party partners developing software and solutions based on our DSPs;
- capitalize on our relationships and leadership within our worldwide community of semiconductor and OEM licensees who are developing CEVA-based solutions;
- capitalize on our technology leadership in the development of advanced DSP technologies to create and develop new, strategic relationships with OEMs and semiconductor companies to replace their internal DSPs or incumbent DSP suppliers with CEVA-based solutions; and
- capitalize on our IP licensing and royalty business model which we believe is the best vehicle for a pervasive adoption of our technology and allows us to focus our resources on research and development of new licensable technologies and applications.

Products

We are the leading licensor of SIP platform solutions and DSP cores to the semiconductor industry. We offer a family of programmable DSP cores and a portfolio of application-specific platforms, including wireless baseband (terminal and infrastructure), multimedia (HD audio, HD video, imaging and gesture), voice (VoIP), Bluetooth and serial storage technology (SATA and SAS).

CEVA DSP Cores

We market a family of synthesizable, programmable DSP cores, each delivering a different balance of performance, power dissipation and cost, thereby allowing customers to select a DSP core ideally suited for their target application. The ability to match processing power to the application is a crucial consideration when designers select a DSP supplier. Our DSP cores are families of architectures, each largely software compatible, meaning that software from one core within the same architecture can be applied to another core, which significantly reduces investment in code development, tools and design engineer training.

We deliver our DSP cores in the form of a hardware description language definition (known as a soft core or a synthesizable core). All CEVA DSP cores can be manufactured on any process using any physical library, and all are accompanied by a complete set of tools and an integrated development environment. An extensive third-party network supports CEVA DSP cores with a wide range of complementing software and platforms. In addition, we provide development platforms, software development kits and software debug tools, which facilitate system design, debug and software development.

CEVA Platforms & Solutions

In order to reduce the cost, complexity, and risk in bringing products to market, CEVA has developed a suite of system platforms and solutions. These platforms and solutions combine the hardware and software elements that are essential for designers deploying CEVA s state-of-the-art DSP and IP cores. Platforms typically

Table of Contents

integrate a CEVA DSP core, hardware subsystem and application-specific (e.g. LTE, Wi-Fi, vision or audio) software. Our family of DSP-based platforms is targeted for cellular, Wi-Fi and satellite baseband, advanced audio and voice, DTV demodulation, image enhancement and computer vision. We also offer platform solutions for Bluetooth and serial storage technology (SATA and SAS).

Customers

We have licensed our DSP cores and application-specific platforms to leading semiconductor and OEM companies throughout the world. These companies incorporate our IP into application-specific chipsets or custom-designed chipsets that they manufacture, market and sell to consumer electronics companies. We also license our DSP cores and application-specific platforms to OEMs directly. Included among our licensees are the following customers: Broadcom, Icom, Intel, Intersil, Marvell, Mediatek, Mindspeed, MStar, NEC, NXP, PMC-Sierra, Renesas, Samsung, Sharp, Solomon Systech, Sony, Spreadtrum, ST Ericsson, Sunplus, Toshiba, VIA Telecom and Xincomm. As of the end of 2012, we had 27 licensees shipping products incorporating our technologies, pursuant to 35 licensing agreements. Three customers accounted for 24%, 13% and 12% of our total revenues for 2012.

We derive a significant amount of revenues from a limited number of customers. Three customers separately accounted for 24%, 13% and 12% of our total revenues for 2012. One customer accounted for 24%, 17% and 18% of our total revenues for 2012, 2011 and 2010, respectively. Generally, the identity of our 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 and annual basis. With respect to our royalty revenues, four royalty paying customers each represented 10% or more of our total royalty revenues for 2012 and 2011, and collectively represented 74% and 66% of our total royalty revenues for 2012 and 2011, respectively. However, two of the four 10% or more royalty paying customers in 2012 and 2011 did not exceed 10% of our total royalty revenues for 2010. We expect that a significant portion of our future revenue 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.

International Sales and Operations

Customers based in EME (Europe and Middle East) and APAC (Asia Pacific) accounted for 79% of our total revenues for 2012, 76% for 2011 and 79% for 2010. Customers in each of Germany, China and Japan accounted for greater than 10% of our total revenues for 2012. Customers in each of Germany, Switzerland and China accounted for greater than 10% of our total revenues for both 2011 and 2010. Although the majority of our sales to foreign customers are denominated in United States dollars, we are subject to risks of conducting business internationally. These risks include fluctuations in exchange rates, unexpected changes in regulatory requirements, delays resulting from difficulty in obtaining export licenses for certain technologies, tariffs, other barriers and restrictions and the burden of complying with a variety of foreign laws. Information on the geographic breakdown of our revenues and location of our long-lived assets is contained in Note 10 to our consolidated financial statements, which appear elsewhere in this annual report.

Moreover, the majority of our expenses, mainly employee salaries, are paid in currencies other than the U.S. dollar, principally the Israeli currency, New Israeli Shekel (NIS), and to some extent the Euro and the British pound, which subjects us to the risks of foreign currency fluctuations and economic pressures in those regions. As a result, an increase in the value of the currencies other than the U.S. dollar in comparison to the U.S. dollar could increase the cost of our operating expenses. To protect against the increase in value of forecasted foreign currency cash flows resulting from salaries paid in currencies other than the U.S. dollar, during the year, we instituted a foreign currency cash flow hedging program. We hedge portions of the anticipated payroll for our Israeli, Irish and British employees denominated in the NIS, the Euro and the British pound for a period of one to twelve months with forward and options contracts. There are no assurances that future hedging transactions will successfully mitigate losses caused by currency fluctuations.

Table of Contents

Sales and Marketing

We license our technology through a direct sales force. As of December 31, 2012, we had 27 employees in sales and marketing. We have sales offices and representation in Asia Pacific (APAC) region, Japan, Sweden, Israel and the United States.

Maintaining close relationships with our customers and strengthening these relationships are central to our strategy. We typically launch each new DSP core, platform or solution upgrade with a signed license agreement with a tier-one customer, which signifies to the market that we are focused on viable applications that meet broad industry needs. Staying close to our customers allows us to create a roadmap for the future development of existing cores and application platforms, and helps us to anticipate the next potential applications for the market. We seek to use our customer relationships to deliver new products in a faster time to market.

We use a variety of marketing initiatives to stimulate demand and brand awareness in our target markets. These marketing efforts include contacts with industry analysts, presenting at key industry trade shows and conferences, and posting information on our website and live technology-oriented webinars. Our marketing group runs competitive benchmark analyses to help us maintain our competitive position.

Technical Support

We offer technical support services through our offices in Israel, Ireland, Asia Pacific (APAC) region, Japan, Sweden and the United States. As of December 31, 2012, we had 17 employees in technical support. Our technical support services include:

- assistance with implementation, responding to customer-specific inquiries, training and, when and if they become available, distributing updates and upgrades of our products;
- application support, consisting of providing general hardware and software design examples, ready-to-use software modules and guidelines to our licensees to assist them in using our technology; and
- design services, consisting of creating customer-specific implementations of our DSP cores and application platforms.

We believe that our technical support services are a means to assist our licensees to embed our cores and platforms in their designs and products. Our technology is highly complex, combining sophisticated DSP core architecture, integrated circuit designs and development tools. Effective customer support in helping our customers to implement our solutions enables them to shorten the time to market for their applications. Our support organization is made up of experienced engineers and professional support personnel. We conduct technical training for our licensees and their customers, and meet with them from time to time to track the implementation of our technology.

Research and Development

Our research and development team is focused on improving and enhancing our existing products, as well as developing new products to broaden our offerings and market opportunities. These efforts are largely driven by current and anticipated customer needs.

Our research and development team, consisting of 124 engineers as of December 31, 2012, work in five development centers located in Israel, Ireland and the United Kingdom. This team consists of engineers who possess significant experience in developing DSP cores, solutions and application platforms, Bluetooth and serial storage technology (SATA and SAS). In addition, we engage third party contractors with specialized skills as required to support our research and development efforts. Our research and development expenses, net of related research grants, were approximately $18 million, $22 million and $20 million in 2010, 2011 and 2012, respectively.

Table of Contents

We encourage our research and development personnel to maintain active roles in various international organizations that develop and maintain standards in the electronics and related industries. This involvement allows us to influence the development of new standards; keeps us informed as to important new developments regarding standards; and allows us to demonstrate our expertise to existing and potential customers who also participate in these standards-setting bodies.

Competition

The markets in which we operate are intensely competitive. They are subject to rapid change and are significantly affected by new product introductions. We compete with other suppliers of licensed DSP cores and solutions. We believe that the principal competitive elements in our field are DSP performance, overall chip cost, power consumption, flexibility, reliability, communication and multimedia software availability, design cycle time, tool chain, customer support, financial strength, name recognition and reputation. We believe that we compete effectively in each of these areas, but can offer no assurance that we will have the financial resources, technical expertise, and marketing or support capabilities to compete successfully in the future.

The markets in which we compete are dominated by large, fully-integrated semiconductor companies that have significant brand recognition, a large installed base and a large network of support and field application engineers. We face direct and indirect competition from:

- IP vendors that offer programmable DSP cores;
- IP vendors of general purpose processors with DSP extensions;
- IP vendors that offer hardware-based DSP implementation as opposed to software-based DSP, which is our specialization; and
- internal design groups of large chip companies or OEMs that develop proprietary DSP cores or engines for their own application-specific chipsets.

We face direct competition in the DSP core space mainly from Verisilicon, which licenses DSP cores in addition to its semiconductor business.

In recent years, we also have faced competition from companies that offer Central Processor Unit (CPU) intellectual property. These companies products are used for host functions in various applications, such as in mobile and home entertainment products. These applications typically also incorporate a programmable DSP that is responsible for communication and video/audio/voice compression. CPU companies, such as ARM Holdings, Imagination Technologies, Synopsys and Tensilica have added DSP technology and make use of it to provide platform solutions in the areas of baseband, video, imaging, gesture and audio.

With respect to certain large potential customers, we also compete with internal engineering teams, which may design programmable DSP core products in-house. Companies such as Broadcom, Mediatek, Qualcomm, Samsung and ST-Ericsson license our designs for some applications and use their own proprietary cores for other applications. These companies also may choose to license their proprietary DSP cores to third parties and, as a result, become direct competitors.

Aside from the in-house research and development groups, we do not compete with any individual company across the range of our market offerings. Within particular market segments, however, we do face competition to a greater or lesser extent from other industry participants. For example, in the following specific areas we compete with the companies indicated:

- in the image enhancement & vision market Imagination Technologies, ARM, Tensilica and Silicon Image;
- in the serial storage technology market Gennum s Snowbush IP Group, Silicon Image and Synopsys;

in the Bluetooth market RivieraWaves and Mindtree; and in audio applications market ARM Holdings, Synopsys, Tensilica and Verisilicon.

Proprietary Rights

Our success and ability to compete are dependent on our ability to develop and maintain the proprietary aspects of our intellectual property and to operate without infringing the proprietary rights of others. We rely on a combination of patent, trademark, trade secret and copyright laws and contractual restrictions to protect the proprietary aspects of our technology. These legal protections afford only limited protection of our technology. We also seek to limit disclosure of our intellectual property and trade secrets by requiring employees and consultants with access to our proprietary information to execute confidentiality agreements with us and by restricting access to our source code and other intellectual property. Due to rapid technological change, we believe that factors such as the technological and creative skills of our personnel, new product developments and enhancements to existing products are more important than specific legal protections of our technology in establishing and maintaining a technology leadership position.

We have an active program to protect our proprietary technology through the filing of patents. Our patents relate to our DSP cores and application-specific platform technologies. As of December 31, 2012, we hold 46 patents in the United States and 11 patents in the EME (Europe and Middle East) region and four patents in Asia Pacific (APAC) region, totaling 61 patents, with expiration dates between 2013 and 2030. In addition, as of December 31, 2012, we have 16 patent applications pending in the United States, 11 pending patent applications in Canada, 17 pending patent applications in the EME region and 9 pending patent applications in the APAC region, totaling 53 pending patent applications.

We actively pursue foreign patent protection in countries where we feel it is prudent to do so. Our policy is to apply for patents or for other appropriate statutory protection when we develop valuable new or improved technology. The status of patents involves complex legal and factual questions, and the breadth of claims allowed is uncertain. Accordingly, there are no assurances that any patent application filed by us will result in a patent being issued, or that our issued patents, and any patents that may be issued in the future, will afford us adequate protection against competitors with similar technology; nor can we be assured that patents issued to us will not be infringed or that others will not design around our technology. In addition, the laws of certain countries in which our products are or may be developed, manufactured or sold may not protect our products and intellectual property rights to the same extent as the laws of the United States. We can provide no assurance that our pending patent applications or any future applications will be approved or will not be challenged by third parties, that any issued patents will effectively protect our technology, or that patents held by third parties will not have an adverse effect on our ability to do business.

The semiconductor industry is characterized by frequent litigation regarding patent and other intellectual property rights. Questions of infringement in the semiconductor field involve highly technical and subjective analyses. 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. Litigation may in the future be necessary to enforce our patents and other intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. We cannot assure you that we would be able to prevail in any such litigation, or be able to devote the financial resources required to bring such litigation to a successful conclusion.

In any potential dispute involving our patents or other intellectual property, our licensees also could become the targets of litigation. We are generally bound to indemnify licensees under the terms of our license agreements. Although our indemnification obligations are generally subject to a maximum amount, these obligations could nevertheless result in substantial expenses. In addition to the time and expense required for us to indemnify our licensees, a licensee s development, marketing and sale of products embodying our solutions could be severely disrupted or shut down as a result of litigation.

We also rely on trademark, copyright and trade secret laws to protect our intellectual property. We have registered trademark in the United States for our name CEVA and the related CEVA logo, and currently market our DSP cores and other technology offerings under this trademark.

Employees

The table below presents the number of employees of CEVA as of December 31, 2012 by function and geographic location.

	Number
Total employees	**193**
Function	
Research and development	124
Sales and marketing	27
Technical support	17
Administration	25
Location	
Israel	142
Ireland	14
United States	10
United Kingdom	7
China	7
Elsewhere	13

Our employees are not represented by any collective bargaining agreements, and we have never experienced a work stoppage. We believe our employee relations are good.

A number of our employees are located in Israel. Certain provisions of Israeli law and the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations (the Israeli federation of employers organizations) apply to our Israeli employees.

In 2004, we finalized and adopted a new Code of Business Conduct and Ethics regarding the standards of conduct of our directors, officers and employees, and the Code is available on our website at www.ceva-dsp.com.

Corporate History

Our company was incorporated in Delaware on November 22, 1999 under the name DSP Cores, Inc. We changed our name to ParthusCeva, Inc. in November 2002 and to CEVA, Inc. in December 2003.

Available Information

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to reports pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are available, free of charge, on our website at www.ceva-dsp.com, as soon as reasonably practicable after such reports are electronically filed with the Securities and Exchange Commission and are also available on the SEC s website at www.sec.gov.

Our website and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K.

Table of Contents

ITEM 1A. RISK FACTORS

We caution you that the following important factors, among others, could cause our actual future results to differ materially from those expressed in forward-looking statements made by or on behalf of us in filings with the Securities and Exchange Commission, press releases, communications with investors and oral statements. Any or all of our forward-looking statements in this annual report, and in any other public statements we make, may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in the discussion below will be important in determining future results. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make in our reports filed with the Securities and Exchange Commission.

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

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. Many of our competitors are striving to increase their share of the growing DSP market 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;
- we compete with CPU IP or configurable CPU IP providers, such as ARM Holdings, Imagination Technologies (resulting from its acquisition of MIPS Technologies), Synopsys and Tensilica, who offer DSP configured CPU and/or DSP extensions to their IP;
- we compete with internal engineering teams at companies such as Broadcom, Mediatek, Qualcomm, Samsung and ST Ericsson 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 Gennum s Snowbush IP group, Silicon Image and Synopsys, that offer similar products, thereby leading to pricing pressures for both licensing and royalty revenue;
- we compete in the imaging & vision market with Imagination Technologies and Silicon Image;
- we compete in the VoIP applications market with ARM Holdings, Imagination Technologies (resulting from its acquisition of MIPS Technologies) and Verisilicon; and
- we compete in the audio applications market with ARM Holdings, Synopsys, Tensilica 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 DSP 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.

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;

Table of Contents

- any delay in execution of any anticipated licensing arrangement during a particular quarter;
- 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;
- 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;
- 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 of the Euro, the British Pound and 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 certain R&D government grant payments;
- our ability to scale our operations in response to changes in demand for our technologies;
- entry into new markets, including China, India and Latin America;
- 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 the weakest quarter for us in relation to royalty revenues as this period represents lower post-Christmas first quarter handset and consumer product shipments. However, the magnitude of this second quarter decrease varies annually and may be impacted by global economic conditions, market share changes 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.

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 revenue derived from a limited number of customers.

We derive a significant amount of revenues from a limited number of customers. Three customers separately accounted for 24%, 13% and 12% of our total revenues for 2012. One customer accounted for 24%, 17% and 18% of our total revenues for 2012, 2011 and 2010, respectively. Generally, the identity of our 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 and annual basis. With respect to our royalty revenues, four royalty paying customers each represented 10% or more of our total royalty revenues for 2012 and 2011, and collectively represented 74% and 66% of our total royalty revenues for 2012 and 2011, respectively. We expect that a significant portion of our future revenue 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.

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

License agreements for our DSP cores have not historically provided for substantial ongoing license payments so past licensing revenue may not be indicative of the amount of such revenue in any future period. Significant portions of our anticipated future revenue, therefore, will likely depend upon our success in attracting new customers or expanding our relationships with existing customers. However, 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. 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 revenue and cash flow. Royalty revenues were approximately 60%, 60% and 51% of our total revenues for 2012, 2011 and 2010, 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. For example, our royalty revenue decreased in 2012 in connection with a significant decline in the average selling prices of low-cost 2G feature phones. Furthermore, consolidation among our customers may increase the leverage of our existing customers to extract concessions from us in royalty rates.

We generate a significant amount of our total revenues from the handsets and mobile broadband markets and our business and operating results may be materially adversely affected if we do not continue to succeed in these highly competitive markets.

Revenues derived from the handsets and mobile broadband markets accounted for approximately 77% of our total revenues for both 2012 and 2011, and 72% for 2010. Moreover, a significant percentage of our handset revenues are from royalties derived from sales of 2G feature phones. Any adverse change in our ability to compete and maintain our competitive position in the handsets and mobile broadband markets, including through

Table of Contents

the introduction by competitors of enhanced technologies that attract OEM customers that target these markets, would harm our business, financial condition and results of operations. Moreover, the handsets and mobile broadband markets are extremely competitive and are facing intense pricing pressures, and we expect that competition and pricing pressures will only increase. For example, our royalty revenue decreased in 2012 in connection with a significant decline in the average selling prices of low-cost 2G feature phones. Our existing OEM customers also may fail to introduce new handsets or mobile broadband devices that attract consumers, or encounter significant delays in developing, manufacturing or shipping new or enhanced products in these 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.

According to the latest research from Gartner, 2012 global mobile phone sales declined by 1.7% year-on-year, from 1.78 billion to 1.75 billion. The last time Gartner reported a decline was in 2009. Since a significant portion of our revenues are derived from the handset 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 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 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.

Table of Contents

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 DSPs towards licensing open DSP cores. Furthermore, the third-party licensable intellectual property model is highly dependent on the market adoption of new services and products, such as smartphones, mobile broadband, ultra-low-cost phones in emerging markets, Personal Multimedia Players (PMP), Blu-ray DVDs, connected digital TVs and set-top boxes with high definition audio and video. 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.

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 79% of our total revenues for 2012, 76% for 2011 and 79% for 2010 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 revenue 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; 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.

Our operating results are affected by general economic conditions and the highly cyclical nature of the semiconductor industry.

During the global downturn that started in the second half of 2008 and continued throughout 2009, general worldwide economic conditions significantly deteriorated, and resulted in decreased consumer confidence and spending, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns. Notwithstanding improvements in business conditions since the second half of 2009, there continues to be uncertainty about the global economy and outlook, which continue to make it difficult for our customers, the end-product customers, our vendors and us to accurately forecast and plan future business activities and make reliable projections.

Moreover, 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.

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

Our success will depend on our ability to successfully manage our geographically dispersed operations.

Most of our employees are located in Israel and Ireland. 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.

Our research and development expenses may increase if the grants we currently receive from the Israeli government 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. We received an aggregate of $2,849,000, $2,518,000 and $2,322,000 in 2012, 2011 and 2010, respectively. 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.

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 revenue is 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 to some extent Euro and British Pound, 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. We expect to continue to experience the effect of exchange rate currency fluctuations on an annual and quarterly basis.

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 $20.2 million, $21.5 million and $17.9 million for 2012, 2011 and 2010, respectively. 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. 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

Table of Contents

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 programmable DSP cores and application IP 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.

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;
- 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 these 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.

Our business depends on our customers and their suppliers obtaining required complementary components.

Some of the raw materials, components and subassemblies included in the products manufactured by our OEM customers are obtained from a limited group of suppliers. Supply disruptions, shortages or termination of any of these sources could have an adverse effect on our business and results of operations due to the delay or discontinuance of orders for products containing our IP, especially our DSP cores, until those necessary components are available.

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.

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 2013) 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 2014. 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.

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.

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 a substantial portion of our taxable income historically has been generated there. Currently, some of 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 and Irish 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 double taxed both in Israel and the U.S due to different Controlled Foreigner Corporation rules.

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.

Table of Contents

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our headquarters are located in Mountain View, California and we have principal offices in Herzeliya, Israel and Dublin, Ireland.

We lease buildings for our executive offices, and engineering, sales, marketing, administrative and support operations and design centers. The following table summarizes information with respect to the principal facilities leased by us as of December 31, 2012:

Location	Term	Expiration	Area (Sq. Feet)	Principal Activities
Mountain View, CA, U.S.	5 years	2015	3,643	Headquarters; sales and marketing; administration
Herzeliya, Israel	4 years	2014	28,880	Research and development; administration; sales
Dublin, Ireland (1)	1 year	2013	2,270	Research and development; administration
Cork, Ireland (2)	5 years	2016	2,870	Research and development
Belfast, UK (3)	15 years	2019	2,600	Research and development

(1) On March 2013, we agreed with the landlord to extend the current lease to September 30, 2013.
(2) Break clause in the lease exercisable in 2013.
(3) Break clause in the lease exercisable on payment of one year rent.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we are involved in litigation relating to claims arising out of our operations in the normal course of business. We are not a party to any legal proceedings, the adverse outcome of which, in management s opinion, would have a material adverse effect on our results of operations or financial position.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

Table of Contents

EXECUTIVE OFFICERS OF THE REGISTRANT

Below are the names, ages and principal recent business experience of our current executive officers. All such persons have been appointed by our board of directors to serve until their successors are elected and qualified or until their earlier resignation or removal.

Gideon Wertheizer, age 56, has served as our Chief Executive Officer since May 2005. He joined our board of directors in January 2010. Mr. Wertheizer has 30 years of experience in the semiconductor and Silicon Intellectual Property (SIP) industries. He previously served as the Executive Vice President and General Manager of the DSP business unit at CEVA. Prior to joining CEVA in November 2002, Mr. Wertheizer held various executive positions at DSP Group, Inc., including such roles as Executive VP Strategic Business Development, Vice President for Marketing and Vice President of VLSI design. Mr. Wertheizer holds a BsC for electrical engineering from Ben Gurion University in Israel and executive MBA from Bradford University in the United Kingdom.

Yaniv Arieli, age 44, has served as our Chief Financial Officer since May 2005. Prior to his current position, Mr. Arieli served as President of U.S. Operations and Director of Investor Relations of DSP Group beginning in August 2002 and Vice President of Finance, Chief Financial Officer and Secretary of DSP Group s DSP Cores Licensing Division prior to that time. Before joining DSP Group in 1997, Mr. Arieli served as an account manager and certified public accountant at Kesselman & Kesselman, a member of PricewaterhouseCoopers, a leading accounting firm. Mr. Arieli is a CPA and holds a B.A. in Accounting and Economics from Haifa University in Israel and an M.B.A. from Newport University and is also a member of the National Investor Relation Institute.

Issachar Ohana, age 47, has served as our Vice President, Worldwide Sales, since November 2002 and our Executive Vice President, Worldwide Sales, since July 2006. Prior to joining CEVA in November 2002, Mr. Ohana was with DSP Group beginning in August 1994 as a VLSI design engineer. He was appointed Project Manager of DSP Group s research and development in July 1995, Director of Core Licensing in August 1998, and Vice President Sales of the Core Licensing Division in May 2000. Mr. Ohana holds a B.Sc. in Electrical and Computer Engineering from Ben Gurion University in Israel and an MBA from Bradford University in the United Kingdom.

Table of Contents

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock began trading on The NASDAQ Global Market and the London Stock Exchange on November 1, 2002. Our common stock currently trades under the ticker symbol CEVA on NASDAQ and under the ticker symbol CVA on the London Stock Exchange. As of February 28, 2013, there were approximately 974 holders of record, which we believe represents approximately 7,573 beneficial holders. The closing price of our common stock on The NASDAQ Global Market on March 8, 2013 was $15.56 per share. The following table sets forth, for the periods indicated, the range of high and low closing prices per share of our common stock, as reported on The NASDAQ Global Market.

	Price Range of Common Stock	
	High	**Low**
2012		
First Quarter	$ 30.48	$ 21.91
Second Quarter	$ 22.94	$ 15.47
Third Quarter	$ 17.80	$ 14.17
Fourth Quarter	$ 16.30	$ 13.15
2011		
First Quarter	$ 26.84	$ 21.17
Second Quarter	$ 34.33	$ 25.68
Third Quarter	$ 32.94	$ 23.25
Fourth Quarter	$ 33.02	$ 22.81

We have never paid any cash dividends. We intend to retain future earnings, if any, to fund the development and growth of our business and currently do not anticipate paying cash dividends in the foreseeable future.

Equity Compensation Plan Information

Information as of December 31, 2012 regarding options granted under our option plans and remaining available for issuance under those plans will be contained in the definitive 2013 Proxy Statement for the 2013 annual meeting of stockholders to be held on June 11, 2013 and incorporated herein by reference.

Issuer Purchases of Equity Securities

The table below sets forth the information with respect to repurchases of our common stock during the three months ended December 31, 2012.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)
Month #1 (October 1, 2012 to October 31, 2012)				727,478
Month #2 (November 1, 2012 to November 30, 2012)	243,326	$ 14.45	243,326	484,152
Month #3 (December 1, 2012 to December 31, 2012)				484,152
TOTAL	243,326	$ 14.45	243,326	484,152 (2)

Table of Contents

(1) In January 2012, our Board of Directors reaffirmed its authorization for the repurchase of 1,966,700 shares of our common stock all pursuant to Rule 10b-18 of the Securities Exchange Act of 1934, as amended.
(2) The number represents the number of shares of our common stock that remain available for repurchase pursuant to our share repurchase program.

2013 Annual Meeting of Stockholders

We anticipate that the 2013 annual meeting of our stockholders will be held on June 11, 2013 in New York City, NY.

Stock Performance Graph

Notwithstanding anything to the contrary set forth in any of the Company s previous or future filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, that might incorporate this proxy statement or future filings made by the Company under those statutes, the below Stock Performance Graph shall not be deemed filed with the United States Securities and Exchange Commission and shall not be deemed incorporated by reference into any of those prior filings or into any future filings made by the Company under those statutes.

	12/31/07	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12
CEVA, Inc.	**100.00**	**57.33**	**105.32**	**167.90**	**247.83**	**128.99**
NASDAQ Composite	**100.00**	**60.02**	**87.24**	**103.08**	**102.26**	**120.41**
Morningstar Semiconductor	**100.00**	**55.63**	**91.71**	**107.79**	**103.63**	**110.40**

The stock performance graph above compares the percentage change in cumulative stockholder return on the common stock of our company for the period from December 31, 2007, through December 31, 2012, with the cumulative total return on The NASDAQ Global Market (U.S.) Composite Index and the Morningstar Semiconductor Group Index.

Table of Contents

This graph assumes the investment of $100 in our common stock (at the closing price of our common stock on December 31, 2007), the NASDAQ Global Market (U.S.) Composite Index and the Morningstar Semiconductor Group Index on December 31, 2007, and assumes dividends, if any, are reinvested.

Comparisons in the graph above are based upon historical data and are not indicative of, nor intended to forecast, future performance of our common stock.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data should be read in conjunction with, and are qualified by reference to, our consolidated financial statements and the related notes, as well as our Management s Discussion and Analysis of Financial Condition and Results of Operations for the fiscal year ended December 31, 2012, both appearing elsewhere in this annual report.

	Year Ended December 31,				
	2008	2009	2010 (in thousands)	2011	2012
Consolidated Statements of Income Data:					
Revenues:					
Licensing	$ 21,701	$ 18,764	$ 18,395	$ 20,239	$ 18,248
Royalties	14,349	16,225	22,866	36,403	31,950
Other revenue	4,315	3,478	3,650	3,597	3,479
Total revenues	40,365	38,467	44,911	60,239	53,677
Cost of revenues	4,668	4,117	3,712	3,559	3,952
Gross profit	35,697	34,350	41,199	56,680	49,725
Operating expenses:					
Research and development, net	20,172	16,561	17,909	21,543	20,243
Sales and marketing	7,088	6,732	7,308	8,937	9,231
General and administrative	6,637	6,087	6,108	7,639	7,884
Amortization of intangible assets	53				
Reorganization, restructuring and severance charge	4,121				
Total operating expenses	38,071	29,380	31,325	38,119	37,358
Operating income (loss)	(2,374)	4,970	9,874	18,561	12,367
Financial income, net	2,729	2,048	2,095	2,909	3,380
Other income, net	12,011	3,712			
Income before taxes on income	12,366	10,730	11,969	21,470	15,747
Income tax expense	3,801	2,384	591	2,908	2,062
Net income	$ 8,565	$ 8,346	$ 11,378	$ 18,562	$ 13,685
Basic net income per share	$ 0.43	$ 0.42	$ 0.54	$ 0.80	$ 0.60
Diluted net income per share	$ 0.42	$ 0.41	$ 0.51	$ 0.77	$ 0.59

	December 31,				
	2008	2009	2010 (in thousands)	2011	2012
Consolidated Balance Sheet Data:					
Working capital	$ 83,886	$ 101,169	$ 114,928	$ 136,483	$ 131,545
Total assets	137,586	155,444	186,608	219,140	216,333

Total long-term liabilities	3,788	4,483	5,486	5,607	6,158
Total stockholders equity	$ 121,659	$ 139,096	$ 168,468	$ 200,920	$ 196,068

Table of Contents

QUARTERLY FINANCIAL INFORMATION

	Three months ended							
	March 31,	June 30,	September 30, 2011	December 31,	March 31,	June 30,	September 30, 2012	December 31,
Revenues:								
Licensing	$ 5,108	$ 5,195	$ 5,225	$ 4,711	$ 5,116	$ 5,364	$ 4,213	$ 3,555
Royalties	9,206	8,272	8,766	10,159	9,106	7,595	7,046	8,203
Other revenue	738	921	856	1,082	890	633	747	1,209
Total revenues	15,052	14,388	14,847	15,952	15,112	13,592	12,006	12,967
Cost of revenues	948	876	811	924	870	1,011	1,046	1,025
Gross profit	14,104	13,512	14,036	15,028	14,242	12,581	10,960	11,942
Operating expenses:								
Research and development, net	5,250	5,405	5,158	5,730	5,486	5,425	4,637	4,695
Sales and marketing	2,224	2,327	2,099	2,287	2,289	2,104	2,235	2,603
General and administrative	1,754	1,732	2,057	2,096	1,869	1,849	1,940	2,226
Total operating expenses	9,228	9,464	9,314	10,113	9,644	9,378	8,812	9,524
Operating income	4,876	4,048	4,722	4,915	4,598	3,203	2,148	2,418
Financial income, net	545	707	784	873	948	974	731	727
Income before taxes on income	5,421	4,755	5,506	5,788	5,546	4,177	2,879	3,145
Income taxes	770	632	571	935	689	698	285	390
Net income	$ 4,651	$ 4,123	$ 4,935	$ 4,853	$ 4,857	$ 3,479	$ 2,594	$ 2,755
Basic net income per share	$ 0.20	$ 0.18	$ 0.21	$ 0.21	$ 0.21	$ 0.15	$ 0.12	$ 0.12
Diluted net income per share	$ 0.19	$ 0.17	$ 0.20	$ 0.20	$ 0.20	$ 0.15	$ 0.11	$ 0.12
Weighted average shares used to compute net income per share (in thousands):								
Basic	22,692	23,107	23,390	23,491	23,507	22,873	22,526	22,300
Diluted	23,888	24,165	24,253	24,293	24,239	23,449	23,019	22,737

Table of Contents

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion together with the consolidated financial statements and related notes appearing elsewhere in this annual report. This discussion contains forward-looking statements that involve risks and uncertainties. Actual results may differ materially from those included in such forward-looking statements. Factors that could cause actual results to differ materially include those set forth under Risk Factors, as well as those otherwise discussed in this section and elsewhere in this annual report. See Forward-Looking Statements and Industry Data.

BUSINESS OVERVIEW

The following discussion and analysis is intended to provide an investor with a narrative of our financial results and an evaluation of our financial condition and results of operations. The discussion should be read in conjunction with our consolidated financial statements and notes thereto for the year ended December 31, 2012, both appearing elsewhere in this annual report.

CEVA is the world s leading licensor of DSP cores and platform solutions. Our technologies are widely licensed and power many of the world s leading semiconductor and original equipment manufacturer (OEM) companies. In 2012, our licensees shipped more than one billion CEVA-powered chipsets targeted for a wide range of diverse end markets. To date, more than 4 billion CEVA-powered devices have shipped, illustrating the strong market deployment of our technology.

During the past six years, our business has shown profitability growth and market share expansion as a result of the widespread deployment of our DSP cores with all major handset OEMs, including HTC, Huawei, Lenovo, LG Electronics, Motorola, Nokia, Samsung, Sony and ZTE. Based on internal data and Strategy Analytics worldwide shipment data, CEVA s worldwide market share of cellular baseband chips that incorporate our technologies was approximately 46% of the worldwide shipment volume based on preliminary data for third quarter 2012 worldwide shipments. Revenues derived from the handset and mobile broadband markets accounted for approximately 77% of our total revenues for 2012.

We believe the adoption of our DSP cores and technologies in the handset and mobile broadband markets continues to progress. Specifically, we believe the emergence of merchant 3G cellular chips from companies such as Broadcom, Intel and Spreadtrum, all of whom are our customers, are strong positive drivers for our future market share expansion. Moreover, Strategy Analytics forecasts that worldwide cellular baseband shipments will grow by 4.58% in 2013 to reach 2.387 billion units. We believe that the majority of this growth will come from low cost 3G smartphones in developing countries, especially China, and the broader adoption of 4G LTE-based advanced smartphones in mature markets. We are well positioned to capitalize on the growth in these segments, as well as growth from other mobile connected devices such as tablets, notebooks and other machine to-machine devices, as key chip suppliers serving these markets use our technologies broadly.

Beyond products enabled by our technologies for cellular baseband communications , we continue to strategically target growth in non-baseband applications, such as audio, voice, imaging, vision and connectivity. Advanced audio and wideband voice processing requires significantly more DSP performance than existing solutions used in smartphones, automotive and digital home applications. Our audio/voice product lines, including the CEVA-TeakLite-III and new CEVA-TeakLite-4 DSPs, are ideally positioned to address these requirements, and can enable us to continue to expand our licensing base in these markets.

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 handset as well as the other evolving cellular markets, such as mobile computing and machine to machine. Our competitive edge in software-defined radio technology for the next generations of LTE

Table of Contents

and Wi-Fi, and the inherent low cost and power performance balance of our technologies, puts us in a strong position to simultaneously capitalize on mass market adoption and address all of the growth vectors of the space.

Our proven track record in baseband technologies, in particular our pioneering position in software-defined radio, allows us to expand into the base station market, including the high volume potential in small cells.

The spectral efficiency of LTE enables additional and very interesting new opportunities for DSP-related products. One such use is Voice Over LTE, where higher bit rate speech codecs combined with advanced noise and echo cancellation, allow substantially clearer phone calls along with higher intelligibility that is required for services such as voice recognition.

The market potential for image enhancement and vision analytics in cameras offers a new growth segment for the company. Our MM3101 platform is the only one in the industry today that offers a unified vision and imaging platform that can support these future developments. Per ABI Research, one billion cameras were shipped in 2012, and this number is predicted to grow to 2.7 billion in 2017. 80% of this volume is attributable to smartphones, where we already have a strong foothold through our other technologies. Mobile OEMs are looking for new DSLR features such as smarter autofocus, best picture using super resolution algorithms, and better image capture in low-light environments. Furthermore, with the addition of video analytics support, cameras will enable new services like augmented reality, gesture recognition and advanced safety capabilities in cars. We see this new revolution as an emerging opportunity for us to significantly expand our footprint in smartphones and further into tablets, PCs and automotive applications.

Notwithstanding the various growth opportunities we have outlined above, our business operates in a highly competitive 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 cellular connectivity, and voice, audio and video convergence in the markets that we operate. 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. Moreover, 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 handset market, any negative trends in that market would adversely affect our financial results. According to latest research from Gartner, 2012 global mobile phones sales declined by 1.7% year-on-year, from 1.78 billion to 1.75 billion. The last time Gartner reported a decline was in 2009. Nonetheless, based on our shipment data, we managed to buck this global handset market decline by increasing shipment volumes in 2012. More significantly, we managed to capture a greater portion of 3G shipments based on CEVA DSPs, recording a 11% year-over-year growth.

However, 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

Table of Contents

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 revenue is 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 performance.

CRITICAL ACCOUNTING POLICIES, ESTIMATES AND ASSUMPTIONS

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP). These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. The significant accounting policies that we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- revenue recognition;
- income taxes;
- equity-based compensation; and
- impairment of marketable securities.

In many cases, the accounting treatment of a particular transaction is specifically dictated by U.S. GAAP and does not require management s judgment in its application. There are also areas in which management s judgment in selecting among available alternatives would not produce a materially different result.

Revenue Recognition

Significant management judgments and estimates must be made and used in connection with the recognition of revenue in any accounting period. Material differences in the amount of revenue in any given period may result if these judgments or estimates prove to be incorrect or if management s estimates change on the basis of development of business or market conditions. Management s judgments and estimates have been applied consistently and have been reliable historically.

We generate our revenues from (1) licensing intellectual property, which in certain circumstances is modified for customer-specific requirements, (2) royalty revenues and (3) other revenues, which include revenues from support, training and sale of development systems. We license our IP to semiconductor companies throughout the world. These semiconductor companies then manufacture, market and sell custom-desiIN-RIGHT: 0pt" align="justify">Comprehensive loss was comprised of net loss plus the market value adjustment on our interest rate swap that expired on February 19, 2011, which was designated as a cash flow hedge. Comprehensive loss consisted of the following components:

(in thousands)	Three Months Ended March 31,	
	2011	2010
Net loss	$ (2,716)	$ (2,996)
Change in fair value of interest rate swap, net of income tax of $1 for the three months ended March 31, 2011 and net of income tax benefit of $(14) for the	1	(22)

three months ended March 31, 2010				
Reclassification of derivative net losses to statement of operations, net of income tax of $7 for the three months ended March 31, 2011 and $13 for the three months ended March 31, 2010		10		21
Total comprehensive loss	$	(2,705)	$	(2,997)

NOTE 10 – CLAIMS LIABILITIES

We are self-insured up to certain limits for bodily injury, property damage, workers' compensation, cargo loss and damage claims and medical benefits. Provisions are made for both the estimated liabilities for known claims as incurred and estimates for those incurred but not reported.

Our self-insurance retention levels are $0.5 million for workers' compensation claims per occurrence, $0.05 million for cargo loss and damage claims per occurrence and $1.0 million for bodily injury and property damage claims per occurrence. For medical benefits, the Company self-insures up to $0.25 million per plan participant per year with an aggregate claim exposure limit determined by our year-to-date claims experience and the number of covered lives. We are completely self-insured for physical damage to our own tractors and trailers, except that we carry catastrophic physical damage coverage to protect against natural disasters. We maintain insurance above the amounts for which we self-insure, to certain limits, with licensed insurance carriers. We have excess general, auto and employer's liability coverage in amounts substantially exceeding minimum legal requirements, and we believe this coverage is sufficient to protect against material loss.

We record claims accruals at the estimated ultimate payment amounts based on information such as individual case estimates or historical claims experience. The current portion reflects the amounts of claims expected to be paid in the next twelve months. In making the estimates of ultimate payment amounts and the determinations of the current portion of each claim we rely on past experience with similar claims, negative or positive developments in the case and similar factors. We re-evaluate these estimates and determinations each reporting period based on developments that occur and new information that becomes available during the reporting period.

NOTE 11 – ACCRUED EXPENSES

Accrued expenses consisted of the following:

	(in thousands)			
	March 31, 2011		December 31, 2010	
Salaries, wages and employee benefits	$	5,512	$	3,288
Other (1)		5,196		5,113
Total accrued expenses	$	10,708	$	8,401

(1) As of March 31, 2011 and December 31, 2010, no single item included within other accrued expenses exceeded 5.0% of our total current liabilities.

NOTE 12 – NOTE PAYABLE

On October 20, 2010, the Company's Board of Directors approved an unsecured note payable of $1.3 million, payable in monthly installments of principal and interest of approximately $0.1 million, scheduled to mature on September 1, 2011 and bearing interest at 2.6%. The balance of the note payable at March 31, 2011 was $0.7 million. The note payable is being used to finance a portion of the Company's annual insurance premiums.

At December 31, 2009, we had an unsecured note payable of $1.0 million. The note, which was payable in monthly installments of principal and interest of approximately $0.1 million and bearing interest at 3.4%, matured on September 1, 2010. The note payable was being used to finance a portion of the Company's annual insurance premiums.

NOTE 13 – LONG-TERM DEBT

Long-term debt consisted of the following:

	(in thousands)			
	March 31, 2011		December 31, 2010	
Revolving credit agreement (1)	$	56,686	$	49,900
Capitalized lease obligations (2)		54,223		48,616
		110,909		98,516
Less current maturities		(27,318)		(18,766)
Long-term debt and capital leases, less current maturities	$	83,591	$	79,750

(1) On April 19, 2010, we entered into a new Credit Agreement with Branch Banking and Trust Company as Administrative Agent, which replaced our Amended and Restated Senior Credit Facility scheduled to mature on September 1, 2010. The Credit Agreement provides for available borrowings of up to $100.0 million, including letters of credit not to exceed $25.0 million. Availability may be reduced by a borrowing base limit as defined in the Credit Agreement. The Credit Agreement provides an accordion feature allowing us to increase the maximum borrowing amount by up to an additional $75.0 million in the aggregate in one or more increases, subject to certain conditions. The Credit Agreement bears variable interest based on the type of borrowing and on the Administrative Agent's prime rate or the London Interbank Offered Rate plus a certain percentage, which is determined based on our attainment of certain financial ratios. A quarterly commitment fee is payable on the unused portion of the credit line and bears a rate which is determined based on our attainment of certain financial ratios. The obligations of the Company under the Credit Agreement are guaranteed by the Company and secured by a pledge of substantially all of the Company's assets with the exception of real estate. The Credit Agreement includes usual and customary events of default for a facility of this nature and provides that, upon the occurrence and continuation of an event of default, payment of all amounts payable under the Credit Agreement may be accelerated, and the lenders' commitments may be terminated. The Credit Agreement contains certain restrictions and covenants relating to, among other things, dividends, liens, acquisitions and dispositions outside of the

ordinary course of business, and affiliate transactions. The new Credit Agreement will expire on April 19, 2014.

Borrowings under the Credit Agreement are classified as "base rate loans," "LIBOR loans" or "Euro dollar loans." Base rate loans accrue interest at a base rate equal to the Administrative Agent's prime rate plus an applicable margin that is adjusted quarterly between 0.0% and 1.0%, based on the Company's leverage ratio. LIBOR loans accrue interest at LIBOR plus an applicable margin that is adjusted quarterly between 2.00% and 3.25% based on the Company's leverage ratio. Euro dollar loans accrue interest at the LIBOR rate in effect at the beginning of the month in which the borrowing occurs plus an applicable margin that is adjusted quarterly between 2.00% and 3.25% based on the Company's leverage ratio. On a per annum basis, the Company must pay a fee on the unused amount of the revolving credit facility of between 0.25% and 0.375% based on the Company's leverage ratio, and it must pay an annual administrative fee to the Administrative Agent of 0.03% of the total commitments.

The interest rate on our overnight borrowings under the Credit Agreement at March 31, 2011 was 3.25%. The interest rate including all borrowings made under the Credit Agreement at March 31, 2011 was 2.5%. The interest rate on the Company's borrowings under the agreements for the three months ended March 31, 2011 was 2.6%. A quarterly commitment fee is payable on the unused portion of the credit line and bears a rate which is determined based on our attainment of certain financial ratios. At March 31, 2011, the rate was 0.25% per annum. The Credit Agreement is collateralized by revenue equipment having a net book value of $171.2 million at March 31, 2011, and all trade and other accounts receivable. The Credit Agreement requires us to meet certain financial covenants (i.e., a maximum leverage ratio of 3.00 and a minimum fixed charge ratio of 1.4) and to maintain a minimum tangible net worth of approximately $106.1 million at March 31, 2011. We were in compliance with these covenants at March 31, 2011. The covenants would prohibit the payment of dividends by us if such payment would cause us to be in violation of any of the covenants. As the Company reprices its debt on a quarterly basis, the borrowings under the Credit Agreement approximate its fair value.

(2) Our capitalized lease obligations have various termination dates extending through January 2015 and contain renewal or fixed price purchase options. The effective interest rates on the leases range from 2.2% to 4.1% at March 31, 2011. The lease agreements require us to pay property taxes, maintenance and operating expenses.

NOTE 14 – LEASES AND COMMITMENTS

The Company leases certain revenue equipment under capital leases with terms of 36, 42 or 45 months. Balances related to these capitalized leases are included in property and equipment in the accompanying consolidated balances sheets and are set forth in the table below for the three months ended March 31, 2010 and 2011.

	(in thousands)		
	Capitalized Costs	Accumulated Amortization	Net Book Value
March 31, 2011	$ 78,301	$ 23,578	$ 54,723
December 31, 2010	69,795	20,777	49,018

We have entered into leases with lenders who participated in our Amended and Restated Senior Credit Facility and who participate in the Credit Agreement we entered into on April 19, 2010. Those leases contain cross-default provisions with the Facility and the new Credit Agreement, which replaced that Facility. We have also entered into leases with other lenders who do not participate in our Credit Agreement. Multiple leases with lenders who do not participate in our Credit Agreement generally contain cross-default provisions.

We routinely monitor our equipment acquisition needs and adjust our purchase schedule from time to time based on our analysis of factors such as new equipment prices, the condition of the used equipment market, demand for our freight services, prevailing interest rates, technological improvements, fuel efficiency, equipment durability, equipment specifications and the availability of qualified drivers.

As of March 31, 2011, we had commitments for purchases of revenue equipment in the aggregate amount of approximately $33.8 million for the remainder of 2011, none of which is cancelable by us upon advance written notice, and approximately $0.8 million for non-revenue purchases.

NOTE 15 – INCOME TAXES

For each of the three month periods ended March 31, 2011 and 2010, our effective tax rate was 30.6%. Income tax expense varies from the amount computed by applying the statutory federal tax rate to income before income taxes primarily due to state income taxes, net of federal income tax effect, adjusted for permanent differences, the most significant of which is the effect of the per diem pay structure for drivers. Drivers may elect to receive non-taxable per diem pay in lieu of a portion of their taxable wages. This per diem program increases our drivers' net pay per mile, after taxes, while decreasing gross pay, before taxes. As a result, salaries, wages and employee benefits are slightly lower, and our effective income tax rate is higher than the statutory rate. Generally, as pre-tax income increases, the impact of the driver per diem program on our effective tax rate decreases because aggregate per diem pay becomes smaller in relation to pre-tax income. Due to the partially nondeductible effect of per diem pay, our tax rate will fluctuate in future periods based on fluctuations in earnings and in the number of drivers who elect to receive this pay structure.

13

We account for any uncertainty in income taxes by determining whether it is more likely than not that a tax position we have taken in a tax return will be sustained upon examination by the appropriate taxing authority based on the technical merits of the position. In that regard, we have analyzed filing positions in our federal and applicable state tax returns as well as in all open tax years. The only periods subject to examination for our federal returns are the 2008, 2009 and 2010 tax years. We believe that our income tax filing positions and deductions will be sustained on audit and do not anticipate any adjustments that will result in a material change to our consolidated financial position, results of operations and cash flows. In conjunction with the above, our policy is to recognize interest related to unrecognized tax benefits as interest expense and penalties as operating expenses. We have not recorded any unrecognized tax benefits through March 31, 2011.

NOTE 16 – EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is computed based on the weighted average number of shares of Common Stock outstanding during the period. Diluted earnings (loss) per share is computed by adjusting the weighted average number of shares of Common Stock outstanding by Common Stock equivalents attributable to dilutive stock options and restricted stock. The computation of diluted loss per share does not assume conversion, exercise, or contingent issuance of securities that would have an antidilutive effect on loss per share.

The following table sets forth the computation of basic and diluted earnings (loss) per share:

	(in thousands, except per share amounts) Three Months Ended March 31,			
	2011		2010	
Numerator:				
Net loss	$	(2,716)	$	(2,996)
Denominator:				
Denominator for basic earnings (loss) per share – weighted average shares		10,298		10,277
Effect of dilutive securities:				
Employee stock options and restricted stock		--		--
Denominator for diluted earnings (loss) per share – adjusted weighted average shares and assumed conversions		10,298		10,277
Basic earnings (loss) per share	$	(0.26)	$	(0.29)
Diluted earnings (loss) per share	$	(0.26)	$	(0.29)
Weighted average anti-dilutive employee stock options and restricted stock		129		156

NOTE 17 – LITIGATION

We are party to routine litigation incidental to our business, primarily involving claims for personal injury and property damage incurred in the transportation of freight. We maintain insurance to cover liabilities in excess of certain self-insured retention levels. Though management believes these claims to be routine and immaterial to our long-term financial position, adverse results of one or more of these claims could have a material adverse effect on our financial position or results of operations in any given reporting period.

On July 2, 2010 a former driver team member, filed a lawsuit against us titled Hermes Cerdenia vs. USA Truck, Inc. in the Superior Court of the State of California for the County of San Bernardino, alleging various violations of the California Labor Code and seeking certification of the suit as a class action to include "all individuals currently and formerly employed in California as drivers, or other similarly titled positions." We have successfully removed the case to the United States District Court, Central District of California and have filed an answer denying the plaintiff's allegations. The lawsuit seeks monetary damages for the alleged violations. In February 2011, settlement of the lawsuit was negotiated through mediation subject to the District Court's review and approval. Such approval is expected later in 2011. At March 31, 2011, all but $0.05 million of the agreed upon settlement amount had been accrued and this remaining balance was accrued at April 30, 2011.

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

Forward-Looking
Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. These statements generally may be identified by their use of terms or phrases such as “expects,” “estimates,” “anticipates,” “projects,” “believes,” “plans,” “intends,” “may,” “will,” “should,” “could,” “potential,” “continue,” “future” and similar substance. Forward-looking statements are based upon the current beliefs and expectations of our management and are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified, which could cause future events and actual results to differ materially from those set forth in, contemplated by, or underlying the forward-looking statements. Accordingly, actual results may differ from those set forth in the forward-looking statements. Readers should review and consider the factors that may affect future results and other disclosures by the Company in its press releases, Annual Report on Form 10-K and other filings with the Securities and Exchange Commission. Additional risks associated with our operations are discussed in our Annual Report on Form 10-K for the year ended December 31, 2010 under the heading “Risk Factors” in Item 1A of that report and updates, if any, to that information are included in Item 1A of Part II of this report. We disclaim any obligation to update or revise any forward-looking statements to reflect actual results or changes in the factors affecting the forward-looking information. In light of these risks and uncertainties, the forward-looking events and circumstances discussed in this report might not occur.

All forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by this cautionary statement.

References to the “Company,” “we,” “us,” “our” and words of similar import refer to USA Truck, Inc. and its subsidiary.

The following discussion should be read in conjunction with our consolidated financial statements and notes thereto and other financial information that appears elsewhere in this report.

Overview

The following Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) is intended to help the reader understand USA Truck, Inc., our operations and our present business environment. MD&A is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and notes thereto and other financial information that appears elsewhere in this report. This overview summarizes the MD&A, which includes the following sections:

Our Business – a general description of our business, the organization of our operations and the service offerings that comprise our operations.

Results of Operations – an analysis of our consolidated results of operations for the periods presented in our consolidated financial statements and a discussion of seasonality, the potential impact of inflation and fuel availability and cost.

Off-Balance Sheet Arrangements – a discussion of significant financial arrangements, if any, that are not reflected on our balance sheet.

Liquidity and Capital Resources – an analysis of cash flows, sources and uses of cash, debt, equity and contractual obligations.

Critical Accounting Estimates – a discussion of accounting policies that require critical judgment and estimates.

Our Business

We operate primarily in the for-hire truckload segment of the trucking industry. Customers in a variety of industries engage us to haul truckload quantities of freight, with the trailer we use to haul that freight being assigned exclusively to that customer’s freight until delivery. Our business is classified into three operating and reportable segments: our Trucking operating segment consisting primarily of our General Freight and Dedicated Freight service offerings; our Strategic Capacity Solutions (“SCS”) operating segment consisting entirely of our freight brokerage service offering; and our rail Intermodal operating segment. We previously included the results of our freight brokerage and Container-on-Flat-Car (“COFC”) portion of our rail Intermodal service offering in our SCS operating segment. The Trailer-on-Flat-Car (“TOFC”) portion of our rail Intermodal service offering was classified within our Trucking operating segment. COFC and TOFC are now combined and reported as Intermodal and brokerage is now reported as SCS. SCS and Intermodal are reported as separate operating segments.

Our SCS and Intermodal operating segments are intended to provide services which complement our Trucking services, primarily to existing customers of our Trucking operating segment. A majority of the customers using our SCS and Intermodal services are also customers of our Trucking operating segment. Both our SCS and Intermodal operating segments, while making significant contributions to our business, represent less than 20% of our consolidated revenue.

Substantially all of our base revenue from the three operating segments is generated by transporting, or arranging for the transportation of, freight for customers and is predominantly affected by the rates per mile received from our customers and similar operating costs. For the three months ended March 31, 2011 and March 31, 2010, Trucking base revenue represented 83.2% and 90.4% of base revenue, respectively, with the remaining base revenue being generated through SCS and Intermodal.

We generally charge customers for our services on a per-mile basis. The expenses which have a major impact on our profitability are the variable costs of transporting freight for our customers. The variable costs include fuel expense, insurance and claims and driver-related expenses, such as wages and benefits.

Trucking. Trucking includes the following primary service offerings provided to our customers:

- General Freight. Our General Freight service offering provides truckload freight services as a short- to medium-haul common carrier. We have provided General Freight services since our inception and we derive the largest portion of our revenue from these services.

- Dedicated Freight. Our Dedicated Freight service offering is a variation of our General Freight service, whereby we agree to make our equipment and drivers available to a specific customer for shipments over particular routes at specified times. In addition to serving specific customer needs, our Dedicated Freight service offering also aids in driver recruitment and retention.

Strategic Capacity Solutions. Our SCS operating segment consists entirely of our freight brokerage service offering which matches customer shipments with available equipment of authorized carriers and provides services that complement our Trucking operations. We provide these services primarily to our existing Trucking customers, many of whom prefer to rely on a single carrier, or a small group of carriers, to provide all their transportation needs. To date, a majority of the customers of SCS have also engaged us to provide services through one or more of our Trucking service offerings. For the three months ended March 31, 2011 and March 31, 2010, SCS services generated approximately 11.6% and 7.0%, respectively, of total base revenue.

Intermodal. Our rail Intermodal service offering provides our customers cost savings over General Freight with a slightly slower transit speed, while allowing us to reposition our equipment to maximize our freight network yield. Since its inception, our rail Intermodal operating segment had derived primarily all its revenue from TOFC service. However, as TOFC represents a small and shrinking share of the intermodal market, it became evident we would need to develop a COFC service offering. For that reason, during August 2010, the Company entered into a long-term agreement with BNSF Railway to lease private 53’ domestic intermodal containers. The addition of private containers offers the Company an opportunity to continue its growth in the intermodal marketplace and to continue to offer our customers additional transportation solutions. For the three months ended March 31, 2011 and March 31, 2010, rail intermodal services generated approximately 5.2% and 2.6%, respectively, of total base revenue.

Results of Operations

Executive Overview

While we made substantial strategic progress during the quarter, our advances were almost entirely offset by exogenous factors. We posted healthy revenue growth, particularly in our SCS and Intermodal service offerings, and we improved our earnings per share through continued execution of our VEVA (Vision for Economic Value Added) strategic plan. However, rising fuel prices, unusually harsh winter weather, increased government regulation and a tightening market for drivers combined to significantly and adversely impact our results.

In our Trucking segment:

Our Spider Web lane density improved considerably year-over-year (to 48.7% of our loads from 38.1% for the comparable quarter of 2010). Because Spider Web network freight yielded $0.24 more per loaded mile than our legacy network freight, we experienced an overall year-over-year rate improvement of over $0.10 per mile. That rate improvement translated into a $0.35 per share improvement in our earnings.

Fuel prices steadily increased throughout the quarter, rising 30.0% above last year’s average first quarter price and easily outpacing our ability to offset the additional cost through our fuel surcharge revenues. Fuel surcharges typically lag market prices by a week, which means this week’s fuel surcharge revenue is based on last week’s lower price while we are actually paying this week’s higher price at the pump. We also consumed more fuel than usual during the January and February winter storms due to increased engine idling necessitated by stranded trucks and the need to protect our drivers from dangerously frigid exterior temperatures. The result was a $2.3 million increase in fuel cost net of fuel surcharge recoveries, equivalent to approximately $0.14 per share.

Costs to maintain our fleets of tractors and trailers grew by $1.3 million ($0.08 per share) as layers of recent government regulations took their toll (even as we drove down the average age of the fleets). Maintenance requirements for the Department of Transportation’s Compliance, Safety, Accountability (“CSA”) program, new engine emissions requirements mandated by the Environmental Protection Agency and various rules imposed by California’s Air Resources Board all drove our costs higher during the quarter as did the harsh winter weather.

Weather also interrupted the flow of new drivers through our orientation process during February. This interruption coincided with qualified drivers becoming increasingly difficult to recruit as CSA has increased demand for highly qualified drivers and simultaneously decreased the overall supply of drivers. Despite a decline in our driver turnover rate, 8.4% of our fleet was unmanned during the quarter (compared to 5.1% a year ago and our goal of 3.0%). In fact, we ended the quarter with over 10% of our trucks unmanned. We will not lower our hiring standards to man our trucks because the cost of doing so is much higher in the long-term than the short-term costs associated with elevated recruiting expense and reduced tractor utilization (which combined during the quarter to reduce earnings by more than $0.10 per share).

We have efforts underway to address these challenges to the extent possible, and expect to make progress in all of them during the second quarter as we capitalize on the winter freight bid season to continue building Spider Web lane density with select customers.

In our SCS segment:

We grew base revenue by 86.3% while simultaneously expanding our gross margin. Our SCS team members exhibited superb execution during the quarter, collaborating with our Trucking segment to provide innovative solutions to our customers’ transportation needs. We plan to open two new SCS branch offices during the second quarter (located in Clearwater, Florida and Roseville, California), bringing our total to ten, as well as opening additional branches later in 2011.

In our Intermodal segment:

We made an investment in the future of our business model last summer when we decided to enter into an exclusive-use agreement for a meaningful number of intermodal containers. Prior to that decision, practically all of our intermodal revenue was derived from trailer-on-flat-car service (“TOFC”). However, because TOFC represents a small and shrinking share of the intermodal market, it became strategically necessary for us to build a container-on-flat-car service offering using our own privately-controlled assets in order to provide a service model relevant to our customers.

We took possession of many of our containers last fall, too late to secure adequate freight volume for them prior to the first quarter seasonal lull in intermodal shipments. The result was insufficient load volume and pricing to offset the additional fixed costs associated with the new containers, thus widening our Intermodal operating loss during the first quarter despite the increase in revenue. During the second quarter, we are working to add volume with key customers, improve lane-specific pricing, build density in key lanes and add drayage operations in metropolitan areas to improve margin.

While our first quarter results are disappointing, our underlying strategic progress has been meaningful. In addition to narrowing our net loss during the quarter, we also improved operating cash flow, free cash flow (cash flow from operations less net cash used in investing activities) (which increased approximately $9.7 million) and the overall health of our balance sheet (44.2% total debt, less cash, to total capitalization ratio compared to 45.8% at March 31, 2010). We believe freight and capacity dynamics in the marketplace are favorable for additional pricing gains in the second quarter, which we expect will benefit all three of our business segments as we press forward with the VEVA strategic plan.

By agreement with our customers, and consistent with industry practice, we add a graduated surcharge to the rates we charge our customers as diesel fuel prices increase above an agreed-upon baseline price per gallon. The surcharge is designed to approximately offset increases in fuel costs above the baseline. Fuel prices are volatile, and the fuel surcharge increases our revenue at different rates for each period. We believe that comparing operating costs and expenses to total revenue, including the fuel surcharge, could provide a distorted comparison of our operating performance, particularly when comparing results for current and prior periods. Therefore, we have used base revenue, which excludes the fuel surcharge revenue, and instead taken the fuel surcharge as a credit against the fuel and fuel taxes and purchased transportation line items in the table setting forth the percentage relationship of certain items to base revenue below.

We do not believe that a reconciliation of the information presented on this basis and corresponding information comparing operating costs and expenses to total revenue would be meaningful. Data regarding both total revenue, which includes the fuel surcharge, and base revenue, which excludes the fuel surcharge, is included in the Consolidated Statements of Operations included in this report.

Base revenue from our SCS and Intermodal operating segments has fluctuated in recent periods. These services typically do not involve the use of our tractors and trailers. Therefore, an increase in revenue from these operating segments tends to cause expenses related to our operations that do involve our equipment—including fuel expense, depreciation and amortization expense, operations and maintenance expense, salaries, wages and employee benefits and insurance and claims expense—to decrease as a percentage of base revenue. Likewise, a decrease in revenue from these operating segments tends to cause those expenses to increase as a percentage of base revenue with a related increase in purchased transportation expense. Since changes in revenue from these operating segments generally affect all such expenses, as a percentage of base revenue, we do not specifically mention it as a factor in our discussion of increases or decreases in those expenses in the period-to-period comparisons below. Base revenue from our SCS operating segment increased approximately 86.3% for the three months ended March 31, 2011, compared to the same period of the prior year. Base revenue from our Intermodal operating segment increased approximately 123.9% for the three months ended March 31, 2011, compared to the same period of the prior year.

Three Months Ended March 31, 2011 Compared to Three Months Ended March 31, 2010

Results of Operations – Combined Services

Total base revenue for the quarter increased 11.7% to $99.7 million for the quarter ended March 31, 2011 from $89.2 million for the same quarter of 2010. We incurred a net loss of $2.7 million, or $0.26 per share, for the quarter as compared to a net loss of $3.0 million, or $0.29 per share, for the same quarter of 2010.

Our effective tax rate remained unchanged at 30.6% in the first quarter of 2011 as compared to the same quarter of 2010. Income tax expense varies from the amount computed by applying the federal tax rate to income before income taxes primarily due to state income taxes, net of federal income tax effect, adjusted for permanent differences, the most significant of which is the effect of the per diem pay structure for drivers. Due to the partially nondeductible effect of per diem payments, our tax rate will vary in future periods based on fluctuations in earnings and in the number of drivers who elect to receive this pay structure.

Results of Operations – Trucking

Relationship of Certain Items to Base Revenue

The following table sets forth the percentage relationship of certain items to base revenue of our Trucking operations for the periods indicated. Fuel and fuel taxes are shown net of fuel surcharges.

	Three Months Ended March 31,			
	2011		2010	
Base Trucking revenue	100.0	%	100.0	%
Operating expenses and costs:				
Fuel and fuel taxes	17.3		16.9	
Salaries, wages and employee benefits	38.6		40.3	
Purchased transportation	9.2		8.2	
Depreciation and amortization	15.1		15.4	
Operations and maintenance	11.2		9.5	
Insurance and claims	7.0		7.5	
Operating taxes and licenses	1.6		1.7	
Communications and utilities	1.1		1.1	
Gain on disposal of assets, net	(1.1)		--	
Other	5.0		4.1	
Total operating expenses and costs	105.0		104.7	
Operating loss	(5.0)	%	(4.7)	%

18

Key Operating Statistics:

	Three Months Ended March 31, 2011	2010
Operating loss (in thousands)	$ (4,117)	$ (3,760)
Total miles (in thousands) (1)	58,662	61,481
Empty mile factor (2)	10.0%	10.2%
Weighted average number of tractors (3)	2,342	2,344
Average miles per tractor per period	25,048	26,229
Average miles per tractor per week	1,948	2,040
Average miles per trip (4)(5)	556	576
Base Trucking revenue per tractor per week (5)	$ 2,752	$ 2,677
Number of tractors at end of period (3)	2,338	2,349
Operating ratio (6)	105.0%	104.7%

(1) Total miles include both loaded and empty miles.

(2) The empty mile factor is the number of miles traveled for which we are not typically compensated by any customer as a percent of total miles traveled.

(3) Tractors include Company-operated tractors in-service plus tractors operated by independent contractors.

(4) Average miles per trip is based upon loaded miles divided by the number of Trucking shipments.

(5) Our Trailer-on-Flat-Car rail Intermodal service offering was previously included in our Trucking operating segment. Container-on-Flat-Car rail Intermodal and Trailer-on-Flat-Car rail Intermodal are now combined and reported as Intermodal. Because of this reclassification, previously reported amounts for average miles per trip and base Trucking revenue per tractor per week have been recalculated excluding Trailer-on-Flat-Car rail Intermodal from Trucking.

(6) Operating ratio is based upon total operating expenses, net of fuel surcharge revenue, as a percentage of base revenue.

Our base Trucking revenue for the three months ended March 31, 2011, increased 2.7% from $80.7 million to $82.9 million from the comparable quarter of 2010; our operating loss for the quarter was $4.1 million compared to a net operating loss of $3.8 million for the first quarter of 2010.

Overall, our operating ratio deteriorated by 0.3 percentage points of base revenue to 105.0% as a result of the following factors:

- Salaries, wages and employee benefits decreased by 1.7 percentage points of base revenue due to a reduction in miles driven attributable to a higher percentage of unmanned trucks compared to the 2010 period and the harsh winter weather experienced in January and February. This resulted in a reduction in driver pay of approximately $0.7 million. Additionally, our net Trucking base revenue per mile increased by approximately 7.7% plus we incurred lower workers' compensation expense and health and welfare costs due to a reduction in claims activity in the first quarter of 2011 as compared to the first quarter of 2010. These decreases were partially offset by an increase in wages in our maintenance division, the result of increasing the number of terminal locations to better service our operations. During the first quarter of 2011, we saw evidence of a tightening market of eligible drivers related to the implementation of the Department of Transportation's ("DOT") Compliance, Safety, Accountability ("CSA") program. New hours-of-service rules being reviewed by the DOT and CSA may further reduce the pool of eligible drivers and lead to increases in driver expenses that would increase salaries, wages and employee benefits.

- Fuel and fuel taxes increased 0.4 percentage points of base Trucking revenue as we saw fuel prices increase an average of 30.0% over the comparable quarter of 2010. This increase was partially offset by the above-mentioned increase in our net Trucking revenue per mile. The steady increases in fuel prices during the quarter prevented our fuel surcharge program from keeping pace with the rising costs. In addition, the harsh winter weather required us to consume more fuel than usual during the January and February winter storms due to increased engine idling necessitated by stranded trucks and the need to protect our drivers from dangerously frigid exterior temperatures. These two factors resulted in an approximate $2.3 million increase in fuel cost net of fuel surcharge recoveries, equivalent to approximately $0.14 per share. Fuel costs may continue to be affected in the future by price fluctuations, the terms and collectability of fuel surcharge revenue and the percentage of total miles driven by owner operators.

- Purchased transportation, which is comprised of independent contractor compensation and fees paid to external transportation providers such as Mexican carriers, increased by 1.0 percentage points of base Trucking revenue. This increase was due primarily to an increase in carrier expense related to Mexico as we saw our revenue from shipments into and out of the country increase 29.2% over the same period in 2010. Also contributing to the increase in purchased transportation was an 8.5% increase in owner-operator expense. We expect this expense would continue to increase as the economy improves and if we achieve our long-term goals to grow our independent contractor fleet.

- Depreciation and amortization expense decreased 0.3 percentage points of base Trucking revenue due to the above-mentioned increase in our base Trucking revenue per tractor per week. During the quarter, we purchased 155 tractors and 200 trailers, which will be used to replace existing older equipment in an effort to reduce the age of our fleet. Prices for new equipment have risen in recent years and tractors more so due to Environmental Protection Agency mandates related to engine emissions. As a result of our plan to reduce the age of our fleet and the increased costs of new equipment, we expect depreciation and amortization expense to increase as a percentage of base Trucking revenue in future periods. Depreciation and amortization expense may be affected in the future as equipment manufacturers change prices and if the prices of used equipment fluctuate.

- Operations and maintenance expense increased 1.7 percentage points of base Trucking revenue primarily due to a 33.6% increase in direct repair costs related to the maintenance requirements for the Department of Transportation's CSA program, new engine emissions requirements mandated by the Environmental Protection Agency, various rules imposed by California's Air Resources Board, harsh winter weather and the higher mileage equipment remaining in our fleet. Our average tractor age as of March 31, 2011 was 27.5 months compared to 25.5 months at March 31, 2010 whereas our average trailer age was 66.2 months and 63.5 months, respectively. This increase was partially offset by the above mentioned increase in our base Trucking revenue per mile. On April 1, 2009, we changed our method of accounting for tires which changed the way we recognized cost for tires placed into service. Accordingly, operations and maintenance expense related to this change increased in 2011 over that of 2010 by approximately $0.9 million. Operations and maintenance expense may decrease as the age of our fleet decreases, but we do not expect to see the benefits of the new equipment in this line item for a number of quarters.

- Insurance and claims expense decreased 0.5 percentage points of base Trucking revenue as we saw a 13.3% reduction in physical damage expense for the quarter as well as a reduction in the number of severe accidents in the first quarter of 2011 compared to 2010, combined with the above mentioned increase in our base Trucking revenue per week. This reduction in severe accidents is the result of the continuing education of our drivers regarding accident prevention. If we are able to continue to successfully execute our "War on Accidents" safety initiative, we would expect insurance and claims expense to gradually decrease over the long term, though remaining volatile from period-to-period.

- Other expenses increased 0.9 percentage points of base Trucking revenue in the first quarter of 2011 compared to the first quarter of 2010 predominately driven by higher recruiting related expenses and an increase in the number of maintenance terminals to service our equipment. Weather interrupted the flow of new drivers through our orientation process during February. The Department of Transportation's CSA program has increased the difficulty of recruiting qualified drivers as the demand for those highly qualified drivers has increased, while the program has simultaneously decreased the overall supply of drivers. Despite a decline in our driver turnover rate, 8.4% of our fleet was unmanned during the quarter (compared to 5.1% a year ago and our goal of 3.0%). We will not lower our hiring standards to man our trucks because the cost of doing so is much higher in the long-term than the short-term costs associated with elevated recruiting expense and reduced tractor utilization.

- Gain on the disposal of equipment increased 1.1 percentage points in the quarter ended March 31, 2011 as compared to the first quarter of 2010 due to the stronger used equipment market.

Results of Operations – Strategic Capacity Solutions

The following table sets forth certain information relating to our SCS segment for the periods indicated.

	Three Months Ended March 31,	
	2011	2010
Total SCS revenue	$ 16,462	$ 8,363
Intercompany revenue	(2,425)	(1,080)
Net revenue	$ 14,037	$ 7,283
Operating income (in thousands)	$ 1,333	$ 321
Gross margin (1)	15.6 %	13.0%

20

(1) Gross margin is calculated by dividing total base revenue, less purchased transportation expense, less fuel surcharge revenue by total base revenue. This calculation includes intercompany revenue and expenses.

Base revenue from SCS increased 86.3% to $11.6 million from $6.2 million for the first quarter of 2011 as compared to the same quarter of 2010, while operating income increased from $0.3 million to $1.3 million for the same period. Overall, SCS revenue growth can be attributed to our efforts to integrate and cross-sell this service with our traditional Trucking services. In addition, we plan to continue to build our SCS infrastructure by establishing and developing new branches across the United States.

Overall, operating income increased approximately $1.0 million to $1.3 million. This increase was primarily a result of the continued expansion of our SCS operations, as we added three branches since the first quarter of 2010. The resulting increase in operating expenses has been more than offset with the increase in revenues from these additional branch locations. If we are successful in continuing to build our SCS business, we would expect to see expenses as a percent of total revenue decline further in the next several quarters.

Results of Operations – Intermodal

The following table sets forth certain information relating to our Intermodal segment for the periods indicated.

	Three Months Ended March 31,	
	2011	2010
Total Intermodal revenue	$ 7,429	$ 3,603
Intercompany revenue	(698)	(721)
Net revenue	$ 6,731	$ 2,882
Operating loss (in thousands)	$ (398)	$ (59)
Gross margin (1)	6.0 %	3.6%

(1) Gross margin is calculated by dividing total base revenue, less purchased transportation expense, less fuel surcharge revenue by total base revenue. This calculation includes intercompany revenue and expenses.

Base revenue from Intermodal increased 123.9% to $5.2 million from $2.3 million for the quarter ended March 31, 2011, while our operating loss increased from $0.06 million to $0.4 million. Overall, the base revenue growth can be attributed to our efforts to integrate and cross-sell this service with our traditional Trucking services. In addition, during the late summer of 2010 we entered into an exclusive-use agreement for a meaningful number of leased intermodal containers, which contributed to this revenue growth and we anticipate our Intermodal revenue to increase in the coming quarters as we expand this program. We took possession of many of our containers last fall, too late to secure adequate freight volume for them prior to the first quarter seasonal lull in intermodal shipments. The result was insufficient load volume and pricing to offset the additional fixed costs associated with the new containers, thus widening our Intermodal operating loss during the first quarter despite the increase in revenue. As we continue to build our intermodal container business, we would expect to see the expenses associated with these containers decline as a percent of revenue in the next several quarters.

Seasonality

In the trucking industry, revenue generally decreases as customers reduce shipments during the winter holiday season and as inclement weather impedes operations. At the same time, operating expenses increase due primarily to decreased fuel efficiency and increased maintenance costs. Future revenue could be impacted if customers, particularly those with manufacturing operations, reduce shipments due to temporary plant closings. Historically, many of our customers have closed their plants for maintenance or other reasons during January and July.

Inflation

Most of our operating expenses are inflation sensitive, and we have not always been able to offset inflation-driven cost increases through increases in our revenue per mile and our cost control efforts. The effect of inflation-driven cost increases on our overall operating costs is not expected to be greater for us than for our competitors.

Fuel Availability and Cost

The motor carrier industry is dependent upon the availability of fuel. Fuel shortages or increases in fuel taxes or fuel costs have adversely affected our profitability and will continue to do so. Fuel prices have fluctuated widely, and fuel prices and fuel taxes have generally increased in recent years. We have not experienced difficulty in maintaining necessary fuel supplies, and in the past we generally have been able to partially offset increases in fuel costs and fuel taxes through increased freight rates and through a fuel surcharge that increases incrementally as the price of fuel increases above an agreed upon baseline price per gallon. Typically, we are not able to fully recover increases in fuel prices through rate increases and fuel surcharges, primarily because those items do not provide any benefit with respect to empty and out-of-route miles, for which we typically do not receive compensation from customers.

Off-Balance Sheet Arrangements

We do not currently have off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on our consolidated financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources. From time to time, we enter into operating leases relating to facilities and office equipment that are not reflected in our balance sheet.

Liquidity and Capital Resources

On April 19, 2010, we entered into a new Credit Agreement with Branch Banking and Trust Company as Administrative Agent, which replaced our Amended and Restated Senior Credit Facility that was to mature on September 1, 2010. The Credit Agreement provides for available borrowings of up to $100.0 million, including letters of credit not exceeding $25.0 million. Availability may be reduced by a borrowing base limit as defined in the Credit Agreement. The Credit Agreement provides an accordion feature allowing us to increase the maximum borrowing amount by up to an additional $75.0 million in the aggregate in one or more increases, subject to certain conditions. The Credit Agreement bears variable interest based on the type of borrowing and on the Administrative Agent's prime rate or the London Interbank Offered Rate plus a certain percentage, which is determined based on our attainment of certain financial ratios. A quarterly commitment fee is payable on the unused portion of the credit line and bears a rate which is determined based on our attainment of certain financial ratios. The obligations of the Company under the Credit Agreement are guaranteed by the Company and secured by a pledge of substantially all of the Company's assets with the exception of real estate. The Credit Agreement includes usual and customary events of default for a facility of this nature and provides that, upon the occurrence and continuation of an event of default, payment of all amounts payable under the Credit Agreement may be accelerated, and the lenders' commitments may be terminated. The Credit Agreement contains certain restrictions and covenants relating to, among other things, dividends, liens, acquisitions and dispositions outside of the ordinary course of business, and affiliate transactions. The new Credit Agreement will expire on April 19, 2014.

The nature of our business requires significant investments in new revenue equipment. We have financed new tractor and trailer purchases predominantly with cash flows from operations, the proceeds from sales or trades of used equipment, borrowings under our Credit Agreement and capital lease purchase arrangements. We have historically met our working capital needs with cash flows from operations and with borrowings under financing arrangements. We use these financing arrangements to minimize fluctuations in cash flow needs and to provide flexibility in financing revenue equipment purchases. Management is not aware of any known trends or uncertainties that would cause a significant change in our sources of liquidity. We expect our principal sources of capital to be sufficient to finance our operations, annual debt maturities, lease commitments, letter of credit commitments, stock repurchases and capital expenditures over the next twelve months. There can be no assurance, however, that such sources will be sufficient to fund our operations and all expansion plans for the next several years, or that any necessary additional financing and facility renewal will be available, if at all, in amounts required or on terms satisfactory to us.

Our balance sheet debt, less cash, represents 44.2% of our total capitalization, and we have no material off-balance sheet debt. Our capital leases currently represent 48.6% of our total debt and carry an average fixed rate of 3.4%. We also have additional availability on our revolving credit line of approximately $41.5 million, which we could have borrowed without violating any of our current financial covenants applicable to us on March 31, 2011. We expect our net capital expenditures for the remainder of 2011 to be approximately $41.3 million.

Cash Flows

	(in thousands) Three Months Ended March 31,	
	2011	2010
Net cash provided by operating activities	$ 4,717	$ 4,588
Net cash used in investing activities	(8,339)	(17,923)
Net cash provided by financing activities	3,539	13,366

22

Cash generated from operations increased $0.1 million during the first quarter of 2011 as compared to the first quarter of 2010, primarily due to the net effect of the following factors:

- A decrease in net loss of $0.3 million;
- A $1.5 million decrease in cash provided from accounts receivable resulting from extended payment terms and a larger proportional share of revenue from our SCS segment and an increase in fuel surcharge revenue;
- A $0.9 million decrease of cash used in trade accounts payable and accrued expenses primarily due to timing of fuel payments;
- A $0.9 million increase in the gain on the sale of equipment due to a stronger used equipment market;
- A reduction of $0.5 million in deferred taxes; and
- A decrease of $0.9 million in cash used for prepaid expenses and inventories, which was primarily due to additional tire purchases effecting our prepaid tire account and fees related to the 2010 renewal of our Credit Facility.

Cash used in investing activities decreased $9.6 million during the first quarter of 2011 as compared to the same time period of 2010 primarily due to the method utilized to finance acquisition of revenue equipment. During 2010, we primarily utilized borrowings from our Credit Agreement to fund revenue equipment acquisitions and during 2011 we utilized more lease based financing. In 2010, our equipment purchasing increased due to the opportunity to purchase pre-2010 emission engines which allowed us some time to gain a better understanding of the new emission technology in our application and network and delay the increased cost of purchasing the new engines.

Cash provided by financing activities decreased $9.8 million during the first quarter of 2011 as compared to the same time period in 2010. We borrowed a net amount on our Credit Facility of $6.8 million in 2011 compared to $17.8 million in net borrowings in 2010, resulting in an $11.0 million decrease in net borrowings on our Credit Agreement, partially offset by a $1.0 million decrease in bank drafts outstanding. Net borrowings on our Credit Agreement were higher in 2010 due to revenue equipment purchases.

Debt

On April 19, 2010, we entered into a new Credit Agreement with Branch Banking and Trust Company as Administrative Agent, which replaced our Amended and Restated Senior Credit Facility that was to mature on September 1, 2010. The Credit Agreement provides for available borrowings of up to $100.0 million, including letters of credit not exceeding $25.0 million. Availability may be reduced by a borrowing base limit as defined in the Credit Agreement. The Credit Agreement provides an accordion feature allowing us to increase the maximum borrowing amount by up to an additional $75.0 million in the aggregate in one or more increases, subject to certain conditions. The Credit Agreement bears variable interest based on the type of borrowing and on the Administrative Agent’s prime rate or the London Interbank Offered Rate plus a certain percentage, which is determined based on our attainment of certain financial ratios. A quarterly commitment fee is payable on the unused portion of the credit line and bears a rate which is determined based on our attainment of certain financial ratios. The obligations of the Company under the Credit Agreement are guaranteed by the Company and secured by a pledge of substantially all of the Company’s assets with the exception of real estate. The Credit Agreement includes usual and customary events of default for a facility of this nature and provides that, upon the occurrence and continuation of an event of default, payment of all amounts payable under the Credit Agreement may be accelerated, and the lenders’ commitments may be terminated. The Credit Agreement contains certain restrictions and covenants relating to, among other things, dividends, liens, acquisitions and dispositions outside of the ordinary course of business, and affiliate transactions. The new Credit Agreement will expire on April 19, 2014.

Borrowings under the Credit Agreement are classified as “base rate loans,” “LIBOR loans” or “Euro dollar loans.” Base rate loans accrue interest at a base rate equal to the Administrative Agent’s prime rate plus an applicable margin that is adjusted quarterly between 0.0% and 1.0%, based on the Company’s leverage ratio. LIBOR loans accrue interest at LIBOR plus an applicable margin that is adjusted quarterly between 2.00% and 3.25% based on the Company’s leverage ratio. Euro dollar loans accrue interest at the LIBOR rate in effect at the beginning of the month in which the borrowing occurs plus an applicable margin that is adjusted quarterly between 2.00% and 3.25% based on the Company’s leverage ratio. On a per annum basis, the Company must pay a fee on the unused amount of the revolving credit facility of between 0.25% and 0.375% based on the Company’s leverage ratio, and it must pay an annual administrative fee to the Administrative Agent of 0.03% of the total commitments.

The interest rate on our overnight borrowings under the Credit Agreement at March 31, 2011 was 3.25%. The interest rate including all borrowings made under the Credit Agreement at March 31, 2011 was 2.5% and for the three months ended March 31, 2011 was 2.6%. A quarterly commitment fee is payable on the unused portion of the credit line and bears a rate which is determined based on our attainment of certain financial ratios. At March 31, 2011, the rate was 0.25% per annum. The Credit Agreement is collateralized by revenue equipment having a net book value of $171.2 million at March 31, 2011, and all trade and other accounts receivable.

23

The Credit Agreement requires us to meet certain financial covenants (i.e., a maximum leverage ratio of 3.00 (currently and through the end of the Credit Agreement), and a minimum fixed charge ratio of 1.4) and to maintain a minimum tangible net worth of approximately $106.1 million at March 31, 2011. We were in compliance with these covenants at March 31, 2011. The covenants would prohibit the payment of dividends by us if such payment would cause us to be in violation of any of the covenants.

We have entered into leases with lenders who participate in our Credit Agreement and who participated in our Amended and Restated Senior Credit Facility, which was replaced by the Credit Agreement. Those leases contain cross-default provisions with the Credit Agreement and the previous Facility. We have also entered into leases with other lenders who do not participate in our Credit Agreement nor participated in our previous Facility. Multiple leases with lenders who do not participate in our Credit Agreement generally contain cross-default provisions.

We record derivative financial instruments in the balance sheet as either an asset or liability at fair value, with classification as current or long-term depending on the duration of the instrument. Changes in the derivative instrument's fair value must be recognized currently in earnings unless specific hedge accounting criteria are met. For cash flow hedges that meet the criteria, the derivative instrument's gains and losses, to the extent effective, are recognized in accumulated other comprehensive income and reclassified into earnings in the same period during which the hedged transaction affects earnings.

On February 6, 2009, we entered into a $10.0 million interest rate swap agreement with an effective date of February 19, 2009. The rate on the swap was fixed at 1.57% until February 19, 2011. The interest rate swap agreement was accounted for as a cash flow hedge.

Equity

At March 31, 2011, we had stockholders' equity of $135.0 million and total debt including current maturities of $111.6 million, resulting in a total debt, less cash, to total capitalization ratio of 44.2% compared to 40.8% at December 31, 2010.

Purchases and Commitments

As of March 31, 2011, our capital expenditures forecast, net of proceeds from the sale or trade of equipment, was $41.3 million for the remainder of 2011, approximately $38.0 million of which relates to revenue equipment acquisitions. To the extent further capital expenditures are feasible based on our debt covenants and operating cash requirements, we would use the balance of $3.3 million primarily for property acquisitions, facility construction and improvements and maintenance and office equipment. We routinely evaluate our equipment acquisition needs and adjust our purchase and disposition schedules from time to time based on our analysis of factors such as freight demand, driver availability and the condition of the used equipment market. During the three months ended March 31, 2011, we made $16.8 million of net capital expenditures, including $16.3 million for revenue equipment purchases and $0.5 million for facility expansions and other expenditures.

The following table represents our outstanding contractual obligations at March 31, 2011, excluding letters of credit:

	(in thousands) Payments Due By Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual Obligations:					
Long-term debt obligations (1)	$ 56,686	$ --	$ --	$ 56,686	$ --
Capital lease obligations (2)	56,588	28,668	23,445	4,475	--
Purchase obligations (3)	34,606	34,606	--	--	--
Rental obligations	4,396	1,919	1,673	493	311
Total	$ 152,276	$ 65,193	$ 25,118	$ 61,654	$ 311

24

(1) Long-term debt obligations, excluding letters of credit in the amount of $1.8 million, consists of our Credit Agreement, which matures on April 19, 2014. The primary purpose of this agreement is to provide working capital for the Company; however, the agreement is also used, as appropriate, to minimize interest expense on other Company purchases that could be obtained through other more expensive capital purchase financing sources. Because the borrowing amounts fluctuate and the interest rates vary, they are subject to various factors that will cause actual interest payments to fluctuate over time. Based on these factors, we have not included in this line item an estimate of future interest payments.

(2) Includes interest payments not included in the balance sheet.

(3) Purchase obligations include commitments to purchase approximately $33.8 million of revenue equipment, none of which is cancelable by us upon advance written notice.

Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. We base our assumptions, estimates and judgments on historical experience, current trends and other factors that management believes to be relevant at the time our consolidated financial statements are prepared. Actual results could differ from those estimates, and such differences could be material.

The most significant accounting policies and estimates that affect our financial statements include the following:

- Revenue recognition and related direct expenses based on relative transit time in each period. Revenue generated by our Trucking operating segment is recognized in full upon completion of delivery of freight to the receiver's location. For freight in transit at the end of a reporting period, we recognize revenue pro rata based on relative transit time completed as a portion of the estimated total transit time. Expenses are recognized as incurred.

Revenue generated by our SCS and Intermodal operating segments is recognized upon completion of the services provided. Revenue is recorded on a gross basis, without deducting third party purchased transportation costs because we have responsibility for billing and collecting such revenue.

Management believes these policies most accurately reflect revenue as earned and direct expenses, including third party purchased transportation costs, as incurred.

- Selections of estimated useful lives and salvage values for purposes of depreciating tractors and trailers. We operate a significant number of tractors and trailers in connection with our business. We may purchase this equipment or acquire it under leases. We depreciate purchased equipment on the straight-line method over the estimated useful life down to an estimated salvage or trade-in value. We initially record equipment acquired under capital leases at the net present value of the minimum lease payments and amortize it on the straight-line method over the lease term. Depreciable lives of tractors and trailers range from three years to ten years. We estimate the salvage value at the expected date of trade-in or sale based on the expected market values of equipment at the time of disposal.

We make equipment purchasing and replacement decisions on the basis of various factors, including, but not limited to, new equipment prices, used equipment market conditions, demand for our freight services, prevailing interest rates, technological improvements, fuel efficiency, equipment durability, equipment specifications and driver availability. Therefore, depending on the circumstances, we may accelerate or delay the acquisition and disposition of our tractors and trailers from time to time, based on an operating principle whereby we pursue trade intervals that economically balance our maintenance costs and expected trade-in values in response to the circumstances existing at that time. Such adjustments in trade intervals may cause us to adjust the useful lives or salvage values of our tractors or trailers. By changing the relative amounts of older equipment and newer equipment in our fleet, adjustments in trade intervals also increase and decrease the average age of our tractors and trailers, whether or not we change the useful lives or salvage values of any tractors or trailers. We also adjust depreciable lives and salvage values based on factors such as changes in prevailing market prices for used equipment. We periodically monitor these factors in order to keep salvage values in line with expected market values at the time of disposal. Adjustments in useful lives and salvage values are made as conditions warrant and when we believe that the changes in conditions are other than temporary. These adjustments result in changes in the depreciation expense we record in the period in which the adjustments occur and in future periods. These adjustments also impact any resulting gain or loss on the ultimate disposition of the revenue equipment. Management believes our estimates of useful lives and salvage values have been materially accurate as demonstrated by the insignificant amounts of gains and losses on revenue equipment dispositions in recent periods. However, management will continually review salvage values to assure that book values do not exceed market values.

To the extent depreciable lives and salvage values are changed, such changes are recorded in accordance with the applicable generally accepted accounting principles existing at the time of change.

- Estimates of accrued liabilities for claims involving bodily injury, physical damage losses, employee health benefits and workers' compensation. We record both current and long-term claims accruals at the estimated ultimate payment amounts based on information such as individual case estimates, historical claims experience and an estimate of claims incurred but not reported. The current portion of the accrual reflects the amounts of claims expected to be paid in the next twelve months. In making the estimates, we rely on past experience with similar claims, negative or positive developments in the case and similar factors. We do not discount our claims liabilities. See our Claims Liabilities disclosure elsewhere in this report and in our Annual Report on Form 10-K for additional information.

- Stock option valuation. The assumptions used to value stock options are dividend yield, expected volatility, risk-free interest rate, expected life and anticipated forfeitures. As we have not paid any dividends on our Common Stock, the dividend yield is zero. Expected volatility represents the measure used to project the expected fluctuation in our share price. We use the historical method to calculate volatility with the historical period being equal to the expected life of each option. This calculation is then used to determine the potential for our share price to increase over the expected life of the option. The risk-free interest rate is based on an implied yield on United States zero-coupon treasury bonds with a remaining term equal to the expected life of the outstanding options. Expected life represents the length of time we anticipate the options to be outstanding before being exercised. Based on historical experience, that time period is best represented by the option's contractual life. Anticipated forfeitures represent the number of shares under options we expect to be forfeited over the expected life of the options.

- Accounting for income taxes. Our deferred tax assets and liabilities represent items that will result in taxable income or a tax deduction in future years for which we have already recorded the related tax expense or benefit in our consolidated statements of operations. Deferred tax accounts arise as a result of timing differences between when items are recognized in our consolidated financial statements compared to when they are recognized in our tax returns. Significant management judgment is required in determining our provision for income taxes and in determining whether deferred tax assets will be realized in full or in part. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. We periodically assess the likelihood that all or some portion of deferred tax assets will be recovered from future taxable income. To the extent we believe recovery is not probable, a valuation allowance is established for the amount determined not to be realizable. We have not recorded a valuation allowance at March 31, 2011, as all deferred tax assets are more likely than not to be realized.

We believe that we have adequately provided for our future tax consequences based upon current facts and circumstances and current tax law. During the three months ended March 31, 2011, we made no material changes in our assumptions regarding the determination of income tax liabilities. However, should our tax positions be challenged, different outcomes could result and have a significant impact on the amounts reported through our consolidated statements of operations.

- Prepaid tires. Effective April 1, 2009, we changed our method of accounting for tires. Commencing when the tires, including recaps, are placed into service, we account for them as prepaid expenses and amortize their cost over varying time periods, ranging from 18 to 30 months depending on the type of tire. Prior to April 1, 2009, the cost of tires was fully expensed when they were placed into service. We believe the new accounting method more appropriately matches the tire costs to the period during which the tire is being used to generate revenue.

New Accounting Pronouncements

See "Note 6 – New Accounting Pronouncements" to the consolidated financial statements included in this Form 10-Q for a description of the most recent accounting pronouncements and their effect, if any.

ITEMQUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
3.

We experience various market risks, including changes in interest rates, foreign currency exchange rates and commodity prices.

Interest Rate Risk. We are exposed to interest rate risk primarily from our Credit Agreement. The Credit Agreement bears variable interest based on the type of borrowing and on the Administrative Agent's prime rate or the London Interbank Offered Rate plus a certain percentage which is determined based on our attainment of certain financial ratios. At March 31, 2011, we had $58.5 million outstanding pursuant to our Credit Agreement including letters of credit of $1.8 million. Assuming the outstanding balance at March 31, 2011 was to remain constant, a hypothetical one-percentage point increase in interest rates applicable to the Credit Agreement would increase our interest expense over a one-year period by approximately $0.6 million.

On February 6, 2009, we entered into a $10.0 million interest rate swap agreement with an effective date of February 19, 2009. The rate on the swap was fixed at 1.57% until February 19, 2011. The interest rate swap agreement was accounted for as a cash flow hedge.

Foreign Currency Exchange Rate Risk. We require customers to pay for our services in U.S. dollars. Although the Canadian government makes certain payments, such as tax refunds, to us in Canadian dollars, any foreign currency exchange risk associated with such payments is not material.

Commodity Price Risk. Fuel prices have fluctuated greatly and have generally increased in recent years. In some periods, our operating performance was adversely affected because we were not able to fully offset the impact of higher diesel fuel prices through increased freight rates and fuel surcharge revenue recoveries. We cannot predict the extent to which high fuel price levels will continue in the future or the extent to which fuel surcharge revenue recoveries could be collected to offset such increases. In May 2010, we entered into a contract to hedge 0.5 million gallons of diesel fuel per month for July 2010 through June 2012. In June 2010, we accepted a favorable settlement offered by the other party to terminate the contract in exchange for a $1.2 million payment to us. The contract was terminated before the hedging began in July 2010. Had we not terminated the contract and had fuel prices decreased below the contracted price, the result would have been a negative impact on our fuel costs. As of March 31, 2011, we did not have any derivative financial instruments to reduce our exposure to fuel price fluctuations, but may use such instruments in the future. Accordingly, volatile fuel prices will continue to impact us significantly. A significant increase in fuel costs, or a shortage of diesel fuel, could materially and adversely affect our results of operations. Further, these costs could also exacerbate the driver shortages our industry experiences by forcing independent contractors to cease operations.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, an evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer (the "CEO") and Chief Financial Officer (the "CFO"), of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our management, including the CEO and CFO, concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective at the reasonable assurance level. There have been no changes in our internal control over financial reporting during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We have confidence in our internal controls and procedures. Nevertheless, our management, including our CEO and CFO, does not expect that our disclosure procedures and controls or our internal controls will prevent all errors or intentional fraud. An internal control system, no matter how well-conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of such internal controls are met. Further, the design of an internal control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all internal control systems, no evaluation of controls can provide absolute assurance that all our control issues and instances of fraud, if any, have been detected.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are party to routine litigation incidental to our business, primarily involving claims for personal injury and property damage incurred in the transportation of freight. We maintain insurance to cover liabilities in excess of certain self-insured retention levels. Though management believes these claims to be routine and immaterial to our long-term financial position, adverse results of one or more of these claims could have a material adverse effect on our financial position or results of operations in any given reporting period.

On July 2, 2010 a former driver team member, filed a lawsuit against us titled Hermes Cerdenia vs. USA Truck, Inc. in the Superior Court of the State of California for the County of San Bernardino, alleging various violations of the California Labor Code and seeking certification of the suit as a class action to include "all individuals currently and formerly employed in California as drivers, or other similarly titled positions." We have successfully removed the case to the United States District Court, Central District of California and have filed an answer denying the plaintiff's allegations. The lawsuit seeks monetary damages for the alleged violations. In February 2011, settlement of the lawsuit was negotiated through mediation subject to the District Court's review and approval. Such approval is expected later in 2011. At March 31, 2011, all but $0.05 million of the agreed upon settlement amount had been accrued and this remaining balance was accrued at April 30, 2011.

ITEM
1A.
RISK
FACTORS

Certain risks associated with our operations are discussed in our Annual Report on Form 10-K for the year ended December 31, 2010, under the heading "Risk Factors" in Item 1A of that report. We do not believe there have been any material changes in these risks during the three months ended March 31, 2011.

ITEMUNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
2.

(a) Recent unregistered sales of securities.

None.

(b) Use of proceeds from registered sales of securities.

None.

(c) Purchases of equity securities by the issuer and affiliated purchasers.

On October 21, 2009, the Board of Directors of the Company approved the repurchase of up to 2,000,000 shares of the Company's Common Stock expiring on October 21, 2012. Subject to applicable timing and other legal requirements, these repurchases may be made on the open market or in privately negotiated transactions on terms approved by the Company's Chairman of the Board or President. Repurchased shares may be retired or held in treasury for future use for appropriate corporate purposes including issuance in connection with awards under the Company's employee benefit plans. During the three months ended March 31, 2011, we did not repurchase any shares of our Common Stock. Our current repurchase authorization has 2,000,000 shares remaining.

The following table sets forth information regarding shares of Common Stock purchased or that may yet be purchased by us under the current authorization during the first quarter of 2011.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
January 1 – January 31	--	$ --	--	2,000,000
February 1 – February 28	--	--	--	2,000,000
March 1 – March 31	--	--	--	2,000,000
Total	--	$ --	--	2,000,000

We may reissue repurchased shares under our equity compensation plans or as otherwise directed by the Board of Directors.

We are required to include in the table above purchases made by us or by an affiliated purchaser. For this purpose, "affiliated purchaser" does not include our Employee Stock Purchase Plan, which provides that shares purchased for team members under that Plan may be shares provided by us or shares purchased on the open market. Open market purchases under that Plan are made by the administrator of the Plan, which is an agent independent of us. Any shares purchased by the administrator are not counted against the number of shares available for purchase by us pursuant to the repurchase authorization described above.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. (REMOVED AND RESERVED)

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibits

3.1	Restated and Amended Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to the Company’s Registration Statement on Form S-1, Registration No. 33-45682, filed with the Securities and Exchange Commission on February 13, 1992 [the “Form S-1”]).
3.2	Amended Bylaws of the Company as currently in effect (incorporated by reference to Exhibit 3.2 to the Company’s annual report on Form 10-K for the year ended December 31, 2001).
3.3	Certificate of Amendment to Certificate of Incorporation of the Company filed March 17, 1992 (incorporated by reference to Exhibit 3.3 to Amendment No. 1 to the Form S-1 filed with the Securities and Exchange Commission on March 19, 1992).
3.4	Certificate of Amendment to Certificate of Incorporation of the Company filed April 29, 1993 (incorporated by reference to Exhibit 5 to the Company’s Registration Statement on Form 8-A/A filed with the Securities and Exchange Commission on June 2, 1997 [the “Form 8-A/A”]).
3.5	Certificate of Amendment to Certificate of Incorporation of the Company filed May 13, 1994 (incorporated by reference to Exhibit 6 to the Form 8-A/A).
4.1	Specimen certificate evidencing shares of the Common Stock, $.01 par value, of the Company (incorporated by reference to Exhibit 4.1 to the Form S-1).
4.2	Instruments with respect to long-term debt not exceeding 10.0% of the total assets of the Company have not been filed. The Company agrees to furnish a copy of such instruments to the Securities and Exchange Commission upon request.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

USA Truck, Inc.
(Registrant)

Date: May 6, 2011	By:	/s/ Clifton R. Beckham Clifton R. Beckham President and Chief Executive Officer
Date: May 6, 2011	By:	/s/ Darron R. Ming Darron R. Ming Vice President, Finance and Chief Financial Officer

INDEX TO EXHIBITS
USA TRUCK, INC.

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