

DSP GROUP INC /DE/
Form 10-Q
August 09, 2016

United States
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2016

or

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

For the transition period from _____ to

Commission File Number 1-35256

DSP GROUP, INC.

(Exact name of registrant as specified in its charter)

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

161 S. San Antonio Road, Suite 10 **94022**

Los Altos, California
(Address of Principal Executive Offices) (Zip Code)

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

As of August 3, 2016, there were 21,894,013 shares of Common Stock (\$.001 par value per share) outstanding.

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PART 1. FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****DSP GROUP, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(U.S. dollars in thousands, except share and per share data)**

	June 30, 2016 Unaudited	December 31, 2015 Audited
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 17,808	\$ 13,704
Restricted deposit	168	168
Marketable securities and short-term deposits	22,784	18,070
Trade receivables	17,136	19,211
Other accounts receivable and prepaid expenses	2,364	3,319
Inventories	12,850	11,453
TOTAL CURRENT ASSETS	73,110	65,925
PROPERTY AND EQUIPMENT, NET	3,956	3,764
LONG-TERM ASSETS:		
Long-term marketable securities	81,962	89,714
Long-term prepaid expenses and lease deposits	1,240	743
Deferred income taxes	1,001	1,311
Severance pay fund	11,795	11,578
Investment in other companies	1,800	1,800
Intangible assets, net	3,209	3,851
Goodwill	5,276	5,276
	106,283	114,273
TOTAL ASSETS	\$ 183,349	\$ 183,962

Note: The balance sheet at December 31, 2015 has been derived from the audited financial statements on that date.

See notes to condensed consolidated financial statements.

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DSP GROUP, INC.**CONDENSED CONSOLIDATED BALANCE SHEETS**

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

	June 30, 2016 Unaudited	December 31, 2015 Audited
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	\$ 12,910	\$ 13,103
Accrued compensation and benefits	7,476	7,788
Income tax accruals and payables	1,800	1,864
Accrued expenses and other accounts payable	5,782	5,026
Total current liabilities	27,968	27,781
LONG-TERM LIABILITIES:		
Deferred income taxes	316	476
Accrued severance pay	11,948	11,703
Accrued pensions	727	684
Total long-term liabilities	12,991	12,863
STOCKHOLDERS' EQUITY:		
Capital stock:		
Common stock, \$ 0.001 par value -		
Authorized shares: 50,000,000 shares at June 30, 2016 and December 31, 2015;		
Issued and outstanding shares: 21,742,684 and 21,572,616 shares at June 30, 2016 and		
December 31, 2015, respectively		
	22	22
Additional paid-in capital	363,267	361,023
Treasury stock	(123,749)	(125,697)
Accumulated other comprehensive loss	(474)	(1,267)
Accumulated deficit	(96,676)	(90,763)
Total stockholders' equity	142,390	143,318
Total liabilities and stockholders' equity	\$ 183,349	\$ 183,962

Note: The balance sheet at December 31, 2015 has been derived from the audited financial statements on that date.

See notes to condensed consolidated financial statements.

DSP GROUP, INC.**CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues	\$36,164	\$37,247	\$63,823	\$75,282
Cost of revenues (1)	20,279	22,012	36,221	44,512
Gross profit	15,885	15,235	27,602	30,770
Operating expenses:				
Research and development, net (2)	9,036	8,855	17,925	17,971
Sales and marketing (3)	3,323	2,974	6,715	6,037
General and administrative (4)	2,275	2,460	4,558	4,981
Intangible assets amortization	321	321	642	642
Total operating expenses	14,955	14,610	29,840	29,631
Operating income (loss)	930	625	(2,238)	1,139
Interest and other income, net	273	291	565	626
Income (loss) before taxes on income	1,203	916	(1,673)	1,765
Taxes on income	123	186	160	262
Net income (loss)	\$1,080	\$730	\$(1,833)	\$1,503
Net earnings (loss) per share:				
Basic	\$0.05	\$0.03	\$(0.08)	\$0.07
Diluted	\$0.05	\$0.03	\$(0.08)	\$0.06
Weighted average number of shares used in per share computations of net earnings (loss):				
Basic	21,739	22,064	21,725	22,115
Diluted	22,845	23,717	21,725	23,801

(1) Includes equity-based compensation expense in the amount of \$83 for both the three months ended June 30, 2016 and 2015, and \$144 and \$153 for the six months ended June 30, 2016 and 2015, respectively.

(2) Includes equity-based compensation expense in the amount of \$521 and \$613 for the three months ended June 30, 2016 and 2015, respectively; and \$947 and \$1,151 for the six months ended June 30, 2016 and 2015, respectively.

(3) Includes equity-based compensation expense in the amount of \$194 and \$178 for the three months ended June 30, 2016 and 2015, respectively; and \$325 and \$330 for the six months ended June 30, 2016 and 2015, respectively.

(4) Includes equity-based compensation expense in the amount of \$461 and \$537 for the three months ended June 30, 2016 and 2015, respectively; and \$828 and \$1,030 for the six months ended June 30, 2016 and 2015, respectively.

See notes to condensed consolidated financial statements.

DSP GROUP, INC.**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)****(U.S. dollars in thousands)**

	Three Months Ended June 30,	
	2016	2015
Net income:	\$1,080	\$730
Other comprehensive income:		
Available-for-sale securities:		
Changes in unrealized gains/losses	205	(549)
Reclassification adjustments for losses included in net income	7	-
Net change	212	(549)
Cash flow hedges:		
Changes in unrealized gains/losses	(110)	454
Reclassification adjustments for (gains) losses included in net income	(14)	145
Net change	(124)	599
Change in unrealized components of defined benefit plans:		
Amortization of actuarial loss and prior service benefit	4	5
Net change	4	5
Foreign currency translation adjustments, net	18	(5)
Other comprehensive income	110	50
Comprehensive income	\$1,190	\$780

DSP GROUP, INC.**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)****(U.S. dollars in thousands)**

	Six Months Ended June 30, 2016 2015	
Net income (loss):	\$(1,833)	\$1,503
Other comprehensive income:		
Available-for-sale securities:		
Changes in unrealized gains/losses	618	(134)
Reclassification adjustments for losses included in net income (loss)	33	26
Net change	651	(108)
Cash flow hedges:		
Changes in unrealized gains/losses	58	162
Reclassification adjustments for losses included in net income (loss)	15	625
Net change	73	787
Change in unrealized components of defined benefit plans:		
Amortization of actuarial loss and prior service benefit	8	10
Net change	8	10
Foreign currency translation adjustments, net	61	(53)
Other comprehensive income	793	636
Comprehensive income (loss)	\$(1,040)	\$2,139

See notes to condensed consolidated financial statements.

DSP GROUP, INC.**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

(U.S. dollars in thousands)

	Six Months Ended	
	June 30,	
	2016	2015
Net cash provided by operating activities	\$4,760	\$2,141
Investing activities		
Purchases of marketable securities	(26,112)	(15,342)
Proceeds from maturity of marketable securities	21,500	4,068
Proceeds from sales of marketable securities	7,987	10,332
Purchases of property and equipment	(1,012)	(1,202)
Decrease in restricted deposits	-	453
Net cash provided by (used in) investing activities	2,363	(1,691)
Financial activities		
Purchase of treasury stock	(3,737)	(6,346)
Issuance of common stock and treasury stock upon exercise of stock options	666	1,138
Net cash used in financing activities	(3,071)	(5,208)
Increase (Decrease) in cash and cash equivalents	4,052	(4,758)
Erosion- due to exchange rate differences	52	(55)
Cash and cash equivalents at the beginning of the period	13,704	20,544
Cash and cash equivalents at the end of the period	\$17,808	\$15,731

See notes to condensed consolidated financial statements.

DSP GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(UNAUDITED)

(U.S. dollars in thousands)

	Number of Common Stock	Common Stock	Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Other Comprehensive Income (Loss)	Total Stockholders' Equity
Three Months Ended June 30, 2015							
Balance at March 31, 2015	22,227	\$ 22	\$ 357,185	\$(118,909)	\$(87,853)	\$(980)	\$ 149,465
Net income	-	-	-	-	730	-	730
Change in accumulated other comprehensive loss	-	-	-	-	-	50	50
Purchase of treasury stock	(425)	(*)	-	(4,899)	-	-	(4,899)
Issuance of treasury stock upon exercise of stock options, stock appreciation rights and restricted stock units by employees and directors	193	(*)	-	1,879	(1,554)	-	325
Equity-based compensation	-	-	1,411	-	-	-	1,411
Balance at June 30, 2015	21,995	\$ 22	\$ 358,596	\$(121,929)	\$(88,677)	\$(930)	\$ 147,082
Three Months Ended June 30, 2016							
Balance at March 31, 2016	21,697	\$ 22	\$ 362,008	\$(124,212)	\$(96,109)	\$(584)	\$ 141,125
Net income	-	-	-	-	1,080	-	1,080
Change in accumulated other comprehensive income	-	-	-	-	-	110	110
Purchase of treasury stock	(132)	(*)	-	(1,270)	-	-	(1,270)
Issuance of treasury stock upon exercise of stock options, stock appreciation rights and restricted stock units by employees and directors	178	(*)	-	1,733	(1,647)	-	86
Equity-based compensation	-	-	1,259	-	-	-	1,259
Balance at June 30, 2016	21,743	\$ 22	\$ 363,267	\$(123,749)	\$(96,676)	\$(474)	\$ 142,390

(*) Represents an amount lower than \$1.

See notes to condensed consolidated financial statements.

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DSP GROUP, INC.**CONDENSED STATEMENTS OF STOCKHOLDERS' EQUITY****(UNAUDITED)****(U.S. dollars in thousands and shares in thousands)**

	Number of Common Stock	Common Stock	Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Other Comprehensive Income (Loss)	Total Stockholders' Equity
Six Months Ended June 30, 2015							
Balance at December 31, 2014	21,844	\$ 22	\$ 355,906	\$(122,387)	\$ (85,352)	\$ (1,566)	\$ 146,623
Net income	-	-	-	-	1,503	-	1,503
Change in accumulated other comprehensive income	-	-	-	-	-	636	636
Purchase of treasury stock	(550)	(1)	-	(6,345)	-	-	(6,346)
Issuance of treasury stock upon purchase of common stock under employee stock purchase plan	116	(*)	-	1,124	(260)	-	864
Issuance of treasury stock upon exercise of stock options, stock appreciation rights and restricted stock units by employees and directors	585	1	26	5,679	(4,568)	-	1,138
Equity-based compensation	-	-	2,664	-	-	-	2,664
Balance at June 30, 2015	21,995	\$ 22	\$ 358,596	\$(121,929)	\$ (88,677)	\$ (930)	\$ 147,082
Six Months Ended June 30, 2016							
Balance at December 31, 2015	21,573	\$ 22	\$ 361,023	\$(125,697)	\$ (90,763)	\$ (1,267)	\$ 143,318
Net loss	-	-	-	-	(1,833)	-	(1,833)
Change in accumulated other comprehensive income	-	-	-	-	-	793	793
Purchase of treasury stock	(408)	(*)	-	(3,676)	-	-	(3,676)
Issuance of treasury stock upon purchase of common stock under employee stock purchase plan	114	(*)	-	1,114	(236)	-	878
Issuance of treasury stock upon exercise of stock options, stock appreciation rights and restricted stock	464	(*)	-	4,510	(3,844)	-	666

units by employees and
directors

Equity-based compensation	-	-	2,244	-	-	-	2,244
Balance at June 30, 2016	21,743	\$ 22	\$363,267	\$(123,749)	\$ (96,676)	\$ (474)	\$ 142,390

*) Represents an amount lower than \$1.

See notes to condensed consolidated financial statements.

DSP GROUP, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****June 30, 2016****(UNAUDITED)****(U.S. dollars in thousands, except share and per share data)****NOTE A—BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. For further information, reference is made to the consolidated financial statements and footnotes thereto included in the Annual Report on Form 10-K of DSP Group, Inc. (the "Company") for the year ended December 31, 2015.

NOTE B—INVENTORIES

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

	June 30, 2016 (Unaudited)	December 31, 2015 (Audited)
Work-in-process	\$ 7,278	\$ 6,384
Finished goods	5,572	5,069
	\$ 12,850	\$ 11,453

Inventory write-off amounted to \$151 and \$311 for the six months ended June 30, 2016 and 2015, respectively.

NOTE C—NET EARNINGS (LOSS) PER SHARE

Basic net earnings (loss) per share is computed based on the weighted average number of shares of common stock outstanding during the period. For the same periods, diluted net earnings (loss) per share further includes the effect of dilutive stock options, stock appreciation rights and restricted share units outstanding during the period, all in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") No. 260 "Earnings per Share." The following table sets forth the computation of basic and diluted net earnings (loss) per share:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	Unaudited			
Net income (loss)	\$1,080	\$730	\$(1,833)	\$1,503
Earnings (loss) per share:				
Basic	\$0.05	\$0.03	\$(0.08)	\$0.07
Diluted	\$0.05	\$0.03	\$(0.08)	\$0.06
Weighted average number of shares of common stock outstanding during the period used to compute basic net earnings (loss) per share (in thousands)	21,739	22,064	21,725	22,115
Incremental shares attributable to exercise of outstanding options, stock appreciation rights and restricted stock units (assuming proceeds would be used to purchase treasury stock) (in thousands)	1,106	1,653	-	1,686
Weighted average number of shares of common stock used to compute diluted net earnings (loss) per share (in thousands)	22,845	23,717	21,725	23,801

NOTE D—MARKETABLE SECURITIES and time deposits

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

The Company classifies marketable securities as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported in other comprehensive income. The amortized cost of marketable securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and interest are included in financial income, net. Interest and dividends on securities are included in financial income, net. The following is a summary of available-for-sale securities at June 30, 2016 and December 31, 2015:

	Amortized cost		Unrealized gains (losses), net		Fair value	
	June 30, 2016	December 31, 2015	June 30, 2016	December 31, 2015	June 30, 2016	December 31, 2015
	(Unaudited)	(Audited)	(Unaudited)	(Audited)	(Unaudited)	(Audited)
Short term deposits	5,632	\$5,568	\$-	\$ -	\$5,632	\$5,568
U.S. GSE securities	22,321	23,645	(24)	(114)	22,297	23,531
Corporate obligations	76,643	79,072	174	(387)	76,817	78,685
	\$104,596	\$108,285	\$150	\$ (501)	\$104,746	\$107,784

The amortized cost of marketable debt securities and short-term deposits at June 30, 2016, by contractual maturities, is shown below:

	Amortized cost	Unrealized gains (losses)		Fair value
		Gains	Losses	
Due in one year or less	\$22,769	\$19	\$(4)	\$22,784
Due after one year to five years	81,827	290	(155)	81,962
	\$104,596	\$309	\$(159)	\$104,746

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

Management believes that as of June 30, 2016, the unrealized losses in the Company's investments in all types of marketable securities were temporary and no impairment loss was realized in the Company's condensed consolidated statement of income.

The unrealized losses related to corporate obligations were primarily due to changes in interest rates. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2016.

The total fair value of marketable securities with outstanding unrealized losses as of June 30, 2016 amounted to \$34,094, while the unrealized losses for these marketable securities amounted to \$159. Of the \$159 unrealized losses outstanding as of June 30, 2016, a portion of which in the amount of \$94 related to marketable securities that were in a loss position for more than 12 months and the remaining portion in the amount of \$65 was related to marketable securities that were in a loss position for less than 12 months.

Proceeds from maturity of available-for-sale marketable securities during the six months ended June 30, 2016 and 2015 were \$21,500 and \$4,068, respectively. Proceeds from sales of available-for-sale marketable securities during the six months ended June 30, 2016 and 2015 were \$7,987 and \$10,332, respectively. Net realized loss from the sale of available-for-sale securities for the six months ended June 30, 2016 were \$33 compared to net realized loss for the six months ended June 30, 2015 of \$26. The Company determines realized gains or losses on the sale of marketable securities based on a specific identification method.

Marketable securities are periodically reviewed for impairment. If management concludes that any marketable security is impaired, management determines whether such impairment is other-than-temporary. Factors considered in making such a determination include the duration and severity of the impairment, the reason for the decline in value and the potential recovery period, and the Company's intent to sell, or whether it is more likely than not that the Company will be required to sell the marketable security before recovery of cost basis. If any impairment is considered other-than-temporary, the marketable security is written down to its fair value through a corresponding charge to financial income, net.

NOTE e—TAXES ON Income

The effective tax rate used in computing the provision for income taxes is based on projected fiscal year income before taxes, including estimated income by tax jurisdiction. Tax provision for the six months ended June 30, 2016 and 2015 does not include tax benefits associated with equity-based compensation expenses.

The total amount of net unrecognized tax benefits was \$1,660 and \$1,711 at June 30, 2016 and December 31, 2015, respectively. The Company accrues interest and penalties, relating to unrecognized tax benefits, in its provision for income taxes. At June 30, 2016 and December 31, 2015, the Company had accrued interest and penalties relating to unrecognized tax benefits of \$272 and \$180, respectively.

The Company intends to permanently reinvest earnings of its foreign operations and its current operating plans do not demonstrate a need to repatriate foreign earnings to fund the Company's U.S. operations. However, if these funds were needed for the Company's operations in the United States, the Company would be required to accrue and pay U.S. taxes as well as taxes in other countries to repatriate these funds. The determination of the amount of additional taxes related to the repatriation of these earnings is not practicable, as it may vary based on various factors such as the location of the cash and the effect of regulation in the various jurisdictions from which the cash would be repatriated.

NOTE f—SIGNIFICANT CUSTOMERS

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

Sales to VTech Holdings Ltd. ("VTech") represented 29% and 31% of the Company's total revenues for the three months ended June 30, 2016 and 2015, respectively. Sales to VTech represented 30% and 31% of the Company's total revenues for the six months ended June 30, 2016 and 2015, respectively.

Sales to Guo Wei Electronics Ltd. ("Guo Wei Electronics") represented 8% and 12% of the Company's total revenues for the three months ended June 30, 2016 and 2015, respectively. Sales to Guo Wei Electronics represented 8% and 11% of the Company's total revenues for the six months ended June 30, 2016 and 2015, respectively.

Sales to Samsung Electronics Co., Ltd ("Samsung") represented 13% and 0% of the Company's total revenues for the three months ended June 30, 2016 and 2015, respectively, as well as the six months ended June 30, 2016 and 2015, respectively.

Revenues derived from sales through the Company's distributor, Ascend Technology Inc., ("Ascend Technology"), accounted for 17% and 18% of the Company's total revenues for the three months ended June 30, 2016 and 2015, respectively. Revenues derived from sales through Ascend Technology accounted for 16% and 17% of the Company's total revenues for the six months ended June 30, 2016 and 2015, respectively.

Revenues derived from sales through the Company's distributor, Tomen Electronics Corporation ("Tomen Electronics"), accounted for 12% and 18% of the Company's total revenues for the three months ended June 30, 2016 and 2015, respectively, and 10% and 16% of the Company's total revenues for the six months ended June 30, 2016 and 2015, respectively. Tomen Electronics sells the Company's products to a limited number of customers. One customer, Panasonic Communications Co., Ltd. ("Panasonic"), has continually accounted for a majority of the sales of Tomen Electronics. Sales to Panasonic through Tomen Electronics generated approximately 10% and 15% of the Company's total revenues for the three months ended June 30, 2016 and 2015, respectively, and 8% and 13% of the Company's

total revenues for the six months ended June 30, 2016 and 2015, respectively.

NOTE G—DERIVATIVE INSTRUMENTS

The Company accounts for derivative instruments in accordance with FASB. ASC No. 815 "Derivatives and Hedging" ("ASC 815"). Due to the Company's global operations, it is exposed to foreign currency exchange rate fluctuations in the normal course of its business. The Company's treasury policy allows it to offset the risks associated with the effects of certain foreign currency exposures through the purchase of foreign exchange forward contracts and put options (collectively, "hedging contracts"). The policy, however, prohibits the Company from speculating on hedging contracts for profit.

To protect against the increase in value of forecasted foreign currency cash flows resulting from salary and lease payments of its Israeli facilities denominated in the Israeli currency, the New Israeli Shekels ("NIS"), during the year, the Company instituted a foreign currency cash flow hedging program. The Company hedges portions of the anticipated payroll and lease payments denominated in NIS for a period of one to twelve months with hedging contracts. Accordingly, when the dollar strengthens against the foreign currencies, the decline in present value of future foreign currency expenses is offset by losses in the fair value of the hedging contracts. Conversely, when the dollar weakens, the increase in the present value of future foreign currency cash flows is offset by gains in the fair value of the hedging contracts. These hedging contracts are designated as cash flow hedges, as defined by ASC 815 and are all effective hedges of these expenses.

In accordance with ASC 815, for derivative instruments that are designated and qualify as a cash flow hedge (i.e. hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Any gain or loss on a derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item is recognized in current earnings during the period of change. As of June 30, 2016, the Company had outstanding option contracts in the amount of \$8,600 and no outstanding foreign exchange forward contracts. These hedging contracts do not contain any credit-risk-related contingency features. See Note K for information on the fair value of these hedging contracts.

The fair value of derivative assets and derivative liabilities were \$82 and \$44, respectively, at June 30, 2016. The Company recorded a net amount of \$38 in other accounts receivable in the condensed consolidated balance sheet at June 30, 2016.

The amount recorded as an expense in research and development expenses, sales and marketing expenses and general and administrative expenses in the condensed consolidated statements of income for the six months ended June 30, 2016 that resulted from the above referenced hedging transactions was \$12, \$1 and \$2, respectively.

The amount recorded as an income in research and development expenses, sales and marketing expenses and general and administrative expenses in the condensed consolidated statements of income for the three months ended June 30, 2016 that resulted from the above referenced hedging transactions was \$11, \$1 and \$2, respectively.

The fair value of the outstanding derivative instruments at June 30, 2016 and December 31, 2015 is summarized below:

		Fair Value of Derivative Instruments	
		June 30,	December 31,
Balance Sheet Location		2016	2015
Derivative Assets (Liabilities)			
Foreign exchange forward and options contracts	Accrued expenses and other accounts payable	\$ -	\$ (36)
	Other accounts receivable and prepaid expenses	38	-
		\$ 38	\$ (36)

The effect of derivative instruments in cash flow hedging transactions on income and other comprehensive income ("OCI") for the three and six months ended June 30, 2016 and 2015 is summarized below:

	Gains (Losses) on Derivatives Recognized in OCI			
	for the three months ended June 30, 2016		for the six months ended June 30, 2015	
	2016	2015	2016	2015
Foreign exchange forward and option contracts	\$(110)	\$454	\$58	\$162

	Gains (Losses) Reclassified from OCI into Income				
	for the three months ended June 30, 2016		for the six months ended June 30, 2015		
Location	2016	2015	2016	2015	
Foreign exchange forward and option contracts	Operating expenses	\$14	\$(145)	\$(15)	\$(625)

NOTE h—CONTINGENCIES

From time to time, the Company may become involved in litigation relating to claims arising from its ordinary course of business. In addition, as is typical in the semiconductor industry, the Company has been and may from time to time be notified of claims that the Company may be infringing patents or intellectual property rights owned by third parties. The Company currently believes that there are no claims or actions pending or threatened against it, the ultimate disposition of which would have a material adverse effect on the Company.

NOTE i—EQUITY-BASED COMPENSATION

Grants for the Three Months ended June 30, 2016 and June 30, 2015:

The weighted-average estimated fair value of restricted stock units ("RSUs") granted during the three months ended June 30, 2016 was \$9.40 per share, with a pre-vest cancellation rate assumption of 4.32% (annualized percentage).

No employee stock options or stock appreciation rights ("SAR") were granted during the three months ended June 30, 2016.

No employee stock options, SARs or RSUs were granted during the three months ended June 30, 2015.

Employee Stock Benefit Plans

As of June 30, 2016, the Company had two equity incentive plans from which the Company may grant future equity awards and three expired equity incentive plans from which no future equity awards may be granted but had outstanding equity awards granted prior to expiration. The Company also had one employee stock purchase plan. As of June 30, 2016, approximately 1,056,000 shares of common stock remain available for grant under the Company's employee stock purchase plan and 644,000 shares of common stock remain available for grant under the Company's equity incentive plans.

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

	Number of Options/SARs/RSUs	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years) (3)	Aggregate Value (*)
	in thousands			in thousands
Outstanding at March 31, 2016	3,901	\$ 5.67		
Options granted	-	-		
RSUs granted	24	-		
Options / SARs / RSUs cancelled/forfeited/expired	(131) 6.20		
Options / SARs exercised and RSUs vested	(337) \$ 5.69		
Outstanding at June 30, 2016 (1)	3,457	\$ 5.61	2.83	\$ 17,811
Exercisable at June 30, 2016 (2)	2,300	\$ 7.55	2.51	\$ 7,516

(*) Calculation of aggregate intrinsic value is based on the share price of the Company's common stock on June 30, 2016 (\$10.61 per share).

(1) Due to the ceiling imposed on the stock appreciation right ("SAR") grants, the outstanding amount above can be exercised for a maximum of 2,971 shares of the Company's common stock as of June 30, 2016. SAR grants made prior to January 1, 2009 are convertible for a maximum number of shares of the Company's common stock equal to 50% of the SARs subject to the grant. SAR grants made on or after January 1, 2009 and before January 1, 2010 are convertible for a maximum number of shares of the Company's common stock equal to 75% of the SARs subject to the grant. SAR grants made on or after January 1, 2010 and before January 1, 2012 are convertible for a maximum number of shares of the Company's common stock equal to 66.67% of the SARs subject to the grant. SAR grants made on or after January 1, 2012 are convertible for a maximum number of shares of the Company's common stock equal to 50% of the SARs subject to the grant.

(2) Due to the ceiling imposed on the SAR grants, the exercisable amount above can be exercised for a maximum of 1,814 shares of the Company's common stock as of June 30, 2016.

(3) Calculation of weighted average remaining contractual term does not include the RSUs that were granted, which have indefinite contractual term.

Additional information about stock options, SARs and RSUs outstanding and exercisable at June 30, 2016 with exercise prices above \$10.61 per share (the closing price of the Company's common stock on June 30, 2016) is as follows:

Exercise Prices	Exercisable		Unexercisable		Total	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
	SARs / RSUs	(in thousands)	SARs / RSUs	(in thousands)	SARs / RSUs	(in thousands)
Above \$10.61	170	\$ 13.41	79	\$ 11.38	249	\$ 12.77
Less than \$10.61	2,130	\$ 7.08	1,078	\$ 1.06	3,208	\$ 5.06
Total	2,300	\$ 7.55	1,157	\$ 1.76	3,457	\$ 5.61

The Company's aggregate equity-based compensation expense for the three months ended June 30, 2016 and 2015 totaled \$1,259 and \$1,411, respectively. The Company did not recognize any income tax benefit relating to the Company's equity-based compensation expense for the three months ended June 30, 2016 and 2015.

As of June 30, 2016, there was \$5,465 of total unrecognized equity-based compensation expense related to unvested equity-based compensation awards granted under the Company's equity incentive plans. This amount is expected to be recognized during the period from 2016 through 2020.

NOTE j—Pension Liability

The information in this note represents the net periodic pension and post-retirement benefit costs and related components in accordance with FASB ASC No. 715 "Employers' Disclosures about Pensions and Other Post-Retirement Benefits." The components of net pension and post-retirement periodic benefit cost (income) for the three months ended June 30, 2016 and 2015 are as follows:

	June 30, 2016	June 30, 2015
Components of net periodic benefit cost:		
Service cost and amortization of loss	\$ 10	\$ 12
Interest cost	9	9
Expected return on plan assets	(1)	(2)
Net periodic benefit cost	\$ 18	\$ 19

The net pension liability as of June 30, 2016 amounted to \$727.

NOTE k—FAIR VALUE MEASUREMENTS

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

The Company measures its cash equivalents, short-term deposits, marketable securities and foreign currency derivative contracts at fair value. Cash equivalents, short-term deposits and marketable securities are classified within Level 1 or Level 2 value hierarchies as they are valued using quoted market prices or alternative pricing sources and models utilizing market observable inputs. Foreign currency derivative contracts are classified within Level 2 value hierarchy as the valuation inputs are based on quoted prices and market observable data of similar instruments.

The following table provides information by value level for assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2016:

Description	Balance as of June 30, 2016	Fair Value Measurements		
		Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market mutual funds	\$1,117	\$1,117	-	-
Short-term marketable securities and cash deposits:				
U.S. GSE securities	\$376	-	\$376	-
Corporate debt securities	\$16,776	-	\$16,776	-
Long-term marketable securities:				
U.S. GSE securities	\$21,921	-	\$21,921	-
Corporate debt securities	\$60,041	-	\$60,041	-
Derivative Assets	\$38	-	\$38	-

The following table provides information by value level for assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2015.

Description	Balance as of December 31, 2015	Fair Value Measurements		
		Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market mutual funds	\$ 1,089	\$1,089	-	-
Short-term marketable securities and time deposits:				
U.S. GSE securities				
Corporate debt securities	\$ 12,501	-	\$12,501	-
Long-term marketable securities:				
U.S. GSE securities	\$ 23,531	-	\$23,531	-
Corporate debt securities	\$ 66,184	-	\$66,184	-
Derivative liabilities	\$ (36)	-	\$(36)	-

In addition to the assets and liabilities described above, the Company's financial instruments also include cash and cash equivalents, restricted and short-term deposits, trade receivables, other accounts receivable, trade payables, accrued expenses and other payables. The fair value of these financial instruments was not materially different from their carrying values at June 30, 2016 due to the short-term maturity of these instruments.

NOTE 1—STOCKHOLDERS' EQUITY

During the first six months of 2016, the Company repurchased 407,906 shares of common stock at an average purchase price of \$9.01 per share for an aggregate purchase price of \$3,676. As of June 30, 2016, 497,134 shares of common stock remained authorized for repurchase under the Company's board-authorized share repurchase program.

Repurchases of common stock are accounted for as treasury stock, and result in a reduction of stockholders' equity. When treasury shares are reissued, the Company accounts for the reissuance in accordance with Accounting Principles Board Opinion No. 6, "Status of Accounting Research Bulletins" and charges the excess of the repurchase cost over

issuance price using the weighted average method to accumulated deficit. In the case where the repurchase cost over issuance price using the weighted average method is lower than the issuance price, the Company credits the difference to additional paid-in capital.

During the first six months of 2016, the Company issued approximately 578,000 shares of common stock out of treasury stock to employees who exercised their stock options, SARs or RSUs, or purchased shares from the Company's 1993 Employee Stock Purchase Plan.

NOTE M—SEGMENT INFORMATION

Description of segments:

The Company operates under three reportable segments.

The Company's segment information has been prepared in accordance with ASC 280, "Segment Reporting." Operating segments are defined as components of an enterprise engaging in business activities about which separate financial information is available that is evaluated regularly by the Company's chief operating decision-maker ("CODM") in deciding how to allocate resources and assess performance. The Company's CODM is its Chief Executive Officer, who evaluates the Company's performance and allocates resources based on segment revenues and operating income.

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

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

Home - Wireless chipset solutions for converged communication at home. Such solutions include integrated circuits targeted for cordless phones sold in retail or supplied by telecommunication service providers, home gateway devices supplied by telecommunication service providers which integrate the DECT/CAT-iq functionality, integrated circuits addressing home automation applications, as well as fixed-mobile convergence solutions. In this segment, (i) revenues from cordless telephony products exceeded 10% of the Company's total revenues and amounted to 55% and 74% of the Company's total revenues for the first half of 2016 and 2015, respectively, and 56% and 72% of the Company's total revenues for the second quarter of 2016 and 2015, respectively, and (ii) revenues from home gateway products amounted to 8% and 12% of the Company's total revenues for the first half of 2016 and 2015, respectively, and 7% and 11% of the Company's total revenues for the second quarter of 2016 and 2015, respectively.

Office - Comprehensive solution for Voice-over-IP (VOIP) office products, including office solutions that offer businesses of all sizes low-cost VOIP terminals with converged voice and data applications. Revenues from the Company's VOIP products represented 20% and 12% of its total revenues for the first six months of 2016 and 2015, respectively. Revenues from the Company's VOIP products represented 20% and 14% of its total revenues for the second quarter of 2016 and 2015, respectively. No revenues derived from other products in the office segment exceeded 10% of the Company's total revenues for the first six months of 2016 and 2015.

Mobile - Products for the mobile market that provides voice enhancement, always-on and far-end noise elimination targeted for mobile phone and mobile headsets and wearable devices that incorporate the Company's noise suppression, always-on and voice quality enhancement HDclear technology. Revenues from the Company's mobile products represented 13% of its total revenues for the second quarter and first half of 2016. No revenues were derived from this segment in the comparable periods of 2015.

Segment data:

The Company derives the results of its business segments directly from its internal management reporting system and by using certain allocation methods. The accounting policies the Company uses to derive business segment results are substantially the same as those the Company uses for consolidation of its financial statements. The CODM measures the performance of each business segment based on several metrics, including earnings from operations. The CODM uses these results, in part, to evaluate the performance of, and to assign resources to, each of the business segments.

The Company does not allocate to its business segments certain operating expenses, which it manages separately at the corporate level. These unallocated costs include primarily amortization of purchased intangible assets, equity-based compensation expenses, and certain corporate governance costs.

Selected operating results information for each business segment was as follows for the three months ended June 30, 2016 and 2015:

	Three months ended June 30,			
	Revenues		Income (loss) from operations	
	2016	2015	2016	2015
Home	\$24,211	\$32,055	\$4,843	\$7,112
Office	\$7,392	\$5,192	\$(475)	\$(1,102)
Mobile	\$4,561	\$-	\$(1,408)	\$(3,150)
Total	\$36,164	\$37,247	\$2,960	\$2,860

Selected operating results information for each business segment was as follows for the six months ended June 30, 2016 and 2015:

	Six months ended June 30,			
	Revenues		Income (loss) from operations	
	2016	2015	2016	2015
Home	\$42,866	\$66,406	\$6,321	\$14,288
Office	\$12,470	\$8,876	\$(2,498)	\$(1,715)
Mobile	\$8,487	\$-	\$(2,225)	\$(6,987)
Total	\$63,823	\$75,282	\$1,598	\$5,586

The reconciliation of segment operating results information to the Company's consolidated financial information was as follows for the three and six months periods ended June 30, 2016:

	Three months	Six months
Income from operations	\$2,960	\$1,598
Unallocated corporate, general and administrative expenses	(450)	(950)
Equity-based compensation expenses	(1,259)	(2,244)
Intangible assets amortization expenses	(321)	(642)
Financial income, net	273	565
Total consolidated income before taxes	\$1,203	\$(1,673)

The reconciliation of segment operating results information to the Company's consolidated financial information was as follows for the three and six months ended June 30, 2015:

	Three months	Six months
Income from operations	\$2,860	\$5,586
Unallocated corporate, general and administrative expenses	(503)	(1,141)
Equity-based compensation expenses	(1,411)	(2,664)
Intangible assets amortization expenses	(321)	(642)
Financial income, net	291	626
Total consolidated income before taxes	\$916	\$1,765

NOTE N —ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table summarizes the changes in accumulated balances of other comprehensive income for the three months ended June 30, 2016:

	Unrealized gains (losses) on available-for-sale marketable securities	Unrealized gains (losses) on cash flow hedges	Unrealized gains (losses) on components of defined benefit plans	Unrealized gains (losses) on foreign currency translation	Total
Beginning balance	\$ (62)	\$ 162	\$ (348)	\$ (336)	\$(584)
Other comprehensive income (loss) before reclassifications	205	(110)	-	18	113
Losses (gains) reclassified from accumulated other comprehensive income (loss)	7	(14)	4	-	(3)
Net current period other comprehensive income (loss)	212	(124)	4	18	110
Ending balance	\$ 150	\$ 38	\$ (344)	\$ (318)	\$(474)

The following table provides details about reclassifications out of accumulated other comprehensive income for the three months ended June 30, 2016:

Details about Accumulated Other Comprehensive Income (Loss) Components	Amount	Affected Line Item in the Statement of Income
	Reclassified from Accumulated Other Comprehensive Income (Loss)	
Losses on available-for-sale marketable securities	\$ 7	Financial income, net
	-	Provision for income taxes
	7	Total, net of income taxes

Gains on cash flow hedges	(11)	Research and development
	(1)	Sales and marketing
	(2)	General and administrative
	(14)	Total, before income taxes
	-		Provision for income taxes
	(14)	Total, net of income taxes
Losses on components of defined benefit plans	2		Research and development
	2		Sales and marketing
	4		Total, before income taxes
	-		Provision for income taxes
	4		Total, net of income taxes
Total reclassifications for the period	\$ (3)	Total, net of income taxes

The following table summarizes the changes in accumulated balances of other comprehensive income (loss) for the six months ended June 30, 2016:

	Unrealized gains (losses) on available-for-sale marketable securities	Unrealized gains (losses) on Cash Flow Hedges	Unrealized gains (losses) on components of defined benefit plans	Unrealized gains (losses) on foreign currency translation	Total
Beginning balance	\$ (501)	\$ (35)	\$ (352)	\$ (379)	\$(1,267)
Other comprehensive income (loss) before reclassifications	618	58	-	61	737
Losses reclassified from accumulated other comprehensive income (loss)	33	15	8	-	56
Net current period other comprehensive income	651	73	8	61	793
Ending balance	\$ 150	\$ 38	\$ (344)	(318)	\$(474)

The following table provides details about reclassifications out of accumulated other comprehensive income for the six months ended June 30, 2016:

Details about Accumulated Other Comprehensive Income (Loss) Components	Amount Reclassified from Accumulated Other Comprehensive Income (Loss)	Affected Line Item in the Statement of Income
Losses on available-for-sale marketable securities	\$ 33	Financial income, net
	-	Provision for income taxes
	33	Total, net of income taxes
Losses on cash flow hedges	12	Research and development
	1	Sales and marketing
	2	General and administrative
	15	Total, before income taxes

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	-	Provision for income taxes
	15	Total, net of income taxes
Losses on components of defined benefit plans	4	Research and development
	4	Sales and marketing
	8	Total, before income taxes
	-	Provision for income taxes
	8	Total, net of income taxes
Total reclassifications for the period	\$ 56	Total, net of income taxes

NOTE O—GOVERNMENT GRANTS

Government grants received by the Company's Israeli subsidiary relating to categories of operating expenditures are credited to the consolidated statements of income during the period during which the expenditure to which they relate is charged. Royalty and non-royalty-bearing grants from the Israeli Office of the Chief Scientist ("OCS") for funding certain approved research and development projects are recognized at the time when the Company's Israeli subsidiary is entitled to such grants, on the basis of the related costs incurred, and are included as a deduction from research and development expenses, net.

The Company recorded grants in the amount of \$1.0 and \$1.6 million for the three month periods ended June 30, 2016 and 2015, respectively.

The Company recorded grants in the amount of \$1.6 million for both the six month periods ended June 30, 2016 and 2015, respectively.

The Company's Israeli subsidiary is obligated to pay royalties amounting to 5% of the sales of certain products, the development of which benefited from grants received from the OCS in previous years. The obligation to pay these royalties is contingent on actual sales of such products. Grants received from the OCS may become repayable if certain criteria under the grants are not met. In addition, the grants may be required to be repaid with a multiple of up to six times the initial grant amount in case the technology that was developed using these grants are transferred, directly or indirectly, to a third party.

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

This report and certain information incorporated herein by reference contain forward-looking statements, which are provided under the "safe harbor" protection of the Private Securities Litigation Reform Act of 1995. All statements included or incorporated by reference in this report, other than statements that are purely historical in nature, are forward-looking statements. Forward-looking statements are generally written in the future tense and/or are preceded by words such as "will," "may," "should," "could," "expect," "suggest," "believe," "anticipate," "intend," "plan," or other similar words. Forward-looking statements include statements regarding:

Our belief that sales of our DECT products will continue to represent a substantial percentage of our revenues for the rest of 2016;

Our belief that our past research and development investments in new technologies are beginning to materialize;

Our belief that the inventory correction cycle in the cordless market should be exhausted in the second quarter of 2016 and the projected rate of decline in our revenues for this mature market will go back to the secular decline levels of 10% to 15% for the second half of 2016;

Our belief that the rapid deployment of new communication access methods, including mobile, wireless broadband, cable and other connectivity, the traditional cordless telephony market using fixed-line telephony is declining and we expect will continue to decline, which would reduce our revenues derived from, and unit sales of, cordless telephony products;

Our belief that the market will remain price sensitive for our traditional cordless telephony products and expect that price erosion and the decrease in the average selling prices of such products to continue;

Our intention to leverage our strong technology base and customer relationships to maximize growth and revenue opportunities for our new products;

Our anticipation that annual revenues generated from our new products to increase significantly in 2016 as compared to 2015;

Our belief that our available cash and cash equivalents at June 30, 2016 should be sufficient to finance our operations for the foreseeable future.

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

This Quarterly Report on Form 10-Q includes trademarks and registered trademarks of DSP Group. Products or service names of other companies mentioned in this Quarterly Report on Form 10-Q may be trademarks or registered trademarks of their respective owners.

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

Overview

The following discussion and analysis is intended to provide investors 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 condensed consolidated financial statements and notes thereto.

Business Overview

DSP Group is a leading global provider of wireless chipset solutions for converged communications, delivering system solutions that combine semiconductors and software with reference designs. We provide a broad portfolio of wireless chipsets integrating DECT, Wi-Fi, PSTN and VOIP technologies with state-of-the-art application processors. We also enable converged voice, audio and data connectivity across diverse consumer products – from cordless and VOIP phones to home gateways and connected multimedia screens. A majority of our revenues is derived from products targeted for digital cordless telephony. Such revenues currently represent approximately 55% of our total revenues for the first half of 2016, down from 74% for the first half of 2015.

Our revenues were \$63.8 million for the first half of 2016, a decrease of 15% in comparison to the same period of 2015, mainly due to a decrease in sales of our cordless telephony and home gateway products, offset to some extent by an increase in sales of our VOIP and HDClear (Mobile) products. Revenues from our new products accounted for 45% of our total revenues for the first half of 2016, up 49% year over year.

Sales of our HDClear products were \$8.5 million for the first half of 2016, representing 13% of our total revenues for the first half of 2016. We had no HDClear product sales in the comparable period of 2015.

Sales of our VOIP products increased from \$8.9 million for the first six months of 2015 to \$12.5 million for the first six months of 2016, representing 20% of our total revenues for the first half of 2016, as compared to 12% of our total revenues for the first half of 2015.

Sales of our home gateway products decreased from \$8.9 million for the first six months of 2015 to \$5.3 million for the first six months of 2016, representing 8% of our total revenues for the first six months of 2016, as compared to 12% of our total revenues for the first six months of 2015.

Sales of our cordless telephony products decreased from \$56.1 million for the first six months of 2015 to \$35.2 million for the first six months of 2016, representing 55% of our total revenues for the first half of 2016, as compared to 74% of our total revenues for the first half of 2015. We believe that the decline was primarily attributable to an inventory correction cycle during the first half of 2016, and that the projected rate of decline in our revenues for this mature market will go back to the secular decline levels of 10% to 15% for the second half of 2016.

Our gross margin increased to 43.2% of revenues for the first half of 2016 from 40.9% for the first half of 2015, primarily due to a change in the mix of products sold and mix of customers, mostly shifting of revenues from cordless telephony products to new products with higher gross margin, offset to some extent by a decrease in total revenues and an increase in royalties in the first half of 2016 compared to the first half of 2015.

Our operating loss was \$2.2 million for the first half of 2016, as compared to an operating income of \$1.1 million for the first half of 2015. The change from operating income to operating loss was mainly as a result of a decrease in total revenues and an increase in operating expenses during the first six months of 2016, as compared to the first six months of 2015, offset to some extent by an increase in gross margin during the first half of 2016, as compared to the first half of 2015. Our operating expenses increased to \$29.8 million for the first six months of 2016, as compared to \$29.6 million for the first six months of 2015.

Notwithstanding our success in increasing our gross margin, we expect that our financial condition will continue to be challenged by the steady decline of the cordless telephony market. With the rapid deployment of new communication access methods, including mobile, wireless broadband, cable and other connectivity, the traditional cordless telephony market using fixed-line telephony will continue to decline, which will continue to reduce our revenues derived from, and unit sales of, cordless telephony products. Furthermore, our business also may be significantly affected by the outcome of the competition between cellular phone operators and fixed-line operators for the provision of residential communication. A significant majority of our revenues are currently generated from sales of chipsets used in cordless phones that are based on fixed-line telephony. If we are unable to continue to develop new technologies to address alternative connectivity methods, our business could be materially adversely affected.

We see evidence that our past research and development investments in new technologies are beginning to materialize. We have achieved a number of design wins for our new products and a number of such new products have begun mass shipments. Moreover, 2015 marked the achievement of a significant milestone for the company with initial mass production shipments of HDClear products to Samsung Electronics Co. Ltd (“Samsung”). In the first half of 2016, our HDClear product was integrated in one of Samsung’s flagship mobile phones. Aggregate revenues derived from our new products were 45% and 26% of our total revenues for the first half of 2016 and 2015, respectively. Based on a strong pipeline of design wins, our current mix of new products and anticipated commercialization schedules of customers incorporating our new products, we anticipate annual revenues generated from our new products to increase significantly in 2016 as compared to 2015.

However, despite our success thus far, we can provide no assurances about our continued success in introducing new products and penetrating new markets, as well as our predictions regarding market trends. Furthermore, although our new products targeted for mobile devices, home control & automation and enterprise VOIP solutions are gradually being introduced into the market, market adoption of such products is at early stages and may require us to increase our research and development spending to capitalize on opportunities in those markets. Moreover, although we have achieved a number of design wins with top-tier OEMs for new products, revenue generated from the commercialization of new products is a measured process as there is generally a long lead time from a design win to commercialization. From initial product design win to volume production, many factors could impact the timing and/or amount of sales actually realized from the design win. In addition to general price sensitivity and price erosion in the markets we operate, the introduction of new products may accelerate price erosion of older products. As a result, we expect the market to remain price sensitive for our traditional cordless telephony products and expect that price erosion and the decrease in the average selling prices of such products to continue. Furthermore, various other factors, including increases in the cost of raw materials and commodities and our suppliers passing such increases onto us, increases in silicon wafer costs and increases in production, assembly and testing costs, and shortage of capacity to fulfill our fabrication, assembly and testing needs, all may decrease our gross profit and harm our ability to grow our revenues in future periods.

As of June 30, 2016, our principal source of liquidity consisted of cash and cash equivalents of \$17.8 million and marketable securities and short term deposits of \$104.7 million, totaling \$122.6 million.

RESULTS OF OPERATIONS

Total Revenues. Our total revenues were \$36.2 million for the second quarter of 2016, as compared to \$37.2 million for the same period in 2015. Our total revenues were \$63.8 million for the first half of 2016, as compared to \$75.3 million for the same period in 2015. Both the decrease in revenues for the second quarter and first six months of 2016 compared to the comparable periods of 2015 was primarily as a result of a decrease in sales of our cordless telephony and home gateway products, offset to some extent by an increase in sales of our VOIP and HDclear products.

Sales of our cordless telephony products decreased from \$27.0 million for the second quarter of 2015 to \$20.3 million for the second quarter of 2016, representing 56% of our total revenues for the second quarter of 2016, as compared to 72% of our total revenues for the second quarter of 2015 and represented a decrease of 25% in absolute dollars for the comparable periods. The above mentioned decrease was mainly attributable to decreased demand from our customers in all markets, primarily because of an inventory correction cycle that we believe was exhausted in the second quarter of 2016. Sales of our cordless telephony products decreased from \$56.1 million for the first half of 2015 to \$35.2 million for the first half of 2016, representing 55% of our total revenues for the first half of 2016, as compared to 74% of our total revenues for the first half of 2015. The decrease in sales of our cordless telephony products as a percentage of our total revenues for the six months ended June 30, 2016 as compared to 2015 was mainly attributable to decreased demand from our customers. Sales of our home gateway products decreased from \$4.2 million for the second quarter of 2015 to \$2.6 million for the second quarter of 2016, representing 7% of our total revenues for the second quarter of 2016, as compared to 11% of our total revenues for the second quarter of 2015, and represented a decrease of 37% in absolute dollars for the comparable periods. Sales of our home gateway products decreased from \$8.9 million for the first half of 2015 to \$5.3 million for the first half of 2016, representing 8% of our total revenues for the first half of 2016, as compared to 12% of our total revenues for the first half of 2015, and represented a decrease of 41% in absolute dollars for the comparable periods. The decrease in sales of our home gateway products was mainly attributable to lower demands from our customers.

Sales of our VOIP products increased from \$5.2 million for the second quarter of 2015 to \$7.4 million for the second quarter of 2016, representing 20% of our total revenues for the second quarter of 2016, as compared to 14% of our total revenues for the second quarter of 2015, and represented an increase of 42% in absolute dollars for the comparable periods. Sales of VOIP products increased from \$8.9 million for the first half of 2015 to \$12.5 million for the first half of 2016, representing 20% of our total revenues for the first half of 2016, as compared to 12% of our total revenues for the first half of 2015, and represented an increase of 40% in absolute dollars for the comparable periods. The increase was mainly attributable to a growth in market demand for our VOIP products that resulted from the growth of our market share within this domain.

Sales of our HDClear products were \$4.6 and \$8.5 million for the second quarter and first half of 2016, respectively, representing 13% of our total revenues for both the second quarter and first half of 2016. There were no HDClear sales in the first half of 2015. The increase was mainly attributable to the integration of our HDClear product in one of Samsung's flagship mobile phones.

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

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
United States	\$1,384	\$816	\$2,105	\$1,306
Japan	4,788	6,954	7,453	13,450
Europe	2,491	2,508	4,160	5,110
Hong-Kong	14,729	18,093	26,431	38,080
China	1,834	2,425	4,365	5,106
Taiwan	4,801	5,498	8,168	9,697
Korea	5,093	184	9,520	392
Other	1,044	769	1,621	2,141
Total revenues	\$36,164	\$37,247	\$63,823	\$75,282

Sales to our customers in Hong Kong decreased for the second quarter and first half of 2016, as compared to the comparable periods of 2015, representing a 19% and 31% decrease in absolute dollars, respectively. The decrease in our sales to Hong Kong for the comparable periods resulted mainly from (i) a decrease in sales to VTech Holdings Ltd. ("VTech"), representing a 9% and 17% decrease in absolute dollars for the second quarter and first half of 2016, as compared to the comparable periods of 2015, (ii) a decrease in sales to CCT Telecom Ltd, representing a 29% and 56% decrease in absolute dollars for the second quarter and first half of 2016, respectively, as compared to the comparable periods of 2015, and (iii) a decrease in sales to Shenzhen Guo Wei Electronics Ltd. ("Guo Wei Electronics"), representing a 32% and 44% decrease in absolute dollars for the second quarter and first half of 2016, as compared to the comparable periods of 2015.

Sales to our customers in Japan decreased for the second quarter and first half of 2016 as compared to the same periods of 2015, representing a decrease of 31% and 45% in absolute dollars, respectively. The decrease in our sales to Japan for the comparable periods resulted mainly from (i) a decrease in sales to the Japanese domestic market, representing a 20% and 30% decrease in absolute dollars for the second quarter and first half of 2016, respectively, as compared to the comparable periods of 2015, and (ii) a decrease in sales, through our distributor, Tomen Electronics, Ltd. ("Tomen Electronics"), to Panasonic Communications Ltd ("Panasonic"), representing a 38% and 48% decrease in absolute dollars for the second quarter and first half of 2016, respectively, as compared to the comparable periods of 2015.

Sales to our customers in Taiwan decreased for the second quarter and first half of 2016, as compared to the same periods of 2015, representing a decrease of 13% and 16% in absolute dollars, respectively. The decrease in our sales to Taiwan for the comparable periods resulted mainly from a decrease in sales through our distributor, Ascend Technology Inc. ("Ascend Technology").

We generated meaningful revenues from Samsung in Korea during the second quarter and first half of 2016 mainly due to the integration of our HDClear product in one of Samsung's flagship mobile phones.

As our products are generally incorporated into consumer electronics products sold by our OEM customers, our revenues are affected by seasonal buying patterns of consumer electronics products sold by our OEM customers that incorporate our products, as well as inventory correction cycles within the market.

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

VTech is a significant OEM customer based in Hong Kong. Sales to VTech represented 29% and 31% of our total revenues for the three months ended June 30, 2016 and 2015, respectively. Sales to VTech represented 30% and 31% of our total revenues for the six months ended June 30, 2016 and 2015, respectively.

Sales to Guo Wei Electronics represented 8% and 12% of our total revenues for the three months ended June 30, 2016 and 2015, respectively. Sales to Guo Wei Electronics represented 8% and 11% of our total revenues for the six months ended June 30, 2016 and 2015, respectively.

Sales to Samsung represented 13% and 0% of our total revenues for the three months ended June 30, 2016 and 2015, respectively. Sales to Samsung represented 13% and 0% of our total revenues for the six months ended June 30, 2016 and 2015, respectively.

Revenues derived from sales through our distributor, Tomen Electronics, accounted for 12% of our total revenues for the three months ended June 31, 2016, as compared to 18% for the comparable period of 2015. Revenues from Tomen Electronics accounted for 10% of our total revenues for the six months ended June 30, 2016, as compared to 16% for the comparable period of 2015.

Tomen Electronics sells our products to a limited number of customers. One customer, Panasonic, has continually accounted for a majority of sales through Tomen Electronics. Sales to Panasonic through Tomen Electronics generated 10% and 15% of our total revenues for the three months ended June 30, 2016 and 2015, respectively. Sales to Panasonic through Tomen Electronics generated 8% and 13% of our total revenues for the six months ended June 30, 2016 and 2015, respectively.

Revenues derived from sales through our distributor, Ascend Technology, accounted for 17% and 18% of our total revenues for the three months ended June 30, 2016 and 2015, respectively. Revenues from Ascend Technology accounted for 16% and 17% of our total revenues for the six months ended June 30, 2016 and 2015, respectively. Ascend Technology sells our products to a limited number of customers, however none of those customers accounted for more than 10% of our total revenues for the three and six month periods ended June 30, 2016 and 2015.

Significant Products. Revenues from our digital cordless telephony products represented 56% and 72% of our total revenues for the three months ended June 30, 2016 and 2015, respectively. Revenues from our digital cordless telephony products represented 55% and 74% of our total revenues for the six months ended June 30, 2016 and 2015, respectively. We believe that sales of digital cordless telephony products will continue to represent a substantial percentage of our revenues for the remainder of 2016. We believe that the rapid deployment of new communication access methods, as well as the lack of growth in fixed-line telephony, will reduce our total revenues derived from, and unit sales of, cordless telephony products for the short and long term.

Revenues from our home gateway products represented 7% and 11% of our total revenues for the three months ended June 30, 2016 and 2015, respectively. Revenues from our home gateway products represented 8% and 12% of our total revenues for the six months ended June 30, 2016 and 2015, respectively.

Revenues from our VOIP products represented 20% and 14% of our total revenues for the three months ended June 30, 2016 and 2015, respectively. Revenues from our VOIP products represented 20% and 12% of our total revenues for the six months ended June 30, 2016 and 2015, respectively.

Revenues from our HDClear products represented 13% and 0% of our total revenues for the three months ended June 30, 2016 and 2015, respectively. Revenues from our HDClear products represented 13% and 0% of our total revenues for the six months ended June 30, 2016 and 2015, respectively.

Gross Profit. Gross profit as a percentage of revenues was 43.9 % for the second quarter of 2016 and 40.9% for the second quarter of 2015. Gross profit as a percentage of revenues was 43.2 % for the first half of 2016 and 40.9% for the first half of 2015. The increase in our gross profit for the comparable periods was primarily due to a change in the mix of products sold and mix of customers, mostly shifting of revenues from cordless telephony products to new products with higher gross margin, offset to some extent by a decrease in total revenues and an increase in royalties in 2016, as compared to the comparable periods of 2015.

As gross profit reflects the sale of chips and chipsets that have different margins, changes in the mix of products sold have impacted and will continue to impact our gross profit in future periods. Our gross profit may decrease in the future due to a variety of factors, *including* the continued decline in the average selling prices of our products, changes

in the mix of products sold, our failure to achieve cost reductions, roll-out of new products in any given period, our success in introducing new engineering processes to reduce manufacturing costs, increases in the cost of raw materials such as gold, oil and silicon wafers, and increases in production, assembly and testing costs. Moreover, our suppliers may pass the increase in the cost of raw materials and commodities onto us, which would further reduce the gross margins of our products. There are no guarantees that our ongoing efforts in cost reduction and yield improvements will keep pace with the anticipated continuing decline in average selling prices of our products.

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

Research and Development Expenses, net. Our research and development expenses, net, increased to \$9.0 million for the second quarter of 2016 from \$8.9 million for the second quarter of 2015. This was mainly due to a decrease in funding recognized from the Israeli Office of the Chief Scientist (“OCS”), as well as an increase in labor contractors and subcontractor expenses, offset to some extent by a decrease in IP and tape-out expenses, as well as a decrease in equity-based compensation in the second quarter of 2016, as compared to the second quarter of 2015.

Research and development expenses, net, decreased to \$17.9 million for the first half of 2016 from \$18.0 million for the first half of 2015. This was mainly due to a decrease in IP and tape-out expenses and a decrease in equity-based compensation in the first half of 2016 as compared to 2015, partially offset by an increase in labor contractors and subcontractor expenses in the first half of 2016, as compared to the first half of 2015.

Our research and development expenses, net, as a percentage of our total revenues were 25% and 24% for the three months ended June 30, 2016 and 2015, respectively, and 28% and 24% for the six months ended June 30, 2016 and 2015, respectively. The increase in research and development expenses, net, as a percentage of our total revenues for the three and six months periods ended June 30, 2016 was mainly due to a decrease in our total revenues for the comparable periods.

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

Sales and Marketing Expenses. Our sales and marketing expenses increased to \$3.3 million for the second quarter of 2016 from \$3.0 million for the second quarter of 2015. Sales and marketing expenses increased to \$6.7 million for the first six months of 2016 from \$6.0 million for the first six months of 2015. The increase in sales and marketing expenses for the second quarter of 2016, compared to the comparable period of 2015, was mainly due to an increase in sales commissions on sales of HDClear products in the second quarter of 2016, compared to the second quarter of 2015. The increase in sales and marketing expenses for the first half of 2016, compared to the comparable period of 2015, was mainly due to increases in payroll expenses and sales commissions on sales of HDClear products in the first half of 2016, as compared to the first half of 2015.

Our sales and marketing expenses, net, as a percentage of our total revenues were 9% and 8% for the three months ended June 30, 2016 and 2015, respectively, and 11% and 8% for the six months ended June 30, 2016 and 2015, respectively. The increase in sales and marketing expenses, net, as a percentage of our total revenues for the three and six months periods ended June 30, 2016 was mainly due to a decrease in our total revenues and an increase in sales and marketing expenses for the comparable periods.

Sales and marketing expenses consist mainly of sales commissions, payroll expenses to direct sales and marketing employees, travel, trade show expenses, and facilities expenses associated with and allocated to sales and marketing activities.

General and Administrative Expenses. Our general and administrative expenses were \$2.3 million and \$2.5 million for the second quarter of 2016 and 2015, respectively. Our general and administrative expenses decreased to \$4.6 million for the first six months of 2016 from \$5.0 million for the first six months of 2015. The decrease in general and administrative expenses for the second quarter and the first six months of 2016, as compared to the comparable periods of 2015, was mainly due to a decrease in legal expenses, accounting fees, and equity based compensation expenses.

General and administrative expenses as a percentage of our total revenues were 6% and 7% for the three months ended June 30, 2016 and 2015, respectively, and 7% for both the six months ended June 30, 2016 and 2015. The decrease in general and administrative expenses as a percentage of our total revenues for the three months ended June 30, 2016 as compared to 2015 was mainly due to a decrease in general and administrative expenses for the comparable periods ,offset to some extent by a decrease in total revenues for the comparable periods.

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

Description of Segments. We operate under three reportable segments.

Our segment information has been prepared in accordance with ASC 280, "Segment Reporting." Operating segments are defined as components of an enterprise engaging in business activities about which separate financial information is available that is evaluated regularly by the company's chief operating decision-maker ("CODM") in deciding how to allocate resources and assess performance. Our CODM is our Chief Executive Officer, who evaluates the Company's performance and allocates resources based on segment revenues and operating income.

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

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

Home - Wireless chipset solutions for converged communication at home. Such solutions include integrated circuits targeted for cordless phones sold in retail or supplied by telecommunication service providers, home gateway devices supplied by telecommunication service providers which integrate the DECT/CAT-iq functionality, integrated circuits addressing home automation applications, as well as fixed-mobile convergence solutions. In this segment, (i) revenues from cordless telephony products exceeded 10% of our total revenues and amounted to 55% and 74% of our total revenues for the first half of 2016 and 2015, respectively, and 56% and 72% of our total revenues for the second quarter of 2016 and 2015, respectively, and (ii) revenues from home gateway products amounted to 8% and 12% of our total revenues for the first half of 2016 and 2015, respectively, and 7% and 11% of our total revenues for the second quarter of 2016 and 2015, respectively.

Office - Comprehensive solution for Voice-over-IP (VOIP) office products, including office solutions that offer businesses of all sizes low-cost VOIP terminals with converged voice and data applications. Revenues from the Company's VOIP products represented 20% and 12% of its total revenues for the first six months of 2016 and 2015, respectively. Revenues from the Company's VOIP products represented 20% and 14% of its total revenues for the second quarter of 2016 and 2015, respectively. No revenues derived from other products in the office segment exceeded 10% of the Company's total revenues for the first six months of 2016 and 2015.

Mobile - Products for the mobile market that provides voice enhancement, always-on and far-end noise elimination targeted for mobile phone and mobile headsets and wearable devices that incorporate our noise suppression and voice quality enhancement HDClear technology. Revenues from our mobile products represented 13% of our total revenues for the second quarter and first half of 2016. No revenues were derived from this segment in the comparable periods of 2015.

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

Selected operating results information for each business segment was as follows for the three months ended June 30, 2016 and 2015:

Three months ended June 30				
	Revenues		Income (loss) from operations	
	2016	2015	2016	2015
Home	\$24,211	\$32,055	\$4,843	\$7,112
Office	\$7,392	\$5,192	\$(475)	\$(1,102)
Mobile	\$4,561	\$-	\$(1,408)	\$(3,150)
Total	\$36,164	\$37,247	\$2,960	\$2,860

Selected operating results information for each business segment was as follows for the six months ended June 30, 2016 and 2015:

Six months ended June 30				
	Revenues		Income (loss) from operations	
	2016	2015	2016	2015
Home	\$42,866	\$66,406	\$6,321	\$14,288
Office	\$12,470	\$8,876	\$(2,498)	\$(1,715)
Mobile	\$8,487	\$-	\$(2,225)	\$(6,987)
Total	\$63,823	\$75,282	\$1,598	\$5,586

Sales to our customers in the home segment decreased for the second quarter and the first half of 2016 as compared to the comparable periods of 2015, representing a decrease of 24% and 35% in absolute dollars, respectively. The decrease in sales in the home segment for the comparable periods was mainly attributable to (i) decreased demands for cordless phones over the comparable periods, partially as a result of an inventory correction cycle which we believe was exhausted in the second quarter of 2016, and (ii) decreased demands for home gateway products over the comparable periods mainly due to unusually higher demand from our customers during the first half of 2015.

Sales to our customers in the office segment increased for the second quarter and the first half of 2016 as compared to the comparable periods of 2015, representing an increase of 42% and 40% in absolute dollars, respectively. The increase in sales in the office segment for the comparable periods was mainly due to an increase in demands due to our increased market share of VOIP products.

The increase in sales to our customers in the mobile segment for the second quarter and first half of 2016 as compared to the second quarter and first half of 2015 was mainly due to the integration of our HDClear product in one of

Samsung's flagship mobile phones.

The reconciliation of segment operating results information to our consolidated financial information is included in Note M to our condensed consolidated financial statements.

Amortization of Intangible Assets. During the second quarter and the first half of 2016 and 2015, we recorded an expense of \$0.3 and \$0.6 million, respectively, relating to the amortization of intangible assets associated with the acquisition of BoneTone Communications ("BoneTone") in 2011.

Financial Income, net. Financial income, net, amounted to \$0.3 million for both the three month periods ended June 30, 2016 and 2015. Financial income, net, amounted to \$0.6 million for both the six month periods ended June 30, 2016 and 2015.

Provision for Income Taxes. Our income tax expenses were \$0.1 million and \$0.2 million for the second quarter and the first half of 2016, as compared to \$0.2 million and \$0.3 million of income tax expenses for the second quarter and the first half of 2015.

The income tax expenses for the second quarter and first half of 2016 were mainly attributed to current tax expenses of \$0.2 million and \$0.3 million, respectively, offset to some extent by income in the amount of \$0.1 million and \$0.2 million for the second quarter and first half of 2016, respectively, resulting from the amortization of deferred tax liability related to intangible assets acquired in connection with the BoneTone acquisition

The income tax expenses for the second quarter and the first half of 2015 were mainly attributed to current tax expenses of \$0.3 million and \$0.4 million, respectively, offset to some extent by income in the amount of \$0.1 million and \$0.2 million for the second quarter and first half of 2015, respectively, resulting from the amortization of deferred tax liability related to intangible assets acquired in connection with the BoneTone acquisition

LIQUIDITY AND CAPITAL RESOURCES

Operating Activities. During the first six months of 2016, we generated \$4.8 million of cash and cash equivalents from our operating activities, as compared to \$2.1 million of cash generated for operating activities for the first half of 2015. The increase in cash from our operating activities during the first half of 2016 as compared to the first half of 2015, was mainly due to a decrease in accounts receivable of \$2.1 million in the first half of 2016, as compared to an increase of \$2.5 million in the first half of 2015 and an increase of \$1.6 million in accrued expenses and accrued compensation and benefits in the first half of 2016, compared to a decrease of \$0.8 in the first half of 2015. Those increases were partially offset by an increase in inventories by \$1.4 million in the first half of 2016, compared to a decrease in inventories of \$1.5 million in the first half of 2015 and a decrease in net income in the first half of 2016 as compared to the first half of 2015.

Investing Activities. We invest excess cash in marketable securities of varying maturity, depending on our projected cash needs for operations, capital expenditures and other business purposes. During the first half of 2016, we purchased \$26.1 million of marketable securities, as compared to \$15.3 million of marketable securities during the first half of 2015. During the first half of 2016, \$21.5 million of marketable securities matured and were called by the issuers, as compared to \$4.1 million during the first half of 2015. During the first half of 2016 and 2015, \$8.0 million and \$10.3 million, respectively, of marketable securities were sold. As of June 30, 2016, the amortized cost of our marketable securities and short term deposits was \$104.6 million and their stated market value was \$104.7, representing \$0.1 million of unrealized Gains.

Our capital equipment purchases, consisting primarily of research and development software tools, computers, peripheral, engineering test and lab equipment, leasehold improvements, furniture and fixtures, totaled \$1.0 and \$1.2 million, for the first six months of 2016 and 2015, respectively.

Financing Activities. During the first six months of 2016, we paid an aggregate purchase price of \$3.7 million for approximately 414,000 repurchased shares of common stock at an average purchase price of \$9.02 per share. During the first six months of 2015, we repurchased approximately 550,000 shares of common stock at an average purchase price of \$11.54 per share for an aggregate purchase price of \$6.3 million.

In addition, during the first half of 2016, we received \$0.7 million upon the exercise of employee stock options, as compared to \$1.1 million for the first half of 2015. We cannot predict cash flows from exercises of stock options for future periods.

In November 2013, we entered into a share repurchase plan, in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934, for the repurchase of our common stock for up to 2.7 million shares. This was in addition to the approximately 308,000 shares that were available for repurchase pursuant to the Board's prior authorizations. Furthermore, in August 2015, our Board authorized an additional \$10 million dollar buyback program, of which 0.5 million shares were available for repurchase under a Rule 10b5-1 plan.

At June 30, 2016, approximately 0.5 million shares of our common stock were available for repurchase under our board authorized share repurchase programs.

As of June 30, 2016, we had cash and cash equivalents totaling approximately \$17.8 million and marketable securities and time deposits of approximately \$104.7 million. Out of total cash, cash equivalents and marketable securities of \$122.6 million, \$111.2 million was held by foreign entities. Our intent is to permanently reinvest earnings of our foreign operations and our current operating plans do not demonstrate a need to repatriate foreign earnings to fund our U.S. operations. However, if these funds were needed for our operations in the United States, we would be required to accrue and pay U.S. taxes as well as taxes in other countries to repatriate these funds. The determination of the amount of additional taxes related to the repatriation of these earnings is not practicable, as it may vary based on various factors such as the location of the cash and the effect of regulation in the various jurisdictions from which the cash would be repatriated.

Our working capital at June 30, 2016 was approximately \$45.1 million, compared to \$39.9 as of June 30, 2015. The increase in working capital was mainly due to (i) cash and cash equivalents generated between June 30, 2015 and June 30, 2016 from our operating activities, and (ii) cash received upon the exercise of employees stock options in the amount of \$0.8 million between June 30, 2015 and June 30, 2016 and (iii) the replacement of long term marketable securities and deposits with short term marketable securities and deposits. The above mentioned increases were offset to some extent by the repurchase of our common stock in the amount of \$10.6 million between June 30, 2015 and June 30, 2016. We believe that our current cash, cash equivalents, cash deposits and marketable securities will be sufficient to meet our cash requirements for both the short and long term.

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

Off-Balance Sheet Arrangements

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

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk. It is our policy not to enter into interest rate derivative financial instruments, except for hedging of foreign currency exposures discussed below. We do not currently have any significant interest rate risk since we do not have any financial obligations.

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

We hold an investment portfolio of marketable securities consisting principally of debentures of U.S. corporations, and U.S. government sponsored enterprises. We intend, and have the ability, to hold such investments until recovery of any temporary declines in market value or maturity.

Interest rate fluctuations relating to our cash and cash equivalents and within our investment portfolio have not had, and are not currently anticipated to have, a material effect on our financial position on an annual or quarterly basis.

Foreign Currency Exchange Rate Risk. A significant part of our sales and expenses are denominated in U.S. dollars. Part of our expenses in Israel is paid in NIS, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the NIS. Our primary expenses paid in NIS are employee salaries and lease payments on our Israeli facilities. Furthermore, a portion of our expenses for our European operations are paid in the Euro, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and the Euro. Our primary expenses paid in Euro are employee salaries, lease and operational payments on our European facilities. To partially protect the company against an increase in value of forecasted foreign currency cash flows resulting from salary and lease payments denominated in NIS during 2016, we instituted a foreign currency cash flow hedging program. The option and forward contracts used are designated as cash flow hedges, as defined by FASB ASC No. 815, "Derivatives and Hedging," and are all effective as hedges of these expenses. For more information about our hedging activity, see Note G to the attached Notes to the Condensed Consolidated Financial Statement for the period ended June 30, 2016. An increase in the value of the NIS and the Euro in comparison to the U.S. dollar could increase the cost of our research and development expenses and general and administrative expenses, all of which could harm our operating profit. Although we currently are using a hedging program to minimize the effects of currency fluctuations relating to the NIS, our hedging position is partial, may not exist at all in the future and may not succeed in minimizing our foreign currency fluctuation risks.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2016.

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

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

ITEM 1A. RISK FACTORS.

There are no material changes to the Risk Factors described under the title "Factors That May Affect Future Performance" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015 other than (1) changes to the Risk Factor below entitled "We generate a significant amount of our total revenues from the sale of digital cordless telephony products and our business and operating results may be materially adversely affected if we do not continue to succeed in this highly competitive market or if sales within the overall cordless digital market decreases;" (2) changes to the Risk Factor below entitled "We rely significantly on revenue derived from a limited number of customers;" (3) changes to the Risk Factor below entitled "Our future success is dependent on market acceptance of our HDClear product family targeted for the mobile device market and market acceptance of our VOIP products, which are intensively competitive markets with dominant and established players;" (4) changes to the Risk Factor below entitled "We rely on a few distributors for a significant portion of our total revenues and the failure of those distributors to perform as expected would materially reduce our future sales and revenues;" (5) changes to the Risk Factor below entitled "Because we have significant international operations, we may be subject to political, economic and other conditions relating to our international operations that could increase our operating expenses and disrupt our business;" (6) changes to the Risk Factor below entitled "We are exposed to fluctuations in currency exchange rates;" (7) changes to the Risk Factor below entitled "Because we have significant operations in Israel, we may be subject to political, economic and other conditions affecting Israel that could increase our operating expenses and disrupt our business;" (8) changes to the Risk Factor below entitled "The tax benefits available to us under Israeli law requires us to meet several conditions, and may be terminated or reduced in the future, which would increase our taxes;" and (9) changes to the Risk Factor below entitled "We are exposed to fluctuations in currency exchange rates."

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

Sales of our digital cordless telephony products comprised 55% and 74% of our total revenues for the first half of 2016 and 2015, respectively. Any adverse change in the digital cordless market or in our ability to compete and maintain our competitive position in that market would harm our business, financial condition and results of operations.

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

Furthermore, the decline in fixed line telephony together with the rapid deployment of new communication access methods, including mobile, wireless broadband, cable and other connectivity will decrease sales of products using fixed-line telephony. Our business also may be affected by the outcome of the competition between cellular phone operators and fixed-line operators for the provision of residential communication. A significant majority of our revenues are currently generated from sales of chipsets used in cordless phones that are based on fixed-line telephony, and the continued decline in fixed-line telephony would reduce our revenues derived from, and unit sales of, our digital cordless telephony products.

As an example, revenues from cordless telephony products decreased by 37% from the first half of 2015 to the first half of 2016. We currently believe that this reduction is mostly attributable to inventory correction cycles of our customers and their customers but we can provide no assurance that our revenue decline rates will revert back to the secular decline levels of 10% to 15% for the second half of 2016.

In addition, the digital cordless telephony market is competitive and is facing pricing pressures, and we expect that competition and pricing pressures will continue. It is possible that we may one day be unable to respond to increased pricing competition for digital cordless telephony processors or other products through the introduction of new products or reduction of manufacturing costs. This inability to compete would have a material adverse effect on our business, financial condition and results of operations. Likewise, any significant delays by us in developing, manufacturing or shipping new or enhanced products in this market also would have a material adverse effect on our business, financial condition and results of operations.

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

We expect that a limited number of customers, varying in identity from period-to-period, will account for a substantial portion of our revenues in any period. Our four largest customers – VTech, Panasonic (through Tomen), Guo Wei Electronics and Samsung accounted for approximately 59% and 55% of our total revenues for the first half of 2016 and 2015, respectively. Sales to VTech represented 30% and 31% of our total revenues for the first half of 2016 and 2015, respectively. Sales to Panasonic represented 8% and 13% of our total revenues for the first half of 2016 and 2015, respectively. Sales to Shenzhen Guo Wei Electronics Ltd represented 8% and 11% of our total revenues for the first half of 2016 and 2015, respectively; Sales to Samsung represented 13% and 0% of our total revenues for the first half of 2016 and 2015. Typically, our sales are made on a purchase order basis, and none of our customers has entered into a long-term agreement requiring it to purchase our products. Moreover, we do not typically require our customers to purchase a minimum quantity of our products, and our customers can generally reschedule the delivery date of their orders on short notice without significant penalties. A significant amount of our revenues will continue to be derived from a limited number of large customers. Furthermore, the primary customers for our products are original equipment manufacturers (OEMs) and original design manufacturers (ODMs) in the cordless digital market. This industry is highly cyclical and has been subject to significant economic downturns at various times, particularly in recent periods. These downturns are characterized by production overcapacity and reduced revenues, which at times may affect the financial stability of our customers. Therefore, the loss of one of our major customers, or reduced demand for products from, or the reduction in purchasing capability of, one of our major customers, could have a

material adverse effect on our business, financial condition and results of operations.

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

Our ability to increase our revenues and offset declining revenues from our cordless product family are substantially dependent on our ability to gain market share for our HDClear and VOIP product families. Moreover, we are targeting a new market with our HDClear product family, a market with dominant and established players selling to OEM customers with whom they have established relationships. We will need to win over such customers, with whom we do not have established relationships, to gain market share. If we are unable to generate meaningful revenues from our HDClear product family and gain significant market share in the mobile device market, our operating results would be adversely affected. Furthermore, our future growth is also dependent on the market acceptance of our VOIP products, a market where we also compete with existing and potential competitors, many of whom have significantly greater financial, technical, manufacturing, marketing, sales and distribution resources and management expertise than we do. Moreover, all of our current revenues from HDClear products are generated from a sole customer. Our ability to maintain and grow our revenues for this product line is substantially dependent on our continued success in having our products being integrated into the end products of this sole customer.

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

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

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

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

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

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

In addition to direct sales, we use a network of distributors to sell our products. Particularly, revenues derived from sales through our Japanese distributor, Tomen Electronics, accounted for 10% and 16% of our total revenues for the first half of 2016 and 2015, respectively. Revenues derived from sales through another distributor, Ascend Technology, accounted for 16% and 17% of our total revenues for the first half of 2016 and 2015, respectively. Our future performance will depend, in part, on those distributors to continue to successfully market and sell our products. Furthermore, Tomen Electronics sells our products to a limited number of customers. One customer, Panasonic, has continually accounted for a majority of the sales through Tomen Electronics. Sales to Panasonic through Tomen Electronics generated 8% and 13% of our total revenues for the first half of 2016 and 2015, respectively. The loss of Tomen Electronics and/or Ascend Technology as our distributors and our inability to obtain satisfactory replacements in a timely manner would materially harm our sales and results of operations. Additionally, the loss of Panasonic and Tomen Electronics' inability to thereafter effectively market our products would also materially harm our sales.