

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 1996

COMMISSION FILE NUMBER 0-23006

DSP GROUP, INC.

(Exact name of registrant as specified in its charter)

DELAWARE

94-2683643

(State or other jurisdiction of
incorporation and organization)

(I.R.S. Employer Identification No.)

3120 SCOTT BOULEVARD, SANTA CLARA, CA 95054
(Address of principal executive offices, including zip code)

(408) 986-4300
(Registrant's telephone number)

Securities registered pursuant to Section 12(b) of the Act:
NONE

Securities registered pursuant to Section 12(g) of the Act:
COMMON STOCK, \$.001 PER SHARE
(Title of class)

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

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based on the closing price of the Common Stock on March 3, 1997, as reported on the Nasdaq National Market, was approximately \$94,771,750. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded from this computation in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 3, 1997 the Registrant had outstanding 9,560,528 shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Registrant's Annual Report to Stockholders for the fiscal year ended December 31, 1996 are incorporated by reference into Part II of this Form 10-K Report. With the exception of those portions which are incorporated by reference, the Registrant's 1996 Annual Report is not deemed filed as part of this Report.
2. Portions of the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 20, 1997 are incorporated by reference into Part III of this Form 10-K Report.

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PART I

ITEM 1. BUSINESS.

FOR A DISCUSSION OF VARIOUS RISKS AND UNCERTAINTIES AFFECTING THE COMPANY'S FUTURE OPERATIONS SEE "FACTORS AFFECTING FUTURE OPERATING RESULTS" BEGINNING ON PAGE 14 BELOW. THIS ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 1996 CONTAINS TRADEMARKS OF THE COMPANY.

DSP Group develops and markets digital signal processing integrated circuits and software for use in digital speech products targeted at the consumer telephone and computer telephony markets. Digital speech technology provides several advantages over analog speech technology, including higher attainable levels of compression, greater ability to process and manipulate data, and faster development of products through use of a programmable digital signal processor ("DSP") rather than dedicated analog hardware. As a result, digital speech technology is incorporated today in the digital telephone answering device ("TAD") market and enables the implementation of many new applications in computer telephony such as voice mail messaging, digital simultaneous voice and data ("DSVD") transmission and video conferencing.

The Company has developed digital signal processing and digital speech technologies, including proprietary algorithms, software, system designs and VLSI circuit designs that have enabled the introduction of three synergistic product families: speech and telephony digital signal processing integrated circuits, proprietary architectures for digital signal processors ("DSP core designs") and proprietary TrueSpeech-Registered Trademark- digital speech compression algorithms.

SPEECH AND TELEPHONY PROCESSORS

The Company has developed two series of speech and telephony processors for use in the consumer telephone and computer telephony markets. Both series are based on the Company's DSP core designs, incorporate several of its digital telephony signal processing algorithms and provide TrueSpeech compression capabilities. In 1989, the Company introduced the first cost effective speech processor for use in digital TADs and today the Company is the leading independent supplier of DSPs to digital TAD suppliers. The Company's TAD speech processors are incorporated in the products of leading digital TAD suppliers such as Alcatel, AT&T, British Telecom, L.G. Electronics, Panasonic, Philips, Sagem, Samsung, Sanyo, Siemens, Sony and Uniden.

DSP Group has also developed a series of speech co-processors for use in conjunction with microprocessors in personal computers and in many standalone applications to enhance the microprocessors' speech and telephony capabilities. The Company's speech co-processors utilize many of the same technologies used in its TAD speech processors. These speech co-processors provide a variety of real-time speech applications for personal computers, standalone videophones, portable dictation devices and Internet telephony applications, such as voice mail messaging, DSVD transmission and video conferencing.

DSP CORE DESIGNS

DSP Group has also developed proprietary, low power DSP core designs--the PineDSPCore and OakDSPCore--which represent low cost solutions for current and emerging digital signal processing applications. The Company's DSP core designs are incorporated in its own family of speech and telephony processors and are also licensed to more than twenty entities, including LSI Logic, NEC, Samsung, Siemens, TEMIC and VLSI Technology. These licensees may use the Company's DSP core designs to develop their own DSPs for various products, including cellular telephones, modems, audio boards and cordless telephones. In the fourth quarter of 1995, the first shipment of products utilizing the Company's PineDSPCore technology occurred; however, royalties from these shipments have not been significant to date.

TRUESPEECH

The Company has developed TrueSpeech, a family of proprietary speech compression algorithms which it incorporates in its TAD speech processors and personal computer speech co-processors and also licenses to various companies in the computer telephony and personal computer industries. The Company believes that TrueSpeech offers several advantages over other currently available speech compression technologies, including a combination of high compression ratios, high quality speech playback and cost effectiveness. The proliferation of speech applications in the computer telephony and personal computer market requires standardized digital speech compression technologies. The Company seeks to establish industry standards for its target markets based on TrueSpeech algorithms. However, the establishment of industry standards depends upon the acts of third parties, which are not within the control of the Company. The development of industry standards utilizing TrueSpeech algorithms would create an opportunity for the Company to develop and market speech co-processors that provide complete TrueSpeech solutions and enhance the performance and functionality of products incorporating these speech co-processors. For example, in the personal computer market, Microsoft has incorporated a TrueSpeech algorithm in Windows 95. In addition, in the video conferencing market, the International Telecommunications Union ("ITU") in February 1995 established G.723, which is predominantly composed of a TrueSpeech algorithm, as the standard speech compression technology for use in video conferencing over public telephone lines.

PRODUCT FAMILIES, TECHNOLOGY AND CUSTOMERS

The Company has incorporated its proprietary algorithms and technologies in three product families--speech and telephony processors, DSP core designs and TrueSpeech software--for use in the consumer telephone and computer telephony markets.

SPEECH AND TELEPHONY PROCESSORS

The Company has developed and introduced two series of DSPs speech processors for digital TADs, telephony applications, modems, disk controllers and other communication applications, which were first introduced in 1989 for digital TADs, and personal computer speech co-processors, which were first introduced in late 1994, to maximize the benefits of TrueSpeech compression in personal computer applications. Both series are based upon the Company's cost effective, low power DSP core designs and incorporate its TrueSpeech algorithms. The Company is currently developing a third generation DSP core design for use with applications that require faster processing speeds. The following chart describes some

of the Company's other speech and telephony technologies that may be incorporated in various combinations in its products.

TECHNOLOGY	DESCRIPTION
Caller ID and Call Waiting Caller ID	Identifies the telephone number being used by the calling party, when the line is not engaged and when the receiving party is already engaged on another call
Call Progress Tone Detection	Detects standard telephony signals during the progress of the telephone call
DTMF Signaling	Detects and generates DTMF signals ("touch tones") that comply with telephone requirements
Full Duplex Speakerphone	Allows simultaneous two-way (full-duplex), hands-free operation of the telephone and incorporates acoustical echo cancellation for suppression of room echoes and electrical echo cancellation for elimination of electrical echoes
Speech Prompts	Provides time-date stamp capabilities and allows the user to access operating instructions
Variable Speed Playback (FlexiSpeech-Registered Trademark-)	Permits playback of distortion-free, natural sounding speech at variable speeds
Voice Operated Switch ("VOX") (Smart-Vox-Registered Trademark-)	Detects human speech and stops recording during periods of silence, thereby conserving available memory
Voice Recognition	Allows voice command operation of functions

These technologies enable the Company's speech and telephony processors to provide a variety of speech capabilities for digital TAD, telephony and computer telephony products.

TAD SPEECH PROCESSORS. DSP Group's TAD speech processors are currently incorporated in over 80 models of digital TADs from approximately 50 different companies. These models include standalone digital TADs, integrated digital TADs, facsimile machines with integrated digital TADs, standalone speaker phones with integrated digital TADs, hand-held devices and digital cordless telephones with integrated digital TADs. To date, the Company has shipped approximately 13 million speech processors to digital TAD suppliers, including approximately 5.8 million TAD speech processors in 1996. TAD speech processor product sales accounted for 73% of the Company's total revenues in 1996.

The Company's TAD speech processors use TrueSpeech to provide high quality speech recording and playback. All of the Company's TAD speech processors are based on the Company's PinedSPCore and incorporate certain of the Company's technologies, including VOX, caller ID, DTMF signaling and call progress tone detection. Some of the Company's TAD speech processors feature additional technologies, including speech prompt capabilities, variable speed playback and full duplex speakerphone. The following

table sets forth certain characteristics of the primary TAD speech processors currently offered by the Company:

DSP GROUP'S TAD SPEECH PROCESSORS

	D6305	D6375	D6455	D6371	D6471	D6301
	-----	-----	-----	-----	-----	-----
Process Geometry (microns).....	0.8	0.8	0.8	0.6	0.6	0.6
Minutes Record, 4 Mbit Memory.....	15-17	15-17	25-27	15-17	25-27	15
Memory Type.....	ARAM	ARAM	ARAM	Flash	Flash	Flash
Advanced Features:						
Speech Prompts.....	Yes	Yes	Yes	Yes	Yes	Yes
Variable Speed Playback.....	--	Yes	--	--	Yes	Yes
Full Duplex Speakerphone.....	--	Yes	Yes	--	Yes	--
Caller ID and Call Waiting Caller ID.....	--	--	--	Yes	Yes	Yes
Other Required Components:(1)						
Microcontroller.....	Yes	Yes	Yes	Yes	Yes	Yes
Codec.....	Yes	Yes	Yes	Yes	Yes	Yes
EPROM.....	Yes	Yes	Yes	--	--	--
Battery.....	Yes	Yes	Yes	--	--	--

(1) In addition to the Company's speech processors, digital TADs require other electrical and electronic components as indicated. The approximate digital subsystem costs include the estimated total cost of the Company's TAD speech processors and the other associated electrical and electronic components required for a digital TAD.

DSP Group's D6301 and D6471, its newest TAD speech processors, interface directly with a new flash memory chip introduced by Samsung and facilitate lower overall system costs for digital TADs. The new Samsung flash memory chip is designed for speech recording and is less expensive than other currently available flash memories. The D6301 and D6471 eliminate the need for audio-grade random access memories ("ARAMs"), which from time to time have constrained the growth of the digital TAD market due to supply shortages. By allowing substitution of a flash memory for an ARAM, the D6301 and D6471 also eliminate the need for battery circuitry to maintain the data in the ARAM during power failures and an EPROM to store pre-recorded voice prompts and time-date stamps.

The following is a list of TAD manufacturers and resellers whose products incorporate the Company's TAD speech processors:

TAD MANUFACTURERS AND RESELLERS

TAD MANUFACTURERS

TAD RESELLERS

Alcatel
Ascom
Daewoo
D&B Electronics
CCT Telecom
GE/Thomson
Hanchang
Hanwha Telecom
HPF Ascom
Hyundai
I.N.T. Corp.
Interisa
Kinpo
L.G. Electronics
Matra

Maxon
NEC
Norris
Panasonic
Philips
Sagem
Samsung
Sanyo
Sharp
Siemens
Smoothline
Sony
Uniden
Vtech
Yupiteru

Amstrad
Bell South
Bosch
British Telecom
Cresta
France Telecom
GE
German Telecom
Loewe-Binatone
Northwestern Bell
Peacock
Phonemate
Radio Shack
Southwestern Bell
Swiss Telecom
Telyco

PERSONAL COMPUTER SPEECH CO-PROCESSORS. The Company has developed its personal computer speech co-processors as complementary application-specific DSPs to enhance the performance and functionality of personal computer products using TrueSpeech. While the current generation of microprocessors contained in personal computers can compress and record speech in real-time, the microprocessors are not specifically designed to run digital speech processing algorithms and, therefore, require a substantial amount of the personal computer's computing power to do so. As a result, the use of speech co-processors that incorporate TrueSpeech in personal computers provides a more efficient utilization of the personal computer's computing power. After becoming familiar with new speech applications, the Company believes many personal computer users will demand real-time speech compression capability and manufacturers will begin to provide real-time speech compression by including application-specific DSPs on personal computer products such as modems, audio boards, PCMCIA cards and personal computer based videophone and video conferencing products.

To date, the Company has announced three speech co-processors--the CT8005, CT8015 and CT8020--for use in personal computers, DSVD modems, video telephones and video conferencing equipment. These speech co-processors are based on the Company's DSP core designs, incorporate TrueSpeech and many of its other proprietary algorithms and technologies, and are fully controlled by the personal computer's host processor. All of the Company's speech co-processors contain the TrueSpeech algorithm incorporated in Windows 95. The CT8005 provides telephone and speech recording and playback functions in personal computers, while the CT8015 is designed as a low-cost solution for use in DSVD modems and in Internet telephony products. The CT8020 is designed for use in video telephones and video conferencing equipment and also implements all the specifications of the G.723 speech compression standard for video telephony. The CT8020 may also be utilized in many Internet-based telephone applications as well.

The Company has begun shipments of the CT8005 and the CT8015, and expects to begin volume production of the CT8020 in 1997. The following table sets forth the features of the personal computer speech co-processors currently offered by the Company:

DSP GROUP'S PERSONAL COMPUTER SPEECH CO-PROCESSORS

	CT8005	CT8015	CT8020
First Sample Date.....	Q2 95	Q2 95	Q1 96
DSP Core Design.....	PineDSPCore	PineDSPCore	OakDSPCore
Process Geometry (microns).....	0.8	0.8	0.6
TrueSpeech Algorithm Data Rate, Kilobits Per Second.....	8.5	8.5	8.5, 6.3, 5.3, 4.8 & 4.1
Features:			
Voice Mail Messaging.....	Yes	--	Yes
Telephone Answering.....	Yes	--	Yes
Full Duplex Speakerphone.....	Yes	Yes	Yes
Variable Speed Message Playback.....	Yes	--	Yes
Full Duplex DSVD.....	--	Yes	Yes
Video Conferencing.....	--	--	Yes
Internet Telephony.....	Yes (HDX)	Yes	Yes

FUTURE SPEECH AND TELEPHONY PROCESSORS. The Company is developing its next generation of TAD speech processors based on 0.5 micron technology to reduce its manufacturing costs and increase its competitiveness in the price sensitive TAD business. In addition, the Company intends to continue to enhance its existing speech and telephony processors through the addition of advanced capabilities and to develop new speech and telephony processors for emerging applications. For example, the Company intends to enhance its TAD speech processors through the addition of capabilities such as superior quality full duplex speakerphone, caller ID, call waiting caller ID, integrated facsimile functions and reliable speech recognition technology that can be used to operate digital TADs with spoken commands.

The Company believes that emerging applications for its personal computer speech co-processors may include other personal computer products such as laptop computers, personal digital assistants ("PDAs"), personal communications systems and other mobile computing devices. In addition, DSP Group believes that its digital signal processing and digital speech expertise will also be applicable to emerging digital speech applications for consumer electronics. For example, one manufacturer has introduced and is shipping a personal digital voice recorder with one hour of recording time based on a DSP Group TAD speech processor. This recorder utilizes the Company's variable speed playback algorithm and provides the capability of editing a stored speech file. The recorder also provides memory storage in a detachable module with a PCMCIA connector, allowing transfer of the recorded speech file to a computer with a PCMCIA interface for storage, playback or transmittal over a modem. The Company intends to develop additional speech co-processors for the personal digital voice recorder market, and intends to pursue the use of its technologies for other speech applications in the computer telephony, personal consumer and consumer electronics market.

DSP CORE DESIGNS

The Company's DSP core designs--PineDSPCore and OakDSPCore--are low power, low voltage and low cost digital signal processing integrated circuit architectures with associated advanced software development tools. The Company's DSP cores and associated instruction sets are designed for general purpose applications including speech processing, speakerphone, telephony algorithms and cellular, which enables efficient processing for digital speech applications. The DSP core designs operate at both 3 volts

and 5 volts and incorporate power management features for low power consumption. As digital signal processing and software migrate into high volume communication and computing products, the Company believes there will be a significant demand for low cost, low power DSP platforms. The efficient processing, flexible design and scaleable memories of the Company's DSP core designs allow the development of smaller and lower cost DSP solutions and shorten time to market for new products and product enhancements.

The Company's DSP core designs are small, highly efficient, 16-bit, general purpose DSPs with adjacent modular RAM and ROM and general I/O blocks for flexible layout and design. Universal design rules are used in the DSP core designs to allow easy implementation across multiple semiconductor process technologies. The DSP cores, initially implemented in 1.0 micron CMOS technology, were converted into 0.8 micron CMOS technology and then were further redesigned for 0.6 micron CMOS technology to reduce cost and increase performance.

The PinedSPCore, first introduced in 1992, was developed by the Company's VLSI designers and its software developers to efficiently process speech and telephony algorithms. During 1994, the Company announced its OakDSPCore, an enhanced version of the PinedSPCore that achieves a higher processing speed through improved architecture and is specifically suited for use in personal communication products and higher level processing applications, such as digital cellular telephones, high bit rate modems, DSVD modems and video telephone conferencing applications. The OakDSPCore offers significantly improved processing features compared to the PinedSPCore, including a higher processing speed of 40 MIPS and an advanced, more efficient instruction set. Algorithms implemented on the PinedSPCore instruction set may also be run on the OakDSPCore. The following table shows a comparison of the Company's DSP core designs:

DSP GROUP'S DSP CORE DESIGNS

	PINEDSPCORE	OAKDSPCORE
Word Length.....	16 bit	16 bit
Process Geometry (microns).....	0.8	0.6
Performance.....	25 MIPS	40 MIPS
Voltage.....	3.0 to 5.0 V	3.3V
Advanced Instruction Set.....	--	Yes

The Company incorporates its DSP core designs in its speech and telephony processors and also licenses them to original equipment manufacturers ("OEMs"). The Company's licensing program, introduced in 1992, enables OEMs to incorporate the Company's DSP core designs in the OEMs products. Licensing revenues are generally recognized on shipment by the Company provided that no significant vendor or post contract support obligations remain outstanding and that collection of the resulting receivable is deemed probable. In addition, most licenses require the licensee to pay the Company ongoing per-unit royalties based on the unit shipments of the licensee's products and a monthly support fee. The timing and amount of royalties from licensing of the DSP core designs will depend on the timing of each licensee's product development and the degree of market acceptance of such licensee's product, both of which are not within the Company's control. To date, royalty revenues from the licensing of DSP core designs have not been significant. The following is a partial list of companies who have licensed the

Company' s DSP core designs and representative applications for which they have the right to use the DSP core designs:

DSP CORE DESIGN LICENSES

LICENSEES	REPRESENTATIVE APPLICATIONS
Adaptec.....	Disk Drive
Asahi Kasei Microsystems.....	Cordless Telephone
Atmel.....	Communications
DSP Communications, Inc.....	Digital Cellular Telephone
GEC Plessey.....	Communications
Harris Semiconductor.....	Video Conferencing
Hyundai.....	Communications
Integrated Circuit Systems.....	Multimedia Boards
Kenwood.....	Audio
NEC.....	Communications & Consumer Products
LSI Logic.....	ASIC Library
Samsung.....	Communications & Multimedia
Siemens.....	Digital Cellular Telephone
Silicon Systems.....	Modem
TEMIC (Daimler-Benz).....	Communications
VLSI Technology.....	Communications & PCs
Xicor.....	Programmable DSP

The Alta Group of Cadence, Mentor Graphics and Synopsys have announced the development of electronic design automation ("EDA") tools, system level design kits and software co-design and co-simulation products for systems designers that use the PineDSPCore and OakDSPCore. In addition, a number of independent software vendors, including QSound and VoCal Technologies, have announced the development of digital signal processing algorithms that operate on the PineDSPCore and OakDSPCore for a variety of communications and multimedia applications. The Company believes that these developments make its DSP core designs more attractive to potential OEM licensees.

TRUESPEECH PRODUCTS

TrueSpeech is a high-quality, cost effective speech compression technology based on complex mathematical algorithms that are derived from the way airflow from the lungs is shaped by the throat, mouth and tongue during speech. This shaping of bursts of air is what the ear interprets as speech. TrueSpeech converts this speech into digital data and then selectively eliminates and enhances certain sound data to replicate human speech. Originally developed for consumer telephone applications, such as the Company's TAD speech processors, the Company has since enhanced TrueSpeech for use in the computer telephony and personal computer markets.

The Company seeks to establish industry standards for digital speech compression technology based on its TrueSpeech algorithms for emerging speech applications in the consumer telephone and computer telephony markets. However, the establishment of industry standards depends upon the acts of third parties, which are not within the control of the Company. The development of industry standards utilizing TrueSpeech algorithms would create an opportunity for the Company to develop and market speech co-processors that would serve as complementary application-specific DSPs to enhance the performance and functionality of personal computers using TrueSpeech. In the personal computer market, Microsoft has incorporated a TrueSpeech algorithm in Windows 95. In the video telephone market, the ITU in February 1995 established G.723, which is predominantly composed of a TrueSpeech algorithm, as the standard speech compression technology for video conferencing over public telephone lines. In addition to

the Company's TrueSpeech algorithm, G.723 incorporates elements of algorithms developed by France Telecom and the University of Sherbrooke. The Company believes that the ITU's selection positions other TrueSpeech algorithms as strong candidates for adoption as formal industry standards for other applications. In addition, although the ITU committee has approved the G.723 standard for analog telephone line, there is no assurance that the video conference market in analog line will be widely accepted, mainly due to quality and price issues. Furthermore, in March 1997, the International Multimedia Teleconferencing Consortium ("IMTC"), a nonprofit industry group, recommended the use of G.723 as the default audio coder for all voice transmissions over the Internet or for Internet Protocol ("IP") applications for H.323 conferencing products. The IMTC will forward its recommendation to its membership for approval in May 1997.

The Company believes that the principal advantages of TrueSpeech compared with other currently available digital speech compression technologies are as follows:

HIGH COMPRESSION RATIO. The three versions of TrueSpeech currently offered for license by DSP Group compress digital speech at ratios ranging from 15:1 to 26:1. These compression ratios are between seven and twelve times greater than the compression provided by Pulse Code Modulation ("PCM") used in current generation telephone speech transmissions and four to six times greater than compression using Adaptive Differential PCM ("ADPCM") currently used in personal computer audio cards. As a result, a standard 1.4 megabyte floppy diskette can hold approximately 37 minutes of speech using the most advanced version of TrueSpeech commercially available, compared to approximately three minutes using PCM and six minutes using ADPCM. Competitors have introduced other advanced speech compression algorithms that offer compression ratios comparable to the most advanced TrueSpeech algorithms, including competing algorithms that were submitted by several companies to the ITU standards committee evaluating speech compression algorithms for video telephones. The ITU testing showed that TrueSpeech provides superior quality playback and requires lower computational complexity than these competing algorithms.

HIGH QUALITY SPEECH. Another advantage of TrueSpeech is that it reproduces high quality speech playback with minimum distortion by selectively eliminating nonessential and background sound data without significant loss of speech quality. TrueSpeech has received high scores for speech quality from a number of independent evaluators. For example, TrueSpeech scored the highest on the ITU's intricately structured test used to numerically rate the quality of the five competing speech compression algorithms submitted for adoption as the G.723 standard for video telephones.

COST EFFECTIVENESS. TrueSpeech's ability to achieve high speech compression with lower computational complexity provides it with a competitive cost advantage. As an example, competing speech compression algorithms evaluated by the ITU use 20% to 50% more computing power for the same compression and transmission rates, and more RAM and ROM for storage and operation. Consequently, competing speech compression algorithms require larger, more expensive DSPs and result in higher cost solutions.

The Company incorporates its TrueSpeech technology in its speech and telephony processors and also licenses TrueSpeech to computer telephony and personal computer companies for inclusion in their products. The Company's TrueSpeech licensees include Atmel, Cirrus Logic, Creative Labs, Dialogic, IBM, Integrated Circuit Systems, Intel, LSI Logic, Lucent, Microsoft, Multi-Tech, Netspeak, Philips, Phylon, Prodigy, Siemens, Sierra Semiconductor, Silicon Systems, Smith Micro, Texas Instruments ("TI"), Unisys, US Robotics, VDOnet and VLSI Technology. In addition, the Company has ported its TrueSpeech algorithms to certain DSP platforms offered by Analog Devices, Lucent, Motorola and TI, four leading merchant vendors of programmable DSPs. To date, the Company's royalties from TrueSpeech licenses have not been significant.

SALES, MARKETING AND DISTRIBUTION

The Company markets and distributes its products through a direct sales and marketing organization, consisting of 16 employees, as well as through a network of distributors and independent manufacturers' representatives. A marketing and sales team located in the Company's headquarters in Santa Clara, California pursues business with the Company's customers in North America. In Japan, the Company operates from a marketing and support office in Tokyo, and through Tomen Electronics, a local distributor. In the rest of Asia, the Company operates through RTI, a distributor in Hong Kong, and through manufacturers' representatives in Hong Kong, Malaysia, Singapore, South Korea and Thailand. To handle sales and distribution in Europe, the Company operates a marketing and support office located in France and has manufacturers' representatives located in Denmark, Germany, Spain and the United Kingdom. The Company's distributors are not subject to minimum purchase requirements and can cease marketing the Company's products at any time. The loss of one or more representatives or the failure of such parties to renew agreements with the Company upon expiration could have an adverse effect on the Company's business, financial condition and results of operations.

In 1996, sales to Tomen Electronics and Samsung comprised 17% and 11% of total revenues, respectively. In 1995, sales to Tomen Electronics comprised 25% of total revenues. In 1994, sales to Tomen Electronics, RTI Industries and TI accounted for 22%, 16% and 10% of total revenues.

Export sales accounted for 91%, 81% and 80% of total revenue in 1996, 1995 and 1994, respectively. Due to its export sales, the Company is subject to the risks of conducting business internationally, including unexpected changes in regulatory requirements, fluctuations in exchange rates that could increase the price of the Company's products in foreign markets, delays resulting from difficulty in obtaining export licenses for certain technology, tariffs, other barriers and restrictions, and the burden of complying with a variety of foreign laws. All of the Company's export sales are denominated in United States dollars. See Note 4 of Notes to Consolidated Financial Statements appearing on pages 41 and 42 of the Company's Annual Report to Stockholders for the year ended December 31, 1996, for a summary of the Company's operations within various geographic areas.

MANUFACTURING AND DESIGN METHODOLOGY

Since the Company's products are based on its proprietary DSP core designs, which are not dependent upon a particular foundry's library cells, these products can be manufactured at a number of independent foundries. All of the Company's manufacturing occurs at independent foundries. The Company contracts fabrication services for speech and telephony processors from Taiwan Semiconductor Manufacturing Company ("TSMC"), Tower Semiconductor ("Tower") and Samsung Semiconductor, Inc. ("Samsung"), to provide such service. Under non-exclusive agreements, these independent foundries normally provide the Company with finished, packaged and tested speech processors at variable prices depending on the volume of units purchased. The Company customarily pays for fully-tested products meeting predetermined specifications. To ensure the integrity of quality assurance procedures, the Company develops detailed test procedures and specifications for each product and requires each foundry to use such procedures and specifications before shipping finished products.

TI produces and distributes an early generation of the Company's TAD speech processors, based on a TI DSP platform, to certain European OEM customers, for which TI pays a royalty to the Company. TI's production of these TAD speech processors has declined from 27% of the Company's total production of TAD speech processors in 1994 to 6% for 1995, and to 0.3% in 1996. The decline is due primarily to these customers converting to newer generations of TAD speech processors, including those sold directly by the Company.

The Company plans to continue to use independent foundries to manufacture digital speech processors and other products for the consumer telephone and computer telephony markets. To obtain an adequate supply of wafers, however, the Company plans to consider various transactions, including the use

of contracts that commit the Company to purchase specified quantities of wafers, equity investments in or loans to independent foundries in exchange for guaranteed production, and the formation of joint ventures to own foundries. Any such investment or transaction would require substantial capital investments, which may require the Company to seek additional equity or debt financing. The Company's reliance on independent foundries involves a number of risks such as the foundries achievement of acceptable manufacturing yields and allocation of capacity to the Company.

In addition to the Company's speech processors, digital TADs include various other components such as ARAMs, codecs and flash memories that are supplied by third party manufacturers. Temporary fluctuations in the pricing and availability of these components could have a material adverse effect on sales of the Company's speech processors for digital TADs and other computer telephony products, which could in turn have a material adverse effect on the Company's business, financial condition and results of operations.

COMPETITION

The markets in which the Company operates are extremely competitive and the Company expects that competition will increase. In each of the Company's business activities it faces current and potential competition from competitors that have significantly greater financial, technical, manufacturing, marketing, sales and distribution resources and management expertise than the Company. The Company's future prospects will be highly dependent upon the successful development and introduction of new products that are responsive to market needs. There can be no assurance that the Company will be able to successfully develop or market any such products.

The principal competitive factors in the digital TAD speech processor market include price, speech quality, compression ratio, value-added features such as variable speed message playback and speakerphone, customer support and the timing of product introductions by the Company and its competitors. The Company believes that it is competitive with respect to each of these factors. Currently, the key competitive challenge for digital TADs is the relative lower cost of analog tape-based machines. The Company believes that the continuing decline in prices of digital speech processors and silicon memory devices will close the cost gap between the analog and digital solution. The Company's principal competitors in the TAD speech processor market include AT&T, Lucent Microelectronics, Macronix, National Semiconductor, TI, Toshiba and Zilog.

The principal competitive factors in the DSP core designs market for high volume, low cost applications include such features as small size, low power, flexible I/O blocks and associated development tools. The Company's DSP core designs compete with companies such as Analog Devices, Clarkspur Designs, TCSI and Tensleep, which license DSP platforms, and Analog Devices, AT&T, Motorola and TI, which sell their own complete DSP solutions.

Several digital speech compression technologies exist and are currently being developed that may be promoted by competitors as industry standards for the computer telephony and personal computer markets. The Company's TrueSpeech algorithms compete with ADPCM, and the speech compression technologies used in GSM and VSELP, each of which is available in the public domain. There are many versions of these algorithms that have been developed by different parties, including AT&T (which has been actively involved in the development of GSM) and Motorola (which developed the original VSELP). Although TrueSpeech has achieved a degree of acceptance in the computer telephony and personal computer markets, ADPCM and the speech compression technologies for GSM and VSELP are widely used in the development and implementation of new products in the telephony industry. In addition, other advanced speech compression algorithms have been introduced by competitors which offer compression ratios comparable to the TrueSpeech algorithms, including a competing algorithm sponsored by the University of Sherbrooke that the ITU standards committee has adopted as the speech compression standard for DSVD modems. Large companies, such as AT&T, Creative Labs, Motorola and Rockwell,

have speech processing technologies that can be applied to speech compression for use in the markets for which the Company's products are targeted.

Price competition in the markets in which the Company currently competes and proposes to compete is intense and may increase, which could have a material adverse effect on the Company's business, financial condition and results of operations. The Company has experienced and expects to continue to experience increased competitive pricing pressures for its TAD speech processors. The Company earned higher gross margins in the fourth quarter of 1996 due primarily to lower product cost. There can be no assurance that the Company will be able to further reduce product costs or be able to compete successfully as to price or any other of the key competitive factors.

RESEARCH AND DEVELOPMENT

The Company believes that continued timely development and introduction of new products are essential to maintaining its competitive position. The Company currently conducts most of its product development effort in-house and at December 31, 1996 had a staff of 51 research and development personnel, 43 of which are located in Israel. The Company also employs independent contractors to assist with certain product development and testing activities. During the years 1996, 1995 and 1994, the Company spent approximately \$8.5 million, \$8.4 million and \$4.4 million, respectively, on research and development activities.

RELATIONSHIPS WITH AFFILIATED COMPANIES

The Company has a \$2.0 million equity investment in, and has entered into technology arrangements with, AudioCodes Ltd. ("AudioCodes"), an Israeli corporation primarily engaged in DSP-related contract engineering in connection with speech and speech algorithm technologies. The Company owns 35% of the capital stock of AudioCodes, a company formed in April 1993 by two former employees of DSP Group. Pursuant to an agreement between the Company and AudioCodes, the Company and AudioCodes have joint ownership of any speech compression technology developed by AudioCodes. The Company has established this relationship to complement its in-house product development efforts.

In July 1996, the Company invested \$2.0 million of cash for approximately 40% of the equity interests in Aptel Ltd. ("Aptel"), an emerging company in its product development stage located in Israel. Aptel has expertise in spread spectrum direct sequence modulation technology, which is applicable to the development of products for two-way paging systems and telemetry applications. Expenses related to the acquisition were \$158,000. The total cost of the acquisition was allocated to the estimated fair value of the assets acquired. As a result, the Company incurred a one-time write-off of acquired in-process technology of \$1.5 million based on an independent estimate of value. As of December 31, 1996, the Company's equity in Aptel had a book value of \$0.4 million. The Company has a two-year option to purchase additional stock from Aptel at the same valuation to enable the Company to increase its ownership interest in Aptel to 51%, and an additional option to acquire the then remaining outstanding stock of Aptel from its current shareholders payable at the seller's option in either cash or stock of the Company.

LICENSES, PATENTS AND TRADEMARKS

The Company has been granted six United States patents and has five patents pending in the United States. The Company actively pursues foreign patent protection in other countries of interest to the Company. The policy of the Company is to apply for patents or for other appropriate statutory protection when it develops valuable new or improved technology. The status of patents involves complex legal and factual questions and the breadth of claims allowed is uncertain. Accordingly, there can be no assurance that any patent application filed by the Company will result in patents being issued, or that its patents, and any patents that may be issued in the future, will afford protection against competitors with similar technology; nor can there be any assurance that patents issued to the Company will not be infringed or designed around by others. In addition, the laws of certain countries in which the Company's products are

or may be developed, manufactured or sold, including Hong Kong, Japan and Taiwan, may not protect the Company's products and intellectual property rights to the same extent as the laws of the United States.

The Company attempts to protect its trade secrets and other proprietary information through agreements with its customers, suppliers, employees and consultants, and through other security measures. Although the Company intends to protect its rights vigorously, there can be no assurance that these measures will be successful.

The semiconductor and software industries are subject to frequent litigation regarding patent and other intellectual property rights. While the Company has not been involved in any material patent or other intellectual property rights litigation to date, there can be no assurance that third parties will not assert claims against the Company with respect to existing or future products or that the Company will not need to assert claims against third parties to protect its proprietary technology. For example, AT&T has asserted that G.723, which is primarily composed of a TrueSpeech algorithm, includes certain elements covered by patents held by AT&T and has requested that video conferencing equipment manufacturers license this technology from AT&T. In the event of litigation to determine the validity of any third party claims or to protect its proprietary technology, such litigation could result in significant expense to the Company and could divert the efforts of the Company's technical and management personnel, whether or not such litigation is determined in favor of the Company. In the event of an adverse result in any such litigation, the Company could be required to expend significant resources to develop non-infringing technology or to obtain licenses to the technology that is the subject of the litigation. There can be no assurance that the Company would be successful in such development or that any such licenses would be available on commercially reasonable terms.

The Company has been issued registered trademarks for the use of the PinedSPCore, OakDSPCore and TrueSpeech trademarks.

While the Company's ability to compete may be affected by its ability to protect its intellectual property, the Company believes that, because of the rapid pace of technological change in the industry, its technical expertise and ability to innovate on a timely basis will be more important in maintaining its competitive position than protection of its intellectual property. The Company believes that, because of the rapid pace of technological change in the consumer telephone, computer telephony and personal computer industries, patents and trade secret protection are important but must be supported by other factors such as the expanding knowledge, ability and experience of the Company's personnel, new product introductions and frequent product enhancements. Although the Company continues to implement protective measures and intends to defend its intellectual property rights, there can be no assurance that these measures will be successful.

BACKLOG

At December 31, 1996, the Company's backlog was approximately \$15.1 million compared with approximately \$14.7 million at December 31, 1995. The Company includes in its backlog all accepted product purchase orders with respect to which a delivery schedule has been specified for product shipment within one year and fees specified in executed licensing contracts. The Company's business in TAD speech processors is characterized by short-term order and shipment schedules. Product orders in the Company's current backlog are subject to changes in delivery schedules or to cancellation at the option of the purchaser without significant penalty. Accordingly, although useful for scheduling production, backlog as of any particular date may not be a reliable measure of sales for any future period.

EMPLOYEES

As of December 31, 1996, the Company had 91 employees, including 51 in research and development, 16 in marketing and sales, and 24 in corporate and administration and manufacturing coordination. Competition for personnel in the semiconductor, software and personal computer industries in general is

intense. The Company believes that its future prospects will depend, in part, on its ability to continue to attract and retain highly skilled technical, marketing and management personnel, who are in great demand. In particular, there is a limited supply of highly qualified engineers with digital signal processing experience. None of the Company's employees is represented by a collective bargaining agreement, nor has the Company ever experienced any work stoppage. The Company believes that its employee relations are good.

FACTORS AFFECTING FUTURE OPERATING RESULTS

THIS FORM 10-K CONTAINS FORWARD LOOKING STATEMENTS CONCERNING THE COMPANY'S FUTURE PRODUCTS, EXPENSES, REVENUE, LIQUIDITY AND CASH NEEDS AS WELL AS THE COMPANY'S PLANS AND STRATEGIES. THESE FORWARD-LOOKING STATEMENTS ARE BASED ON CURRENT EXPECTATIONS AND THE COMPANY ASSUMES NO OBLIGATION TO UPDATE THIS INFORMATION. NUMEROUS FACTORS COULD CAUSE ACTUAL RESULTS TO DIFFER SIGNIFICANTLY FROM THE RESULTS DESCRIBED IN THESE FORWARD-LOOKING STATEMENTS, INCLUDING THE FOLLOWING RISK FACTORS.

POTENTIAL FLUCTUATIONS IN QUARTERLY OPERATING RESULTS. The Company's revenues are derived predominately from product sales and accordingly vary significantly depending on the volume and timing of product orders. The Company's quarterly operating results also depend on the timing of recognition of license fees and the level of per unit royalties. Through 1997, the Company expects that revenues from its DSP core designs and TrueSpeech will be derived primarily from license fees rather than per unit royalties. The uncertain timing of these license fees has caused, and may continue to cause, quarterly fluctuations in the Company's operating results. The Company's per unit royalties from licenses are totally dependent upon the success of its OEM licensees in introducing products utilizing the Company's technology and the success of those OEM products in the marketplace. Royalties from the Company's DSP core designs and TrueSpeech have not been significant to date.

The Company's quarterly operating results may also fluctuate significantly as demand for TADs varies during the year due to seasonal customer buying patterns, and as a result of other factors such as the timing of new product introductions by the Company or its customers, licensees or competitors; market acceptance of new products and technologies; the mix of products sold; fluctuations in the level of sales by OEMs and other vendors of products incorporating the Company's products; and changes in general economic conditions.

DECLINING AVERAGE SELLING PRICES AND GROSS MARGINS; DEPENDENCE ON DIGITAL TAD MARKET. The Company has experienced a decrease in the average selling prices of its TAD speech processors, but has to date been able to offset this decrease on an annual basis through manufacturing cost reductions and the introduction of new products with higher performance. The Company experienced a significant decline in the gross margin on TADs in the second and third quarters of 1996 due to competitive market pricing pressures and delays in ongoing cost reduction efforts. Although significant cost reductions were achieved in the fourth quarter of 1996, there is no guarantee that such on-going efforts will be successful or that they will keep pace with the anticipated, continuing decline in average selling prices. The markets for the Company's products are extremely competitive, and the Company expects that competition will increase. The Company's existing and potential competitors in each of its markets include large and emerging domestic and foreign companies, many of which have significantly greater financial, technical, manufacturing, marketing, sale and distribution resources and management expertise than the Company. Any inability of the Company to respond to increased price competition for its TAD speech processors or its other products through the continuing and frequent introduction of new products or reductions of manufacturing costs, or any significant delays by the Company in developing, manufacturing or shipping new or enhanced products would have a material adverse effect on the Company's business, financial condition and results of operations. Sales of TAD products comprise a substantial portion of the Company's product sales. Any adverse change in the digital TAD market or the Company's ability to compete and maintain its position in that market would have a material adverse effect on the Company's business, financial condition and results of operations.

RELIANCE ON INDEPENDENT FOUNDRIES. All of the Company's integrated circuit products are manufactured by independent foundries. While these foundries have been able to adequately meet the demands of the Company's increasing business, the Company is and will continue to be dependent upon these foundries to achieve acceptable manufacturing yields and quality levels, and to allocate to the Company a sufficient portion of foundry capacity to meet the Company's needs in a timely manner. To meet its increased wafer requirements, the Company has added additional independent foundries to manufacture its TAD speech processors. Revenues could be materially and adversely affected should any of these foundries fail to meet the Company's request for products due to a shortage of production capacity, process difficulties or low yield rates.

RELIANCE ON INTERNATIONAL OPERATIONS; RISK OF OPERATIONS IN ISRAEL. The Company is subject to the risks of doing business internationally, including unexpected changes in regulatory requirements; fluctuations in the exchange rate for the United States dollar; imposition of tariffs and other barriers and restrictions; and the burdens of complying with a variety of foreign laws. The Company is also subject to general geopolitical risks, such as political and economic instability and changes in diplomatic and trade relationships, in connection with its international operations. In particular, the Company's principal research and development facilities are located in the State of Israel and, as a result, at December 31, 1996, 59 of the Company's 91 employees were located in Israel, including 84% of the Company's research and development personnel. In addition, although the Company is incorporated in Delaware, approximately half of the Company's directors and executive officers are non-residents of the United States. Therefore, the Company is directly affected by the political, economic and military conditions to which that country is subject. In addition, many of the Company's expenses in Israel are paid in Israeli currency, thereby also subjecting the Company to foreign currency fluctuations and to economic pressures resulting from Israel's generally high rate of inflation. The rate of inflation in Israel for 1995 and 1996 was 8.1% and 10.6%, respectively. While substantially all of the Company's sales and expenses are denominated in United States dollars, a portion of the Company's expenses are denominated in Israeli shekels. The Company's primary expenses paid in Israeli currency are employee salaries and lease payments on the Israeli facility. As a result, an increase in the value of Israeli currency in comparison to the United States dollar could increase the cost of technology development, research and development expenses and general and administrative expenses. There can be no assurance that currency fluctuations, changes in the rate of inflation in Israel or any of the other aforementioned factors will not have a material adverse effect on the Company's business, financial condition and results of operations.

RELIANCE ON OEMS TO OBTAIN REQUIRED COMPLEMENTARY COMPONENTS. Certain of the raw materials, components and subassemblies included in the products manufactured by the Company's OEM customers, which also incorporate the Company's products, are obtained from a limited group of suppliers. Disruptions, shortages or termination of certain of these sources of supply could occur. For example, the Company's customers for TAD speech processors have in the past experienced difficulties obtaining sufficient timely supplies of ARAMs which are included in certain digital TADs. These shortages are due to the increasing demand for ARAMs for TAD products, and fluctuations in ARAM production as ARAMs are a by-product in the fabrication of dynamic random access memories ("DRAMs") with ARAM yields varying inversely with the DRAM yield. Although such shortages were alleviated during most of 1996, there is no guarantee that such favorable circumstances will continue. In addition, there is a trend in the industry toward the production of 16 Mbit DRAMs, rather than 4 Mbit DRAMs, which may increase the cost of TAD systems because such systems mainly use 4 Mbit ARAMs. Supply disruptions, shortages or termination could have an adverse effect on the Company's business and results of operations due to its customers delay or discontinuance of orders for the Company's products until such components are available.

DEPENDENCE UPON ADOPTION OF INDUSTRY STANDARDS BASED ON TRUESPEECH. The Company's prospects are partially dependent upon the establishment of industry standards for digital speech compression based on TrueSpeech algorithms in the computer telephony and personal computer markets. The development of

industry standards utilizing TrueSpeech algorithms would create an opportunity for the Company to develop and market speech co-processors that provide TrueSpeech solutions and enhance the performance and functionality of products incorporating these co-processors. In February 1995, the ITU established G.723, which is predominately composed of a TrueSpeech algorithm, as the standard speech compression technology for use in video conferencing over public telephone lines. However, the ITU failed to select TrueSpeech as the speech compression technology for DSVD applications and discussed adopting a proposed audio standard based on an existing standard (G.729) sponsored by the University of Sherbrooke. The Company intends to license the compression standard selected by the ITU for inclusion in the Company's DSVD co-processors. The failure to establish industry standards based on TrueSpeech algorithms or to develop and market competitive speech co-processors would have a material adverse effect on the Company's business, financial condition and results of operations.

INTELLECTUAL PROPERTY. As is typical in the semiconductor and software industries, the Company has been and may from time to time be notified of claims that it may be infringing patents or intellectual property rights owned by third parties. For example, AT&T has recently asserted that G.723, which is primarily composed of a TrueSpeech algorithm, includes certain elements covered by patents held by AT&T and has requested that video conferencing equipment manufacturers license such technology from AT&T. If it appears necessary or desirable, the Company may seek licenses under such patents or intellectual property rights that it is allegedly infringing. Although holders of such intellectual property rights commonly offer such licenses, no assurances can be given that licenses will be offered or that the terms of any offered licenses will be acceptable to the Company. The failure to obtain a license for key intellectual property rights from a third party for technology used by the Company could cause the Company to incur substantial liabilities and to suspend the manufacture of products utilizing the technology. The Company believes that the ultimate resolution of these matters will not have a material adverse effect on the Company's business, financial position or results of operations.

ONGOING LITIGATION. In November 1995, after the Company's stock price declined, several lawsuits were filed in the United States District Court for the Northern District of California accusing the Company, its former Chief Executive Officer, and its former Chief Financial Officer of issuing materially false and misleading statements in violation of the federal securities laws. These lawsuits were consolidated into a single amended complaint in February 1996. In the amended complaint, plaintiffs sought unspecified damages on behalf of all persons who purchased shares of the Company's Common Stock during the period June 6, 1995 through November 10, 1995. On June 11, 1996, the Court granted the Company's motion to dismiss the lawsuit, with leave to amend. The plaintiffs filed an amended complaint on July 11, 1996. On March 7, 1997, the Court issued an order dismissing with prejudice all claims based on statements issued by the Company. The Court is permitting plaintiffs to proceed with their claims regarding statements the Company allegedly made to securities analysts, and is also permitting plaintiffs to amend their complaint as to their claim that the Company is responsible for the statements contained in analysts reports. The Company believes the lawsuit to be without merit and intends to defend itself vigorously. The Company believes the ultimate resolution of this matter will not have a material adverse effect on the Company's financial position, results of operations, or cash flows. However, the Company anticipates that in the near term it may incur significant legal expense to defend itself.

POSSIBLE VOLATILITY OF STOCK PRICE. The variety and uncertainty of the factors affecting the Company's operating results, and the fact that the Company participates in a highly dynamic industry, may result in significant volatility in the Company's Common Stock price.

ITEM 2. PROPERTIES.

The Company's operations in the United States are located in an approximately 14,300 square foot leased facility in Santa Clara, California. This facility houses the Company's marketing and support, North American sales, operations, manufacturing coordination and administrative personnel. This facility is

leased through December 1999. The Company's subsidiary, DSP Semiconductors (Israel), Ltd. leases a facility in Givat Shmuel, Israel with approximately 22,000 square feet under a lease ending in May 2000.

ITEM 3. LEGAL PROCEEDINGS.

In November 1995, after the Company's stock price declined, several lawsuits were filed in the United States District Court for the Northern District of California accusing the Company, its former Chief Executive Officer, and its former Chief Financial Officer of issuing materially false and misleading statements in violation of the federal securities laws. These lawsuits were consolidated into a single amended complaint in February 1996. In the amended complaint, plaintiffs sought unspecified damages on behalf of all persons who purchased shares of the Company's Common Stock during the period June 6, 1995 through November 10, 1995. On June 11, 1996, the Court granted the Company's motion to dismiss the lawsuit, with leave to amend. The plaintiffs filed an amended complaint on July 11, 1996. On March 7, 1997, the Court issued an order dismissing with prejudice all claims based on statements issued by the Company. The Court is permitting plaintiffs to proceed with their claims regarding statements the Company allegedly made to securities analysts, and is also permitting plaintiffs to amend their complaint as to their claim that the Company is responsible for the statements contained in analysts reports. The Company believes the lawsuit to be without merit and intends to defend itself vigorously.

On February 12, 1997, BEKA Electronic GmbH ("BEKA") commenced an action in the United States District Court for the Northern District of California against the Company. The action alleges breach of contract, breach of implied covenant of good faith and fair dealing and requests an accounting by the Company in connection with the Company's termination of the Sales Representative Agreement between BEKA and the Company. The complaint seeks an unspecified amount of damages. The Company believes the lawsuit to be without merit and intends to defend itself vigorously.

On October 22, 1996, a lawsuit between the Company and Rockwell International Corporation was settled and Rockwell purchased a license for three versions of the Company's TrueSpeech speech technology. The litigation had been pending since February 1995 in Superior Court of Santa Clara County, California. The Company had alleged unfair competition, violations of state law and an attempt by Rockwell to unfairly influence the DSVD Consortium, a group of companies formed to select a speech compression technology that enables modems to transmit computer data and digital voice simultaneously, in the selection of speech compression technology. A preliminary injunction was issued by the Court in March 1995 enjoining Rockwell from granting royalty-free licenses of its speech compression product during the pendency of the action or until further order of the Court. Rockwell had appealed from the issuance of the preliminary injunction and such appeal had remained pending.

In February 1997, a lawsuit between the Company and Elk Industries, Inc. ("Elk") was settled. The litigation had been pending since April 1996 in the United States District Court for the Southern District of Florida. Elk had alleged patent infringement by the Company in connection with the Company's making, selling and using an audio storage and distribution system allegedly covered under a patent held by Elk.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The section labeled "Price Range of Common Stock" appearing on page 18 of the Registrant's Annual Report to Stockholders for the year ended December 31, 1996 is incorporated herein by reference.

ITEM 6. SELECTED FINANCIAL DATA.

The section labeled "Selected Consolidated Financial Data" appearing on page 17 of the Registrant's Annual Report to Stockholders for the year ended December 31, 1996 is incorporated herein by reference.

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

The section labeled "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing on pages 19 through 25 of the Registrant's Annual Report to Stockholders for the year ended December 31, 1996 is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The consolidated financial statements and related notes and independent auditors report appearing on pages 26 through 47 of the Registrant's Annual Report to Stockholders for the year ended December 31, 1996 are incorporated herein by reference.

The section labeled "Quarterly Data" appearing on page 17 of the Registrant's Annual Report to Stockholders for the years ended December 31, 1995 and 1996 is incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

The section labeled "Directors, Executive Officers and Key Personnel" of the Registrant's definitive Proxy Statement to be filed shortly hereafter for the annual meeting of stockholders to be held on May 20, 1997 is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION.

The section labeled "Executive Compensation and Other Information" of the Registrant's definitive Proxy Statement to be filed shortly hereafter for the annual meeting of stockholders to be held on May 20, 1997 is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The section labeled "Security Ownership of Certain Beneficial Owners and Management" of the Registrant's definitive Proxy Statement to be filed shortly hereafter for the annual meeting of stockholders to be held on May 20, 1997 is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The section labeled "Certain Relationships and Related Transactions" of the Registrant's definitive Proxy Statement to be filed shortly hereafter for the annual meeting of stockholders to be held on May 20, 1997 is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K.

(a) The following documents have been filed as a part of this Annual Report on Form 10-K.

1. Index to Financial Statements.

The following financial statements and related notes and auditor's report are included in the Registrant's Annual Report to Stockholders for the year ended December 31, 1996 and are incorporated herein by reference pursuant to Item 8.

DESCRIPTION	PAGE IN 1996 ANNUAL REPORT TO STOCKHOLDERS
Consolidated Balance Sheets as of December 31, 1996 and 1995.....	28-29
Consolidated Statements of Income for the years ended December 31, 1996, 1995 and 1994.....	27
Consolidated Statements of Stockholders' Equity (Deficit) for the years ended December 31, 1996, 1995 and 1994.....	30-31
Consolidated Statements of Cash Flows for the years ended December 31, 1996, 1995 and 1994.....	32-33
Notes to Consolidated Financial Statements.....	34-47
Report of Ernst & Young LLP, Independent Auditors.....	26

2. Index to Financial Statement Schedules.

The following financial statement schedules and related auditor's report are filed as part of this Annual Report on Form 10-K:

DESCRIPTION	PAGE IN THIS ANNUAL REPORT ON FORM 10-K
Schedule II: Valuation and Qualifying Accounts.....	(included at page 29)
Consent of Ernst & Young LLP, Independent Auditors.....	Exhibit 23 (included at page 28)

All other schedules are omitted because they are not applicable or not required or because the required information is included in the Consolidated Financial Statements or the Notes thereto.

3. List of Exhibits:

EXHIBIT NUMBER	DESCRIPTION
3.1	Amended and Restated Certificate of Incorporation (filed as Exhibit 3.1B to the Registrant's Registration Statement on Form S-1, file no. 33-73482, as declared effective on February 11, 1994 and incorporated herein by reference).
3.2	Bylaws (filed as Exhibit 3.2B to the Registrant's Registration Statement on Form S-1, file no. 33-73482, as declared effective on February 11, 1994 and incorporated herein by reference).
3.3	Amended Bylaws (filed as Exhibit 3.2.c to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1995, and incorporated herein by reference).

EXHIBIT NUMBER	DESCRIPTION
10.1	1991 Employee and Consultant Stock Plan and forms of option agreements thereunder (filed as Exhibit 10.2 to the Registrant's Registration Statement on Form S-1, file no. 33-73482, as declared effective on February 11, 1994 and incorporated herein by reference).
10.2	Israeli Stock Option Plan and form of option agreement thereunder (filed as Exhibit 10.3 to the Registrant's Registration Statement on Form S-1, file no. 33-73482, as declared effective on February 11, 1994 and incorporated herein by reference).
10.3	1993 Directors Stock Option Plan (filed as Exhibit 10.4 to the Registrant's Registration Statement on Form S-1, file no. 33-73482, as declared effective on February 11, 1994 and incorporated herein by reference).
10.4	1993 Employee Stock Purchase Plan and form of subscription agreement thereunder (filed as Exhibit 10.5 to the Registrant's Registration Statement on Form S-1, file no. 33-73482, as declared effective on February 11, 1994 and incorporated herein by reference).
10.5	Registration Rights Agreement, dated August 30, 1993, by and among the Registrant and certain shareholders of the Registrant (filed as Exhibit 10.9 to the Registrant's Registration Statement on Form S-1, file no. 33-73482, as declared effective on February 11, 1994 and incorporated herein by reference).
10.6	Technology Assignment and License Agreement, dated January 7, 1994, by and between the Registrant and DSP Telecommunications, Ltd. (filed as Exhibit 10.24 to the Registrant's Registration Statement on Form S-1, file no. 33-73482, as declared effective on February 11, 1994 and incorporated herein by reference).
10.7	ACL Technology License Agreement, dated June 24, 1994, by and between the Registrant and AudioCodes, Ltd. (filed as Exhibit 10.12 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1994, and incorporated herein by reference).
10.8	Investment Agreement, dated June 16, 1994, by and between the Registrant and AudioCodes Ltd. (see Exhibit 10.30 for Appendix B to Investment Agreement) (filed as Exhibit 10.39 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1994, and incorporated herein by reference).
10.9	Form of Indemnification Agreement for directors and executive officers (filed as Exhibit 10.1 to the Registrant's Registration Statement on Form S-1, file no. 33-73482, as declared effective on February 11, 1994, and incorporated herein by reference).
10.10	Technology Retransfer Agreement, dated as of June 29, 1995, by and among the Registrant, Nogatech, Inc. and Nogatech Ltd. (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1995, and incorporated herein by reference).
10.11	Stock Purchase Agreement, dated as of June 30, 1995, by and among the Registrant, Kenwood Corporation, Tomen Electronics Corp. and Nogatech, Inc. (filed as Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1995, and incorporated herein by reference).
10.12	Promissory Note, dated August 11, 1995, made in favor of the Registrant by Nogatech, Inc. (filed as Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1995, and incorporated herein by reference).
10.13	Davidi Gilo Severance Agreement, dated April 7, 1995 (filed as Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1995, and incorporated herein by reference).

EXHIBIT NUMBER	DESCRIPTION
10.14	Amendment No. 1 to the Stock Option Agreement, effective April 7, 1995, by and between the Registrant and Davidi Gilo (filed as Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1995, and incorporated herein by reference).
10.15	Promissory Note, dated July 3, 1995, made in favor of the Registrant by Davidi Gilo (filed as Exhibit 10.6 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1995, and incorporated herein by reference).
10.16	Employment Termination and Consulting Agreement and Mutual Release, dated October 1, 1995, by and between Registrant and F. Judson Mitchell (filed as Exhibit 10.34 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1995, and incorporated herein by reference).
10.17	Employment Agreement, dated November 1, 1995, by and between Registrant and Igal Kohavi (filed as Exhibit 10.35 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1995, and incorporated herein by reference).
10.18	Severance and Consulting Agreement, dated as of May 6, 1996, by and between the Registrant and Eli Porat (filed as Exhibit 10.36 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1996, and incorporated herein by reference).
10.19	Severance Agreement, dated June 8, 1996, by and between the Registrant and Karin Pitcock (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1996, and incorporated herein by reference).
10.20	Share Purchase and Shareholders Agreement, dated July 4, 1996, by and among Aptel Ltd., the shareholders named therein, and DSP Semiconductors Ltd. (filed as Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1996, and incorporated herein by reference).
10.21	Employment Agreement, dated April 22, 1996, by and between the Registrant and Eli Ayalon (filed as Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1996, and incorporated herein by reference).
10.22	Severance and Consulting Agreement, dated as of October 25, 1996, by and between the Registrant and John Goldsberry (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1996, and incorporated herein by reference).
10.23	Employment Severance and Consulting Agreement, dated as of December 2, 1996, by and between the Registrant and Mike Hoberg.
10.24	Assignment and Assumption Agreement, dated October 9, 1996, by and between the Registrant and Dialogic Corporation, relating to the Registrant's facility located at 3120 Scott Boulevard in Santa Clara, California.
10.25	Sublease, dated October 18, 1996, as amended on December 4, 1996, by and between Dialogic Corporation and the Registrant, relating to the Registrant's facility located at 3120 Scott Boulevard in Santa Clara, California.
10.26	Employment Agreement, dated February 24, 1997, by and between the Registrant and Avi Basher.
10.27	Employment Agreement, dated June 1, 1996, by and between the Registrant and Moshe Shahaf.
10.28	Rescission Agreement, dated as of August 15, 1996, by and between the Registrant and Igal Kohavi.

EXHIBIT NUMBER	DESCRIPTION
10.29	Service Agreement, dated as of August 15, 1996, by and between DSP Semiconductors, Ltd. and Niko Consulting and Management (1995) Ltd.
11	Statements regarding computation of per share earnings (included at page 26).
13	Portions of the Annual Report to Stockholders for the year ended December 31, 1996.
21	Subsidiaries of the Registrant (included at page 27).
23	Consent of Ernst & Young LLP, Independent Auditors (included at page 28).
27	Financial Data Schedule

(b) Reports on Form 8-K

The Company filed a Current Report on Form 8-K dated October 22, 1996, relating to the settlement of the Rockwell litigation.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DSP GROUP, INC.

By: /s/ ELIYAHU AYALON

 Eliyahu Ayalon
 PRESIDENT AND CHIEF EXECUTIVE OFFICER
 (PRINCIPAL EXECUTIVE OFFICER)

Date: March 31, 1997

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

NAME	TITLE	DATE
----- /s/ IGAL KOHAVI ----- Igal Kohavi	Chairman of the Board	March 31, 1997
----- /s/ ELIYAHU AYALON ----- Eliyahu Ayalon	President, Chief Executive Officer and Director (Principal Executive Officer)	March 31, 1997
----- /s/ AVI BASHER ----- Avi Basher	Vice President of Finance, Chief Financial Officer and Secretary (Principal Financial Officer and Principal Accounting Officer)	March 31, 1997
----- /s/ NATHANIEL DE ROTHSCHILD ----- Nathaniel de Rothschild	Director	March 31, 1997
----- /s/ SAMUEL L. KAPLAN ----- Samuel L. Kaplan	Director	March 31, 1997
----- /s/ MILLARD PHELPS ----- Millard Phelps	Director	March 31, 1997
----- /s/ YAIR SHAMIR ----- Yair Shamir	Director	March 31, 1997

DSP GROUP, INC.
 STATEMENTS RE COMPUTATION OF PER SHARE EARNINGS
 (IN THOUSANDS, EXCEPT PER SHARE DATA)

	YEAR ENDED DECEMBER 31,		
	1996	1995	1994
Net Income.....	\$5,979	\$7,211	\$4,032
PRIMARY:			
Computation of weighted average common and common equivalent shares outstanding:			
Weighted average common shares outstanding.....	9,510	9,352	8,111
Common equivalent shares attributable to Convertible Preferred Stock.....	--	--	394
Common equivalent shares from stock options and warrants.....	71	306	630
Shares used in per share computation.....	9,581	9,658	9,135
Net income per share.....	\$ 0.62	\$ 0.75	\$ 0.44
FULLY DILUTED:			
Computation of weighted average common and common equivalent shares outstanding:			
Weighted average common shares outstanding.....	9,510	9,352	8,111
Common equivalent shares attributable to Convertible Preferred Stock.....	--	--	394
Common equivalent shares from stock options and warrants.....	71	312	700
Shares used in per share computation.....	9,581	9,664	9,205
Net income per share.....	\$ 0.62	\$ 0.75	\$ 0.44

LIST OF SUBSIDIARIES

NAME OF SUBSIDIARY	JURISDICTION OF INCORPORATION
--------------------	-------------------------------

- | | |
|----------------------------|--------|
| 1. Nihon DSP K.K. | Japan |
| 2. DSP Semiconductors Ltd. | Israel |
| 3. DSP Group Europe SARL | France |

CONSENT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

We consent to the incorporation by reference in this Annual Report (Form 10-K) of DSP Group, Inc. of our report dated January 26, 1997 (except for Stockholders' Litigation under Note 5, as to which the date is March 7, 1997), included in the 1996 Annual Report to Stockholders of DSP Group, Inc.

Our audits also included the consolidated financial statement schedule of DSP Group, Inc. listed in Item 14(a). This schedule is the responsibility of the Company's management. Our responsibility is to express an opinion based on our audits. In our opinion, the consolidated financial statement schedule referred to above, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also consent to the incorporation by reference in the Registration Statements (Form S-8 Nos. 33-83456 and 33-87390) pertaining to the 1991 Employee and Consultant Stock Plan, the 1991 DSP Group, Inc. Israeli Stock Option Plan, the 1993 Director Stock Option Plan, and the 1993 Employee Stock Purchase Plan of our report dated January 26, 1997 (except for Stockholders' Litigation under Note 5, as to which the date is March 7, 1997), with respect to the consolidated financial statements and schedules incorporated herein by reference or included in this Annual Report (Form 10-K) for the year ended December 31, 1996.

/s/ Ernst & Young LLP

San Jose, California
March 27, 1997

SCHEDULE II

DSP GROUP, INC.
VALUATION AND QUALIFYING ACCOUNTS
(IN THOUSANDS)

DESCRIPTION	BALANCE AT BEGINNING OF PERIOD	CHARGED TO COSTS AND EXPENSES	DEDUCTION	BALANCE AT END OF PERIOD
Year ended December 31, 1994:				
Allowance for doubtful accounts.....	\$ 50	\$100	\$--	\$150
Sales returns reserve.....	50	204	--	254
Year ended December 31, 1995:				
Allowance for doubtful accounts.....	150	15	3	162
Sales returns reserve.....	254	296	269	281
Year ended December 31, 1996:				
Allowance for doubtful accounts.....	162	60	151	71
Sales returns reserve.....	281	245	149	377

EMPLOYMENT SEVERANCE AND CONSULTING AGREEMENT

This Employment Severance and Consulting Agreement is entered into effective as of this 2nd day of December, 1996 (the "Execution Date") by and between Mike Hoberg ("Hoberg") and DSP Group, Inc., a Delaware corporation ("DSPG").

RECITALS

A. Hoberg has served as DSPG's Controller and Chief Accounting Officer.

B. Hoberg has resigned as DSPG's Controller and Chief Accounting Officer as of October 31, 1996, on the terms set forth below.

AGREEMENT

NOW, THEREFORE, the parties hereto hereby agree as follows:

1. Eight (8) days after DSPG receives satisfactory evidence of the fully executed original of this Agreement (assuming that Hoberg has executed this Agreement and has not revoked acceptance within the seven (7) day period as set forth in Section 2 (below), DSPG will cause to be delivered to Hoberg \$250.

2. Provided that Hoberg does not revoke this Agreement prior to the eighth day after the date that this Agreement was executed by Hoberg, and so long as Hoberg is not in breach of this Agreement or any Confidentiality Agreement with DSPG, DSPG shall agree (a) to pay to Hoberg a salary of \$9,533.34 per month through January 31, 1997 (the "Salary"), subject to applicable withholding taxes, deductions, etc., in exchange for Hoberg's continued full-time employment with DSPG reporting directly to the Chief Financial Officer of DSPG and to not compete, in any way directly or indirectly, with DSPG through January 31, 1997, (b) thereafter if Hoberg has remained a full time employee of DSPG through January 31, 1997, to pay to Hoberg an additional amount equal to \$9,533.34 per month through April 30, 1997 (the "Consulting Fee"), subject to applicable withholding taxes, deductions, etc. in exchange for Hoberg's agreement to consult with the Chief Financial Officer of DSPG and (c) provide a mutually acceptable letter of reference. The Salary and Consulting Fee shall be paid bi-monthly, in arrears. Hoberg's stock options in DSPG shall continue to vest up to and through April 30, 1997. Thereafter, Hoberg shall have through June 14, 1997, to exercise his stock options vested as of April 30, 1997 in accordance with the terms of such stock options and thereafter all unexercised stock options shall be null and void. Up to and through April 30, 1997, so long as Hoberg has remained a full time employee of DSPG through January 31, 1997, DSPG shall also continue to provide to Hoberg at its cost the employment benefits which Hoberg is currently receiving to the extent it may lawfully and contractually provide such benefits to him. Upon Hoberg's termination of full time employment, Hoberg shall be paid immediately for all accrued vacation and unreimbursed travel expenses.

3. Upon execution of this Agreement, Hoberg shall submit to DSPG a written report describing in detail all on-going contacts and activities made or performed by Hoberg on DSPG's behalf in order to provide a smooth transition. On, or before January 31, 1997, Hoberg shall return to DSPG all DSPG property in Hoberg's possession and control, including, but not limited to, all keys to DSPG offices and facilities, equipment, and all DSPG credit cards owned by DSPG. Until the earlier to occur of (i) Hoberg's full time employment with another business and (ii) December 31, 1997, DSPG shall (a) agree to maintain and allow Hoberg access and use of the (408) 986-4445 voicemail so long as DSPG maintains its current voicemail system and (b) allow Hoberg the reasonable use and access during DSPG's regular business hours to DSPG's computer and Internet network, printers, fax machines and copiers.

4. Upon execution of this Agreement, Hoberg acknowledges that he has resigned as the Controller and Chief Accounting Officer of DSPG effective as of October 31, 1996, and confirms that he has resigned as the Controller and Chief Accounting Officer of DSPG, notwithstanding any right to revoke other terms of this Agreement concerning his employment as set forth herein.

5. Subject to the terms and conditions of this Agreement, Hoberg hereby agrees that he is entitled to no further severance or bonus from DSPG and agrees that the compensation to be paid hereunder is greater than the compensation and/or severance, if any, to which Hoberg was entitled. Notwithstanding the foregoing, on, or before, January 31, 1997, DSPG shall pay to Hoberg his annual bonus of \$22,800, subject to applicable withholding taxes, deductions, etc., as contemplated in Hoberg's offer of employment from DSPG dated December 10, 1993. Such bonus shall be paid to Hoberg even if Hoberg shall terminate employment with DSPG prior to January 31, 1997.

6. Hoberg represents that Hoberg has had the opportunity to thoroughly discuss all aspects of this Agreement, including the general release provisions, with his advisors; has carefully read and understood all of the provisions of this Agreement; and, that Hoberg has voluntarily entered into this Agreement.

7. Hoberg acknowledges that this Agreement was delivered to Hoberg on the Execution Date, and DSPG agreed that Hoberg had until the close of business on December 23, 1996 (21 days later), to consider the Agreement. Hoberg elected to execute this Agreement on the Execution Date as a matter of Hoberg's choice and acknowledges that he has been afforded sufficient time to consider the Agreement and has obtained legal advice. DSPG acknowledges that Hoberg may revoke this Agreement for a period of seven (7) days following the date this Agreement is executed by Hoberg, but such revocation shall not effect the termination of Hoberg's employment status as the Controller and Chief Accounting Officer of DSPG.

8. As a material inducement to execute this Agreement, and except for the provisions herein and except for claims, if any, that arise under Hoberg's Indemnification Agreement with DSPG dated July 22, 1994 (the "Indemnification Agreement") for

Hoberg's actions as an officer or employee of DSPG through the date of termination of his employment with DSPG, Hoberg hereby irrevocably and unconditionally releases, acquits, and forever discharges DSPG (for purposes of this Section and Sections 9, 10 and 11 (below), DSPG shall include DSPG's predecessors, successors, assigns, agents, subsidiaries, former subsidiaries, directors, former directors, officers, former officers, employees, representatives, attorneys, affiliates (and agents, directors, officers, employees, representatives, and attorneys of such affiliates and former officers, directors, and agents thereof)), and all persons acting by, through, under, or in concert with any of them (collectively "Releasees"), or any of them, from any and all charges, complaints, claims, liabilities, obligations, promises, agreements, controversies, damages, actions, causes of actions, suits, rights, demands, costs, losses, debts, and expenses (including attorneys' fees and costs actually incurred), of any nature whatsoever, known or unknown ("Claim" or "Claims") which Hoberg now has, owns, or holds, or claims to have, owns, or holds, or which Hoberg at any time heretofore had, owned, or held, or claimed to have, owns, or holds, against DSPG or any of DSPG's Releasees.

9. Except for the provisions of this Agreement and except for any claims, causes of action or any other rights of DSPG against Hoberg, including but not limited to any DSPG Claim (as defined below), for which Hoberg is NOT entitled to indemnification under the Indemnification Agreement, DSPG hereby irrevocably and unconditionally releases, acquits, and forever discharges Hoberg from any and all charges, complaints, claims, liabilities, obligations, promises, agreements, controversies, damages, actions, causes of actions, suits, rights, demands, costs, losses, debts, and expenses (including attorneys' fees and costs actually incurred), of any nature whatsoever, known or unknown (a "DSPG Claim") which DSPG now has, owns, or holds, or claims to have, owns, or holds, or which DSPG at any time heretofore had, owned, or held, or claimed to have, owns, or holds, against Hoberg.

10. Hoberg and DSPG each expressly waives and relinquishes all rights and benefits afforded by Section 1542 of the Civil Code of the State of California and does so understanding and acknowledging the significance and consequence of such specific waiver of Section 1542. Section 1542 of the Civil Code of the State of California states as follows:

"A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor."

Thus, notwithstanding the provisions of Section 1542, and for the purpose of implementing a full and complete release and discharge of the Releasees, DSPG and Hoberg expressly acknowledge that this Agreement is intended to include in its effect, without limitation except as expressly set forth in Sections 8 and 9, all Claims which DSPG or Hoberg may have against the other, up to and through the last date of execution of this document, including but not limited to those under the Age Discrimination and

Employment Act, even though one or the other is not currently aware of or suspects such claim to exist in his favor at the time of execution hereof, and that this Agreement contemplates the extinguishment of any such Claim or Claims.

11. Without limiting the generality of the foregoing, DSPG and Hoberg, each hereby agree that in the event that any party hereto should bring any action, suit, or other proceedings against any other party hereto, concerning a breach of this Agreement, the claims released by this Agreement, or contesting the validity of this Agreement, or attempting to rescind, negate, modify or reform this Agreement or any of its terms or provisions, or to remedy, prevent or obtain relief from a breach of this Agreement, the prevailing party to such an action, suit or proceeding, shall be entitled to the attorneys' fees reasonably incurred in each and every such action, suit, or other proceeding, including any and all appeals or petitions therefrom.

12. Hoberg represents and acknowledges that in executing this Agreement he has not relied upon any representation or statement made by any of the Releasees or by any of the Releasees' agents, representatives, or attorneys with regard to the subject matter, basis, or effect of this Agreement, or otherwise.

13. This Agreement shall be binding upon the parties hereto and their heirs, administrators, representatives, executors, successors and assigns (collectively, the "Interested Parties"), and shall inure to the benefit of DSPG and Hoberg, their respective Interested Parties and each of them, and to their heirs, administrators, representatives, executors, successors, and assigns.

14. This Agreement is made and entered into in the State of California, and shall in all respects be interpreted, enforced, and governed under the laws of said State.

15. This Agreement constitutes the entire agreement and understanding between the parties with respect to the subject matter herein, and supersedes and replaces any prior agreements and understandings, whether oral or written between them with respect to such matters. The provisions of this Agreement may be waived, altered, amended or repealed in whole or in part only upon the written consent of both parties to this Agreement.

DSP GROUP, INC.

By /s/ Eli Ayalon

/s/ Michael Hoberg

Eli Ayalon,
Chief Executive Officer

Mike Hoberg

THIS ASSIGNMENT AND ASSUMPTION AGREEMENT, dated the 9th day of October, 1996,

BETWEEN DSP GROUP, INC., a Delaware corporation having a place of business at 3120 Scott Boulevard, Santa Clara, California 95054 ("ASSIGNOR");

AND DIALOGIC CORPORATION, a New Jersey corporation having a place of business at 1515 Route 10, Parsippany, New Jersey 07054 ("ASSIGNEE");

RECITALS

A. MASTER SUBLEASE. Assignor is the sublessee under a written sublease ("MASTER SUBLEASE"), wherein Amdahl Corporation ("MASTER TENANT") leased to Assignor the real property located in the City of Santa Clara, County of Santa Clara, State of California, described as approximately 73,075 square feet of office, research, and development space with an address of 3120 Scott Boulevard ("PREMISES").

B. MASTER LEASE. Master Tenant is the lessee under a written lease dated November 21, 1983, between Carl E. Berg and Mary Ann Berg, Trustees of the Berg Living Trust UTA, dated May 1, 1981, as to an undivided 81.01% interest, Clyde Berg and Nancy Berg, Trustees of the Clyde Berg Living Trust UTA, dated December 17, 1981, as to an undivided 11.83% interest, and Clyde Berg, Trustee of Clyde Berg's Child Trust UTA, dated June 2, 1978, as to an undivided 7.16% interest (collectively, "MASTER LANDLORD"), as amended by an Amendment to Lease dated May 17, 1989, wherein Master Landlord leased to Master Tenant the Premises (the lease and amendment are herein collectively referred to as the "MASTER LEASE").

C. SUBLEASES. Assignor is the sublessor under written subleases with respectively, Netro Corporation dated July __, 1995 ("NETRO SUBLEASE"), CompCore Multimedia, Inc. dated August 4, 1995 ("COMPCORE SUBLEASE") and B&W Project, Inc. dated March 1, 1996 ("B&W SUBLEASE;" collectively, the "SUBLEASES").

D. TRANSACTIONS. Assignee wishes to take an assignment of Assignor's interests under the Master Sublease and the Subleases, and Assignor desires to assign to Assignee its interests under the Master Sublease and the Subleases.

TERMS

NOW, THEREFORE, for and in consideration of the foregoing premises and the mutual covenants contained herein, the parties agree as follows:

1. ASSIGNMENT AND ASSUMPTION; EFFECTIVE DATE. Assignor hereby assigns all of its right, title and interest as sublessee under the Master Sublease and its right, title and its interest as sublessor under the Subleases to Assignee as of January 1, 1997 ("EFFECTIVE DATE"). This Assignment includes all of Assignor's right, title and interest in and to the security deposit thereunder, the improvements at the Premises and any warranties relating to the Premises. Assignee hereby agrees to assume all obligations of the sublessee under the Master Sublease and of the sublessor under the Subleases which arise on and after the Effective Date. The parties shall adjust for any rent and other payments due to Master Tenant under the Master Sublease attributable to periods prior to and following the Effective Date. The obligations of the Assignee under this agreement are subject to the continued accuracy of the Assignor's representations and warranties set forth in section 4(a) hereof and the satisfaction of the conditions to this Assignment set forth in sections 4(b) and (c) hereof ("CONDITIONS"). If the Condition relating to the obtaining of consents has not been satisfied or waived on or before October 31, 1996, either party may terminate this agreement by giving notice to the other party, whereupon this agreement shall be NULL and VOID AB INITIO; if any other Condition has not been satisfied or waived by the Assignee on or before October 31, 1996, without limiting its right to the remedies of specific performance or damages for any default or breach of warranty or misrepresentation by Assignor under this agreement, Assignee may terminate this agreement by giving notice to the Assignor, prior to the Effective Date whereupon this agreement shall be NULL and VOID AB INITIO.

2. AGREEMENT; PAYMENTS.

(a) MONTHLY INSTALLMENTS. Assignee agrees to pay to Assignor and to Master Tenant the amounts set forth in Schedule 2(a). Each installment due shall be payable on the first day of each month starting on January 1, 1997 at the following address:

If to DSP Group, Inc. ("Assignor"):	If to Amdahl Corporation ("Master Tenant"):
To be advised	1250 East Arques Avenue
	P.O. Box 3470
	Sunnyvale, CA 94088-3470

(i) Such payments to Master Tenant shall be treated in the same manner, including (such term when used in this agreement shall mean "including without limitation") notice, grace periods, default and remedy provisions, as if they were all monthly "Base Rent" under the Master Sublease.

(ii) If Assignee shall fail to pay any installment to Assignor on its due date and the failure continues for 10 days after Assignor gives Assignee written notice thereof, then Assignor shall have the right to collect a one time late charge equal to 4% of the amount not paid. If the failure continues for 10 days after such notice, then Assignor may elect that all installments due to it under Schedule 2(a) be immediately payable.

(iii) Notwithstanding the foregoing, if the Assignee is not in default and has not voluntarily terminated the Master Sublease, under the Master Sublease beyond applicable notice and cure periods and (A) if Master Tenant rejects the Master Lease or (B) if either Master Landlord or Master Tenant otherwise fails to provide Assignee with quiet enjoyment of the Premises, no further payments shall be required under Schedule 2(a) hereto.

(b) NEW SUBLEASE: PURCHASE OF FURNITURE, FIXTURES AND EQUIPMENT ("FF&E"). Assignee may enter into a sublease of space at the Premises to Assignor and Assignor may convey to Assignee FF&E at the Premises, but any such transactions shall be under separate, independent contracts to be negotiated.

(c) ACCESS TO PREMISES. Assignor shall provide access to the Premises to Assignee, its employees, agents, contractors and suppliers, on and after December 1, 1996 for the purpose of installing fixtures, cabling, testing phone lines and performing assorted other work as described in Exhibit 2(c) hereto in order to prepare for Assignee's occupancy. Such access will be on reasonable advance notice to Assignor and Assignee's activities at the Premises shall be conducted in such a manner as will not unreasonably interfere with Assignor's use and occupancy of the Premises.

(d) SECURITY DEPOSIT. LETTER OF CREDIT. On or prior to the Effective Date, Assignee shall reimburse Assignor for the security deposit under the Master Sublease in the amount of \$32,883.75 and shall substitute Assignee's letter of credit in the amount of \$290,000.00 in the form of Exhibit 2(d) hereto for Assignor's letter of credit held by Master Tenant pursuant to section 6 of the Master Sublease.

(e) NO TRANSFER OF MAINTENANCE CONTRACTS. Assignor shall be responsible for the cancellation and/or termination of all service, maintenance and similar agreements for the providing of goods or services with respect to the Premises as of the Effective Date unless instructed to do so in writing by Assignee. Assignee shall make independent arrangements for the providing of maintenance, services and its other operating requirements as of such date. Assignee will not assume or have any obligation with respect to Assignor's long term volume arrangement with MCI.

3. CONTINUING LIABILITY OF ASSIGNOR; ASSUMPTION OF LIABILITIES BY ASSIGNEE; CROSS-INDEMNITY. The Assignor shall remain liable for and shall discharge on a current basis all obligations of the "Sublessee" (as defined in the Master Sublease) under the

Master Sublease arising on or prior to the Effective Date, while the Assignee shall become responsible for and shall discharge on a current basis all obligations of the "Sublessee" under the Master Sublease arising after the Effective Date. The parties will adjust and apportion any such charges as of the Effective Date. Assignor hereby agrees to save, defend with counsel reasonably satisfactory to Assignee, indemnify and hold harmless Assignee from and against any and all claims, losses, liabilities, damages and expenses (including reasonable attorney's fees) which may arise from the breach of any representation, warranty or agreement of Assignor hereunder or any act or omission or liability of Assignor or any subtenant of Assignor arising prior to or on the Effective Date. Assignee hereby agrees to save, defend with counsel reasonably satisfactory to Assignor, indemnify and hold harmless Assignor from and against any and all claims, losses, liabilities, damages and expenses (including reasonable attorneys fees) which may arise from any act or omission or liability of Assignee or any subtenant of Assignee arising after the Effective Date. It is the intent of the parties that Assignor shall retain the Sublessee's responsibility and liability under the Master Sublease or under law for any environmental conditions of the Premises existing as of the Effective Date and that Assignee shall have the Subtenant's responsibility and liability under the Master Sublease or under law for any environmental conditions of the Premises arising thereafter. If any action or proceeding is brought against either indemnified party by reason of any such claim, upon written notice from the indemnified party, the other party shall at its expense resist or defend such action or proceeding by counsel approved by the indemnified party in writing, which approval the indemnified party shall not unreasonably withhold.

4. STATUS OF MASTER SUBLEASE AND SUBLEASES; CONSENT OF MASTER LANDLORD, MASTER TENANT; OTHER CONDITIONS TO CLOSING.

(a) REPRESENTATIONS, WARRANTIES AND COVENANTS OF ASSIGNOR. Assignor hereby represents, warrants and covenants to Assignee as follows:

(i) The Master Lease. To the best knowledge of the Assignor, the "Master Lease is in full force and effect, there is no default (or any claim of default) by Master Landlord or Master Tenant under the Master Lease, and no event has occurred which, with the giving of notice or the lapse of time would become a default thereunder, and no such notice has been given by either party to the other during the term of the Master Lease. True and complete copies of the Master Lease, including all amendments, are attached hereto as Exhibit 4(a)(i).

(ii) The Master Sublease. The Master Sublease is in full force and effect. There is no default (or any claim of default) by Master Tenant or Assignor under the Master Sublease, and no event has occurred which, with the giving of notice or the lapse of time would become a default thereunder, and no such notice has been given by either party to the other, under section 3(a) thereof or otherwise, during the term of the Master Sublease. Assignor is not aware of any basis for the giving of any such

notice. True and complete copies of the Master Sublease, including all amendments, are attached hereto as Exhibit 4(a)(ii). Base Rent under the Master Sublease has been paid through October 1996 and any other amounts due thereunder have been paid in full through September 30, 1996 and both Base Rent and such other amounts due under the Master Sublease will be paid in full through the Effective Date. The Master Tenant is holding a security deposit in the amount of \$32,883.75, together with the letter of credit contemplated by the Master Sublease in the current amount of \$290,000. There have not been any claims asserted against the security deposit or letter of credit. The expiration date of the Master Sublease is April 30, 2004.

(iii) The Subleases. Each Sublease is in full force and effect. There is no default (or any claim of default) by any subtenant or by Assignor under any Sublease, and no event has occurred which, with the giving of notice or the lapse of time would become a default thereunder, and no such notice has been given by either party to the other. Assignor is not aware of any basis for the giving of any such notice. True and complete copies of each Sublease, including all amendments, are attached hereto as Exhibit 4(a)(iii). Rent under each Sublease has been paid in full through October 1996 (September in the case of Metro) and any other amounts due thereunder have been paid in full through September 30, 1996 and both rent and such other amounts due under the Subleases will be paid in full through the Effective Date. The Assignor is holding and on the Effective Date will transfer to Assignee security deposits as set forth on Schedule 4(a)(iii) hereto. There have not been any claims asserted against the security deposits. The expiration date of each Sublease is set forth on such Schedule.

(iv) The Premises. On the date hereof and as of the Effective Date the Premises, including without limitation all building systems, are and will be in good working order, are, to the knowledge of Assignor, in compliance with all applicable laws, including the Americans with Disabilities Act of 1990 and all environmental laws, and are in compliance with the requirements contained in the Master Lease, the Master Sublease and the Subleases. Assignor has received no formal or informal notice of any building or other violation with respect to the Premises, and is aware of no threat thereof or any basis therefore. Except for work in the space leased to Subtenants and work done after the Effective Date (or by Assignee after receiving access to the Premises, at the end of the term of the Master Sublease there is no substantial restoration required of any tenant work or improvements presently located at the Premises.

(v) No Modification, Default. Assignor shall remain current and be fully in compliance with its obligations under the Master Sublease and the Subleases through the Effective Date. Neither the Master Sublease nor any Sublease will be amended or modified.

(b) CONSENTS: ESTOPPEL CERTIFICATES; OTHER DELIVERIES. Assignee's obligations under this agreement are contingent upon (i) Assignor obtaining the consents and estoppel certificates of the Master Landlord and the Master Tenant, and the estoppel certificates of the subtenants under the Subleases (the forms of consents and estoppel certificates are attached hereto as Exhibit 4(b)), and (ii) Assignee's satisfaction, in its sole discretion, with its physical inspection of the Premises by a qualified engineer, its review of the income and expense records relating to the operation of the Premises and its title search confirming that the Master Lease and the Master Sublease are the senior, duly perfected encumbrances on the Premises. Assignor shall use its best and diligent efforts to request and obtain such consents and estoppels and Assignee shall provide its reasonable cooperation. On or prior to October 31, 1996, each party shall deliver to the other certified copies of corporate resolutions authorizing this agreement and ratifying all actions taken or to be taken by such party hereunder, or a certificate of an executive officer of the corporation to such effect, together with such other assurances of corporate power and authority and other matters as may be reasonably requested by either party.

(c) EFFECTIVE DATE: CLOSING DELIVERIES; BRING-DOWN. As of the Effective Date, Assignor shall provide to Assignee a recertification of Assignor's representations, warranties and covenants set forth in this section 4, a recordable memorandum of this Assignment of the Master Lease and shall deliver the Premises in good condition (and in any event substantially the same condition as on the date hereof), broom clean, and in full compliance with the Master Lease, the Master Sublease and the Subleases, and shall deliver originally executed copies of Master Sublease and the Subleases, along with original consents, estoppels and certificates and any other items contemplated by this agreement.

5. NOTICES. All notices from one party to the other shall be sent to the addresses first set forth above. Either party may designate in writing to the other party a substitute address for notices, and thereafter notices shall be directed to the substitute address. Every notice shall be deemed to have been given or served at the time that the same shall be hand-delivered, deposited with a nation-wide overnight courier service or deposited in the United States mails, by registered or certified mail, postage prepaid, return receipt requested, in the manner aforesaid.

6. BROKER. Assignee and Assignor respectively represent and warrant to each other that no brokers other than Grubb & Ellis, Brown, Stevens, Elmore & Sparre and CPS Brokerage (collectively, the "BROKERS") has been involved in connection with the consummation of this Assignment and Assumption. Each party agrees to indemnify the other from and against any loss, damage or expenses (including litigation costs and reasonable attorneys' fees) by reason of any claim for compensation or commission by

any person other than the Brokers based upon an allegation of relations or negotiations between the claimant and the indemnitor inconsistent with the representations herein made. This representation, warranty and covenant shall survive the Closing. Assignor shall be responsible for the compensation of the Brokers.

7. FURTHER ASSURANCES; SURVIVAL. Each party hereto agrees to execute such further documents or take such other actions as the other may reasonably request to effectuate the purposes of this agreement, provided that no such document or action shall be requested if it increases the other party's actual or potential liabilities or obligations hereunder or decreases the requesting party's obligations or liabilities hereunder. Any errors, omissions or estimations in computing adjustments shall be corrected as soon as practicable thereafter. The representations, warranties and obligations of the parties shall survive the Effective Date for a period of four (4) years.

8. COUNTERPARTS. This agreement may be executed in any number of counterparts (and by facsimile signature pages), all of which taken together shall constitute the original hereof. When counterparts have been executed by and delivered to all parties hereto, or their counsel, they shall have the same effect and if the signatures were all on the same copy hereof.

9. ARBITRATION. Any dispute between the parties arising out of this Agreement shall be submitted to final and binding arbitration in the City of Santa Clara, County of Santa Clara, State of California, under the Commercial Arbitration Rules of the American Arbitration Association then in effect, upon written notification and demand of either party therefor. In the event either party demands such arbitration, the American Arbitration Association shall be requested to submit a list of prospective arbitrators consisting of persons experienced in matters involving business disputes. The provisions of California Code of Civil Procedure Section 1283.05, and the laws of the State of California, are incorporated herein and shall be applicable to the arbitration. In making the award, the arbitrator shall award recovery of costs and expenses of the arbitration and reasonable attorneys' fees to the prevailing party. Any award may be entered as a judgment in any court of competent jurisdiction. Should judicial proceedings be commenced to enforce or carry out this provision or any arbitration award, the prevailing party in such proceedings shall be entitled to reasonable attorneys' fees and costs, in addition to other relief. Either party shall have the right, prior to receiving an arbitration award, to obtain preliminary relief from a court of competent jurisdiction to: (i) avoid injury or prejudice to that party; (ii) to protect the rights of any party; (iii) to maintain the status quo as it existed immediately prior to the dispute; or (iv) to obtain possession of property in order to avoid a material risk of damage to, or loss of, that property.

10. APPLICABLE LAW. This agreement shall be governed by and construed in accordance with the laws of the State of California applicable to contracts between California residents entered into and to be performed entirely within the State of California.

IN WITNESS WHEREOF, Assignor and Assignee have executed this Assignment and Assumption Agreement as of the date first written above.

WITNESS OR ATTEST: DSP GROUP, INC., Assignor

/s/

Secretary

By: /s/ John P. Goldsberry

Name: John P. Goldsberry III
Title: Chief Financial Officer

WITNESS OR ATTEST: DIALOGIC CORPORATION, Assignor

/s/

Secretary

By: /s/ Edward B. Jordan

Name: Edward B. Jordan
Title: Chief Financial Officer

SUBLEASE

1. PARTIES. This Sublease, dated October 18, 1996, is made between Dialogic Corporation, a New Jersey corporation ("Sublessor"), and DSP Group, Inc., a Delaware corporation ("Sublessee").

2. MASTER SUBLEASE. Sublessor is the sublessee under a written sublease ("Master Sublease"), wherein Amdahl Corporation ("Master Tenant") leased to Sublessor the real property located in the City of Santa Clara, County of Santa Clara, State of California, described as approximately 73,075 square feet of office, research, and development space with an address of 3120 Scott Boulevard ("Master Premises"). Effective January 1, 1997 Sublessor is the successor by assignment of the Sublessee's interest in the Master Sublease.

3. MASTER LEASE. Master Tenant is the lessee under a written lease dated November 21, 1983, between Carl E. Berg and Mary Ann Berg, Trustees of the Berg Living Trust UTA, dated May 1, 1981, as to an undivided 81.01% interest, Clyde Berg and Nancy Berg, Trustees of the Clyde Berg Living Trust UTA, dated December 17, 1981, as to an undivided 11.83% interest, and Clyde Berg, Trustee of Clyde Berg's Child Trust UTA, dated June 2, 1978, as to an undivided 7.16% interest (collectively, "Master Landlord"), as amended by an Amendment to Lease dated May 17, 1989, wherein Master Landlord leased to Master Tenant the Master Premises. Said lease and amendments are herein collectively referred to as the "Master Lease".

4. PREMISES. Sublessor hereby subleases to Sublessee on the terms and conditions set forth in this Sublease the following portion of the Master Premises ("Premises"): 14,334 square feet, including the optional area and shipping/receiving, on the first floor as set forth on Exhibit A attached hereto. The square footage area figures presented in this agreement will be verified, by a qualified firm and at the Sublessor's expense, according to the BOMA Standard Method of Floor Measurement (ANSI Z65.1-1980 Reaffirmed, 1989) for rentable area. The

measured square footage amounts will be incorporated into this lease by an attachment and the monthly rent expense adjusted. If Sublessee desires to vacate the 813 square feet of optional space it shall give Sublessor at least ten (10) days prior written notice. Sublessee shall also have the right to use the common areas (restrooms, elevator to garage, hallways thereto) of the Master Premises, but not those areas used by Sublessor or its personnel or invitees, and to use the docking area for shipping and receiving. Additionally, Sublessee's employees shall be permitted to use the exercise facilities at the Master Premises, if such facilities are present, at their own cost provided any employee desiring to use such facilities has been evaluated and trained before using the facilities in the same manner as Sublessor's employees and signed a release form in favor of Sublessor. Sublessor shall be able to increase the amount of rent retroactively to any period of time that it can show that Sublessee used, for any purpose including storage of materials, more space than it notified Sublessor that it was using ("Unauthorized Usage"). Rent for the Unauthorized Usage shall be twice the rental per foot set forth herein.

5. PARKING. Sublessee shall be entitled to that number of parking spaces according to the following formula rounded down to the nearest whole number:

$$\frac{\text{Square footage leased by Sublessee} \times 278}{72,000} = \text{Number of parking spaces}$$

For example, in the first month of this Sublease, Sublessee shall be entitled to a total of 55 parking spaces calculated as follows:

$$\frac{14,334 \times 278}{72,000} = 55$$

Sublessee shall be entitled to have one underground parking space per thousand square feet of their rented premises, rounded down to the nearest whole number. Initially this shall be equal to fourteen (14) underground parking spaces.

6. WARRANTY BY SUBLESSOR. Sublessor warrants and represents to Sublessee that the Master Sublease has not been amended or modified except as expressly set forth herein, that

Sublessor is not now, and as of the commencement of the term hereof will not be, in default or breach of any of the provisions of the Master Sublease, and that Sublessor has no knowledge of any claim by the Master Tenant that Sublessor is in default or breach of any of the provisions of the Master Sublease. Further, Sublessor represents that it has no knowledge of any claim by Master Landlord that Master Tenant is in default or breach of any provisions of the Master Lease.

7. TERM. The term of this Sublease shall commence on January 1, 1997 ("Commencement Date") and end of December 31, 1999 ("Termination Date"), unless otherwise sooner terminated in accordance with the provisions of this Sublease. In the event the term commences on a date other than the Commencement Date, Sublessor and Sublessee shall execute a memorandum setting forth the actual date of commencement of the term. Possession of the Premises shall be delivered to Sublessee on the commencement of the term. If for any reason Sublessor does not deliver possession to Sublessee on the commencement of the term due solely to Sublessor's fault, Sublessor shall not be subject to any liability for such failure, the Termination Date shall not be extended by the delay, and the validity of this Sublease shall not be impaired, but rent shall abate until delivery of possession. Notwithstanding the foregoing, if Sublessor has not delivered Possession to Sublessee within thirty (30) days after the Commencement Date due solely to Sublessor's fault, then at any time thereafter and before delivery of possession, Sublessee may give written notice to Sublessor of Sublessee's intention to cancel this Sublease. Said notice shall set forth an effective date for such cancellation which shall be at least ten (10) days after delivery of said notice to Sublessor. If Sublessor delivers possession to Sublessee on or before such effective date, this Sublease shall remain in full force and effect. If Sublessor fails to deliver possession to Sublessee on or before such effective date, this Sublease shall be canceled, in which case all consideration previously paid by Sublessee to Sublessor on account of this Sublease shall be returned to Sublessee, this Sublease shall thereafter be of no further force and effect, and Sublessor shall have no further liability to Sublessee on account of such delay or cancellation. If Sublessor permits Sublessee to take

possession prior to the commencement of the term, such early possession shall not advance the Termination Date and shall be subject to the provisions of this Sublease, including without limitation the payment of rent.

Sublessor agrees to let Sublessee utilize its presently occupied space on the third floor of the Premises for a period of forty days after allowing Sublessee occupancy of the leased Premises on the first floor following Netro's vacating of said space. The payment made by Sublessee in accordance with section 9.1 of this agreement shall represent full consideration for the use of this third floor space for the forty day period. In the event that Sublessee is not able to completely vacate the third floor Premises within forty days after occupancy of the first floor Premises, Sublessee agrees to pay to the Sublessor of record, a penalty fee equal to \$750 per day in addition to its rent obligation under the Sublease. This penalty fee shall be increased to \$1,500 per day for each day Sublessee has not vacated the third floor Premises after sixty days after initial occupancy of the first floor Premises.

8. OPTIONS TO EXTEND TERM. Sublessee has not been granted any option to extend the term of this sublease.

9. RENT.

9.1 RENT. Sublessee shall pay to Sublessor as rent hereunder, without deduction, setoff, notice, or demand, at 3120 Scott Boulevard, Santa Clara, California, 95054 or at such other place as Sublessor shall designate from time to time by notice to Sublessee, the sum of \$1.50 per square foot of leased space per month, in advance on the first day of each month of the term. This monthly rental amount will increase to \$1.52 per square foot for the calendar year commencing January 1, 1998 and to \$1.55 per square foot for the calendar year commencing January 1, 1999. This monthly rental amount is inclusive of the following Premises and common area expenses: property taxes, lighting replacement, cleaning and maintenance of common area restrooms, landscape maintenance, trash disposal, exterior building security

services, water services, gas services, sewer services, HVAC and air conditioning services, and plumbing services in the common areas. All other services and expenses shall be the responsibility of Sublessee, including, without limitation, janitorial and electrical services for the leased Premises. Sublessee shall prepay to Sublessor upon execution of this Sublease the sum of Twenty-one Thousand, Five Hundred One and No/100 Dollars (\$21,501.00) as rent (or partial rent if the actual rent is higher) for the last month of the initial term of this Sublease. If the term begins or ends on a day other than the first or last day of a month, the rent for the partial months shall be prorated on a per diem basis.

9.2 EARLY TERMINATION. If Sublessee terminates this Sublease at any time prior to the initial term, Sublessee shall pay an early termination fee in the amount of three (3) months average rent based on the period of time Sublessee leased the Premises.

9.3 USE OF RECEPTIONIST. Sublessee shall be entitled to utilize the services of Sublessor's receptionist on a nonexclusive basis for a period of forty (40) hours per week (Monday through Friday from 8 AM to 5 PM, Holidays and days off taken by Sublessor excepted) in exchange for payment to Sublessor in addition to all costs, rents, or payments set forth in this Sublease of an amount equal to Eighty Dollars (\$80) per week.

9.4 USE OF SHIPPING/RECEIVING. Sublessor shall be entitled to utilize the services of Sublessee's shipping clerk on a nonexclusive basis for a period of forty (40) hours per week (Monday through Friday from 8 am to 5 pm, Holidays and days taken off by Sublessee excepted) in exchange for payment to Sublessee of an amount equal to Twenty (\$20.00) per day. This amount will be reviewed no later than March 31, 1997 and renegotiated in good faith by the parties. The shipping clerk shall not act as agent of Sublessor, but merely log in receipt of material and make available outgoing material to shipper for pick-up.

10. SECURITY DEPOSIT. Sublessee shall deposit with Sublessor upon execution of this Sublease the sum of Twenty-one Thousand, Five Hundred One and No/100 Dollars (\$21,501.00)

as security for Sublessee's faithful performance of Sublessee's obligation hereunder ("Security Deposit"). If Sublessee fails to pay rent or other charges (including any payments for Improvements) when due under this Sublease, or fails to perform any of its other obligations hereunder, Sublessor may use or apply all or any portion of the Security Deposit for the payment of an rent or other amount then due hereunder and unpaid, for the payment of any other sum for which Sublessor may become obligated by reason of Sublessee's default or breach, or for any loss or damage sustained by Sublessor as a result of Sublessee's default or breach. If Sublessor so uses any portion of the Security Deposit, Sublessee shall within ten (10) days after written demand by Sublessor, restore the Security Deposit to the full amount originally deposited, and Sublessee's failure to do so shall constitute a default under this Sublease. Sublessor shall not be required to keep the Security Deposit separate from its general accounts, and shall have no obligation or liability for payment of interest on the Security Deposit. In the event Sublessor assigns its interest in this Sublease, Sublessor shall deliver to its assignee so much of the Security Deposit as is then held by Sublessor. Within ten (10) days after the term has expired, or Sublessee has vacated the Premises, whichever shall last occur, and provided Sublessee is not then in default of any of its obligations hereunder, the Security Deposit, or so much thereof as had not theretofore been applied by Sublessor, shall be returned to Sublessee or to the last assignee, if any, of Sublessee's interest hereunder.

11. USE OF PREMISES. The Premises shall be used and occupied only for office use, research and development, assembly and testing, marketing and distribution of telecommunications products and shall not be used in violation of the Master Lease or local, federal, or state law.

12. IMPROVEMENTS. Sublessee shall not make any improvements or alterations (collectively, "Improvements") to the leased Premises without the prior written consent of Sublessor (including Sublessor's consent and approval of all contractors used on the Improvements) during the terms of this Sublease, and such approval is not to be unreasonably

withheld. Sublessee shall be responsible for compliance with all state and local laws regarding such Improvements. Any Improvements initiated by Sublessee that may result in an inspection of the Premises by a governmental authority, will require Sublessee to notify Sublessor at least ten (10) days in advance of such inspection.

13. ASSIGNMENT AND SUBLETTING. Sublessee shall not assign this Sublease or further sublet all or any part of the Premises without the prior written consent of Sublessor (and the consents of Master Landlord and Master Tenant, if such consents are required under the terms of the Master Lease and Master Sublease, respectively), and such approval is not to be unreasonably withheld.

14. INSURANCE POLICIES. All insurance policies required to be maintained by Sublessee pursuant to the Master Lease shall name Sublessor, Master Tenant and Master Landlord as additional insureds.

15. MAINTENANCE, REPAIRS AND ALTERATIONS.

15.1 MAINTENANCE. Throughout the Term, Sublessor, at its cost, shall maintain, in good and sanitary condition, all portions of the Premises, including, without limitation, all structural components of the Premises, including, without limitation, the electrical and plumbing systems, in good order and condition, except that damage occasioned by Sublessee's acts shall be repaired by Sublessee at its expense. Sublessee agrees to keep the Premises clean and neat in appearance and to remove all trash and debris which may be found in or around the Premises. Sublessee waives the provisions of California Civil Code Sections 1941 and 1942 with respect to Sublessor's obligations for tenantability of the Premises and Sublessee's right to make repairs and deduct the expenses of such repairs from rent.

15.2 OBLIGATIONS. If Sublessee fails to perform Sublessee's obligations under this Section or under any other Section of this Lease, Sublessor may, at Sublessor's option, enter

upon the Premises after two (2) days prior written notice to Sublessee (except in the case of emergency, in which case no notice shall be required), perform such obligations on Sublessee's behalf and put the Premises in good order, condition and repair. The cost thereof together with interest thereon at the maximum rate then allowable by law shall be due and payable as additional rent to Sublessor on the first (1st) day of the month immediately following that month during which Sublessor performs such obligation.

15.3 REPAIR. On the last day of the Term or on any sooner termination, Sublessee shall surrender the Premises to Sublessor in the same condition as received, ordinary wear and tear excepted, clean and free of debris and broom clean. Sublessee shall repair any damage to the Premises occasioned by the installation or removal of its trade fixtures, furnishings and equipment and reinstall carpet (the same quality as that was taken out) or other items taken out of the Premises.

15.4 SURRENDER. All alterations, improvements and additions (whether or not they constitute trade fixtures of Sublessee), which may be made on the Premises, shall become Sublessor's property and remain upon and be surrendered with the Premises at the expiration of the Term.

15.5 SECURITY. Not Applicable.

16. OTHER PROVISIONS OF SUBLEASE. All applicable terms and conditions of the Master Lease and the Master Sublease are incorporated into and made a part of this Sublease (including, without limitation, the default provisions set forth in Section 10 of the Master Lease) as if Sublessor were the lessor thereunder, Sublessee the lessee thereunder, and the Premises the Master Premises, EXCEPT for the following:

(a) MASTER LEASE: The first four (4) paragraphs of the untitled section of the Master Lease before Section 1 and found on pages 1 through 5 of the Master Lease, Sections 2, 4, 5, 7, 13, 15, 21, 22, 33, 34, 35, and Exhibit B.

(b) MASTER SUBLEASE: Article I, Recitals contained in Article II, Sections 1, 3, 4, 5(a), 6, 7, 9, 13, 17, and Exhibit C.

(c) CONFLICTS: If any terms of the Master Lease or the Master Sublease conflict with the terms of this Sublease, the terms of this Sublease shall control.

17. ATTORNEYS' FEES. If Sublessor or Sublessee shall commence an action against the other arising out of or in connection with this Sublease, the prevailing party shall be entitled to recover its costs of suit and reasonable attorneys' fees.

18. AGENCY DISCLOSURE. Sublessor and Sublessee each warrant that they have not dealt with any real estate brokers in connection with this transaction and that no real estate broker fees or commissions are due.

19. NOTICES. All notices and demands may or are to be required or permitted to be given by either party on the other hereunder shall be in writing. All notices and demands by the Sublessor to Sublessee shall be sent by United States Mail, postage prepaid, addressed to the Sublessee at the Premises, and to the address herein below, or to such other place as Sublessee may from time to time designate in a notice to the Sublessor. All notices and demands by the Sublessee to Sublessor shall be sent by United States Mail, postage prepaid, addressed to the Sublessor at the address set forth herein, and to such other person or place as the Sublessor may from time to time designate in a notice to the Sublessee.

To Sublessor: Dialogic Corporation
1515 Route 10
Parsippany, NJ 07054
Attention: Chief Financial Officer

To Sublessee: DSP Group, Inc.
3120 Scott Boulevard
Santa Clara, CA 95054
Attention: Senior Officer

20. CONSENT BY LESSOR. THIS SUBLEASE SHALL BE OF NO FORCE OR EFFECT UNLESS CONSENTED TO BY MASTER LANDLORD AND MASTER TENANT WITHIN 10 DAYS AFTER EXECUTION HEREOF, IF SUCH CONSENT IS REQUIRED UNDER THE TERMS OF THE MASTER LEASE OR THE MASTER SUBLEASE.

21. COMPLIANCE. The parties hereto agree to comply with all applicable federal, state, and local laws, regulations, codes, ordinances and administrative orders having jurisdiction over the parties, property or the subject matter of this Agreement.

22. ARBITRATION. Any dispute between the parties arising out of this Agreement shall be submitted to final and binding arbitration in the City of Santa Clara, County of Santa Clara, State of California, under the Commercial Arbitration Rules of the American Arbitration then in effect, upon written notification and demand of either party therefore. In the event either party demands such arbitration, the American Arbitration Association shall be requested to submit a list of prospective arbitrators consisting of persons experienced in matters involving business disputes. The provisions of California Code of Civil Procedure Section 1283.05, and the laws of the State of California, are incorporated herein and shall be applicable to the arbitration. In making the award, the arbitrator shall award recovery of costs and expenses of the arbitration and reasonable attorneys' fees to the prevailing party. Any award may be entered as a judgment in any court of competent jurisdiction. Should judicial proceedings be commenced to enforce or carry out this provision or any arbitration award, the prevailing party in such proceedings shall be entitled to reasonable attorneys' fees and costs, in addition to other relief. Either party shall have the right, prior to receiving an arbitration award, to obtain preliminary relief from a court of competent jurisdiction to: (i) avoid injury or prejudice to that party; (ii) to protect the rights of

any party; (iii) to maintain the status quo as it existed immediately prior to the dispute; or (iv) to obtain possession of property in order to avoid a material risk of damage to, or loss of, that property.

23. SEVERABILITY. Sublessor and Sublessee hereby agree and acknowledge that should any condition, provision, covenant contained in this Sublease and any and all addenda, modifications, or changes thereof, be found to be in violation of any federal, state, county or local statute, law, order, rule or regulation, said condition, provision or covenant shall be eliminated or severed from said Sublease Agreement and any addenda thereto, and said condition, provision, or covenant shall not invalidate, eliminate, or alter the terms of all other conditions, provisions, and covenants contained in the Sublease or addenda thereto.

24. MODIFICATION. This Sublease shall not be amended, modified, appended or altered unless said amendment, modification, appendage, or alteration is made in writing and duly executed and signed by a Sublessor and Sublessee.

25. ENTIRE AGREEMENT. This Agreement and the exhibits attached hereto and the other documents delivered pursuant hereto constitute the full and entire understanding and agreement between and among the parties with regard to the subjects hereof and thereof and shall supersede any and all oral or written communications, correspondence, agreements, understandings, promises, or representations.

26. INDEMNIFICATION. Sublessee shall defend, indemnify and hold harmless Sublessor, Master Tenant, Master Landlord and their respective partners, directors, officers, employees, agents and representatives from any and all claims, liabilities, causes of action, liens, judgments, awards, damages, losses, fines, penalties, sanctions, costs, and expenses that arise from, or are related to either (i) Sublessee's breach of any duties, obligations, liabilities, or covenants that arise from said Sublease or any modification addenda, or alteration of this Sublease, or (ii) any and all claims of third parties made against the Sublessor, Master Tenant, or Master Landlord

that arise from the conduct, actions, representations, agreements, warranties, guarantees, or promises of Sublessee and any partners, directors, officers, employees, agents, licensees, invitees and representatives of Sublessee.

27. SIGNAGE. Subject to the limitations of local signage regulations, Sublessor agrees to let Sublessee install one wall mounted sign on the right hand side of the concrete exterior facade of the building above the first floor windows in front of the area to be leased by Sublessee. The parties have agreed that Sublessee's sign may consist of the white lettered portion (which spells "DSP GROUP") of one of its current signs, and that the sign may be illuminated so as to be visible and readable from Scott Boulevard, provided that the sign's brightness is reduced to be significantly less bright than Sublessor's signs. All costs including, but not limited to, the construction, installation, removal, and necessary permits for this sign will be the responsibility of the Sublessee.

Sublessor: DIALOGIC CORPORATION

Sublessee: DSP GROUP, INC.

By: /s/ EDWARD B. JORDAN

By: /s/ MARTIN M. SKOWRON

Title: Chief Financial Officer and
Vice President

Title: Senior Vice President

MASTER LANDLORD'S CONSENT TO SUBLEASE

The undersigned Master Landlord under the Master Lease, hereby consents to the foregoing Sublease without waiver of any restriction in the Master Lease concerning further assignment or subletting. Master Landlord certifies that as of the date Master Landlord's execution hereof, neither Master Tenant nor Master Landlord is in default or breach of any of the provisions of the Master Lease, and that the Master Lease has not been amended or modified except as expressly set forth in the foregoing Sublease.

Master Landlord: /s/

By: -----

Title: -----

MASTER TENANT'S CONSENT TO SUBLEASE

The undersigned Master Tenant under the Master Sublease, hereby consents to the foregoing Sublease without waiver of any restriction in the Master Sublease concerning further assignment or subletting.

Master Tenant: AMDAHL CORPORATION

By: /s/ Jonathon C. Andersen

Title: Director, Corporate Real Estate

CONSENTS OF MASTER LANDLORD AND MASTER TENANT

Notwithstanding any of the provisions in the attached sublease, each of Master Landlord and Master Tenant hereby consents to the attached sublease with a term commencing January 1, 1997, between Dialogic Corporation ("Sublessor"), a New Jersey corporation, and DSP Group, Inc. ("Sublessee"), a Delaware corporation, on the following conditions:

1. Nothing contained in said sublease or this consent shall create any obligations or duties on the part of the Master Landlord beyond those in the Master Lease;
2. Nothing contained in said sublease or this consent shall release, excuse, or waive performance of any obligation of Master Tenant under the Master Lease;
3. Nothing in said sublease or this consent shall amend or modify any provision of the Master Lease or otherwise affect Master Landlord's or Master Tenant's rights and remedies under the Master Lease;
4. This consent applies only to the attached sublease and shall not authorize any further sublease or assignment during the term of the Master Lease or during any option period of the Master Lease; and
5. The Sublessee acknowledges that the rent it is paying is less than the rent required pursuant to the terms of the Master Lease.

There exists no event of default, breach, failure of condition or event of default under the Master Lease to the best of Master Landlord's knowledge, but Master Landlord has made no independent investigation.

Landlord has been advised that Sublessor and Sublessee may agree to perform tenant improvements to the subject property. Landlord reserves the right, pursuant to the terms of the Master Lease, to require Master Tenant to return the premises to the condition contemplated under the Master Lease.

MASTER LANDLORD

MASTER TENANT
Amdahl Corporation

/s/ Carl E. Berg

By: /s/ Jonathon C. Andersen

By: Carl E. Berg
For Berg Family Trusts

Name: Jonathon C. Andersen
Title: Director, Corporate Real Estate

FIRST AMENDMENT TO SUBLEASE

This amendment dated December 4, 1996, for reference purposes only, is made and entered into by and between Dialogic Corporation ("Sublessor") and DSP Group, Inc. ("Sublessee").

RECITALS:

- A. The parties have previously entered into a Sublease dated October 18, 1996, for reference purposes only.
- B. The premises defined in the Sublease as specified in paragraph 4 states the following:
- The square footage area figures presented in this agreement will be verified, by a qualified firm and at the Sublessor's expense, according to the BOMA Standard Method of Floor Measurement (ANSI Z65.1-1980 Reaffirmed, 1989) for rentable area.
- C. Sublessor has engaged a qualified architectural firm to measure the square footage pursuant to paragraph 4 of the Sublease.

NOW THEREFORE, the parties agree as follows:

1. To amend the square footage as defined in paragraph 4 to be 15,645.
2. To increase the monthly rent as defined in paragraph 9 to be \$23,467.
3. To increase the total number of parking spaces as defined in paragraph 5 to be 60.
4. To increase the security deposit as defined in paragraph 10 to be \$23,467.
5. Except as specifically amended or modified by this First Amendment to Sublease, all other terms and provisions of the Sublease shall remain unmodified and in full force and effect.

Sublessor: DIALOGIC CORPORATION

Sublessee: DSP GROUP, INC.

By: /s/ Edward B. Johns

By: /s/ Martin M. Skowron

Title: Chief Financial Officer
and Vice President

Title: Senior Vice President

EMPLOYMENT AGREEMENT

THIS AGREEMENT, made and entered into this 24th day of February, 1997 by and between DSP Semiconductors Ltd., of Givat Shmuel, a company existing under the laws of the State of Israel (hereinafter the "Company"), and Avi Basher of 10/51 Ino-shaki Street, Jerusalem, Israel (hereinafter "Basher"), effective as of the 15th day of October, 1996 (the "Effective Date").

RECITAL

The Company desires to employ Basher and to avail itself of Basher's talents and abilities, and Basher desires to be employed by the Company, subject to the terms of and conditions set forth herein.

AGREEMENT

NOW, THEREFORE, the parties hereto hereby agree as follows:

1. EMPLOYMENT DUTIES

1.1 BASHER'S DUTIES

- 1.1.1. Basher shall perform the responsibilities of the Vice President of Finance and Chief Financial Officer of the Company and its US parent, DSP Group, Inc., and any responsibilities incidental thereto, all such, as stated, to be commensurate with his background, education, experience and professional standing. Basher shall devote his full productive time, attention, energy, and skill to the business of the Company during the Employment Term set forth below. Basher shall not become engaged in any other occupation whether for compensation or not while employed hereunder, without the express written consent of the Company's Board of Directors.
- 1.1.2. Basher acknowledges that his employment with the Company will require frequent travel spanning extended periods outside Israel. Furthermore, Basher agrees to extensive world-wide travel under his employment with the Company.
- 1.1.3. Basher understands and acknowledges that as his position is a senior managerial position in substance, as defined in the Work and Rest Hours Law, 1951, and requires a high level of trust, the provisions of said law shall not apply to Basher and Basher agrees that he may be required to work beyond the regular working hours of the Company, for no additional compensation other than as specified in this Agreement.
- 1.1.4. Basher agrees and undertakes throughout the Employment Term not to receive any payment, compensation or any other benefit from any third party directly related to his employment hereunder or to the Company or its parent company, DSP Group, Inc.
- 1.1.5. Basher agrees and undertakes not to perform any act or to omit to perform any act which may breach his fiduciary duty to the Company or its parent company, DSP Group, Inc. or which may place him in a position of conflict of interest with the objectives of the Company or its parent company, as the case may be. In addition, Basher agrees and undertakes to promptly inform the Company and its parent company, DSP Group, Inc., of any such matter which may place him in such a situation of potential conflict of interest.

2. TERM

This Employment Agreement commenced as of the Effective Date and shall continue indefinitely, unless sooner terminated under the terms of this Agreement. As used herein, the term "Employment

Term" refers to the entire period of employment of Basher under this Agreement, beginning October 15, 1996.

3. COMPENSATION

Basher shall be compensated as follows:

3.1. FIXED SALARY

3.1.1. Basher shall receive a fixed monthly Gross Salary of NIS 31,970 (the "Gross Salary"), payable on a monthly basis. The Gross Salary shall be adjusted monthly to the Consumer Price Index (the "Index"). The Gross Salary shall be adjusted to the monthly increase of the last published Index (September 1996 Index-140.0), in comparison to the last published Index known at the time of execution of this Agreement.

3.1.2. It is hereby agreed by the parties that the Gross Salary adjustments according to the Index, shall be deemed to include any adjustments for Cost of Living Increase ("Tosefet Yoker") that apply to Basher as an employee, unless such adjustment to the Cost of Living Increase shall be higher than the adjustment to the last published Index in any given month, in which case the Index adjustments shall be in respect of the Tosefet Yoker alone.

3.2. BONUS

During the Employment Term, the Board of Directors shall consider granting Basher an annual bonus.

3.3. VACATION

Basher shall accrue paid vacation at the rate of 22 business days for each twelve (12) months of employment. Basher may not accumulate his vacation days for more than twenty-four (24) months of employment.

3.4. SICK LEAVE

Basher shall accrue sick leave at the same rate generally available to the Company's employees according to the provisions of the Sick Pay Law-1976 and subject to Basher producing the required medical certificates.

3.5. BENEFITS

3.5.1. During the term of Basher's employment, Basher shall be entitled to Manager's Insurance (Bituach Minhalim) in an amount equal to 15.83% of the Gross Salary, which shall be paid monthly to said Manager's Insurance Plan directly by the Company. The insurance shall be allocated as follows: (i) 8.33% in respect of severance compensation, (ii) 5% in respect of pension and (iii) 2.5% of the Gross Salary in respect of disability. An additional 5% of the Gross Salary shall be deducted by the Company from the monthly payment of Basher's salary as Basher's contribution to said Manager's Insurance.

3.5.2. The Manager's Insurance policy provided for Basher's benefit shall be registered in the Company's name. The contributions to the Manager's Insurance Policy shall be paid by the Company in lieu of any other legal obligation to make payments on account of severance or pension in respect of Basher's employment during the Employment Term. Should the provisions made for severance pay not cover the amount owed by the Company to Basher by law, then the Company shall pay Basher the difference, all in accordance with Israeli law. Basher's agreement to the last two sentences shall exempt the Company from the requirement to apply to the Minister of Labor and Welfare for an approval under Section 14 of the Severance Pay Law; however, should such application be deemed necessary,

Basher's signature hereupon shall be deemed his consent to the Company's application in Basher's name in such matter.

- 3.5.3. The sums accumulated in the Manager's Insurance policy shall be transferred to Basher upon termination of his employment hereunder, unless Basher has committed an act in breach of Basher's fiduciary duty towards the Company or its parent company, DSP Group, Inc., as determined solely by the Company.
- 3.5.4. The Company shall provide and pay Basher Recreation Funds (Dmai Havra'ah) at the rate required by law and regulations.
- 3.5.5. The Company shall contribute to a Continuing Education Fund chosen by it for the benefit of Basher in an amount equal to 7.5% of his Gross Salary per month subject to Basher's contribution of an additional 2.5% of his Gross Salary per month.
- 3.5.6. The Company shall provide Basher with a car for use in connection with his employment and for personal reasonable use. The Company shall bear all expenses due to use and maintenance of the car, in the same fashion as is customary with the Company.
- 3.5.7. The Company shall provide Basher with a telephone in his private residence solely for use in connection with his employment with the Company, and shall bear the expense of the telephone bills, subject to timely presentation of such bills by Basher to the Company.
- 3.5.8. Within sixty (60) days of the date hereof, the Company shall provide Basher with directors and officers' liability insurance as is customary at the Company.

4. EXPENSES

The Company shall reimburse Basher for his normal and reasonable expenses incurred for travel, entertainment and similar items in promoting and carrying out the business of the Company in accordance with the Company's general policy, in effect from time to time. As a condition of reimbursement, Basher agrees to provide the Company with copies of all available invoices and receipts, and otherwise account to the Company in sufficient detail to allow the Company to claim an income tax deduction for such paid item, if item is deductible. Reimbursement shall be made on a monthly, or more frequent, basis.

5. COVENANT NOT TO COMPETE

Basher agrees that during the Employment Term as Vice President of Finance and Chief Financial Officer of the Company, he is and shall be in a position of special trust and confidence and will have access to confidential and proprietary information about the Company's business and plans. Basher agrees that he will not directly or indirectly, either as an employee, employer, consultant, agent, principal, partner, stockholder, corporate officer, director, or in any similar individual or representative capacity, engage or participate in any business and any future Company's business during the term of employment, including projects under consideration by the Company at the time of termination during the term of his employment, or in the event of a Termination For Cause (as defined below) of employment for a period of two (2) years thereafter, or in the event of a termination not for cause for a period of twelve (12) months.

For the purposes of this Section 5, the term "Company" shall mean any subsidiaries, any other affiliates and its parent company.

6. CONFIDENTIALITY AND TRADE SECRETS

6.1. KNOW-HOW AND INTELLECTUAL PROPERTY

It is understood that the Company has developed or acquired and will continue to develop or acquire certain products, technology, unique or special methods, manufacturing and assembly

processes and techniques, trade secrets, written marketing plans and customer arrangements, and other proprietary rights and confidential information which are not in the public domain, and shall during the Employment Term continue to develop, compile and acquire said items (all hereinafter collectively referred to as the "Company's Property"). It is expected that Basher will gain knowledge of and utilize the Company's Property during the course and scope of his employment with the Company, and will be in a position of trust with respect to the Company's Property.

6.2 COMPANY'S PROPERTY

It is hereby stipulated and agreed that the Company's Property shall remain the Company's sole property. It is further stipulated and agreed by the parties, as a material inducement for the Company having entered into this Agreement and remaining a party hereto (subject to any early termination hereof by the Company), that Basher shall be bound by the Confidential Disclosure and Non-Use Agreement appended hereto as APPENDIX A.

In the event that Basher's employment is terminated, for whatever reason, Basher agrees not to copy, make known, disclose or use, any of the Company's Property. Without derogating from the Company's rights under the law of torts, Basher further agrees not to endeavor or attempt in any way to interfere with or induce a breach of any prior contractual relationship that the Company may have with any employee, customer, contractor, supplier, representative, or distributor for a period of two (2) years from the date of any termination of Basher's employment with the Company for any reason whatsoever. Basher agrees, upon termination of employment, to deliver to the Company all confidential papers, documents, records, lists and notes (whether prepared by Basher or others) comprising or containing the Company's Property, without retaining any copies thereof, and any other property of the Company.

It is hereby agreed that a breach of Sections 5 and 6 including Appendix A hereto shall be considered as a material breach of this Agreement.

For the purposes of this Section 6, the term "Company" shall also mean any subsidiaries, any other affiliates and its parent company.

7. TERMINATION

7.1 GENERAL

Either party may terminate this Agreement, without cause, upon ninety (90) days advance written notice to the other party.

7.2 TERMINATION FOR CAUSE

The Company may immediately terminate Basher's employment at any time for Cause. Termination for Cause shall be effective from the receipt of written notice thereof to Basher. "Cause" means: (i) material neglect of his duties or a material violation of any of the provisions of this Agreement, which continues after written notice and a reasonable opportunity (not to exceed seven (7) days) in which to cure; (ii) conviction of any felonious offense; or (iii) intentionally imparting confidential information relating to the Company or its business to third parties, other than in the course of carrying out his duties hereunder. The Company's exercise of its rights to terminate with Cause shall be without prejudice to any other remedy it may be entitled at law, in equity, or under this Agreement.

8. CORPORATE OPPORTUNITIES

In the event that during the Employment Term, any business opportunity related to the Company's business shall come to Basher's knowledge, Basher shall promptly notify the Company's Board of Directors of such opportunity. Basher shall not appropriate for himself or for any other person other

than the Company, any such opportunity, except with the express written consent of the Board of Directors, in advance. Basher's duty to notify the Company and to refrain from appropriating all such opportunities shall neither be limited by, nor shall such duty limit, the application of the general law of Israel relating to the fiduciary duties of an agent or employee.

9. RESERVE DUTY

Immediately upon receipt of a notice of reserve duty, Basher shall report such notice to the Company's Board of Directors. Upon Basher's return from reserve duty, Basher shall deliver to the Company appropriate confirmation of reserve duty served from his military unit, against which the Company shall pay Basher his regular compensation package with respect to the period served.

10. MISCELLANEOUS

10.1. ENTIRE AGREEMENT

This Agreement constitutes the entire agreement and understanding between the parties with respect to the subject matters herein, and supersedes and replaces any prior agreements and understandings, whether oral or written between them with respect to such matters. The provisions of this Agreement may be waived, altered, amended or repealed in whole or in part only upon the written consent of both parties to this Agreement.

10.2. NO IMPLIED WAIVERS

The failure of either party at any time to require performance by the other party of any provision hereof shall not affect in any way the right to require such performance at any time thereafter, nor shall the waiver by either party of a breach of any provision hereof be taken or held to be a waiver of any subsequent breach of the same provision or any other provision.

10.3. Personal Services

It is understood that the services to be performed by Basher hereunder are personal in nature and the obligations to perform such services and the conditions and covenants of this Agreement cannot be assigned by Basher. Subject to the foregoing, and except as otherwise provided herein, this Agreement shall inure to the benefit of and bind the successors and assigns of the Company.

10.4. SEVERABILITY

If for any reason any provision of this Agreement shall be determined to be invalid or inoperative, the validity and effect of the other provisions hereof shall not be affected thereby, provided that no such severability shall be effective if it causes a material detriment to any party.

10.5. APPLICABLE LAW

This Agreement shall be governed by and construed in accordance with the law of the State of Israel.

10.6. NOTICES

All notices, requests, demands, instructions or other communications required or permitted to be given under this Agreement or related to it shall be in writing and shall be deemed to have been duly given upon delivery, if delivered personally, or if given by prepaid telegram, or mailed first-class postage prepaid, registered or certified mail, return receipt requested, shall be deemed to have been given five (5) days after such delivery, if addressed to the other party at the addresses as set forth on the signature page below. Either party hereto may change the address to which such communications are to be directed by giving written notice to the other party hereto of such change in the manner above provided.

10.7. MERGER, TRANSFER OF ASSETS, OR DISSOLUTION OF THE COMPANY

This Agreement shall not be terminated by any dissolution of the Company resulting from either merger or consolidation in which the Company is not the consolidated or surviving Company or a transfer of all or substantially all of the assets of the Company. In such event, the rights, benefits and obligations herein shall automatically be assigned to the surviving or resulting company or to the transferee of the assets.

10.8. NO CONFLICTING AGREEMENTS

Basher declares that he is not bound by any agreement, understanding or arrangement according to which the execution of and compliance with this Agreement may constitute a breach or default.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above.

DSP Semiconductors Ltd.

By:	/s/ ELI AYALON	/s/ AVI BASHER
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	Eli Ayalon	Avi Basher
	Title: PRESIDENT & CEO	

EMPLOYMENT AGREEMENT

THIS AGREEMENT, made and entered into this 1st day of June, 1996 by and between DSP Semiconductors Ltd., of Givat Shmuel, a company existing under the laws of the State of Israel (hereinafter the "Company"), and Moshe Shahaf of 17 Beresheet Street, Givatayim, Israel (hereinafter "Shahaf"), effective as of the 1st day of June, 1996 (the "Effective Date").

RECITAL

The Company desires to employ Shahaf and to avail itself of Shahaf's talents and abilities, and Shahaf desires to be employed by the Company, subject to the terms of and conditions set forth herein.

AGREEMENT

NOW, THEREFORE, the parties hereto hereby agree as follows:

1. EMPLOYMENT DUTIES

1.1. SHAHAF'S DUTIES

1.1.1. Shahaf shall perform the responsibilities of the Vice President of R & D and Chief Technology Officer of the Company, and any responsibilities incidental thereto, all such, as stated, to be commensurate with his background, education, experience and professional standing. Shahaf shall devote his full productive time, attention, energy, and skill to the business of the Company during the Employment Term set forth below. Shahaf shall not become engaged in any other occupation whether for compensation or not while employed hereunder, without the express written consent of the Company's Board of Directors.

1.1.2. Shahaf acknowledges that his employment with the Company will require frequent travel spanning extended periods outside Israel. Furthermore, Shahaf agrees to extensive world-wide travel under his employment with the company.

1.1.3. Shahaf understands and acknowledges that as his position is a senior managerial position in substance, as defined in the Work and Rest Hours Law, 1951, and requires a high level of trust, the provisions of said law shall not apply to Shahaf and Shahaf agrees that he may be required to work beyond the regular working hours of the Company, for no additional compensation other than as specified in this Agreement.

1.1.4. Shahaf agrees and undertakes throughout the Employment Term not to receive any payment, compensation or any other benefit from any third party directly related to his employment hereunder or to the Company or its parent company, DSP Group, Inc.

1.1.5. Shahaf agrees and undertakes not to perform any act or to omit to perform any act which may breach his fiduciary duty to the Company or its parent company, DSP Group, Inc. or which may place him in a position of conflict of interest with the objectives of the Company or its parent company, as the case may be. In addition, Shahaf agrees and undertakes to promptly inform the Company and its parent company, DSP Group, Inc., of any such matter which may place him in such a situation of potential conflict of interest.

2. TERM

This Employment Agreement commenced as of the Effective Date and shall continue indefinitely, unless sooner terminated under the terms of the Agreement. As used herein, the term "Employment Term" refers to the entire period of employment of Shahaf under this Agreement, beginning June 1, 1996.

3. COMPENSATION

Shahaf shall be compensated as follows:

3.1. FIXED SALARY

3.1.1. Shahaf shall receive a fixed monthly Gross Salary of NIS 31,000 (the "Gross Salary"), payable on a monthly basis. The Gross Salary shall be adjusted monthly to the Consumer Price Index (the "Index"). The Gross Salary shall be adjusted to the monthly increase of the last published Index, in comparison to the last published Index known at the time of execution of this Agreement.

3.1.2. It is hereby agreed by the parties that the Gross Salary adjustments according to the Index, shall be deemed to include any adjustments for Cost of Living Increase ("Tosefet Yoker") that apply to Shahaf as an employee, unless such adjustment to the Cost of Living Increase shall be higher than the adjustment to the last published Index in any given month, in which case the Index adjustments shall be in respect of the Tosefet Yoker alone.

3.2. BONUS

During the Employment Term, the Board of Directors shall consider granting Shahaf an annual bonus.

3.3. VACATION

Shahaf shall accrue paid vacation at the rate of 22 business days for each twelve (12) months of employment. Shahaf may not accumulate his vacation days for more than twenty-four (24) months of employment.

3.4. SICK LEAVE

Shahaf shall accrue sick leave at the same rate generally available to the Company's employees according to the provisions of the Sick Pay Law-1976 and subject to Shahaf producing the required medical certificates.

3.5. BENEFITS

3.5.1. During the term of Shahaf's employment, Shahaf shall be entitled to Manager's Insurance (Bituach Minhalmim) in an amount equal to 15.83% of the Gross Salary, which shall be paid monthly to said Manager's Insurance Plan directly by the Company. The insurance shall be allocated as follows: (i) 8.33% in respect of severance compensation, (ii) 5% in respect of pension and (iii) 2.5% of the Gross Salary in respect of disability. An additional 5% of the Gross Salary shall be deducted by the Company from the monthly payment of Shahaf's salary as Shahaf's contribution to said Manager's Insurance.

3.5.2. The Manager's Insurance policy provided for Shahaf's benefit shall be registered in the Company's name. The contributions to the Manager's Insurance Policy shall be paid by the Company in lieu of any other legal obligation to make payments on account of severance or pension in respect of Shahaf's employment during the Employment Term. Should the provisions made for severance pay not cover the amount owed by the Company to Shahaf by law, then the Company shall pay Shahaf the difference, all in accordance with Israeli law. Shahaf's agreement to the last two sentences shall exempt the Company from the requirement to apply to the Minister of Labor and Welfare for an approval under Section 14 of the Severance Pay Law; however, should such application be deemed necessary, Shahaf's signature hereupon shall be deemed his consent to the Company's application in Shahaf's name in such matter.

- 3.5.3. The sums accumulated in the Manager's Insurance policy shall be transferred to Shahaf upon termination of his employment hereunder, unless Shahaf has committed an act in breach of Shahaf's fiduciary duty towards the Company or its parent company, DSP Group, Inc., as determined solely by the Company.
- 3.5.4. The Company shall provide and pay Shahaf Recreation Funds (Dmai Havra'ah) at the rate required by law and regulations.
- 3.5.5. The Company shall contribute to a Continuing Education Fund chosen by it for the benefit of Shahaf in an amount equal to 7.5% of his Gross Salary per month subject to Shahaf's contribution of an additional 2.5% of his Gross Salary per month.
- 3.5.6. The Company shall provide Shahaf with a car for use in connection with his employment and for personal reasonable use. The Company shall bear all expenses due to use and maintenance of the car, in the same fashion as is customary with the Company.
- 3.5.7. The Company shall provide Shahaf with a telephone in his private residence solely for use in connection with his employment with the Company, and shall bear the expense of the telephone bills, subject to timely presentation of such bills by Shahaf to the Company.
- 3.5.8. Within sixty (60) days of the date hereof, the Company shall provide Shahaf with directors and officers' liability insurance as is customary at the Company.

4. EXPENSES

The Company shall reimburse Shahaf for his normal and reasonable expenses incurred for travel, entertainment and similar items in promoting and carrying out the business of the Company in accordance with the Company's general policy, in effect from time to time. As a condition of reimbursement, Shahaf agrees to provide the Company with copies of all available invoices and receipts, and otherwise account to the Company in sufficient detail to allow the Company to claim an income tax deduction for such paid item, if item is deductible. Reimbursement shall be made on a monthly, or more frequent, basis.

5. COVENANT NOT TO COMPETE

Shahaf agrees that during the Employment Term as Vice President of R & D and Chief Technology Officer of the Company, he is and shall be in a position of special trust and confidence and will have access to confidential and proprietary information about the Company's business and plans. Shahaf agrees that he will not directly or indirectly, either as an employee, employer, consultant, agent, principal, partner, stockholder, corporate officer, director, or in any similar individual or representative capacity, engage or participate in any business and any future Company's business during the term of employment, including projects under consideration by the Company at the time of termination during the term of his employment, or in the event of a Termination For Cause (as defined below) of employment for a period of two (2) years thereafter, or in the event of a termination not for cause for a period of twelve (12) months.

For the purposes of this Section 5, the term "Company" shall mean any subsidiaries, any other affiliates and its parent company.

6. CONFIDENTIALITY AND TRADE SECRETS

6.1. KNOW-HOW AND INTELLECTUAL PROPERTY

It is understood that the Company has developed or acquired and will continue to develop or acquire certain products, technology, unique or special methods, manufacturing and assembly processes and techniques, trade secrets, written marketing plans and customer arrangements, and other proprietary rights and confidential information which are not in the public domain, and

shall during the Employment Term continue to develop, compile and acquire said items (all hereinafter collectively referred to as the "Company's Property"). It is expected that Shahaf will gain knowledge of and utilize the Company's Property during the course and scope of his employment with the Company, and will be in a position of trust with respect to the Company's Property.

6.2. COMPANY'S PROPERTY

It is hereby stipulated and agreed that the Company's Property shall remain the Company's sole property. It is further stipulated and agreed by the parties, as a material inducement for the Company having entered into this Agreement and remaining a party hereto (subject to any early termination hereof by the Company), that Shahaf shall be bound by the Confidential Disclosure and Non-Use Agreement appended hereto as APPENDIX A.

In the event that Shahaf's employment is terminated, for whatever reason, Shahaf agrees not to copy, make known, disclose or use, any of the Company's Property. Without derogating from the Company's rights under the law of torts, Shahaf further agrees not to endeavor or attempt in any way to interfere with or induce a breach of any prior contractual relationship that the Company may have with any employee, customer, contractor, supplier, representative, or distributor for a period of two (2) years from the date of any termination of Shahaf's employment with the Company for any reason whatsoever. Shahaf agrees, upon termination of employment, to deliver to the Company all confidential papers, documents, records, lists and notes (whether prepared by Shahaf or others) comprising or containing the Company's Property, without retaining any copies thereof, and any other property of the Company.

It is hereby agreed that a breach of Sections 5 and 6 including Appendix A hereto shall be considered as a material breach of this Agreement.

For the purposes of this Section 6, the term "Company" shall also mean any subsidiaries, any other affiliates and its parent company.

7. TERMINATION

7.1. GENERAL

Either party may terminate this Agreement, without cause, upon ninety (90) days advance written notice to the other party.

7.2. TERMINATION FOR CAUSE

The Company may immediately terminate Shahaf's employment at any time for Cause. Termination for Cause shall be effective from the receipt of written notice thereof to Shahaf. "Cause" means: (i) material neglect of his duties or a material violation of any of the provisions of this Agreement, which continues after written notice and a reasonable opportunity (not to exceed seven (7) days) in which to cure; (ii) conviction of any felonious offense; or (iii) intentionally imparting confidential information relating to the Company or its business to third parties, other than in the course of carrying out his duties hereunder. The Company's exercise of its rights to terminate with Cause shall be without prejudice to any other remedy it may be entitled at law, in equity, or under this Agreement.

8. EMPLOYEE OPTION PLAN

Subject to the approval of the Board of Directors of DSP Group, Inc. and subject to the terms and conditions to the DSP Group Inc.'s Employee Option Plan for employees of the Company, Shahaf shall be entitled to receive up to 70,000 shares of the Common Stock of DSP Group, Inc. The vesting schedule of said options shall be as follows: 25% of the shares will vest at the end of the 1st year from the date of grant of said options and the number of shares equal to 6.25% shares will vest at the end of

each 3 month period thereafter. The exercise price shall be decided by the Company's Board of Directors on the date of the grant of said options.

9. CORPORATE OPPORTUNITIES

In the event that during the Employment Term, any business opportunity related to the Company's business shall come to Shahaf's knowledge, Shahaf shall promptly notify the Company's Board of Directors of such opportunity. Shahaf shall not appropriate for himself or for any other person other than the Company, any such opportunity, except with the express written consent of the Board of Directors, in advance. Shahaf's duty to notify the Company and to refrain from appropriating all such opportunities shall neither be limited by, nor shall duty limit, the application of the general law of Israel relating to the fiduciary duties of an agent or employee.

10. RESERVE DUTY

Immediately upon receipt of a notice of reserve duty, Shahaf shall report such notice to the Company's Board of Directors. Upon Shahaf's return from reserve duty, Shahaf shall deliver to the Company appropriate confirmation of reserve duty served from his military unit, against which the Company shall pay Shahaf his regular compensation package with respect to the period served.

11. MISCELLANEOUS

11.1. ENTIRE AGREEMENT

This Agreement constitutes the entire agreement and understanding between the parties with respect to the subject matters herein, and supersedes and replaces any prior agreements and understandings, whether oral or written between them with respect to such matters. The provisions of this Agreement may be waived, altered, amended or repealed in whole or in part only upon the written consent of both parties to this Agreement.

11.2. NO IMPLIED WAIVERS

The failure of either party at any time to require performance by the other party of any provision hereof shall not affect in any way the right to require such performance at any time thereafter, nor shall the waiver by either party of a breach of any provision hereof be taken or held to be a waiver of any subsequent breach of the same provision or any other provision.

11.3. PERSONAL SERVICES

It is understood that the services to be performed by Shahaf hereunder are personal in nature and the obligations to perform such services and the conditions and covenants of this Agreement cannot be assigned by Shahaf. Subject to the foregoing, and except as otherwise provided herein, this Agreement shall inure to the benefit of and bind the successors and assigns of the Company.

11.4. SEVERABILITY

If for any reason any provision of this Agreement shall be determined to be invalid or inoperative, the validity and effect of the other provisions hereof shall not be affected thereby, provided that no such severability shall be effective if it causes a material detriment to any party.

11.5. APPLICABLE LAW

This Agreement shall be governed by and construed in accordance with the laws of the State of Israel.

11.6. NOTICES

All notices, requests, demands, instructions or other communications required or permitted to be given under this Agreement or related to it shall be in writing and shall be deemed to have been duly given upon delivery, if delivered personally, or if given by prepaid telegram, or mailed first-class postage prepaid, registered or certified mail, return receipt requested, shall be deemed to have been given five (5) days after such delivery, if addressed to the other party at the addresses as set forth on the signature page below. Either party hereto may change the address to which such communications are to be directed by giving written notice to the other party hereto of such change in the manner above provided.

11.7. MERGER, TRANSFER OF ASSETS, OR DISSOLUTION OF THE COMPANY

This Agreement shall not be terminated by any dissolution of the Company resulting from either merger or consolidation in which the Company is not the consolidated or surviving Company or a transfer of all or substantially all of the assets of the Company. In such event, the rights, benefits and obligations herein shall automatically be assigned to the surviving or resulting company or to the transferee of the assets.

11.8. NO CONFLICTING AGREEMENTS

Shahaf declares that he is not bound by any agreement, understanding or arrangement according to which the execution of and compliance with this Agreement may constitute a breach or default.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above.

DSP Semiconductors Ltd.

By: /s/ ELI AYALON /s/ MOSHE SHAHAF

 Eli Ayalon Moshe Shahaf
 Title: CEO AND PRESIDENT

RESCISSION AGREEMENT
BETWEEN IGAL KOHAVI AND DSP GROUP, INC.

THIS RESCISSION AGREEMENT (this "Agreement") made and entered into this 15th day of August, 1996, by and between Mr. Igal Kohavi and DSP Group, Inc., a Delaware corporation ("DSPG").

Whereas Mr. Kohavi and DSP Group, Inc. ("DSPG") made and entered into an employment agreement effective as of November 1, 1995, by which DSPG wished to hire Mr. Kohavi as the Chairman of its Board of Directors (the "Employment Agreement"); and

Whereas Niko Consulting and Management (1995) Ltd. ("Niko"), a company held in equal parts by Igal Kohavi and Nitza Kohavi, and DSP Semiconductors Ltd. ("DSPS"), a wholly-owned subsidiary of DSPG, wish to enter into a services agreement simultaneously with the execution hereof, which agreement provides that Niko will provide through its employee, Igal Kohavi, the management services requisite to chair the Board of Directors of each DSPS and DSPG;

IT IS THEREFORE HEREIN AGREED that the Employment Agreement is hereby rescinded by Mr. Kohavi and DSPG, having no effect whatsoever.

DSP Group, Inc.
a Delaware Corporation

/s/ ELI AYALON

/s/ IGAL KOHAVI

Name: Eli Ayalon
Title: Chief Executive Officer

Igal Kohavi

SERVICE AGREEMENT
BETWEEN NIKO CONSULTING AND MANAGEMENT (1995) LTD.
AND DSP SEMICONDUCTORS LTD.

THIS SERVICE AGREEMENT is made and entered into this 15th day of August, 1996, by and between DSP Semiconductors Ltd., an Israeli company (the "Corporation"), and Niko Consulting and Management (1995) Ltd., an Israeli company (the "Contractor").

RECITAL

The Corporation desires to engage the services of Igal Kohavi ("Kohavi") as the Chairman of the Board of Directors of the Corporation and of the Board of Directors of its parent company, DSP Group, Inc., and the Contractor is willing to make available those services, on the terms and subject to the conditions set forth herein.

AGREEMENT

NOW THEREFORE, the parties hereto hereby agree as follows:

1. DUTIES OF THE PARTIES

- a. General. The Corporation hereby contracts with the contractor to hire the services of Kohavi, and the Contractor hereby agrees to provide those services to the Corporation, on the terms and conditions hereinafter set forth.

It is clearly understood that the services of Kohavi are provided by the Contractor on an independent contractor basis, and that no employer-employee relationship will exist between the Corporation and Kohavi.

- b. Corporation's Duties. The Corporation shall allow Kohavi to, and Kohavi shall, perform responsibilities normally incident to his position as Chairman, commensurate with his background, education, experience and professional standing. The Corporation shall provide Kohavi with the use of a private office, stenographic help, office equipment, supplies, customary services and cooperation suitable for the performance of his duties.
- c. Kohavi's Duties. Unless otherwise agreed to by the parties, Kohavi shall serve as the Corporation's Chairman as well as the Chairman of the Board of Directors of its parent company, DSP Group, Inc. Kohavi shall devote on average thirty (30) hours per week of his productive time, attention, energy, and skill to the business of the Corporation during the service period set forth below. Kohavi shall report directly to the Corporation's Board of Directors. Kohavi is expected to work approximately one hundred twenty (120) days per annum for the Corporation.

2. TERM.

This Agreement shall commence as of October 1, 1995, and shall continue for a period of three (3) years, unless sooner terminated under the terms of this Agreement. Thereafter, this Agreement may be renewed by the Contractor and the Board of Directors of the Corporation and the Board of Directors of its parent company, DSP Group, Inc. (as the case may be) on such terms as the parties may agree to in writing. Absent written notice to the contrary thirty (30) days prior to the end of the service period, this Agreement will be renewed for consecutive one (1) year extensions. As used herein, the term "service period" refers to the entire period of service hereunder, including any agreed-to extension.

3. COMPENSATION

As compensation for the services provided under this agreement, the Corporation shall pay the Contractor sums as follows:

- a. Fixed Payment. A fixed annual sum of Two Hundred and Fifty Thousand Dollars (\$250,000), plus VAT. The Corporation agrees to review the fixed sum following the end of each twelve (12) month period during the service period based upon Kohavi's services and the Corporation's financial results during the calendar year, and to make such increase as may be determined appropriate in the discretion of the Corporation's Board of Directors.
- b. Payment. The above sum shall be payable on a monthly basis.
- c. Bonus Compensation. During the service period, the Corporation shall pay the Contractor a bonus or bonuses at the discretion of the Board of Directors, based on the performance of Kohavi.
- d. The Corporation shall provide Kohavi with Director and Officer Insurance, if reasonably available to the Corporation, similar in coverage and effect to that covering its other officers and directors. Kohavi shall in no event receive less insurance coverage than that available to any other officer or director. The Corporation shall, at a minimum, keep in full force and effect its indemnification agreement previously entered into with Kohavi.

4. EXPENSES.

The Corporation shall reimburse the contractor for Kohavi's normal and reasonable expenses incurred for travel, entertainment and similar items in promoting and carrying out the business of the Corporation in accordance with the Corporation's general policy as adopted by the Corporation's management from time to time. As a condition of reimbursement, the Contractor agrees to provide the Corporation with copies of all available invoices and receipts, and otherwise account to the Corporation

in sufficient detail to allow the Corporation to claim an income tax deduction for such paid item, if such item is deductible. Reimbursements shall be made on a monthly, or more frequent basis. The Corporation shall also reimburse the Contractor for all professional membership dues incurred by Kohavi, if any; all technical books purchased by Kohavi; and all moving and relocation expenses, incurred by Kohavi at the Corporation's request.

5. CONFIDENTIALITY AND COMPETITIVE ACTIVITIES

The Contractor agrees that during the service period, Kohavi will be in a position of special trust and confidence and have access to confidential and proprietary information about the Corporation's business and plans. The Contractor undertakes that Kohavi will not directly or indirectly, either as an employee, employer, consultant, agent, principal, partner, stock-holder, corporate officer, director, or in any similar individual or representative capacity, engage or participate in any business that is in competition with the Corporation. Notwithstanding anything in the foregoing to the contrary, Kohavi shall be allowed to invest as a shareholder in publicly-traded companies, or through a venture capital firm or an investment pool in which he has no active role. As a precondition of his engagement, the Corporation may require Kohavi to personally sign this undertaking.

6. TRADE SECRETS.

- a. Special Techniques. It is hereby agreed that the Corporation has developed or acquired certain products, technology, unique or special methods, manufacturing and assembly processes and techniques, trade secrets, special written marketing plans and special customer arrangements, and other proprietary rights and confidential information and shall during the service period continue to develop, compile and acquire said items (all hereinafter collectively referred to as the "Corporation's Property"). It is expected that Kohavi will gain knowledge of and utilize the Corporation's Property during the course and scope of his engagement with the Corporation, and will be in a position of trust with respect to the Corporation's Property.
- b. Corporation's Property. It is hereby stipulated and agreed that the Corporation's Property shall remain the Corporation's sole property. In the event that this Agreement is terminated, for whatever reason, The Contractor agrees that Kohavi will not copy, make known disclose or use, any of the Corporation's Property without the Corporation's prior written consent which may be unreasonably withheld. In such event, the Contractor further agrees for itself and for Kohavi, not to endeavor or attempt in any way to interfere with or induce a breach of any prior proprietary contractual relationship that the Corporation may have with any employee, customer, contractor, supplier, representative, or distributor for nine (9) months. The Contractor agrees upon termination of his agreement to cause Kohavi to deliver to the Corporation all confidential papers, documents, records,

lists and notes (whether prepared by Kohavi or others) comprising or containing the Corporations' Property. The Corporation recognizes that violation of covenants and agreements contained in this Section 6 may result in irreparable injury to the Corporation which would not be fully compensable by way of money damages. As a precondition of his engagement, the Corporation may require Kohavi to personally sign this undertaking.

- c. Covenant Not to Compete. For a period of one (1) year from the date of any termination of this agreement with the Corporation, the Contractor and/or Kohavi shall not, directly or indirectly, either as an employee, employer, consultant, agent, principal, partner, stockholder, corporate officer, Director, or in any other individual or representative capacity, engage or participate in any activities within the States of Israel and California, which are the same as, or competitive with, the activities in which the Corporation is presently engaged. As a precondition of his engagement, the Corporation may require Kohavi to personally sign this undertaking.

7. TERMINATION

- a. General. The Corporation may terminate this Agreement without cause, by written notice. The Contractor may voluntarily terminate his agreement hereunder upon ninety (90) days' advance written notice to the Corporation.
- b. Termination for Cause. The Corporation may immediately terminate this agreement at any time for cause. Termination for cause shall be effective from the receipt of written notice thereof to the Contractor specifying the grounds for termination and all relevant facts. Cause shall be deemed to include: (i) neglect of Kohavi's duties or a violation of any of the provisions of this Agreement, which continues after written notice and a reasonable opportunity (not to exceed thirty (30) days) in which to cure; (ii) fraud, embezzlement, defalcation or conviction of any felonious offense; or (iii) any intentional imparting of confidential information relating to the Corporation or its business to competitors or to other third parties other than in the course of carrying out of the duties hereunder. The Corporation's exercise of its rights to terminate with cause shall be without prejudice to any other remedy it may be entitled at law, in equity, or under this Agreement.
- c. Termination Upon Death or Disability. This Agreement shall automatically terminate upon Kohavi's death. In addition, if any disability or incapacity of Kohavi to perform his duties as the result of any injury, sickness, or physical, mental or emotional condition continues for a period of thirty (30) business days out of any one hundred twenty (120) calendar-day period, the Corporation may terminate this Agreement upon written notice.

- d. Compensation Upon Termination. Notwithstanding any provisions of this Agreement, the Corporation may terminate this Agreement for any reason. If the Corporation terminates this Agreement without cause (including upon death or disability as specified in paragraph c above), the Corporation shall pay the Contractor an amount equal to the monthly fixed payment at the then-current rate, multiplied by the number nine (9). The Corporation shall not pay any amount of compensation if this Agreement is terminated by the Corporation for cause. If the Contractor voluntarily terminates this agreement no compensation shall be due. In the event of a nonrenewal by the Corporation, the Corporation shall pay to the Contractor as a compensation an amount equal to the fixed monthly payment at the then-current rate, multiplied by the number (6).

8. CORPORATE OPPORTUNITIES.

- a. Duty to Notify. In the event that the Contractor or Kohavi, during the service period, shall become aware of any business opportunity related to the Corporations' digital signal processing business, they shall promptly notify the Corporation's Directors of such opportunity. The Contractor or Kohavi shall not appropriate for themselves, or for any other person other than the Corporation, or any affiliate of the Corporation, any such opportunity unless, as to any particular opportunity, the Board of Directors of the Corporation fails to take appropriate action within thirty (30) days. The Contractor's and Kohavi's duty to notify the Corporation and to refrain from appropriating all such opportunities for thirty (30) days shall neither be limited by nor shall such duty limit, the application of the general law relating to the fiduciary duties of agents or officers.
- b. Failure to Notify. In the event that the Contractor of Kohavi fails to notify the Corporation of, or so appropriates, any such opportunity without the express written consent of the Board of Directors, the Contractor shall be deemed to have violated the provisions of this Section, notwithstanding the following:
 - i. The capacity in which such opportunity was acquired; or
 - ii. The probable success in the Corporation's hands of such opportunity.

9. MISCELLANEOUS

- a. Entire Agreement. This Agreement constitutes the entire agreement and understanding between the parties with respect to the subject matters herein, and supersedes and replaces any prior agreements and understandings, whether oral or written between them with respect to such matters. The provisions of this Agreement may be waived, altered, amended or repealed in whole or in part only upon the written consent of both parties to this Agreement.

- b. No Implied Waivers. The failure of either party at any time to require performance by the other party of any provision hereof shall not affect in any way the right to require such performance at any time thereafter, nor shall the waiver by either party of a breach of any provision hereof be taken or held to be a waiver of any subsequent breach of the same provision or any other provisions.
- c. Personal Services. It is understood that the services to be performed by Kohavi hereunder are personal in nature and the obligations to perform such services and the conditions and covenants of this Agreement cannot be performed by the Contractor through any other person, or assigned by Kohavi. Subject to the foregoing, and except as otherwise provided herein, this Agreement shall inure to the benefit of and bind the successors and assigns of the Corporation.
- d. Indemnity. It is expressly agreed that Kohavi is the employee of the Contractor only. The Contractor undertakes to make all necessary payments to the tax and National Insurance authorities in respect of Kohavi, and further undertakes to immediately indemnify the Corporation for any liability that may be imposed on it for any failure of the Contractor. The Corporation shall be entitled to set off any sum owed to it by the Contractor pursuant to the indemnification obligations under this provision.
- e. Severability. If for any reason any provision of this Agreement shall be determined to be invalid or inoperative, the validity and effect of the other provisions hereof shall not be affected thereby; provided that no such severability shall be effective if it causes a material detriment to any party.
- f. Applicable Law. This Agreement shall be governed by and construed in accordance with the laws of the State of California.
- g. Notices. All notices, requests, demands, instructions or other communications required or permitted to be given under this Agreement shall be in writing and shall be deemed to have been duly given upon delivery, if delivered personally, or if given by prepaid telegram, or mailed first-class, postage prepaid, registered or certified mail, return receipt requested, shall be deemed to have been given seventy-two (72) hours after such delivery, if addressed to the other party at the addresses as set forth on the signature page below. Either party hereto may change the address to which such communications are to be directed by given written notice to the other party of such change in the manner above provided.
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h. Merger, Transfer of Assets, or Dissolution of the Corporation. This Agreement shall not be terminated by any dissolution of the Corporation resulting from either merger or consolidation in which the Corporation is not the consolidated or surviving corporation or a transfer of all or substantially all of the assets of the Corporation. In such event, the rights, benefits and obligations herein shall automatically be assigned to the surviving or resulting corporation or to the transferee of the assets.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above

DSP Semiconductors, Ltd.
and Israeli company

Niko Consulting and Management
an Israeli company (1995) Ltd.

By: /s/ Eli Ayalon

Name: Eli Ayalon
Title: President and CEO

By: /s/ Igal Kohavi

Name: Igal Kohavi
Title: President

Agreed by:

DSP Group, Inc.
a Delaware corporation

By: /s/ Eli Ayalon

Name: Eli Ayalon
Title: President and Chief Executive Officer

I, Igal Kohavi, an employee of Niko Consulting and Management (1995) Ltd., will cause that the Contractor fulfill its obligations under the above Service Agreement and will personally render the services required of the Contractor under the above Services Agreement.

/s/ Igal Kohavi

Igal Kohavi

DSP GROUP, INC.

PRICE RANGE OF COMMON STOCK

The Company's Common Stock (Nasdaq symbol "DSPG") began trading publicly on the Nasdaq National Market on February 11, 1994 in connection with the Company's initial public offering. Prior to that date, there was no public market for the Company's Common Stock. The following table presents for the periods indicated the intraday high and low sale prices for the Common Stock as reported by the Nasdaq National Market.

1996	HIGH	LOW
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First Quarter	\$13.75	\$8.25
Second Quarter	\$15.00	\$8.75
Third Quarter	\$10.50	\$6.75
Fourth Quarter	\$11.25	\$7.38

1995	HIGH	LOW
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First Quarter	\$23.25	\$13.75
Second Quarter	\$26.00	\$19.25
Third Quarter	\$26.00	\$17.50
Fourth Quarter	\$19.25	\$ 7.75

As of December 31, 1996, there were approximately 180 holders of record of the Company's common stock, which the Company believes represents approximately 9,000 beneficial holders. The Company has not paid cash dividends on its common stock and presently intends to follow a policy of retaining any earnings for reinvestment in its business, and in any case, the Company is prohibited from paying dividends until its accumulated deficit of \$12,342,000 is eliminated.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS: 1996

RESULTS OF OPERATIONS

1996 has been a unique year for DSP Group. Results of operations for 1996 must be viewed as a two-phase era divided by the turnaround the Company went through in the second half of 1996. A major setback, showing signs back in the fourth quarter of 1995, affected the first half of 1996, resulting in the decline of product gross margins, accumulation of inventories and negligible operating income.

The second half of 1996 is marked by the introduction of a new management team and the Company's turnaround. Product costs decreased, R&D sensibly redirected and G&A expenses reduced. The turnaround resulted in gradually improving margins which stabilized in the fourth quarter on new profitable levels.

TOTAL REVENUES

Total revenues were \$52.9 million in 1996, \$50.4 million in 1995 and \$28.6 million in 1994, representing an increase over the prior year of 5% for 1996 compared with 76% for 1995. These results reflect the major setback the Company went through, beginning in the fourth quarter of 1995, as well as the marked turnaround performed by the new management in the second half of 1996. This setback was a result of a decline in revenues of TAD speech processors (due to softness in the TAD market caused by declining average selling prices). The new management targeted the high costs of manufacturing and operating expenses and succeeded in reducing both to create higher profits.

Through 1996 the Company maintained its role as a leading supplier of technologically advanced, cost effective speech processors. The Company's future operating results will be dependent upon a variety of factors - see also "Factors Affecting Operating Results" in this report and in Form 10K.

Export sales, primarily consisting of TAD speech processors shipped to manufacturers in Asia and Europe, represented 91%, 81% and 80% of total revenues for the Company in 1996, 1995 and 1994 respectively.

All export sales are denominated in U.S. dollars.

SIGNIFICANT CUSTOMERS

Revenues from a distributor, Tomen Electronics, accounted for 17% of total revenues in 1996 compared to 25% in 1995. Revenues from the Samsung group accounted for 11% of total revenues in 1996.

In 1994 revenues from three customers, Tomen Electronics, RTI Industries (a distributor) and Texas Instruments, accounted for 22%, 16% and 10% of total revenues, respectively. The loss of one or more major distributors or major customers could have an adverse effect on the Company's business, financial condition and results of operations.

GROSS PROFIT

Gross profit as a percentage of total revenues was 42% in 1996, 48% in 1995 and 50% in 1994. The overall decline in gross margin was due to competitive market pricing pressure for TAD products and the setback discussed earlier. In the fourth quarter of 1996 gross margins increased to 44%.

Product gross profit as a percentage of product sales decreased to 29% in 1996 from 40% in 1995 and 35% in 1994. The low margins were primarily due to lower average selling prices which were not accompanied by a reciprocal decrease in product costs. However, product gross margin in the fourth quarter of 1996 increased to 35% from an average gross margin of 26% in the first three quarters.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses increased marginally in 1996 to \$8.5 million from \$8.4 million in 1995. However, through 1997 the Company expects R&D expenses to stabilize on an annual rate of \$8.0 million. This slightly lower level of R&D expenses, achieved while maintaining R&D capacity, is attributable to the consolidation of R&D activities in Israel and elimination of redundancies. The outcome is a closely managed, leaner and better focused research team. Other factors contributing to lower R&D were a reduction in the tape-out counts per chip and a decrease in the cost of materials associated with the Company's development of new speech processors for TAD products and personal computer telephony applications. Research and development expenses as a percentage of total revenues decreased to 16% in 1996 from 17% in 1995.

Research and development expenses increased to \$8.4 million in 1995 from \$4.4 million in 1994. The increase was due primarily to the reinforcement and build up of a stronger R&D work-force to maintain revenues in excess of \$50 million a year. As a result of these increases, research and development expenses as a percentage of total revenues increased to 17% in 1995 from 15% in 1994.

SALES AND MARKETING EXPENSES

Sales and marketing expenses decreased in 1996 to \$4.4 million from \$5.1 million in 1995. The annualized rate for the second half of 1996 was even lower at \$4.1 million. This decrease was due primarily to the consolidation of sales and sales related activities in the U.S., a reduction in sales and marketing personnel including the elimination of redundant managerial layers and strict monitoring of expenses. The above decrease was partially offset by higher marketing expenses in the European office which had started to operate at the end of 1995.

Sales and marketing expenses increased to \$5.1 million in 1995 from \$3.8 million in 1994. The increase was due primarily to expenses associated with increased sales and marketing staff essential for the penetration stage to the market of TAD, DSPCore and TrueSpeech-Registered Trademark- technologies. Sales and marketing expenses as a percentage of total revenues declined to 8% in 1996 from 10% and 13% in 1995 and 1994, respectively.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses increased marginally to \$5.7 million in 1996 from \$5.6 million in 1995. G&A expenses in 1996 contain one time charges associated with the departure of senior management in the Santa Clara office offset by reduced legal expenses. In the second half of 1996 the annualized rate of G&A expenses was \$4.9 million compared to \$6.5 million in the first half.

General and administrative expenses increased to \$5.6 million in 1995 from \$4.1 million in 1994. The increase was due primarily to legal, insurance and other expenses as well as expenses associated with litigation against Rockwell International ("Rockwell") for unfair trade practices. General and administrative expenses as a percentage of total revenues decreased to 11% in 1996 and 1995 from 14% in 1994 due primarily to the growth in total revenues.

UNUSUAL ITEMS

In July 1996 the Company invested \$2.0 million of cash for approximately 40% of the equity interests in Aptel Ltd. ("Aptel"), a related party, which is located in Israel. Aptel is an emerging Company in its product development stage. Aptel has expertise in spread spectrum direct sequence modulation technology, which is applicable to the development of products for two-way paging systems and telemetry applications. In connection with the acquisition, the Company recorded a one-time write-off of acquired in-process R&D technology of \$1.5 million based on an independent estimate of value.

In the second quarter of 1995, the Company decided to sell its 89% equity interest in its subsidiary Nogatech Inc. Accordingly, the Company incurred a charge of \$500,000 to write down Nogatech Inc., to its estimated fair value less costs to sell. In addition, in April 1995, the former chairman of the board resigned to pursue other business interests and the Company incurred \$413,000 of severance expense as a result.

In May 1994, the Company expensed \$1.1 million of acquired research and development obtained in connection with the purchase of all the outstanding stock of Nogatech, Inc., not previously held by the Company amounting to approximately an additional 50% of the then outstanding stock of Nogatech, Inc. In September of 1994, the Company sold its optical disk technology obtained in the purchase of Nogatech to an investor group, and recorded a gain of \$646,000.

OTHER INCOME (EXPENSE)

Interest and other income increased to \$1.6 million in 1996 from \$1.4 million in 1995 and \$1.2 million in 1994. The increase in 1996 and 1995 is a result of higher average cash, cash equivalents and marketable securities balances while the increase in 1994 was attributed to the investment of the proceeds from the Company's initial public offering in February 1994. In the last quarter of 1996, cash and cash equivalents and marketable securities rose by more than

\$9.0 million to \$43.0 million. Other income in 1994 also included \$205,000 of previously unrecognized gains due to adjustments to stockholder notes receivable resulting from changes in the consumer price index.

Equity in loss of unconsolidated subsidiaries was \$457,000, \$212,000 and \$238,000 in 1996, 1995 and 1994 respectively. The increase in 1996 was mainly due to equity loss of Aptel since July of 1996, when the Company acquired a 40% equity ownership interest. Equity in loss of unconsolidated subsidiaries also included amortization of the excess of purchase price over net assets acquired for an equity investment in AudioCodes, Ltd., made in the second quarter of 1994.

GAIN ON SETTLEMENT OF LITIGATION

In October 1996, the Company entered into a settlement agreement with Rockwell International Corporation. As part of the litigation settlement a one time gain of \$3.8 million, net of legal expenses was recorded.

GAIN ON SALE OF STOCK IN AFFILIATE

The Company sold its remaining equity interest in DSP Communications, Inc. ("DSPC"), in DSPC's initial public offering in 1995. DSPC is the successor of a former subsidiary of the Company, DSP Telecommunications, Ltd. The equity interest, which had no book value, was sold for \$1.9 million of cash. In 1994, the Company sold a portion of its equity interest in DSPC for \$1.9 million of cash, including amounts to related parties of \$1.4 million, resulting in a pretax gain of \$1.9 million.

PROVISION FOR INCOME TAXES

The effective tax rate for the years ended December 31, 1996, 1995 and 1994 was 15%, .7% and 8%, respectively. The tax rate for 1996 is greater than 1995 due to decreased benefits from the utilization of net operating loss carry forwards and other deferred tax assets, offset slightly by greater benefits received from tax exempt interest income and foreign tax holidays. In 1995 and 1994, the Company benefited, for federal, state, and Israeli tax purposes, from the utilization of its net operating loss carry forwards as well as the recognition of certain other deferred tax assets in 1995. The tax provision for 1994 consisted primarily of federal alternative minimum tax, and withholding taxes on royalties from an independent foundry.

DSP Semiconductors Ltd. in Israel has been granted "Approved Enterprise" status by the Israel government according to two investment plans. The Approved Enterprise status allows a tax holiday for a period of 2 - 4 years and a corporate tax rate of 10% for additional 6 - 8 years on the respective investment plans' proportionate share of taxable income. The Company believes its effective tax rate may remain lower than the statutory rate in the future due to increased benefits of the Israeli tax holiday.

A net deferred tax asset of approximately \$1.0 million is reflected in the financial statements. Approximately \$3.0 million of the future U.S. taxable income will be necessary to realize this deferred tax asset. While there can be no assurance that future U.S. income will be sufficient to realize this benefit, management is of the opinion that it is more likely than not that this benefit will be realized in the near future based upon projected income. A valuation allowance of approximately \$3.7 million was provided in the financial statements. Approximately, \$2.2 million of the valuation allowance for deferred tax assets is attributable to stock option deductions, the benefit of which will be credited to equity when realized. The remaining valuation allowance relates to U.S. operating losses, tax credit carry forwards, and temporary differences for which the generation of U.S. taxable income in the near future is not projected.

LIQUIDITY AND CAPITAL RESOURCES

OPERATING ACTIVITIES. In 1996, net cash provided by operating activities was \$11.3 million provided primarily by (i) \$6.0 million of net income of which \$3.8 million was derived from the settlement with Rockwell, (ii) \$1.7 million of depreciation and amortization and a \$1.5 million write-off of acquired in-process technology R&D from a related party (iii) a \$1.2 million decrease in deferred income tax and a \$2.6 million decrease in accounts receivable. These were partially offset by (i) a \$1.0 million decrease in accounts payable and (ii) a \$0.6 million decrease in income taxes payable.

It should be noted that cash provided by operating activities for the second half of 1996 was \$13.1 million compared

with \$1.8 million of cash used in operating activities in the first half.

In 1995, net cash provided by operations was \$4.1 million, provided primarily by (i) \$7.2 million of net income of which \$1.9 million was derived from the sale of stock in an affiliate, (ii) \$1.6 million of depreciation and amortization and a \$500,000 non-cash charge to write-down of impaired assets, and (iii) a \$1.3 million increase in income taxes payable. These were partially offset by (i) a \$1.7 million decrease in accounts payable, (ii) a \$1.5 million increase in accounts receivable associated with growth in revenues, (iii) a \$1.0 million increase in inventories to maintain availability of finished TAD products, and (iv) a \$2.2 million increase in deferred income taxes.

In 1994, net cash used in operations was \$356,000, caused primarily by a \$3.9 million increase in accounts receivable associated with the increase in revenues, and a \$2.3 million increase in inventories to maintain availability of finished TAD products and to introduce the Nogavision product line. These uses were partially offset by (i) \$4.0 million of net income, of which \$1.9 million was derived from the sale of stock in an affiliate and \$1.0 million was derived from the reimbursement of expenses and gain on sale of technology to related party in exchange for notes receivable, (ii) a \$2.9 million increase in accounts payable associated with the growth in business, and (iii) a charge to income of \$1.1 million for acquired research and development.

INVESTING ACTIVITIES

In 1996, 1995 and 1994, the Company purchased \$32.2 million, \$28.3 and \$21.0 million, respectively, and sold \$20.6 million, \$18.2 million and \$12.0 million, respectively, of investments classified as marketable securities. Capital equipment additions in 1996, 1995 and 1994 were \$0.8 million, \$3.1 million and \$1.7 million, respectively, for computer hardware and software used in engineering development, engineering test equipment, vehicles, and furniture and fixtures. The 1995 acquisitions of capital equipment were primarily in response to increased headcount and new facility requirements in Israel. The Company capitalized \$173,000, \$265,000 and \$288,000 of software development costs in 1996, 1995 and 1994, respectively.

In July 1996, the Company invested \$2.0 million of cash for approximately 40% of the equity interests in Aptel, a related party. Expenses related to the acquisition were \$158,000. The total cost of the acquisition was allocated to the estimated fair value of the assets acquired, and as a result the Company incurred a one-time write-off of acquired in-process technology of \$1.5 million based on an independent estimate of value. The Company has a two-year option to purchase additional stock from Aptel at the same valuation to enable the Company to increase its ownership interest to 51% in Aptel, and an additional option to acquire the then remaining outstanding stock of Aptel from its shareholders payable at the seller's option in either cash or stock of the Company.

In March 1995 the Company sold all of its shares of DSPC Common Stock in DSPC's initial public offering and in April 1995 upon the exercise of the underwriters' overallotment option. Net proceeds of the sales, after underwriters' commissions, amounted to \$1.9 million in 1995. In 1994, the Company had previously sold a portion of its holding in DSPC for \$1.9 million of cash.

In August, 1995, the Company concluded the sale of its equity interest in Nogatech to two purchasers for \$1.5 million of cash. In addition, in exchange for the receipt from Nogatech of certain fixed assets, reimbursement of post June 30, 1995 cash fundings of Nogatech, a \$400,000 secured promissory note and future sales of certain Nogatech products, the Company issued limited licenses to Nogatech to use certain technology of the Company and canceled all other amounts owed the Company by Nogatech. The Company has attributed \$250,000 of the purchase price to the value of these limited licenses sold to Nogatech based upon the Company's licensing pricing structure.

In 1994, the Company acquired from Scitex Corporation, Ltd, the then remaining 50% of outstanding capital stock of Nogatech, Inc. not previously held by the Company for cash payment of \$2.0 million. Legal, accounting and professional costs associated with the purchase were \$100,000. In 1994, the Company also increased its equity interests in AudioCodes, Ltd., by purchasing common stock directly from AudioCodes for \$1.6 million of cash and purchasing common stock and options from two founders of AudioCodes for \$280,000 of cash to each founder. In 1993, the Company made a \$500,000 investment in AudioCodes. The Company now has a 35% equity interest in AudioCodes.

FINANCING ACTIVITIES

In 1996, the Company received \$0.5 million compared to \$1.9 million and \$2.0 million in 1995 and 1994, respectively, upon the exercise of employee stock options and issuance of Common Stock under the employee stock purchase plan. Repayment of stockholders' notes receivable accounted for \$0.4 million, \$0.7 million and \$0.9 million in 1996, 1995 and 1994, respectively.

The Company's revolving line of credit with a domestic bank provides for borrowings of up to \$2.0 million and expires in June 1997. Amounts borrowed under the line of credit are collateralized by substantially all of the Company's U.S. tangible assets and the Company is also subject to certain financial covenants. At December, 1996, the aggregate amount available to be borrowed under the revolving line of credit was \$2.0 million.

In July 1995, the former Chairman of the Board paid \$1.1 million as full payment on two full-recourse promissory notes and accrued interest. The notes had been issued in 1994 in connection with a warrant exercise and related withholding taxes.

The Company completed its initial public offering in February 1994. Net proceeds, after underwriting commissions and expense associated with the offering, were \$27.6 million. The Company also received cash of \$2.0 million upon the exercises of common stock options and warrants in 1994. In 1994, the Company repaid the \$1.5 million note to a foreign bank as well as repaid \$335,000 owed under a line of credit with the same foreign bank.

At December 31, 1996, the Company's principal source of liquidity consisted of cash and cash equivalents totaling \$12.2 million, marketable securities of \$30.8 million and amounts available under the domestic bank line of credit of \$2.0 million. The Company's working capital at December 31, 1996 was \$47.9 million up from \$39.3 million at December 31, 1995.

The Company believes that its current cash and its available line of credit will be sufficient to meet its cash requirements through at least the next twelve months. The Company has investigated, and continues to investigate, means to acquire greater control over wafer production, whether by joint venture, equity investments in or loans to wafer suppliers. There can be no assurance that the Company will consummate any such transactions. As part of its business strategy, the Company occasionally evaluates potential acquisitions of business, products and technologies. Accordingly, a portion of its available cash may be used for the acquisition of complementary products or business. Such potential transactions may require substantial capital resources, which may require the Company to seek additional debt or equity financing.

FACTORS AFFECTING OPERATING RESULTS

The stockholders' letter and discussion in this annual report concerning the Company's future products, expenses, revenue, liquidity and cash needs as well as the Company's plans and strategies contain forward-looking statements concerning the Company's future operations and financial results. These forward-looking statements are based on current expectations and the Company assumes no obligation to update this information. Numerous factors could cause results to differ from those described in these statements and prospective investors and stockholders should carefully consider the factors set forth below in evaluating these forward-looking statements.

The Company's revenues are derived predominantly from product sales and accordingly vary significantly depending on the volume and timing of product orders. The Company's quarterly operating results also depend on the timing of the recognition of license fees and the level of per unit royalties. The uncertain timing of such license fees has caused, and may continue to cause, quarterly fluctuations in the Company's operating results. The Company's per unit royalties

are dependent upon the success of its original equipment manufacturer ("OEM") licensees in introducing products utilizing the Company's technology and the success of those OEM products in the marketplace. In the fourth quarter of 1995, the first shipment of products utilizing the Company's PinedSPCore technology occurred. However, royalties from such shipments and TrueSpeech have not been significant to date.

The Company's quarterly operating results may fluctuate significantly as demand for TADs varies during the year due to seasonal customer buying patterns, and other factors, including the mix of products sold; fluctuations in the level of sales by OEMs and other vendors of products incorporating the Company's products; changes in general economic conditions; and other factors, including those documented elsewhere in this report.

The Company has experienced and is experiencing a decrease in the average selling prices of its TAD speech processors. During 1996, the Company was able to partially offset this decrease on an annual basis through manufacturing cost reductions and the introduction of new higher priced products with higher performance. However, any inability of the Company to respond to increased price competition for these and other products through the continuing and frequent introduction of new products or reductions of manufacturing costs would have a material adverse effect on the Company's business, financial condition and results of operations. The markets for the Company's products are extremely competitive and the Company expects this competition will increase. The Company's existing and potential competitors in each of its markets include large and emerging domestic and foreign companies, many of which have significantly greater financial, technical, manufacturing, marketing, selling and distribution resources and management expertise than the Company. Sales of TAD products comprise a substantial part of the Company's product sales. Any adverse change in the digital TAD market or the Company's ability to compete and maintain its position in that market would have material adverse effect on the Company's business, financial condition and results of operations.

All of the Company's integrated circuit products are manufactured by independent foundries. While these foundries have been able to adequately meet the demands of the Company's increasing business, the Company is and will continue to be dependent upon these foundries to achieve acceptable manufacturing yields, quality levels and costs, and to allocate to the Company a sufficient portion of foundry capacity to meet the Company's needs in a timely manner. To meet increased wafer requirements, the Company has added additional independent foundries to manufacture its TAD speech processors. The Company believes that it now has sufficient foundry capacity through 1998. Revenues could be materially and adversely affected, however, should any of these foundries fail to meet the Company's request for products due to a shortage of production capacity, process difficulties or low yield rates.

Certain of the raw materials, components and subassemblies included in the products manufactured by the Company's OEM customers, which also incorporate the Company's products, are obtained from a limited group of suppliers. Distribution shortages or termination of certain of these sources of supply could occur. For example, the Company's customers for TAD speech processors have experienced difficulties obtaining sufficient timely supplies of Audio-grade random access memories ("ARAMs") which are included in current digital TADs. These shortages were due to the increasing demand for ARAMs for TAD products, and fluctuations in ARAM production as ARAMs are a by-product in the fabrication of dynamic random access memories ("DRAMs") with ARAM yields varying inversely with the DRAM yield. Supply disruptions, shortages or termination could have an adverse effect on the Company's business and a result of operations due to its customer's delay or discontinuance of orders for the Company's products until such components are available.

The Company's prospects are partially dependent upon the establishment of industry standards for digital speech compression based on TrueSpeech algorithms in the computer telephony markets. This would create an opportunity for the Company to develop and market speech co-processors that provide TrueSpeech solutions and enhance the performance and functionality of products incorporating these co-processors. In the fourth quarter of 1995, the International Telecommunications Union ("ITU") gave final approval to TrueSpeech as the speech compression technology for low bit-

rate video conferencing (G.723.1). For simultaneous voice and data ("DSVD") modems, the ITU has adopted a proposed audio standard based on an existing standard (G.729) sponsored by the University of Sherbrooke rather than a standard based on TrueSpeech. The Company intends to license the speech compression standard selected by the ITU to be included in the Company's DSVD co-processors. The failure to establish industry standards based on TrueSpeech algorithms or to develop and market competitive speech co-processors would have material adverse effect on the Company's business, financial condition and results of operations.

G.723.1 is also one of the speech coders for the H.323 based conferencing applications. This standard provides conferencing capabilities over the packet-based networks, most significantly the Internet and other IP networks. Since G.723.1 is the lowest bit-rate technology in the list of speech coders for this standard, it may be adopted by the industry as the choice of speech coder for the Internet conferencing applications.

As is typical in the semiconductor industry, the Company has been and may from time to time be notified of claims that it may be infringing patents or intellectual property rights owned by third parties. For example, AT&T has asserted that G.723.1, which is primarily composed of TrueSpeech algorithm, includes certain elements covered by patents held by AT&T and has requested that video conferencing manufacturers license such technology from AT&T. Other organizations including Lucent, NTT and VoiceCraft recently raised claims in public that they have patents related to the G.723.1 technology. If it appears necessary or desirable, the Company may seek licenses under such patents or intellectual property rights that it is allegedly infringing. Although holders of such intellectual property rights commonly offer such licenses, no assurances can be given that licenses will be offered or that terms of any offered licenses will be acceptable to the Company. The failure to obtain a license for key intellectual property rights from a third party for technology used by the Company could cause the Company to incur substantial liabilities and to suspend the manufacture of products utilizing the technology used by the Company could cause the Company to incur substantial liabilities and to suspend the manufacture of products utilizing the technology. However, the Company in its licensing activities represents only the four co-developers' patents and intellectual property rights as they relate to the G.723.1 technology. The Company believes that the ultimate resolution of these matters will not have material adverse effect on the Company's financial position and results of operations, or cash flows.

In November 1995, after the Company's stock price declined, several lawsuits were filed in the United States District Court for the Northern District of California accusing the Company, its former Chief Executive Officer, and its former Chief Financial Officer of issuing materially false and misleading statements in violation of the federal securities laws. These lawsuits were consolidated into a single amended complaint in February 1996. In the amended complaint, plaintiffs sought unspecified damages on behalf of all persons who purchased shares of the Company's Common Stock during the period June 6, 1995 through November 10, 1995. On June 11, 1996, the Court granted the Company's motion to dismiss the lawsuit, with leave to amend. The plaintiffs filed an amended complaint on July 11, 1996, and the Court on August 14, 1996, held a hearing on the Company's motion to dismiss the complaint. On March 7, 1997, the Court issued an order dismissing with prejudice all claims based on statements issued by the Company. The Court is permitting the plaintiffs to proceed with their claims regarding statements the Company allegedly made to securities analysts, and is also permitting the plaintiffs to amend their complaint as to their claim that the Company is responsible for the statements contained in analysts' reports. The Company believes the lawsuit to be without merit and intends to defend itself vigorously.

Variety and uncertainty of the factors affecting the Company's operating results, and the fact that the Company participates in a highly dynamic industry, may result in significant volatility in the Company's Common Stock price.

Report of Ernst & Young LLP, Independent Auditors

The Board of Directors and Stockholders
DSP Group, Inc.

We have audited the accompanying consolidated balance sheets of DSP Group, Inc. as of December 31, 1996 and 1995, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of DSP Group, Inc. at December 31, 1996 and 1995, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles.

/s/ Ernst & Young LLP

San Jose, California
January 26, 1997,
except for Stockholders' Litigation under
Note 5, as to which the date is
March 7, 1997

DSP GROUP, INC.

CONSOLIDATED BALANCE SHEETS

	DECEMBER 31,	
	1996	1995

	(IN THOUSANDS, EXCEPT PER	
	SHARE AMOUNTS)	

ASSETS		
Current assets:		
Cash and cash equivalents	\$12,172	\$14,679
Marketable securities	30,762	19,149
Accounts receivable, less allowance for returns and doubtful accounts of \$636 in 1996 and \$613 in 1995	4,833	7,461
Accounts and notes receivable from related parties and officers	28	668
Inventories	2,957	3,000
Deferred income taxes	500	784
Prepaid expenses and other current assets	1,357	876

Total current assets	52,609	46,617
Property and equipment, at cost:		
Computer equipment	5,985	5,518
Furniture and fixtures and other	1,040	718
Leasehold improvements	299	452

	7,324	6,688
Less accumulated depreciation and amortization		
	4,033	2,591

	3,291	4,097
Investments in unconsolidated subsidiaries, net of accumulated amortization of \$695 in 1996 and \$409 in 1995 relating to excess of purchase price over net assets acquired		
	2,415	2,244
Other assets, net of accumulated amortization of \$284 in 1996 and \$98 in 1995		
	388	507
Deferred income taxes	504	1,389

Total assets	\$59,207	\$54,854

See accompanying notes.

DSP GROUP, INC.

CONSOLIDATED BALANCE SHEETS (continued)

	DECEMBER 31,	
	1996	1995

	(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,428	\$ 2,437
Accrued compensation and benefits	1,739	1,891
Income taxes payable	908	1,517
Accrued royalties	176	547
Deferred revenue	-	50
Accrued expenses and other	507	871

Total current liabilities	4,758	7,313
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value:		
Authorized shares - 5,000		
Issued and outstanding shares - none	-	-
Common stock, \$0.001 par value:		
Authorized shares - 20,000		
Issued and outstanding shares - 9,540 in 1996 and 9,439 in 1995	10	9
Additional paid-in capital	66,781	66,287
Stockholders' notes receivable	-	(434)
Accumulated deficit	(12,342)	(18,321)

Total stockholders' equity	54,449	47,541

Total liabilities and stockholders' equity	\$59,207	\$54,854

See accompanying notes.

DSP Group, Inc.

Consolidated Statements of Income

	YEARS ENDED DECEMBER 31,		
	1996	1995	1994

	(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)		
Revenues:			
Product sales	\$41,290	\$41,425	\$20,170
Licensing, royalties, and other (includes related party revenues of \$1,709 in 1996, \$884 in 1995, and \$308 in 1994)	11,620	9,012	8,434

Total revenues	52,910	50,437	28,604
Cost of revenues:			
Cost of product sales	29,432	24,775	13,083
Cost of licensing, royalties, and other (includes related party costs of \$355 in 1996 and \$179 in 1995)	1,096	1,308	1,146

Total cost of revenues	30,528	26,083	14,229

Gross profit	22,382	24,354	14,375
Operating expenses:			
Research and development (includes related party expenses of \$269 in 1996, \$127 in 1995, and \$672 in 1994)	8,481	8,396	4,350
Sales and marketing (includes related party expenses of \$0 in 1996, \$85 in 1995, and \$2 in 1994)	4,429	5,135	3,779
General and administrative (includes related party expenses of \$0 in 1996, \$34 in 1995, and \$100 in 1994)	5,669	5,624	4,074
Unusual items	1,529	913	458

Total operating expenses	20,108	20,068	12,661

Operating income	2,274	4,286	1,714
Other income (expense):			
Interest and other income	1,627	1,399	1,214
Interest expense and other	(158)	(102)	(142)
Gain on settlement of litigation, net of expenses	3,750	-	-
Equity in income (loss) of unconsolidated subsidiaries, net of amortization of goodwill of \$286 in 1996, \$273 in 1995, and \$136 in 1994	(457)	(212)	(238)
Gain on sale of stock in affiliated company (includes gain on sale to related party of \$1,351 in 1994)	-	1,893	1,851

Income before provision for income taxes	7,036	7,264	4,399
Provision of income taxes	1,057	53	367

Net income	\$ 5,979	\$ 7,211	\$ 4,032

Net income per share	\$ 0.62	\$ 0.75	\$ 0.44
Shares used in per share computation	9,581	9,658	9,135

See accompanying notes.

DSP GROUP, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	CONVERTIBLE PREFERRED STOCK		COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	STOCKHOLDERS' NOTES RECEIVABLE	ACCUMULATED DEFICIT	TOTAL STOCKHOLDERS' EQUITY
	SHARES	AMOUNT	SHARES	AMOUNT				
(IN THOUSANDS)								
Balance at December 31, 1993	3,446	\$ 4	2,705	\$ 3	\$32,952	\$(878)	\$(29,564)	\$ 2,517
Exercise of Common Stock options by employees and third parties for cash and notes receivable	-	-	395	-	2,001	(181)	-	1,820
Sale of Common Stock for cash upon exercise of warrants	-	-	63	-	132	-	-	132
Exercise of Common Stock warrants in exchange for notes receivable and cash	-	-	141	-	427	(425)	-	2
Conversion of Preferred Stock to Common Stock	(3,446)	(4)	3,512	4	-	-	-	-
Cashless exercise of warrants	-	-	83	-	-	-	-	-
Sale of Common Stock, net of issuance costs	-	-	2,300	2	27,639	-	-	27,641
Repayments on notes	-	-	-	-	-	862	-	862
Consumer price index adjustment	-	-	-	-	-	(205)	-	(205)
Net income	-	-	-	-	-	-	4,032	4,032
Balance at December 31, 1994	-	-	9,199	9	63,151	(827)	(25,532)	36,801
Exercise of Common Stock options by employees and third parties for cash and notes receivable	-	-	224	-	1,986	(313)	-	1,673
Compensation expense upon acceleration of stock option vesting	-	-	-	-	130	-	-	130
Sale of Common Stock under employee stock purchase plan	-	-	16	-	222	-	-	222
Income tax benefit from stock options exercised	-	-	-	-	798	-	-	798
Payments on notes receivable from stockholders	-	-	-	-	-	706	-	706
Net income	-	-	-	-	-	-	7,211	7,211
Balance at December 31, 1995	-	-	9,439	9	66,287	(434)	(18,321)	47,541
Exercise of Common Stock options by employees	-	-	77	1	283	-	-	284
Sale of Common Stock under employee stock purchase plan	-	-	24	-	211	-	-	211
Payments on notes receivable from stockholders	-	-	-	-	-	434	-	434
Net income	-	-	-	-	-	-	5,979	5,979
Balance at December 31, 1996	-	\$ -	9,540	\$10	\$66,781	\$ -	\$(12,342)	\$54,449

See accompanying notes.

DSP GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEARS ENDED DECEMBER 31,		
	1996	1995	1994

	(IN THOUSANDS)		
OPERATING ACTIVITIES			
Net income	\$ 5,979	\$ 7,211	\$ 4,032
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,729	1,551	911
Amortization of software development costs	185	98	-
Loss (gain) on disposal of equipment	-	(30)	22
Deferred revenue	(50)	(53)	(78)
Deferred income tax	1,169	(2,173)	-
Reimbursement of expenses and gain on sale of technology to related party	-	-	(977)
Gain on sale of stock of affiliated company	-	(1,893)	(1,851)
Gain on write-off of deferred rent	(380)	-	-
Consumer price index and foreign currency translation adjustments to stockholders' notes receivable	-	-	(205)
Acquired research and development from related party	1,529	-	1,104
Equity in (income) loss of unconsolidated subsidiaries	171	(61)	96
Write-down/write-off of assets	290	500	-
Write-off of capitalized software development cost	31	89	-
Compensation expense upon acceleration of stock option vesting	-	130	-
Changes in operating assets and liabilities:			
Accounts receivable	2,628	(1,521)	(3,861)
Accounts and notes receivable from related parties	640	742	(743)
Inventories	43	(1,044)	(2,317)
Prepaid expenses and other current assets	(481)	(297)	1,005
Other assets	(14)	41	(142)
Accounts payable	(1,009)	(1,673)	2,889
Accrued compensation and benefits	(152)	600	17
Income taxes payable	(609)	1,344	133
Accrued royalties	(371)	249	(188)
Accrued expenses and other	16	335	(203)
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Net cash provided by (used in) operating activities	11,344	4,145	(356)

See accompanying notes.

DSP GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

	YEARS ENDED DECEMBER 31,		
	1996	1995	1994

(IN THOUSANDS)			
INVESTING ACTIVITIES			
Purchase of available-for-sale marketable securities	\$(32,217)	\$(28,310)	\$(21,009)
Sale of available-for-sale marketable securities	20,604	18,171	12,000
Purchases of equipment	(836)	(3,060)	(1,664)
Sale of equipment	-	75	40
Purchase of Nogatech, Inc., net of cash acquired	-	-	(2,034)
Sale of Nogatech, Inc.	-	1,259	-
Equity investment in AudioCodes, Ltd.	-	-	(2,194)
Sale of stock of affiliated company	-	1,893	1,851
Equity investment in Aptel Ltd.	(2,158)	-	-
Capitalized software development costs	(173)	(265)	(288)
Payment on note receivable issued in connection with reimbursement of expenses and sale of technology to related party	-	-	250

Net cash used in investing activities	(14,780)	(10,237)	(13,048)

FINANCING ACTIVITIES			
Line of credit	-	5	(165)
Repayments of debt and notes payable to related parties	-	-	(1,540)
Sale of Common Stock for cash upon exercise of options, warrants, and employee stock purchase plan	495	1,895	1,954
Sale of Common Stock, net of issuance costs	-	-	27,641
Repayment of stockholders' notes receivable	434	706	862
Income tax benefit from stock option exercises	-	798	-

Net cash provided by financing activities	929	3,404	28,752

Increase (decrease) in cash and cash equivalents	(2,507)	(2,688)	15,348
Cash and cash equivalents at beginning of year	14,679	17,367	2,019

Cash and cash equivalents at end of year	\$ 12,172	\$ 14,679	\$ 17,367

See accompanying notes.

DSP GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

	YEARS ENDED DECEMBER 31,		
	1996	1995	1994

	(IN THOUSANDS)		
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Cash paid during the period for:			
Interest expense	\$ 17	\$ 7	\$ 49
Income taxes	\$372	\$221	\$ 73
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES			
Issuance of Common Stock in exchange for notes receivable, net of repurchases	\$ -	\$313	\$181
Exercise of Common Stock warrants in exchange for notes payable	\$ -	\$ -	\$425
Conversion of Preferred Stock into Common Stock	\$ -	\$ -	\$ 4

See accompanying notes.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1996

1. BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

DSP Group, Inc. (the "Company") is engaged in the development of high-performance, cost-effective DSP-based software and integrated circuits for digital speech products targeted at the convergence of the personal computer, communications, and consumer electronics markets. The Company has three wholly owned subsidiaries: DSP Semiconductors Ltd. (DSP Semiconductors Israel), an Israeli corporation primarily engaged in VLSI design; Nihon DSP K.K. (DSP Japan), a Japanese corporation primarily engaged in marketing and sales; and DSP Group Europe SARL, a French corporation primarily engaged in marketing and sales.

CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly and majority owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

USE OF ESTIMATES

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

REVENUE RECOGNITION

PRODUCT SALES

Product sales relate to shipments of speech processors for digital telephone answering machines. Revenue is recognized upon shipment. The Company has no ongoing commitments after shipment other than for warranty and sales returns/exchanges by distributors. The Company accrues estimated sales returns/exchanges upon recognition of sales. The Company has not experienced significant warranty claims to date, and accordingly, the Company provides for the cost of warranty when specific problems are identified.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

REVENUE RECOGNITION (CONTINUED)

LICENSING AND ROYALTY REVENUES

Licensing revenues, including technology revenues, are generally recognized on shipment by the Company provided that no significant vendor or post-contract support obligations remain outstanding and collection of the resulting receivable is deemed probable. Insignificant vendor and post-support obligations are accrued upon shipment. Certain royalty agreements provide for per unit royalties to be paid to the Company based on shipments by customers of units containing the Company's products. Revenue under such agreements is recognized at the time of shipment by the customer.

EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Depreciation and amortization are provided using the straight-line method over the estimated useful lives of the assets, which range from three to seven years, or the life of the lease, whichever is shorter.

INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out method) or market and are composed of the following:

	DECEMBER 31,	
	1996	1995
	(IN THOUSANDS)	
Raw materials	\$ -	\$ 2
Work-in-process	217	28
Finished goods	2,740	2,970
	<u>\$2,957</u>	<u>\$3,000</u>

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

EQUITY INVESTMENTS

The Company has investments in two companies which are accounted for under the equity method.

AUDIOCODES, LTD.

The Company has a 35% ownership interest in AudioCodes, Ltd. (AudioCodes), an Israeli corporation primarily engaged in DSP-related contract engineering relating to speech and audio algorithm technologies. In 1993, the Company purchased stock of AudioCodes for a total cost of \$500,000, representing a 26% equity interest. In 1994, the Company acquired additional stock representing approximately a 9% equity interest for \$2,172,000 in cash. The Company purchased this stock directly from AudioCodes for \$1,612,000 in cash and from two founders of AudioCodes for \$280,000 in cash to each individual. The Company also obtained options to purchase an additional 5% of the outstanding stock of AudioCodes.

The Company accounts for its ownership in AudioCodes using the equity method. The investment amount includes the excess of purchase price over net assets acquired (approximately \$1,907,000 at the date of purchase), which was attributed to developed technology, and is being amortized over a seven-year period. The Company contributed almost all of the cash of AudioCodes, and as such, it will record 100% of any cumulative losses incurred by AudioCodes from the date of the Company's investment. If AudioCodes has cumulation profits from the date of the Company's investment, the Company will record only its percentage share of earnings. The Company and AudioCodes have joint ownership of any speech-related technology developed by AudioCodes, and the Company has a license to such technology in exchange for quarterly license fees and royalties payable by the Company to AudioCodes. The Company's equity in the net income (loss) of AudioCodes was \$36,000 in 1996, \$61,000 in 1995, and \$(102,000) in 1994. As of December 31, 1996, the difference in the investment in AudioCodes and the Company's proportionate share of net assets is \$1,269,000, primarily related to the unamortized portion of developed technology.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

EQUITY INVESTMENTS (CONTINUED)

APTEL LTD.

In July 1996, the Company invested \$2,000,000 of cash for approximately 40% of the equity interests in Aptel Ltd. (Aptel), which is located in Netanya, Israel. Aptel is an emerging company in its product development stage. Aptel has expertise in spread spectrum direct sequence modulation technology, which is applicable to the development of products for two-way paging systems and telemetry applications. Expenses related to the acquisition were \$158,000. In accordance with Accounting Principles Board Opinion No. 16, the total cost of the acquisition was allocated to the estimated fair value of the assets acquired, and as a result, the Company incurred a one-time write-off of acquired in-process technology of \$1,529,000 based on an independent estimate of value.

The Company has a two-year option to purchase additional stock from Aptel at the same price to enable the Company to increase its ownership interest to 51% and an additional option to acquire the then remaining outstanding stock of Aptel from its stockholders payable at the seller's option in either cash or stock of the Company. Igal Kohavi, Chairman of the Company, is Chairman of Polaris Venture Capital Fund which, together with other associated parties under its leadership, held an approximate 70% equity interest in Aptel prior to the Company's investment, and is a director of Aptel. The Company's equity in the net losses of Aptel, including amortization of related intangibles, was \$221,000 in 1996. As of December 31, 1996, the difference between the Company's recorded investment in Aptel and its proportionate share of net assets is \$53,000.

FOREIGN CURRENCY TRANSACTIONS

Foreign operations are measured using the U.S. dollar as the functional currency. Accordingly, monetary accounts (principally cash, receivables, and liabilities) are remeasured using the foreign exchange rate at the balance sheet date. Operations accounts and nonmonetary balance sheet accounts are remeasured at the rate in effect at the date of transaction. The effects of foreign currency remeasurement are reported in current operations and have not been significant to date.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

NET INCOME PER SHARE

Net income per share is computed using the weighted average number of shares of Common Stock and dilutive common equivalent shares from Convertible Preferred Stock (using the if-converted method). Net income per share includes the dilutive effect of stock options and warrants (using the treasury stock method). Fully diluted earnings per share is not presented because it is not significantly different than primary earnings per share.

CONCENTRATION OF CREDIT RISK

Financial instruments that subject the Company to credit risk consist principally of cash, cash equivalents, marketable securities, and trade receivables. By policy, the Company places its cash, cash equivalents, and marketable securities only with high-credit quality financial institutions and corporations and, other than U.S. Government Treasury instruments, limits the amounts invested in any one institution or type of investment. The majority of the Company's product sales are to distributors who in turn sell to manufacturers of consumer electronics products. The Company's licensing revenues are primarily from customers that have licensed rights to use the Company's DSPCore microprocessor architectures and speech compression technology. No collateral is required from the Company's customers; however, some of the customers pay using letter of credit. Write-offs for bad debts have not been significant to date.

CONCENTRATION OF OTHER RISKS

Sales of TAD products comprise a substantial portion of the Company's product sales. Any adverse change in the digital TAD market or the Company's ability to compete and maintain its position in that market would have a material adverse effect on the Company's business, financial condition, and results of operations. The Company's operating results also depend on the timing of the recognition of license fees and the level of per unit royalties. During 1997, the Company expects that revenues from its DSPCore designs and TrueSpeech will continue to be derived primarily from license fees rather than per unit royalties. However, the uncertain timing of such license fees may continue to cause fluctuations in the Company's operating results. The Company's royalties from such products are totally dependent upon the success of its original equipment manufacturer (OEM) licenses in introducing these products and the success of such products in the marketplace.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CONCENTRATION OF OTHER RISKS (CONTINUED)

All of the Company's integrated circuit products are manufactured by independent foundries. While these foundries have been able to adequately meet the demands of the Company's business, the Company is and will continue to be dependent upon these foundries to achieve acceptable manufacturing yields, quality levels, costs, and to allocate to the Company sufficient foundry capacities to meet the Company's needs in a timely manner. Revenues could be materially and adversely affected should any of these foundries fail to meet the Company's request for products due to a shortage of production capacity, process difficulties, or low yield rates. Certain of the raw materials, components, and subassemblies included in the products manufactured by the Company's OEM customers, which also incorporate the Company's products, are obtained from a limited group of suppliers. Disruptions, shortages, or termination of certain of these sources of supply could occur.

ACCOUNTS AND NOTES RECEIVABLE FROM RELATED PARTIES AND OFFICERS

Accounts and notes receivable from related parties and officers included \$400,000 of notes receivable from related parties at December 31, 1995. Such notes receivable were repaid in full in fiscal 1996.

NOTES FROM OFFICERS

In July 1995, the Company accepted from the former Chairman a \$383,000 full-recourse promissory note as consideration for his exercise of an option to purchase 22,000 shares of Common Stock and payment for related withholding taxes. The note's interest rate was prime plus 1% per annum (9.75% at December 31, 1995). The former Chairman paid \$70,000 of principal in September 1995 and paid the remaining principal and interest in February 1996. In August 1994, the Company agreed to accept from its former Chairman a \$425,000 full-recourse promissory note bearing interest at 6.5% per annum, due in August 1997, as consideration for a warrant exercise of approximately 141,000 shares of Common Stock and a \$592,000 full-recourse promissory note bearing interest at 8.76% per annum, due in August 1995, for withholding taxes on this exercise. Both notes were repaid in 1995.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CASH EQUIVALENTS

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. The carrying amount (at cost) of cash and cash equivalents as of December 31, 1995 and 1996 approximates fair value (quoted market price).

SECURITIES AVAILABLE-FOR-SALE

All debt and equity securities have been designated as available-for-sale under Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (FAS 115). The amortized cost of available-for-sale debt securities is adjusted for the amortization of premiums and accretion of discounts to maturity. Such amortization is included in investment income. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in investment income. The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in interest and other income.

The following is a summary of available-for-sale securities at December 31, 1996 and 1995:

	AMORTIZED COST	
	1996	1995
	(IN THOUSANDS)	
Obligations of states and political subdivisions	\$16,891	\$14,753
Municipal auction rate preferred stock	2,200	4,400
Corporate obligations	19,301	-
Other	-	636
	\$38,392	\$19,789
	=====	
Amounts included in marketable securities	\$30,762	\$19,149
Amounts included in cash and cash equivalents	7,630	640
	\$38,392	\$19,789
	=====	

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

SECURITIES AVAILABLE-FOR-SALE (CONTINUED)

At December 31, 1996 and 1995, the carrying amount of securities approximated the fair value (quoted market price), and the amount of unrealized gain or loss was not significant. Gross realized gains or losses for 1996, 1995, and 1994 were not significant.

The amortized cost of available-for-sale debt securities at December 31, 1996, by contractual maturities, are shown below:

	AMORTIZED COST

	(IN THOUSANDS)
Due in one year or less	\$31,196
Due after one year to eighteen months	4,996

	\$36,192
	=====

CAPITALIZED SOFTWARE DEVELOPMENT COSTS

The Company capitalizes software development costs beginning at the time technological feasibility is determined to have occurred using either the detailed program design or working model approach. Capitalized software development costs are stated at the lower of cost or net realizable value and are amortized on a straight-line basis over the greater of their estimated economic life, generally from two to five years, or the ratio of current revenues to estimated current and future revenues for the software products.

RECLASSIFICATIONS

Certain reclassifications have been made to the 1994 and 1995 consolidated financial statements to conform to the 1996 presentation.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

GAIN ON SETTLEMENT OF LITIGATION

In October 1996, the Company entered into agreements with Rockwell International, Inc. (Rockwell) to license certain of the Company's TrueSpeech speech technologies and to settle all pending litigation between the companies. In connection with the litigation settlement in fiscal 1996, the Company recorded in other income a one time gain on settlement of litigation, net of expenses of \$3,750,000.

2. STOCKHOLDERS' EQUITY

PUBLIC OFFERING

In February 1994, the Company sold a total of 2,300,000 shares of Common Stock at \$14.00 per share through its initial public offering. The net proceeds (after underwriters' commissions and fees and other costs associated with the offering) totaled \$27,641,000. In connection with the offering, all Convertible Preferred Stock totaling 3,446,000 shares with an aggregate paid-in value of \$29,535,000 was converted into 3,512,000 shares of Common Stock of the Company. At December 31, 1996, the Company had an accumulated deficit of approximately \$12,342,000 and, until this deficit is eliminated, will be prohibited from paying dividends.

PREFERRED STOCK

The Board of Directors has the authority, without any further vote or action by the stockholders, to provide for the issuance of up to 5,000,000 shares of Preferred Stock in one or more series with such designations, rights, preferences, and limitations as the Board of Directors may determine, including the consideration received, the number of shares comprising each series, dividend rates, redemption provisions, liquidation preferences, sinking fund provisions, conversion rights, and voting rights.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. STOCKHOLDERS' EQUITY (CONTINUED)

STOCK PURCHASE PLAN, STOCK OPTION PLANS, AND WARRANTS

The Company has various stock plans under which employees, consultants, officers, and directors may be granted options to purchase the Company's Common Stock. A summary of the various plans is as follows:

1991 EMPLOYEE AND CONSULTANT STOCK PLAN

In 1991, the Company adopted the 1991 Employee and Consultant Stock Plan (the 1991 Plan). Under the 1991 Plan, employees and consultants may be granted incentive or nonqualified stock options or stock purchase rights for the purchase of the Company's Common Stock. The 1991 Plan expires in 2001 and currently provides for the purchase of up to 2,800,000 shares of the Company's Common Stock.

The exercise price of options under the 1991 Plan shall not be less than the fair market value of the Common Stock for incentive stock options and not less than 85% of the fair market value of the Common Stock for nonqualified stock options, as determined by the Board of Directors.

Options under the 1991 Plan are generally exercisable over a 48-month period beginning twelve months after issuance or as determined by the Board of Directors. Options under the 1991 Plan expire five years after the date of grant.

During October 1995, employees and officers holding options to purchase shares of the Company's Common Stock were offered the opportunity to exchange their existing options for the same number of options at the then current market price. Under the terms of the program, options to purchase 395,000 shares of the Company's Common Stock were exchanged and are reflected in grant and cancellation activity for fiscal 1995.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. STOCKHOLDERS' EQUITY (CONTINUED)

STOCK PURCHASE PLAN, STOCK OPTION PLANS, AND WARRANTS (CONTINUED)

DIRECTORS' PLAN

The Directors' Stock Option Plan (the Directors' Plan) was adopted in January 1994. Under the Directors' Plan the Company is authorized to issue nonqualified stock options to purchase up to 175,000 shares of the Company's Common Stock at an exercise price equal to the fair market value of the Common Stock on the date of grant. The Directors' Plan provides that each person who is an outside director on the effective date of the Directors' Plan and each outside director who subsequently becomes a member of the Board of Directors shall automatically be granted an option to purchase 8,000 shares (the First Option). Additionally, each outside director shall automatically be granted an option to purchase 2,000 shares (a Subsequent Option) on January 1 of each year if, on such date, he/she shall have served on the Board of Directors for at least six months.

In May 1996, the stockholders approved certain amendments to the plan to increase the First Option grant from 8,000 shares to 15,000 shares. In addition, Subsequent Option grants were increased from 2,000 shares to 5,000 shares commencing with the grants to be made on January 1, 1997.

Options granted under the Directors' Plan generally have a term of ten years. The First Option is exercisable 25% after the first year (one-third after the first year for options granted after May 1996) and in quarterly installments over the ensuing three years (one-third at the end of each twelve-month period for options granted after May 1996). Each Subsequent Option becomes exercisable in full on the fourth anniversary from the date of grant (one-third at the end of each twelve-month period from the date of grant for options granted after May 1996).

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. STOCKHOLDERS' EQUITY (CONTINUED)

STOCK PURCHASE PLAN, STOCK OPTION PLANS, AND WARRANTS (CONTINUED)

1993 ISRAELI PLAN

In 1993, the Company adopted the DSP Group, Inc. Israeli Stock Option Plan (the 1993 Israeli Plan) under which the Company is authorized to issue nonqualified stock options to purchase up to 167,000 shares of the Company's Common Stock at an exercise price equivalent to fair market value. Options are immediately exercisable and expire five years from the date of grant. All options and shares are held in a trust until the later of 24 months from the date of grant or the shares are vested based on a vesting schedule determined by a committee appointed by the Board of Directors. Nonvested shares are subject to repurchase by the Company at the original issuance price.

A summary of activity under the U.S. Plan, the 1993 Israeli Plan, and the Directors' Plan is as follows:

	OPTIONS OUTSTANDING		
	SHARES AVAILABLE FOR GRANT	SHARES UNDER OPTION	PRICE PER SHARE
----- (SHARES IN THOUSANDS)			
Balance at December 31, 1993	269	556	\$ 1.80 - \$ 9.75
Authorized	600	-	\$ -
Granted	(754)	754	\$11.00 - \$22.50
Exercised	-	(392)	\$ 1.80 - \$14.00
Canceled	29	(29)	\$ 1.80 - \$14.00

Balance at December 31, 1994	144	889	\$ 1.80 - \$22.50
Authorized	500	-	\$ -
Granted	(902)	902	\$15.13 - \$24.25
Exercised	-	(224)	\$ 1.80 - \$15.40
Canceled	505	(505)	\$ 1.80 - \$24.25

Balance at December 31, 1995	247	1,062	\$ 1.80 - \$24.25

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. STOCKHOLDERS' EQUITY (CONTINUED)

STOCK PURCHASE PLAN, STOCK OPTION PLANS, AND WARRANTS (CONTINUED)

	OPTIONS OUTSTANDING		
	SHARES AVAILABLE FOR GRANT	SHARES UNDER OPTION	WEIGHTED AVERAGE EXERCISE PRICE
Balance at December 31, 1995	247	1,062	1.80 - \$24.25
Authorized	875	-	\$ -
Granted	(990)	990	\$9.61
Exercised	-	(77)	\$3.71
Canceled	500	(500)	\$13.00
Balance at December 31, 1996	632	1,475	\$10.94

A summary of the Company's stock option activity and related information for the year ended December 31, 1996, is as follows:

RANGE OF EXERCISE PRICES	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
	NUMBER OF OUTSTANDING DECEMBER 31, 1996	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER OF EXERCISABLE AS OF DECEMBER 31, 1996	WEIGHTED AVERAGE EXERCISE PRICE
\$ 1.80 - \$ 7.99	246,596	4.91	\$ 6.90	52,026	\$ 4.18
\$ 8.00 - \$ 9.99	356,258	4.81	\$ 8.45	22,350	\$ 9.75
\$10.00 - \$14.99	656,544	4.07	\$12.27	201,831	\$13.10
\$15.00 - \$24.25	215,635	3.66	\$15.25	99,091	\$15.25
\$ 1.80 - \$24.25	1,475,033	4.33	\$10.94	375,298	\$12.29

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. STOCKHOLDERS' EQUITY (CONTINUED)

STOCK PURCHASE PLAN, STOCK OPTION PLANS, AND WARRANTS (CONTINUED)

EMPLOYEE STOCK PURCHASE PLAN

Upon the closing of the Company's initial public offering, the Company adopted the 1993 Employee Stock Purchase Plan (the 1993 Purchase Plan). An aggregate of 350,000 shares of the Company's Common Stock have been reserved for issuance under the 1993 Purchase Plan. The 1993 Purchase Plan provides that substantially all employees may purchase stock at 85% of its fair market value on specified dates via payroll deductions. There were approximately 24,000 shares issued under the 1993 Purchase Plan in 1996, 16,000 in 1995, and none in 1994.

COMMON STOCK RESERVED FOR FUTURE ISSUANCE

Shares of Common Stock of the Company reserved for future issuance at December 31, 1996 are as follows:

	1996
	----- (IN THOUSANDS)
Employee Stock Purchase Plan	310
Stock Options	2,107
Undesignated Preferred Stock	5,000
	----- 7,417 =====

STOCK-BASED COMPENSATION

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB Opinion No. 25) and related interpretations in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (FAS 123), requires the use of option valuation models that were not developed for use in valuing employee stock options. Under APB Opinion No. 25, because the exercise price of the Company's stock options generally equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. STOCKHOLDERS' EQUITY (CONTINUED)

STOCK-BASED COMPENSATION (CONTINUED)

Pro forma information regarding net income and earnings per share is required by FAS 123 which also requires that the information be determined as if the Company has accounted for its employee stock options granted subsequent to December 31, 1994 under the fair value method of FAS 123. The fair value of these options was estimated at the date of grant using a Black-Scholes multiple option pricing model with the following weighted average assumptions: risk-free interest rates of 6.10% and 6.30% for 1996 and 1995, respectively; a dividend yield of 0.0%; a volatility factor of the expected market price of the Company's Common Stock of 0.55; and a weighted average expected life of the option of 3.6 years. The weighted average net fair value of options granted in 1996 and 1995 was \$4.53 per share and \$6.58 per share, respectively.

The Company does not recognize compensation cost related to employee purchase rights under the Employee Stock Purchase Plan. To comply with the pro forma reporting requirements of FAS 123, compensation cost is estimated for the fair value of the employees' purchase rights using the Black-Scholes model with the following assumptions for those rights granted in 1995 and 1996; dividend yield of 0.0%; an expected life ranging up to 0.5 years; expected volatility factor of 0.55; and a risk free interest rate of 5.72%. The weighted average fair value of those purchase rights granted in January 1995, July 1995, January 1996, and July 1996 were \$6.29, \$10.96, \$2.99, and \$2.46, respectively.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options and because changes in the subjective assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. STOCKHOLDERS' EQUITY (CONTINUED)

STOCK-BASED COMPENSATION (CONTINUED)

Had compensation cost for the Company's stock-based compensation plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method of FAS 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

	1996	1995

	(IN THOUSANDS, EXCEPT PER SHARE DATA)	
Pro forma net income	\$2,843	\$5,112
Pro forma earnings per share	\$ 0.31	\$ 0.53

For pro forma disclosure under FAS 123, the repricing of stock options in October 1995 is treated as a modification of an award. Any additional compensation arising from the modification is recognized over the remaining vesting period of the new grant. FAS 123 is effective for options granted by the Company commencing January 1, 1995. All options granted before January 1, 1995 have not been valued and no pro forma compensation expense has been recognized. However, any option granted before January 1, 1995, that was repriced in 1995, is treated as a new grant within 1995 and is valued accordingly. In addition, since compensation expense is recognized over the vesting period of the related options, which are generally four years, and because pro forma disclosure is only required commencing with 1995, the initial impact on pro forma income may not be representative of compensation expense in future years.

3. BORROWINGS

In June 1996, the Company renewed its revolving line of credit with a domestic bank that provides for borrowings of up to \$2,000,000, including secured letters of credit. The line of credit expires June 1, 1997. Borrowings are collateralized by substantially all of the Company's U.S. assets. The Company is also subject to certain financial covenants. At December 31, 1996, the aggregate amount available to be borrowed under the revolving line of credit was \$2,000,000.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

3. BORROWINGS (CONTINUED)

In June 1995, the domestic bank renewed a \$350,000 standby letter of credit used as a security deposit for the sublease of the building the Company rents as its corporate headquarters. Borrowings against the line bear interest at prime (8.25% at December 31, 1996).

4. INDUSTRY SEGMENT REPORTING

The Company and its subsidiaries operate in one industry segment, principally the development of affordable, high-performance, cost-effective DSP-based software, integrated circuits, and circuit boards.

Operations outside the United States include research, development, sales, and certain general and administrative functions. The Company's Israeli subsidiary performs research, development, sales, marketing, technical support, and certain general and administrative functions. The Company's Japanese and French subsidiaries perform marketing and technical support activities.

The following is a summary of operations within geographic areas:

	1996	1995	1994

(IN THOUSANDS)			
Sales to unaffiliated customers:			
United States	\$51,883	\$49,163	\$28,299
Israel	1,027	1,274	305

	\$52,910	\$50,437	\$28,604
	=====		
Transfers between geographic areas (eliminated in consolidation):			
Israel	\$ 7,435	\$ 4,846	\$ 3,282
Japan	574	542	583
Europe	436	-	-

	\$ 8,445	\$ 5,388	\$ 3,865
	=====		

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

4. INDUSTRY SEGMENT REPORTING (CONTINUED)

	1996	1995	1994

	(IN THOUSANDS)		
Income (loss) before provision for income taxes (including intercompany amounts):			
United States	\$ 7,504	\$ 7,183	\$ 5,492
Israel	(596)	123	(1,204)
Japan	7	36	111
France	121	(78)	-

	\$ 7,036	\$ 7,264	\$ 4,399
	=====		
Identifiable assets:			
United States	\$54,880	\$51,614	\$40,928
Israel	4,039	3,045	2,432
Japan	219	195	203
France	69	-	-

	\$59,207	\$54,854	\$43,563
	=====		
Export sales:			
Asia	\$35,477	\$27,636	\$14,322
Europe	10,853	12,188	8,357
Israel	1,747	1,274	305

	\$48,077	\$41,098	\$22,984
	=====		

Sales to one distributor totaled 17% of total revenues in 1996, and sales to one other customer totaled 11% of total revenues for 1996. Sales to the same distributor totaled 25% of total revenue in 1995. In 1994, sales to two distributors totaled 22% and 16% of total revenues, and sales to another customer accounted for 10% of total revenues.

5. COMMITMENTS AND CONTINGENCIES

COMMITMENTS

The Company leases certain equipment and facilities under noncancelable operating leases. The Company has significant leased facilities in Givat Shmuel, Israel and in Santa Clara, California. The Santa Clara facility was leased by the Company through 2003, and portions of the facility were subleased to other tenants. In October 1996, however, the Company negotiated an assignment of its lease obligations to another Company (the Assignee) effective January 1997. Accordingly, as of January 1, 1997, the Company is no longer obligated under its former Santa Clara facility lease and is no longer a sublessor to other tenants. In connection with the assignment of the lease, the Company wrote off approximately \$205,000 of leasehold improvements and recorded a gain of approximately \$380,000 related to deferred rent on the facility. Beginning in fiscal 1997, the Company will receive payments from the lessor of \$322,000 in 1997, \$322,000 in 1998, \$322,000 in 1999, and \$295,000 in 2000 as compensation for the higher rents to be paid by the Assignee. In addition, commencing January 1, 1997, the Company began subleasing a new space in the same building from the Assignee under a separate sublease agreement that expires in December 1999.

At December 31, 1996, the Company is required to make the following minimum lease payments, as revised to reflect the assignment of the Santa Clara facility lease, the payments to be received from the lessor on the Santa Clara facility leases, and the Company's sublease of the new space as described above (IN THOUSANDS):

1997	\$ 720
1998	724
1999	634
2000	151
2001	354
Thereafter	143

	\$2,726
	=====

Total rental expense for all leases was approximately \$334,000 (net of sublease income of \$546,000, and a gain of \$380,000 on write-off of deferred rent), \$656,000 (net of sublease income of \$171,000), and \$546,000 for the years ended December 31, 1996, 1995, and 1994, respectively.

5. COMMITMENTS AND CONTINGENCIES (CONTINUED)

CONTINGENCIES

The Company is involved in certain claims arising in the normal course of business, including claims that it may be infringing patent rights owned by third parties. The Company is unable to foresee the extent to which these matters will be pursued by the claimants or to predict with certainty the eventual outcome. However, the Company believes that the ultimate resolution of these matters will not have a material adverse effect on its financial position, results of operations, or cash flows.

The estimate of the potential impact on the Company's financial position or overall results of operations or cash flows for the above matter could change in the future.

STOCKHOLDERS' LITIGATION

In November 1995, after the Company's stock price declined, several lawsuits were filed in the United States District Court for the Northern District of California (the Court) accusing the Company, its Chief Executive Officer, and its former Chief Financial Officer of issuing materially false and misleading statements in violation of the federal securities laws. These lawsuits were consolidated into a single amended complaint in February 1996. In the amended complaint, plaintiffs seek unspecified damages on behalf of all persons who purchased shares of the Company's stock during the period from June 6, 1995 through November 10, 1995. On June 11, 1996, the Court granted the Company's motion to dismiss the lawsuit with leave to amend. The plaintiffs filed an amended complaint on July 11, 1996. On March 7, 1997, the Court issued an order dismissing with prejudice all claims based on statements issued by the Company. The Court is permitting the plaintiffs to proceed with their claim regarding statements the Company allegedly made to securities analysts and is also permitting the plaintiffs to amend their complaint as to their claim that the Company is responsible for the statements contained in the analysts' reports. The Company believes the lawsuit to be without merit and intends to defend itself vigorously. The Company believes the ultimate resolution of this matter will not have a material adverse effect on the Company's financial position, results of operations, or cash flows.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6. INCOME TAXES

The tax provision (benefit) for the years ended December 31, 1996, 1995, and 1994 consists of the following:

	1996	1995	1994

(IN THOUSANDS)			
Federal taxes:			
Current	\$ (180)	\$ 1,898	\$ 154
Deferred	1,099	(2,173)	-
	-----	-----	-----
	919	(275)	154
State taxes:			
Current	3	239	10
Deferred	70	-	-
	-----	-----	-----
	73	239	10
Foreign taxes:			
Current	65	89	203
	-----	-----	-----
Provision (benefit) for income taxes	\$ 1,057	\$ 53	\$ 367
	=====	=====	=====

Pretax income (loss) from foreign operations, exclusive of an in-process technology write-off of \$1,529,000 in 1996, was \$1,061,000 in 1996, \$(81,000) in 1995, and \$(1,093,000) in 1994.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6. INCOME TAXES (CONTINUED)

A reconciliation between the Company's effective tax rate and the U.S. statutory rate of 34% in 1996 and 35% in 1995 and 1994 is as follows:

	YEARS ENDED DECEMBER 31,		
	1996	1995	1994

	(IN THOUSANDS)		
Tax at U.S. statutory rate	\$ 2,396	\$ 2,646	\$ 1,539
Operating losses utilized	(2,117)	(2,603)	(1,443)
Valuation of temporary differences	948	(779)	(219)
Alternative minimum tax in excess of regular tax	-	-	73
State taxes	3	155	-
Tax exempt interest income	(422)	(177)	-
Foreign withholding tax	-	31	92
Foreign income taxed at rates other than U.S. rate	(306)	13	23
Research and development expensed upon acquisition	520	-	175
Basis difference upon sale of subsidiary	-	711	-
Research credit utilized	-	(126)	-
Amortization of intangible assets	92	162	79
Other individually immaterial items	(57)	20	48
	-----	-----	-----
	\$ 1,057	\$ 53	\$ 367
	=====		

As of December 31, 1996, the Company had federal net operating loss and tax credit carryforwards of approximately \$8,000,000 and \$450,000, respectively. The federal net operating loss carryforward will expire at various dates beginning in the years 2006 through 2009, if not utilized.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6. INCOME TAXES (CONTINUED)

In September 1993, the Company issued Series F Preferred Stock. The issuance of such stock resulted in a change in ownership pursuant to the provisions of the Tax Reform Act of 1986. Accordingly, the Company's federal net operating losses incurred prior to the change of ownership are subject to an annual limitation in future periods. Utilization of the net operating loss carryforwards is limited to approximately \$3,300,000 per year.

Significant components of the Company's deferred tax assets and liabilities as of December 31, 1996 and 1995 are as follows:

	1996	1995

	(IN THOUSANDS)	
Deferred tax assets:		
Research credits	\$ 450	\$ 100
Net operating loss carryforwards	2,700	4,200
Capitalized research and development	450	540
Other	1,100	840

Total deferred tax assets	4,700	5,680
Valuation allowance	(3,696)	(3,507)

Net deferred tax assets	\$ 1,004	\$ 2,173
	=====	

Approximately \$2,227,000 of the valuation allowance at December 31, 1996 is related to benefits of stock option deductions, which will be allocated to paid-in capital when realized.

DSP Semiconductors Israel (DSP Israel) has been awarded "Approved Enterprise" status by the Israeli government according to two investment plans that included investments of \$3,788,000 and \$760,000, respectively. The "Approved Enterprise" status allowed DSP Israel a two-year tax holiday on undistributed earnings commencing with the year 1992 for which taxable income had been attained and a corporate tax rate of 10%, for an additional eight years, on the first investment plan's proportionate share of income. The proportionate share of income related to the second investment plan will entitle DSP Israel to a four-year tax holiday on undistributed earnings commencing with the 1996 tax year and a corporate tax rate of 10% for an additional six years. The aggregate dollar and per share benefit of the Israeli tax holiday was \$306,000 and \$0.03, respectively, for 1996.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

7. RELATED PARTY TRANSACTIONS

In 1996, 1995, and 1994, the Company performed certain contract engineering, research and development, sales and marketing, and general and administrative services for and received certain research and development, sales and marketing, and general and administrative services from DSP Communications, Inc. (DSPC), amounting to approximately \$0 and \$0 in 1996, \$919,000 and \$122,000 in 1995, and \$454,000 and \$394,000 in 1994, respectively.

In 1994, the Company entered into a license agreement with DSPC that gave DSPC rights to develop five integrated circuits using the Company's OakDSPCore digital signal processor technology. DSPC had previously licensed the Company's PineDSPCore digital signal processor technology. The Company recorded \$305,000 of licensing and other revenues in connection with this transaction in 1994.

In 1995 and 1994, the Company performed certain research and development and general and administrative services for Zen Research, amounting to approximately \$127,000 in 1995 and \$41,000 in 1994.

In 1993, the Company entered into a development and licensing agreement with AudioCodes (SEE NOTE 1). Under the agreement, AudioCodes is to perform certain research and development services for the Company. Upon development of the technology, the Company is to pay AudioCodes a licensing fee and maintenance fees of approximately 15% to 24% of the net revenue and 8% of the gross revenue realized from the sale of the technology. In 1996, 1995, and 1994, the Company recorded approximately \$0, \$527,000, and \$380,000, respectively, of research and development costs related to this agreement and \$260,000 in 1996 and \$179,000 in 1995 of licensing fees.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

8. SALE OF STOCK OF DSPC

The Company sold its remaining 131,000 shares of Common Stock of DSPC, the successor of a former subsidiary of the Company, DSP Telecommunications Ltd., in April 1995 upon the exercise of the underwriters' overallotment option in connection with DSPC's initial public offering. As the Company's basis in the investment had no book value, the sale resulted in a gain of approximately \$1,200,000 in the second quarter of 1995. The Company had sold 73,000 shares of Common Stock of DSPC in DSPC's March 1995 initial public offering, resulting in a gain of approximately \$666,000 in the first quarter of 1995. DSPC is a Delaware corporation primarily engaged in the development and marketing of integrated circuits based on digital signal processing for the wireless communications market. In 1994, the Company sold 1,234,000 shares of DSPC stock to a group of investors for \$1,851,000 in cash of which \$1,551,000 and \$300,000 were sold during the second and fourth quarter of 1994, respectively. Of this amount, \$1,351,000 was sold to investors who were also stockholders of the Company. As the Company's basis in the investment had no book value, the sale resulted in a gain of \$1,851,000.

9. ACQUISITIONS AND DISPOSALS

The Company had a joint development agreement with Scitex Corporation, Ltd., an Israeli corporation, under which Nogatech, Inc. (Nogatech) was formed to engage in the development and marketing of DSP-based image processing and video compression technology for products targeting the consumer electronics and office automation markets. Nogatech was incorporated in January 1993. The Company contributed technology with no book value in exchange for stock representing a 50% ownership in Nogatech. The Company accounted for this investment using the equity method; however, since the Company's basis in the investment had no book value and the Company was not obligated to fund any losses under the joint development agreement, the Company did not recognize any losses on this investment.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

9. ACQUISITIONS AND DISPOSALS (CONTINUED)

On May 3, 1994, the Company acquired the remaining 50% of the outstanding capital stock of Nogatech from Scitex Corporation, Ltd., for \$2,000,000 cash. Legal, accounting, and appraisal costs related to the transaction were \$100,000. The acquisition was accounted for as a purchase in accordance with Accounting Principles Board Opinion No. 16. The excess of the total acquisition cost over the recorded value of assets acquired was approximately \$2,015,000 and was allocated, based on values determined by an independent appraisal, to existing technology which had reached technological feasibility, in-process research and development, and other tangible and intangible assets.

To determine the value of the existing technology, the expected future cash flows of each existing technology product were discounted taking into account risks related to the characteristics and applications of each product, existing and future markets, and assessments of the life cycle stage of each product. Based on this analysis, the existing technology, which had reached technological feasibility, was assigned a value of \$853,000 and capitalized. This capitalized technology was amortized over a three-year period beginning with first product shipment in October 1994.

To determine the value of the technology in the development stage, the Company considered, among other factors, the stage of development of each project, the time and resources needed to complete each project, expected income, and associated risks. Associated risks included the inherent difficulties and uncertainties in completing the project and thereby achieving technological feasibility and risks related to the viability of and potential changes to future target markets. This analysis resulted in a value of \$1,104,000 being assigned to technology in the development stage that had not yet reached technological feasibility and did not have alternative future uses. Therefore, in accordance with generally accepted accounting principles, the \$1,104,000 of technology in the development stage was expensed.

Other identifiable tangible assets, intangible assets, and liabilities were also identified in this process and were determined to have a net asset value of \$143,000. The statement of operations includes Nogatech's results of operations for the eight months ended December 31, 1994, as Nogatech was acquired on May 3, 1994.

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

9. ACQUISITIONS AND DISPOSALS (CONTINUED)

Pursuant to the Stock Purchase Agreement, on August 11, 1995, the Company sold its equity interest in Nogatech to two purchasers for \$1,500,000 in cash. The purchasers consisted of a customer of the Company and a stockholder of the Company. The Company also agreed to cancel all other amounts that Nogatech owed the Company and grant limited licenses to Nogatech to use certain technology of the Company in exchange for: (i) the receipt of certain fixed assets; (ii) reimbursement of post-June 30, 1995 cash fundings to Nogatech; (iii) royalties not to exceed \$750,000 on any future sales of certain Nogatech products; and (iv) a \$400,000 promissory note to the Company from Nogatech. The promissory note and interest computed at a rate of 8.75% per annum was paid in January 1996. The Company attributed \$250,000 of the sales price to the value of these limited licenses sold to Nogatech based upon the Company's licensing pricing structure.

10. UNUSUAL ITEMS

During the second quarter of 1995, the Company formulated a plan to divest its 89% equity interest in its Nogatech subsidiary. The Company incurred a \$500,000 charge for the write-down of Nogatech's intangible assets in accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." Nogatech's revenues for the period from January 1, 1995 through August 11, 1995 were \$500,000, and Nogatech incurred an operating loss, exclusive of the \$500,000 write-off, of \$767,000.

In April 1995, the former Chairman of the Board of Directors resigned to focus his efforts on DSPC where he serves as Chairman. The Company incurred \$413,000 of severance expense as a result of this resignation. The expense consisted \$283,000 for severance payments to be made over a two-year period and a \$130,000 charge for accelerated vesting of the former Chairman's outstanding stock options.

In September 1994, the Company sold its optical disk technology to an investor group who formed Zen Research and recorded a gain of \$646,000. On May 3, 1994, the Company acquired from Scitex Corporation, Ltd. the remaining 50% of the outstanding capital stock of Nogatech not previously held by the Company and consequently recorded a \$1,104,000 charge for acquired research and development from a related party in the second quarter of 1994 (SEE NOTE 9, ACQUISITIONS AND DISPOSALS).

DSP GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

10. UNUSUAL ITEMS (CONTINUED)

In July 1996, the Company acquired a 40% equity ownership interest in Aptel, Ltd., a company located in Israel. In connection with the acquisition, the Company recorded a charge of \$1,529,000 for acquired research and development from a related party in the third quarter of 1996 (SEE NOTE 1, EQUITY INVESTMENTS).

DSP GROUP, INC.

SELECTED CONSOLIDATED FINANCIAL DATA

	YEARS ENDED DECEMBER 31,				
	1996	1995	1994	1993	1992
	(In thousands, except per share amounts)				
STATEMENT OF OPERATIONS DATA:					
Revenues	\$52,910	\$50,347	\$28,604	\$12,447	\$ 8,860
Net income (loss)	\$ 5,979	\$ 7,211	\$ 4,032	\$ (467)	\$ (7,874)
Net income (loss) per share	\$.62	\$.75	\$.44	\$ (.13)	\$ (2.42)
Shares used in per share computation	9,581	9,658	9,135	3,504	3,248
BALANCE SHEET DATA:					
Cash, cash equivalents and marketable securities	\$42,934	\$33,828	\$26,376	\$ 2,019	\$ 2,641
Working capital (deficit)	\$47,851	\$39,304	\$29,824	\$ 1,797	\$ (8,197)
Total assets	\$59,207	\$54,854	\$43,563	\$ 8,070	\$ 5,015
Long-term obligations, less current portion	\$ -	\$ -	\$ -	\$ 1,211	\$ 4,267
Total stockholders' equity (deficit)	\$54,449	\$47,541	\$36,801	\$ 2,517	\$ (11,179)

	FISCAL YEARS BY QUARTER							
	1996				1995			
	4TH	3RD	2ND	1ST	4TH	3RD	2ND	1ST
	(Unaudited, in thousands, except per share amounts)							
QUARTERLY DATA:								
Revenues	\$15,081	\$13,611	\$13,021	\$11,197	\$13,023	\$13,068	\$12,462	\$11,884
Gross Profit	\$ 6,660	\$ 5,015	\$ 4,940	\$ 5,767	\$ 4,837	\$ 6,607	\$ 6,722	\$ 6,188
Net income (loss) (1)	\$ 5,400	\$ (263)	\$ 268	\$ 574	\$ 570	\$ 2,490	\$ 2,438	\$ 1,713
Net income (loss) per share	\$.56	\$ (.03)	\$.03	\$.06	\$.06	\$.26	\$.25	\$.18

(1) See Notes 8, 9, and 10 of Notes to Consolidated Financial Statements for explanation of gain on sale of stock in affiliate in first and second quarters of 1995, write-down of impaired asset and charge for severance expense in second quarter of 1995, charge for acquired in process research and development in third quarter of 1996, and the gain on settlement of a lawsuit in the fourth quarter of 1996.

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE FINANCIAL STATEMENTS IN THE ANNUAL REPORT ON FORM 10-K OF DSP GROUP, INC. FOR THE YEAR ENDED DECEMBER 31, 1996 AND IS QUALIFIED IN ITS ENTIRETY TO SUCH FINANCIAL STATEMENTS

1,000

YEAR		
DEC-31-1996		
JAN-01-1996		
DEC-31-1996		
		12,172
	30,762	
	5,469	
	636	
	2,957	
	52,609	
		7,324
	4,033	
	59,207	
4,758		
		0
0		
		0
		10
	54,439	
59,207		
		41,290
	52,910	
		29,432
	30,528	
	8,481	
	0	
	158	
	7,036	
	1,057	
5,979		
	0	
	0	
		0
	5,979	
	0.62	
	0.62	