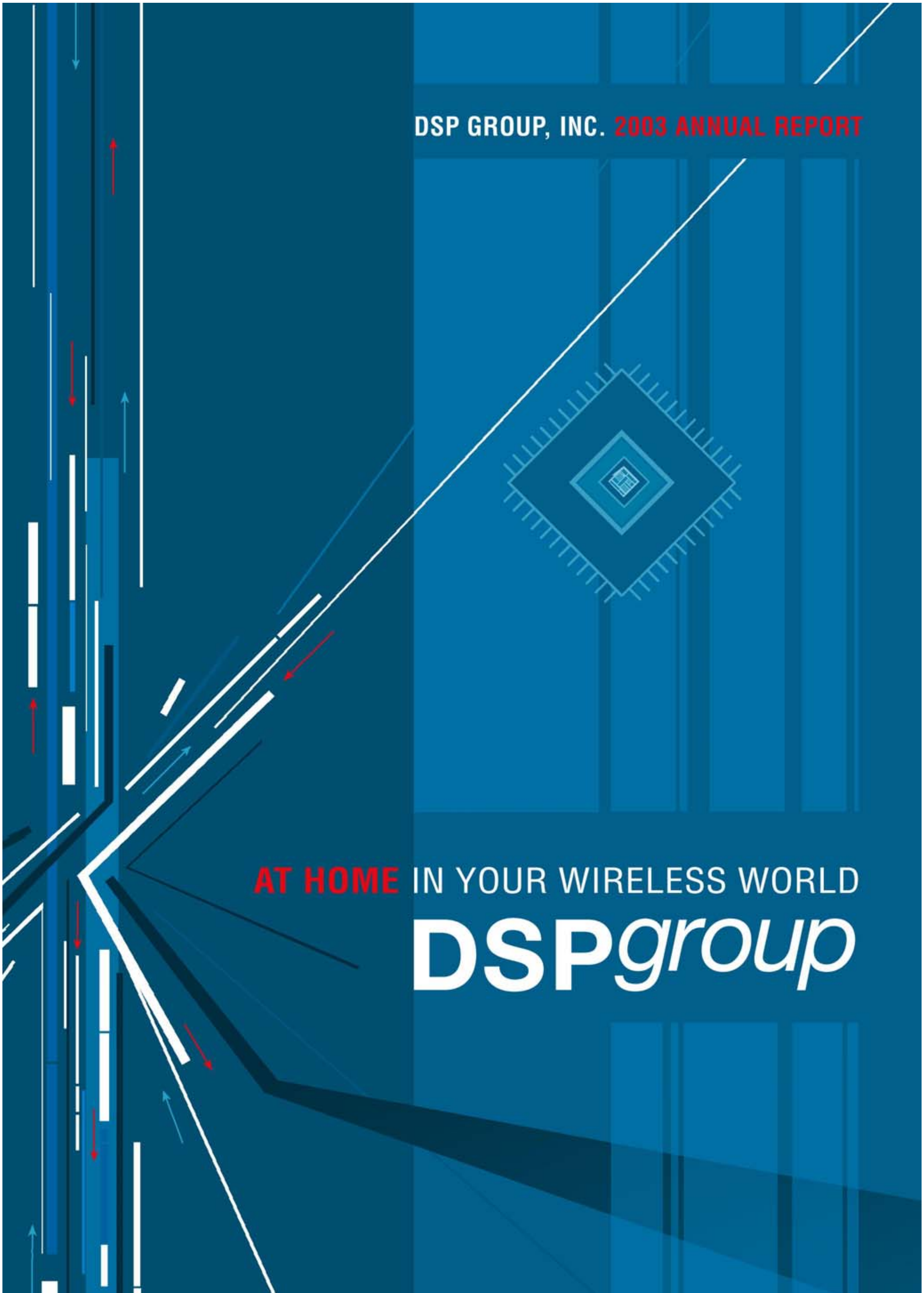
DSP GROUP, INC. 2003 ANNUAL REPORT
AT HOME IN YOUR WIRELESS WORLD
DSPgroup

Contents

ERNST & YOUNG

REPORT OF INDEPENDENT AUDITORS

To The Stockholders of
DSP Group, Inc.

We have audited the accompanying consolidated balance sheets of DSP Group, Inc. ("the Company") and its subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2003. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. 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. and its subsidiaries as of December 31, 2003 and 2002, and the consolidated results of their operations and cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material reports the information set forth therein.

Tel-Aviv, Israel
January 27, 2004

KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31, 2003	December 31, 2002
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 36,812	$ 39,919
Marketable securities	42,490	45,371
Trade receivables, less allowance for returns of $123 in 2003 and 2002 and for doubtful accounts of $708 in 2003 and $339 in 2002	15,844	4,873
Deferred income taxes	1,326	1,685
Other accounts receivable and prepaid expenses	1,462	1,352
Inventories	8,466	6,916
Assets Of Discontinued Operations	-	4,737
TOTAL CURRENT ASSETS	106,400	104,853
PROPERTY AND EQUIPMENT, NET	7,108	4,690
LONG-TERM ASSETS:		
Long-term marketable securities	197,071	150,692
Investments in equity securities of traded companies	47,138	12,031
Long-term prepaid expenses and lease deposits	513	386
Severance pay fund	2,360	1,616
Intangible assets, net	2,076	-
Goodwill	5,804	5,804
TOTAL LONG-TERM ASSETS	254,962	170,529
TOTAL ASSETS	$ 368,470	$ 280,072

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

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands, except share data

	December 31, 2003	December 31, 2002
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	$ 11,221	$ 6,745
Accrued compensation and benefits	9,000	4,556
Income taxes payables	11,107	7,328
Accrued expenses and other accounts payable	14,185	9,668
TOTAL CURRENT LIABILITIES	45,513	28,297
LONG-TERM LIABILITIES:		
Accrued severance pay	2,555	1,686
Deferred income taxes	14,592	2,371
Other long-term liabilities	1,429	-
TOTAL LONG-TERM LIABILITIES	18,576	4,057
STOCKHOLDERS' EQUITY:		
Preferred stock, $0.001 par value - Authorized shares - 5,000,000 at December 31, 2003 and 2002; issued and outstanding shares - none at December 31, 2003 and 2002	-	-
Common stock, $0.001 par value - Authorized shares: 50,000,000 at December 31, 2003 and 2002; issued and outstanding shares: 28,615,884 at December 31, 2003 and 27,247,947 at December 31, 2002	29	27
Additional paid-in capital	174,700	156,443
Treasury stock	(1,192)	-
Accumulated other comprehensive income	23,045	476
Retained earnings	107,799	90,772
TOTAL STOCKHOLDERS' EQUITY	304,381	247,718
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 368,470	$ 280,072

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

CONSOLIDATED STATEMENTS OF INCOME

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

	Year ended December 31, 2003	2002	2001
Revenues	$ 152,875	$ 125,158	$ 89,430
Costs of revenues	83,077	74,412	53,122
Gross profit	69,798	50,746	36,308
Operating expenses:			
Research and development	25,599	19,745	21,066
Sales and marketing	11,977	10,745	9,168
General and administrative	6,953	5,048	4,907
In-process research and development write-off	2,727	-	-
Aborted spin-off expenses and other	-	865	-
Total operating expenses	47,256	36,403	35,141
Operating income	22,542	14,343	1,167
Financial and other income:			
Interest and other income, net	8,188	9,452	12,522
Equity in earnings of affiliate	-	-	105
Minority interest in losses of subsidiary	-	-	173
Income after financial and other income	30,730	23,795	13,967
Impairment of available-for-sale marketable securities	-	(10,229)	-
Income before taxes on income	30,730	13,566	13,967
Taxes on income	5,375	894	2,406
Income from continuing operations	25,355	12,672	11,561
Income from discontinued operations of Ceva (net of applicable income taxes of $0, $813 and $3,255 for 2003, 2002 and 2001, respectively)	-	2,470	10,355
Net income	$ 25,355	$ 15,142	$ 21,916
Earnings per share from continuing operations:			
Basic	$ 0.91	$ 0.47	$ 0.43
Diluted	$ 0.86	$ 0.45	$ 0.42
Earnings per share from discontinued operations:			
Basic	$ -	$ 0.09	$ 0.39
Diluted	$ -	$ 0.09	$ 0.37
Net earnings per share:			
Basic	$ 0.91	$ 0.56	$ 0.82
Diluted	$ 0.86	$ 0.54	$ 0.79

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

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

U.S. dollars in thousands, including share data

	Number of Common stock	Common stock amount	Additional paid-in capital	Treasury stock	Accumulated other comprehensive income	Retained earnings	Total comprehensive income	Total stockholders' equity
Balance at January 1, 2001	26,248	$ 27	$ 151,787	$ (19,940)	$ -	$ 114,291		$ 246,165
Purchase of treasury stock	(40)	*) -	-	(811)	-	-		(811)
Issuance of Common stock upon acquisition of VoicePump	161	*) -	3,651	-	-	-		3,651
Issuance of treasury stock upon exercise of stock options by employees	451	*) -	-	10,841	-	(6,752)		4,089
Issuance of treasury stock upon purchase of ESPP shares by employees	53	*) -	-	1,287	-	(503)		784
Tax benefit related to exercise of stock options	-	-	531	-	-	-		531
Total comprehensive income:								
Net income	-	-	-	-	-	21,916	$ 21,916	21,916
Unrealized gain on available-for-sale marketable securities, net	-	-	-	-	2,683	-	2,683	2,683
Unrealized loss from hedging activities	-	-	-	-	(31)	-	(31)	(31)
Total comprehensive income							$ 24,568	
Balance at December 31, 2001	26,873	27	155,969	(8,623)	2,652	128,952		278,977
Dividend to stockholders as a result of the separation of Ceva	-	-	-	-	-	(48,428)		(48,428)
Issuance of treasury stock upon exercise of stock options by employees	314	*) -	-	7,463	-	(4,566)		2,897
Issuance of treasury stock upon purchase of ESPP shares by employees	49	*) -	-	1,160	-	(328)		832
Issuance of Common stock upon exercise of stock options by employees	12	*) -	150	-	-	-		150
Tax benefit related to exercise of stock options	-	-	324	-	-	-		324
Total comprehensive income:								
Net income	-	-	-	-	-	15,142	$ 15,142	15,142
Unrealized losses on available-for-sale marketable securities, net.	-	-	-	-	(2,207)	-	(2,207)	(2,207)
Realized gain from hedging activities	-	-	-	-	31	-	31	31
Total comprehensive income							$ 12,966	
Balance at December 31, 2002	27,248	27	156,443	-	476	90,772		247,718

*) Represents an amount lower than $1.

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

U.S. dollars in thousands, including share data

	Number of Common stock	Common stock amount	Additional paid-in capital	Treasury stock	Accumulated other comprehensive income	Retained earnings	Total comprehensive income	Total stockholders' equity
Balance at December 31, 2002	27,248	27	156,443	-	476	90,772		247,718
Issuance of treasury stock upon purchase of ESPP shares by employees	28	*) -	-	603	-	(256)		347
Issuance of Common stock upon exercise of stock options by employees	1,397	1	17,274	-	-	-		17,275
Issuance of Common stock upon purchase of ESPP shares by employees	24	*) - 9 8	298	-	-	-		298
Issuance of treasury stock upon exercise of stock options by employees	665	1	-	14,362	-	(8,072)		6,291
Tax benefit related to exercise of stock options	-	-	685	-	-	-		685
Purchase of treasury stock	(746)	*) -	-	(16,157)	-	-		(16,157)
Total comprehensive income:								
Net income	-	-	-	-	-	25,355	25,355	25,355
Unrealized gains on available-for-sale marketable securities, net	-	-	-	-	22,432	-	22,432	22,432
Unrealized gain from hedging activities, net					137		137	137
Total comprehensive income							$ 47,924	
Balance at December 31, 2003	28,616	$ 29	$ 174,700	$ (1,192)	$ **) 23,045	$ 107,799		$ 304,381

*) Represents an amount lower than $1.

**) Composed as follows:

Accumulated unrealized gain from available-for-sale marketable securities, net of taxes	$ 22,908
Unrealized gain from hedging activities, net	137
Accumulated other comprehensive income	$ 23,045

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31		
	2003	**2002**	**2001**
Cash flows from operating activities:			
Net income	$ 25,355	$ 15,142	$ 21,916
Adjustments required to reconcile net income to net cash provided by operating activities:			
Depreciation	3,224	2,589	2,536
Increase (decrease) in deferred income taxes, net	(272)	(3,048)	2,459
Net gain on sale of property and equipment	(27)	-	(12)
Capital gain on realization of investment in equity securities of traded companies	(241)	(3)	-
Impairment of tangible and intangible assets	-	98	-
Amortization of intangible assets	379	-	-
Amortization of goodwill	-	-	964
In-process research and development write-off	2,727	-	-
Accrued interest and amortization of premium (accretion of discount) on held-to-maturity marketable securities	1,989	2,377	(1,389)
Equity in earnings of affiliate	-	-	(105)
Minority interest in losses of subsidiary	-	-	(173)
Impairment of available-for-sale marketable securities	-	10,229	-
Tax benefit related to exercise of stock options	685	324	531
Decrease (increase) in trade receivables	(10,971)	1,442	4,042
Decrease (increase) in other accounts receivable and prepaid expenses	27	546	(388)
Decrease (increase) in inventories	(1,550)	(4,868)	763
Decrease (increase) in long-term prepaid expenses and lease deposits	(127)	58	(107)
Increase (decrease) in trade payables	1,972	1,412	(2,506)
Increase (decrease) in accrued compensation and benefits	4,444	(426)	479
Increase (decrease) in income taxes payable	3,684	4,470	(940)
Increase (decrease) in accrued expenses and other accounts payable	3,075	3,940	(1,690)
Increase (decrease) in accrued severance pay, net	125	(7)	68
Other	(6)	-	-
Net cash provided by operating activities	34,492	34,275	26,448
Cash flows from investing activities:			
Purchase of held-to-maturity marketable securities	(191,882)	(144,269)	(194,020)
Proceeds from sales and maturity of held-to-maturity marketable securities	146,395	156,474	162,930
Purchases of property and equipment	(3,158)	(1,924)	(3,033)
Proceeds from sale of property and equipment	72	53	49
Proceeds from realization of available-for-sale equity securities of traded companies	508	1,504	-
Purchase of available-for-sale marketable securities	-	(2,000)	-
Acquisition of Teleman Multimedia Inc. assets	(2,325)	-	-
Cash received from (contributed to) discontinued operations	4,737	(6,463)	(2,325)
Net cash provided by (used in) investing activities	(45,653)	3,375	(36,399)

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31		
	2003	**2002**	**2001**
Cash flows from financing activities:			
Issuance of common stock and treasury stock upon exercise of stock options and upon purchase of employee stock purchase plan	24,211	3,877	4,873
Purchase of treasury stock	(16,157)	-	(811)
Dividend related to the separation of Ceva	-	(40,754)	-
Net cash provided by (used in) financing activities	8,054	(36,877)	4,062
Increase (decrease) in cash and cash equivalents	(3,107)	773	(5,889)
Cash and cash equivalents at the beginning of the year	39,919	39,146	45,035
Cash and cash equivalents at the end of the year	$ 36,812	$ 39,919	$ 39,146
(a) Cash acquired in acquisition of VoicePump Inc.:			
Estimated fair value of assets acquired and liabilities assumed of the subsidiary at the date of acquisition:			
Minority interest in subsidiary	$ -	$ -	$ (737)
Goodwill	-	-	(2,914)
Less- issuance of common stock	-	-	3,651
(b) Non-cash transactions:			
Non cash contribution of prepaid offering expenses, property, equipment and inventory, net of assumed liabilities	$ -	$ 7,674	$ -
Purchase of property and equipment	$ 2,504	$ -	$ -
Supplemental disclosures of cash flows activities:			
Cash paid during the year for:			
Taxes on income	$ 1,202	$ 2,462	$ 3,806

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except per share figures
and prices and percentages)

NOTE 1: GENERAL

DSP Group, Inc., a Delaware corporation (the "Company") and its subsidiaries are a fabless semiconductor company that is a leader in the short-range residential wireless market. It develops various applications with advanced radio frequency (RF) devices and communications technologies and speech-processing algorithms, including digital 900 MHz, 2.4 GHz, Digital Enhanced Cordless Telecommunications (DECT) (1.9 GHz) telephony and 5.8 GHz for voice, video and data communication in residential, small office/home, medium-sized enterprises, and automotive applications. The Company also develops and markets embedded, integrated silicon/software solution for Digital Voice Recorder, Hands Free car kit, Voice-over-Digital-Subscriber Line (VoDSL), Voice-over-Internet-Protocol (VoIP) applications, and other Voice-over-Packet applications for Integrated Access Device and Internet Protocol telephony markets.

The Company has six wholly-owned subsidiaries: (1) DSP Group Ltd. ("DSP Group Israel"), an Israeli corporation primarily engaged in research and development, marketing and sales, technical support and certain general and administrative functions; (2) RF Integrated Systems Inc. ("RF US"), a Delaware corporation primarily engaged in research and development of RF technology for wireless products; (3) Nihon DSP K.K. ("DSP Japan"), a Japanese corporation primarily engaged in marketing and technical support activities; (4) VoicePump Inc. ("VoicePump") a California corporation primarily engaged in the design, research and development and marketing of software applications for VoDSL and VoIP; (5) DSP Video Korea ("DSP Korea"), a Korean corporation, incorporated in 2003, and primarily engaged in the design, research and development of video applications; and (6) DSPG Edinburgh Limited ("DSP Scotland"), a Scottish corporation, primarily engaged in development and marketing of DECT-based telephony solutions.

Acquisition of Teleman Multimedia Inc.:

During the second quarter of 2003, the Company entered into an asset purchase agreement with DSP Group Israel, and Teleman Multimedia Inc. ("Teleman"), a Delaware corporation, pursuant to which DSP Group Israel acquired substantially all of the assets of Teleman. Teleman, founded in 1998, has developed an advanced silicon platform for video compression and decompression designed to interface with image sensors and panel displays. The Teleman silicon platform supports compression standards such as MPEG4, JPEG and H263.

The assets purchased by DSP Group Israel consisted of property and equipment, and other assets (including intangible assets such as workforce and intellectual property) used by Teleman in the conduct of its business. The consideration for the assets purchased from Teleman consisted of cash in an aggregate amount of $5,000 and transaction expenses in the amount of approximately $250. $2,100 of the consideration was paid on May 16, 2003, the closing date of the acquisition, and the remaining consideration is to be paid in two future installments as follows: $1,450 on May 16, 2004, and $1,450 on May 16, 2005. The latter two installments were recorded at fair value of $1,442 and $1,429, respectively. The amount of consideration was determined based upon arms-length negotiations between the Company, on the one hand, and Teleman and Teleman's shareholders, on the other hand. In addition, the Company hired 10 engineers that were previously employed by Teleman.

Disposition of assets and combination with Parthus

On November 1, 2002, the Company contributed its DSP cores licensing business (the "Separation") to Ceva, Inc., one of its then wholly-owned subsidiaries ("Ceva"). Immediately thereafter, Ceva affected a combination (the "Combination") with Parthus Technologies PLC ("Parthus").

Under the terms of the Separation, the Company transferred the assets and liabilities of its DSP cores licensing business to Ceva in exchange for Ceva common stock. The Company immediately thereafter distributed all of the Ceva common stock it held to the Company's stockholders of record on October 31, 2002. Ceva then affected the Combination whereby Ceva acquired Parthus and issued Ceva common stock to the former Parthus shareholders pursuant to a scheme of arrangement. After the Combination, the combined company was renamed ParthusCeva, Inc. and subsequently changed its name to Ceva, Inc. (for purposes of discussion in these notes to the consolidated financial statements, the combined company will continue to be referred to as "ParthusCeva"). ParthusCeva's common stock is quoted on the Nasdaq National Market and listed on the London Stock Exchange. As part of the transaction, the Company contributed to Ceva cash in the amount of $40,000 and property, equipment, inventory, paid transaction costs in the amount of $7,674 and paid $754 as a tax payment upon the Separation. Parthus also made a $60,000 capital repayment to its shareholders immediately prior to the Combination. The Company received private letter rulings from the U.S. Internal Revenue Service to the effect that, among other things, the Separation was a tax-free transaction to the Company's stockholders under Section 355 of the Internal Revenue Code of 1986, as amended, for federal income tax purposes, except with respect to cash distributed in lieu of fractional shares to the Company's stockholders.

At the effective time of the Separation, each stockholder of record of the Company on October 31, 2002 (the "Distribution Record Date") received one share of ParthusCeva's common stock for every three shares of the Company's common stock (the "Common Stock") held by such stockholder on the record date (the "Distribution"). Fractional shares were not issued. Instead, fractional interests were aggregated and sold on the open market on the first day after the closing of the transaction, and cash in lieu of fractional shares was distributed ratably to the Company's stockholders who would otherwise have received a fractional interest in ParthusCeva's common stock. The Distribution was made to the Company's stockholders without payment of any consideration or the exchange of any shares by the Company's stockholders. At the effective time of the Combination, in exchange for Parthus ordinary shares which were cancelled as part of the scheme of arrangement, each shareholder of Parthus received 0.015141 of a share of ParthusCeva's common stock for each ordinary share of Parthus held by such shareholder (0.15141 shares per Parthus ADS) on October 31, 2002, the record date for the Combination, and cash in lieu of fractional shares.

As a result of the Separation and Combination, the Company distributed 9,041,851 shares of ParthusCeva's common stock to its stockholders (representing 50.1% of ParthusCeva after the transaction), and ParthusCeva issued 8,998,887 shares of its common stock to the former Parthus shareholders (representing 49.9% of ParthusCeva after the transaction) and assumed options to purchase approximately 1,644,435 shares of ParthusCeva's common stock based on Parthus options outstanding as of June 30, 2002. The relative ratio of shares distributed to the Company's stockholders and issued to the former Parthus shareholders, as well as the other material terms of the transaction, were determined pursuant to arms-length negotiations between the parties. Options to purchase common stock outstanding under the Company's stock option plans were also adjusted as of November 1, 2002 to reflect the distribution of assets to ParthusCeva in connection with the Separation. (See also Note 9).

In accounting for the Separation, the Company recorded in the statements of changes in stockholders' equity and consolidated statements of cash flows $48,428 as a deemed dividend in-kind to its stockholders, representing the carrying amount of its investment in Ceva. This dividend in-kind consisted of cash contribution to Ceva in the amount of $40,000 and a tax payment of $754 recorded in the consolidated statements of cash flow and a non-cash contribution of prepaid offering expenses, inventory and property and equipment, net of assumed liabilities, in the amount of $7,674. (See also Note 9).

The Company's financial statements for the prior years, which included the licensing and technology business of Ceva, were reclassified to present the assets, liabilities, results of operations and cash flows of Ceva as discontinued operations in accordance with Statement of Financial Accounting Standard No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"). (See also Note 14).

The discontinued operations presented for prior years included allocations of certain of the Company's corporate headquarters assets, liabilities and expenses relating to the licensing business.

The net income from discontinued operations included costs directly attributed to the licensing and technology business, including charges for shared facilities, functions and services used by the licensing business. Certain costs and expenses were allocated based on management's estimates of the cost of services provided to the licensing business. Such costs included research and development costs and sales expenses.

During the year ended December 31, 2003, the Company collected approximately $4,737 from customers of the DSP cores licensing business that it transferred to Ceva in November 2002. This amount was included under "cash received from discontinued operations" in the Company's consolidated statements of cash flows.

VoicePump Inc.

VoicePump is primarily engaged in the design, research and development and marketing of software applications for VoDSL and VoIP. In March 2000, the Company acquired (1) approximately 1,960,250 shares of common stock of VoicePump from certain VoicePump shareholders in exchange for approximately 261,000 shares of Common Stock and a nominal amount of cash (to pay for fractional shares) and (2) approximately 1,027,397 shares of VoicePump common stock directly from VoicePump.

In February 2001, the Company exercised its option and acquired the remaining shares of VoicePump (1,210,750 shares), in exchange for 161,433 shares of Common Stock. As a result of the purchase of the remaining equity, VoicePump became a wholly-owned subsidiary of the Company. Pro forma information in accordance with APB No. 16 has not been provided, since the revenues and net loss of 2001 and total assets as of December 31, 2001 were not material in relation to the Company's total revenues, net income and total assets.

The Company's investment in VoicePump includes the excess of its purchase price over the net assets acquired (approximately $5,804 as of December 31, 2003 and 2002), which was attributed to goodwill. The Company ceased amortization of the goodwill related to the acquisition of VoicePump after December 31, 2001. For more information about goodwill amortization, see Note 2.

Concentration of other risks

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 sufficient portion of foundry capacity 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, low yield rates or financial instability. For example, foundries in Taiwan produce a significant portion of the Company's wafer supply. As a result, earthquakes, aftershocks or other natural disasters in Asia, could preclude the Company from obtaining an adequate supply of wafers to fill customers' orders and could harm the Company's business, financial position, and results of operations. Additionally, certain of the raw materials, components, and subassemblies included in the products manufactured by the Company's original equipment manufacturer (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 and could negatively affect the Company's business condition and results of operations.

The Company sells its products to customers primarily through a network of distributors and representatives. The Company's largest distributor, Tomen Electronics, sells the Company's products to a limited number of customers. One customer, Panasonic Communications Co., Ltd. ("Panasonic"), has continually accounted for a majority of Tomen Electronics' sales. The Company's future performance will depend, in part, on Tomen Electronics' continued success in marketing and selling its products. The loss of Tomen Electronics as the Company's distributor and the Company's inability to obtain a satisfactory replacement in a timely manner may harm its sales and results of operations. Additionally, the loss of Panasonic and Tomen Electronics' inability to thereafter effectively market the Company's products could also harm the Company's sales and results of operations.

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared according to United States Generally Accepted Accounting Principles ("US GAAP").

Use of estimates

The preparation of the financial statements in conformity with US GAAP 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.

Financial statements in U.S. dollars

All of the revenues of the Company and its subsidiaries are generated in U.S. dollars ("dollar"). In addition, a substantial portion of the costs of the Company and its subsidiaries are incurred in dollars. The Company's management believes that the dollar is the primary currency of the economic environment in which the Company and its subsidiaries operate. Thus, the functional and reporting currency of the Company and its subsidiaries is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into dollars in accordance with Statement of Financial Accounting Standard No. 52, "Foreign Currency Translations" ("SFAS No. 52"). All transactional gains and losses of the remeasurement of monetary balance sheet items are reflected in the consolidated statements of income as financial income or expenses, as appropriate, and have not been significant to date for all years presented.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany transactions and balances were eliminated in the consolidation.

Cash equivalents

The Company and its subsidiaries consider all highly liquid investments, which are readily convertible to cash with maturity of three months or less at the date of acquisition, to be cash equivalents.

Marketable securities

The Company and its subsidiaries account for investments in debt and equity securities in accordance with Statement of Financial Accounting Standard No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"). Management determines the appropriate classification of its investments in debt and equity securities at the time of purchase and reevaluates such determinations at each balance sheet date.

At December 31, 2003 and 2002, the Company classified its investment in marketable securities as held-to-maturity and available-for-sale.

Debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity and are stated at amortized cost. The amortized cost of held-to-maturity securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization, accretion, decline in value judged to be other than temporary and interest are included in financial income, net.

Investment in equity securities of traded companies classified as available-for-sale securities are stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss), a separate component of stockholders' equity, net of taxes. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the consolidated statements of income.

According to Staff Accounting Bulletin No. 59 "Accounting for Non-current Marketable Equity Securities" ("SAB No. 59") management is required to evaluate each period whether a security's decline in value is other than temporary. In 2002, the Company recognized an other-than-temporary decline in the carrying value of its available-for-sale securities in the amount of $10,229 which was included in the statements of income as impairment of available-for-sale marketable securities.

Fair value of financial instruments

The following methods and assumptions were used by the Company and its subsidiaries in estimating the fair value disclosures for financial instruments.

The carrying values of cash and cash equivalents, trade receivables and trade payables approximate fair values due to the short-term maturities of these instruments. The carrying value of held-to-maturity marketable securities is based on amortized cost, and do not differ significantly from the quoted market value. The fair value of available-for-sale marketable securities is based on quoted market price (See Note 6).

Gross realized gains or losses for 2003, 2002, and 2001 were not significant (See Notes 3 and 6).

Inventories

Inventories are stated at the lower of cost or market value. Inventory write-offs and write-down provisions are provided to cover risks arising from slow-moving items or technological obsolescence.

The Company and its subsidiaries periodically evaluate the quantities of inventory on hand relative to current and historical selling prices and historical and projected sales volume. Based on this evaluation provisions are made in each period to write down inventory to its market prices.

Cost is determined as follows:

Work in progress - represents the cost of raw materials and manufacturing.
Finished products - on the basis of direct manufacturing costs.

Property and equipment

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, at the following annual rates:

	%
Computers and peripheral equipment	20-33
Office furniture and equipment	7-10
Motor vehicles	15
Leasehold improvements	Over the terms of the lease

Intangible assets

Intangible assets acquired on or after July 1, 2001, are amortized over their useful life using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets", ("SFAS No. 142"). Patents and work force are amortized over a weighted average of 4 years.

Impairment of long lived assets

The long-lived assets and certain identifiable intangibles of the Company and its subsidiaries are reviewed for impairment in accordance with Statement of Financial Accounting Standard No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144") whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2003, no impairment losses were identified.

Goodwill

Goodwill represents excess of the costs over the estimated fair value of the net assets of businesses acquired. Goodwill, which arose from acquisitions prior July 1, 2001, was amortized until December 31, 2001, on a straight-line basis over 7 years. Under Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142") goodwill acquired in a business combination for which date is on or after July 1, 2001 is not amortized.

SFAS No. 142 requires goodwill to be tested for impairment on adoption of the statement and at least annually thereafter or between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Goodwill attributable to the reporting unit is tested for impairment by comparing the fair value of the reporting unit with its carrying value. Fair value is determined using market capitalization. The Company performed the annual impairment tests during the second fiscal quarter of 2002 and 2003. The Company found no instances of impairment of its recorded goodwill. As of December 31, 2003, no impairment losses were identified.

Severance pay

The Company's subsidiary, DSP Group Israel has a liability for severance pay pursuant to Israeli law, based on the most recent monthly salary of its employees multiplied by the number of years of employment as of the balance sheet date for such employees. DSP Group Israel's liability is fully provided by monthly deposits with severance pay funds and insurance policies.

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of its obligations pursuant to Israeli severance pay law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies and includes immaterial profits.

DSP Korea has a liability for severance pay pursuant to Korean law, based on the most recent monthly salary of its employees multiplied by the number of years of employment as of the balance sheet date for such employees.

Severance expenses for the years ended December 31, 2003, 2002 and 2001, were approximately $822, $392 and $875, respectively.

Revenue recognition

The Company and its subsidiaries generate their revenues from sale of products. The Company and its subsidiaries sell their products through direct sales force and throughout a network of distributors and representatives.

In December 2003, the Securities and Exchange Commission (the "SEC") issued Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition" ("SAB No. 104") which revises or rescinds certain sections of SAB No. 101 "Revenue Recognition." The changes noted in SAB No. 104 did not have a material effect on the Company's consolidated result of operations, consolidated financial position or consolidated cash flows.

Product sales are recognized in accordance with SEC Staff Accounting Bulletin No. 104, "Revenue Recognition " ("SAB No. 104") when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable, collectability is probable, and no significant obligations remain.

The Company generally does not grant a right of return to its customers. The Company maintains provision for product returns, based on its experience in accordance with Statement of Financial Accounting Standard No. 48 "Revenue Recognition When Right of Return Exists" (SFAS No. 48). The provision has been deducted from revenues and amounted to $123 for each of the years ended December 31, 2003, 2002 and 2001.

Revenues subject to certain price protection are deferred until such future price changes can be reasonably estimated. The provision for price protection was deducted from revenues, and amounted to $26, $44 and $194 for the years ended December 31, 2003, 2002 and 2001, respectively.

Research and development costs

Research and development costs are charged to the consolidated statement of income as incurred.

Net earnings per share

Basic net earnings per share is computed based on the weighted average number of shares of Common Stock outstanding during the year. Diluted net earnings per share further includes the effect of dilutive stock options outstanding during the year, all in accordance with Statement of Financial Accounting Standard No. 128, "Earnings per Share" ("SFAS No. 128").

Options outstanding to purchase approximately 1,495,279, 3,825,000 and 2,670,000 shares of Common Stock for the years ended December 31, 2003, 2002 and 2001, respectively, were not included in the computation of diluted net earnings per share, because option exercise prices were greater than the average market price of the Common Stock and therefore, their inclusion would have been anti-dilutive.

Income taxes

The Company and its subsidiaries account for income taxes in accordance with Statement of Financial Accounting Standard No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). This statement prescribes the use of the liability method, whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates that will be in effect when the differences are expected to reverse. The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

Concentrations of credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, trade receivables, long-term deposits, held-to-maturity marketable securities, investment in equity securities of traded companies and derivatives instruments.

A majority of the cash and cash equivalents of the Company and its subsidiaries is invested in U.S. dollars deposits in major U.S. and Israeli banks. Such cash and cash equivalents held in U.S. banks may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the deposits and investments of the Company and its subsidiaries are financially sound, and accordingly, minimal credit risk exists with respect to these deposits and investments.

A majority of the products sales of the Company and its subsidiaries is to distributors who in turn sell to manufacturers of consumer electronics products. The customers of the Company and its subsidiaries are located primarily in Japan, Asia, Europe and the United States. The Company and its subsidiaries perform ongoing credit evaluations of their customers. A general and specific allowance for doubtful accounts is determined, based on the estimation of management and historical experience. Under certain circumstances, the Company may require letter of credit, other collateral or guarantee fees. The Company covers part of its customers' debts by credit insurance.

The Company's held-to-maturity marketable securities include investments in debentures of U.S. corporations, states and political subdivisions. Management believes that those corporations and states institutions are financially sound, the portfolio is well diversified, and accordingly, minimal credit risk exists with respect to these marketable securities.

Derivative instruments

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

For derivative instruments that are designated and qualify as a cash flows hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Any gain or loss on a derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item is recognized in current earnings during the period of change.

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

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

As of December 31, 2003, the Company recorded comprehensive income amounting to $137 from its put options and forward contracts in respect to anticipated payroll and rent payments expected in 2004. Such amounts will be recorded into earnings in 2004.

Accounting for stock-based compensation

The Company accounts for stock-based compensation in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25") and FASB interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation" ("FIN No. 44") in accounting for its employee stock options. Under APB No. 25, when the exercise price of the employee's options equals or is higher than the market price of the underlying Company stock on the date of grant, no compensation expense is recognized.

The Company adopted the disclosure provisions of Statement of Financial Accounting Standard No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS No. 148"), which amended certain provisions of Statement of Financial Accounting Standard No. 123 "Accounting for Stock-Based Compensation" ("SFAS No. 123") to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation, effective as of the beginning of the fiscal year. The Company continues to apply the provisions of APB No. 25 in accounting for stock-based compensation.

Pro forma information regarding the Company's net income and net earnings per share is required by SFAS No. 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method prescribed by SFAS No. 123.

The fair value of these options is amortized over their vesting period and estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions; risk-free interest rates of 2.37%, 2.37% and 3.7% for 2003, 2002 and 2001, respectively; a dividend yield of 0.0% for each of those years; a volatility factor of the expected market price of the Common Stock of 0.396 for

2003, 0.44 for 2002 and 0.81 for 2001; and a weighted-average expected life of the option of 2.9 years for 2003, 2002 and 2001.

	Year ended December 31,		
	2003	2002	2001
	Weighted average fair value of options grants		
Exercise price equals market price at date of grants	$ 5.58	$ 5.49	$ 9.63

The following table illustrates the effect on net income and net earnings per share, assuming that the Company had applied the fair value recognition provision of SFAS No. 123 on its stock-based employee compensation:

	Year ended December 31,		
	2003	2002	2001
Net income, as reported	$ 25,355	$ 15,142	$ 21,916
Deduct - stock-based compensation expense determined under fair value method for all awards, net of related tax effects	9,338	12,712	17,113
Pro forma net income	$ 16,017	$ 2,430	$ 4,803
Net earnings per share:			
Basic, as reported	$ 0.91	$ 0.56	$ 0.82
Basic, pro forma	$ 0.57	$ 0.09	$ 0.18
Diluted, as reported	$ 0.86	$ 0.54	$ 0.79
Diluted, pro forma	$ 0.54	$ 0.09	$ 0.17
Net income from continuing operations, as reported	$ 25,355	$ 12,672	$ 11,561
Deduct – stock-based compensation expenses related to continuing operations determined under fair value method for all awards, net of related tax effect	8,677	11,145	8,208
Pro forma net income from continuing operations	$ 16,678	$ 1,527	$ 3,353
Net earnings per share from continuing operations:			
Basic, as reported	$ 0.91	$ 0.47	$ 0.43
Basic, pro forma	$ 0.59	$ 0.06	$ 0.13
Diluted, as reported	$ 0.86	$ 0.45	$ 0.42
Diluted, pro forma	$ 0.56	$ 0.05	$ 0.12

Impact of recently issued accounting standards

In April 2003, the FASB issued SFAS No. 149 ("SFAS 149"), "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS 149 amends and clarifies (1) the accounting guidance on derivative instruments (including certain derivative instruments embedded in other contracts) and (2) hedging activities that fall within the scope of FASB Statement No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities." SFAS 149 amends SFAS 133 to reflect decisions made (1) as part of the Derivatives Implementation Group ("DIG") process that effectively required amendments to SFAS 133, (2) in connection with other projects dealing with financial instruments, and (3) regarding implementation issues related to the application of the definition of a derivative. SFAS 149 is effective (1) for contracts entered into or modified after June 30, 2003, with certain exceptions, and (2) for hedging relationships designated after June 30, 2003. The guidance is to be applied prospectively.

Generally, SFAS 149 improves financial reporting by (1) requiring that contracts with comparable characteristics be accounted for similarly, and (2) clarifying when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS 149 does not have a material impact on the Company's financial statements.

NOTE 3: MARKETABLE SECURITIES

The following is a summary of held-to-maturity securities at December 31, 2003 and 2002:

	Amortized cost		Unrealized gains (losses)		Estimated fair value	
	2003	2002	2003	2002	2003	2002
Obligations of states and political subdivisions	$ 99,244	$ 69,006	$ (259)	$ 825	$ 98,985	$ 69,831
Corporate obligations	140,317	127,057	2,012	2,836	142,329	129,893
	$ 239,561	$ 196,063	$ 1,753	$ 3,661	$ 241,314	$ 199,724

Gross realized gain or losses for 2003 and 2002 were not significant.

The amortized cost of held-to-maturity debt securities at December 31, 2003, by contractual maturities, are shown below:

	Amortized cost	Estimated fair value
Due in one year or less	$ 42,490	$ 42,750
Due after one year to six years.	197,071	198,564
	$ 239,561	$ 241,314

NOTE 4: INVENTORIES

Inventories are composed of the following:

	December 31,	
	2003	2002
Work-in-progress	$ 2,593	$ 955
Finished products	5,873	5,961
	$ 8,466	$ 6,916

NOTE 5: PROPERTY AND EQUIPMENT, NET

Composition of assets, grouped by major classifications, is as follows:

	December 31, 2003	December 31, 2002
Computers and peripheral equipment	$ 22,896	$ 17,421
Office furniture and equipment	893	856
Motor vehicles	369	431
Leasehold improvements	1,792	1,626
	25,950	20,334
Less accumulated depreciation	18,842	15,644
Depreciated cost	$ 7,108	$ 4,690

NOTE 6: INVESTMENTS IN EQUITY SECURITIES OF TRADED COMPANIES

The following is a summary of investments in equity securities of traded companies as of December 31, 2003 and 2002:

	Cost		Unrealized gains		Estimated fair value	
	2003	2002	2003	2002	2003	2002
AudioCodes Ltd. (1)	$ 10,726	$ 10,726	$ 35,739	$ 757	$ 46,465	$ 11,483
Tomen Corporation (2)	281	281	392	-	673	281
Tower Semiconductors Ltd. (3)	-	267	-	-	-	267
	$ 11,007	$ 11,274	$ 36,131	$ 757	$ 47,138	$ 12,031

(1) AudioCodes, Ltd.

AudioCodes, Ltd. ("AudioCodes") is an Israeli corporation primarily engaged in the design, research, development, manufacturing and marketing of hardware and software products that enable simultaneous transmission of voice and data over networks. The Company acquired an approximate 35% ownership in AudioCodes in two separate transactions in 1993 and 1994. In July 1997, AudioCodes completed a private placement of additional equity securities without the participation of the Company and, as a result, the Company's equity ownership interest in AudioCodes was diluted from 35% to approximately 29%. The Company also had an option under certain conditions to purchase up to an additional 5% of the outstanding stock of AudioCodes.

In January 2000, the Company sold 1,200,000 shares of AudioCodes for approximately $43,800 and recorded in the first quarter of 2000, capital gain in the amount of $40,000. In May 2000 the Company sold an additional 500,000 shares of AudioCodes for $19,223 and recorded in the second quarter of 2000, an additional capital gain in the amount of $17,593. In the fourth quarter of 2000 the Company purchased in the open market 300,000 shares of AudioCodes for $4,868. This transaction created an excess of purchase price over net assets acquired (approximately $3,700 at the date of purchase), which was attributed to goodwill and was amortized until April 1, 2001.

As of December 31, 2003, the Company owned approximately 4,500,000 of AudioCodes shares, which represent approximately 12% of its outstanding ordinary shares (See Note 15).

Since April 1, 2001, the Company no longer maintains a representative on the AudioCodes' Board of Directors, and was not involved in AudioCodes' policy-making processes. Therefore, after April

1, 2001, the Company did not have significant influence over the operating and financial policies of AudioCodes and thus ceased accounting for this investment under the equity method of accounting. As of April 1, 2001, the investment in AudioCodes was reclassified and accounted for as available-for-sale marketable securities in accordance with SFAS No. 115.

The Company's equity in the net earnings of AudioCodes was $105 in the first quarter of 2001.

As of April 1, 2001, the carrying amount of the Company's investment in AudioCodes, under the equity method of accounting, amounted to $20,500. Securities available for sale are carried at fair value, with the unrealized gains and losses, net of income taxes, reported as a separate component of stockholders' equity under "accumulated other comprehensive income" in the consolidated balance sheet.

At June 30, 2002, the evaluation by the Company's management indicated that the decline in value of AudioCodes' ordinary shares was other than temporary in accordance with SAB No. 59. As a result, the Company recognized a loss in its investment in AudioCodes in the amount of $9,795, which was recorded as "impairment of available-for-sale marketable securities" in the Company's consolidated statement of income for the year 2002.

The consolidated balance sheet as of December 31, 2003 and 2002 included an unrealized gain on available-for-sale marketable securities of $22,516 and $476, net of unrealized tax expenses of $15,232 and $280 respectively, in the investment in AudioCodes. (See Note 15).

(2) Tomen Corporation:

In September 2000, the Company invested approximately $485 (50.0 million Yen) in shares of its largest distributor's parent company, Tomen Ltd. ("Tomen"), a Japanese distributor (see Note 1), as part of a long-term strategic relationship. Tomen's shares are traded on the Japanese stock exchange. The Company accounts for its investment in Tomen in accordance with SFAS No. 115 as available-for-sale marketable securities.

At December 31, 2002, the evaluation by the Company's management indicated that the decline in value of Tomen stock was other than temporary in accordance with SAB No. 59. As a result, the Company recognized a loss in its investment in Tomen in the amount of $203, which was recorded as "impairment of available-for-sale marketable securities" in the consolidated statement of income for the year 2002.

(3) Tower Semiconductor Ltd:

Tower Semiconductor Ltd. ("Tower") is an independent wafer manufacturer. In January 2002, the Company invested in Tower's common stock for a total consideration of $2,000, which was recorded at fair market value as available-for-sale marketable securities in accordance with SFAS No. 115.

In June 2002, the Company sold 250,000 shares of Tower's Common stock for $1,504, without any significant capital gain. At December 31, 2002, an evaluation by the Company's management indicated that the decline in value of Tower's common stock was other than temporary in accordance with SAB No. 59. As a result, the Company recognized a loss in its investment in Tower in the amount of $231, which was recorded as "impairment of available-for-sale marketable securities" in the consolidated statement of income for the year 2002.

In May 2003, the Company sold the remaining 82,945 shares of Tower's common stock for $508. As a result, the Company recorded capital gain in the amount of $241, in its financial statements for the year ended December 31, 2003.

NOTE 7: INTANGIBLE ASSETS, NET

The following table shows the Company's intangible assets for the periods presented:

	Year ended December 31,	
	2003	**2002**
Cost:		
Patents	$ 1,885	$ -
Workforce	570	-
Total	2,455	-
Less - accumulated amortization	379	-
Amortized cost	$ 2,076	$ -

Intangible assets represent the acquisition of certain intellectual property, together with the value of patents, acquired upon the purchase of Teleman. (See Note 1).

Amortization expenses amounted to $379 for the year ended December 31, 2003.

The following table shows the estimated amortization expenses for the periods presented:

Year ended December 31,	
2004	$ 614
2005	614
2006	614
2007	234
	$ 2,076

NOTE 8: GOODWILL

The results of operations presented below for the years ended December 31, 2003, 2002 and 2001, reflect the operations had the Company adopted the non-amortization provision of SFAS No. 142 effective January 1, 2000:

	Year ended December 31,		
	2003	**2002**	**2001**
Net income:			
Net income, as reported	$ 25,355	$ 15,142	$ 21,916
Goodwill amortization	-	-	964
Adjusted net income	$ 25,355	$ 15,142	$ 22,880
Basic net earnings per share:			
Net earnings per share, as reported	$ 0.91	$ 0.56	$ 0.82
Goodwill amortization	-	-	0.04
Adjusted basic net earnings per share	$ 0.91	$ 0.56	$ 0.86
Diluted net earnings per share:			
Net earnings per share, as reported	$ 0.86	$ 0.54	$ 0.79
Goodwill amortization	-	-	0.04
Adjusted diluted net earnings per share	$ 0.86	$ 0.54	$ 0.83

NOTE 9: STOCKHOLDERS' EQUITY

Preferred Stock

The Company's 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.

Common Stock

Currently, 50,000,000 shares of Common Stock are authorized. Holders of the Common Stock are entitled to one vote per share on all matters to be voted upon by the Company's stockholders. Subject to the rights of the holders of the Company's preferred stock, if any, in the event of liquidation, dissolution or winding up, holders of the Common Stock are entitled to share ratably in all of the Company's assets. The Company's Board of Directors may declare a dividend out of funds legally available therefore and, subject to the rights of the holders of the Company's preferred stock, if any, the holders of Common Stock are entitled to receive ratably any such dividends. Holders of Common stock have no preemptive rights or other subscription rights to convert their shares into any other securities. There are no redemption or sinking fund provisions applicable to the Common Stock. In March 2000, the Company affected a two-for-one split of the outstanding shares of Common Stock in the form of a stock dividend.

Dividend Policy

As part of the Separation described in Note 1, the Company distributed to its stockholders shares of Ceva's common stock as a dividend in-kind amounting to $48,428.

At December 31, 2003, the Company had retained earnings of $107,799. The Company has never paid cash dividends on the Common Stock and presently intends to follow a policy of retaining any earnings for reinvestment in its business.

Share Repurchase Program

In July 2003, the Company's Board of Directors authorized a new plan to repurchase up to an additional 2,500,000 shares of Common Stock from time to time on the open market or in privately negotiated transactions, increasing the total shares authorized to be repurchased to 6,500,000 shares. Accordingly, in 2003 and 2001, the Company repurchased 746,000 and 40,000 shares, respectively, of the Common Stock at an average purchase price of $21.66 and $20.3 per share, respectively, for an aggregate purchase price of $16,157 and $811, respectively. As of December 31, 2003, the balance of the share repurchase program is 2,774,000 shares of Common Stock authorized and reserved for repurchase.

Such repurchases of Common stock are accounted for as treasury stock, and result in a reduction of stockholders' equity. When treasury shares are reissued, the Company accounts for the reissuance in accordance with Accounting Principles Board Opinion No. 6 "Status of Accounting Research Bulletins" ("APB No. 6") and charges the excess of the repurchase cost over issuance price using the weighted average method to retained earnings. In case the repurchasing cost is lower than the issuance price, the Company credits the difference to additional paid in capital.

In 2003, 2002 and 2001, the Company issued 693,000, 363,000 and 504,000 shares, respectively, of Common Stock, out of treasury stock, to employees who exercised their stock options or purchased shares from the Company's Employee Stock Purchase Plan ("ESPP").

Stock Purchase Plan and Stock Option Plans

The Company has various stock option plans under which employees, consultants, officers, and directors of the Company and its subsidiaries may be granted options to purchase Common stock. The plans authorize the administrator to grant incentive stock options at an exercise price of not less than 100% of the fair market value of the Common Stock on the date the options is granted. Moreover, it is the Company's policy to grant options at the fair market value. A summary of the various plans is as follows:

Options granted under all stock incentive plans that are cancelled or forfeited before expiration become available for future grant.

Amendment No. 132 of the Israeli Income Tax Ordinance ("the Tax Ordinance") was in effect commencing January 1, 2003. Due to the tax reform, a new tax regulation applies to stock options granted to employees on or after January 1, 2003. The new tax regulation is not applied to stock options granted before January 1, 2003.

1993 Director Stock Option Plan

Upon the closing of the Company's initial public offering, the Company adopted the 1993 Director Stock Option Plan (the "Directors' Plan"). Under the Directors' Plan, which expires in 2014, the Company is authorized to issue nonqualified stock options to the Company's outside, non-employee directors to purchase up to 1,130,875 shares of Common Stock at an exercise price equal to the fair market value of the Common Stock on the date of grant. The Directors' Plan, following certain subsequent amendments approved by the Company's stockholders, provides that each person who is an outside director on the effective date of the Directors' Plan and each outside, non-employee director who subsequently becomes a member of the Board of Directors shall automatically be granted an option to purchase 60,000 shares of Common Stock (the "First Option"). Thereafter, each outside director shall automatically be granted an option to purchase 20,000 shares (a "Subsequent Option") on January 1 of each year if, on such date, he or she shall have served on the Board of Directors for at least six months. In addition, an option to purchase 20,000 shares of Common Stock (a "Committee Option") is granted on January 1 of each year to each outside director for each committee of the Board on which he or she shall have served as a chairperson for at least six months.

Options granted under the Directors' Plan generally have a term of ten years. 25% of the shares pursuant to the First Option are exercisable after the first year (one-third after the first year for options granted after May 1996) and thereafter the shares are exercisable 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). Each Committee Option becomes exercisable (one-third at the end of each twelve-month period from the date of grant after May 1996).

1998 Non-Officer Employee Stock Option Plan

In 1998, the Company adopted the 1998 Non-Officer Employee Stock Option Plan (the "1998 Plan"). Under the 1998 Plan, employees may be granted non-qualified stock options for the purchase of Common Stock. The 1998 Plan expires in 2008 and currently provides for the purchase of up to 5,062,881 shares of Common Stock.

The exercise price of options under the 1998 Plan shall not be less than the fair market value of Common Stock for nonqualified stock options, as determined by the Board of Directors.

Options under the 1998 Plan are generally exercisable over a 48-month period beginning 12 months after issuance or as determined by the Company's Board of Directors. Options under the 1998 Plan expire up to seven years after the date of grant.

2001 Stock Incentive Plan

In 2001, the Company adopted the 2001 Stock Incentive Plan (the "2001 Plan"). Under the 2001 Plan, employees, directors and consultants may be granted incentive or non-qualified stock options and other awards for the purchase of Common Stock. The 2001 Plan expires in 2011, unless it is terminated by the Board of Directors prior to that date. 1,513,663 shares of Common Stock are currently reserved for issuance under the 2001 Plan.

The 2001 Plan authorizes the administrator to grant incentive stock options at an exercise price of not less than 100% of the fair market value of the Common Stock on the date the option is granted.

Options under the 2001 Plan are generally exercisable over a 48-month period beginning 12 months after issuance or as determined by the Board of Directors. Options under the 2001 Plan expire up to seven years after the date of grant.

2003 Israeli Share Option Plan

In 2003, the Company adopted the 2003 Israeli Share Option Plan (the "2003 Plan"), which complies with the Israeli tax reforms. Qualified options and shares are held in trust until the later of 24 months following the year in which the options were granted or the options are vested based on a vesting schedule determined by a committee appointed by the Company's Board of Directors.

1,944,992 shares of Common Stock were reserved for issuance as of December 31, 2003 under the 2003 Plan.

Options under the 2003 Plan are generally exercisable over a 48-month period beginning 12 months after issuance or as determined by the Board of Directors. Options under the 2003 Plan expire up to seven years after the date of grant.

1993 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"). The Company has reserved an aggregate of 700,000 shares of Common Stock 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 52,000, 49,000 and 53,000 shares issued at a weighted average exercise price of $12.40, $16.98 and $14.79, under the Purchase Plan in 2003, 2002 and 2001, respectively.

Stock Reserved For Future Issuance

Shares of Common stock available for future issuance outstanding at December 31, 2003, are as follows:

	In thousands
Employee stock purchase plan	210
Stock options	728
Undesignated preferred stock	5,000
	5,938

As of December 31, 2003, 2002 and 2001, 728,000, 2,781,000 and 1,851,000 shares, respectively, were available for future grant under the various option plans.

The following is a summary of the Company's stock options granted among the various plans:

	Year ended December 31,					
	2003		2002		2001	
	Amount of options	Weighted average exercise price	Amount of options	Weighted average exercise price	Amount of options	Weighted average exercise price
	In thousands	$	In thousands	$	In thousands	$
Options outstanding at beginning of year	6,308	17.03	5,725	21.91	5,286	22.34
Changes during the year:						
Granted	*) 2,482	21.68	1,376	19.22	1,499	18.55
Exercised	(1,676)	11.19	(251)	9.42	(451)	9.07
Forfeited and cancelled	*) (100)	18.77	(514)	24.44	(609)	26.87
Restructuring adjustments (1):	-	-				
Old exercise price	-	-	(6,338)	21.52	-	-
New exercise price	-	-	6,338	17.01	-	-
Additional grants	-	-	1,116	17.01	-	-
Separation of Ceva's employees' options	-	-	(1,144)	17.41	-	-
Options outstanding at end of year	7,014	20.04	6,308	17.03	5,725	21.91
Options exercisable at end of year	2,997	21.02	3,147	17.31	1,985	21.51

*) Excludes 876,000 options that were cancelled and re-granted pursuant to Israeli tax reform.

A summary of activity under the options plans related to Ceva employees post the Separation date:

	Year ended December 31, 2003		Two months ended December 31, 2002	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
	In thousands	$	In thousands	$
Options outstanding at the beginning of the period	1,056	17.96	1,144	17.41
Changes during the period:				
Exercised	(386)	12.47	(75)	9.34
Forfeited and cancelled	(13)	25.79	(13)	18.96
Options outstanding at end of year	657	21.03	1,056	17.96
Options exercisable at end of year	503	20.94	591	17.05

In connection with the Separation, all options to purchase Common Stock held by individuals who continued to work for the Company and its subsidiaries, and by individual who transferred to ParthusCeva, that were outstanding on the date of the Separation and that remained unexercised as of this date, were adjusted as follows:

For employees who continued to work for the Company - The exercise price and the number of shares subject to the Company's options were adjusted to reflect the theoretical reduction in value of Common Stock as a result of the Separation, which was calculated based on the theoretical fair market value of the Company and ParthusCeva post the Separation.

For employees who transferred to ParthusCeva - The exercise price subject to the Company's options were adjusted to reflect the theoretical reduction in value of Common Stock as a result of the Separation, which was calculated based on the theoretical fair market value of the Company and ParthusCeva post the Separation.

The Company has accounted for this transaction under FIN No. 44. According to FIN No. 44, at the time of an equity restructuring transaction, the exercise price may be reduced and the number of shares under the award increased, to offset the decrease in the per-share price of the stock underlying the award. There was no accounting consequence for changes made to the exercise price and the number of shares of an outstanding fixed award as a result of an equity restructuring as both of the following criteria were met:

a. The aggregate intrinsic value of the award immediately after the change is not greater than the aggregate intrinsic value of the award immediately before the change.

b. The ratio of the exercise price per share to the market value per share is not reduced.

The Company granted options to purchase additional 1,116,000 shares of Common Stock to its continuing employees as part of the adjustment described above. The weighted average exercise price of all the outstanding options was reduced from $21.52 to $17.01 (21%).

The options outstanding as of December 31, 2003, have been separated into ranges of exercise price as follows:

	Options outstanding			**Options exercisable**		
Range of exercise price	**Outstanding**	**Remaining contractual life (years)**	**Weighted average exercise price**	**Exercisable**	**Remaining contractual life (years)**	**Weighted average exercise price**
	In thousands			**In thousands**		
$5.38 - $7.71	281	2.14	$ 7.42	281	2.14	$ 7.42
$8.65 - $13.00	744	5.31	$ 11.55	250	4.64	$ 11.43
$13.35 - $20.00	3,209	4.88	$ 16.42	1,471	4.36	$ 16.45
$20.06 - $26.65	2,482	5.82	$ 23.87	667	3.61	$ 25.55
$30.23 - $42.74	955	3.44	$ 32.87	831	3.44	$ 32.92
	7,671		$ 20.08	3,500		$ 21.01

NOTE 10: MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION

In prior years, the Company had two reportable segments and thus, the financial statements in prior years included information regarding both reportable segments and geographic areas. After the Separation, the Company has one reporting segment and thus, the financial statements include information regarding geographic areas only.

The following is a summary of operations within geographic areas based on customer locations:

	Year ended December 31,		
	2003	2002	2001
Revenue distribution:			
United States	$ 1,302	$ 711	$ 1,285
Japan	119,355	99,795	64,346
Europe	3,063	4,819	6,108
Asia (excluding Japan)	29,155	19,833	17,691
	$ 152,875	$ 125,158	$ 89,430

The following is a summary of long-lived assets within geographic areas based on the assets locations:

	December 31,		
	2003	2002	2001
Long-lived assets:			
United States	$ 5,648	$ 6,724	$ 7,027
Israel	6,215	3,657	4,108
Other	3,125	113	59
	$ 14,988	$ 10,494	$ 11,194

The following is a summary of revenues from major customers:

	Year ended December 31,		
	2003	2002	2001
		%	
Customer A *)	58%	66%	56%
Customer B *)	18%	12%	
Customer C	13%	-	-

*) These revenues were generated from sales through Tomen Electronics, the Company's largest distributor.

NOTE 11: COMMITMENTS AND CONTINGENCIES

Commitments

The Company and its subsidiaries lease certain equipment and facilities under noncancelable operating leases. The Company has significant leased facilities in Herzelia Pituach, Israel and in Santa Clara, California. In March 2003, the Company entered into a new lease for its Israel facilities in Herzelia Pituach. The lease agreement is effective until November 2008. The Company leases office facilities in Santa Clara, California. The lease is effective from March 2000 until March 2004. VoicePump also leases office facilities for its research and development personnel in Schaumburg, Illinois. The lease is effective until May 2004. In November 2000, DSP Japan entered into a new facility in Tokyo, Japan. This new lease is effective until October 2004. The Company's subsidiaries in Korea and Scotland have lease agreements for their facility, that terminate in 2005 and 2004, respectively. The Company has operating lease agreements for its vehicles, which terminate in 2004 to 2006.

At December 31, 2003, the Company is required to make the following minimum lease payments under non-cancelable operating leases:

Year ended December 31,	
2004	$ 1,613
2005	1,221
2006	955
2007	400
2008	367
	$ 4,556

Total rental expenses for all leases were approximately $2,172, $2,313 and $2,078 for the years ended December 31, 2003, 2002, and 2001, respectively.

Litigation

The Company is involved in certain claims arising in the normal course of business. 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.

From time to time, the Company may become involved in litigation relating to claims arising in the ordinary course of business activities. Also, 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 asserted that the Company's TrueSpeech algorithm includes certain elements covered by a patent held by AT&T. AT&T sued Microsoft, one of the Company's True Speech licensees, for infringement. The Company was not named in the suit against Microsoft. The Company and its legal counsel currently believes that there are no claims or actions pending or threatened against it, the ultimate disposition of which would have a material adverse effect on the Company. During 2002, Company created a provision, which was included in the costs of revenues, in respect of this legal exposure.

NOTE 12: TAXES ON INCOME

a. The provision for income taxes is as follows:

	Year ended December 31,		
	2003	**2002**	**2001**
Domestic taxes:			
Federal taxes:			
Current	$ 2,259	$ 1,451	$ 905
Deferred	(82)	(3,549)	100
	2,177	(2,098)	1,005
State taxes:			
Current	33	357	142
Deferred	(10)	(141)	8
	23	216	150

	Year ended December 31,		
	2003	2002	2001
Foreign taxes:			
Current	3,447	2,976	1,224
Deferred	(272)	(200)	27
	3,175	2,776	1,251
Taxes on income	$ 5,375	$ 894	$ 2,406

The tax benefits associated with the exercise of stock options reduced taxes currently payable by $685 in 2003, $324 in 2002 and $531 in 2001. Such benefits were credited to additional paid in capital.

b. Income before taxes is comprised as follows:

	Year ended December 31,		
	2003	2002	2001
Domestic	$ 5,155	$ (8,249)	$ 48
Foreign	25,575	21,815	13,919
	$ 30,730	$ 13,566	$ 13,967

c. All accumulated undistributed earnings of DSP Group Israel as of October 30, 2002 were capitalized and subsequent earnings were considered as indefinitely reinvested. Accordingly, no provision for U.S. federal, state and foreign income taxes has been made thereon. Upon distribution of earnings in the form of dividends or otherwise, the Company would be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to foreign countries.

d. A reconciliation between the Company's effective tax rate assuming all income is taxed at statutory tax rate applicable to the income of the Company and the U.S. statutory rate:

	Year ended December 31,		
	2003	2002	2001
Income before taxes on income	$ 30,730	$ 13,566	$ 13,967
Theoretical tax at U.S. statutory tax rate (35%)	$ 10,756	$ 4,748	$ 4,889
State taxes, net of federal benefit	16	235	331
In-process research and development and goodwill amortization	-	-	315
Foreign income taxed at rates other than U.S. rate	(5,785)	(4,859)	(3,699)
Other individually immaterial items	388	770	570
	$ 5,375	$ 894	$ 2,406

e. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities as of December 31, 2003 and 2002 are as follows:

	December 31, 2003	December 31, 2002
Deferred tax assets (short-term):		
Tax credit carryforward	$ 43	$ -
Reserves and accruals	1,220	1,685
Other	63	-
Total deferred tax assets	$ 1,326	1,685
Deferred tax liabilities, net (long-term):		
Investment in AudioCodes	$ (15,232)	(2,277)
Other	640	(94)
Total deferred tax liabilities	(14,592)	(2,371)
Total net deferred tax liabilities	$ (13,266)	$ (686)

Management believes that the deferred net tax assets will be realized based on current levels of future taxable income and potentially refundable taxes. Accordingly, a valuation allowance was not provided.

f. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 ("Israeli Law"):

DSP Group Israel's production facilities have been granted "Approved Enterprise" status under Israeli law in connection with six separate investment plans.

According to the provisions of such Israeli law, DSP Group Israel has chosen to enjoy "Alternative plan benefits," which is a waiver of grants in return for tax exemption. Accordingly, DSP Group Israel's income from an "Approved Enterprise" is tax-exempt for a period of two or four years and is subject to a reduced corporate tax rate of 10%- 25% (based on percentage of foreign ownership) for an additional period of eight or six years, respectively. The tax benefits under these investment plans are scheduled to gradually expire starting in 2005 through 2017.

DSP Group Israel's first and second plans, which were completed and commenced operations in 1994 and 1996, respectively, are tax exempt for two and four years from the first year they have taxable income, respectively, and are entitled to a reduced corporate tax rate of 10% - 25% (based on percentage of foreign ownership) for an additional period of eight and six years, respectively.

The third plan, which was completed and commenced operations in 1998 is tax exempt for two years, from the first year it has taxable income and is entitled to a reduced corporate tax rate of 10% - 25% (based on percentage of foreign ownership) for an additional period of eight years from the first year it has taxable income.

The fourth, fifth and sixth plans were approved in 1998, 2001 and 2003, respectively, which entitle DSP Group Israel to a corporate tax exemption for a period of two years and to a reduced corporate tax rate of 10% - 25% (based on percentage of foreign ownership) for an additional period of eight years from the first year it has taxable income.

Since DSP Group Israel is operating under more than one approval its effective tax rate is the result of a weighted combination of the various applicable rate and tax exemptions and the computation is made for income derived from each program on the basis and formulas specified in the law and in the approvals.

Through December 31, 2003, DSP Group Israel has met all the conditions required under these approvals, which include an obligation to invest certain amounts in property and equipment and an obligation to finance a percentage of investments in share capital.

Should DSP Group Israel fail to meet such conditions in the future, it could be subject to corporate tax in Israel at the standard rate of 36% and could be required to refund tax benefits already received.

The period of tax benefits, as detailed above, is subject to limitations of the earlier of 12 years from commencement of production, or 14 years from receipt of approval.

The tax-exempt income attributable to an "Approved Enterprise" can be distributed to stockholders without subjecting DSP Group Israel to taxes only upon the complete liquidation of DSP Group Israel.

The Company has determined that such tax-exempt income will not be distributed as dividends. Accordingly, no deferred income taxes have been provided on income attributable to DSP Group Israel's "Approved Enterprise." If these retained tax-exempt profits are distributed in a manner other than in the complete liquidation of the company, they would be taxed at the corporate tax rate applicable to such profits as if the company had not elected the alternative benefits (currently 10% for an "Approved Enterprise").

Income in DSP Group Israel from sources other than the "Approved Enterprise" during the benefit period will be subject to tax at the standard rate of corporate tax in Israel of 36%.

By virtue of such Israeli law, DSP Group Israel is entitled to claim accelerated rates of depreciation on equipment used by an "Approved Enterprise" during the first five tax years from the beginning of such use.

g. Tax benefits under Israel's Law for Encouragement of Industry (Taxation), 1969:

DSP Group Israel is an "industrial company" under the Law for the Encouragement of Industry (Taxation), 1969, and as such is entitled to certain tax benefits, mainly the amortization of costs relating to know-how and patents, over eight years, and accelerated depreciation.

h. Separation of Ceva, Ltd.:

DSP Group Israel has obtained a tax ruling for the tax-exempt treatment of the Separation pursuant to section 105A(a) to the Israeli Income Tax Ordinance ("section 105"). Under section 105 and according to the ruling, the majority of the assets that remain in DSP Group Israel cannot be sold for a two-year period and is subject to other requirements as determined by law.

As part of the Separation from Ceva Ltd, certain fractions of the approved plans were assigned to Ceva Ltd. according to the relevant turnover that derives from each activity.

Income from "Alternative plan benefits" is subject to corporate tax income upon distribution to the stockholders. Prior to the Separation, and according to the Income Tax Authority ruling, DSP Group Israel has capitalized all accrued revenues that were accrued until October 30, 2002.

See Note 1 in respect of the ruling obtained from Internal U.S. Revenue Service.

i. Amendment 132 to the Israeli Income Tax Ordinance:

In July 2002, Amendment 132 to the Israeli Income Tax Ordinance (the "Amendment") was approved by the Israeli parliament and was effective as of January 1, 2003. The principal objectives of the Amendment were to broaden the categories of taxable income and to reduce the tax rates imposed on employment income.

There are no material implications of the Amendment applicable to the Company except certain modifications in the qualified taxation tracks of employee stock options. As a result, in 2003, the Company adopted an Israeli Appendix to the 1993 Plan, 1998 Plan and 2001 Plan, which complies with the Israeli tax reforms, and established the 2003 Plan.

NOTE 13: NET EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted net earnings per share:

	Year ended December 31,		
	2003	2002	2001
Numerator:			
Income from continuing operations	$ 25,355	$ 12,672	$ 11,561
Income from discontinued operations of Ceva	$ -	$ 2,470	$ 10,355
Net income	$ 25,355	$ 15,142	$ 21,916
Denominator:			
Weighted average number of shares of Common Stock outstanding during the year used to compute basic net earnings per share (in thousands)	27,912	27,070	26,641
Incremental shares attributable to exercise of outstanding options (assuming proceeds would be used to purchase treasury stock) (in thousands)	1,681	971	965
Weighted average number of shares of Common Stock used to compute diluted net earnings per share (in thousands)	29,593	28,041	27,606
Basic net earnings per share	$ 0.91	$ 0.56	$ 0.82
Diluted net earnings per share	$ 0.86	$ 0.54	$ 0.79
Basic earnings per share (continuing operations)	$ 0.91	$ 0.47	$ 0.43
Diluted earnings per share (continuing operations)	$ 0.86	$ 0.45	$ 0.42
Basic earnings per share (discontinued operations)	$ -	$ 0.09	$ 0.39
Diluted earnings per share (discontinued operations)	$ -	$ 0.09	$ 0.37

NOTE 14: DISCONTINUED OPERATIONS

The Separation and Combination were completed on November 1, 2002. These transactions were accounted for in accordance with Statements of Financial Accounting Standard No. 144 "Accounting for the Impairment or Disposal or Long Lived Assets ("SFAS No. 144"). For more details of the Separation and Combination, see Note 1.

As a result of the Separation and Combination, the results of operations, including revenue, operating expenses, financial income and income taxes of the DSP cores licensing business for the years ended December 31, 2002 and 2001, were reclassified in the accompanying statements of income as discontinued operations. The Company's balance sheet at December 31, 2002 reflected the assets and the liabilities of the DSP cores licensing business as assets of the discontinued operations within current assets.

As of the date of the Separation, Ceva's trade receivable remained with the Company.

The results of operations of the Ceva business, which were reported separately as discontinued operations in the statement of income for the years ended December 31, 2002 and 2001, are summarized as follows:

	Year ended December 31,	
	2002	**2001**
Revenues	$ 14,122	$ 25,244
Cost of revenues	1,058	1,251
Gross profit	13,064	23,993
Operating expenses:		
Research and development, net	5,208	5,095
Selling and marketing	2,436	2,911
General and administrative	2,608	2,839
Total operating expenses	10,252	10,845
Operating income	2,812	13,148
Disposal of assets and liabilities	393	-
Financial income, net	78	462
Income before taxes on income	3,283	13,610
Taxes on income	813	3,255
Net income from discontinued operations	$ 2,470	$ 10,355
Net earnings per share for discontinued operations:		
Basic	$ 0.09	$ 0.39
Diluted	$ 0.09	$ 0.37

NOTE 15: SUBSEQUENT EVENT

During January 2004, the Company sold 2,000,000 shares of AudioCodes Ltd. (see Note 6) ordinary shares for an average price of $12.80 per share. The gross proceeds were approximately $25,650, resulting in a one-time capital gain of approximately $13,000.